An Roinn Airgeadais
Department of Finance

ATAD Implementation

Article 4 Interest Limitation

Feedback Statement

December 2020

Prepared by the Tax Division
Department of Finance
www.gov.ie/finance

Contents

1 Introduction

Global tax avoidance requires a global solution

The international tax landscape has changed dramatically in recent years. Countries have taken coordinated action to increase tax transparency and address weaknesses of the international tax system that created opportunities for base erosion and profit shifting (BEPS) by multinational enterprises. No country can eradicate those gaps and mismatches by acting alone and Ireland has been an active participant in recent international efforts, led by the OECD and G20, to ensure a better functioning international tax system.

Anti-Tax Avoidance Directives

At European Union (EU) level, two Anti-Tax Avoidance Directives[1] (ATAD) were agreed to implement three of the OECD BEPS Actions and two additional measures in a coordinated way throughout the EU.

In Ireland, work on three of the five measures is now complete:

- Ireland's long-standing General Anti-Abuse Rule (GAAR), in place since 1989, already met the minimum ATAD standard;
- Ireland introduced an ATAD-compliant Exit Tax in Finance Act 2018; and
- Ireland implemented Controlled Foreign Company or "CFC" rules in Finance Act 2018.

In addition, the first and most substantial part of the fourth measure, Anti-Hybrid rules, was introduced in Finance Act 2019. The remaining part of the fourth measure, additional rules to neutralise Reverse-Hybrid mismatches, will be transposed by 1 January 2022, as required by ATAD. The Department of Finance will commence a separate process of stakeholder consultation on rules to neutralise Reverse-Hybrid mismatches in early 2021, to be followed by the introduction of legislation in Finance Bill 2021.

ATAD Interest Limitation Rule

This Feedback Statement considers the fifth and final ATAD measure, an Interest Limitation Rule (ILR), which will also be implemented in Finance Bill 2021. Article 4 of ATAD requires 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, which is based on the recommended approach outlined in the OECD BEPS Action 4 2015 Final Report, is intended to limit base erosion through the use of interest expenses to create excessive interest deductions or exempt or deferred income. Commentary prepared by the OECD has been mentioned in this paper where relevant.

[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 and Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries. References to 'ATAD' below refer to Council Directive (EU) 2016/1164 as amended by Council Directive (EU) 2017/952.

ATAD allows Member States some degree of prescribed optionality in transposing the ILR but does not require the introduction of targeted anti-avoidance rules. However, as ATAD is a minimum standard Directive, Member States may provide more restrictive rules, provided these comply with the fundamental freedoms of the Internal Market.

To assist in navigating the rest of this Feedback Statement, the ILR requirements are broadly as follows (with defined terms in ATAD being indicated by the use of single quotation marks and italics):

- It requires a limit on deductible interest of a maximum of 30 per cent of '*EBITDA*' per '*taxpayer*'.
  - For this purpose, a notional local group can be considered to be a single '*taxpayer*'.

- The following exemptions may be included:
  - A *de minimis* exemption for net interest expense of up to €3 million per '*taxpayer*' per period;
  - An exemption for '*standalone entities*';
  - Interest on loans entered into before 17 June 2016 (to the extent the loans are not modified);
  - Interest on loans used to fund '*long-term public infrastructure projects*'; and
  - '*Financial undertakings*' may be excluded from the rules.

- Two "group ratio" options may be provided, which may allow a higher interest deduction to an individual company by reference to the position of the wider group.

- Member States have the option to allow taxpayers to carry forward interest that is subject to the restriction and that cannot be deducted in an accounting period for offset in a future period, and to either carry back disallowed interest for three years or carry forward excess interest capacity for five years.

Structure of this Feedback Statement

The contents of this Feedback Statement are as follows:

- Section 2 sets out the broad policy approach and details of the consultation period.
- Section 3 gives an overview of the intended operational structure for the ILR, based on a seven step approach.
- Section 4 sets out possible approaches to definitions relevant to Steps 2 to 4, involving the calculation of different 'interest equivalent' measures.
- Section 5 sets out potential approaches to the calculation of '*EBITDA*' and related terms (Step 5).
- Section 6 sets out a possible method to calculate the ILR restriction (Step 6).
- Section 7 sets out potential approaches to the carry-forward/back options (Step 7).
- Section 8 discusses a number of exemptions provided for in ATAD.
- Section 9 introduces the "group ratios" and poses relevant consultation questions.
- Section 10 introduces the concept of the notional local group and poses relevant consultation questions.
- Section 11 includes miscellaneous technical questions.

2 Feedback Statement on the ATAD ILR

This Feedback Statement builds on the November 2018 public consultation on implementation of the ATAD Anti-Hybrid rules and ILR. Most respondents noted the complexity of the ILR and proposed that further detailed consultation would take place during the development of the ILR legislation, to enable companies to comply with the new requirements when implemented. The Department of Finance is therefore publishing this Feedback Statement to respond to the views expressed in replies to the public consultation and to set out possible approaches to some of the technical aspects of the ILR.

