Irish Tax Institute

March 2021

ATAD Implementation Article 4 Interest Limitation

Response to Feedback Statement

Table of Contents

1. About the Irish Tax Institute ... 2
2. Summary ... 3
3. Institute Recommendations/Observations ... 7
4. Response to Questions in the Feedback Statement ... 12
4.1. Interaction between existing rules and ATAD ILR ... 12
4.2. Interest equivalent, exceeding borrowing costs, EBITDA - Steps 2 to 5 ... 15
4.3. Applying the ILR to a single company – Step 6 ... 18
4.4. Carry forward/back options – Step 7 ... 19
4.5. ATAD exemptions ... 21
4.6. Providing "group ratios" ... 26
4.7. Treating a notional local group as a single 'taxpayer' ... 30
4.8. Other technical issues ... 34
Appendix 1 ... 35

1. About the Irish Tax Institute

The Irish Tax Institute is the leading representative and educational body for Ireland's Chartered Tax Advisers (CTA) and is the country's only professional body exclusively dedicated to tax.

The Chartered Tax Adviser (CTA) qualification is the gold standard in tax and the international mark of excellence in tax advice. We benchmark our education programme against the very best in the world. The continued development of our syllabus, delivery model and assessment methods ensure that our CTAs have the skills and knowledge they need to meet the ever-changing needs of their workplaces.

Our membership of over 5,000 is part of the 30,000 strong international CTA network which includes the Chartered Institute of Taxation UK and the Tax Institute of Australia. The Institute is also a member of the CFE Tax Advisers Europe (CFE), the European umbrella body for tax professionals.

Our members provide tax services and business expertise to thousands of Irish owned and multinational businesses as well as to individuals in Ireland and internationally. Many also hold senior roles in professional service firms, global companies, Government, Revenue, state bodies and in the European Commission.

The Institute is, first and foremost, an educational body but since its foundation in 1967, it has played an active role in the development of tax administration and tax policy in Ireland. We are deeply committed to playing our part in building an efficient and innovative tax system that serves a successful economy and a fair society. We are also committed to the future of the tax profession, our members and our role in serving the best interests of Ireland's taxpayers in a new international world order.

Irish Tax Institute - Leading through tax education

2. Summary

The Irish Tax Institute welcomes the opportunity to engage with the Department of Finance on the implementation of the final EU Anti-Tax Avoidance Directive (ATAD)[1] measure, Interest Limitation Rule (ILR), the implementation of which will be a very complex process and impact most businesses in Ireland.

Feedback Statement on the implementation of the ATAD ILR in Ireland
Article 4 of ATAD requires EU Member States to introduce a fixed ratio rule that links a company's allowable net interest deductions (i.e., deductible interest expenses in excess of taxable interest income) directly to its level of economic activity, based on taxable earnings before deducting net interest expense, depreciation and amortisation (EBITDA). The ATAD ILR operates by limiting the allowable tax deduction for net interest costs in a tax period to 30% of EBITDA.

The implementation of the ILR will likely impact differently on the range of Irish businesses, including, foreign direct investment, domestic businesses and Irish indigenous business with a global presence. All these companies are significant contributors to the Irish economy in terms of Exchequer returns and employment.

Therefore, we are in favour of adopting the broadest implementation of reliefs and exemptions permitted under the ATAD to mitigate risks to Ireland's international competitiveness while also addressing the range and diversity of Irish businesses impacted by the ILR.

The Feedback Statement confirms that a two-stage approach is being adopted by the Department of Finance to develop this measure due to the complexity of the ATAD ILR and its interaction with domestic legislation. This means that policymakers have firstly developed an approach to the operation of the ATAD ILR on a single company basis and questions on this draft legislative approach have been set out in the Feedback Statement.

When the framework of the ILR on a single company basis has been established, policymakers propose to then develop legislative approaches to consider the notional local group and group ratio options and have also included a range of consultation questions on these options in the Feedback Statement. It has been signalled that a second Feedback Statement containing the draft legislative provisions for the whole ILR provision (i.e., on a single entity and group basis) will be published in mid-2021.

We strongly believe that Ireland should adopt both group ratio options (i.e., Equity Ratio Rule and Group Ratio Rule) and allow the taxpayer the discretion to choose which methodology. Given the complexity involved, we would suggest the proposed legislation on the group aspects of the ILR should be published much earlier than

[1] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market.

mid-2021, as signalled in the Feedback Statement, if the complexities are to be satisfactorily considered for Finance Act 2021.

In addition, the Feedback Statement confirms that policymakers, in the context of Finance Act 2021, intend to largely overlay the new ILR provision on top of existing comprehensive rules that restrict the deductibility of interest expenses which provide strong protections for the Irish corporate tax base.

The Irish corporate tax system has some unique features compared to other EU countries. These include the existence of two corporate tax rates, a range of interest deduction rules that are increasingly more complex and a risk of double tax associated with the treatment of interest charges within an Irish group under recently extended transfer pricing rules.[2] The proposed implementation of the ILR will add further complications and the intention to layer the ILR on top of existing rules is likely to result in Ireland having one of the most complicated interest deductibility regimes within the EU.

We believe that policymakers should take the important opportunity to consolidate the Irish interest regime to allow for a broad business purpose test for interest and to maximise the optionality permitted within the ATAD. In a post-BREXIT environment, it is evident that Ireland is becoming more aligned with its EU partners and the ILR should be no exception.

Comparison with the German tax regime for deduction of interest

In contrast, Germany, when balancing protections against base erosion, has adopted a simplified corporate income tax regime for interest deductions that is very closely aligned with the measures contained in Article 4 of ATAD.

In Germany, interest is a tax-deductible expense if it meets a general test of being incurred for a business purpose and is typically recognised for tax purposes in accordance with German generally accepted accounting practice (GAAP).

Intragroup loan arrangements are within the scope of German transfer pricing provisions, which apply an arms' length standard in pricing the deductible expense and are broadly in line with OECD transfer pricing guidelines.

Germany applies earnings-stripping rules for an unlimited deduction of interest expense up to the amount of interest income and the net interest expense (i.e., interest expense in excess of interest income) is deductible up to 30% of EBITDA for tax purposes. This is almost identical to the ILR under ATAD. This restriction applies to any kind of interest expense, irrespective of whether it is derived from intercompany financing or third-party debt. Interest expenses not deductible under the earnings-stripping rule can be carried forward into future tax years without time and amount restraints. The utilisation of the interest carry-forward in future years is again subject to the earnings-stripping rule.

[2] Section 835E TCA 1997 introduced by Finance Act 2019 and substituted by Finance Act 2020 (subject to commencement order).

Lastly, Germany has a general anti-abuse rule (GAAR) which, like Ireland's GAAR can apply, as a last resort, to deny a deduction for an expense which arises because of an artificial arrangement that has a tax avoidance motive and does not have a commercial purpose.

Germany does not have the myriad of additional measures that Ireland currently has to provide corporation tax relief for interest expenses[3] and to deny relief in certain circumstances.[4]

Key considerations when implementing the ATAD ILR in Ireland

When implementing the ILR provision, policymakers should ensure that the legislation is aligned with ATAD and does not go beyond what is required in the Directive. Furthermore, the ILR should not impose additional, overly complex rules, on top of existing comprehensive provisions, which will likely increase the cost of borrowings, significantly increase the administrative burden for companies and put Ireland and Irish groups at a competitive disadvantage.

Given the Government's stated position from the outset when ATAD was agreed has been that our existing interest deductibility rules are equally effective to those contained in the Directive, it is clear that a redesign of Ireland's corporation tax regime for deducting interest is necessary to rebalance the effect of the comprehensive protections already afforded within the existing regime, with those now available under recently introduced anti-hybrid measures and extended transfer pricing rules and the forthcoming implementation of the ILR on top of these measures.

In our view, this redesign should reflect a general test for permitting a deduction for interest expense that is incurred for a business or commercial purpose, similar to the German regime, which would coincide with the removal of sections 247/249 TCA 1997. Certain targeted measures within the existing legislation, such as bond-washing or interest on capital gains, could be preserved by policymakers.

We have summarised our recommendations for the implementation of the ATAD ILR and our observations on the proposed draft legislative approach provided in the first Feedback Statement[5] on the ILR in section 3 of this submission. We have responded to the specific questions raised in the Feedback Statement, to the extent that it has been possible, within the short consultation time period, in section 4.

Conclusion

In view of the very technical nature of this measure and its significant impact on most businesses, we would stress that early and frequent engagement on this issue is crucial to securing a successful outcome that works for business and the Exchequer.

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[3] Sections 81, 97, 243, 247 and 249 TCA 1997.

