Close Company Definitions and Rules

By: Anne Tynan, CTA, on behalf of the CPA Examinations Team for Strategic Level, Advanced Tax Strategy, March 2024.

This article is provided to support students in their revision of the close company rules that apply to the taxation of companies liable to Irish taxation and to the shareholders, directors, and associates of those companies. This article will summarise (1) the tests to determine if a company is a close company for Irish tax purposes and related definitions, (2) the tax implications of close company status on certain transactions between the company, its shareholders, directors and associates, and (3) close company surcharge calculations. Students are required to have detailed knowledge of all aspects of the close company rules which can be examined up to competency level 3 on the Advanced Tax Strategy exam paper.

(1) Close Company Tests and Related Definitions

It is important to reflect on whether close company rules apply in most ATS exam questions that involve companies. This is particularly the case if questions involve transactions.

between the company and its shareholders, directors, or their associates. As ATS is an open book exam, students are unlikely to be asked to define a close company. Students should therefore be able to analyse and determine close company status based on the information provided in the question. This is done by analysing the close company tests as set out in section 430(1) of Taxes Consolidation Act 1997. The tests focus on who **controls** the company. There are two tests, and a company needs to meet just one of these to be considered a close company for Irish tax purposes.

1. 5 or fewer participators control the company
2. Participators who are *also* directors control the company (any number)

<u>Related Definitions</u>

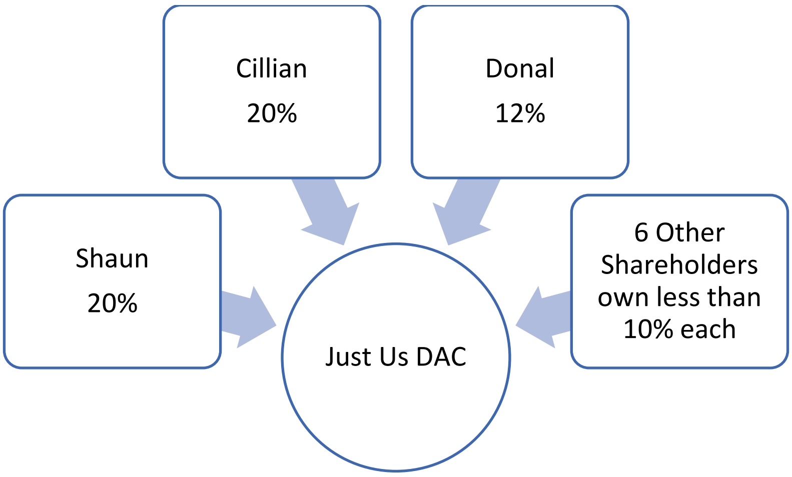
CONTROL – owns or is entitled to own the majority of voting power or share capital; entitled to majority of income on distribution; entitled to greater part of assets in the event of winding up of the company.

PARTICIPATOR (or potential) – a person who owns or is entitled to acquire the share capital, voting rights, or loan capital; a loan creditor; a person who has a right or entitled to acquire a right to receive or participate in distribution of the company; is entitled to secure income or assets of the company directly or indirectly for his benefit.

DIRECTOR – includes a manager who is the beneficial owner of (or directly / indirectly able to control) 20% of more of share capital of the company.

