

Surcharge on undistributed income of service companies

Part 13-02-06

This document should be read together with section 441 TCA 1997

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Introduction

Section 441 Taxes Consolidation Act 1997 (TCA 1997) provides for an additional charge of corporation tax (referred to as a “surcharge”) on close companies which are service companies (as defined) in respect of certain undistributed income. The rate of the surcharge is 15% on such undistributed income.

A surcharge may also apply in respect of a service company’s undistributed investment and estate income. Section 440 TCA 1997 provides for a surcharge on close companies at the rate of 20% of the excess of the aggregate of the distributable investment income and the distributable estate income over the distributions made for an accounting period. This is dealt with in Tax and Duty Manual [Part 13-02-05](#).

1. 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% on 50% of the company’s undistributed professional and service income and a surcharge of 20% on the company’s undistributed investment and estate income.

General Background

2. 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 that 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 or the provision of professional services and as falling within the provisions of Section 441:

- Accountant
- Actor
- Actuary
- Archaeologist
- Architect
- Auctioneer/Estate Agent
- Barrister
- Computer programmer
- Dentist
- Doctor

Engineer
Journalist
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
Management Consultant³
Public relations companies
Stockbrokers.

Where a professional body provides guidance regarding the activities of that profession, the guidance will be an important factor in establishing if a company is a “service company”.

Where preliminary work is done which of itself could be considered “non-professional” in nature, but which is integral to enabling the company to provide a “professional” service, such work should not be classified in isolation as non-professional but rather will be considered to be integral to and part of a “profession/professional service”. One example of this would be preparatory work which is carried out in the production of financial accounts.

In order to determine whether income is professional or non-professional in nature, the income of a professional service company should be considered on a client by client basis relative to the services provided. For example, where the company provides only bookkeeping or payroll services to a client, that income will be considered to be non-professional in nature.

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

² Durant V CIR [12 TC 245].

³ Appeal Commissioners Determination 76TACD2021 (Original designation 1503TAC/17).

While 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.

Companies Providing Medical Locum Services

Where a company is providing the services of a medical practitioner(s) to an unconnected party or parties, the business of such a company is considered to be the provision of staff rather than the carrying on of a profession or the provision of professional services.

3. 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 employment, 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)].

4. Surcharge

The surcharge of 15% 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.

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)].

Example 1 Apportionment of surcharges

Where a service company has both undistributed trading income and also undistributed estate and/or investment income it is necessary to apportion the surcharges at the different rates, as in this example.

The accounting period of a company is the 12-month period ending on 31 December 2022. The company does not distribute all its distributable income. Its respective income and distribution positions are -

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% of the DTI plus 100% of the aggregate of the DII and DEI.

$$\text{€}5,000 + (\text{€}3,000 + \text{€}4,000)$$

$$= \text{€}12,000$$

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—

$$\text{€}1,000 @ 20\% = \text{€}200$$

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

$$\text{Total surcharge imposed} = \text{€}950$$

Example 2 Marginal Relief

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)]. The example below deals with this.

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

Surcharge @ 15% = €330

Maximum liability – 4/5ths ($\text{€}2,200 - \text{€}2,000$) = €160

Marginal relief – ($\text{€}330 - \text{€}160$) = €170

Surcharge imposed = €160

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