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Minister Michael McGrath T.D.
Department of Finance
Government Buildings
Upper Merrion Street
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31 March 2023

Leasing and leasing related matters

Dear Minister

We are writing to you with a number of proposed changes to the Taxes Consolidation Act (TCA) 1997 in connection with certain leasing and leasing related matters.

Ireland is a leading global centre for leasing and asset finance. Ireland's success as a leasing hub is down to a great many factors including the presence of extensive expertise within the leasing industry as well as the wide range of service providers which support the industry. It is also the case that Ireland's tax policy has been a significant positive contributing factor. For example, Ireland's extensive treaty network and the country's 12.5% rate of corporation tax have played a significant part in developing the leasing sector in Ireland

A working group was formed by the Department of Finance in early 2021 to discuss technical issues arising in the area of leasing in order to identify matters that require legislative amendment and those which could be clarified via Revenue guidance. It is clear from discussions at the working group in recent months that a number of legislative amendments are needed to provide the necessary certainty sought by taxpayers in the leasing sector.

At the most recent meeting of the working group on 7 March, practitioners were invited to make a submission to the Department on these issues. Accordingly, we have set out in the body of this submission a number of areas where our members believe that legislative change is necessary, and we have made suggestions as to how this might be achieved.

We would welcome the opportunity to discuss the matters raised in this submission with you or your officials.

Member of the Confédération Fiscale Européenne

Directors: Colm Browne, President, Peadar Andrews, Brian Brennan, Oonagh Carney, Ian Collins, Amanda-Jayne Comyn, Maura Dineen, Aidan Fahy, Stephen Gahan, Aileen Keogan, Aoife Lavan, Laura Lynch, Sarah Meredith, Colm O'Callaghan, Tom Reynolds, Kieran Twomey, Shane Wallace, Tommy Walsh, Martin Lambe (Chief Executive).

Immediate Past President: Karen Frawley.

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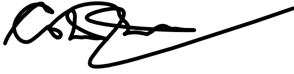
Yours sincerely



Colm Browne
Institute President

Summary of Institute Recommendations in relation to Leasing and Leasing Related Activities

A summary of our recommendations for legislative amendments which are needed to provide certainty for taxpayers in the leasing sector are set out below. We have provided a detailed analysis of each matter in Appendix I to this submission.

1. Loss Relief – leasing and leasing related activities

- Arising from a recent change in Revenue interpretation, a legislative amendment is necessary to ensure that losses arising from the trade of leasing are available to offset against income from both leasing and leasing related activities.

2. Gains on disposal of leasing plant and machinery

- Resulting from a recent change in Revenue interpretation, a legislative amendment is necessary to ensure that gains on the disposal of leased plant and machinery are taxed as part of the leasing trade profits.

3. Definition of Leasing Group

- Introduce an additional definition of Leasing Group which allows (but does not oblige) a company to qualify as being in a Leasing Group where it, along with any of its 75%+ direct or indirect parent entities, and that entity's direct and indirect 75%+ subsidiaries, form a Leasing Group.

4. Expand the scope of leasing related activities

- Introduce a legislative amendment to classify the following activities as falling within scope of leasing related activities in section 403 TCA 1997:
  - Manufacturer orders
  - Parted out assets
  - Carbon offset credits
  - Financing via an intermediary group company

5. Entitlement to deductions under Case IV for certain expenses

- Provide legislative confirmation of the application of Case I computational principles by way of amendment to section 402 TCA 1997 to allow for a deduction of finance expense, operating expenses, sales, general and administrative expenses incurred in relation to the leasing activities.

6. Intra-group financing

- Resulting from a recent change in Revenue interpretation, in our view clarification by way of legislative amendment to the Case III rules for (corporate) lending (to include provision of guarantees to align with the leasing ringfence rules) is necessary by:

  - Allowing taxation on a net basis, i.e., extend section 77(3) TCA 1997 to cover Case III lending or repeal section 76(5) TCA 1997.
  - Allow for taxation of Case III lending activities in the functional currency of the lender.
  - Apply Case I computational rules (e.g., applying accruals basis of taxation and allowing for deductions for expenses that would be deductible for a Case I lender).
  - Amend section 452 TCA 1997 to apply to interest paid by a company in the ordinary course of its trade or business.

7. Value based loss relief and capital allowances

- Amend section 403 TCA 1997 to allow for value-based loss relief within the leasing ringfence rules.
- Disapply section 287 and section 289 TCA 1997 to companies in respect of capital allowances to which section 403 would apply and amend section 403 to allow companies within scope of section 403 that disclaim part of its capital allowances in a given year, to make a claim for those allowances in any subsequent year.

8. Amend Section 80A – capital allowances

- Introduce a legislative amendment to:
  - Abolish the pro rata allocation methodology applicable for operating leases and replace with provisions whereby the capital allowances claim for a company within the regime is stated to be equal to the accounting depreciation/impairment on that asset for the relevant tax year.
  - Confirm the balancing allowance/balancing charge arising on the disposal of an asset is stated to be the accounting gain or loss arising on disposal.
- Amend the reference to “normal accounting practice” to “generally accepted accounting practice” which is the language generally used in the tax legislation.

9. Taxation of lessors of plant and machinery

- Arising from changes in accounting rules and Revenue’s desire to codify certain practices, amend section 76D and section 299 to address the following:

  - Section 76D should confirm that the general rule is that a lessor will be subject to tax on the full amount of the lease rentals it earns irrespective of whether the lease is a finance lease or operating lease of plant and machinery.

- Section 76D should provide for a variation to the general treatment in a situation where the lessor does not, or cannot, claim capital allowances in respect of the leased plant and machinery (e.g., because it has made a joint election with a lessee under section 299 or because it is not entitled to capital allowances because it does not meet all of the conditions required). In which case that lessor is to be subject to tax only on the interest / financing element booked to its income statement.
- Section 76D should confirm that the general rule is that a lessee is entitled to a tax deduction for both the financing expense and the amortisation expense booked to its income statement under the new accounting rules.
- Section 76D should modify this general position in the case of a section 299 election whereby only the financing element is deductible.
- Section 299 should be updated to reflect the fact that a lessee no longer will record a lease as a finance lease and instead, the characterisation of a lease as a finance lease is something determined with reference to the lessor.

APPENDIX I

1. Loss relief - leasing and leasing related activities

Section 403 TCA 1997 sets out the legislative framework for the leasing “ringfence”. In brief, the ringfence was introduced so as to treat certain equipment leasing activities as a separate trade and to restrict the use of losses generated from capital allowances claimed on the leased equipment to shelter profits arising from those ringfenced activities.

In conjunction with the ending of the IFSC/Shannon regime, section 403 was subsequently amended in 2006 such that the ringfenced losses were permitted to be used to shelter income and gains arising on certain leasing related activities. These activities are:

- (I) leasing of machinery or plant;
- (II) provision of finance and guarantees to fund the purchase of machinery or plant which is similar to the type of machinery or plant leased by the companies referred to in (I) above;
- (III) provision of leasing expertise in connection with the lease of machinery or plant which is similar to the type of machinery or plant leased by the companies referred to in (I) above;
- (IV) disposal of leased machinery or plant acquired by the company in the course of its trade; and
- (V) activities which are ancillary to those set out in (I) to (IV) above.

The ringfence rules in section 403 operate, in their current form, such that income and gains arising from the above listed activities are treated as coming within the ringfence and, as a result, capable of being sheltered by ringfenced leasing losses.

We understand that Revenue has reviewed section 403 and have come to a view that the drafting of the legislation currently is such that, while the leasing of plant and machinery is deemed to be a separate trade, the income arising from the leasing related activities listed above (other than leasing itself) is not part of this separate trade.

We believe that it was always the policy intent, when section 403 was expanded, to treat the leasing and other related activities as part of a single trade for corporation tax purposes. This understanding of the policy position is the one on which, affected leasing companies and groups have relied upon when preparing their corporation tax returns to date.

In order to ensure that the legislation aligns with the policy intent, we believe it is necessary for section 403 to be amended so that it is clear that all of these activities should be treated as forming part of a single trade for Irish corporation tax purposes.

Not doing so would have grave implications for the leasing industry in Ireland. It would mean, for example, that where a company carried on a mix of leasing and leasing related activities, while it could use losses arising in the current year in respect of its leasing activities to shelter profits arising in respect of its leasing related activities, it would be unable to use ringfenced losses carried forward from prior years to shelter such income as the general scheme of loss relief under the Irish corporation tax rules streams carried forward trading losses for use against profits arising from the same trade (only).

In addition, given that lessors have, in practice, treated lease and lease related activities as a single trade since at least 2006, it would be very challenging (if not impossible) for lessors to now review historical tax returns in order to stream their tax losses between lease and lease related activities. As such, we believe it is essential that this change be made.

2. Gains on disposal of leasing plant and machinery

As discussed above, the current drafting of section 403 operates such that income and gains arising from plant and machinery leasing and other leasing related activities (set out above) may be sheltered by ringfenced leasing losses. The long-standing interpretation of the operation of the ringfence in section 403 (as applied by taxpayers in practice for many years and reflected in Revenue practice and in publications endorsed by Revenue[1]) is that the gains (above original cost) on the disposal of leased equipment within the ringfence would form part of a leasing company's trading activities and included in its taxable trading income on that basis.

We understand that Revenue has concluded that this interpretation should no longer apply in all instances. This is a significant issue for lessors as the sale of leased assets is a core aspect of their trade (i.e., lessors seek to exploit depreciating assets for profit via both the lease and also the sale of the assets). As a result, it is necessary to amend the legislation to reflect the dual aspect to the trade.

In considering how such a change should be made, in our view it is essential to maintain the policy intent behind the broadened leasing ringfence such that it is possible to use ringfenced leasing losses against gains arising on leased equipment. This includes the use of leasing losses brought forward from prior years to shelter such gains. If this were not the case, it could result in a situation where a leasing company with substantial leasing losses brought forward from prior years would be prevented from using those losses to shelter gains on leased plant and machinery leased as part of its trading activities. Clearly this would be at odds with the policy intent and would be a significant

[1] The Irish Tax Institute's Taxing Financial Transactions book was published in 2004. In the Leasing Chapter of the book, it was stated that the Revenue Commissioners were prepared to accept that gains on the sale of leased equipment were trading in nature, where the lessor was carrying on a trade of leasing. This position was reviewed and approved by Revenue in prior to publication.

divergence from how the law has been applied historically. As such, it is important that the changes made to the legislation allow for the original policy intent to be adhered to.

We believe that this can be achieved by means of a change to section 603 TCA 1997. This section exempts capital gains arising on “an asset which is tangible movable property and a wasting asset” except where such asset was used in a trade and capital allowances were or could have been claimed.

In this regard, a “wasting asset” is defined (in section 560 TCA 1997) as an asset with a predictable life not exceeding 50 years and, for this purpose, plant and machinery is deemed to have a predictable life of less than 50 years. Consequently, leased plant and machinery should come within this definition. The term “tangible moveable property” is not defined but, in its normal meaning, should cover the vast majority of leased equipment.

