

Surcharge on Certain Undistributed Income of Close Companies

Part 13-02-05

This document should be read in conjunction with section 440 of the Taxes Consolidation Act 1997 – the document incorporates Revenue Guidance previously outlined in Tax Briefing 25 February 1997.

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Please consult the page entitled “Tax clearance, filing returns and paying taxes” on the [COVID-19 pages on the Revenue website](#) for further information in relation to concessions made for corporation tax.

Details for caseworkers in relation to COVID-19 temporary measures may be found in section 11 of this manual.

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Background

The reason for 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 440 provides for an additional charge of corporation tax (referred to as a “surcharge”) on close companies at the rate of 20 per cent of the excess of the aggregate of the distributable investment income and the distributable estate income over the distributions made for an accounting period [s440(1)(a) TCA].

Service Companies

Separately, section 441 TCA deals specifically with the surcharge on the undistributed income of Service Companies.

Tax and Duty Manual [Part 13-02-06](#) refers.

1 Exceptions to surcharge

There is no surcharge where the excess is €2,000 (€635 for accounting periods ending on or before 31 December 2012) or less and marginal relief is provided where the excess is slightly more (i.e. the amount of the surcharge may not be greater than 80% of the amount by which the excess is greater than €2,000). 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)]. It should be noted that marginal relief runs out when the excess exceeds €2,666.

An associated company must be counted for the purposes of the surcharge even if it was an associated company for part only 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 occurring on or after 27 November, 1975 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. 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 making such a distribution, no surcharge or a reduced surcharge should be made. However, decisions would ultimately be made on the facts of each individual case.

Case example: 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 – **Noble v Laygate Investments Ltd [1978] STC 430**.

2 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.

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” and “distributable income” before understanding the meaning of “distributable estate and investment income”.

4 Definition of income [s434(4)]

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:

- 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,
- 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
- 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:

- any loss incurred in the accounting period in any trade or profession carried on by the company,

- 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,
- 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,
- any amount allowable as a deduction against relevant trading income by virtue of section 243A.

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, in the nature of rent from land or buildings which is chargeable to tax under Case III, IV or V of Schedule D.

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 but does not include such income received in the course of trading. However, without affecting the meaning of “franked investment income”, 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 allowed under section 243 other than charges of an excepted trade (i.e. charges allowed against non-trading income). These are deductible in calculating estate and investment income of a company for surcharge purposes.

The term “trading company” means 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.

5 Distributions of a company for an accounting period

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 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 (under 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.

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 [s434(3)].

6 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:

- the amount of franked investment income for the accounting period, and
- an amount determined by applying to the amount of the income of the company for the accounting period 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 for the accounting period, 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:

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

Section 434[(5)(b)] provides that the trading income of a company for an accounting period shall be the income of the company for the accounting period after deducting:

- an amount equal to the amount specified in subparagraph (ii) of paragraph (a),
- where the aggregate of the amounts specified in clauses (I) and (II) of paragraph (a) exceeds the sum of the amounts specified in subparagraphs (i) and (ii) of that paragraph, the amount of the excess, and
- charges on income paid for the purposes of an excepted trade within the meaning of section 21A [s434(5)(a)]

7 Computation of surcharge under section 440

For the purpose of section 440:

- (a) “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;

Note: In the case of a trading company, the distributable estate and investment income for an accounting period shall be the amount determined in accordance with paragraph (a) reduced by 7.5 per cent [s434(5A)(b)].

The amount of income for part of an accounting period shall be a proportionate part of the amount for the whole period [434(6)].

- (b) For the purpose of section 440, 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.

The surcharge is calculated by taking 20% of the difference as between (a) and (b).

8 Example of calculation of surcharge under section 440

X Ltd has the following results for the accounting period ended 31 December 2013

Chargeable gain (as adjusted)	5,000
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 2013, X Ltd incurred expenses on behalf of a participator of 400.

In addition, a final dividend of 2,000 was declared by X Ltd for the period ended 31 December 2013 and this was paid on 1 February 2014.

X Ltd paid charges of 3,000 in respect of its trading activities and claimed 4,000 of loss relief in respect of loss relief under s. 396(1) for a loss which arose in the accounting period ended 31 December 2011.

Step 1: Calculate the “income” of the company

Schedule D	Case I	32,000
	Case IV	8,000
	Case V	6,000
Less: relevant trading charges (S.243A) (available against Case I income)		3,000
		43,000

Step 2: Calculate the Estate and Investment Income

(i) Franked Investment Income	2,000
(ii) $\frac{43,000 \times 14,000}{46,000}$	13,087
	15,087
Management expenses	(400)

Step 3: Distributable Estate and Investment Income

Estate and Investment Income	14,687
Less: Corporation Tax $12,687 \times 25\%$ $2,000 \times 0\%$	(3,172) -
	11,515
Less: “Trading company” reduction @ 7.5% (same reduction applies to both estate and investment income)	(864)
Net distributable estate and investment income	10,651

Step 4: Calculate “surchargeable” amount

Distributable estate and investment income	10,651
Less: Distributions for the period	(2,000)
Surchargeable amount	8,651

Step 5

Surcharge	8,651 x 20%	1,730
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This surcharge is treated as part of the corporation tax liability for the subsequent accounting year ending 21 December 2014 and is payable if no further dividends are paid by the company before 30 June 2015 (i.e. within 18 months following the relevant accounting period).

9 Interaction of section 23 type reliefs

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

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

“Revenue are now prepared to accept 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.**”

10 Temporary measures in relation to COVID-19

10.1 Temporary concession (see important update below)

In cases where a distribution is 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 will, on application, extend the 18-month period for distributions by a further 9 months.

10.2 Important update (end of concession)

The COVID-19 related temporary concession referred to above will only apply to accounting periods ending up to 31 March 2022.

Normal close company surcharge rules will 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 may be found 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 can be made (taking account of any restriction imposed by law as regards the making of distributions as required by section 434(7) TCA 1997) is not made by the end of the extended period, the resulting surcharge will be 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 was found that there was no basis for the company not paying a dividend within the normal 18-month timeframe, the surcharge and normal due dates would apply, i.e. the due dates for the corporation tax liability for the 12-month accounting period following the surcharged accounting period, and interest would apply to the late payment of the surcharge.