Due to the complexity of the ATAD ILR and its interaction with domestic legislation, a two-stage approach to the development of this measure is being taken. It is intended first to develop a robust legislative approach to the operation of the ILR, including carry-forward provisions, on a single company basis. This first ILR Feedback Statement will allow the draft legislative approach to be tested by stakeholders to identify any potential uncertainties or unintended consequences to be resolved in the policy or drafting approaches.

When the framework of the interest limitation and carry-forward on a single company basis is firmly established, legislative approaches will then be developed to consider the notional local group and group ratio options. To assist in this process, this Feedback Statement contains consultation questions on a range of technical and policy issues relevant to the development of those options. It is planned that a second Feedback Statement will be published in mid-2021 containing draft legislative approaches to the ILR provision as a whole, including all the group and exemption options.

Interested stakeholders are therefore invited to:

- Give your views on the specific questions set out below, noting that there is no requirement to answer every question.
- Provide numerical examples where possible to illustrate your points.
- Provide details of alternative approaches that you feel might be beneficial (including minor suggestions).
- Where appropriate, estimate any Exchequer cost/yield of your preferred option.
- Provide details of relevant issues not covered in this Feedback Statement.

2.1 Consultation period

The consultation period will run to 8 March 2021. Any submissions received after this date may not be considered and early engagement is encouraged.

Any queries or requests for clarification can be directed to ctreview@finance.gov.ie in advance of the consultation deadline.

2.2 How to respond

The preferred means of response is by email to ctreview@finance.gov.ie. If it is not possible to reply by email, or if you wish to make a submission both electronically and in hard copy, submissions may also be sent by post to:

ATAD Implementation – Interest Limitation Feedback Statement
Tax Division
Department of Finance
Government Buildings
Upper Merrion Street
Dublin 2
D02 R583

Please include contact details if you are responding by post.

Please also indicate whether you are contributing to the consultation process as a professional adviser, representative body, business representative or member of the public.

2.3 Freedom of Information

Responses to this consultation are subject to the provisions of the Freedom of Information Act 2014. Parties should also note that responses to the consultation may be published on the Department of Finance's website.

2.4 Next steps

Due to the complexity of the ATAD ILR and its interaction with domestic legislation, Ireland is adopting an iterative approach to stakeholder consultation. The views of stakeholders are important in ensuring that Ireland's ILR will, when introduced, be clearly understood and operable in practice, while also meeting the standards required under ATAD.

The Department of Finance will carefully consider the responses to this Feedback Statement and may invite key stakeholders to meet with them and with Revenue officials, by video conference or in person as appropriate under public health guidelines. The insights obtained during this consultation process will inform the contents of the next Feedback Statement on the ATAD ILR. The second Feedback Statement is planned for mid-2021, in advance of the introduction of the ILR in Finance Bill 2021 with an effective date of 1 January 2022.

3 Overview of proposed approach to ILR

3.1 Existing rules

The taxation of interest in Ireland is governed by the Taxes Consolidation Act, 1997 (TCA 1997) and long-standing case law principles. These provide that tax relief for interest is subject to strict criteria, including that it must be incurred/paid for certain qualifying purposes. Corporation tax relief for interest is most commonly available in the following circumstances:

(a) It is incurred wholly and exclusively for the purposes of a trade (section 81 TCA 1997);
(b) It is incurred on loans used to acquire, improve or maintain a rental property (in which case it is deductible only against the rental income and is subject to certain restrictions) (section 97 TCA 1997); or
(c) It is annual interest paid on loans used to acquire a shareholding in an Irish rental income company, a trading company, or the holding company of such companies, or in lending money to such companies (with requirements for common ownership, directors and more) (section 247 TCA 1997).

Tax relief is denied where the conditions for relief are not satisfied. In addition, qualification for relief for interest as a trading deduction is also subject to transfer pricing rules and the provisions of section 130 TCA 1997 which can, in some cases, operate to treat as a non-deductible distribution interest payable on a debt instrument that has the characteristics of equity. Interest relief is also subject to a number of targeted anti-avoidance provisions.

3.2 Interaction between existing rules and ATAD ILR

Ireland's existing comprehensive set of rules has evolved over time to combat abusive practices and it provides strong protection to the Exchequer. By contrast, the ILR is a more generic fixed ratio-based limit on current year interest deductibility, without general or targeted anti-avoidance rules. Furthermore, while our domestic rules permanently disallow non-qualifying interest, the ILR permits the deferral of excessive interest charges, so that amounts disallowed in one year may qualify as a deduction in another year, subject to conditions.

As a result, it is intended to largely overlay the new ILR on top of the existing rules. Retention of the existing protections of the domestic regime will allow greater scope to exercise the optionality within ATAD (for example, through the inclusion of the *de minimis* rule), thereby minimising additional administrative burdens for small businesses.