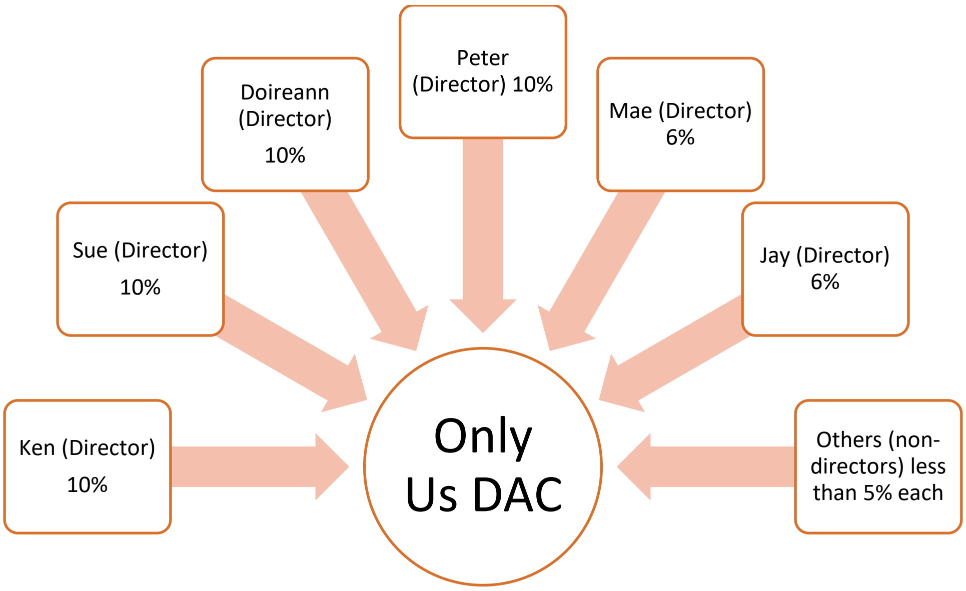
ASSOCIATE – family members excluding in-laws and nieces/nephews; another company controlled by the individual; shares held by a trust that the individual has set up; participator with an interest in shares of the company subject to a trust, excluding approved pension fund or trust for benefit of employees, directors, or their dependants.

Example 1



This example demonstrates a company that satisfies Test 1 as 3 participators (Shaun 20% + Cillian 20% + Donal 12%) control 52% of the shareholding. Therefore, Just Us DAC is a close company for Irish Tax Purposes.

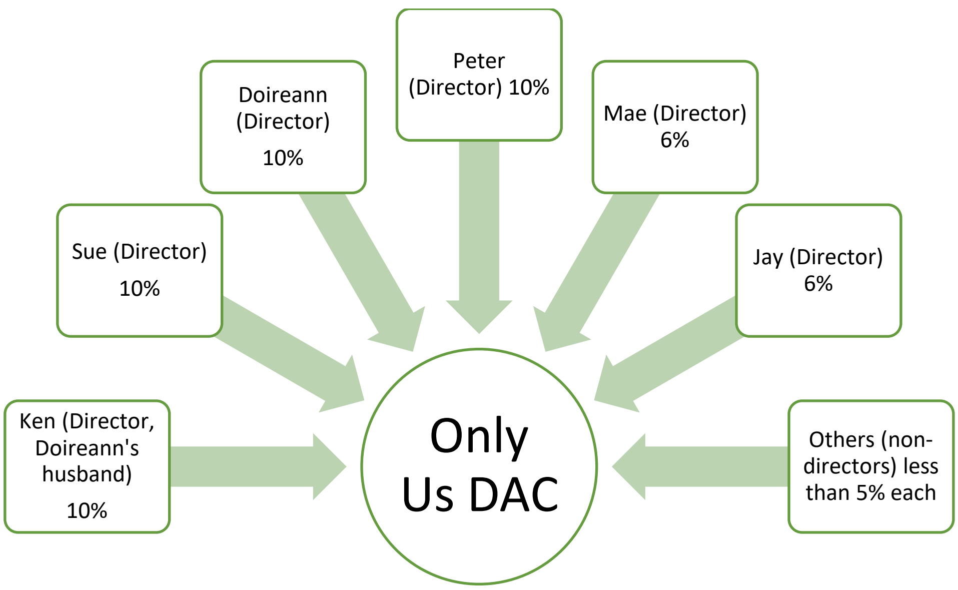
Example 2



This company does not meet Test 1 as cumulatively the 5 largest shareholders do not control more than 50% of Only Us DAC (Ken 10% + Sue 10% + Doireann 10% + Peter 10% + Mae 6% = 46%). However, the participators <u>who are also directors</u> of the company (Ken 10% + Sue 10% + Doireann 10% + Peter 10% + Mae 6% + Jay 6%), control 52% of the company and therefore the company satisfies Test 2 and is considered a close company for Irish tax purposes. There is no limit to the number of directors that we can include when establishing control for the purpose of test 2.

