This technical query paper was submitted to Revenue in response to their invitation at a meeting of the TALC BEPS Implementation Subcommittee on 9 December 2021 for written submissions on areas of the legislation governing the ATAD Interest Limitation Rules that raise issues of uncertainty in the context of developing new Revenue guidance on the matter.

Feedback and Issues for Clarification in Revenue Guidance on the ATAD Interest Limitation Rule (ILR)

28 January 2022

1. Equity Ratio Rule

Single Company Worldwide Group Context

In the context of a single company worldwide group, the calculation of "E" in the Equity Ratio rule must be increased by an *amount "equal to the amount owed by the relevant entity to its associated enterprises which gives rise to deductible interest equivalent".*

We would welcome confirmation from Revenue as to the position whereby a debt may be owed in addition to accrued, unpaid interest on same and whether the combined principal and accrued debt should be taken into the adjustment of E or whether this is limited solely to the amount of the principal.

We would also welcome clarification from Revenue as to whether the "amount owed" refers to amounts owed from a legal perspective or an accounting perspective.

Differing Accounting Standards

We would welcome confirmation as to the applicable accounting standards which should be referred to in identifying "E" and "A" in the application of the Equity Ratio Rule, in particular with respect to a qualifying Section 110 company which qualifies as a Single Company Worldwide Group and prepares its tax computation using 2004 GAAP.

Negative Equity

It is our understanding that in the application of the Equity Ratio Rule, it may be possible for "negative equity" to arise. Confirmation of same would be welcome.

Two Percent Leeway

The Equity Ratio in Section 835AAI operates by comparing the relevant taxpayer's ratio of equity-to-assets to that of the Worldwide Group. This calculation is performed using

accounting results, but the taxpayer's calculations must be done using the same GAAP as the Worldwide Group.

Under this relief, where the taxpayer's ratio of equity-to-assets is not more than two percentage points less than the Worldwide Group's ratio, ILR is disapplied.

We understand that this reference to two percentage points less than the Worldwide Group's equity-to-assets ratio is intended as an absolute measure (viz. Worldwide Group's equity-to-assets ratio minus 2%) and not a relative measure (viz. 98% of the Worldwide Group's equity-to-assets ratio). We would suggest that Revenue's guidance confirms this point.

Reserves

We would welcome clarification from Revenue that the term "reserves" captures all forms of reserves recorded on the balance sheet under the relevant accounting standards (e.g., capital reserves, revaluation reserves, revenue reserves, capital contribution reserves etc).

2. Equity Ratio & Accounts Conversion

As a practical matter, where an Irish subsidiary of an international group prepares its financial results under Irish GAAP or IFRS ("Local GAAP") and the Parent entity into which it is consolidated prepares its consolidated results under a different GAAP ("Parent GAAP"), typically the accounting system will be set up so as to be able to produce a set of accounts under Local GAAP (which will go on to be audited for local purposes) and a Reporting Pack prepared under Parent GAAP which is provided to the Parent entity. This Reporting Pack would typically be prepared prior to any group consolidation adjustments being made (which could be handled at the Parent entity level) and, therefore, would represent a Parent GAAP version of the results of the Local entity on a standalone basis.

(We note that it may well be the case that all accounting is handled by a single global accounting team based in the Parent jurisdiction or some other jurisdiction; nevertheless, notwithstanding the physical location of the accounting team, typically a similar approach will be applied to address Local reporting and group reporting).

As a result, we would suggest that Revenue guidance would confirm that Revenue would accept the results for the Reporting Pack as the basis for a comparison under the Equity Ratio Rule (subject to any further local or group audit adjustments that arise after the Reporting Pack is produced e.g., intra-group recharges booked as part of accounts finalisation / audit process)

We would propose that the above would be applicable both to single entitles and Interest Groups where they are preparing a Local group consolidation and prepare a Reporting Pack on that basis (subject to adjustments required by S.835AAL (14)).

In the event that there is a local Interest Group and there is no local consolidation prepared under Parent GAAP, we expect that the Interest Group would need to prepare a consolidated Reporting Pack (or equivalent) should it wish to apply the Equity Ratio.

