

## **Surcharge on Certain Undistributed Income of Close Companies**

### **Part 13-02-05**

This document should be read in conjunction with sections 434 and 440 of the Taxes Consolidation Act 1997

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## Introduction

Section 440 TCA 1997 provides for an additional charge of corporation tax (referred to as a “surcharge”) on close companies. The imposition of this surcharge is to discourage the practice of allowing passive non-trading profits of close companies to accumulate, thereby avoiding income tax at the higher rate on distributions from such profits.

Section 441 deals specifically with the surcharge on the undistributed income of Service Companies. Tax and Duty Manual [Part 13-02-06](#) provides further guidance on this surcharge.

### 1 Computation of surcharge under section 440

The surcharge is applied at a rate of 20 per cent on the excess of the “distributable estate and investment income” of the company over the distributions made by the company for an accounting period [s440(1)(a)].

#### **EXAMPLE 1**

A close company has distributable estate and investment income of €15,000 and pays a dividend of €5,000 in respect of an accounting period.

The close company will pay a surcharge of €2,000, equal to 20% of the excess of €10,000.

### 2 Exceptions to surcharge

There is no surcharge where the excess is €2,000<sup>1</sup> or less.

#### **EXAMPLE 2**

A close company has distributable estate and investment income of €20,000 and makes a distribution of €19,000 in respect of an accounting period.

As the excess is under €2,000, no surcharge is due.

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<sup>1</sup> €635 for accounting periods ending on or before 31 December 2012.

Marginal relief is provided where the excess is slightly more than €2,000. The amount of the surcharge may not be greater than 80% of the amount by which the excess is greater than €2,000. It should be noted that marginal relief runs out when the excess exceeds €2,666.

**EXAMPLE 3**

The excess of distributions made by a close company over its distributable estate and investment income is €2,500.

Marginal relief applies so that the surcharge is restricted to 80% of the amount by which the excess of €2,500 is greater than €2,000.

i.e.  $80\% \times (2,500 - 2,000) = €400$ .

The close company will pay a surcharge of €400.

The limit of €2,000 is proportionally reduced if the accounting period is less than 12 months.

Where a company has associated companies the €2,000 limit is divided by the number of associated companies, including the company itself [s440(1)(b)].

An associated company must be counted for the purposes of the surcharge even if it was an associated company for only part of the accounting period concerned. Two or more associated companies of another company are to be counted even if they were associated with that other company for different parts of the period [s440(4)].

The amount on which the surcharge is made cannot exceed the accumulated undistributed income at the end of the accounting period after taking account of any transfer to capital reserves or bonus issues or any other transaction which would have the effect of artificially reducing such accumulated income [s440(2)].

Where a company is subject to any restriction imposed by law as regards the making of distributions, regard shall be had to this restriction in determining the amount of income on which a surcharge shall be imposed under section 440 [s434(7)]. The likelihood is that if a close company can show that it would have made a distribution sufficient to avoid or reduce a surcharge were it not for the fact that it was legally prevented from doing so, no surcharge or a reduced surcharge should be made. However, decisions would ultimately be made on the facts of each individual case.

Case example: *Noble v Laygate Investments Ltd* [1978] STC 430. A company whose articles of association imposed restrictions on the payment of dividends, contended that it was prevented from paying dividends by reason of a restriction imposed by law. However, a shortfall assessment on the company was upheld. The court held that the company was free to alter its articles if it wished to do so.

### 3 How the surcharge is imposed

To understand how the surcharge is to be imposed under section 440, it is necessary to define the different elements which make up the calculation of the surcharge. It is particularly essential to define the meaning of “income”, “estate income” and “investment income” before understanding the meaning of “estate and investment income” and subsequently the “distributable estate and investment income”.

### 4 Definition of income

Section 434(4) outlines how the “**income**” of a company for an accounting period should be computed. The income of a company for an accounting period shall be the income for the accounting period, computed in accordance with the Corporation Tax Acts, exclusive of franked investment income, **before** deducting:

- (a) any loss incurred in any trade, or profession carried on by the company, which is carried forward from an earlier, or carried back from a later, accounting period,
- (b) any loss which if it were a profit would be chargeable to corporation tax on the company under Case III or IV of Schedule D and which is carried forward from an earlier accounting period or any expenses of management or any charges on income which are so carried forward, and
- (c) any excess of deficiencies over surpluses which if such excess were an excess of surpluses over deficiencies would be chargeable to corporation tax on the company under Case V of Schedule D and which is carried forward from an earlier, or carried back from a later, accounting period,

and **after** deducting:

- (d) any loss incurred in the accounting period in any trade or profession carried on by the company,
- (e) any loss incurred in the accounting period which if it were a profit would be chargeable to corporation tax on the company under Case III or IV of Schedule D,
- (f) any excess of deficiencies over surpluses which if such excess were an excess of surpluses over deficiencies would be chargeable to corporation tax on the company for the accounting period under Case V of Schedule D, and
- (g) any amount allowable as a deduction against relevant trading income by virtue of section 243A<sup>2</sup>.