[4] Sections 130, 254, 291A, 437, 542, 811C, 812, 813, 814, 815, 817A, 817B, 817C, 840A TCA 1997.

[5] Department of Finance, ATAD Implementation – Article 4 Interest Limitation, Feedback Statement, December 2020.

In welcoming the commitment in the recent update to Ireland's Corporation Tax Roadmap[6] to establish a "formal annual stakeholder engagement process", we suggested to the Minister that this process should allow for subgroups to undertake detailed, tax technical work in the case of complex issues, such as interest limitation.

We would urge the immediate establishment of such a subgroup to allow all stakeholders to proactively engage with the Department on the implementation of the ILR. This iterative consultation process should happen well in advance of the summer months and the planned publication of a second Feedback Statement on the ILR.

[6] Ireland's Corporation Tax Roadmap January 2021 Update.

3. Institute Recommendations/Observations

Interaction between existing rules and ATAD ILR

1. The Institute believes that a fundamental reconstruction of Ireland's existing rules on interest deductibility is needed in parallel with the implementation of new ATAD compliant ILR.

   However, as policymakers intend to largely overlay the new ILR provision on top of Ireland's existing measures we recommend, at a minimum, that the following modifications be made to existing tax legislation in Finance Bill 2021, to help to integrate the ILR into domestic legislation without imposing significant additional complex rules on businesses, while maintaining the necessary protections for the corporate tax base:

   - Remove section 130 (2)(d)(iv) TCA 1997 and related sections 130 (2B), 452, 452A and 845A TCA 1997.
   - Remove section 130 (2)(d)(iii)(II) TCA 1997.
   - Modify section 247 TCA 1997 to remove the requirement for a common director under subsection 3(b) and the restriction imposed on the purchase of certain intragroup assets under subsection 4E and certain recovery of capital rules in section 249 TCA 1997.
   - Remove section 840A TCA 1997.
   - Remove the interest expense from the scope of the 80% cap under section 291A TCA 1997.

2. In our view, a redesign of the corporate tax code in Finance Bill 2022 should reflect a general test for permitting a deduction for interest expense that is incurred for a business or commercial purpose, similar to the German regime, coinciding with the removal of sections 247/249 TCA 1997, while using the protections afforded by the new 30% EBITDA ATAD ILR, balanced with anti-hybrid rules and extended transfer pricing rules against base erosion risks.

A possible seven-step approach

3. The concept of the seven-step approach would appear to be acceptable on a single company basis, however, it is difficult to provide further detailed comments when several fundamental definitions contained within key steps remain undefined.

Interest equivalent, exceeding borrowing costs, EBITDA – Steps 2 to 5

4. We believe it would be preferable to align to the greatest extent possible the meaning of 'interest equivalent' with the definition of 'borrowing costs' that is in the Directive. The definition of 'interest equivalent', in our view, should consider the specific circumstances of the taxpayer as certain income/expenses may be

'economically equivalent to interest' for one taxpayer but this may not necessarily be the case for all taxpayers.

5. It is not possible to comment further on the possible definitions of 'taxable interest equivalent', 'deductible interest equivalent', 'exceeding borrowing costs' and 'exceeding deductible interest equivalent' as the meaning of 'relevant profits' and 'relevant entity' have not been set out in the Feedback Statement and these terms fundamentally underpin each of these definitions.

6. As the meaning of 'relevant profits' and 'relevant entity' have not been set out in the Feedback Statement, the starting point for calculating the EBITDA of an entity remains unclear.

Applying the ILR to a single company – Step 6

7. Careful implementation is required to ensure that by treating the 'excess amount' of interest as income under Case IV rather than under Case I, that a cash-tax charge does not inadvertently arise which would otherwise have been sheltered from corporation tax because of available losses. A relevant entity should be allowed to shelter a Case IV charge in respect of restricted interest with any and all other reliefs available to it.

Carry forward/back options – Step 7

8. Careful implementation is necessary to ensure that the carry forward of non-deductible 'exceeding borrowing costs' and 'excess interest capacity' operate as intended and in alignment with ATAD. Ongoing consultation with stakeholders is needed to ensure that these matters can be addressed prior to implementation.

ATAD exemptions

9. We welcome the proposal that Ireland's ILR provisions will include the *de minimis* exemption, however, further clarity is needed for businesses on how the *de minimis* amount will operate in practice. Where taxpayers are confident that their relevant interest expense will not exceed the *de minimis* amount, they should not be required to carry out a detailed computation in order to evidence their entitlement to that relief.

10. In the absence of moving to a fiscal consolidation system in Ireland, a methodology that addresses how the *de minimis* amount will operate among group members will need to be devised when extending the ILR provisions beyond a single entity basis to groups. This methodology should not be unduly complex given the *de minimis* is intended to create an exclusion from the ILR particularly for small and medium sized businesses.

11. In the context of implementing Article 4 (8) of ATAD and where worldwide group exceptions apply under the ILR, the measures could refer to group consolidated financial statements drawn up under IFRS and FRS, as well as accounting standards considered equivalent under Irish company law and EU regulation. Indeed, Germany and France recognise USA GAAP as equivalent.

12. We recommend that the proposed definition of an 'associated enterprise' in the Feedback Statement for the purpose of ILR is amended to remove the 'acting together' test and 'significant influence' test because these tests relate to the definition of an associated enterprise for the purposes of the anti-hybrid rules only and are not included in Article 2 (4) of ATAD which sets out the meaning of an 'associated enterprise' for interest limitation purposes.

13. We consider that the associated enterprise requirement could also be modified, using a *bona fide* clause, to ensure that a 'standalone entity' is defined in a manner that will work in practice and takes account of entities that are legally remote.

14. We welcome the adoption of the 'legacy debt' exemption into Irish law, however, the requirement to define it by reference to section 135 (8) TCA 1997 is unclear given that ATAD refers to loans. It would be preferable to align with the Directive. In addition, given the importance of the concept of 'modification' it would be vital that Revenue guidance provides clarification, using practical examples, as to how this concept will be applied in practice. It should also be possible to design a simplified system that defines with greater certainty when a loan is substantially modified.

15. We believe a broad base approach to the definition of public infrastructure should be adopted for the purposes of the 'long-term public infrastructure project' exemption and it should not be limited to public private partnership projects. Any definition should be flexible enough to adapt to changing social policy objectives and include projects located in any EU Member State in line with ATAD.

16. In our view, groups containing financial undertakings should be exempt from the ILR, given the regulatory capital and solvency requirements that apply on a consolidated basis to the entire group. If it is not possible to extend the exemption for financial undertakings to an entire group, it would be important that any exemption for financial undertakings adopted into Irish legislation would be optional for the taxpayer.

Providing "group ratios"

17. It is our view that Ireland should adopt both "group ratio" rules as permitted under the Directive.

18. We recommend that the rules regarding the treatment of joint ventures for the purposes of the group ratios should follow generally accepted accounting practice.

19. In our view, the Group Ratio Rule should be calculated using EBITDA based on the group's consolidated accounts. At a practical level, it would not be possible for many worldwide groups to calculate EBITDA per entity around the world using tax adjusted values and then aggregate them. Such an approach would in most scenarios render the Group Ratio Rule inoperable.

20. We believe the definition of third-party borrowings for the purposes of the Group Ratio Rule in Irish law should be based on what is considered third-party external debt in a group's consolidated financial statements.

21. In the event that the exemption for financial undertakings is adopted into Irish law, we do not believe the financials relevant to such exempt undertakings need to be excluded from a group's consolidated financial accounts for the purposes of the operation of the group ratios, given financial undertakings are highly regulated and pose a lower BEPS risk.

Treating a notional local group as a single 'taxpayer'

22. We would recommend a new definition to be inserted into Irish law to determine the members of the notional local group. We would suggest that an entity must be both included in the consolidated financial statements of the ultimate parent and subject to corporation tax in Ireland in order to be included in the notional local group. However, the mechanical operation of the ILR amongst members of the notional local group could reflect existing group loss relief provisions.

23. We believe that membership of the notional local group approach should be optional for taxpayers. It is not uncommon for group companies to operate as separate business units or for commercial reasons some group companies may operate, and report separate to other group members within a group. Therefore, groups require the flexibility to decide which entities will form part of the notional local group.

24. In our view, it is not necessary to have a single company responsible for reporting information on behalf of the notional local group. We consider that an approach similar to that used under existing corporation tax group loss relief provisions could be adopted to the reporting requirements for members of a notional local group.

25. In the absence of fiscal consolidation, we believe that the ILR should be applied to the results of the notional local group based on normal consolidated accounting principles. To do otherwise and require the "unpicking" of intra-group transactions in our view would be unworkable. The administration involved in

carrying out effectively a “de-consolidation” of intragroup transactions would be overly burdensome and far outweigh any benefit.

