

Treatment of interest payments and other forms of consideration to directors and participators as distributions

Part 13-02-01

This document should be read in conjunction with sections 433, 436 and 437 of the Taxes Consolidation Act 1997

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Introduction

This document outlines the extended meaning of distributions, which includes interest payments and other forms of consideration to directors and benefits provided for participators.

The document also outlines the type of payments, which fall within this extended meaning and it provides illustrative examples.

1 Extension of the meaning of “distribution”

Where a company is a close company the meaning of “**distribution**” is extended to include **certain interest** or other consideration paid or given to directors or their associates and **benefits** provided for participators. It follows that no deduction is allowable either in, computing income from any source or against total profits for any such payments [see sections 76(5), 243(1) and 81 TCA].

2 Payments within the extended meaning of distribution

The payments within the extended meaning of distributions are as follows:

- (a) Certain interest **exceeding** a prescribed limit paid to **directors** or their associates (see paragraph 3 of this Instruction and section 437).
- (b) Any expense incurred by the company, in or in connection with the provision, for any **participator** of living or other accommodation, of entertainment, of domestic or other services or of other benefits or facilities of whatever nature, to the extent that the expense is not made good to the company by the participator (see paragraphs 6 and 7 of this Instruction and section 436).

3 Interest paid to directors and directors’ associates

(1) Where a close company pays interest or gives any other consideration for the use of money advanced, or credit given by any person and that interest is paid to a person who is a director of the close company, or of any company which controls or is controlled by the close company, **and** who has a **material interest** (see below):

- in the close company, or
- where the close company is controlled by another company, in that other company,

then the interest paid, or consideration given, should be dealt with in accordance with paragraphs (2) and (3) below (unless the interest is paid by a close company carrying on a business of banking - see paragraph 4).

Material Interest

A person has a “**material interest**” in a close company if they on their own, they and their associates, or their associates by themselves, hold beneficially, either directly or indirectly, more than 5% of the ordinary share capital of the company [section 437(2) TCA].

Interest as a distribution

Interest which is a distribution under section 437 is excluded from the operation of section 246(2) and is therefore to be paid without deduction of income tax. However, such interest is a “relevant distribution” for the purposes of dividend withholding tax [sections 20(1) and 172A and 172B].

(2) Where interest paid or consideration given in an accounting period falls within (1) above, it is a distribution **only to the extent that it exceeds** a sum equal to interest at 13% per annum (the sum should be proportionately reduced for shorter accounting periods), or such other rate of interest as the Minister for Finance may from time to time prescribe, **on whichever is the smaller of:**

- (a) the total of the loans, advances and credits on which the interest within (1) above, was paid in the accounting period, or if that total was different at different times in the accounting period, the average total over the accounting period, and
- (b) the nominal amount of the issued share capital plus any share premium account of the company, taking both amounts as at the beginning of the accounting period. (A share premium account arises where shares are issued at a price in excess of their nominal value - see section 71(5) of the Companies Act 2014).

When a company registered in the State has redeemed preference shares and has created a capital redemption reserve fund equal to the nominal amount of the shares redeemed, the amount of that fund at the beginning of the accounting period may be added to the nominal amount of the issued share capital for the purpose of computing the 13% limit.

(3) The total amount of the interest which is not allowable as a deduction in arriving at corporation tax profits for the accounting period and is to be regarded as a distribution is given by the computation in (2) above.

Where interest within (1) above is paid in any accounting period to two or more persons and, exceptionally, it is necessary to determine how much of the total disallowance (see (2) above) is applicable to each of those persons, that total should be apportioned between those persons according to the amounts of interest paid to them respectively.

Examples illustrating points in (1) to (3) above are given below:

Example 1

A and B are directors of a close company which is not controlled by any other company and both have a material interest in the company. During the accounting period to 31 December 2022 -

- On 30 June 2022, A makes a loan of €10,000 at 17% per annum to the company.
- On 30 September 2022, B makes a loan of €6,000 at 15% per annum to the company.
- A person (who has not at any time had a material interest in the company) makes a loan of €12,000 at 13% per annum to the company.