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<sup>2</sup> Paragraphs (d) to (g) are not taken into account when determining amount “B” in the formula for “estate and investment income”.

Section 434(1) provides for both the definition of terms used in section 440 and for the calculation of the various amounts which make up the surcharge. Relevant definitions under this section are as follows:

**“Estate income”** means income which is chargeable to tax under Case III, IV or V of Schedule D and which arises from the ownership of land (including any interest in or right over land) or from the letting furnished of any building or part of a building. For example, this includes rental income from land and buildings.

Income of a company resident in the State which consists of a distribution made by another company resident in the State is referred to as **“franked investment income”** [section 156]. For the purposes of calculating surcharges, “franked investment income” excludes distributions made out of exempt income (e.g. distributions out of exempt patent royalty income or profits or gains from occupation of certain woodlands).

The term **“investment income”** of a company is income other than estate income which would not, in the hands of an individual, be “earned income” within the meaning of section 3. For example, this includes interest and dividend income. However, without affecting the meaning of “franked investment income”,

- it does not include such income received as trading income, and
- a dividend or other distribution by a company will not be regarded as “investment income” for the purposes of the close company surcharge if the close company to which it is paid would be exempt from tax on any gains on the disposal of those shares under section 626B at the time the dividend or distribution is being made.

**“Relevant charges”** are charges on income paid in the accounting period and allowed under section 243, other than charges of an excepted trade. These are deductible in calculating the estate and investment income of a company for surcharge purposes.

The amount for part of an accounting period of any description of income referred to in section 434 shall be a proportionate part of the amount for the whole period [section 434(6)].

## 5 Estate and investment income of a company for an accounting period

Section 434(5)(a) provides that the “**estate and investment income**” of a company for an accounting period shall be the amount by which the sum of:

- (i) the amount of franked investment income for the accounting period, and
- (ii) an amount determined by applying to the amount of the “income” of the company the fraction  $A/B$ , where –
  - A is the aggregate of the amounts of estate income and investment income taken into account in computing the income of the company, and
  - B is the amount of the company's income before taking account of any amount specified in paragraphs (d) to (g) of subsection (4),

exceeds the aggregate of:

- (I) the amount of relevant charges, and
- (II) the amount which is an allowable deduction in computing the total profits for in respect of expenses of management by virtue of section 83(2).

## 6 Non-allowable deductions

Renewable energy investments (section 486B) are not deductible against estate and investment income for the purposes of the close company surcharge.

Capital allowances are not deductible against estate and investment income for the purposes of the close company surcharge. For the avoidance of doubt, this does not affect the availability of a deduction for capital allowances which are, by virtue of section 307 TCA 1997, treated as a trading expense of the trade when computing income for the purposes of section 434 TCA 1997.

## 7 Distributable estate and investment income

The “**distributable estate and investment income**” of a company for an accounting period means the estate and investment income of the company for the accounting period after deducting the amount of corporation tax which would be payable by the company for the accounting period if the tax were computed on the basis of that income [section 434(5A)(a)].

In most cases the amount of corporation tax would be payable at a rate of 25%. In some cases, the amount of corporation tax payable would be nil, such as in the case of exempt franked investment income.

In the case of a **“trading company”**, the distributable estate and investment income is reduced by 7.5 per cent [section 434(5A)(b)]. A trading company is any company which exists wholly or mainly for the purpose of carrying on a trade, and any other company whose income does not consist wholly or mainly of investment or estate income [section 434(1)].

## 8 Distributions of a company for an accounting period

The close company surcharge is applied to the amount of distributable estate and investment income that exceeds the distributions of the company for the accounting period.

Under section 434(2), the **“distributions of a company for an accounting period”** shall be taken to be the aggregate of:

- any dividends which are declared for or in respect of the accounting period and are paid or payable during the accounting period or within 18 months after the end of the accounting period, and
- all distributions, other than dividends, made in the accounting period.

