Company Charge to Income Tax on Loans to Participators

Part 13-02-03

This document should be read in conjunction with sections 438, 438A, 439 and 239 of the Taxes Consolidation Act (TCA) 1997

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Introduction

This manual outlines the operation of section 438 TCA 1997, a section designed to counter the withdrawal of profits from a close company in the guise of a loan. Where the section applies, a charge to income tax at the standard rate arises on the grossed-up equivalent of a loan or advance made by the close company to a participator or an associate of the participator. The amount assessed is treated as if it were an annual payment, however it is not regarded as a charge on the company's income and it is not deductible for corporation tax purposes. There are provisions for giving relief to the company in respect of any part of the loan or advance repaid to the company.

The section does not apply where the company's ordinary business includes the making of loans. The section also does not apply where the loan does not exceed €19,050 and the borrower is an employee or director who works full-time for the company or an associated company and does not have a material interest (broadly, a more than 5% shareholding) in the company.

If the loan is released or written off, it becomes income of the borrower in accordance with section 439.

1. Loan to a participator

Where a close company makes a loan or advances money to –

(a) an individual who is a participator in the company, or

(b) an individual who is an associate of a participator in the company[1], or

(c) a company that is not resident in Ireland, another Member State of the EU or the UK and which is a participator or an associate of a participator in the close company, or

(d) a company which is acting in a fiduciary or representative capacity and is a participator or an associate of a participator in the close company,

then, unless the loan or advance is made in the ordinary course of the close company's business and that business includes the lending of money, the following treatment shall apply in accordance with section 438(1).

The close company is obliged to account to Revenue under section 239 (as a "relevant payment") an amount of income tax, at the standard rate for the year of assessment in which the loan or advance is made, on the grossed-up equivalent of the loan or advance, as if that grossed-up equivalent were an annual payment made by the company. However, the deemed annual payment will not be allowed as a charge on the company's income within

[1] "Participator" and "associate" are defined in section 433. Broadly, a participator is a person with a share or interest in the capital or income of a company and an associate of that person would include their relative or partner. Further guidance on these terms is available in Tax and Duty Manual Part 13-01-02.

the meaning of section 243 ("allowance of charges on income"). The amount is therefore not deductible for corporation tax purposes.

The charge to income tax is imposed on the company by deeming the company to have paid an annual payment. This deeming is for the purpose of section 438 only. Consequently, the deemed annual payment is not to be regarded as income in the hands of the borrower, and the borrower is not entitled to any credit for the income tax borne by the company in respect of the deemed annual payment.

Example 1

A close company makes a loan of €1,000 to an individual who is a participator in the company. The company's business does not ordinarily include the lending of money. The participator is not an employee or director of the company.

The company is treated as paying an annual payment of €1,250 to the individual and is obliged to remit income tax of €250 to Revenue in accordance with section 239.
[€1,000 / (1 – 0.2) = €1,250 regrossed amount].

This amount is not treated as income of the participator and he does not have a liability to tax in respect of the loan.

"Individual" includes "individuals" [section 18(a) of the Interpretation Act 2005]. Therefore, where a close company makes a loan or advance to a partnership and one of the partners is a participator in the company, the other partners are his or her associates and the loan or advance is within (a) and (b) above.

Similarly, where a loan is made to trustees and any shares or obligations of the company are subject to the trust, the trustees are participators and/or associates of a participator and the loan is therefore within (a) and (b) above. Where the trustees are a "trust company" and that company is a participator or an associate of a participator, (d) above will apply.

Any participator in a company which controls another company is deemed to be a participator in that other company [section 438(7) refers].

Section 438 applies only if the company is a close company at the time the loan or advance is made.

2. Extended meaning of the word 'loan'

A close company is regarded as making a loan to any person in the following circumstances:

(a) Where the person incurs a debt to the close company, or

(b) Where a debt due from the person to a third party is assigned to the close company.

Where (a) or (b) above applies, the close company is regarded as making a loan equal to the amount of the debt [see section 438(2) TCA].

A close company is not regarded as making a loan to a person in circumstances where that person incurs a debt to the close company if –

- the debt is incurred for the supply of goods or services in the ordinary course of the close company's trade or business, and
- the period of credit given by the close company to that person does not exceed six months or the period of credit normally given to the company's customers, whichever is the shorter.