While we expect that for most international groups, the above approach will hopefully be acceptable, there may be instances where Reporting Packs are not prepared in this way. Consequently, we would suggest that Revenue facilitate such situations (to the extent possible). In these situations, it is possible that a taxpayer might wish to "convert" its Local GAAP balance sheet into a Parent GAAP balance sheet. In this scenario, we would suggest that Revenue Guidance could confirm that Revenue would accept a conversion of this type where the taxpayer concerned prepares a "walk" from the Local GAAP balance sheet to the Parent GAPP balance sheet.

As with the Reporting Pack approach mentioned above, to the extent that there is a local Interest Group, we would expect that they would need to prepare a Local consolidation and then prepare the suggested "walk" for the Interest Group concerned.

3. Sub-fund & Series Consolidation

For the purposes of ILR (and also for anti-hybrid purposes) whether or not a company is included in the consolidated financial statements of another is an important determination. In this regard, the ILR legislation (Section 835AY) defines a 'consolidating entity' as 'an entity which is included in the ultimate consolidated financial statements, other than a non-consolidating entity'.

In this regard, a 'non-consolidating entity' is defined as an entity which is valued in the ultimate consolidated financial statements using fair value accounting, or on the basis that it is an asset held for sale, or an equivalent.

The exception for non-consolidating entities is, at its heart, a clarification – albeit it a useful one. Even without the explicit exception in the legislation, we do not think that one would consider an entity to be a 'consolidating entity' simply because, for example, another company held a small number of shares in it and, as a result, any gain or loss on those shares happen to be reflected in the investor's financial statements. Such an interpretation would mean that a company with a handful of shares in, say, Apple would make Apple a consolidating entity of that shareholder (and, indeed, all its shareholders).

On a plain reading of the legislation, notwithstanding the explicit exception for non-consolidating entities, it seems clear that to be a consolidating entity, the results of an entity concerned would need to be included in the financial statements of the investor.

This distinction is important because we have become aware of a limited number of circumstances where there can be inclusion of part of the results of certain investment vehicles.

In particular, certain SPVs are established with multiple series of note issuances. While the company itself does not have separate internal legal silos (as Irish company law does not permit this other than for certain regulated funds), there are effective

contractual silos between the different series issuances as the different series of notes track (on a limited recourse basis) the results of certain specific investments which means that gains or losses in respect of those investments have no bearing on the results of the other series.

In certain cases, if a particular investor in one series has a sufficiently large stake in that particular series, it may end up consolidating the results of that series into its financial statements. As such an investor would not be treating the investment in that series as an asset held for sale on its balance sheet or fair valuing the results through its income statement, its investment would not be in a 'non-consolidating entity'.

For clarity, this does not mean that the investor consolidates all the results of the SPV – only the results of that series. Moreover, it is not consolidating a share of the total / aggregate results of the SPV (like, say, a partner in a partnership might do with respect to the overall results of that partnership's business). Instead, the investor is consolidating a particular, segregated component of the SPV's results that is determined without regard to the results of the other series or to the aggregate results of the SPV.

We do not think that this relationship should fall under the definition of 'consolidating entity' because the entity's results, as a whole, are not included in the investor's financial statements, nor is a pro rata share of its aggregate results.

We note a similar point may arise for investors in a sub-fund of an umbrella fund.

For clarity, we suggest that Revenue guidance confirms that where an investor in a sub-fund of a fund or an investor in a series note issued by a multi-series issuing investment vehicle (being a note which tracks, on a limited recourse basis, a particular asset, or pools of assets, such that the risks and rewards arising therefrom are segregated to the investors in that series only) and that investor consolidates the results of that sub-fund or series without otherwise consolidating all of the results of the fund or investment vehicle, the fund or investment vehicle (as the case may be) shall not be a consolidating entity of that investor.