We propose that the section could be amended to provide that where the taxpayer is a company and the exception to the capital gains tax exemption applies, the actual amount of the non-exempt gains would be treated as increasing (or creating) a balancing charge under section 288 TCA 1997. This should result in such gains being included in the taxable trading profits of the company concerned thus allowing the gain to be computed under that company’s functional currency and applying corporation tax (rather than capital gains tax) computational principles.

We believe this approach will achieve the above-mentioned objectives of ensuring the change results in an outcome as closely aligned to current practice as possible and, consequently, is consistent with the underlying policy intent. While the measure would not be specific to leasing, we note that this approach is relatively narrow and we would not expect it to have a material impact on the Exchequer as gains arising in respect of such assets (i.e., wasting assets that are tangible moveable property) are relatively rare outside of the leasing industry (and, historically, the leasing industry has treated such gains as part of its trading activities thus the *status quo* is maintained).

Furthermore, we would not anticipate material spill-over effects as the change would be limited to companies (thereby removing any impact for individuals) and would not apply to all forms of plant and machinery or items that are deemed to be plant and machinery such as intangible assets (as they clearly cannot be considered tangible moveable property).

We have included in Appendix II, an illustration of how the legislative changes could be implemented.

3. Definition of Leasing Group

As discussed above, section 403 operates, in its current formulation, to restrict the use of leasing losses arising from capital allowances on leased plant and machinery such

that they may only be used to shelter leasing profits from the same trade or, in the case of a company, to shelter income from certain other leasing related activities.

In applying the ringfence, there are two criteria which determine whether or not a company and its activities come within these provisions:

- the activities of the company or the company and the group of companies of which it is a part must wholly or mainly carry on the leasing of plant or machinery; and

- at least 90% of the activities of the company concerned must consist of the leasing of equipment or the lease related activities enumerated above.

In applying the first test it is necessary to determine whether a company is a member of a group (a "Leasing Group") for the purposes of the ringfence. In this regard, the legislation currently allows a company to be considered a member of a group where it falls under either of two possible Leasing Group definitions.

Under the first definition, a Leasing Group comprises:

(a) the company concerned; **and**
(b) every company in respect of which it is a (direct or indirect) 75%+ subsidiary; **and**
(c) every company which is a (direct or indirect) direct or indirect subsidiary of the company.

Essentially, therefore, the Leasing Group comprises the company and 75%+ related entities above and below it.

Under the second Leasing Group definition, the Leasing Group can comprise:

(a) the company concerned; **and either**
(b) every company of which it is a (direct or indirect) 75%+ subsidiary and which is tax resident in same country as the company in (a); **or**
(c) every company which are its (direct or indirect) subsidiaries and are tax resident in same country as it.

Consequently, under the second definition of a Leasing Group, the company can essentially "look up" to all of its Irish tax resident 75%+ related parent entities or "look down" to all of its Irish tax resident 75%+ related subsidiaries.

There was an important practical rationale for defining a Leasing Group in these particular ways. Had the legislation simply provided that the Leasing Group was to comprise all entities of which the company concerned was in its 75%+ related Leasing Group (like a capital gains tax group) and this was done on a worldwide basis, it would mean that the group to be tested would be the whole worldwide group. In the case of Irish lessor groups that are subsidiaries of multinationals (and many are subsidiaries of

global conglomerates or large global financial institutions), those groups might include material non-leasing activities and thus the requirement that the group be wholly or mainly leasing could easily be failed.

However, as drafted, the definition allows some flexibility around how a Leasing Group is defined and so essentially the first test allows a company to look at all of its subsidiaries plus any entities above it in a direct chain of ownership (but ignores other entities in the broader international group of which it is not in a direct line of ownership). Thus, for example, if an Irish leasing subgroup was owned by an international holding company which also owned non-leasing subgroups, then the Leasing Group definition would include the Irish leasing companies and their ultimate parent but not the parent's other subsidiaries.

Under the second test, the company concerned can look either at just its Irish resident subsidiaries or at its parent entities but, again, would not need to include subsidiaries of those parent entities. This optionality can be important where the Irish leasing subgroup is owned by parent that, itself, has non-leasing activities of its own (e.g., an international bank). In such a scenario, if the Irish subgroup had to include the activities of the bank parent when assessing whether or not the Leasing Group was wholly or mainly leasing this could prevent it from qualifying.

(i) Amendment of Group Definition

While the drafting of this legislation was well intentioned and functions well for many Leasing Groups, there are some inadvertent drafting issues which present a problem for certain Leasing Groups.

It is not unusual to see an Irish leasing platform established as an Irish holding company with multiple leased-asset owning subsidiaries and a servicing subsidiary (which employs all the employees and which provides lease management services to other group entities). While the activities of all the subsidiary companies and the servicing company would be within the ringfence, the servicing company might not be within the definition of a Leasing Group as described above. This is because if all of the asset leasing companies are sister entities to the servicer, then they are not included in the definition of Leasing Group as it applies to the servicer because the existing Leasing Group definitions only allow the company concerned to "look up" and / or "look down" but not "sideways". Certain lenders can request that the servicer entity be held separately (i.e., as a sister company and not in the direct chain of ownership) from the asset owning companies when lessors seek to raise finance.

We believe this is an inadvertent outcome of the drafting and there is no policy reason to treat a servicer held under this structure differently from one where, say, the leased-asset owning companies were subsidiaries of the Irish servicer rather than sister entities.

We believe that this issue can be readily addressed through a minor technical

amendment to the legislation and that such a change does not represent an alteration of existing policy. Making this change would restore certainty on this point for those Leasing Groups affected.

Essentially, the proposed change would seek to introduce an additional definition of Leasing Group which allows (but does not oblige) a company to qualify as being in a Leasing Group where it along with any of its 75%+ direct or indirect parent entities and that parent entity's direct and indirect 75%+ subsidiaries form a Leasing Group.

In the example above, this would mean that the Irish servicer could look up to the Irish holding company and include it and all of the 75%+ subsidiaries of that holding company. Consequently, it could include all of the parent's leased-asset owning subsidiaries when testing if it is in a Leasing Group.

Importantly, it could also go to any indirect 75%+ parent companies above that Irish holding company. This would be important because there can be group structures where there are multiple tiers of holding companies or financing companies sitting above a servicer such that limiting the Leasing Group test to only the direct 75%+ parent would be insufficient. Thus, it is important that the company concerned can choose to go up the ownership chain to any level but is not obliged to go all the way to the top of the chain of ownership (as this could mean bringing in an entire international group whose activities might include both leasing and non-leasing activities).

In addition, we believe it is appropriate to take the opportunity to also codify certain practices that have been applied in interpreting the above-mentioned group test. In particular, it would be useful to codify that, in assessing whether the activities of a company and a Leasing Group of which it is a part, consist wholly or mainly of the leasing of machinery or plant, that this test is to apply to the activities of all of these companies "taken together".

Furthermore, in applying the above-mentioned 90% test with respect to the activities of the Leasing Group, that it is clarified that one does not take account of any shareholdings of companies within the Leasing Group in making this assessment.

We have included in Appendix III an illustration of how these various changes could be effected.

4. Expand the scope of leasing related activities in Section 403

As the leasing industry has continued to evolve and grow, so has the range of activities in which it is involved. As a result, certain activities which are now more commonly carried on by Leasing Groups are not clearly within the leasing ringfence. Given the proposal to update section 403 in respect of certain other matters discussed in this submission, we would suggest that the opportunity is taken to provide a clear legislative basis for some of

these activities which are now more commonly carried on by Leasing Groups in connection with their leasing activities. This modernisation of the ringfence rules should help protect and enhance Ireland's status as the global centre for leasing and financing.

We have included in Appendix III suggested wording for the proposed amendments outlined below.

(i) *Manufacturer orders*

It has become common for airlines and lessors to place large orders with aircraft manufacturers. In the case of airlines, it is not unusual for them to sell some of their purchase orders to lessors as they may not have the capital to fund such an expensive programme on their own.

Where a lessor has bought some of the purchase order contracts from an airline (on the basis the aircraft will be leased back to that airline), it may be the case that having so many aircraft on lease to a single airline would represent too large a risk based on the lessor group's risk appetite i.e., they may want to ensure that they have a wide diversification of lessees so that they are not exposed overly to one airline or region. As such, in these circumstances they may sell on some of their purchase order contracts (along with the agreement to lease back to that airline) to another lessor.

In the case of lessors themselves, where they have agreed to purchase a large number of aircraft, they may need to de-risk their position by selling on some of these purchase order slots.

Under the terms of a typical purchase agreement such as this, the contracting party (i.e., the airline or lessor) agrees to make a series of pre-delivery payments ("PDPs") to the manufacturer during the course of construction with a final payment being made upon delivery of the aircraft by the manufacturer to the counterparty.

Depending on the facts and circumstances, the sale of these order contracts could arise before construction has begun, while construction is ongoing, or when the aircraft is ready for delivery. As such, what is being sold can be a form of contractual rights/obligation (along with the deposits paid as PDPs), or a fully constructed aircraft (possibly subject to the payment of a final purchase consideration).

This industry practice has become substantially more common over the years and it is seen as an integral part of Leasing Groups commercial activities. We would recommend that the leasing related activities enumerated in section 403 are expanded to include gains and losses arising from the purchase and sale of these contracts (i.e., rights to buy/interests in plant and machinery of a type leased by the relevant Leasing Group).

(ii) *Parts and parting out*

A number of Leasing Groups have extended their activities to include the parting out of used assets (e.g., previously leased aircraft) which are at the end of their useful life but which still have valuable components that can be reused and recycled. In addition, some leasing companies have taken to purchasing and selling such parted-out assets as part of a larger second hand inventory management business. This area is becoming more important in the context of the ESG agenda where recycle and reuse of valuable components from second-hand assets (rather than allowing them to be scrapped) is seen as an important social good.

We propose that the leasing related activities in section 403 are extended to include gains and losses arising in connection with the parting out of assets of a type leased by the Leasing Group concerned as well as the purchase and sale of component parts of plant and machinery of a type that the Leasing Group leases.

(iii) *Carbon offsets*

As mentioned above, the ESG agenda is becoming more important generally and is an area of particular focus in the transport part of the leasing industry, particularly in respect of means of transport that have a substantial carbon footprint. A number of transport assets lessors are innovating in this space and are looking at buying and/or generating carbon offset credits which they can then sell to the lessee (e.g., an airline) to allow them offset some of the carbon footprint which they generate from the use of the leased assets. While this activity is relatively recent, we expect that it could increase substantially over the coming years.

In light of promoting the overall green agenda as well as promoting Ireland as a centre for ESG activity, we propose that the leasing related activities enumerated in section 403 are expanded to include gains and losses in respect of the purchase and sale of carbon offset credits by lessors to lessees of plant and machinery of a type they lease.

(iv) *Financing*

The ringfence already covers the provision of finance and guarantees to fund the purchase of machinery or plant of a type leased by the Leasing Group concerned.

In some cases, it may be necessary to provide such finance and guarantees via an intermediary company (see discussion on intra-group financing below). To copper-fasten the inclusion of such activities as being in the ringfence, we propose that the legislation is amended to clarify that it applies to direct and indirect financing/guarantee activities.