It is acknowledged that overlaying the ILR on the existing domestic system may give rise to particular complexities or provide opportunities for the simplification of existing provisions where new protections are introduced by the ILR. It is anticipated that consideration of these issues will continue over the coming years as the ILR becomes established, however there is also some limited scope to consider these issues in advance of Finance Bill 2021. Stakeholders are therefore invited to give their views on these issues.

Question 1
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?

Question 2
What, if any, further adaptations of the existing legislation could be considered in later Finance Bills?

3.3 A possible seven step approach

The purpose of the ILR is to restrict interest deductibility under certain circumstances, and its application should not alter other aspects of a company's corporation tax computation. As the Irish corporation tax system incorporates different rates of tax on income (the 12.5% trading rate and the 25% rate primarily for passive income), the ILR must take these features into account when calculating any current restriction and in determining the operation of carried forward non-deductible interest or excess interest capacity.

Therefore, it is proposed that the ILR would be applied after the company has prepared its corporation tax computation for the relevant accounting period in the usual way. The remainder of this Feedback Statement considers a possible seven step approach to applying the ILR on a single company basis as set out below, with further details and relevant definitions included in sections 4 to 7 of this paper.

Step 1: calculate the company's corporation tax liability before the interest limitation;

Step 2: identify the company's 'interest equivalent income'[a] and 'interest equivalent expenses'[a];

Step 3: identify the company's 'taxable interest equivalent'[b];

Step 4: identify the company's 'deductible interest equivalent'[c];

Step 5: based on the previous steps, calculate '*exceeding borrowing costs*'[d] and '*EBITDA*'[e];

Step 6: apply the interest limitation where the '*exceeding borrowing costs*'[d] are higher than 30% of '*EBITDA*'[e], with the excess being 'non-deductible interest'; and

Step 7: carry forward[f] any 'non-deductible interest' (or, where the '*exceeding borrowing costs*'[d] are lower than 30% of '*EBITDA*'[e], any *'excess interest capacity'*).

[a] Possible definitions of these terms are set out at 4.1.
[b] A possible definition of this term is set out at 4.2.
[c] A possible definition of this term is set out at 4.3.
[d] A possible definition of this term is set out at 5.1.
[e] A possible definition of this term is set out at 5.3.
[f] Section 7 outlines possible approaches to the carry-forwards.

Question 3
Comments are invited on this possible approach, including whether any other matters should be considered in the transposition process. (More detailed questions relating to each step are contained later in this paper, so responses to this question should focus on the general approach.)

4 Interest equivalent – Steps 2 to 4

Article 4 of ATAD limits a taxpayer's tax deduction for '*exceeding borrowing costs*' in a tax period to a maximum of 30 per cent of its '*EBITDA*'. *'Exceeding borrowing costs'* is defined in ATAD as "the amount by which the deductible borrowing costs of a taxpayer exceed taxable interest revenues and other economically equivalent taxable revenues that the taxpayer receives according to national law". '*Borrowing costs*' and amounts economically equivalent to interest are therefore key concepts for the purposes of the ILR and each of these is considered below.

4.1 Interest equivalent income and expenses (Step 2)

Article 2(1) of ATAD defines '*borrowing costs*' quite widely to include, as defined in national law: (i) interest expenses on all forms of debt; (ii) other costs economically equivalent to interest; and (iii) expenses incurred in connection with the raising of finance.

The OECD explains that "payments economically equivalent to interest" includes those that are linked to the financing of an entity and determined by applying a fixed or variable percentage to an actual or notional principal over time. The OECD also recommends that any payment may be subject to limitation under the best practice approach where it is used as part of an arrangement which, taken as a whole, gives rise to amounts that are economically equivalent to interest.

A potential approach to the definition of 'interest equivalent' could be as follows:

"*interest equivalent*" includes any amount of —
(a) interest,
(b) amounts economically equivalent to interest including —
  (i) discounts, and
  (ii) amounts referred to in paragraphs (c) of the definition of financing return in *section 835AH*,
(c) expenses incurred in connection with raising finance, including —
  (i) guarantee fees, and
  (ii) arrangement fees, and

shall also include any amount arising from an arrangement, or part of an arrangement, which could reasonably be considered, when the arrangement is considered in the whole, to be economically equivalent to interest.

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

4.2 Taxable interest equivalent (Step 3)

ATAD focusses on the amount of interest which is deductible against taxable income, and not amounts which are related to exempt income. This requires a definition of 'taxable interest equivalent', which could be as follows:

"*taxable interest equivalent*" means any amount of interest equivalent that is income chargeable to corporation tax and that is taken into account in calculating the relevant profits[2] of a relevant entity[2].