4. Application of the ILR in the context of Interest Groups

<u>Calculation of results for an Interest Group</u>

- Two worked examples are contained in the attached excel, one addressing group relief only by way of excess section 247 interest and one where trading losses (in addition to section 247) are available for surrender.
- The assumption made with respect to both examples is that all companies are members of a worldwide group and a section 411 group.
- The assumption is also made that there is no legacy debt in the year; for the purposes of the example any amounts in respect of capital allowances, finance lease etc are ignored.

- It is also assumed that Section 247(4G) is not at issue in these scenarios and the claims/surrenders made in respect of group relief are purely for illustrative purposes only.
- The worked examples are based on an aggregation approach for the results of the interest group members (see comments below).
- The worked examples would suggest that the relevant profit and net interest equivalent (including deductible and taxable interest equivalents) should be calculated first and then combined into one single EBITDA prior to identifying the disallowable and allowable amounts.

The rationale for such an approach is twofold:

- Firstly, to prevent trading or other interest expenses from being given more flexibility than would otherwise be provided for under current relief provisions (i.e., section 81 or section 97). Where income and expenses (prior to the application of tax provisions including the ILR) of each interest group member are aggregated, there is a risk of increased flexibility for expenses being set against income of another company.

- Secondly, the apportionment of the disallowable amount to the member of an interest group (per section 835AAL (6)) requires an assessment of the DIE of the interest group member compared to the DIE of the interest group overall. To arrive at the DIE for the individual member of the interest group, this would suggest an individual assessment starting at the identification of the relevant profits and ending with the total EBITDA of the group.

- See worked examples, we would welcome Revenue's confirmation that this is correct. We have also included a simplified worked example in the Appendix.

<u>Consolidation of Results of the Interest Group Members</u>

Section 835AAL (3) confirms that the amounts calculated for the interest group shall 'comprise' the results of the members of the group. Clarity in guidance that the word 'comprise' can be interpretated as both consolidate or aggregate, at the choice of the interest group would be welcomed.

5. Interest Equivalents

Section 835AY defines interest equivalents as including various enumerated types of payment. Guidance would be welcomed on the matters outlined below.

<u>Finance element of non-finance lease payments</u>

The finance income element of non-finance lease payments is essentially a measure of the gross profit arising from an operating lease. Section 835AY requires the calculation at the outset of a lease of a percentage that is then applied to the lease income of the lessor (and is not revised unless the lease terms are amended). The percentage is stated as the excess of the expected income under the lease ('A') over the expected

diminution in value of the asset in the accounts of the lessor, applying the lessor's then accounting policy, ('B') as a fraction of that projected income ('A').

A similar approach is taken vis a vis lease expenses save that as a right of use asset (rather than the leased asset itself) is on the balance sheet of the lessee the excess is measured against the right of use asset ('B').

The measure of 'B' appears to be tied specifically to accounting results and policy. However, the measure of 'A' is not based on accounting results. Consequently, guidance would be welcome. In particular, we note that leases may include payments that are not necessarily taxed as income (such as maintenance reserves which are refundable and consequently held on the balance sheet) and may have elements which are contingent (e.g., linked to floating interest rates or dependent on the extent of use of the asset).

We would suggest that guidance confirms that 'A' is the best estimate of the projected taxable income as determined at the commencement of the lease and, for that purpose, to the extent that amounts are receivable under the lease that would not be immediately credited to the lessor's income statement (and hence included in taxable income), they are only included to the extent that of the best estimate of so much of those amounts as will ultimately be credited to the lessor's income statement.

Financial assets and financial liabilities

Section 835AY makes provision with respect to instruments classified as financial assets or financial liabilities (within the meaning of Section 76B), the coupon or return on which principally comprises interest or other interest equivalents. The portion of the profit or loss on such an asset or liability should be treated as equivalent to interest to the extent that it would be reasonable to consider that such amount is economically equivalent to interest.

The definition refers to financial assets or financial liabilities within the meaning of Section 76B. We understand that this is intended to incorporate all such financial assets and liabilities as defined in Section 76B (viz. financial assets or financial liabilities under international accounting standards) and which, therefore, are instruments to which Section 76B could apply. We understand that it is not intended to incorporate only those instruments to which Section 76B has actually applied in the relevant tax year of the particular taxpayer (i.e., financial assets and liabilities that have been subject to fair value accounting). We would suggest that Revenue's guidance confirms this point.