26. The notional local group should have full discretion as to how any amounts are allocated between the various members of the group.

27. We believe section 422 TCA 1997, which provides a mechanism for group loss relief purposes to address circumstances where the surrendering company and the claimant company’s accounting periods do not coincide, could be adapted for the ILR provisions.

Other technical issues

28. In our view, more restricted reliefs should be used in priority to exceeding deductible interest or excess interest capacity which may be carried forward indefinitely. It would be important to ensure that any order of priority does not inadvertently result in excess interest capacity carried forward lapsing where relief might otherwise have been available.

4. Response to Questions in the Feedback Statement

We have responded to the consultation questions raised in the first Feedback Statement[7] on the ILR in the sections below to the extent that it has been possible within the short consultation time period.

4.1. Interaction between existing rules and ATAD ILR

Questions 1 & 2:
What, if any, limited adaptations of the existing legislation could be introduced in Finance Bill 2021, to assist in effectively integrating the ATAD ILR with existing domestic rules?
What, if any, further adaptations of the existing legislation could be considered in later Finance Bills?

While we firmly believe that a fundamental consolidation of Ireland's existing rules on interest deductibility is needed in parallel with the implementation of new ATAD compliant ILR in the tax code, we consider the following adaptations of the existing legislation should be introduced, at a minimum, in Finance Bill 2021 given thin capitalisation rules will effectively be introduced for the first time in Ireland on top of extremely complex existing interest deductibility measures.

Layering the ILR onto existing interest deductibility and anti-avoidance rules, for example, in sections 130 and 247/249 TCA 1997, will result in additional complexity in the corporate tax code. Therefore, the Institute recommends the following modifications to the existing tax legislation to help to integrate the ILR into domestic legislation without imposing significant additional complex rules on businesses, while maintaining the necessary protections for the corporate tax base.

These are:

- **Removing section 130 (2)(d)(iv) TCA 1997** which automatically treats interest paid on debt to a non-resident 75% group member as a distribution, which is not otherwise within the scope of section 130 measures that are targeted on debt with "equity type" characteristics. Consequently, **sections 130 (2B), 452, 452A and 845A TCA 1997** which provide for elections to override this automatic distribution treatment would no longer be relevant where distribution treatment no longer applies and therefore, should also be removed.

- Consideration should also be given to the **removal of section 130 (2)(d)(iii)(II) TCA 1997** as it is equally a measure that addresses the quantum of interest akin to thin capitalisation rules (rather than the purpose of the interest), which will now be addressed by the 30% EBITDA cap under the ATAD ILR.

[7] Department of Finance, ATAD Implementation – Article 4 Interest Limitation, Feedback Statement, December 2020

- In our view, the updated provisions in the corporate tax code should reflect a broad base for interest deduction against both trading and non-trading income, using the protection of the new 30% EBITDA ratio rule against base erosion risks and removing the existing interest restrictions within sections 247/249 TCA 1997. However, as the current intention of policymakers is to largely overlay the new ILR on top of Ireland's existing interest deductibility rules, the rules and conditions in **sections 247 and 249 TCA 1997 need to be modified** to address the impact of the recovery of capital and other rules as companies prepare to comply with the ATAD ILR**.**

    - For example, consideration should be given to **removing the requirement for a common director under section 247 (3)(b) TCA 1997**. ATAD does not require a similar condition for ILR and there is now an opportunity to simplify our existing rules.

    - **Section 247 (4E) TCA 1997** denies interest relief as a charge in respect of interest on an intra-group loan used to finance the purchase of certain assets from another group company. Consideration should be given to simplifying or removing this measure (similar to the proposed removal of section 840A below) as the ATAD ILR applies the limitation cap not only on interest and borrowing costs associated with third-party debt but also on financing costs associated with group debt.

    - The very broad scope of the application of the deemed recovery of capital rules in **section 249 TCA 1997** can mean common steps taken by companies to tidy up balance sheets of group companies and to simplify forecasting and monitoring compliance with an equivalent interest limitation rule, can trigger the deemed recovery of capital provisions in circumstances which are wholly unrelated to the borrowing in question. The impact of the recovery of capital rules in section 249 TCA 1997 on businesses as they prepare to comply with the ATAD ILR needs to be examined and we have set out further analysis of these issues in Appendix 1.

- Section 840A TCA 1997 is an anti-avoidance provision that denies a trading deduction for interest payable on intra-group borrowings which are used to acquire certain types of assets from a connected group company. We suggest **removing section 840A TCA 1997** as it can impact *bona fide* transactions and the ATAD ILR will in any case apply the limitation cap to both group and third-party borrowings.

- **Removing the interest expense from the scope of the 80% cap in section 291A TCA 1997**, as the interest will be subject to the 30% of EBITDA restriction under the ATAD ILR going forward.

<u>Further adaptations of existing legislation for consideration in later Finance Bills</u>
As previously stated, we believe a redesign of Ireland's corporation tax regime for deducting interest is necessary with the implementation of the ATAD ILR. In our

view, there should be an ambitious and targeted timeline for such a redesign. We recommend that the updated provisions in the Irish corporate tax code be ready for implementation in Finance Bill 2022 and they should reflect a broad base for interest deduction against both trading and non-trading income, using the protection of the new 30% EBITDA ratio rule against base erosion risks and removing the existing interest restrictions within sections 247/249 TCA 1997. Retaining two separate interest limitation regimes on a permanent basis could make Ireland very uncompetitive for inward investment, compared with other jurisdictions and is likely to increase the cost of borrowing for Irish businesses.

By comparison, both Germany and the UK operate straightforward EBITDA-based interest limitation regimes. However, as Ireland has differing rules for trading and non-trading activities, a legislative basis for claiming a tax deduction for interest arising in a non-trading context would need to be established within the Irish tax code, in conjunction with the full removal of section 247 TCA 1997, by incorporating a general test for permitting a deduction for interest expense that is incurred for a business or commercial purpose, similar to the German regime.

Targeted measures within existing legislation, such as bond-washing and the treatment of interest on capital gains, could be preserved by policymakers to address concerns regarding the removal of some measures contained within the existing tax code for the deductibility of interest.

Question 3:
Comments are invited on the possible seven step approach, including whether any other matters should be considered in the transposition process.

The concept of setting out how the ILR would be applied on a single company basis in seven clear steps in the Feedback Statement would appear to be acceptable. However, it is difficult to provide further detailed comments on the seven-step approach when a number of fundamental definitions contained within key steps remain undefined, such as, “relevant profits” and “relevant entity” in Step 4 relating to the meaning of “deductible interest equivalent” and what is meant by “portion of the exceeding borrowing costs of the relevant entity” for I in the calculation of EBITDA under Step 5.

4.2. Interest equivalent, exceeding borrowing costs, EBITDA - Steps 2 to 5

Question 4:
Comments are invited on the possible definition of 'interest equivalent'.

A detailed definition of borrowing costs is set out in ATAD, which includes costs 'economically equivalent to interest' and expenses incurred in connection with the raising of finance as defined in national law.[8]

It would be expected that in most cases symmetrical treatment would apply to expense payments and receipts so that an expense which is treated as 'deductible interest equivalent' in one company would be recognised as 'taxable interest equivalent' in the receiving company. In our view, the definition of 'interest equivalent' should consider the specific circumstances of the taxpayer as certain income/expenses may be 'economically equivalent to interest' for one taxpayer but this may not necessarily be the case for all taxpayers. This will, for example, be relevant when considering the position of leasing companies and the impact of IFRS 16 on the accounting treatment of leases. If leasing income is not treated as economically equivalent to interest, then leasing companies could be negatively impacted by the ILR.

Given the broad range of the type of income/expenses that could potentially be treated as economically equivalent to interest and the different circumstances of the taxpayer, it may be preferable to transpose the definition of 'borrowing costs' that is in the Directive to the greatest extent possible into Irish law rather than what is proposed as a definition of 'interest equivalent' in the Feedback Statement. Using a legislative definition that is more aligned with the meaning of borrowing costs in the Directive could be further supported by Revenue guidance regarding the scope of the terms.