4.3 Deductible interest equivalent (Step 4)

The ILR applies where the 'deductible interest equivalent' exceeds the taxable amounts calculated under Step 2. This concept is complex to define as Ireland gives tax relief for interest in different ways, including on a value basis as part of a group loss relief claim under section 420B TCA 1997. The following approach could be used to define 'deductible interest equivalent':

(a) In this Part, ***"deductible interest equivalent"*** means:
- (i) any amount of interest equivalent which is deductible in computing the relevant profits of the relevant entity,
- (ii) any amount of interest equivalent which is deductible from the relevant profits of the relevant entity,
- (iii) an amount calculated as —
  - (A) 8 times any amount which is deductible from the tax chargeable on the relevant profits of the relevant entity which is referable to an interest equivalent where those profits are taxable at the rate specified in *section 21(1)(f)*, and
  - (B) 4 times any amount which is deductible from the tax chargeable on the relevant profits of the relevant entity which is referable to an interest equivalent where those profits are taxable at the rate specified in *section 21A(3)(a)*,

but no amount shall be treated as deductible —
- (I) under *subparagraph (i)* or *(ii)* where it reduces the relevant profits below zero, or
- (II) under *subparagraph (iii)* where it reduces the tax chargeable below zero;

(b) References in this Part to an amount of interest equivalent which is deductible shall be construed as a reference to the amount calculated in accordance with *paragraph (a)*.

(c) References in this Part to the profits against which an amount of interest equivalent is deductible shall, in relation to borrowing costs referred to in *paragraph (a)(iii)*, be taken to be the profits, the tax chargeable on which was reduced by the interest equivalent.

Question 5
Comments are invited on these possible definitions of 'taxable interest equivalent' and 'deductible interest equivalent'.

[2] The next Feedback Statement will include possible definitions of the terms 'relevant profits' and 'relevant entity'.

5 Exceeding borrowing costs and EBITDA – Step 5

'*EBITDA*' is a key term in relation to the application of the ILR because deductibility of a taxpayer's net interest costs is only restricted where they exceed a fixed ratio of the taxpayer's '*EBITDA*'. Tax exempt income is to be excluded from '*EBITDA*'.

A number of key terms must be defined before introducing the calculation for '*EBITDA*'. Article 4(2) of ATAD provides that '*EBITDA*' is calculated by adding back to income chargeable to corporation tax the tax-adjusted amounts for '*exceeding borrowing costs*', depreciation and amortisation.

5.1 Exceeding borrowing costs

'*Exceeding borrowing costs*' are defined in Article 2(2) of ATAD as the amount by which deductible borrowing costs exceed taxable interest revenues and other economically equivalent taxable revenues. A potential approach to the definition of '*exceeding borrowing costs*' is set out below, and it is noted that the term 'exceeding deductible interest equivalent' (discussed in section 5.2) is a component part of this definition and should be read in conjunction with the below:

'*exceeding borrowing costs*', in respect of an accounting period, shall be the greater of an amount calculated by the following formula and nil —

D – E

where —

D is the exceeding deductible interest equivalent [see 5.2], and

E is the amount of taxable interest equivalent [from Step 3 – see 4.2]

5.2 Exceeding deductible interest equivalent

Component **D** in the above definition of '*exceeding borrowing costs*' is 'exceeding deductible interest equivalent'. ATAD provides that Member States may have a *de minimis* amount, below which the interest limitation does not apply. It also provides that "legacy debt", being debt entered into before 17 June 2016 (the date of agreement of the first ATAD), may be excluded from the calculation of '*exceeding borrowing costs*', although the exclusion does not extend to subsequent modifications of such loans.

The specific details of the *de minimis* and "legacy debt" provisions are considered further in section 8 of this paper. However, for the purposes of the above calculation of *'exceeding borrowing costs'*, it is noted that 'exceeding deductible interest equivalent' could be defined as shown overleaf.

"*exceeding deductible interest equivalent*", in respect of an accounting period, means the greater of an amount calculated by the following formula and nil —

(A – B) – C

where —

A is the amount of the deductible interest equivalent [from Step 4 – see 4.3],

B is an amount in respect of legacy debt [see 8.3], and

C is the de minimis amount [see 8.1].

Question 6

Comments are invited on these possible definitions of '*exceeding borrowing costs*' and 'exceeding deductible interest equivalent'.

5.3 Calculation of EBITDA

Having regard to the above definitions, '*EBITDA*' could be reflected in Irish legislation as follows:

'*EBITDA*', in respect of an accounting period, shall be calculated as follows —

P + I + DA

where —

P is the relevant profits of the relevant entity,

I is 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)* [in the possible definition of deductible interest equivalent – see 4.3], and

DA is allowances in respect of capital expenditure under *Part 9* or *Part 29*, made to or on a relevant entity in computing that entity's relevant profits less any amount of those allowances which are referable to deductible interest equivalent.

Question 7

Comments are invited on this possible definition of '*EBITDA*'.