3. Loan or advances not to be treated as annual payments

Section 438(3) provides that where a close company makes a loan or advance, for any purpose, to a director or employee of the close company or of its associated company, that loan or advance is not within section 438 if all of the following conditions are satisfied:

(a) neither the amount of the loan nor that amount when taken with any other outstanding loans made by the close company or any of its associated companies to the borrower, or to the spouse or civil partner of the borrower, exceeds €19,050,

(b) the borrower works full-time for the close company or any of its associated companies, and

(c) the borrower does not have a material interest in the close company or any of its associated companies.

A material interest is defined in section 437(2). A person is regarded as having a material interest in a company if the person (on the person's own or together with associates), or an associate of the person (with or without any other associates) is the beneficial owner of, or is able to control, more than 5 per cent of the ordinary share capital of the company.

Where the borrower acquires a material interest (or an existing interest is enlarged so as to become material) at a time when any loan remains wholly or partly outstanding, the company is regarded as making to him/her a loan or loans equal to the amount or amounts so outstanding at the time when the material interest is acquired. Loans deemed to be so made are not excluded and the company is required to account to Revenue for tax in accordance with the provisions of section 438(1).

Relief is therefore not given for loans intended to be used to substantially increase the borrower's stake in the company.

Example 2

A close company makes two loans during the year.

The first loan is for an amount of €10,000 and is made to an employee who works full-time for the company. The employee is a participator of the company, with a holding of 2 per cent of the ordinary share capital that is not regarded as a material interest. The employee's spouse also has a loan of €7,000 from an associated company of the close company.

The second loan from the close company is for an amount of €20,000. The loan is made to a director who works part-time for an associated company. The director is a participator of the close company but does not have a material interest in the close company or in any associated company. The director and her civil partner do not have any other loans.

The first loan is not within the provisions of section 438 as the conditions in subsection (3) are met. The second loan is within section 438 as the loan exceeds €19,050 and the borrower does not work full-time for the close company or any of its associated companies.

4. Interposition of an Intermediary

A loan or advance made by a close company which is not directly within section 438(1), but which is part of an arrangement, which involves a person other than the close company making a payment or transferring assets to (or liabilities from) a participator or associate of a participator, is a loan or advance deemed to have been made by the close company to that participator or associate for the purpose of section 438(1) [section 438(5) refers]. For example, this includes a loan to enable employees or trustees, who are not participators, to buy shares from an existing shareholder.

However, this provision does not apply where:

- the arrangement is made by a person in the ordinary course of a business carried on by that person,
- the deemed borrower (i.e. the existing shareholder in the company), can show that the deemed loan to him/her satisfies the conditions in section 438(3), or
- the full amount of the loan or advance is included in the total income of the participator or associate. For example, this may happen where the payment to the recipient is treated as his income for income tax purposes, such as a distribution within sections 130 to 135 or section 436.

Example 3

X Ltd., a close company, instead of making a loan to A, an individual participator, makes it to an associated company, Y Ltd. Y Ltd. then passes the loan to A.

The loan by X Ltd. to Y Ltd. is treated as if it had been made directly to A.

Example 4

A Ltd., a close company, makes a loan to D, an individual who is a participator in B Ltd., but not in A Ltd. B Ltd., acting in concert with A Ltd., then makes a loan to E, an individual who is a participator in A Ltd. but not in B Ltd.

A Ltd and B Ltd are treated as if they had made loans to their own participators, i.e. E and D respectively.

5. Registered Industrial and Provident Societies

A registered industrial and provident society is treated as a close company if it would be such, but for the exclusion of such societies contained in section 430(1)(b). Accordingly, loans and advances made to a participator in such a registered industrial and provident society may be subject to a charge to tax under this section [section 438(8) and section 430 refer].

6. Repayment of loan or advance

Where a close company has been assessed to tax under section 438 in respect of a loan or advance and that loan or advance has subsequently been repaid to the company, then the company can claim a repayment of that tax. If the loan or advance has been partially repaid then the company may claim a refund of a proportionate part of that tax.

Notwithstanding any limitation in section 865(4) on the time within which a claim for a repayment of tax is required to be made, section 438(4) allows a claim for a repayment of tax to be made within 4 years from the end of the year of assessment in which the loan or advance, or any part of the loan or advance, is repaid to the company.