5. Entitlement to deductions under Case IV for certain expenses

The current Case I and Case IV frameworks provide for taxation of gross rental receipts offset by relief for expenditure incurred on the cost of the leased asset under the capital allowances regime. Where the lessor is not entitled to capital allowances on the leased asset, the lessor is taxed on the financing element of the lease rental (see separate discussion on Section 76D and leasing taxation).

The legislation includes the following provisions in respect of Case IV lessors:

- Relief for capital allowances (and adjustments for balancing allowances and charges) on leased plant and machinery (section 298 and section 402 TCA 1997).
- The measurement of the tax adjusted profits and losses in the functional currency of the lessor under relevant accounting standards (section 402).

In administering the legislation, Revenue's practice includes the following:

- Deductions for interest and financing expense; and
- Lease operating expenses as well as for sales, general and administrative expenses incurred in relation to the leasing activities under Case I principles.

In order to provide certainty to taxpayers, we recommend that these practices are put on a legislative footing. As noted above, a number of these issues are already addressed in section 402. We would propose that the legislative confirmation of the application of Case I computational principles could be included as a further amendment to section 402 (noting that a small technical amendment is required to this section anyway in respect of the foreign exchange treatment mentioned above).

Insofar as interest and financing expenses deductibility is concerned, section 76 TCA 1997 provides for a general prohibition on companies deducting yearly interest but this is subject to section 77 TCA 1997 which permits a deduction in respect of the computation of income from a trade. To extend the statutory basis to Case IV lessors (only), it would perhaps make sense to address this in section 402 as well. If it were preferred to address this for all Case IV companies, this could be done by means of a modification to section 77 to extend the provisions to Case IV activities.

6. Intra-group financing

Intra-group financing is a very common feature for lessors generally and aircraft leasing groups in particular (as they tend to have a large number of companies with substantial intra-group financing). In particular, it is possible that a company might be engaged in back-to-back lending where, for example, a lender advances a single loan to the company concerned and the company uses those proceeds to lend to one or more subsidiaries. Such an arrangement is not uncommon and may be required by a lender where they wish to have only a single counterparty (rather than multiple borrowers) and

where they want better security in respect of their lending (which is achieved by having a single lender which indirectly owns all of the leased assets being financed thereby achieving a form of cross-collateralisation).

The historic practices in respect of activities carried on within the section 403 ringfence confirmed that such activities should be considered to be trading in nature and thus taxed under Schedule D, Case I at the 12.5% rate. However, more important than the application of the 12.5% tax rate is the fact that trading principles permit tax deductions for interest expense on such intra-group lending. As noted above, section 76 provides for a general prohibition on companies deducting yearly interest but this is subject to section 77 which permits a deduction in respect of the computation of income from a trade.

If this type of intra-group trading activity were taxed under Case III principles instead, these intermediary financing companies would be taxed on the gross amount of their income without relief for their interest expense. Moreover, where the underlying asset-owning borrowers are trading companies, they would be entitled to a tax deduction at the 12.5% rate and if the lender were not taxed as a trading company, it would pay tax on the gross amount at 25%. This would not only negate the tax deduction but would cause the group to incur an additional 12.5% tax (i.e., 25% - 12.5%) – quite possibly making the company insolvent as its tax liability might easily exceed its net profit.

As outlined above, we understand that, notwithstanding the historic position, having reviewed the legislation Revenue's current interpretation is that depending on the relevant facts and circumstances, these intermediary financing companies may be taxable under Case III on their gross income. If this interpretation were to be applied, it would represent a very significant issue for the leasing industry and make Ireland a very unattractive location to conduct business (it is very rare for countries to tax a financing company on its gross interest income without any deduction allowed for interest expenses).

For completeness, we note that using intermediary financing companies that elect into the Section 110 regime might be a solution; however, we understand that a review of the Section 110 regime is to occur shortly and absent knowing the outcome of that review, we believe it is necessary to assume that this approach may not be an option. We also note that it may also not be feasible given Revenue's interpretation of certain aspects of the Section 110 regime; in particular Revenue's view that notwithstanding that Ireland has a general exemption from tax for dividends received by Irish resident companies from other Irish resident companies, that Irish dividends received by a Section 110 company are, in fact, subject to tax.

Given how fundamental and existential this issue is for the leasing industry, it is imperative that the legislation is amended. In this regard, we propose the amendment of Case III rules for (corporate) lending (to include provision of guarantees to align with ringfence rules) by:

- Allowing taxation on a net basis i.e., extend section 77(3) to cover Case III lending or repeal section 76(5).
- Allowing for taxation of Case III lending activities in functional currency of the lender.
- Applying Case I computational rules (e.g., applying accruals basis of taxation and allowing for deductions for expenses that would be deductible for a Case I lender).
- Amending section 452 to apply to interest paid by a company in the ordinary course of its trade or business.

7. Value based loss relief and capital allowances

The long-standing interpretation of the operation of the ringfence in section 403 includes the following:

Section 403 operates to restrict the use of losses arising from capital allowances claimed on leased plant and machinery to income arising from a deemed separate leasing trade and, in the case of a qualifying company, to income arising from certain leasing related activities (as set out above). The rules also allow a company to surrender current year ringfenced leasing losses to other group companies to shelter their leasing income or income from related leasing activities.

(i) *Value based loss relief*

The general scheme of relief for trading losses under the corporation tax rules is that trading losses may be carried forward indefinitely but can only be used in future years to shelter profits from the same trade. These trading losses may also be surrendered in the year in which they are created to shelter the trading profits of other companies within the relevant corporation tax loss group. In addition, current year trading losses may be used by the company concerned (or surrendered to other companies within its corporation tax loss group) on a value basis to shelter non-trading income (i.e., income taxed at the 25% corporation tax rate).

Our understanding is that the intention of policymakers in drafting the section 403 restrictions was that all of the rental income of the company concerned and any income arising from the specified leasing related activities would form part of a company's trading profits.

However, as outlined above, we understand that, notwithstanding the historic position, Revenue do not intend to continue with this interpretation and, as a result, they believe that, depending on the relevant facts and circumstances, it is possible that some of the income arising from lease related activities may not form part of a company's trade. Where this interpretation applies, the current drafting of section 403 means that a company with current year ringfenced trading leasing losses could not use those losses to shelter, on a value basis, any ringfenced income it has that is taxed at the higher rate.

In addition, it could not surrender such trading losses to other companies in its corporation tax group which have leasing or leasing related ringfenced income. This would put such companies at a significant disadvantage to other Irish corporate taxpayers (above and beyond the disadvantage created from the leasing ringfence itself).

In light of Revenue's intentions in relation to the application of section 403 and the law more generally, we believe it is essential that section 403 is amended such that value based loss relief is permitted within the leasing ringfence rules.

(ii) *Capital allowance claims*

As previously mentioned, under the general scheme of corporation tax, trading losses carried forward from previous tax years may only be used to shelter profits arising from the same trade. They may not, for example, be used to shelter profits from other trades carried on by the company or passive income earned by the company or surrendered to other companies in the same corporation tax loss group.

Historically, the practice of treating all income and gains arising within the leasing ringfence as forming part of that company's trading activities meant that all of a company's ringfenced income and gains could be sheltered by ringfenced losses carried forward. In light of the above-mentioned intentions of Revenue, this will result in a situation where a company with ringfenced trading leasing losses carried forward could not use them to shelter current year passive ringfenced income. This will represent a substantial change in practice and will likely be significantly detrimental to the Irish leasing industry.

We appreciate that it may not be possible to either change the scheme of corporation tax loss utilisation generally or to make provision for separate rules in respect of the utilisation of historic losses for companies within scope of section 403. However, we believe it is reasonable to take account of the fact that section 403 imposes a significant restriction and disadvantage on leasing companies and that it would, therefore, be reasonable and equitable to allow a modification within the provisions of section 403 to its operation in respect of ringfenced leasing losses.

In this regard, a significant reason for the introduction of the ringfence in section 403 was due to the fact that the Irish capital allowances regime allows for an accelerated basis of tax depreciation in respect of assets with a long life because it applies a straight-line basis of depreciation over a period of 8 years that applies to all plant and machinery (with limited exceptions) irrespective of its economic life. As a result, companies which lease big ticket assets tend to have large trading losses generated early in the life of a lease of an asset with those losses carried forward to shelter profits earned in later years.

As such, the reason that substantial losses are triggered arises from the relatively accelerated granting of tax depreciation on these assets. This would not happen if it were possible for such companies to choose not to claim all of the allowances which they are entitled to in a given tax year such that they could claim a lower amount and defer the claim for the remainder until future years.

Under such an arrangement, where those unclaimed allowances are instead claimed in a future year, they would represent a current year deduction/loss and, therefore, could be used for the purposes of sheltering other income on a value basis or surrender to other group companies in respect of their current year profits under the general corporation tax loss rules.

It is understood that there is a general principle under which a taxpayer can choose to disclaim capital allowances if it so wishes. However, this is modified by the legislation in section 287 TCA 1997 and section 289 TCA 1997 whereby if a taxpayer chooses not to claim capital allowances in a given year, it is deemed to have claimed them and is, therefore, effectively prevented from claiming them in a later year.

We suggest that these rules be disapplied in their application to companies in respect of capital allowances to which section 403 would apply and that additional legislation is inserted in section 403 to confirm the ability of a company to which the section applies that does disclaim part of its capital allowances in a given year, to make a claim for those allowances in any subsequent year.

We believe that this is a modest change and reflects the fact that such leasing companies are already subject to substantial restrictions as a consequence of the application of section 403 and that this relaxation is merely a moderation of that existing restriction. While this introduces a new element to the section 403 rules, in practice, its effect would be to maintain the *status quo* that has applied to the leasing industry while having regard for Revenue's technical position.

8. Amendments to Section 80A

The section 80A TCA 1997 regime was introduced (originally only for finance leases but subsequently for operating leases) to address the fact that the Irish capital allowances rules grant allowances in respect of plant and machinery on a straight-line basis over 8 years irrespective of the economic life of the asset concerned. As such, for lessors leasing, essentially small ticket items, where the lease period is substantially less than 8 years, a substantial mismatch can arise.

The regime was introduced with a view to eliminating this difference by, in broad terms, essentially following the accounting treatment of leased assets with a predictable useful

life not exceeding 8 years. Where a qualifying company opts into the regime, it is intended, from a policy perspective, that it will be taxed broadly in line with its accounting results.

The section 80A rules for finance leasing work relatively well in that they follow the accounting treatment of the company concerned and require no special adjustments beyond what a non-section 80A lessor would require. However, the section 80A rules for operating leases are quite complex and there are a significant number of drafting issues which do not align with the policy intent.

A more detailed explanation of the issues is included in Appendix IV. In summary while it was broadly intended that the rules should operate so that a company within the regime would have capital allowances equal to the accounting depreciation arising in respect of the asset concerned (essentially allowing it to use its accounting depreciation as a substitute for a separate capital allowances calculation), this does not occur because the legislation is drafted in such a way that the company's capital allowance claim for its leased assets is taken to be the aggregate accounting depreciation recorded in respect of those assets in the relevant year pro rated between all of those assets based on their purchase price.