6 Applying the ILR to a single company – Step 6

Once the company has calculated its '*exceeding borrowing costs*' and '*EBITDA*', it must use them to apply the ILR, as discussed below. The same factors that caused complexity in relation to the definition of 'deductible interest equivalent', such as the different rates of corporation tax, will cause complexity in designing how the ILR itself will actually apply. For this reason, it is essential to ensure a robust framework for the operation of the ILR based on a single company approach is developed, before attempting to layer on the additional complexity of the notional local group approach and the group ratios.

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. One way in which the ILR could be introduced into Irish legislation to achieve this is as shown below. The below refers to exemptions for *'standalone entities'* and *'financial undertakings'*, which are considered in section 8 of this paper.

(1) In this Part:
"**allowable amount**" means an amount calculated as 30 per cent of EBITDA [see 5.3];
"**excess amount**" means the amount by which the exceeding borrowing costs [see 5.1] is greater than the allowable amount.

(2) This section applies to a relevant entity for an accounting period where —
(a) that relevant entity is, at any time in that accounting period, not a standalone entity [see 8.2],
(b) the relevant entity is not a financial undertaking [see 8.5], and
(c) the relevant entity has an excess amount in respect of the accounting period.

(3) Where this section applies, a relevant entity shall be treated as receiving, for the purposes of the Corporation Tax Acts, an amount of income calculated as —

$$\mathbf{H} + \frac{\mathbf{S}}{\mathbf{2}}$$

where —

H is the amount of relevant profits that are taxable at the rate specified in *section 21A(3)(a)* against which the excess amount was deducted (referred to as the "higher rate profits"), and

S is the amount of relevant profits that are taxable at the rate specified in *section 21(1)(f)* against which the excess amount was deducted (referred to as the "standard rate profits").

(4) The amount of income referred to in *subsection (3)* shall be chargeable to corporation tax under Case IV of Schedule D, and shall be treated as income —
(a) arising in the accounting period,
(b) against which no loss, deficit, expense or allowance may be set off, and
(c) which shall not be reckoned in computing the relevant entity's total income for the accounting period.

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

7 Carry forward/back options – Step 7

Article 4(6) of ATAD provides that Member States may choose to grant taxpayers one of the following three options:

a) carry forward indefinitely any net interest which is not deductible in the current tax period; or
b) carry forward indefinitely and to carry back, for a maximum of three years, net interest that cannot be deducted in the current period; or
c) carry forward indefinitely net interest which cannot be deducted in the current period as well as the carry forward, for a maximum period of five years, of unused interest capacity.

The OECD explains that the purpose of such flexibility is to recognise that: (i) some groups are subject to legal or practical constraints that limit their ability to align net interest expense and EBITDA in each entity; and (ii) other mismatches in the timing of earnings and interest expenses, or earnings volatility, could also result in an entity exceeding the benchmark fixed ratio under a fixed ratio rule from time to time.

It is noted that Ireland's existing domestic provisions on interest deductibility will remain largely in place, providing for permanent restriction of deductibility where appropriate. Therefore, having regard to the views expressed by stakeholders to date, it is proposed to elect for option c) above, i.e. to permit the indefinite carry forward of interest that cannot be deducted under the fixed ratio rule in the current period (see 7.1) and the carry forward, for a maximum period of five years, of unused interest capacity (see 7.2).

As with the operation of the ILR restriction, in order to ensure the correct value for an interest deduction is maintained, the carry-forward provisions could operate in practice by focussing on the tax value of any disallowed interest deduction carried forward. This approach is set out on the following pages.

7.1 Carry forward of non-deductible interest

The effective carry forward of '*exceeding borrowing costs*' which cannot be deducted in the current period due to the ILR could be incorporated into Irish legislation as follows:

(1) Where a relevant entity is treated as receiving an amount of income under *section XXX(3)* [Step 6, as discussed at section 6 of this paper] that relevant entity may make a claim to carry forward into subsequent accounting periods an amount equal to the amount of tax chargeable on that income (referred to in this Part as "the interest tax credit").

(2) Subject to *subsection (3)*, where a relevant entity makes a claim under *subsection (1)*, the relevant entity shall be entitled to reduce the corporation tax payable that is referable to its relevant profits, but for the application of this section, in subsequent accounting periods by the amount of the interest tax credit.

(3) (a) A relevant entity shall not be entitled to reduce its corporation tax payable for an accounting period other than a period in which the allowable amount is greater than the exceeding borrowing costs (and the amount of that excess is referred to in this Part as "the interest capacity").

(b) The maximum interest tax credit that a relevant entity may claim in an accounting period shall be such that an amount calculated as four times the interest tax credit claimed does not exceed the interest capacity for that accounting period.

(4) Any relief under *subsection (2)* shall be given as far as possible from corporation tax payable in respect of the first subsequent accounting period and, in so far as it cannot be so given, from the corporation tax payable in respect of the next accounting period and so on.

(5) Where a relevant entity makes a claim under *subsection (1)* in respect of a number of accounting periods, any relief under *subsection (2)* shall be given in respect of an interest tax credit carried forward from an earlier accounting period in priority to interest tax credit carried forward from a later accounting period.