For example, an area requiring further clarification would be foreign exchange movements and hedging agreements. The definition of 'borrowing costs' in the ATAD includes "…*notional interest amounts under derivative instruments or hedging arrangements related to an entity's borrowings, certain foreign exchange gains and losses on borrowings and instruments connected with the raising of finance*…"

We would suggest that foreign exchange movements on loan principal, as well as foreign exchange movements on hedging instruments that do not arise directly on the interest rate, should not fall within the meaning of 'borrowing costs'. This is on the basis that such foreign exchange movements arise on the borrowing itself, for example on the translation of a foreign currency denominated outstanding loan principal amount into the functional currency of the taxpayer as opposed to on the cost of the borrowing (i.e., the interest on a loan). Ireland's corporation tax regime does not treat foreign exchange gains and losses on borrowings in the same manner as interest expense. Excluding currency risks from the scope of the ILR would be

[8] Article 2(1) ATAD

consistent with the scope of such costs recommended by the OECD and adopted under ATAD.

Careful consideration also needs to be given to the meaning of interest equivalent in the context of Case I traders providing credit, for example, on consumer goods which is part of their core trading activity or in the case of treasury companies. Often it can be challenging to differentiate between the definition and legal definition of the interest and principal components relating to the fair value movements on such loan books, fluctuating up and down. In fact, it could prove an impossible tax calculation each year if such movements are not fully regarded as equivalent to interest because the required analysis of the legal character of the amounts in question to distinguish between what constitutes interest versus principal would not be readily available.

The implications of IFRS 16 on the treatment for the right of use of assets should also be considered from a lessee perspective.

Question 5:
Comments are invited on the possible definitions of ‘taxable interest equivalent’ and ‘deductible interest equivalent’.

Question 6:
Comments are invited on the possible definitions of *‘exceeding borrowing costs’* and ‘*exceeding deductible interest equivalent’*.

The meaning of ‘relevant profits’ and ‘relevant entity’ have not been set out in the Feedback Statement. These terms fundamentally underpin the definitions of ‘taxable interest equivalent’, ‘deductible interest equivalent’, ‘exceeding borrowing costs’ and ‘exceeding deductible interest equivalent’. Therefore, it is not possible to comment on these four possible definitions and the overall approach that is to be adopted for the implementation of the ILR, without having a full understanding of all relevant terms contained in the proposed definitions.

Furthermore, the proposed definition of ‘deductible interest equivalent’ provides that no amount shall be treated as deductible where it reduces the relevant profits below zero or alternatively, where it reduces the tax chargeable below zero. We understand from discussions at TALC that there may be drafting errors in this particular section, however, careful consideration is needed to ensure that the definition of ‘deductible interest equivalent’ does not inadvertently create a charge resulting in a tax liability in a year in which there are losses available.

Given the potential impact of these definitions on the operation of the ILR, it is essential that an opportunity for further consultation with businesses and stakeholders is provided to review the draft legislation in its totality to ensure that there are no unintended consequences when the provisions are applied in practice.

Question 7:
Comments are invited on the possible definition of 'EBITDA'.

The Feedback Statement puts forward a proposed definition of EBITDA to be reflected in Irish tax legislation. Central to understanding the scope of the proposed definition is the meaning of 'relevant profits' and 'relevant entity' which are intrinsic parts of the suggested formula. However, as the meaning of these key terms has not yet been confirmed in the Feedback Statement, the starting point for calculating the EBITDA of an entity remains unclear.

We note that 'I' in the proposed formula for calculating EBITDA refers to *"the portion of the exceeding borrowing costs of the relevant entity that is referable to exceeding deductible interest equivalent referred to in paragraph (a)(i) and (ii)"*. We do not fully understand what is meant by the phrase 'the portion of' in this context and we would welcome further clarification on this. Furthermore, it is not evident how to take account of circumstances where capital allowances have been disclaimed.

The Feedback Statement notes that tax exempt income is to be excluded from 'EBITDA'. As outlined in our response to the *Consultation on ATAD Implementation – Hybrids and Interest Limitation*[9], it is important, in our view, that foreign dividends that remain subject to corporation tax in Ireland should be included in EBITDA. As Ireland is a small economy, Irish outbound groups may generate relatively low levels of EBITDA from the Irish market but would have substantive headquarter activities in the State. These companies may have to bear some of the burden of interest expense associated with their international expansion and could be disproportionately impacted if such foreign dividends are not included when measuring its EBITDA.

When considering how to reflect EBITDA in Irish tax legislation policymakers also need to be cognisant of the impact of any move to a more territorial regime, as signalled in the recent updated Corporation Tax Roadmap[10], and the potential expansion of the class of tax-exempt dividends to be excluded from the measure of EBITDA, if a foreign dividend regime is introduced. The importance of considering the entire Irish corporate tax system and its future direction cannot be underestimated, as each of these developments are inextricably interlinked.

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[9] Irish Tax Institute Response to the Department of Finance Consultation on ATAD Implementation – Hybrids and Interest Limitation, January 2019.

[10] Ireland's Corporation Tax Roadmap January 2021 Update.

4.3. Applying the ILR to a single company – Step 6

Question 8:
Comments are invited on the possible approach to the operation of the ILR.

The Feedback Statement notes that as the ILR is designed to be a deferral of deductibility, rather than a prohibition on deductibility, it should not alter any other relief claimed by the company in the period, other than reliefs in respect of an amount of interest equivalent. It is important to note that the ILR restriction can prove to be a permanent denial of interest expense (not a deferral) and the feedback from our members suggests that this has often been the practical impact of the application of the ILR for many groups in the UK.

It is also worth noting that the implementation of the ILR could likely lead to an immediate increase in the effective tax rate for companies from an accounting perspective if the rules and exceptions are too narrowly drawn and create uncertainty that they can record a deferred tax asset. This could negatively impact key performance measures, such as earnings per share, return on capital employed and payback periods that are important to the market valuation of publicly traded Irish companies and their investment decisions.

The approach to the operation of the ILR under Step 6 proposes to treat the 'excess amount' of interest as income chargeable to corporation tax under Case IV against which no loss, deficit, expense or allowance may be set off. This puts this 'excess amount', into another category of income from Case I to Case IV, creating further complication. After all, interest is an economic cost of doing business. This approach is effectively treating the imposition of the limitation as a clawback of relief, which is introducing more complexity to the transposition of the ATAD ILR into Irish law.

Careful implementation is required to ensure that by treating the 'excess amount' of interest as income under Case IV rather than under Case I that a cash-tax charge does not arise which would otherwise have been subject to relief from corporation tax because of available losses.

4.4. Carry forward/back options – Step 7

Questions 9 & 10:
Comments are invited on the possible approach to carrying forward non-deductible 'exceeding borrowing costs' and the possible approach to carrying forward 'excess interest capacity'.

Three policy options are set out in ATAD for the carry forward of unutilised interest relief by a taxpayer. EU Member States must choose which of the three options to implement.[11]

The three options are:

(a) to carry forward, without time limitation, exceeding borrowing costs which cannot be deducted in the current tax period; or

(b) to carry forward, without time limitation, and back, for a maximum of three years, exceeding borrowing costs which cannot be deducted in the current tax period; or

(c) to carry forward, without time limitation, exceeding borrowing costs and, for a maximum of five years, unused interest capacity, which cannot be deducted in the current tax period.

The Feedback Statement confirms that Irish policymakers intend to elect for Option C (i.e., to permit the indefinite carry forward of interest that cannot be deducted under the fixed ratio rule in the current period and the carry forward, for a maximum period of five years of unused interest capacity) in recognition of the views expressed by stakeholders up to now. The Institute had recommended the implementation of Option C into Irish legislation in response to the 2019 consultation on ATAD ILR and maintains that position.

The proposed methodology for implementing Option C is that unused interest deductions will be carried forward as an interest tax credit equal to the Case IV tax charge imposed under Step 6. Excess interest capacity is to be carried forward as unused interest capacity less four times the carried forward interest tax credits claimed in that period.

We believe that careful implementation is necessary to ensure that these carry forward provisions operate as intended and in alignment with ATAD. Tax certainty is critical for businesses and if the carry forward provisions lead to unexpected outcomes this could impact an entity's key performance metrics including its effective tax rate, earnings per share and return on capital employed that are all relevant to the investment decisions. Ongoing collaboration with stakeholders would ensure that the potential mechanical issues in the operation of the provisions can be addressed prior to implementation. For instance, it would be important to ensure that relief is provided at the appropriate time and that the use of the credit-based

[11] Article 4(6) Council Directive EU 2016/1164 of 12 July 2016 laying down the rules against tax avoidance practices that directly affect the functioning of the internal market ("ATAD").

approach to the carry forward does not result in unused interest capacity expiring where it would have been available for use if a deduction-based system had been used.

The use of a credit-based approach rather than a deduction-based approach also raises questions around the use of losses. For example, how will the carry back of losses be addressed and will it be necessary to recalculate EBITDA?

4.5. ATAD exemptions

Question 11:
Comments are invited on the possible approach to the *de minimis* exemption, and on the potential need for anti-avoidance provisions to accompany such an exemption.

