Update to Close Company Surcharge Provisions

August 2022

CONTENTS

INTRODUCTION

The surcharge on undistributed income of certain companies is a tax avoidance provision that applies to a significant proportion of companies operating in Ireland each year. This measure generally imposes a surcharge of 20% on the income of “close companies” that is not distributed within 18 months of the accounting period in which the income was received.

Similar to a number of other COVID-19 related concessions, the Revenue commissioners provided a temporary concession in relation to the surcharge. Essentially, the concession meant that companies could apply to have the 18 month window to distribute profits extended by a further 9 months to help ease the burden that the pandemic placed on companies in relation to managing cash-flow.

As of the **1st April 2022**, the concession has been lifted and it is now important for companies to be aware of the impact this may have on their income moving forward.

What is a close company?

In essence, a close company is an Irish resident company which is controlled by five or fewer “participators”. A participator for the purposes of this measure is somebody who has an “interest” in the income of the company, such as a person who has share/loan capital or voting rights in the company. The surcharge on this type of company is 20% of its undistributed passive income such as rental or dividend income.

What are the tax implications?

The rationale for the close company surcharge is to prevent participators of close companies accumulating income within the company over a number of years before extracting this cash in a way that would avoid or reduce potential income tax liabilities. For example, marginal rates of income tax are typically higher than Capital Gains Tax (“CGT”) which could apply in a wind up or liquidation of the company (52% vs. 33%).

In order to avoid the 20% surcharge it is possible for the company to declare a dividend to its shareholders within 18 months of the relevant accounting period.
As mentioned above, due to COVID-19, Revenue permitted a temporary concession extending this period by 9 months on application. However, the concession has since been removed and the original 18 month period has been reinstated as shown below.

Example 1:

ABC Ltd is a standalone close company and it had net distributable investment income of €10,000 in the year to 30 April 2022 (after a deduction of notional tax and a 7.5% discount for trading companies). It paid a dividend of €6,000 in the 18 month period following the year end.

The surcharge is calculated as follows:

	€
Net Distributable income	10,000
Less: Dividend paid out	(6,000)
Excess	4,000
Surcharge @ 20%	800

It should be noted that "De minimis relief" provides that no surcharge applies where the distributable excess is less than €2,000 and also provides for marginal relief where the excess is between €2,000 and €2,668.

Impact of updated Revenue Guidance

The ability to apply for an extension to the period in which a distribution can be made has been removed for all companies with an accounting period ending after the 31st March 2022.
For companies who have an accounting period ending after this date, it is vitally important to be aware that a distribution must be made within 18 months of their accounting period ending due to the removal of the concession. Where the income is not distributed, it will be subject to the applicable close company surcharge and efforts to avail of an extension may be rejected by Revenue.

A point to note for "Service Companies"

A common trend within professional services is for professionals (e.g. medical doctors, veterinarians, pharmacists) to attempt to incorporate practices where permitted to do so by their respective professional bodies. The preference to incorporate arises from the ability to tax profits at lower rates of corporation tax and to structure the future operations of their business where there is a significant rate of growth.

These companies, in addition to the close company surcharge, may also be exposed to a separate charge known as the "services company surcharge". This surcharge applies a 15% charge on half of the company's undistributed professional income as outlined below:

Example 2:

Pet Ltd makes up accounts to 31 December 2021. During the year its only source of income was from its Veterinary business and its tax-adjusted profit was €50,000. It paid a dividend of €5,000 just after the year-end.

	€
Income	50,000
Less Corporation Tax @ 12½%	(6,250)
Distributable Income	43,750
50% subject to surcharge	21,875
Less: Dividend Paid	(5,000)
Excess	16,875
Surcharge @ 15%	2,531

*Similar to the Close Company surcharge, "de minimis relief" may also apply here.

There has been a number of tax appeal cases dealing with this surcharge in recent years as it is not always initially clear what income is derived from "professional services." If you feel your company may be subject to this surcharge, please feel free to contact us for further information on its application. The Revenue concession outlined above for undistributed investment similarly applies to relevant companies with undistributed professional income.However, this concession has similarly been withdrawn by Revenue and companies should be aware of its impact.

What can Moore offer you or your staff?

At Moore, we assist portfolios of clients across various industries in relation to both the close company and services company surcharges. We advise companies on structuring their business activities to efficiently plan on the most prudent course of action to avoid incurring unnecessarily tax charges.
We provide a comprehensive service to owner managed businesses including:

- personal one to one consultations on structuring opportunities
- tax planning on profit extraction and other benefits
- compliance reminder e-mails in advance of deadlines
- preparation of tax calculations and dividend withholding tax returns

- provision of advice in relation to the scope of the services company surcharge
- payment of liabilities on behalf of taxpayers

We have established an efficient process to cater for our clients' needs which allows us to provide a highly effective and personalised service.

If this is something you believe may be of interest to you or your business, please feel free to contact us and we can provide any additional information you may require.

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