Question 9
Comments are invited on this possible approach to carrying forward non-deductible '*exceeding borrowing costs*'.

7.2 Carry forward of excess interest capacity

The five year carry forward of unused interest capacity could be incorporated into Irish legislation as follows:

(1) In this section, **"excess interest capacity"**, in respect of an accounting period, means an amount calculated by the following formula —

IC - (4 x TC)

where —
IC is the interest capacity in respect of the accounting period, and
TC is the interest tax credit claimed in the accounting period;

(2) A relevant entity may make a claim to carry forward its excess interest capacity for a period of 60 months from the end of the accounting period in which it arose (referred to in this section as the "relevant period").

(3) Where —
(a) a relevant entity has made a claim under *subsection (1)* and
(b) during the relevant period the relevant entity is treated as receiving an amount of income under *section XXX(3)* [Step 6, as discussed at section 6 of this paper],
the relevant entity shall be entitled to reduce the amount of that income by the excess interest capacity carried forward.

(4) Any relief under *subsection (3)* shall be given as far as possible against income arising in the first subsequent accounting period and, in so far as it cannot be so given, against the income in respect of the next accounting period and so on.

(5) Where a relevant entity makes a claim under *subsection (1)* in respect of a number of accounting periods, any relief under *subsection (3)* shall be given in respect of any excess interest capacity carried forward from an earlier accounting period in priority to excess interest capacity carried forward from a later accounting period.

Question 10
Comments are invited on this possible approach to carrying forward 'excess interest capacity'.

8 ATAD exemptions

As noted above, ATAD provides for a number of exemptions when calculating the ILR, as follows:

- A *de minimis* exemption for net interest expense of up to €3 million per '*taxpayer*' per period;
- An exemption for '*standalone entities*';
- Interest on loans entered into before 17 June 2016 (to the extent the loans are not modified);
- Interest on loans used to fund '*long-term public infrastructure projects*'; and
- '*Financial undertakings*' may be excluded from the rules.

8.1 *De minimis* exemption

The *de minimis* exemption was referred to in the definition of 'exceeding deductible interest equivalent' in Step 4 of the proposed approach to applying the ILR (see 5.2). In order to reduce the administrative and compliance burden of the ILR, ATAD allows Member States to include a *de minimis* threshold, below which full deductibility of exceeding borrowing costs is permitted. Member States can set that *de minimis* at any amount up to €3 million. The ILR restriction would apply in respect of interest in excess of the *de minimis* threshold only.

A potential approach to the *de minimis* exemption could be as shown below.

"*de minimis amount*" in respect of an accounting period of 12 months means €3,000,000, and where an accounting period is shorter than 12 months, that amount shall be reduced proportionately.

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

8.2 Excluding '*standalone entities*'

As BEPS takes place primarily through excessive interest payments mostly between '*associated entities*', Article 4(3)(b) of ATAD permits Member States to exempt '*standalone entities*' from the interest limitation. A '*standalone entity*' could be defined in accordance with Article 4(3)(b) as follows:

"*standalone entity*" means 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 [defined overleaf],
(b) has no associated enterprises [defined overleaf], and
(c) does not have a permanent establishment in a territory other than the State.

For these purposes, the question of whether a company is a member of a 'worldwide group' must be determined. ATAD Article 2(10) defines a '*consolidated group for financial accounting purposes*' as "a group consisting of all entities which are fully included in consolidated financial statements drawn up in accordance with the International Financial Reporting Standards or the national financial reporting system of a Member State". ATAD Article 4(8) further states that, "For the purposes of [the ILR], the taxpayer may be given the right to use consolidated financial statements prepared under accounting standards other than the International Financial Reporting Standards or the national financial reporting system of a Member State".

In accordance with ATAD Article 2(10) and ATAD Article 4(8), possible approaches to these definitions could be as follows:

'worldwide group' means 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;

"*ultimate parent"* means an entity that —

(a) (i) prepares consolidated financial statements under generally accepted accounting practice, or

(ii) where *sub-paragraph (i)* does not apply, would be required under international accounting standards to prepare consolidated financial statements, and

(b) (i) whose results are not fully included in any other consolidated financial statements prepared under generally accepted accounting practice, or

(ii) where *sub-paragraph (i)* does not apply, whose results would not be fully included in any other consolidated financial statements if they were prepared under international accounting standards;

"*ultimate consolidated financial statements"* means —

(a) the consolidated financial statements prepared by the ultimate parent under generally accepted accounting practice, or

(b) where there are no consolidated financial statements to which *paragraph (a)* relates, such consolidated financial statements as would be required to be prepared under international accounting standards.