Example 5

A close company makes a loan to an associate of a participator during the accounting period ending on 31 December 2022. The company is assessed to tax in respect of that loan under section 438. The associate repays the loan in full on 1 July 2024.

The close company may claim a repayment of tax, provided the claim is made within 4 years from the end of the 2024 year of assessment (i.e. the claim must be made to Revenue on or before 31 December 2028).

7. Application of section 239

The formal procedure for the purposes of the charge, assessment and recovery of income tax (on payments by resident companies), prescribed by section 239, applies to any amount, which under section 438, is deemed to be an annual payment [section 239(1)(a)].

The income tax in respect of the "relevant payment" under section 239 forms part of the company's corporation tax liability and must be included on the company's corporation tax return.

The tax also forms part of the company's preliminary tax obligations. See Tax and Duty Manual Part 13-02-04 for information on the operation of preliminary tax in this context.

8. Treatment of borrower where debt is released

Section 439 sets out the tax treatment in circumstances where a loan or advance subject to the provisions in section 438 is subsequently written off or released.

Where a company, which has been or is liable to be assessed under section 438 in respect of a loan or advance, releases or writes off the whole or part of the debt thus created, the person to whom the loan or advance was made is regarded, for the purposes of computing his/her total income, as having received at that time, income of an amount which (after deduction of income tax at the standard rate) is equal to the amount released or written off [section 439(1)(a)].

The amount written off is treated as income received by the person after deduction of income tax by virtue of section 238, at the standard rate of income tax for the year of assessment during which the debt is released or written off. This income is chargeable to tax under Case IV of Schedule D [section 59 refers].

In computing the individual's tax liability, credit is given for the notional tax deducted from the income. However, the income tax notionally deducted under this procedure is not repayable and is not available to relieve the recipient of any obligation to account for tax on annual payments made by him/her [section 439(1)(b) and (c)].

If the amount treated as income under section 439 exceeds the individual's taxable income, then the tax credit is limited to the actual amount of income tax, if any, charged on the excess. In other words, in respect of any part of the amount released which is charged at less than the standard rate of income tax, the tax credit is not to exceed the amount of tax charged. In respect of any part of the amount released which is charged at standard rate or higher rate, the tax credit is equal to tax at the standard rate, on the amount so charged [section 439(1)(d)].

Where a loan, to which section 438 applies, was made to a person who has since died, or to the trustees of a trust which has terminated, and all or part of the loan is written off, the deemed income represented by the debt released is regarded as income of the estate or the beneficiary, as the case may be, at that time. Where the loan is written off to the benefit of the estate of a deceased person which is under administration, the income is included in the aggregate income of the estate [section 439(2) and section 799(1)(b)].

Sections 439 and 438 are to be construed together [section 439(3)].

Example 6

A close company makes a loan to an individual participator of €8,000. The company is deemed under section 438 to have paid an annual payment of €10,000 and is obliged to remit tax of €2,000 to Revenue [8,000 / (1-0.2) = 10,000]. The following year, the company writes off €6,000 of the outstanding loan.

The deemed annual payment of €10,000, in the year the loan is made, is not to be regarded as income in the hands of the participator. However, when the loan is partially written off the participator is regarded as receiving €7,500 of income which must be included in the computation of his total income for the year [6,000 / (1-0.2) = 7,500].

The proportion of tax originally paid by the close company, relating to the part of the loan written off, is not recoverable by the company.

The participator will be given a non-refundable credit for the €1,500 notional tax deducted from the deemed income of €7,500. If the actual amount of income tax charged on that income is less than €1,500, then the credit will be restricted to the actual amount of income tax charged.

9. Loan by company controlled by a close company

Section 438A is an anti-avoidance provision which extends the scope of the close company charge to income tax under section 438 to loans made by a company which is controlled by, or which subsequently comes under the control of, a close company, where such loans would otherwise not give rise to a charge under section 438. Section 438A also ensures that certain tax avoidance arrangements, where the main purpose or one of the main purposes of the arrangement is to avoid or reduce a charge tax under section 438, will fall within the scope of the section 438 charge. Consequently, where a close company does not make the loan itself but sets up or acquires a subsidiary to make the loan to participators in the parent close company, this situation will also come within the scope of the section 438 charge.

Further information: See Part 13 Close Companies for guidance notes on sections 430 to 441 TCA 1997.