It is assumed in both examples above, that the shareholders are *not* related to each other.

Example 3



In this example, Ken and Doireann are husband and wife. They are therefore associates for the purpose of the close company rules. Their shareholdings are amalgamated, and they are treated as one participator. The company can now also be considered a close company under Test 1, as 5 participators (*Ken 20%* + Sue 10% + Peter 10% + Mae 6% + Jay 6%) now control 52% of the company.

Exclusions from Close Company Rules

There are certain exceptions for companies that will not be considered close companies, including:

1. A company not resident in the State,
2. A society registered under the Industrial and Provided Societies Act or a building society,
3. A company controlled by or on behalf of the State and not otherwise a close company,
4. A company controlled by another company which is not itself a close company and cannot be treated as a close company except by including the company as one of the 5 or fewer participators,
5. A 'quoted' company in which 35% or more of the voting rights are held by the public.

A useful reference for further examples of company ownership structures subject to the close company tests can be found in the Revenue Tax and Duty Manual Part 13-02-02, Part 13-02-02 - Illustrative Examples of Close Company Provisions (revenue.ie).

As mentioned above, students at ATS level may not be asked to explain the definition of close company tests but are expected to be able to identify if a company meets either test and the consequences (additional tax) resulting from close company status for both the company and the relevant individuals based on the information provided in the question.

(2) Certain Transactions subject to Additional Taxes

The following transactions give rise to additional tax consequences for both the company and the individual when they take place within a close company:

1. Loans or advances to participators or their associates must be made under deduction of income tax and, if the loan is not repaid the grossed-up amount is treated as income in the hands of the recipient [sections438 and 439].
2. Certain benefits-in-kind (BIK) and expense payments to participators or associates will be treated as distributions [section 436].
3. Interest, in excess of a specified rate, paid to directors or their associates will be treated as a distribution [section 437].

Students must be able to identify the above these transactions from information provided in questions.

Transaction	Tax implication for company	Tax implications for individual
1. Certain BIK/expense payments to participators/associates who are not a director/employee of the company	- BIK/expense payment is disallowed for corporation tax purposes (addback for tax adjusted profit calculation if a deduction has been included in the accounting profit). - Treated as a deemed distribution, therefore the company must account for Dividend Withholding Tax of 25% on the BIK/expense. - Included as a distribution for close company surcharge calculation.	Participator is treated as receiving Schedule F income with a credit allowed for DWT accounted for by the company.
2. Interest, in excess of a specified limit, paid to directors/associates who have directly or indirectly a material interest in the company (> 5%) *Past Exam Paper Questions:* August 2022 Q1(e) April 2023 Q1(a) April 2021 Q1(b)	Loan from director/associate to the company, and the company is paying interest to the director/associate. Specified limit = 13% of the lower of: (i) all loans from directors with a material interest **or** (ii) share capital plus share premium	Interest received within specified limit is taxable as Case III income. AND Excess interest is taxable as Schedule F income with a credit allowed for the DWT accounted for by the company.