For the purpose of the definition of *'standalone entity'*, '*associated enterprise*' must be interpreted in accordance with ATAD Article 2(4). This could potentially be reflected in Irish legislation as follows:

"*associated enterprise"* means an enterprise that is associated with another enterprise under *subsections (1)* to *(4)* of *section 835AA*, other than enterprises which would be considered associated enterprises pursuant only to *sub-paragraphs (e)* or *(f)* of *section 835AA(2)*;

"*enterprise"* has the meaning assigned to it in *section 835Z(1)*.

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

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.

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?

8.3 Exempting "legacy debt" (if not modified)

The "legacy debt" exemption was referred to in the definition of "exceeding deductible interest equivalent" in Step 5 of the proposed approach to applying the ILR (see 5.2). ATAD Article 4(4)(a) provides that Member States may exclude loans which were concluded before 17 June 2016 (the date of agreement of ATAD) from the scope of the ILR. A "legacy debt" could be defined in Irish legislation as:

"*legacy debt*" means a security, within the meaning of *section 135(8)*, that was entered into before 17 June 2016 in respect of which the relevant entity has a deductible interest equivalent.

ATAD Article 4(4)(a) provides that the exclusion for "legacy debt" does not include any expenditure arising from a modification of that loan. Therefore, the amount of the "interest equivalent" arising on that loan which can be excluded from the interest limitation could be defined as:

The amount of interest equivalent in respect of legacy debt for an accounting period, is an amount calculated as the lower of —

(a) the interest equivalent that arises on legacy debt in an accounting period, or
(b) an amount that would have arisen in respect of that accounting period but for any modification of the terms of that debt on or after 17 June 2016, including modifications to the duration of that debt, the principal drawn down or the interest rate on that legacy debt.

It is anticipated that this approach would ensure that the ILR would apply to any amount of "interest equivalent" on "legacy debt" that relates to: an increase in the interest rate; any increase in the capital drawn down; or any extension of the term of the debt. However, a loan entered into before 17 June 2016 would not be regarded as having been modified, and the ILR would not apply, in circumstances where, as a result of benchmark reform and/or withdrawal, it is necessary to replace the reference rate on the loan with a comparable benchmark (for example, due to LIBOR being phased out).

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

8.4 '*Long-term public infrastructure project*' exemption

ATAD Article 4(4)(b) provides that Member States may exclude both the income and associated expenses of certain '*long-term public infrastructure projects*' from the scope of the interest exemption, 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".

It is proposed to consider this exemption and possible approaches to specifying the relevant criteria in the second stage of the development of the ILR.

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

8.5 Excluding '*financial undertakings*'

Recital 9 to ATAD states that, "Although it is generally accepted that financial undertakings, i.e. financial institutions and insurance undertakings, should also be subject to limitations to the deductibility of interest, it is equally acknowledged that these two sectors present special features which call for a more customised approach. As the discussions in this field were not sufficiently conclusive in the international and the Union context, it is not possible to provide specific rules in the financial and insurance sectors and Member States should therefore be able to exclude them from the scope of interest limitation rules". Furthermore, and as noted by the OECD, interest limitation rules must not conflict with or reduce the effectiveness of capital regulation intended to reduce the risk of a future financial crisis.

Therefore, ATAD Article 4(7) provides that Member States may exempt certain '*financial undertakings*' (within the meaning of ATAD Article 2(1)) from the ILR. For these purposes, '*financial undertaking*' could be defined in Irish legislation as shown overleaf.

'financial undertaking' means —

(a) a credit institution as defined in Article 4(1) of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013,

(b) an investment firm as defined in point (1) of Article 4(1) of Directive 2004/39/EC of the European Parliament and of the Council,

(c) an alternative investment fund manager, as defined in point (b) of Article 4(1) of Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011,

(d) a UCITS management company, as defined in point (b) of Article 2(1) of Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009,

(e) an insurance undertaking, as defined in point (1) of Article 13 of Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009,

(f) a reinsurance undertaking, as defined in point (4) of Article 13 of Directive 2009/138/EC of 25 November 2009,

(g) an institution for occupational retirement provision (IORP) falling within the scope of Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 as amended by Directive (EU) 2016/2341 of the European Parliament and of the Council of 14 December 2016,

(h) a pension institution operating pension schemes which are considered to be social security schemes covered by Regulation (EC) No 883/2004 of the European Parliament and of the Council and Regulation (EC) No 987/2009 of the European Parliament and of the Council as well as any legal entity set up for the purpose of investment of such schemes,

(i) an alternative investment fund (AIF), that is either managed by an AIFM as defined in point (b) of Article 4(1) of Directive 2011/61/EU or supervised under the applicable national law;

(j) a UCITS, in the meaning of Article 1(2) of Directive 2009/65/EC,

(k) a central counterparty, as defined in point (1) of Article 2 of Regulation (EU) No 648/2012 of the European Parliament and of the Council, and

(l) a central securities depository, as defined in point (1) of Article 2(1) of Regulation (EU) No 909/2014 of the European Parliament and of the Council.

