

Surcharge on undistributed income of service companies

Part 13-02-06

This document should be read in conjunction with section 441 Taxes Consolidation Act 1997

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Legislation regarding the **surcharge** on the undistributed investment and estate income of close companies is dealt with by section 440 while section 441 deals specifically with the surcharge on the undistributed income of **service companies** [Tax and Duty Manual [Part 13-02-05](#) refers]. The information provided here was initially contained in Tax Briefing Issue 48 of June 2002

Intention of section 441

This section is designed to counter avoidance of tax arising from the non-distribution of income of certain close companies (usually arising from professional activities) which would otherwise attract income tax at the higher rate. The device consists of the setting up of a company for the purpose of carrying on a profession, providing professional services or holding an office or employment. It may also take the form of the setting up of a company controlled by persons engaged in a profession for the purpose of carrying on a business of providing services or facilities for those persons.

The profits of the company are withheld from distribution and therefore bear tax at the company tax rate rather than at the personal tax rates to which the profits, if distributed, would be liable in the hands of the shareholders. As these shareholders are usually liable at rates of personal tax which exceed the company tax rate, the non-distribution results in loss of tax revenue. The section counters this method of tax avoidance by imposing a surcharge of 15 per cent on 50 per cent of the company's undistributed professional and service income and a surcharge of 20 per cent on the company's undistributed investment and estate income.

General Background

Professional Service Company Surcharge

Section 441 TCA 1997 provides for a surcharge on certain undistributed income of service companies. The section defines a service company as including close companies where the principal part of the company's income is derived from:

- The carrying on directly of a profession,
- The provision of professional services,

Or a company-

- Which has or exercises an office or employment.

Also included are:

- The provision of services or facilities to such companies, or
- The provision of services or facilities to an individual or partnership carrying on a profession. However, not included in the latter are genuine cases where the services or facilities are provided for persons not connected with the company.

As the Tax Acts do not define “profession” it must be given its ordinary meaning in accordance with the general principles of statutory construction. In the tax case of CIR V Maxse [12 TC 41], it is stated that profession involves an occupation requiring either intellectual skill, as in painting, sculpture or surgery or skill controlled by the intellectual ability of the operator. It distinguishes this from an operation, which is substantially the production or sale of commodities.

While certain activities clearly fall within this definition and are accepted as being the exercise of a profession, such as medicine or law, there may be question about the status of others. Each case should be examined with regard to its own particular facts and the question of degree is important. However the following are regarded as being professions and as falling within the provisions of Section 441:

Accountant

Actor

Actuary

Archaeologist

Architect

Auctioneer/Estate Agent

Barrister

Computer programmer

Dentist

Doctor

Engineer

Journalist

Management Consultant

Optician

Private School

Quantity Surveyor

Solicitor

Veterinary Surgeon.

While the above are considered to be providing professional services, the list is not intended to be an exhaustive list of all possible professions. The following activities are generally not considered to constitute the carrying on, of a profession:

Advertising Agents¹

Auctioneers of livestock in a cattle mart

Insurance brokers²

The operation of a retail pharmacy

Public relations companies

Stockbrokers.

It is also considered that whereas accountancy comes within the meaning of profession, bookkeeping, payroll and VAT compliance activities would not in themselves constitute a professional activity. Any business involving tax planning, be it investing or structuring, would come within the general heading of accountancy. It is considered that this encompasses financial services.

Insurance Brokers

It should be noted that while it is accepted that the Case I income of insurance broking companies is not within the scope of Section 441, deposit interest on deposits held by such companies is not regarded as arising in the course of the company's trade unless the company can satisfy the very high burden of proof that the deposits are integral to its trade. Therefore deposit interest is assessable under Case III and is within the scope of the Section 440 surcharge on undistributed investment income.

1 MacGiolla Mhaith v Brian Cronin & Associates Ltd [ITR III, 211].

2 Durant V CIR [12 TC 245].

Definition of a Service Company

A “service company” is—

- a close company which carries on directly a profession or whose business consists of the provision of professional services or which has or exercises an office or employment;
- a close company which provides services or facilities of any nature to such a company, to an individual who carries on a profession, to a partnership carrying on a profession, to a person who holds or exercises an office or employee, or to a person or partnership connected with any such person or partnership.

Excluded are genuine cases where the services or facilities are provided for persons not connected with the company [TCA section 441(1)].

A company is not a service company unless the principal part of its income chargeable under Cases I and II of Schedule D or under Schedule E is derived from specified activities, that is —

- carrying on a profession,
- providing professional services,
- having or exercising an office or employment,
- providing services or facilities (other than the excluded services referred to above) to such person or partnership as is referred to above, or
- any two or more of the activities so specified [section 441(2)].

A partnership is to be treated as connected with a company or individual (and vice versa) if any one of the partners is connected with the company or individual, and a partnership is to be treated as connected with another partnership if any one of the partners in it is connected with any one of the partners in the other partnership [section 441(3)].

Surcharge

The surcharge of 15 per cent applies to the amount by which the aggregate of—

- (i) the distributable estate and investment income and
- (ii) 50% of the distributable trading income

exceeds the distributions of the company for the accounting period, but to the extent that the distributable estate and investment income exceeds the distributions for the accounting period a 20% rate of surcharge will apply to that portion of the excess.

A more recent version of this manual is available.

Example 1

The accounting period of a company is the 12 month period ending on 31 December 2017. The company does not distribute all its distributable income. Its respective income and distribution position is —

Distributable trading income (DTI) €10,000

Distributable Investment Income (DII) €3,000

Distributable Estate Income (DEI) €4,000

Distribution for year €6,000

1. Calculate the aggregate of 50 per cent of the DTI plus 100 per cent of the aggregate of the DII and DEI.

$$€5,000 + (€3,000 + €4,000)$$

$$= €12,000$$

2. The amount subject to the surcharge is the amount by which €12,000 exceeds the distribution (€6,000) of the company. This amount is €6,000

3. To establish how the amount is apportioned between the surcharges at the different rates, calculate the excess of the DII and DEI over the distributions

DII + DEI	€7,000
less distribution	€6,000
	€1,000

4. The surcharges are—

$$€1,000 @ 20\% = €200$$

$$€5,000 (€6,000 - €1,000) @ 15\% = €750$$

Total surcharge imposed = €950

There is no surcharge where the excess of the distributable income over the distributions, in the case of a single company or a group of associated companies, does not exceed €2,000 (€635 for accounting periods ending on or before 31 December 2012). Marginal relief is provided where the excess is somewhat more than €2,000 [TCA section 441(4)(b)(i) & (ii)]

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Example 2

Excess distributable income as computed under this subsection €2,200

Surcharge @ 15% = €330

Maximum liability – 4/5ths (€2,200 – €2,000) = €160

Marginal relief – (€330 – €160) = €170

Surcharge imposed = €160

Marginal relief runs out where the excess exceeds €2,461.

The provisions of TCA section 434(2), (3), (3A), (6) and (7) regarding the distributions to be taken into account for the purpose of computing a surcharge are applied for the purposes of the section. The provisions of section 434(4), which defines the income of a company for an accounting period, and sections 434(1) and (5A) which define the distributable estate and investment income and the distributable trading income of a company for an accounting period are also applied for the purposes of this section [section 441(6)].