We would suggest that Revenue's guidance confirms that the assessment of whether the coupon or return on a financial asset or financial liability principally comprises interest (or other interest equivalents) should be determined when the instrument concerned is originated.

We would suggest that Revenue's guidance confirms that the reference to profit or loss is a reference to the taxable / tax-deductible profit or loss.

In treating the profit or loss on these instruments as equivalent to interest, the legislation includes the statement *“the extent that it would be reasonable to consider that such amount is economically equivalent to interest”.* Guidance on Revenue’s understanding of this phrase would be welcome as well as examples of when it would or would not qualify as the interest equivalent treatment of a specific instrument. In particular, we understand that where a company has a profit or loss on a financial asset or financial liability to which the section applies and which is an interest-bearing debt instrument, it would be reasonable to consider that such amount is economically equivalent to interest. We believe it would be helpful to state this in guidance as it represents a situation which we believe would be common for many financial services sector companies, particularly in respect of the acquisition of a debt portfolio which may be subject to effective interest rate accounting treatment or fair-value accounting.

6. Standalone Entities

There is a total exemption from ILR for certain “standalone entities” being entities that:

— have no foreign branches,
— are not included in a financial statements group consolidation under relevant GAAPs, and
— have no ‘associated enterprises’ (as defined in Section 835AY).

The status of orphan entities (that is companies whose shares are held by a trustee for the benefit of a charity – typically for bankruptcy remoteness purposes) may be unclear with respect to the last of these criteria (i.e., no associated enterprises).

For these purposes two enterprises are “associated enterprises” where:

a) one enterprise (directly or indirectly) possesses or is beneficially entitled to 25%+ of the issued share capital of the other (or, in case of an entity without share capital, a 25%+ interest in the ownership rights in the other);
b) one enterprise (directly or indirectly) is entitled to exercise 25%+ of the voting power in the other (where the other enterprise is an entity);
c) one enterprise (directly or indirectly) holds such rights as would entitle it (directly or indirectly) to receive 25%+ of the profits of the other if the whole of its profits were distributed (or, where the other enterprise not a company, holds such rights as would entitle it (directly or indirectly) to a 25%+ share of the profits of the other);
d) both enterprises are associated (under any of the above tests) with the same third enterprise.

In applying these tests to an orphan entity, we believe that these tests should be applied with reference to the beneficiaries or class of beneficiaries of the trust rather than the trustee, as the trustee does not own the shares in its own right, does not receive distributions, etc for its own benefit, and does not vote the shares in its own interest. We believe this should be the case even where the trust is not a bare trust (such that the trustee has discretion). If this were not the case, not only would an orphan vehicle be associated with the trustee (which would seem inequitable given the absence of any true

economic relationship), even the vehicle to which the trustee was associated would be associated with each other.

In so applying the above rationale to a discretionary trust, where none of the beneficiaries or classes of beneficiaries has the ability to mandate the trustee to make a distribution of assets (or income) to them, we do not believe that such beneficiaries (or class thereof) should be treated as an associated enterprise of the orphan as they would not possess or be beneficially entitled to the shares (per (a) above; or have voting power (per (b) above), or have an entitlement to profits (per (c) above).

Moreover, if any beneficiary had any such rights or powers, we believe it follows that if the terms of the trust so provide, or the trustee (where it has discretion to do so) resolves or determines, that no one beneficiary (along with any of its associate enterprises) can receive the benefit of 25% or more of the trust estate then the orphan should not have any associated enterprises.

Absent the above application, unaffiliated orphan entities whose shares are held in a trust, the beneficiaries of which include the same charities, could be treated as associated enterprises.

We would suggest that Revenue's guidance confirms this point.

7. Limitation Spare Capacity

Section 835AY (1) defines it as the amount to which exceeding borrowing costs are lees than the allowable amount. Confirmation would be welcome that where there are no exceeding borrowing costs or where interest spare capacity exists, the limitation spare capacity eligible for carry forward is the allowable amount.