Question 17

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

9 Providing "group ratios"

9.1 OECD recommendation

As previously noted, consideration is being given to providing for "group ratios", as permitted by ATAD Article 4(5) and recommended by the OECD, which noted that "A fixed ratio rule provides a country with a level of protection against base erosion and profit shifting, but it is a blunt tool which does not take into account the fact that groups operating in different sectors may require different amounts of leverage, and even within a sector some groups are more highly leveraged for non-tax reasons." Furthermore, the fixed ratio rule limits both intragroup interest and third-party interest, whereas BEPS primarily involves intragroup debt.

9.2 The two "group ratios"

Therefore, in line with the OECD's recommendation, ATAD provides two possible modifications to the general fixed ratio rule (but only where a '*taxpayer*' is a member of '*a consolidated group for financial accounting purposes*', as discussed at 8.2 above) as follows:

a) The "Equity Ratio Rule" in Article 5(a) allows the taxpayer to fully deduct '*exceeding borrowing costs*' without limit where the ratio of the taxpayer's equity to total assets does not fall more than 2 per cent below the equivalent ratio of the worldwide group as a whole. It is clear from Article 4(5)(a)(ii) that the group's equity ratio (equity divided by total assets) should be calculated based on the group's consolidated accounts.

b) The "Group Ratio Rule" in Article 5(b) replaces the 30 per cent in the fixed ratio rule with a percentage calculated as follows: exceeding borrowing costs relating to third-party loans divided by the group EBITDA. It is less clear from Article 4(5)(b)(i) whether the group ratio (third-party interest divided by EBITDA) should be calculated based on the group's consolidated accounts or using tax-adjusted values.

Consideration is being given to providing for both "group ratios" and allowing the choice of ratio to be at the discretion of the taxpayer. However, it is noted that providing a choice of "group ratios" involves additional complexity in the administration of the ILR for taxpayers.

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

Question 19
Noting that the same definition of 'worldwide group' applies for the "group ratios" and the definition of '*standalone entities*' (see 8.2), 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"?

Question 20
Technical analyses are invited 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. The accounting figures for EBITDA and borrowing costs may bear little resemblance to the Irish tax concepts while the tax-adjusted values give rise to practical difficulties such as how to treat intragroup transactions and negative EBITDAs. Taking account of the provisions of ATAD Article 4(5)(b), and the issues identified above, how could this aspect of the "Group Ratio Rule" be designed?

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*' (see 8.2), 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?

Question 22
How would the application of "group ratios" work, in practical terms, where an exempt '*financial undertaking*' (see 8.5) is a member of a 'worldwide group'?

10 Treating a notional local group as a single '*taxpayer*'

ATAD Article 4(1) allows the option to apply the ILR using a "single approach" (i.e. on a company by company basis) or a "group approach" (i.e. to a local group of companies as defined under national law). In providing this option, ATAD recognises that some Member States permit tax consolidation. Member States (including Ireland) that do not allow tax consolidation are permitted to introduce notional local group provisions for ATAD ILR purposes.

10.1 Defining the notional local group

ATAD does not provide specific guidance or parameters for the definition of the notional local group.

Question 23

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

(i) 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?

(ii) 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?

(iii) 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?

(iv) 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 (as detailed in section 9.3). But what difficulties might a notional local group encounter in carrying out that comparison, particularly where it does not prepare local audited consolidated accounts?

10.2 Optional or mandatory "group approach"

As previously noted, consideration is being given to providing for the local "group approach" and allowing it to be at the discretion of the taxpayer.

Question 24

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

(i) Should a group election be irrevocable or for a finite period only?

(ii) 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?

(iii) What type of anti-fragmentation rules, if any, might be required?

Question 25

Would a mandatory but less complex "group approach" be preferable to an optional "group approach"?

10.3 Practical and technical considerations

Section 6 of this paper sets out how the interest limitation will apply on single company basis. A number of complexities would arise in applying the limitation on a notional local group basis (whether optional or mandatory) and observations in this regard are welcome.

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

Question 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)? How would this work, in practical terms, where an exempt '*financial undertaking*' is a member of the notional local group?

Question 28
How should ILR restrictions be allocated among members of the notional local group? In particular:
(i) How should the notional local group allocate its exceeding deductible interest to the members of the group?
(ii) What should happen in scenarios where the notional local group as a whole has negative EBITDA but some of its members have positive EBITDA?
(iii) 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?
(iv) How should the charge (calculated under Step 6 in section 6 of this paper) 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?
(v) How should changes in membership of the notional local group be dealt with?

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

11 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?

Question 32
Comments are invited on any other technical issues that may require consideration.

An Roinn Airgeadais
Department of Finance

Tithe an Rialtas, Sráid Mhuirfean Uacht,
Baile Átha Cliath 2, D02 R583, Éire
Government Buildings, Upper Merrion Street,
Dublin 2, D02 R583, Ireland

T:+353 1 676 7571
@IRLDeptFinance
www.gov.ie/finance