All loan interest is payable annually on 31 December, the date to which the company makes up its accounts. The issued share capital shown on the balance sheet at 31 December 2022 is as follows:

	€
Ordinary shares	12,000
10% preference shares	<u>7,000</u>
	19,000*

The ordinary shares are made up of €6,000 cash on issue and bonus issue of €6,000. The preference shares were issued at a premium, the company receiving €1.50 for each share with a nominal value of €1. The balance sheet therefore shows a share premium account of €3,500**. The interest paid on 31 December 2022 includes the following:

	€
Interest to A	850
Interest to B	<u>225</u>
Total Interest to A and B	1,075

The payments of interest totalling €1,075, fall to be considered under section 437. The part of that interest which can be treated as a distribution is the excess of €1,075 over 13% **of** whichever is the smaller of:

- (i) the average total of loans made by A and B over the accounting period i.e.

$$\frac{(\text{€}10,000 \times 6) + (\text{€}6,000 \times 3)}{12} = \text{€}6,500 \quad \text{and}$$

- (ii) the nominal amount of the issued share capital plus share premium account i.e.

$$\text{€}19,000^* + \text{€}3,500^{**} = \text{€}22,500$$

Therefore, the amount of the interest to be treated as a distribution is €230 as follows:

Interest to A and B = €1,075 less 13% of €6,500 = €230

The €230 is included with the distributions for the accounting period to 31 December 2022 for the purpose of any surcharge on undistributed income under sections 440 and 441 (see Tax and Duty Manual (TDM) [Part 13-02-05](#) and TDM [Part 13-02-06](#)).

Withholding tax of 25% must be deducted from the distributions.

Example 2

The facts are the same as in Example 1 except that the company does not pay the interest due to B on 31 December 2022.

Therefore, the only loan, which is within section 437, for the accounting period to 31 December 2022 is the loan of €10,000 made by A. The amount to be treated as a distribution is therefore the excess of the €850 loan interest paid to A over 13% of whichever is the smaller of:

- (i) the average total of the loan made by A over the accounting period to 31 December 2022, i.e. €10,000 x 6/12 = €5,000 **and**
- (ii) the nominal amount of the issued share capital plus the share premium account, i.e. €22,500 (as in Example 1).

The amount of the interest to be treated as a distribution is therefore €200:

	€
Interest to A	850
less 13% of €5,000	650
Interest as a distribution	200

Example 3

The company in Examples 1 and 2 borrows no more money during the accounting period to 31 December 2023. The company pays loan interest to A and B as follows

		€
To A, €10,000 at 17%		1,700
To B, €6,000 at 15%	900	
Arrears due to B	225	<u>1,125</u>
Total to A and B		2,825

The amount of interest to be treated as a distribution is the excess of €2,825 over 13% of whichever is the smaller of:

- (i) average loans of A and B during the accounting period to 31 December 2023 i.e. €16,000, **and**
- (ii) nominal amount of issued share capital and share premium account (as before), i.e. €22,500.

The amount of interest to be treated as a distribution is therefore €745:

	€
Interest to A & B	2,825
less 13% of €16,000	<u>2,080</u>
Interest as a distribution	745

4 Close company carrying on the business of banking

Where a close company carries on a business of banking and in the normal course of that business borrows money from another bank at the commercial rate of interest (i.e. the rate the lender would charge on similar loans to other banks), section 437 should not, in practice, be applied to any interest paid on that borrowing.

5 “Artificial” arrangements between two or more companies

Provision is made to counter the possibility of two or more close companies entering into an arrangement to make payments to one another’s participators in order to avoid an item being treated as a distribution under this section [section 436(7)].

6 Non-applicability of section 436

Section 436 does not apply where the expense is incurred in or in connection with the provision of benefits or facilities for any person to whom benefits in kind applies as a director or employee of the company, i.e. these are not treated as distributions.

Nor does it apply to the provision for the spouse, children, or dependants of any such person of any pension, annuity, lump sum, gratuity or other like benefit to be given on his death or retirement.

Any expense incurred in or in connection with the provision of benefits for a participator (or an associate of a participator) who is -

- (a) a director or employee of a company which is a **charity**, or
- (b) employed by a company which carries on business as a **school** (or educational establishment),

is not treated as a distribution, **provided** that the benefits do not clearly exceed those which might normally be provided for an individual holding a similar position with a company in which he was not a participator (or an associate of a participator).

7 Other expenses not to be treated as a distribution

The expenses referred to in sub-paragraph (b) of paragraph 2 above are not to be treated as a distribution where -

- (a) the benefit to the participator (or associate, of the participator) arises on or in connection with the transfer of assets or liabilities by the company to the participator or by the participator to the company;
and
- (b) the participator is a company resident in the State; **and**
- (c) the company providing the benefit is a subsidiary of the company in (b) or the company in (b) is its subsidiary or both are subsidiaries of a third company which is also resident in the State [section 436(5)].

In deciding whether a company is a subsidiary for the purposes of this paragraph, the same rules apply as for section 410(4) - group payments, but with the additional restriction, that any share capital owned directly by a company, is to be left out of account, if a profit on the sale of the shares would be treated as a trading receipt of that company.