8. Interaction with Losses

Clarity would be welcomed, by way of an example, of how the interest limitation rule interacts with loss provisions, particularly where interest as a charge is surrendered to other corporate tax loss group members that may not be part of the interest group. In addition, to assist in interpretation, a general example of the interaction of the interest limitation restriction applying to a group relieving losses would be welcomed.

9. Large Scale Assets

Section 835AY (1) provides the definition of large-scale assets. It may be timely to remind taxpayers seeking assurance as to whether they have a large-scale asset that they should interact with their Revenue team / make a submission to Revenue's technical services.

10. Legacy Debt

We note that the December 2020 Feedback Statement provided confirmation that …" *a loan entered into before 17 June 2016 would not be regarded as having been modified,*

and the ILR would not apply, in circumstances where, as a result of benchmark reform and/or withdrawal, it is necessary to replace the reference rate on the loan with a comparable benchmark (for example, due to LIBOR being phased out)." We would welcome explicit guidance that the above remains true.

In addition, we would welcome clarification from Revenue as to whether or not they consider instruments other than debt which give rise to interest equivalents can qualify for the legacy debt exemption.

11. Format of Reporting and Elections, Other Administrative Concerns

Details to be included on Form CT1

It would be helpful to have sight of the proposed items to be included on the Form CT1 and their format, as soon as possible, in order to allow for updates to tax reporting packages etc which may take some time.

Taxpayers and advisers require clarity on the form of reporting to be adopted in respect of both single company and interest group reporting. In particular, clarity would be welcomed with respect to the position of a taxpayer in a consistent taxable interest equivalent position; where such a taxpayer is not a member of an interest group and accordingly is unlikely to allocate spare capacity to another entity - is there still a need for such a taxpayer to engage in yearly interest reporting? Where possible, it would be preferable to minimise compliance obligations for taxpayers with no interest restriction arising.

Exempt Entities

We would recommend that reporting to be included on the Form CT1 should not be required in a case where an entity qualifies for exemption from ILR. For example, where an entity qualifies as a standalone entity or is entitled to relief under the equity ratio, we would suggest that it not be required to calculate its net borrowing costs (and the components thereof) for disclosure on the Form CT1 as this would create an administrative burden with no real benefit (given the exemption).

For example, in the case of an ILR-exempt equipment lessor with a large portfolio of assets, it would seem excessive to require it to do a calculation in respect of the interest component of all its leases where there is no application of ILR in those circumstances.

12. Preliminary Tax

The operation of the preliminary tax top up rules for accounting periods between 1 January 2022 and 31 December 2027 are modified to allow for a top up of tax within a period of 6 months after the year end to allow for the application of the ILR.

However, the modifications made to section 959AR and section 959AS would appear to have simultaneously removed the ability for taxpayers to make a top up of preliminary tax in respect of:

- chargeable gains on the disposal of assets after the date for the payment of preliminary tax; or
- profits, gains, or losses accrued and not realised in the accounting period on financial assets or liabilities.

We would welcome confirmation from Revenue that the above outcome is not intended, and the ability to make a top up preliminary tax payment in respect of items (a) and (b) will still be available for FY2022 onwards.

Appendix
Simplified Worked Example

Trading company with trading (Case I) and passive (Case V) income

MixCo is an Irish tax resident company. It earns trading income but also earns rental income from a property it rents out to a third party. MixCo has bank debt in place on which it incurs trading interest and also interest which is deductible for Case V purposes.

For the purposes of this example, MixCo is not part of a worldwide group, is not a standalone entity and is not a single company worldwide group. No foreign tax is deducted, and the company has no allowances in respect of capital expenditure in the period in question. Lastly, the company has no amounts in respect of legacy debt.