This will mean that the actual accounting depreciation in respect of a given asset may not be the same as the *pro rata* allocation made to it under the section 80A rules. This has significant implications when it comes to computing the company's balancing allowance or balancing charge in the event of a disposal and, in many cases, that amount will not be the same as the accounting profit or loss arising in respect of the disposal. There are other technical aspects of the rules which mean that in certain cases a company will have an accounting depreciation charge in respect of an asset but not be entitled to capital allowances.

We believe that it is necessary to amend section 80A to remedy these deficiencies and ensure that the original policy objectives can be achieved. We believe that any such changes would be revenue neutral to the Exchequer and will merely align the intended policy with the legislation.

The changes that we recommend are as follows:

- The *pro rata* allocation methodology is abolished and, instead, provision is made whereby the capital allowances claim for a company within the regime is stated to be equal to the accounting depreciation/impairment on that asset for the relevant tax year.
- The balancing allowance/balancing charge arising on the disposal of an asset is stated to be the accounting gain or loss arising on disposal.

We believe that these relatively modest changes should resolve the current issues with section 80A.

In addition, we propose that the reference to “normal accounting practice” in the section are updated to “generally accepted accounting practice” which is the language generally used in the tax legislation.

9. Taxation of lessors of plant and machinery

The basis of taxation for lessors and lessees of plant and machinery is currently the subject of a combination of legislative provisions and longstanding Revenue practice. A detailed discussion paper on these matters is included in Appendix V. However, they can be briefly summarised as follows:

- The general position is that, irrespective of the accounting treatment, payments for the lease of plant and machinery represent rental payments and the full amount of the rental payments should be deductible for the lessee and taxable in the hands of the lessor. This is the case even where the lease would have been classified as a finance lease such that only the financing component is expensed to the accounts of the lessee and included in the income of the lessor.

- Where the lessor meets the relevant conditions, it is entitled to claim capital allowances in respect of the leased plant and machinery.

This above general treatment is modified in certain cases, as follows:

- In the case of a lease of plant and machinery which would have been treated as a finance lease for accounting purposes and where the lessee bears the burden of wear and tear, section 299 TCA 1997 allows the lessee to elect to claim capital allowances on the leased plant and machinery. In those circumstances, its tax deduction for the rental expense is limited to the finance element of the lease payment and no deduction is taken for the principal element of the lease payment (as capital allowances are claimed instead). Where the lessor and lessee are within the Irish tax net, a joint election must be made to apply this treatment but where the lessor is not in the Irish tax net, the lessee can make a unilateral election.

- Section 76D provides that, in the case of a lease which is a finance lease, a lessor is to tax the full amount of the lease payments irrespective of the fact that only the financing component would be included in its income statement. This codifies the above-mentioned longstanding Revenue practice. Importantly, this section is not currently modified where an election is made under section 299 (as described above) whereby the lessee can claim capital allowances instead of the lessor; however, by virtue of longstanding Revenue practice, in such a scenario the lessor is only subject to tax on its financing/interest income component.

The accounting treatment of leased plant and machinery has changed over the past number of years. A detailed discussion paper on this was submitted by practitioners to

Revenue via the TALC FRS 102 subgroup in April 2018, a copy of which is included in Appendix V. In brief, while the situation for lessors has not changed significantly under these new rules, lessees no longer make a distinction in their accounts between finance leases and operating leases. Instead, whenever a lessee enters into a lease, it is obliged to recognise a liability on its balance sheet representing the present value of its future obligations to make payments under the lease. In addition, it recognises an asset on its balance sheet representing the benefit of the future right to use the asset under the terms of the lease.

As the lessee makes payments under the lease, part of that payment is set against the liability booked on the balance sheet with the remainder treated as a financing component expensed to the lessee's profit and loss account. In addition, as the lease term elapses, the lessee will amortise the right of use asset by means of expensing it to its income statement.

Over time, the combined amortisation and balancing cost expensed to the company's income statement will equate to the same total payments that would have been booked to the company's income statement in respect of an operating lease or the combined financing expense and accounting depreciation that would have been booked through the lessee's income statement in the case of a finance lease. (However, the timing of these various different debits to the lessee's income statement are different under the new regime than historically would have been the case.)

We believe it would be appropriate to amend section 76D and section 299 to address these situations as follows:

- Section 76D should confirm that the general rule is that a lessor will be subject to tax on the full amount of the lease rentals it earns irrespective of whether the lease is a finance lease or operating lease of plant and machinery.

- Section 76D should provide for a variation to the general treatment in a situation where the lessor does not, or cannot, claim capital allowances in respect of the leased plant and machinery (e.g., because it has made a joint election with a lessee under section 299 or because it is not entitled to capital allowances because it does not meet all of the conditions required). In which case that lessor is to be subject to tax only on the interest / finance element booked to its income statement.

- Section 76D should confirm that the general rule is that a lessee is entitled to a tax deduction for both the financing expense and the amortisation expense booked to its income statement under the new accounting rules.

- Section 76D should modify this general position in the case of a section 299 election whereby only the financing element is deductible.

- Section 299 should be updated to reflect the fact that a lessee no longer will record a lease as a finance lease and instead, the characterisation of a lease as a finance lease is something determined with reference to the lessor.

It may be necessary to consider whether anti-avoidance provisions should also be introduced to ensure that there cannot be a situation whereby a lessor who has already fully depreciated an asset can then make an election under section 299. This could be achieved, for example, by requiring that a section 299 election be made at the commencement of a lease and not later.

We have included in Appendix VI suggested wording for these amendments.

Appendix II: Gains on Sale

Possible legislative amendments to section 603 are shown in red

603 Wasting chattels

(1) Subject to this section, no chargeable gain shall accrue on the disposal of or of an interest in an asset which is tangible movable property and a wasting asset.

(2) Subsection (1) shall not apply to a disposal of or of an interest in an asset where:

(a) from the beginning of the period of ownership of the person making the disposal to the time when the disposal is made, the asset has been used and used solely for the purposes of a trade or profession and that person has claimed or could have claimed any capital allowance in respect of any expenditure attributable to the asset or interest under paragraph (*a*) or (*b*) of Section 552(1), or

(b) the person making the disposal has incurred any expenditure on the asset or interest which has otherwise qualified in full for any capital allowance.

(3) In the case of the disposal of or of an interest in an asset which, in the period of ownership of the person making the disposal, has been used partly for the purposes of a trade or profession and partly for other purposes, or has been used for the purposes of a trade or profession for part of that period, or which has otherwise qualified in part only for capital allowances:

(a) the consideration for the disposal and any expenditure attributable to the asset or interest under paragraph (a) or (b) of Section 552(1) shall be apportioned by reference to the extent to which that expenditure qualified for capital allowances,

(b) the computation of the gain shall be made separately in relation to the apportioned parts of the expenditure and consideration, and

(c) subsection (1) shall not apply to any gain accruing by reference to the computation in relation to the part of the consideration apportioned to use for the purposes of the trade or profession, or to the expenditure qualifying for capital allowances.

(3A)

(a) Where subsection (2) applies to a disposal by a company of, or of an interest in, an asset, no chargeable gain shall accrue on that disposal.

(b) Where paragraph (a) applies, the amount by which the consideration for that disposal exceeds the amount in respect of which that person has claimed, or could have claimed, any capital allowance for the asset or interest, as the case may be, shall, notwithstanding Section 288(4), be treated as increasing the amounts of sale, insurance, salvage or compensation moneys which would otherwise be take into account under that section in computing the balancing charge (within the meaning of that section) arising on that asset and shall be taxed

in accordance with Section 307 and Section 308.

(c) Where subsection (3) applies, this subsection shall apply to that part of the consideration to which subsection (1) does not apply by virtue of Subsection (3)(c)).

(4) Subsection (1) shall not apply to a disposal of commodities of any description by a person dealing on a terminal market or dealing with or through a person ordinarily engaged in dealing on a terminal market.

Appendix III: Amendments to Section 403

Proposed amendments to Section 403(1)(d) shown in red

(*d*) For the purposes of this section, where, in relation to a company which carries on a business—

(i) the activities—

(I) of the company,

(II) of the company and all companies of which it is a 75 per cent subsidiary (within the meaning of section 9) and all companies which are its 75 per cent subsidiaries (within the same meaning), or

(III) of the company and of a company (the second mentioned company) of which it is a 75 per cent subsidiary (within the meaning of section 9), and all companies which are 75 per cent subsidiaries (within the same meaning) of the second mentioned company, or

(IV) of the company and all companies (being companies which, by virtue of the law of the territory in which the company is resident for the purposes of tax, are so resident in that territory; and for this purpose, "tax", in relation to such a territory, means any tax imposed in the territory which corresponds to corporation tax in the State) of which it is a 75 per cent subsidiary (within the meaning of section 9) or which are its 75 per cent subsidiaries (within the same meaning),

taken together consist wholly or mainly of the leasing of machinery or plant, and

(ii) not less than 90 percent of the activities of the company (other than the holding of shares in one or more other companies the activities of which are included in paragraph (d)(i)) consist of one or more of the following:

(I) the leasing of machinery or plant;

(II) the (direct or indirect) provision of finance and guarantees to fund the purchase of machinery or plant of a type which is similar to the type of machinery or plant leased by the companies referred to in subparagraph (i);

(III) the provision of leasing expertise in connection with machinery or plant of a type which is similar to the type of machinery or plant leased by the companies referred to in subparagraph (i);

(IV) the disposal of machinery or plant acquired by the company in the course of its leasing trade;

(V) the disposal of the right to acquire machinery or plant (or an interest therein) machinery or plant of a type which is similar to the type of machinery or plant leased by the companies referred to in subparagraph (i);

(VI) the parting out of, or the disposal of parts or components of, machinery or plant of a type which is similar to the type of machinery or plant leased by the companies referred to in subparagraph (i);

(VII) the supply or disposal of carbon offsets (as defined in section 110) to lessees of machinery or plant leased by the companies referred to in subparagraph (i);

(VIII) activities which are ancillary to the activities referred to in clauses (I) to ~~(IV)~~ (VII):

then, subject to section 80A(2)(c), income from the company's trade of leasing shall be treated as including—

(A) income from the activities referred to in subparagraph (ii), and

(B) chargeable gains on the disposal of machinery or plant acquired by the company in the course of its leasing trade; and for this purpose the amount of such a gain shall be computed without regard to any adjustment made under section 556(2).

Appendix IV: Additional information on Section 80A

1. Balancing Allowances / Charges

Paragraph (e) of the subsection 2A provides that the wear and tear allowance attributable to each specified asset for a particular accounting period is to be a proportion of the total allowances made to the claimant company for that year. The proportion is to be based on the cost of the particular asset in proportion to the total cost of all the specified assets that the company has during the period.

This allocation method potentially gives rise to some unhelpful anomalies which (1) would negate some of the benefits that the changes to the section would provide for in terms of the simplification of tax computations and (2) could result in some unanticipated taxation consequences for the taxpayer.