Apportionments of distributions on a time basis are to be made where the period for which a company makes up accounts and makes distributions is not an accounting period for corporation tax purposes [section 434(3)].

Section 44 of the Finance Act 2008 amended the close company surcharge rules under section 434(2) and (3A) TCA 1997 to allow a company making a distribution and the company receiving it to jointly elect that the distribution will not be treated as a distribution for the purposes of section 440.

Under current law, in calculating the distributable estate and investment income of a holding company that is a close company, distributions received from a non-resident company are not taken into account (where a disposal of the underlying shares would qualify for relief under section 626B), while distributions received from an Irish-resident company (being franked investment income) are. This section allows an Irish resident holding company and an Irish resident company that pays or makes a distribution to the holding company to elect (in the CT1) that the distribution be afforded the same treatment as distributions received from a non-resident subsidiary. If such an election is made, the distribution will be treated as not being a distribution received by the holding company and as not being a distribution made by the subsidiary. This section applies as respects a dividend paid, or distribution made, on or after 31 January 2008. Both companies making the joint election must be close companies.

The buy back by an unquoted company of its own shares (or its holding company's shares) is not treated as a distribution in certain circumstances [section 176]. However, this payment remains to be treated as a distribution for the purposes of the close company surcharge.

## 9 Examples of calculation of surcharge under section 440

### EXAMPLE 4

TradeCo has the following results for the accounting period ended 31 December 2023:

	€
Chargeable gain (as adjusted)	5,000 <sup>3</sup>
Trading Income (non-professional)	32,000
Rental Income	6,000
Bank Interest (Gross)	8,000
Franked Investment Income	2,000

In the accounting period ended 31 December 2023, TradeCo incurred expenses on behalf of a participator of €400. TradeCo has not been reimbursed for this expense.<sup>4</sup>

In addition, a final dividend of €2,000 was declared by TradeCo for the period ended 31 December 2023 and this was paid on 1 February 2024.

TradeCo paid charges of €3,000 in respect of its trading activities and claimed €4,000 of loss relief under section 396(1) for a loss which arose in the accounting period ended 31 December 2021<sup>5</sup>.

**Step 1:** Calculate the Income of the company.

Schedule D	Case I	32,000
	Case III	8,000
	Case V	<u>6,000</u>
		46,000
Less: relevant trading charges (section 243A) (deductible against Case I income)		<u>(3,000)</u>
Income		43,000

<sup>3</sup> Chargeable gains are not included in the surcharge computation.

<sup>4</sup> Expenses on behalf of a participator are treated as a distribution made by the company [section 436(3)(a)]. This deemed distribution is taken into account in the surcharge computation. The company must remit Dividend Withholding Tax (DWT) to Revenue in respect of this distribution [section 172B]. The company is entitled to recover this DWT amount from the participator and it is assumed in this example that the company has done so.

<sup>5</sup> Losses carried forward or carried back are not deductible in the surcharge computation.

**Step 2:** Calculate the Estate and Investment Income

Franked Investment Income	2,000
Income x A/B = $43,000 \times \frac{(6,000 + 8,000)}{46,000}$	<u>13,087</u>
where: "A" is the aggregate of estate income and investment income, and "B" is the company's income before deduction of relevant trading charges	
Estate and Investment Income	15,087

**Step 3:** Calculate the Distributable Estate and Investment Income

Estate and Investment Income	15,087
Less: Corporation Tax	
13,087 x 25%	(3,272)
2,000 x 0%	<u>(0)</u>
	11,815
Less: "Trading company" reduction @ 7.5%	<u>(886)</u>
Distributable estate and investment income	10,929

**Step 4:** Calculate the "surchargeable" amount.

Distributable estate and investment income	10,929
Less: Distributions for the period (2,000 + 400)	<u>(2,400)</u>
Surchargeable amount	8,529

**Step 5:** Calculate surcharge

<b>Surcharge</b>	$8,529 \times 20\%$	1,706
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If no further dividends are paid in respect of the accounting period ending 31 December 2023 by 30 June 2025 (i.e. within 18 months of the end of the relevant accounting period), then this surcharge amount is treated as part of TradeCo's corporation tax liability for the subsequent accounting period ending 31 December 2024.