The accounting results for MixCo (before application of the ILR) for the year end 31 December 2022 (FY22) are as follows:

Case I profits	10,000,000
Case V profits	10,000,000
Trade Interest payable	-4,000,000
S97 interest payable	-6,000,000
Accounting profit before tax	10,000,000

Tax computation (before ILR)

	Case I	Case V	Total
Taxable profit	10,000,000	10,000,000	
Less interest	-4,000,000	-6,000,000	
Net taxable profit	6,000,000	4,000,000	
Tax charge (12.5% or 25%)	750,000	1,000,000	1,750,000

Step 1: Identify the relevant entity

MixCo is the “relevant entity”

Step 2 - Calculate the Relevant Profit

	Actual	Value based at 12.5%
Case I taxable profit	6,000,000	6,000,000
Case V taxable profit	4,000,000	8000000
Relevant profit		14,000,000

The taxable profits must be value based to ensure that amounts chargeable to tax at the P rate (i.e., the Case V profits) are put on the same footing as amounts chargeable to tax at the T rate (i.e., Case I profits). Accordingly, while no adjustment is required to value base the Case I profits, the Case V profits are doubled.

Step 3 - Identify deductible interest equivalent (DIE) and taxable interest equivalent (TIE)

	Actual	Value based at 12.5%
Trading Interest	4,000,000	4,000,000
S97 Interest	6,000,000	12,000,000
Deductible Interest Equivalent		16,000,000

The interest equivalent must be value based to ensure that amounts deducted against profits chargeable to tax at the P rate (i.e., the S97 Interest) are put on the same footing as amounts giving relief at the T rate (i.e., 12.5%). Accordingly, while no adjustment is required to value base the trading interest deductible, the S97 interest must be doubled. The total deductible interest equivalent is equal to €16m. No interest income was receivable or received in the year by MixCo; accordingly, there is no taxable interest equivalent.

Step 4 - Calculate net interest equivalent

Net interest equivalent	16,000,000
Exceeding borrowing costs	16,000,000

Net interest equivalent is the difference between DIE and TIE. Where the net interest equivalent is equal to or greater than zero, it is referred to as "exceeding borrowing costs".

Step 5- Calculate EBITDA

Relevant Profit (R)	14,000,000
Net Interest Equivalent (I)	16,000,000
Foreign tax (FT)	0
Allowances in respect of capital expenditure	0
Interest on legacy debt	0
EBITDA	30,000,000

Step 6 – Apply the Equity Ratio Rule

As MixCo is not a member of a worldwide group, it cannot avail of the Equity Ratio Rule.

Step 7 - Calculate allowable and disallowable amount (apply Group Ratio Rule where applicable)

EBITDA	30,000,000
EBITDA limit	30%
Allowable amount	9,000,000
Disallowable amount	7,000,000

As MixCo is not a member of a worldwide group, the Group Ratio Rule is not applicable.

Step 8 – Apply the interest limitation rules

The disallowable amount of €7m must be used to reduce the interest equivalent which but for the ILR would be deducted. For the purposes of this step, whether the adjustment is made to trading interest or S97 interest first is irrelevant (i.e., the overall result should be the same for MixCo). For the purpose of this example, both options are shown below

Option 1 - Reduce trading interest in priority

Case I income	10,000,000	
Trading interest (pre ILR)	-4,000,000	
Adjustment per S835AAC (3)	4,000,000	*(€4m disallowable out of a total of €7m)*
Case I taxable income	10,000,000	
Case V income	10,000,000	
S97 Interest	-6,000,000	
Adjustment per S835AAC (4)	1,500,000	*(€3m disallowable remaining x (12.5%/25%)*
Case V taxable income	5,500,000	
Tax at 12.5%	1,250,000	
Tax at 25%	1,375,000	
Total revised tax charge	2,625,000	

Option 2 - Reduce S97 interest in priority

Case V income	10,000,000	
S97 Interest	-6,000,000	
Adjustment per S835AAC (4)	3,500,000	*(€7m disallowable x (12.5%/25%))*
Case V taxable income	7,500,000	
Case I Income	10,000,000	
Trading interest	-4,000,000	
Case I taxable income	6,000,000	
Tax at 12.5%	750,000	
Tax at 25%	1,875,000	
Total revised tax charge	2,625,000	

The disallowable amount of €7m may be carried forward to later years as a deemed borrowing cost of MixCo.