Under ATAD, EU Member States can allow a taxpayer to deduct their net interest costs (i.e., exceeding borrowing costs) in full, where the exceeding borrowing costs do not exceed a *de minimis* threshold of up to €3 million. We welcome the proposal that Ireland's ILR provisions will include a *de minimis* amount of €3 million, however, it would be important to have further clarity regarding how the rules regarding the *de minimis* will operate in practice.

It would appear from the definition of 'exceeding deductible interest equivalent' in paragraph 5.2 of the Feedback Statement that the *de minimis* is treated as an exemption and is deducted from interest expense in arriving at exceeding deductible interest equivalent, while ATAD states that a taxpayer may deduct exceeding borrowing costs up to €3 million. Further clarification is needed on the suggested approach to the *de minimis,* as set out in the Feedback Statement, to fully understand the knock-on impact on the excess capacity available for carry forward.[12]

In the absence of a fiscal consolidation system in Ireland, a methodology for how the *de minimis* amount will be treated among group members will need to be devised when extending the ILR provisions beyond a single entity basis to groups. The methodology devised should be simple, as it is intended to provide an exclusion from these rules for small or medium size businesses.

Question 12:
Comments are invited on the possible definitions, including how single companies not coming within the ATAD definition of 'standalone entity' could be treated.

The Feedback Statement proposes a 'standalone entity' to be defined as meaning "*a company which under section 26(1) is chargeable to corporation tax on all of its profits, wherever arising and that —*

(a) is not a member of a worldwide group,
(b) has no associated enterprises, and
(c) does not have a permanent establishment in a territory other than the State."

Given all profits of an entity must be chargeable to corporation tax according to the proposed definition for a standalone entity, as drafted in the Feedback Statement, the receipt of franked investment income (which is not within the charge to

[12] Paragraph 7.2 of the Feedback Statement.

corporation tax) would result in such an entity not meeting the definition to qualify for the exemption from the interest limitation, even though it would not be a member of a worldwide group nor have any associated enterprises, as defined.

The proposed definition of 'associated enterprise' in the Feedback Statement is broader than what is provided in Article 2 (4) of ATAD, as it includes persons who 'act together' and enterprises with significant influence over the management of another enterprise. ATAD only applies an 'acting together' test and 'significant influence' test for an associated enterprise within the scope of the anti-hybrid rules and not for any of the other ATAD measures. Therefore, we recommend that the definition of 'associated enterprise' for the purpose of ILR is amended accordingly to remove these two additional tests from the definition of an associated enterprise for ILR purposes.

A single entity that does not come within the strict ATAD definition of a 'standalone entity' should be allowed to avail of the group ratio reliefs, because it should be possible for such an entity to obtain relief with respect to true third-party debt, given ATAD recognises that "*BEPS in principle takes place through excessive interest payments among entities which are associated enterprises.*"[13]

Question 13:
Comments are invited on how Ireland might implement ATAD Articles 2(10) and 4(8), having regard to the different accounting standards and State Aid rules.

The Feedback Statement proposes to define 'worldwide group' as meaning *"the ultimate parent and all entities that are fully included in the ultimate consolidated financial statements, and a "member of a worldwide group" shall be construed accordingly".* The definition of 'ultimate parent' refers to entities which prepare consolidated financial statements under generally accepted accounting practice or international accounting standards.

We note that the meaning of the terms 'generally accepted accounting practice' and 'international accounting standards' are defined in section 4 TCA 1997 (and referred to in section 76A and Schedule 17A TCA 1997) which in turn refers to FRS and IFRS (as it applies in Ireland).

In the context of implementing Article 4 (8) of ATAD and where worldwide group exceptions apply under the ILR, the measures could refer to group consolidated financial statements drawn up under IFRS and FRS, as well as equivalent accounting standards. In setting the standard of equivalence, we suggest that Ireland accepts as equivalent those standards which are considered to be equivalent under Irish company law and EU regulation.[14] In fact, Germany and France recognise USA GAAP as equivalent.

[13] Recital 8 of ATAD,
[14] Section 300 (4) Companies Act 2014 / Article 35 EU Commission Regulation 809/2004.

Question 14:
While 'standalone entities' generally present a low risk of BEPS, the OECD notes that, in certain cases, they may be large entities held under complex holding structures involving trusts or partnerships, meaning that a number of apparently unrelated entities are in fact controlled by the same investors. What is your assessment of how the ILR could apply to such entities?

The proposed definition of a 'standalone entity' requires that such a company has no associated enterprises. Under Irish company law, it is not possible to establish a company with no shareholder. Consequently, the only way to establish a 'standalone entity' under Irish law is to use a nominee shareholder who holds the shares on trust but has no beneficial or economic interest in the company. As a result, the company which holds the shares on trust might be an associated enterprise even though the company may have no economic participation in the orphan entity.

We consider that the associated enterprises requirement could be modified, using a *bona fide* clause, to ensure that a 'standalone entity' is defined in a manner that will work in practice and takes account of entities that are legally remote.

Question 15:
Comments are invited on the approaches to defining and exempting *"legacy debt"* and more generally on the concept of a *'modification'* in the context of legacy loans.

ATAD[15] provides that EU Member States may exclude loans that were concluded before 17 June 2016 from the scope of the ILR. It is welcome that the exemption for pre-existing legacy debt will be adopted into Irish legislation. In the Feedback Statement, it is proposed that 'legacy debt' will be defined as a security, within the meaning of section 135 (8) TCA 1997. The requirement to define legacy debt by reference to section 135 (8) is unclear given the ATAD refers to loans. It would be preferable to align with the Directive.

It is likely that there will be facilities which were in place prior to 17 June 2016 in respect of which funds will have been drawn down both before and after this date. Clarity will be required regarding the operation of the ILR provisions in such circumstances, for example, whether the FIFO or LIFO method should be applied to the principal drawn down at a point in time.

The exclusion for 'legacy debt' does not include any expenditure arising from a modification of that loan.[16] Given the importance of the concept of 'modification' it would be important that Revenue guidance provides clarification, using practical examples, as to how this concept will be applied in practice. For example, we

[15] Article 4 (4)(a) of ATAD.
[16] Article 4 (4)(a) of ATAD.

consider that changes to the terms of a loan that are immaterial should not be considered a modification for the purposes of the exclusion. With consultation, it may be possible to develop a clear set of rules to address with certainty when a loan no longer qualifies for the exclusion.

We welcome the confirmation in the Feedback Statement that a loan entered into before 17 June 2016 would not be regarded as having been modified, and the ILR would not apply, in circumstances where, as a result of benchmark reform and/or withdrawal, it is necessary to replace the reference rate on the loan with a comparable benchmark. It is intended that this will address loans modified as a result of the phase out of LIBOR. It would be helpful for businesses to understand how it is intended to incorporate this proviso into the legislation.

Question 16:
Comments are invited on potential approaches to the criteria relevant to the *'long-term public infrastructure project'* exemption.

Article 4 (4)(b) of ATAD provides that EU Member States may exclude both the income and associated expenses of certain 'long-term public infrastructure projects' from the scope of the interest limitation, on the grounds that they present little or no BEPS risks. A 'long-term public infrastructure project' is defined as *"a project to provide, upgrade, operate and/or maintain a large-scale asset that is considered in the general public interest by a Member State".* The Feedback Statement states that policymakers propose to consider this exemption and possible approaches to specifying the relevant criteria in the second stage of the development of the ILR.

As outlined in our response to the Consultation on *ATAD Implementation – Hybrids and Interest Limitation*[17], in our view, the legislation should include an exclusion from the application of the ILR to loans used to fund long-term public infrastructure projects. Generally, long-term infrastructure investment by companies can result in increased growth and employment and the interest costs associated with that investment are often simply costs incurred for expanding a business and are not tax motivated.

We suggest that a broad base approach to the definition of public infrastructure should be adopted and it should not be limited to public private partnership projects. There are a whole range of projects which should be considered long-term infrastructure projects for the general public interest, e.g., utilities, broadband, hospitals etc. Any definition should be flexible enough to adapt to changing social policy objectives. For example, given the ongoing housing crisis, it may be appropriate to consider social housing projects which satisfy certain conditions as public infrastructure. Certainty could be provided in relation to the scope of the definition of public infrastructure by publishing lists which could be updated periodically, as required, to reflect changing social policy objectives.

[17] Irish Tax Institute Response to the Department of Finance Consultation on ATAD Implementation – Hybrids and Interest Limitation, January 2019.

Projects should be considered for the general public interest irrespective of whether they are privately owned or whether a fee is charged to the public for their use. In addition, ATAD is clear that the project may be located in any EU Member State and is not confined to Ireland. This should also be reflected in the domestic provisions.