**EXAMPLE 5**

HoldCo, an investment company, has the following results for the accounting period ended 31 December 2024:

	€
Case V Rental Loss	(4,000)
Case III Foreign dividend income (Note 1)	21,000
Franked Investment Income (Note 2)	8,000

HoldCo incurred management expenses of €1,500 during the accounting period. The company also has excess management expenses of €1,200 carried forward from an earlier accounting period.

The company made a distribution (other than a dividend) of €2,500 to its shareholders during the period.

Note 1: An amount of €3,000 of the foreign dividend income was received in respect of shares at a time when any gain on a disposal would have qualified for relief under section 626B. All of the foreign dividend income is subject to tax at a rate of 25%.

Note 2: HoldCo and one of its Irish subsidiaries, which is also a close company, made a joint election under section 434(3A) to disregard a €1,000 distribution made to HoldCo for the purpose of the close company surcharge. No election was made for the balance of €7,000 Franked Investment Income received.

**Step 1:** Calculate the Income of the company.

Schedule D Case III	21,000
Less: Current year Case V Rental Loss	<u>(4,000)</u>
Income	17,000

**Step 2:** Calculate the Estate and Investment Income

Franked Investment Income (8,000 – 1,000)	7,000
Income x A/B = $17,000 \times \frac{18,000}{21,000}$	14,571
where: “A” is the aggregate of estate income and investment income (disregarding distributions in respect of shares qualifying for s626B relief) “B” is the company’s income before deduction of the current year rental loss	
Less: Expenses of management (1,500 + 1,200)	<u>(2,700)</u>
Estate and Investment Income	18,871

**Step 3: Distributable Estate and Investment Income**

Estate and Investment Income	18,871
Less: Corporation Tax (14,571 – 2,700) x 25%	(2,968)
7,000 x 0%	(0)
Distributable estate and investment income <sup>6</sup>	15,903

**Step 4: Calculate “surchargeable” amount.**

Distributable estate and investment income	15,903
Less: Distributions for the period	(2,500)
Surchargeable amount	13,403

**Step 5: Calculate surcharge**

Surcharge	13,403 x 20%	2,681
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If no further dividends are paid in respect of the accounting period ending 31 December 2024 by 30 June 2026 (i.e. within 18 months of the end of the relevant accounting period), then this surcharge amount is treated as part of HoldCo’s corporation tax liability for the subsequent accounting period ending 31 December 2025.

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<sup>6</sup> As HoldCo is not a trading company, the 7.5% trading reduction does not apply.

## 10 Interaction of section 23 type reliefs

The following guidance, originally included in Tax Briefing 25 of 1997, continues to be Revenue practice:

Interaction of sections 23 FA 1981/43 FA 1994 and surcharges under section 101 Corporation Tax Act 1976:

“Revenue accepts that in computing income of an accounting period for the purpose of section 100(4) CTA 1976 any allowable expenditure under section 23(2) FA 1981 and section 43(2) FA 1994 which is carried forward from an earlier accounting period may be deducted. In other words, it is accepted that any relief under section 23 FA 1981 or section 43 FA 1994 which has not already been used to reduce a charge to tax on the company in question may be used to calculate the estate income and the distributable income of the company for the accounting period.”

## 11 Temporary measures in relation to COVID-19

As a result of the COVID-19 pandemic, Revenue had a temporary concession where, if a distribution was not made within 18 months from the end of the accounting period in which the income arose and in response to COVID-19 circumstances affecting the company, Revenue, on application, extended the 18-month period for distributions by a further 9 months.

The COVID-19 related temporary concession referred to above only applied to accounting periods ending up to 31 March 2022. Normal close company surcharge rules apply to accounting periods ending after this date, i.e., close company surcharges will apply to income of close companies that is not distributed within 18 months from the end of the accounting period in which the income arose.

Full details are on the Revenue website: [COVID-19 and Close company surcharges](#).

The following material is either exempt from or not required to be published under the Freedom of Information Act 2014.

[...]

If a distribution which could be made was not made by the end of the extended period, the resulting surcharge is included in the corporation tax liability for the 12-month accounting period following the surcharged accounting period as normal and interest will apply to the late payment of the surcharge.

The following material is either exempt from or not required to be published under the Freedom of Information Act 2014.

[...]

If a case were reviewed following the expiration of the extended 9-month period and it is determined that there was no basis for the company not paying a dividend within the normal 18-month timeframe, the surcharge and normal due dates apply, i.e. the due dates for the corporation tax liability for the 12-month accounting period following the surcharged accounting period, and interest applies to the late payment of the surcharge.