	Interest paid in excess of specified limit (excess interest) is treated as a deemed distribution. - Excess interest is disallowed for corporation tax purposes (addback for tax adjusted profit calculation if a deduction has been included in the accounting profit). - The company must account for Dividend Withholding Tax of 25%. - Included as a distribution for close company surcharge calculation.	
3. Loan or advance to participator/associate *Exemption from rule:* - Loan provided in ordinary course of business (i.e. by a lending institution) - Advance is under normal credit terms for supply of goods/services - Participator is a full-time director/employee of the company who does not own/control a material interest in the company (> 5%) AND the loan amount does not exceed €19,050. *Past Exam Paper Questions:* August 2023 Q4(b)	- Income Tax payable at 20% - Loan amount is net of 20% Income Tax - Liability due to be paid with Corporation Tax of accounting period in which loan is first provided to participator - Income Tax is repaid by Revenue to the company if loan is repaid by the participator/associate The loan is NOT a deemed distribution and is therefore NOT deductible for the purpose of the close company surcharge calculation.	No implications on initial receipt of loan. If loan is written off, participator is treated as receiving Case IV income for re-grossed amount of loan (company is not entitled to receive refund of Income Tax paid)

(3) Close Company Surcharge Calculations

There are two separate close company surcharge calculations, a 20% surcharge on undistributed estate and investment income [section 440] and potentially a 15% surcharge on undistributed professional service income. Templates are provided for each surcharge calculation to assist students in practising these calculations.

Surcharge on undistributed estate and investment income – 20%
This surcharge applies for all close companies who hold undistributed estate (case V) income and investment (case III, IV and FII) income within the company. Any surcharge liability arising is payable within 18 months of the end of the accounting period.

Template 1: Estate and Investment Income Surcharge Calculation	**€**
Total Income;	
Case I	X
Case III *as calculated for corporation tax purposes*	X
Case IV *as calculated for corporation tax purposes*	X
Case V *as calculated for corporation tax purposes*	X
Current year losses (Case I, III, IV or V)	(x)
Relevant trade charges	(x)
Income after losses and trade charges (i)	X
Estate and Investment Income: (i) x passive income/total income	**X**
Relevant (non-trade) charges	(x)
	X
Less Corporation Tax @ 25%	(X)
After tax estate and investment income	X
Franked investment income (dividend income) *non-trade charges can reduce FII but it is important that no corporation tax is deducted from FII, as this is exempt from CT*	X
Distributable estate and investment income	X
Trading deduction @ 7.5% *of Distributable estate and investment income*	(X)
	X
Dividends paid / Deemed distributions *along with dividends paid during the accounting period or within 18 months of the accounting period end, remember also to consider transaction between the company and its shareholders/directors/associates for any deemed distributions*	(X)
Undistributed estate and investment income	X
Surcharge @ 20%	**X**

Surcharge on undistributed professional service income – 15%
A second additional surcharge may arise for companies with professional service (case II) income. This applies in addition to the estate and investment income surcharge. Close "service" companies are also liable to a surcharge of 15% on one-half of their undistributed trading income [section 441].

Template 2: Professional Service Company Surcharge Calculation	**€**
Case II trading income	X
Current year loss relief	(x)
Relevant trade charges *a second deduction may be claimed for these charges*	(x)
	X
Less Corporation Tax @ 12.5%	(X)
Distributable trading income	X
Distributable trading income x 50%	X
Dividends paid / Deemed distributions *dividends and deemed distributions should be offset against the estate and investment income surcharge first, any remaining dividends and deemed distributions should be offset here*	(X)
Undistributed income	X
Surcharge	**15%**

Past Exam Paper Questions:
April 2023 Q1(a)
April 2022 Q1(a)

Conclusion
This article summarises the key elements and applications of the close company rules. Students are expected to be able to deal with these across both income tax and corporation tax. As this article is a summary for exam revision, it is important that you do not solely rely on this article for exam preparation. You should refer to additional resources and past exam paper questions to study this topic in more detail.

Suggested Further Study Resources:
Advanced Tax by Paula Byrne, Chapter 2 part I
Irish Taxation: Law & Practice, Irish Taxation Institute, Chapter 32
CA Proficiency 2 (ROI), Chartered Accountants Ireland, Chapter 26
Revenue Tax and Duty Manuals Part 13, accessible at [Part 13 - Sections 430-441 (revenue.ie)]