Question 17:
Comments are invited on the exemption generally and the possible definition of *'financial undertaking'*.

ATAD[18] provides that EU Member States may exempt certain 'financial undertakings'[19] from the ILR. As outlined in the Institute's previous response to the *Consultation on ATAD Implementation – Hybrids and Interest Limitation* in January 2019, in our view, groups containing financial undertakings should be exempt from the ILR, given the regulatory capital and solvency requirements that apply on a consolidated basis to the entire group. If it is not possible to extend the exemption for financial undertakings to an entire group, it would be important that any exemption for financial undertakings adopted into Irish legislation would be optional for the taxpayer.

Failure to provide an opt-in clause could result in groups containing financial undertakings being adversely impacted from an automatic exclusion of the financial undertaking from the ILR. Indeed, complexities are likely to arise if a financial undertaking is part of a worldwide group and is required to be excluded from the consolidated accounts for the purposes of the ILR on the basis that it is an exempt undertaking.

[18] Article 4(7) ATAD
[19] Within the meaning of Article 2(1) ATAD

4.6. Providing "group ratios"

Question 18:
If Ireland were to provide only one of the two "group ratios", which would be preferred?

The Feedback Statement states that consideration is being given to providing for both "group ratios" (i.e., the Equity Ratio Rule and the Group Ratio Rule) and allowing the choice of ratio to be at the discretion of the taxpayer. As ATAD gives the taxpayer (rather than the EU Member State) the option to choose between either of the two group ratio rules[20], it is our view that Ireland should adopt both group ratio methodologies.

The Feedback Statement queries which group ratio would be preferred if Ireland were to provide only one of the two group ratios. Companies, depending on their industry, may require different amounts of leverage and therefore may prefer one rule to the other. In our view it is not possible to express a preference that has consensus among our members given the differentiated nature of companies which could be wholly domestic businesses, Irish headquartered with an international outbound strategy or foreign direct investment. We believe ATAD allows for both methods and Ireland as a small competitive economy should maximise the optionality provided.

Question 19:
Noting that the same definition of 'worldwide group' applies for the "group ratios" and the definition of 'standalone entities', does that alter your response to Question 12 above? Also, how could entities such as joint ventures be treated for the purpose of the "group ratios"?

The use of the same definition of 'worldwide group' for the 'group ratios' and the definition of a 'standalone entity' does not alter our response to Question 12 or 13 of the Feedback Statement. It is our view that the rules regarding the treatment of entities, such as, joint ventures must follow generally accepted accounting practice. Otherwise, there is a risk that the provisions would become overly complex resulting in the group ratios being rendered inoperable.

[20] Article 4(5) ATAD

Question 20:
Technical analyses as to whether the "Group Ratio Rule" (third-party interest divided by EBITDA) should be calculated based on the group's consolidated accounts or using tax adjusted values. Taking account of the provisions of ATAD Article 4(5)(b), how could this aspect of the "Group Ratio Rule" be designed?

The purpose of the two possible modifications to the fixed ratio rule under the "group ratios" in ATAD is to mitigate the impact from the application of a one-size fits all fixed ratio to all interest and to allow a deduction for higher interest to a company by reference to the commercial position of the wider group.

Having reviewed the wording of ATAD, we believe it is clear the Group Ratio Rule should be calculated using EBITDA based on the group's consolidated accounts. This position is supported by commentary contained in the OECD BEPS Action 4 – 2016 Update.[21]

It is our understanding that the definition of EBITDA set out in Article 4(2) ATAD, which requires the use of tax-adjusted amounts, is for calculating local Member State EBITDA for the purpose of the 30% interest restriction calculation in Article 4(1). We believe the definition is not relevant for the purpose of the Group Ratio Rule. Article 4(5)(b)(i) refers to the "EBITDA of the group" whereas in subparagraph (ii) the reference is to "EBITDA of the taxpayer calculated pursuant to paragraph 2". It is evident from this wording that there is a distinction between the EBITDA being referred to in subparagraph (i) and subparagraph (ii) of Article 4(5)(b).

If the EBITDA definition in paragraph 4(2) had been intended to apply to the entirety of Article 4 it would not have been necessary to have included the words *"calculated pursuant to paragraph 2"* in subparagraph (ii) of Article 4(5)(b). These words are specifically included in subparagraph (ii) and specifically not included in subparagraph (i). It makes sense to bring in the Article 4(2) definition into subparagraph (ii) of Article 4(5)(b) because it involves a Member State only calculation. Equally it makes sense that the Article 4(2) definition was not brought into subparagraph (i) of Article 4(5)(b) because it involves a global calculation.

In our view, the commentary in the OECD BEPS Action 4 – 2016 Update clearly envisages that the EBITDA used for the purposes of the group earnings ratio will be based on a group's consolidated financial statements. The commentary notes that "*Consolidated financial statements provide the most reliable source of financial information on a worldwide group. Therefore, where possible, the group information required to apply a group ratio rule should be taken from a group's consolidated financial statements*."

[21] OECD (2017), Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 - 2016 Update: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. See paragraphs 121 to 130.

It also notes that "*The first stage in applying the group ratio rule is to calculate the worldwide group's net third party interest/EBITDA ratio. To ensure that a rule is as straightforward as possible for a group to apply and for tax authorities to audit, this should be based on information which can be obtained from the group's consolidated financial statements*."

EBITDA based on a group's consolidated financial statements, which are independently audited, will eliminate intra-group transactions and, in our view, represents a reasonable approximation for locally tax-adjusted figures. While differences may arise, as compared to what might have been if the EBITDA were calculated using tax-adjusted values on an entity-by-entity basis, these differences will largely in any case be attributable to timing differences and over time cancel out.

At a practical level, it would not be possible for many worldwide groups to calculate EBITDA per entity around the world using tax-adjusted values and then aggregate them. Such an approach would in most scenarios render the Group Ratio Rule unworkable, which would seem inconsistent with the policy intention of ATAD to allow safe harbours in the form of two worldwide group-based reliefs. The administrative work to achieve this would be disproportionate and arguably in practice could be considered discriminatory for EU headquartered groups to operate compared with Irish wholly owned groups.

As previously stated, where worldwide group exceptions apply under the ILR, the measures could refer to group consolidated financial statements drawn up under IFRS and FRS, as well as those accounting standards which are regarded as equivalent under Irish company law and EU regulation.[22] In fact, Germany and France recognise USA GAAP as equivalent.

Question 21:
How might third-party borrowings be defined for the purpose of the "Group Ratio Rule"? Should it be borrowings excluding amounts borrowed from other members of the 'worldwide group'? Taking account of the definition of 'standalone entity' which recognises that BEPS can occur between 'associates', should it also exclude borrowings with 'associates? Accounting standards require that transactions with related parties are disclosed: should borrowings with a related party be excluded?

ATAD does not define third-party borrowings for the purpose of the Group Ratio Rule. However, the OECD BEPS Action 4 – 2016 Update recommends that when calculating a group's net third-party interest/EBITDA ratio, net third-party interest expense should be based on a group's financial consolidated financial statements.[23] It suggests that a country may address the risk that third-party interest expense may be inflated by interest paid to related parties outside the group by using targeted

[22] Section 300 (4) Companies Act 2014 / Article 35 EU Commission Regulation 809/2004.
[23] OECD (2017), Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 - 2016 Update: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. Paragraph 138.

rules to ensure that these payments are not used to reduce the effectiveness of the group ratio rule in tackling base erosion and profit shifting.[24]

In our view, the definition of third-party borrowings for the purpose of the Group Ratio Rule in Irish law should simply be based on what is considered third-party external debt in a group's consolidated financial statements. As Ireland has already acknowledged that our national targeted rules on interest deductibility are at least equally effective to the rules contained in ATAD, we do not believe it is necessary to introduce further complexity by excluding borrowings with a related party for the purposes of the Group Ratio Rule.

Question 22:
How would the application of "group ratios" work, in practical terms, where an exempt 'financial undertaking' is a member of a 'worldwide group'?

Having to exclude an exempt financial undertaking from a group's consolidated accounts would be extremely complicated and, in our view, unnecessary. As financial undertakings are highly regulated entities, there is a reduced risk of base erosion arising from excessive interest deductions. Therefore, given that financial undertakings themselves are low risk, we do not believe that the financials relevant to such exempt undertakings in a group's consolidated financial accounts for the purposes of the operation of the group ratios is problematic or gives rise to any additional risk.

[24] OECD (2017), Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 - 2016 Update: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. Paragraphs 140.