In particular, this method of allocation of wear and tear allowances will present difficulties when it comes to computing balancing allowances or charges in respect of individual assets. While the general schema of the section is to allow the leasing company to follow its profit and loss account for the purposes of its tax computations, where an asset is disposed of the profit or loss recorded in the company's profit and loss account in respect of that disposal will take account of the actual accounting depreciation claimed in respect of that particular asset.

However, for the purposes of computing the appropriate balancing allowance / charge in respect of that particular asset, the company would be required to review all previous tax computations for the years in which that asset was owned and to compute, on a *pro rata* basis (in line with the provisions of paragraph (e)) the total amount of wear and tear allowances which the company would be deemed to have claimed in respect of that particular asset. This would almost certainly be a different amount to the amount of accounting depreciation which the company would have claimed in respect of that particular asset. Indeed, the differential could be quite significant where the leasing company has different classes of assets which are depreciated over different periods of time.

This can be illustrated by a simple example. Suppose that a leasing company has two assets (asset A and asset B) both of which cost €100 but asset A is depreciated over two years while asset B is depreciated over five years. In years one and two the company will have a depreciation charge of €50 in respect of asset A and €20 in respect of asset B. However, the amount of wear and tear allowances attributed to asset A and to asset B will be €35 in each case because of the provisions of paragraph (e) (i.e., both assets cost the same amount thus 50% of the total depreciation charge is allocated to each asset.

Now suppose that asset B is disposed of on the first day of year 3 (i.e., after 2 full years depreciation) for €80. The accounting result in respect of that disposal would

be to show a profit on disposal of €20 (sales proceeds of €80 less net book value of €60). However, for the purposes of balancing allowances and charge calculations, the company would be deemed to have claimed €70 of tax depreciation by virtue of the provisions of paragraph (e). Thus, for tax purposes, the company would be deemed to have a balancing charge of €50 (sales proceeds of €80 less tax written down value of €30).

Clearly the above result would mean that the administrative benefits of being able to follow the accounts of the company would be lost for many small ticket lessors who have many thousands of assets because they would have to recompute their tax basis in the asset on its disposal in order to compute a separate tax computation for the disposal of assets from the accounting computation which we booked to the company's accounts.

Even where the company has only one class of assets which it leases, this issue could still arise where for example the accounting policy of the company in the year of acquisition and disposal is to charge accounting depreciation based on the length of time the asset was actually owned during the period. Thus the *pro rata* allocation would be made based on the full cost of the asset acquired/disposed of during that period even though the accounting depreciation actually allocable to that asset would be a different amount.

2. Short Periods

Section 80A applies by modifying the application of section 284 TCA 1997. Section 284 provides that where the basis period is less than one year the amount of wear and tear allowances to be given in respect of qualifying assets is to be restricted on a *pro rata* basis based on the length of the year. The accounting policy for most companies would mean that the level of accounting depreciation charged for an accounting period of less than one year would already be reduced to reflect the shorter period.

Thus, the provisions of section 284 could result in a restriction of the wear and tear allowances available notwithstanding that the amount of accounting depreciation would already be restricted for the shorter accounting period. This issue could be dealt with by disapplying the relevant subsection in section 284 on the grounds that the accounting policy would have already restricted the actual accounting depreciation charge.

3. Ownership at end of year

Section 284 only allows allowances to be made where the asset is in use for the purposes of a company's trade at the end of an accounting period. Thus, for example, where an asset is owned for say eleven months of a twelve month tax year and is sold one month prior to the end of the end of the tax year, section 284

operates such that no allowances are given to the taxpayer in respect of that asset for that tax year. In many cases the accounting policy of the company might dictate that some accounting depreciation charge is made for an asset which is disposed of prior to year end.

Thus, in such an instance the accounting depreciation for such an asset would presumably need to be excluded from the computations of allowances under section 80A under the current rules. Again, this will present practical difficulties for many lessors. However, if this restriction is disapplied there should be no loss of revenue to the Exchequer on the basis that the company would again follow its accounts and thus pick up any balancing allowance or balancing charge in line with the accounting treatment applied by the company.

Appendix V:
Copy of submission by made practitioners to Revenue via the TALC FRS 102 subgroup in April 2018

Change in lease accounting standard - IFRS16

This note has been prepared by practitioners for consideration by Revenue as part of the topics being addressed by the TALC sub-committee working group on FRS 102.

The purpose of this paper is to summarise the expected changes in accounting treatment that will arise upon adoption of IFRS16 which also applies under FRS 101. Although the effective date for changes to the FRS 102 treatment of leases is not yet known, it is expected that, in line with other changes to IFRS standards, changes will be substantially adopted in due course in the treatment of leases under FRS 102 to align these standards with IFRS.

This paper also considers the potential impact of the proposed changes to the lease accounting standards on the Irish tax treatment of leases.

This paper was originally submitted to Revenue for review on 1 February 2017. It has been updated to reflect changes introduced in Section 76A, Finance Act 2017.

Matters reviewed

In considering the potential impact of the changes in lease accounting standards, practitioners have reviewed:

(a) references to finance leases in legislation and in Revenue guidance to consider if legislation or guidance (or both) might need to be updated to reflect future differences in the treatment of leases for lessees and lessors.

(b) the entitlement of lessees to claim capital allowances on leased assets where they bear the burden of wear and tear.

(c) the deductibility of the expense recognised in the lessee income statement for the amortisation of the right to use the leased asset.

(d) the tax treatment of adjustments to lessee accounts following adoption of IFRS16 (amended to reflect the impact of Finance Act 2017).

(e) the tax treatment of lessors subject to tax under Section 80A, Taxes Consolidation Act, 1997 (TCA 1997).

Mindful of the potential complexities associated with any fundamental change in approach to the taxation of leases, where practitioners consider that a change in legislation or guidance may be required, practitioners have sought to suggest changes that are, insofar as possible, aligned with the existing tax treatment of leases.

The approach of seeking to align as much as possible the tax treatment post change in financial accounting standard with that which applied pre adoption of the change is consistent with that which the UK is seeking to adopt having held a public consultation on the detail of the changes that may be required to UK legislation to achieve this objective.

Lease accounting - Today (IAS 17)

- Currently, there is a differentiation between an operating and a finance lease.
- An operating lease is accounted for as an annual income / expense generally on a straightline basis in the profit and loss account (P&L). There is no asset or liability related to the lease accounted for on the balance sheet of the lessee or the lessor (which records the asset under lease as a fixed asset).
- A finance lease is accounted for as financing with an interest charge and depreciation in the P&L. Both the asset and the liability to pay for the asset are recorded on the balance sheet of the lessee.
- A lessor and lessee adopting the same accounting standard should mirror each other's position.

Lease accounting – New rules (IFRS16)

The new lease accounting rules under IFRS16 will come into effect from 1 January 2019 (but can be adopted earlier). The new rules will bring most leases onto the lessee's balance sheet (some limited exemption for smaller (≤ USD 5,000) / short term assets (≤ 12 months). Lessees will be required to:

(a) Recognise a lease liability for the present value of future lease payments.
(b) Recognise a right of use asset to reflect the benefit to be gained from the leased asset over the term of the lease. This right of use asset is amortised to the Income Statement in accordance with the requirements of IAS-16 *i.e.,* the depreciation method reflects the pattern in which future economic benefits pf the right of use asset are consumed – generally this will be on a straightline basis over the term of the lease.
(c) Following the initial recognition of the right to use asset, the lessee also recognises in the Income Statement an 'interest' charge on the lease liability. The timing of recognition of this lease finance expense is based on an effective interest method. This means that the typical profile of the accounting recognition for the lease finance expense is that the expense recognition is upfronted in the early part of the lease even where the cash rental amounts payable are constant.

Over the life of the lease, the lessee recognises the same total lease finance and right of use asset amortisation expense as the cash rentals payable under the lease – but as a result of the profile of recognition of the lease finance expense over the lease period, the combined finance and amortisation expense in each accounting period will vary if compared with the current straightline accounting expense recognition for an operating lease with constant lease rentals.

The attached Briefing note on IFRS 16 Leases outlines in greater detail the accounting treatment and its expected impact on lessors and lessees. [Notwithstanding the passage of time, this high level overview remains relevant in describing some of the most significant changes that are expected to occur upon adoption of the new standard]. The typical balance sheet and income statement impact on a lessee is illustrated in diagrammatic form on page 2 of the document.

Nothing is expected to change in respect of the accounting treatment of hire purchase contracts.

The direct impact on lessors are less significant (change in the definition of a lease). The new definition of a lease will focus on who controls the asset and may change which contracts are considered to be leases for accounting purposes. Certain contracts currently accounted for as leases may, in future, be accounted for as services contracts.

Summary of proposed changes

The following table summarises the lessor and lessee accounting treatment under the new lease accounting standard.

	Lessor	**Lessee**	**LILO (lease in, lease out)**
Balance Sheet	Fixed asset or finance lease receivable	Right to use asset and obligation to pay rentals	Finance lease receivable and obligation to pay rentals
Income Statement	Operating lease income and asset depreciation or Finance lease interest income	Amortisation of right to use asset and finance expense	Finance lease interest income and finance expense

Lessors

For lessors, the treatment of leases under the existing lease accounting standard (IAS 17) has been substantially carried forward under the new standard IFRS16. Leases continue to be classified as either *finance leases* or *operating leases* based on existing IAS-17 classification criteria but additional disclosures are required in the notes to the financial statements to provide a more detailed breakdown of the nature and value of assets subject to operating and/or finance leases.

It is not expected that lessors subject to IAS 17 will face significant/material accounting adjustments upon transition to IFRS 16. Lessors should apply the new standard from its date of application.

Lessor tax position – operating leases

Under existing accounting standards, fixed assets under operating lease arrangements are recognised in the balance sheet caption of fixed assets of the lessor in *property, plant and equipment* and depreciated over their economic life. Lease payments from operating leases are recognised as income on either a straight-line basis or another systematic basis, reflecting a constant periodic rate of return on the lessor's net investment in the lease. Costs incurred in earning the lease income as well as leased asset depreciation are recognised as an expense in the Income Statement.

There should be no change to this accounting treatment under the new standards.

Post adoption of the new standards, lessors should therefore continue to claim capital allowances on expenditure incurred in acquiring the leased asset and not claim a tax deduction for the depreciation accounting expense in computing tax adjusted leasing income.

Operating lease income should be taxed in accordance with the timing and measure of the accounting income in the Income Statement.

Lessor tax position - finance leases

As in the case of operating leases, for lessors there should be no substantial changes to the recognition and accounting for finance leases under the new rules.

Under the new standards, assets held under finance lease arrangements are recognised as a finance lease receivable at an amount equal to the net investment in the lease. Finance income related to a finance lease is allocated over the lease term on a systematic and rational basis. Lease payments are applied against gross investment in the lease to reduce both the principal and the unearned finance income.

The current taxation treatment of finance leases is dependent on whether the lessor bears the burden of wear and tear on the leased asset and claims capital allowances on the expenditure incurred in providing the asset.

