

[13.2.5] Surcharge on certain undistributed income of close companies [Section 440 TCA 1997]

[Updated March 2015]

[This Tax Instruction refers to accounting periods ending on or after 14 March 2001. Any queries with regard to accounting periods ending on any date prior to this date should be referred to the appropriate Revenue district]

[Unless otherwise stated all references to legislation in this Tax Instruction refer to the Taxes Consolidation Act 1997 (TCA)]

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 Instruction [Part 13.2.6](#) refers].

Background (section 440 surcharge on undistributed investment and estate income)

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 [440(1)(a)].

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 [440(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 [440(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 [440(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 but a shortfall assessment on the company was upheld as it was held that it was free to alter its articles if it wished (Noble V Laygate Investments Ltd [1978] STC 430).

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.

Understanding of how the surcharge is to be imposed

In order 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”

Definition of Income [434(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—

- (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,
- (g) any amount which is an allowable 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.

Distributions of a company for an accounting period [section 434(2) – as amended by Finance Act 2008] – Joint Election

Section 44 of the Finance Act 2008 amends the close company surcharge rules under Section 434 [as reflected now in subsection (2) and new subsection (3A) of this section] of the TCA 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 [434(3)].

Estate and investment income of a company for an accounting period [section 434(5)(a)]

(a) 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 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—

- (I) the amount of relevant charges, and
- (II) 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).

- (b) The trading income of a company for an accounting period shall be the income of the company for the accounting period after deducting—
- (i) an amount equal to the amount specified in subparagraph (ii) of paragraph (a),
 - (ii) 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
 - (iii) charges on income paid for the purposes of an excepted trade within the meaning of section 21A [434(5)(a)]

Computation of surcharge under section 440

For the purposes of sections 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 [section 434(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 purposes 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).

Example of calculation of surcharge under section 440

X Ltd has the following results for the accounting period ended 31/12/2013

Chargeable gain (as adjusted)	5000
Trading Income (non-professional)	32000
Rental Income	6000
Bank Interest (Gross)	8000
Franked Investment Income	2000

In the accounting period ended 31/12/2013, X Ltd incurred expenses on behalf of a participator of 400. In addition a final dividend of 2000 was declared by X Ltd for the period ended 31/12/2013 and this was paid on 1/2/2014.

X Ltd paid charges of 3000 in respect of its trading activities and claimed 4000 of loss relief in respect of loss relief under s. 396(1) for a loss which arose in the accounting period ended 31/12/2000.

Step 1

Calculate the “income” of the company:

Schedule D	Case 1	32000
	Case IV	8000
	Case V	6000
Less: relevant trading charges (S.243A)		3000
		43000

Step 2

Calculate the Estate and Investment Income

Calculation 1

(i) Franked Investment Income	2000
(ii) 43000×14000	13087
46000	
	15087
Management expenses	400

Step 3

Distributable Estate and Investment Income

Estate and Investment Income	14687
Less: Corporation Tax $14687 \times 25\%$	3672
	11015
Less: "Trading company" reduction @ 7.5% (same reduction applies to both estate and investment income)	826
Net distributable estate and investment income	10189

Step 4

Calculate “surchargeable” amount

Distributable estate and investment income		10189
Less: Distributions for the period		2000
Surchargeable amount		8189

Step 5

Surcharge amount	8189 X 20%	1637
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This surcharge is treated as part of the corporation tax liability for the subsequent accounting year ending 31/12/2014 and is payable if no further dividends are paid by the company before 30/06/2015 (i.e. within 18 months following the relevant accounting period).