4.7. Treating a notional local group as a single 'taxpayer'

Question 23:
Comments on the possible definitions of notional local group (including how consortia and joint ventures should be treated).
In particular:

- **How should the notional local group be defined? Should it be based on an existing definition (such as that used for group loss relief) or be a new definition?**
- **If a new definition is adopted, are there issues relating to the interaction of a new notional local group for ILR purposes and existing group reliefs?**
- **Does the way in which the notional local group is defined impact on your views on any of the other issues raised in respect of local groups?**
- **What considerations should be given to the operation of the two "group ratios" where the notional local group approach is adopted? For example, it is relatively easy for a single company to compare its balance sheet to the group consolidated balance sheet, in order to calculate if relief is available under the "Equity Ratio Rule. But what difficulties might a notional local group encounter in carrying out that comparison, particularly where it does not prepare local audited consolidated accounts?**

The Feedback Statement queries whether the definition of the notional local group for the purposes of the ILR rules could be based on the existing definition for corporation tax group loss relief. Based on feedback from our members and their experience, we would suggest that a new definition is inserted into Irish law to determine the members of the notional local group by reference to the consolidated financial statements.

Given a consolidated group for financial accounting purposes needs to be considered for the purposes of the definition of a standalone entity, and the group ratio options under the ILR provisions, we would recommend that the membership of the notional local group could be similarly aligned. In this context, we would suggest that an entity must be both included in the consolidated financial statements of the ultimate parent and subject to corporation tax in Ireland in order to be included in the notional local group. This would include both Irish resident companies, currently taxable on their worldwide income, as well as non-resident companies who are engaged in the conduct of a trade in Ireland through a branch or agency. Indeed, the UK applies their interest limitation rules to all UK companies in a consolidated group as defined for IFRS purposes.

Whilst it may be appropriate to adopt a new definition to determine the members of the notional local group, we would recommend that, the mechanical operation of the ILR amongst members of the notional local group could reflect existing measures used for the purposes of group loss relief, for instance, the tax adjusted profits and losses of each group member are computed on a single entity basis. Surrenders and claims for loss relief are made between group members. The loss relief adjustments

are reflected in the final tax adjusted position of the individual group member for the period. In our view, a similar approach could be adopted to the surrender and claiming of excess interest capacity and amounts carried forward.

Q.24: Where an optional "group approach" is provided, the following questions arise:

- **Should a group election be irrevocable or for a finite period only?**
- **What is the best way to manage carried forward amounts held both prior to the formation of the group and immediately before the cessation of the group?**
- **What type of anti-fragmentation rules, if any, might be required?**

Q.25: Would a mandatory but less complex "group approach" be preferable to an optional "group approach"?

We consider that the group approach should be optional. For commercial reasons some groups may operate, and report separate to other group members and therefore groups require the flexibility to decide which entities will form part of the notional local group. We do not believe that a mandatory group approach would be preferable to an optional group approach.

We do not believe that an election should be irrevocable, and consideration should be given to the changes in the facts and circumstances of the group, including change of control and the possibility that the election should be effective but renewable for a defined period.

If a company joins or leaves the group during an accounting period, an adjustment would be required on a time apportioned basis in a similar manner to that which applies for group loss relief.

We do not believe that an anti-fragmentation rule would be required.

Q.26: Is it practical to make a single company responsible for reporting information to Revenue on behalf of the notional local group and allocating amounts (including excess interest capacity and amounts carried forward) among group members?
If so, the following questions arise:

- **What criteria should be used to determine the reporting company?**
- **How should changes in group structures that alter the position of a reporting company in a group (mergers, acquisitions etc.) be managed?**
- **What information should be returned to Revenue by the reporting company?**
- **Should any information be reported at an entity level?**
- **Is there an alternate manner in which information reporting should be dealt with?**

In our view, and in the absence of fiscal consolidation, it is not necessary to have a single company responsible for reporting information on behalf of the notional local group. Such an approach would represent a change from the existing entity-based approach to filing corporation tax returns in Ireland.

We consider that an approach similar to that used under existing corporation tax group loss relief provisions could be adopted to the reporting requirements for members of a notional local group.

For the purposes of the group loss relief provisions, while surrenders and offset claims for loss relief are made between group members, the tax adjusted profits and losses of each group member are computed on a single entity basis and each entity carries forward its own tax attributes.

In our view, a similar approach could be adopted to the surrender and claiming of excess interest capacity and amounts carried forward by members of the notional local group. We believe it should be possible to capture all necessary information for the purposes of surrender and claims of excess interest capacity and amounts carried forward on the corporation tax returns filed by each entity of the notional local group.

Q.27: How should intragroup transactions be treated for the purpose of calculating the consolidated *'EBITDA'* and *'exceeding borrowing costs'* of the notional local group?
ATAD Article 4(1) provides that the results of the notional local group should "comprise the results of all its members". Should the ILR be applied to the notional local group by reference to the amalgamated results of its members, or by reference to the results of the group having disregarded all intragroup transactions (akin to how an accounting consolidation is prepared)?

We believe the ILR should be applied to the results of the notional local group based on normal consolidated accounting principles. In our view, having to "unpick" intra-

group transactions would be unworkable for the purpose of calculating the consolidated ‘EBITDA’ and ‘exceeding borrowing costs’ of the notional local group. The administration involved in carrying out effectively a “de-consolidation” of intra-group transactions would be overly burdensome and far outweigh any benefit and, in any case, over time these transactions would likely unwind. A simpler aggregation of results would be preferable.

Question 28:
How should ILR restrictions be allocated among members of the notional local group? In particular:

- **How should the notional local group allocate its exceeding deductible interest to the members of the group?**
- **What should happen in scenarios where the notional local group as a whole has negative EBITDA but some of its members have positive EBITDA?**
- **How should excess interest capacity carried forward and/or deductible interest carried forward be operated in a notional local group scenario – should these amounts be carried at an entity or a group level?**
- **How should the charge be dealt with when applying the ILR to a notional local group? For example, should it be applied at the head of the group or at entity level?**
- **How should changes in membership of the notional local group be dealt with?**

As outlined in our response to Question 26, a similar approach to that which exists for group loss relief could be adopted to the surrender and claiming of excess interest capacity and amounts carried forward, at an entity level rather than at a group level. The notional local group should have full discretion as to how any amounts are allocated between the various members of the group.

We would suggest that EBITDA should be computed for a notional local group by firstly computing EBITDA for each single group member. Where the result is a negative figure (loss) for the single group member, the negative EBITDA amount can be added to the positive EBITDA amounts of other group members to arrive at an overall group net EBITDA amount for the local group.

If the notional local group has an overall negative EBITDA figure, we suggest that the EBIDTA for the period is treated as nil. The local group should still be entitled to avail of the *de minimis* threshold for the period. The OECD has noted that a profitable entity within a group with an overall negative EBITDA is still making a positive contribution to the group’s results, which should be recognised. In such a scenario it states that under the best practice approach an entity with positive EBITDA which is part of a loss-making group could receive interest capacity equal to

the lower of the entity's actual net interest expense and the net third-party interest expense of the group.[25]

Where members join or leave the notional local group during an accounting period then an adjustment should be made on a time apportioned basis.

Question 29:
Would the answers to Question 28 be different for mandatory application of the "group approach" versus optional?

For commercial reasons, groups require the flexibility to decide which entities will form part of the notional local group. Therefore, as outlined in our response to Questions 24 and 25, we consider that the group approach should be optional.

Question 30:
Where there are different accounting period end dates throughout the group, what approach should be taken to standardise and apportion group transfers of '*exceeding borrowing costs* and interest capacity?

Policymakers could consider adapting the provisions contained in section 422 TCA 1997 for the ILR provisions. This section provides a mechanism for group loss relief purposes to address circumstances where the surrendering company and the claimant company's accounting periods do not coincide.

4.8. Other technical issues

Question 31:
There are provisions throughout the Tax Acts which provide for the order in which certain reliefs are deemed to be used, such as in section 403 TCA 1997. How should the interaction of the ILR and such rules be dealt with?

More restricted reliefs, such as losses under section 403 TCA 1997 or foreign tax credits, should be used in priority to exceeding deductible interest or excess interest capacity which may be carried forward indefinitely. It would be important to ensure that any order of priority does not inadvertently result in excess interest capacity carried forward lapsing where relief might otherwise have been available.

[25] OECD (2017), Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 - 2016 Update: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. See paragraph 152.

Appendix 1

Further details on the impact of the provisions of sections 247 and 249 TCA 1997 as businesses prepare for the implementation of the ATAD ILR

Section 247 TCA 1997 provides relief under interest as a charge provisions for qualifying borrowings which are used to acquire shareholdings in trading companies.