Finance leases where the lessor claims capital allowances on the leased asset

Where the lessor bears the burden of wear and tear on the leased asset, the lessor claims capital allowances on the expenditure incurred on the leased asset. The lessor's accounting measure of lease income (the finance income) is adjusted for tax purposes under Section 76D, TCA 1997 so that the gross amount of the rentals received is taxed and not just the finance income part which is recognised as income in the lessor's Income Statement.

Section 76D, TCA 1997 provides that the total amount of finance lease rental income (being "*the lease payments receivable*" as described in that section) should be included as receipts of the lessor's trade.

On the basis that the adoption by a lessor of IFRS 16 (or the equivalent under FRS102) should be in accordance with "*generally accepted accounting practice*" (as required by Section 76D), where the lease arrangement is a "*finance lease*" under IFRS 16, the provisions of Section 76D related to a "finance lease" for a lessor should continue to apply.

This analysis does not affect the lessor's position in relation to claiming capital allowances on the leased asset which remains unchanged.

Finance leases where the lessee claims capital allowances on the leased asset

Section 299, TCA 1997 provides for lessees to claim capital allowances on leased assets. The section at subsection (1) cross refers to Section 76D where machinery or plant is let by means of a "*finance lease (within the meaning of Section 76D)*" to a lessee. Where certain terms apply under the lease and where the burden of wear and tear on the leased asset falls on the lessee, the expenditure on the provision of the leased plant and machinery is deemed to have been incurred by the lessee.

Where an election is made under Section 299 such that the lessee (and not the lessor) claims capital allowances on the leased plant and machinery, our understanding of current Revenue practice is that the lessor treatment which is prescribed by Section 76D is not applied to such finance leases. Instead, the lessor is taxed on the finance lease income in accordance with the timing and measure of the finance lease income in its Income Statement. The lessor is not entitled to claim capital allowances on the leased asset and is not taxed on the principal element of the finance lease receivable.

Practitioners suggest that this treatment of the lessor in the case of finance leases where capital allowances on the leased asset are claimed by the lessee should continue to apply under the new standards. Practitioners would welcome Revenue confirmation of this in any guidance issued in relation to the adoption of the new standards. In the alternative, such guidance might be included in the Revenue manual guidance related to leasing taxation matters.

Lessees

The most far reaching consequences of the new lease accounting standards will arise for lessees.

Subject to some exclusions, all leases will be viewed as resulting in a lessee obtaining the right to use an asset. Where lease payments are made over time, the lessee will also be considered to have obtained finance from the lessor. The classification of leases as either finance leases or operating leases is eliminated and a single accounting model is introduced

for lessees. As noted above, exceptions apply for short term leases (*i.e.*, leases of less than 12 months) and low value assets (such as a personal computer).

Lessee accounting transition measures upon adoption of new standards

The accounting transition adjustments for lessees afford lessees options upon transition to the new standard. These are summarised on page 51 onwards in the attached accounting briefing document[2].

Where leases were previously classified as operating leases, the lessee may adopt the standard retrospectively or follow a modified retrospective approach. Under the retrospective approach, the lessee restates comparative information and recognises an adjustment in equity at the beginning of the earliest period presented. Any deferred incentive assets or liabilities would be derecognised. Accounting under this approach is covered in Example A of the excel spreadsheet which is attached to this paper and referred to as Appendix B. [The excel spreadsheet workings which comprise Appendix B can be accessed in soft copy by clicking on the icon at the end of this paper.]

Under the modified retrospective approach, the lessee recognises the cumulative effect of initially applying the standard as an adjustment to equity at the date of initial application. A right of use asset and lease obligation is recognised. The liability is measured at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate at that date. The right of use (ROU) can be measured either at its carrying amount as if the standard had always been applied using transition discount rate (*i.e.*, the incremental rate) (accounting under this approach is covered in Example C of Appendix B to this paper) or it can also be measured at an amount equal to the lease liability, adjusted for any prepaid or accrued lease payments (accounting under this approach is covered in Examples B and D of Appendix B to this paper). Any deferred incentive assets or liabilities would be derecognised.

It is considered that adoption of IFRS 16 (and in due course the adoption of expected changes to the accounting for leases under FRS 102) should fall within scope of the provisions of subsection (4) of Section 76A, TCA 1997 which was introduced by Finance Act 2017. It refers at subparagraph (b) both to (i) the adoption of an accounting standard (such as IFRS 16) for the first time as well as when (ii) an amendment of an accounting standard (such as FRS 101 or FRS 102) is adopted for the first time.

Where leases were previously classified as finance leases, under a modified retrospective approach, a right of use asset and lease liability is recognised, at the same carrying amount of the lease asset and liability immediately before that date measured applying IAS 17. In these circumstances, it is not expected that the carrying value of the leased asset should change for the lessee (although the description of the asset changes to right to use asset)

[2] IFRS 16 Leases

nor should the lease financing amount expensed by the lessee in its Income Statement change for the lessee.

Summary of new treatment for the lessee:

(a) The present value of the remaining lease payments are recognised as an asset (*i.e.,* right to use assets);
(b) A financial liability representing the obligation to make future lease payments where the lease payments are made over time is recognised. This liability is measured at the present value of the remaining lease payments discounted using the lessee's incremental borrowing rate, on an on-going basis.
(c) The right to use asset is amortised straightline over the lease term; and
(d) Finance expense arises on the financial liability (as a finance cost which would typically reduce over the life of the lease as payments are made).

Lessee tax position - operating leases

Under existing accounting standards, the full operating lease expense is debited to the lessee's Income Statement. Where the leased asset is in use for the purposes of the lessee's trade, the operating lease rental amount is considered for tax purposes to be a payment which is revenue in character and is deductible as an expense of the trade in accordance with the timing and measure of the expense for accounting purposes.

Under the new standards, where a company makes a lease payment, the payment is allocated in part to the balance sheet to reduce the amount of the lease obligation which is recognised at the inception (or original recognition) of the lease as a liability in the balance sheet. As the lease obligation amount would have been discounted on inception (or original recognition), part of the lease payment is also debited to the Income Statement as a financing expense.

In addition, the lessee's right to use the asset is amortised over the term of the lease which results in a further debit to the company's Income Statement. The total of these debits to the Income Statement of the lessee should equal the total payments that would have been debited to the Income Statement over the lifetime of the lease under the current operating lease accounting rules.

As noted above however, there is expected to be an upfronting of the recognition of the finance expense element of the lease payments such that even where cash rentals payable under the lease have a constant profile the combined lease finance and right to use amortisation amounts recognised in the Income Statement in each accounting period is likely to be upfronted in the early stage of the lease and less than the cash payment amount in the later stage of the lease.

As the legal character of the operating lease rentals remains unchanged and the combined impact of the amortisation of a right to use and finance expense on the Income Statement of

the lessee over the term of the lease is not expected to change for lessees with existing operating leases, practitioners suggest that the tax treatment for lessees should remain unchanged. To achieve this, practitioners suggest that the Income Statement expense which is described as the amortisation of the right to use the leased asset should be deductible for the lessee in accordance with the timing of the recognition of the expense in the Income Statement of the lessee in like manner to the timing of recognition for tax purposes of the finance expense related to the lease.

This treatment is aligned with current Revenue guidance in relation to the tax deductibility of accounting amortisation expense relating to the right to use assets in the context of PPP projects[3].

Practitioners have included in Appendix B to this paper a simple worked example of an asset leased by way of an operating lease with a 10 year term. The lease was entered into on 1 January 2014 at an annual rental of €100,000. Total payments due over the entire term of the lease amount to €1million. The example sets out the sums which would be recognised in the accounts over the 10 year period (under IAS 17 in the years to 31 December 2018 and subsequently under IFRS 16) together with the accounting transition adjustments to be made. Example A shows the position where the full retrospective approach is applied. Examples B, C and D cover the modified retrospective approach with the varying measurement options as outlined on page 5 above.

It can be seen from these workings that the total charges made to the Income Statement over the entire lease term combined with the transition adjustment made to retained earnings equate to the overall payments made over the term of the lease. Practitioners therefore suggest that the tax deduction continues to be claimed based on the charge to the Income Statement (being the total of the amortisation of the right to use the leased asset and the financing expense).

Where the lessee has made an election to adjust its retained earnings to retrospectively reflect the impact of its adoption of the new lease accounting standard, practitioners suggest that this accounting adjustment should be treated as a transition adjustment on first adoption of an accounting within the scope of subsection (4) of Section 76A as outlined on page 5 above.

Lessee position - finance leases

For lessees, where the lease obligation is recognised under current law as a *finance lease,* the existing deductibility of the element of the finance lease that is reflected in the balance follows guidance issued in Statement of Practice IT52, (*i.e.*, that ordinary recurring payments under a finance lease should be written off for tax purposes on a straightline basis and a deduction claimed for the lease rental payments).

[3] Statement of Practice on deductibility of amortisation expense for right to use assets under PPP contracts

In the second tab of the Appendix B excel worksheet, practitioners have illustrated how the current accounting treatment of a finance lease obligation for a lessee results in each lease payment being treated for accounting purposes as comprising two parts – one part being an estimate of the lease finance expense which is recorded as a debit or expense in the income statement and the other part of the lease payment being recorded as a debit or reduction of the lease liability account. Where the lessee claims a tax deduction for the finance lease payment made, this had the effect of claiming a deduction for the combined amount of the lease finance expense (recognised in the income statement) and the reduction in the amount of the lease liability (which is reflected in the balance sheet).

In simple terms, under IFRS 16, the lease payments for accounting purposes under a lease which is currently treated as a finance lease will (in like manner to leases treated as operating leases) be split for accounting purposes into a financing lease expense and a right of use asset which is amortised in the income statement. The lessee recognises a lease obligation liability which reduces in line with the amortisation of the right of use asset. Over the lifetime of the lease, the cash outflows under the lease payments will be reflected as a combination of:

(a) Financing expense which is debited as an expense to the income statement, and
(b) A reduction in the lease obligation which equates to the debit to the income statement of the expense related to the amortisation of the right of use of the asset.

Practitioners suggest that under IFRS 16, the outcome which is currently achieved for lessees in claiming a tax deduction for the combined amount of the lease finance expense and reduction in lease liability is achieved by the lessee claiming a tax deduction for the combined amount of the lease financing expense and the amortisation of the right of use asset. These total the same amounts being the lease payments over the lease period. In its alignment with best accounting practice under relevant accounting standards, this treatment is also considered to be aligned with the principles set down in case law such as *Gallagher v Jones.*

For lessees, there will no longer be a distinction between finance lease and operation lease treatment (which dual model remains relevant only for lessors).

Practitioners therefore suggest that, similar to operating leases, consideration be given to basing the tax deduction for finance leases on the charge to the Income Statement (being the total of the amortisation of the right to use the leased asset and the financing expense). Practitioners suggest that updating statement of practice IT52 could be used as a starting point for confirming the deductibility of the amortisation expense for the right to use the leased asset from the lessee perspective – whether or not the leased asset is recognised as a *finance lease* or *an operating lease* from a lessor perspective.

While no accounting adjustment should arise for finance leases on transition to the new standard, there may be a difference between the total charges made to the Income Statement in the periods before transition and the total payments made on which tax

deductions were claimed *e.g.,* where the timing of lease payments did not perfectly coincide with accounting period end dates. Practitioners suggest that this difference should also be treated in a like manner to a transition adjustment on first adoption of an accounting standard in accordance with subsection (4) of Section 76A (as introduced by Finance Act 2017).