Several limitations apply to these measures and they are also subject to the extensive recovery of capital provisions that apply under section 249 TCA 1997 and corresponding anti-avoidance measures.

The qualifying loan conditions under section 247(3) TCA 1997 which must be satisfied, not only at the time of drawdown of the borrowing but throughout the period that interest is paid on the loan are:

a) when the interest is paid, the investing company must have a material interest in the company, or where the loan is on-lent and used by a company connected with the company, in the company and the connected company,
b) during the period taken as a whole, from applying the loan to the time when the interest was paid, at least one director of the investing company was also a director of the company or, where the loan is on-lent and used by a company connected with the other company, in the company and the connected company,
c) during that period the investing company did not recover any capital from the company or from a connected company, apart from any amount taken into account under section 249.

The section 249 measures are essentially anti-avoidance measures which disallow or restrict interest relief available to a borrower company under section 247 where the borrower company has, or is deemed to have, recovered capital from the company in which the borrowings are invested or a connected company, without using the capital recovered to reduce the loan in respect of which relief is claimed.

If the borrower company recovers or is deemed to recover an amount of capital which is not used to repay the qualifying 247 borrowing, the borrower company is deemed to have repaid an amount of the qualifying borrowing which is equivalent to the recovered capital amount. This means that a corresponding amount of otherwise deductible interest expense paid is restricted on the borrowing and a deduction is denied for the restricted interest paid.

The measures apply not just to actual recoveries of capital by the borrower company from the investee company but also to several deemed recovery of capital events which can include:

- The assignment of connected party debt (even if the debt is wholly unrelated to the qualifying borrowing of the borrowing company or the investment made because of the deployment of the proceeds of the qualifying loan).
- The settlement of debt amounts.
- Recovery of capital arising to subsidiaries in an underlying holding chain of companies, apart from certain circumstances where permitted exclusions are available for capital recoveries resulting from the liquidation or unwinding of intermediate companies in the holding chain which have been undertaken for bona fide commercial purposes.

In general, the way corporate groups comply with earnings stripping measures in other countries is to ensure that the largest borrowers in their group manage their debt levels and forecasted interest costs during the taxable period so as not to exceed 30% of EBITDA. It is normal for groups to endeavour to reduce the risk of exceeding the 30% of EBITDA ceiling where the group overall has debt levels and interest expense within that ceiling. It is typical for these groups to attempt to mitigate any excess interest limitation amount in the period in order to minimise the uncertainties arising from potential reliance on reliefs.

The Feedback Statement proposes the effective carry forward of non-deductible interest (i.e., exceeding borrowing costs) which is similar to the design of measures enacted internationally (as well as those in ATAD) which include provisions to carry forward excess disallowed expenses in one period to future periods. However, as there is always uncertainty surrounding the capacity of the group to use these reliefs in the future (for example, the impact of the COVID-19 pandemic), failure to deduct the disallowed expense can mean an unexpected increase in the effective tax rate of the group for the period. However, this effect could be immediate on the key performance metrics of a company if there is sufficient uncertainty over the probable use of the interest credit thus preventing the recording of a deferred tax asset. A deviation from expected results for the period can affect the perceived performance of the company from the perspective of its shareholders, debt investors and the markets.

In practice, and for bona fide commercial reasons, groups will focus on minimising the risks arising from unforeseen excess interest amounts. Groups operating in Ireland will need to restructure existing debt flows. To do this, the debt is consolidated into and may need to be centred on companies which have the highest capacity to absorb the expense. The group ratios exclusion will of course be helpful here.

Irish groups will be impacted by the broad scope of the deemed recovery of capital rules in section 249 where they take common steps (which are taken by companies subject to equivalent measures in other jurisdictions) to tidy up balance sheets of group companies and to simplify forecasting and monitoring compliance with ILR.

To illustrate this, we have outlined a couple of scenarios below whereby a group taking steps to ready itself for compliance with the new regime will be penalised by triggering the disallowance of an existing relief.

Impact for Irish groups that centralise cash and intra group debtor holdings
In this example, a company ("TopCo") has borrowed from a third-party bank and used the proceeds for a qualifying purpose under section 247, such as lending to a group member that is engaged in carrying on a trade ("TradeCo") who in turn uses the loan proceeds for a qualifying purpose. Separately, TopCo has advanced loans funded from its equity capital in the past to TradeCo who in turn used these loans to fund general working capital requirements as part of its trade.

The group decides it will focus its efforts to centralise cash balances and to monitor net borrowing costs in compliance with ILR in TopCo (which has significant third-party expense) and TradeCo (which is one of the biggest trading companies in the group) The group forecasts that its net borrowing costs will fall below the 30% of EBITDA ILR.

TradeCo holds balances of trade debtors owed by another group member, SubsidiaryCo, which does not have the liquidity to repay the sums due and TradeCo decides to assign these debtors to TopCo in settlement of the prior working capital borrowings. No part of the section 247 loan advance is repaid by TradeCo and TopCo has not realised any cash from the assigned debtor amounts owed by SubsidiaryCo. This assignment of intragroup balances relates to a completely separate loan advanced by TopCo to TradeCo but gives rise to a deemed recovery of capital by the borrower, TopCo, equal to the amount of the debtors assigned/loan repaid by TradeCo. This results in a restriction of TopCo's deductible interest expense.

The effect of these assignments is to deem TopCo to have repaid an amount of its debt to the third-party bank. There is no difference in the amount of interest expense borne by the group. This straightforward tidy up exercise has triggered a disallowance of expense.

It may be technically possible to avoid triggering a deemed recovery of capital in the above scenario, however, to do this it would involve entering into transactions which are not required from a commercial perspective and which potentially give rise to significant additional costs for the group. Therefore, careful consideration needs to be given to simply our existing legislation to remove the barrier/penalties for groups that need to take certain steps to comply with the new ILR regime.

Impact for Irish Outbound Companies
Where an Irish parent company ("Irish TopCo") uses funds borrowed from a third-party bank for a qualifying purpose to invest in the share capital of its direct subsidiary, which is a holding company ("Irish HoldCo"), then the debt borrowed by Irish TopCO may be deductible as interest as a charge under section 247.

In this scenario, Irish Holdco is indirectly holding shares in trading companies through Irish and foreign subsidiary holding companies and uses the funds borrowed to finance the investment in a new foreign group. The deemed recovery of capital provisions may apply in this group structure to Irish HoldCo as it is a holding company which holds other holding companies (section 249 (2)(ac) TCA 1997). The repayments of loans share capital sales and loan assignments between the subsidiary holding companies and trading companies in the group must be monitored, as well as any capital recovered (or deemed to be recovered) by Irish HoldCo or by Irish TopCo.

If the above group may necessarily decide to tidy up some of its intra-group debt in preparation for the application of ILR, this may trigger the recovery of capital rules. For example, where any subsidiary holding companies in the group decides to repay any loans in existence between them and yet there is no actual or commercial changes or impact on the bank borrowings the interest on which is being tested for ILR.

Even though the business intention would be to restructure the level of interest-bearing debt and related net borrowing costs of the Irish group members to be better aligned with EBITDA, the repayments of loans between the subsidiary holding companies may trigger a deemed recovery of capital by Irish HoldCo. This is notwithstanding there is no actual capital recovered from the group's investments and there are no funds received by Irish HoldCo.

The recovery of capital provisions would deem Irish TopCo, the borrower and investing company, to have recovered any capital recovered by "an intermediate holding company" from another company where the company concerned owns directly or indirectly 50% of the share capital of the intermediate holding company or both companies are under the control of the same person.

The result of the application of the deemed recovery of capital provisions is that the receipt of the loan repayment proceeds by a subsidiary holding company triggers a deemed recovery of capital by TopCo such that it is treated as though it had repaid the corresponding amount of its qualifying borrowing to the bank when in fact this did not happen nor would it be possible for this to happen in a commercial environment.

This results in a disallowance of a portion of the interest expense deduction otherwise available to Irish TopCo. The outcome applies notwithstanding that the investment in the Irish and foreign operating groups is held through a parallel ownership chain and is in no way linked to the original borrowing used to finance the investment in the foreign group.

International groups will continually refinance debt to fund growth rather than repay because it is the cheaper and more flexible component of its weighted average cost of capital or there are significant breakage costs. The ability for a group to actually repay debt when there is a deemed or actual recovery (in tax terms) is quite limited in reality.

We believe it is now appropriate to modify the provisions in sections 247 and 249 TCA 1997. It is clear that the deemed recovery provisions in particular can have unintended consequences of impacting wholly commercial financing transactions in an international group that are unrelated to the original debt and not connected with any base erosion, profit shifting or avoidance motivations.