Practitioners have included in Appendix B to this paper on a separate tab a simple worked example of an asset leased by way of a finance lease with a 10 year term. Again, the lease was entered into on 1 January 2014 at an annual rental of €100,000. Total payments due over the entire term of the lease amount to €1million. It can be seen from these workings that, where the treatment suggested above is adopted, the tax deductions claimed over the lease term equate to the total payments made.

Lessee position – lessee claims capital allowances

As noted above, Section 299 provides for the entitlement of lessees to claim capital allowances on leased plant and machinery where certain conditions apply. Practitioners have suggested above that the position of lessors which recognise a *finance lease* in respect of such arrangements should remain unchanged and that Revenue guidance could be updated to confirm that the current lessor position would remain.

For lessees, there will no longer be a distinction between finance lease and operation lease treatment (which dual model remains relevant only for lessors).

Practitioners suggest that consideration is given to updating the wording of Section 299 to confirm that, in a case where an election is made so that the lessee shall claim capital allowances and the lease is a finance lease (from the lessor perspective) the lease expense deduction for the lessee should be confined to the finance element of the lease rental recognised in accordance with generally accepted accounting practice. This could be done by means of small wording changes to the section which have been track-lined in Appendix A to this paper.

These suggested changes seek to confine the combined deductions for the lessee whether as a 'financing expense' trading expense deductions or as capital allowances to the total lease rental amount payable – which limit mirrors that which applies under the section currently.

Where the Income Statement expense related to the amortisation of the right to use asset is not deductible but the lessee remains entitled (provided the relevant conditions are met) to claim capital allowances, this should align the outcome under the section with that which applies to a lessee currently under a finance lease arrangement (albeit that no fixed asset will be recognised in the accounts of the lessee but instead a leased asset described as a right to use asset).

Lease in, lease out ("LILO") entities

A LILO entity is one which has entered into a lease obligation with a head lessor and has, in turn, granted a lease to a sub-lessee. Under the new rules, the sub-lease must be classified as either a finance lease or an operating lease as follows:

(a) If the head lease is a short term lease that the LILO entity has accounted for as a short term or low value lease, the sublease is classified as an operating lease.
(b) Otherwise, the sublease should be classified by reference to the right to use asset arising from the head lease.

For an operating head lease, the LILO entity will, as lessee, recognise a right to use asset and the related finance liability. A sublease is assessed for whether it is a finance lease by reference to the right-of-use asset from the head lease, rather than the underlying asset. Where this set of circumstance applies, the LILO entity therefore derecognises the right-of-use asset relating to the head lease that it transfers to the sub-lessee and recognises the net investment in the sub-lease. Any difference between the carrying amounts of the right-of-use asset and the net investment in the sub-lease is recognised in profit and loss. The LILO entity continues to recognise the lease liability relating to the head lease, which represents the lease payments owed to the head lessor. Consideration should be given to the inter-dependence between the head lease and the sublease. If the terms of the lease in is closely linked to the sub-lease, this interdependence may lead to de-recognition of leased asset from lease receivable with the net profit or margin from the lease in lease out recognised in the income statement in the same amount as if the separate lease receivable and lease liability were recognised on the balance sheet.

The LILO entity should be taxable on the net finance lease interest income where it is not claiming capital allowances on the underlying leased asset. A deduction should also be available for the interest expense in relation to the finance liability.

Section 80A – taxation of certain short-term leases plant and machinery

The provisions of Section 80A, TCA 1997 apply to lessors which lease certain short life plant and machinery assets which are described in that section. Although there may be merit in considering as a separate exercise whether the provisions of that section might be simplified, it is not anticipated that the change in lease accounting standards will fundamentally change the position of lessors which fall within the scope of that section.

As outlined above, the position of lessors under IAS 17 is expected to remain broadly unchanged upon adoption of the new accounting standards. It is therefore not expected that the provisions of Section 80A should require adjustment as a result of changes to the lease accounting standards.

Appendix A

[**Note**: The submission by practitioners to Revenue via the TALC FRS 102 subgroup in April 2018 included to some suggested legislative changes to section 299. Practitioners updated proposals for the amendment of section 299 have been outlined in Appendix VI of this submission]

Appendix B illustrative examples

OPERATING LEASE																
	Original terms															
	Inception	01-Jan-14														
	Term	10 years														
	Expiry	31-Dec-23														
	Annual rent	100,000	*payable in arrears*			**Income statement**										
	Useful life of asset	40 years														
						31-Dec-14	31-Dec-15	31-Dec-16	31-Dec-17	31-Dec-18	31-Dec-19	31-Dec-20	31-Dec-21	31-Dec-22	31-Dec-23	
	Incremental borrowing rate: 01 Jan 2014	10%			**IAS 17**											
	Incremental borrowing rate: 01 Jan 2019	15%			Lease expense	€100,000	€100,000	€100,000	€100,000	€100,000	€100,000	€100,000	€100,000	€100,000	€100,000	**€1,000,000**
EXAMPLE																
A	**Full retrospective approach**				**IFRS 16**											
					Amortisation	€61,446	€61,446	€61,446	€61,446	€61,446	€61,446	€61,446	€61,446	€61,446	€61,446	
	At 1 Jan 2014				Interest	€61,446	€57,590	€53,349	€48,684	€43,553	€37,908	€31,699	€24,869	€17,355	€9,091	
	Lease liability	€614,457				€122,891	€119,036	€114,795	€110,130	€104,998	€99,354	€93,144	€86,314	€78,801	€70,537	**€1,000,000**
	Right of use asset	€614,457														
				Closing	**Transition Adjustment to Accounts**	€22,891	€19,036	€14,795	€10,130	€4,998						
	Lease liabilty	Cash	Interest	Balance					€66,852	€4,998						€71,850
	01-Jan-14			€614,457		**At 1 Jan 2018**										
	31-Dec-14	100,000	€61,446	€575,902												
	31-Dec-15	100,000	€57,590	€533,493		Cr. Lease liability		€435,526								
	31-Dec-16	100,000	€53,349	€486,842		Dr. Right of use asset		€368,674								
	31-Dec-17	100,000	€48,684	€435,526		Dr. Retained earnings		€66,852	Cumulative adjustment to 1 Jan 2018							
	31-Dec-18	100,000	€43,553	€379,079												
	31-Dec-19	100,000	€37,908	€316,987				€4,998	Restatement of 2018 comparatives							
	31-Dec-20	100,000	€31,699	€248,685												
	31-Dec-21	100,000	€24,869	€173,554												
	31-Dec-22	100,000	€17,355	€90,909	**Charges to the Income Statement on which Corporation Tax Deduction Claimed (Note 1)**											
	31-Dec-23	100,000	€9,091	€0	Amortisation						€61,446	€61,446	€61,446	€61,446	€61,446	€307,228
					Interest						€37,908	€31,699	€24,869	€17,355	€9,091	€120,921
					Lease expense under IAS17	€100,000	€100,000	€100,000	€100,000	€100,000						€500,000
					Total	€100,000	€100,000	€100,000	€100,000	€100,000	€99,354	€93,144	€86,314	€78,801	€70,537	**€928,150**
					Add Transition adjustment (5 year spread)						€14,370	€14,370	€14,370	€14,370	€14,370	**€71,850**
					Corporation Tax Deductions Claimed	€100,000	€100,000	€100,000	€100,000	€100,000	€113,724	€107,514	€100,684	€93,171	€84,907	**€1,000,000**
B	**Modified retrospective approach - Option 1**				**IFRS 16**											
	Option 1 - right of use asset measured equal to lease liability				Amortisation						€67,043	€67,043	€67,043	€67,043	€67,043	
	At 1 January 2019				Interest						€50,282	€42,825	€34,248	€24,386	€13,043	
	Lease liability	€335,216				€0	€0	€0	€0	€0	€117,325	€109,868	€101,291	€91,429	€80,087	
	Right of use asset	€335,216														
					Transition Adjustment to Accounts	€0	€0	€0	€0	€0						
				Closing												
	Lease liabilty	Cash	Interest	Balance		**At 1 Jan 2019**										
	01-Jan-19			€335,216												
	31-Dec-19	100,000	€50,282	€285,498		Cr. Lease liability		€335,216								
	31-Dec-20	100,000	€42,825	€228,323		Dr. Right of use asset		€335,216								
	31-Dec-21	100,000	€34,248	€162,571		Cr. Retained earnings		€0								
	31-Dec-22	100,000	€24,386	€86,957												
	31-Dec-23	100,000	€13,043	-€0	**Charges to the Income Statement on which Corporation Tax Deduction Claimed (Note 1)**											
					Amortisation						€67,043	€67,043	€67,043	€67,043	€67,043	€335,216
					Interest						€50,282	€42,825	€34,248	€24,386	€13,043	€164,784
					Lease expense under IAS17	€100,000	€100,000	€100,000	€100,000	€100,000						€500,000
					Corporation Tax Deductions Claimed	€100,000	€100,000	€100,000	€100,000	€100,000	€117,325	€109,868	€101,291	€91,429	€80,087	**1,000,000**

C **Modified retrospective approach - Option 2**

Option 2 - right of use asset measured at inception, using incremental borrowing rate at initial application

At 1 January 2019

Lease liabilty	€335,216	
Right of use asset on inception	€501,877	
Right of use asset on initial application	€250,938	(reduced by 5 years amortisation)

At 1 Jan 2019

Cr. Lease liability	€335,216
Dr. Right of use asset	€250,938
Dr. Retained earnings	€84,277

Lease liabilty	Cash	Interest	Closing Balance
01-Jan-19			€335,216
31-Dec-19	100,000	€50,282	€285,498
31-Dec-20	100,000	€42,825	€228,323
31-Dec-21	100,000	€34,248	€162,571
31-Dec-22	100,000	€24,386	€86,957
31-Dec-23	100,000	€13,043	-€0

Charges to the Income Statement on which Corporation Tax Deduction Claimed (Note 1)											
Amortisation						€50,188	€50,188	€50,188	€50,188	€50,188	€250,938
Interest						€50,282	€42,825	€34,248	€24,386	€13,043	€164,784
Lease expense under IAS17	€100,000	€100,000	€100,000	€100,000	€100,000						€500,000
Total	€100,000	€100,000	€100,000	€100,000	€100,000	€100,470	€93,012	€84,436	€74,573	€63,231	**€915,723**
Add Transition adjustment (5 year spread)						€16,855	€16,855	€16,855	€16,855	€16,855	**€84,277**
Corporation Tax Deductions Claimed	€100,000	€100,000	€100,000	€100,000	€100,000	€117,325	€109,868	€101,291	€91,429	€80,087	**€1,000,000**

D **Modified retrospective approach with pre-payments / accruals**

Option 1 - right of use asset measured equal to lease liability (plus prepayment)

The rent for 2019 amounting to €100,000 has been prepaid

At 1 January 2019

Lease liabilty	€335,216
Right of use asset	€335,216
Right of use asset plus prepayment	€435,216

At 1 Jan 2019

Cr. Lease liability	€335,216
Dr. Right of use asset	€435,216
Cr. Retained earnings	€100,000

01-Jan-19			€335,216
31-Dec-19	100,000	50,282	€285,498
31-Dec-20	100,000	42,825	€228,323
31-Dec-21	100,000	34,248	€162,571
31-Dec-22	100,000	€24,386	€86,957
31-Dec-23	100,000	€13,043	-€0

Charges to the Income Statement on which Corporation Tax Deduction Claimed (Note 1)											
Amortisation						€87,043	€87,043	€87,043	€87,043	€87,043	€435,216
Interest						€50,282	€42,825	€34,248	€24,386	€13,043	€164,784
Lease expense under IAS17	€100,000	€100,000	€100,000	€100,000	€100,000						€500,000
Total	€100,000	€100,000	€100,000	€100,000	€100,000	€137,325	€129,868	€121,291	€111,429	€100,087	**€1,100,000**
Add Transition adjustment (5 year spread)						(€20,000)	(€20,000)	(€20,000)	(€20,000)	(€20,000)	**(€100,000)**
Corporation Tax Deductions Claimed	€100,000	€100,000	€100,000	€100,000	€100,000	€117,325	€109,868	€101,291	€91,429	€80,087	**€1,000,000**

SUMMARY

Income statement recognition

		31-Dec-14	31-Dec-15	31-Dec-16	31-Dec-17	31-Dec-18	31-Dec-19	31-Dec-20	31-Dec-21	31-Dec-22	31-Dec-23	**Total Charge in Income Statement**
Example A	Full retrospective	€100,000	€100,000	€100,000	€100,000	€100,000	€99,354	€93,144	€86,314	€78,801	€70,537	€928,150
Example B	Modified retrospective (with ROU asset = Lease liability)	€100,000	€100,000	€100,000	€100,000	€100,000	€117,325	€109,868	€101,291	€91,429	€80,087	€1,000,000
Example C	Modified retrospective (with ROU asset @ inception, using discount rate @ application)	€100,000	€100,000	€100,000	€100,000	€100,000	€100,470	€93,012	€84,436	€74,573	€63,231	€915,723
Example D	Modified retrospective (with ROU asset = Lease liability with prepayment)	€100,000	€100,000	€100,000	€100,000	€100,000	€137,325	€129,868	€121,291	€111,429	€100,087	€1,100,000

Note 1: Adjustments to be made as required to take account of any lease restrictions on passenger motor vehicles

FINANCE LEASE

Original terms

Inception	01-Jan-14
Term	10 years
Expiry	31-Dec-23
Annual rent	100,000
Useful life of asset	10 years
Incremental borrowing rate: 01 Jan 2014	10%

At initial recognition

Lease liability	€614,457
Fixed assets	€614,457

Movement in Lease Liability
Balance Sheet

	Payment	Interest	Reduction in Lease Liability	Closing Lease Balance
01-Jan-14				€614,457
31-Dec-14	100,000	€61,446	€38,554	€575,902
31-Dec-15	100,000	€57,590	€42,410	€533,493
31-Dec-16	100,000	€53,349	€46,651	€486,842
31-Dec-17	100,000	€48,684	€51,316	€435,526
31-Dec-18	100,000	€43,553	€56,447	€379,079
31-Dec-19	100,000	€37,908	€62,092	€316,987
31-Dec-20	100,000	€31,699	€68,301	€248,685
31-Dec-21	100,000	€24,869	€75,131	€173,554
31-Dec-22	100,000	€17,355	€82,645	€90,909
31-Dec-23	100,000	€9,091	€90,909	€0
	1,000,000	€385,543	€614,457	

A Full retrospective approach

At 1 January 2018

Lease liability	€435,526
Right of use asset	€368,674 (reduced by 4 years amortisation)

No transition adjustment for accounting purposes.

B Modified retrospective approach

At 1 January 2019

Lease liability	€379,079
Right of use asset	€307,228 (reduced by 5 years amortisation)

No transition adjustment for accounting purposes.

Accounting Charges to Income Statement

	31-Dec-14	31-Dec-15	31-Dec-16	31-Dec-17	31-Dec-18	31-Dec-19	31-Dec-20	31-Dec-21	31-Dec-22	31-Dec-23	
Depreciation	€61,446	€61,446	€61,446	€61,446	€61,446	€61,446	€61,446	€61,446	€61,446	€61,446	**€614,457**
Interest	€61,446	€57,590	€53,349	€48,684	€43,553	€37,908	€31,699	€24,869	€17,355	€9,091	**€385,543**
Total Charges to the Income Statement	€ 122,891	€ 119,036	€ 114,795	€ 110,130	€ 104,998	€ 99,354	€ 93,144	€ 86,314	€ 78,801	€ 70,537	**€1,000,000**

Corporation Tax Deductions Claimed / to be Claimed (Notes 1 and 2)

	31-Dec-14	31-Dec-15	31-Dec-16	31-Dec-17	31-Dec-18	31-Dec-19	31-Dec-20	31-Dec-21	31-Dec-22	31-Dec-23	
Reduction in Lease Liability	€38,554	€42,410	€46,651	€51,316	€56,447						€235,378
Depreciation						€61,446	€61,446	€61,446	€61,446	€61,446	€307,228
Interest	€61,446	€57,590	€53,349	€48,684	€43,553	€37,908	€31,699	€24,869	€17,355	€9,091	€385,543
Total	€100,000	€100,000	€100,000	€100,000	€100,000	€99,354	€93,144	€86,314	€78,801	€70,537	**€928,150**
Transition Adjustment for Tax Purposes (spread over 5 years)						€14,370	€14,370	€14,370	€14,370	€14,370	**€71,850**
Total Corporation Tax Deductions	€100,000	€100,000	€100,000	€100,000	€100,000	€113,724	€107,514	€100,684	€93,171	€84,907	**€1,000,000**

Calculation of Transition Adjustment

Total accounting charge to 31 December 2018	€571,850
Less payments made to 31 December 2018 (tax deductions claimed)	(€500,000)
Transition Adjustment for Tax Purposes	**€71,850**

Note 1: Assumes deduction is claimed on amounts paid in all periods to 31 December 2018 and on amounts charged to Income Statement thereafter (with transition adjustment as required)

Note 2: Adjustments to be made as required to take account of any lease restrictions on passenger motor vehicles

Appendix VI: Section 76D and Section 299

Proposed amendments to Section 76D are shown in red

76D ~~Computation~~ Tax computation matters related to ~~of income from finance~~ leases of plant and machinery

(1) In this section “finance lease” means a lease which, under generally accepted accounting practice, falls to be treated as a finance lease.

(1A) Subject to subsections (2) and (3) and Section 299, for the purposes of Case I or II of Schedule D the profits or gains of a trade or profession carried on by a company shall, subject to the provisions of the Corporation Tax Acts other than Section 76A, be computed in accordance with generally accepted accounting practice by treating as trading expenses of the trade:

(a) amounts charged to the company’s income statement in respect of its obligations to make payments under the lease; and

(b) amounts charged to the company’s income statement in respect of the amortisation of its right to use the asset subject to the lease.

(2) Notwithstanding Section 76A and subject to subsection (3) and Section 80A, for the purposes of computing income of a company from a trade of leasing, income of a lessor from a finance lease—

(a) shall not be the amount of income from the lease computed in accordance with generally accepted accounting practice, and

(b) shall be computed, subject to the provisions of the Corporation Tax Acts other than Section 76A, by treating—

 (i) lease payments receivable in respect of the lease as trading receipts of the trade, and
 (ii) as trading expenses of the trade any disbursements or expenses laid out or expended for the purposes of earning those lease payments.

(3) For the purposes of computing income of a company from a trade of leasing, income of a lessor from a finance lease shall be the amount of income from the lease computed in accordance with generally accepted accounting practice where the lessor does not or cannot make a claim to allowances under Part 9 in respect of its expenditure on the asset under lease.

Proposed amendments to Section 299 are shown in red

Section 299 Allowances to lessees

(1) Subject to subsection (3), where machinery or plant is let by means of a ~~finance~~ lease which is regarded as a finance lease for the lessor (within the meaning of section 76D) to a person, by whom a trade is carried on, on the terms of that person being bound to maintain the machinery or plant and deliver it over in good condition at the end of the lease, and if the burden of the wear and tear of the machinery or plant in fact falls directly on that person, then, for the purposes of Sections 283 and 284, the capital expenditure on the provision of the machinery or plant shall be deemed to have been incurred by that person and not by any other person and the machinery or plant shall be deemed to belong to that person and not to any other person.

(2) Subsection (2) of Section 285 shall not apply to qualifying machinery or plant (within the meaning of that section) which is let to a person on the terms mentioned in subsection (1), unless the contract of letting provides that the person shall or may become the owner of the machinery or plant on the performance of the contract, and, where the contract so provides but without becoming the owner of the machinery or plant the person ceases to be entitled (otherwise than on his or her death) to the benefit of the contract in so far as it relates to the machinery or plant, subsection (2) of Section 285 shall be deemed not to have applied in relation to the machinery or plant and accordingly there shall be made all such assessments or amendments of assessments as may be appropriate.

(3)

(a) In this subsection “lease payments”, “lessee” and “lessor” have, respectively, the same meanings as in Section 80A.

(b) Subsection (1) shall only apply where:
- (i) the lessor and lessee jointly elect, or
- (ii) where the lessor is not a person within the charge to tax under Schedule D, the lessee elects,

that this section shall apply for the purposes of sections 283 and 284 by giving notice in writing to the inspector on or before the specified return date for the chargeable period (within the meaning of Section 959A]) in a form approved by the Revenue Commissioners and containing such particulars relating to the lessor and lessee and in connection with the lease as may be specified in the approved form.

(c) Where this section applies:

- (i) the amount to be deducted in computing the profits or gains to be charged to tax under Case 1 of Schedule D for any chargeable period of the lessee in relation to lease payments to be paid in respect of the finance lease, shall be the amount in respect of the lessee’s obligations to make payments under the lease ~~those lease payments~~ which in accordance with generally accepted accounting practice and Section 76D would be deducted in a profit and loss account for that

period (but excluding amounts charged to the company's income statement in respect of the amortisation of its right to use the asset subject to the lease), and accordingly, the aggregate amount (referred to in subparagraph (ii) as the "aggregate deductible amount") to be deducted in computing the profits or gains to be charged to tax under Case 1 of Schedule D for any chargeable period of the lessee in relation to lease payments to be paid in respect of and over the term of the lease, shall be the amount in relation to those lease payments which in accordance with generally accepted accounting practice would be deducted in the profit and loss account over the term of the lease, and

(ii) where capital expenditure deemed to have been incurred by the lessee would otherwise exceed the amount by which the aggregate amount of lease payments to be paid in respect of the lease exceeds the aggregate deductible amount, then the amount of capital expenditure on the provision of plant and machinery for the purposes of subsection (1) shall be deemed to be the amount by which the aggregate amount of the lease payments made in respect of and over the term of the lease exceeds the aggregate deductible amount.