Irish Association of Corporate Treasurers

ATAD Implementation – Interest Limitation Feedback Statement
Tax Division
Department of Finance
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8 March 2021

IACT Response to Feedback Statement: Article 4 ATAD Interest Limitation

Dear Sir/Madam,

The Irish Association of Corporate Treasurers ("**IACT**") welcomes the opportunity to respond to your Feedback Statement of 23 December 2021 on the implementation into Irish law of Article 4 of the EU Anti-Tax Avoidance Directive ("**ATAD**"), otherwise known as the Interest Limitation Rule ("**ILR**"). We appreciate this opportunity to share our views and trust that you will find our comments valuable to the discussion.

The IACT was founded in 1986 with the aim of promoting the practice of corporate treasury management in Ireland. We are a not for profit organisation that provides a forum in which corporate treasurers can meet and exchange information. The IACT currently has in excess of 400 members including practicing treasurers from major Irish public companies, multinationals and commercial state entities, as well as a number of smaller and medium-sized enterprises ("**SMEs**").

We wish to point out that the IACT represents corporate treasurers in Ireland across a number of industries and of a great variety of types and size of businesses. As such, we are well placed to provide a holistic and unbiased perspective on some of the key considerations to be borne in mind in enacting these provisions into Irish law. The IACT does not seek to promote or protect the interests of any particular industry group in Ireland. Nor do we seek to promote or protect organisations of any particular size or scale. What is of relevance to us is that it is recognised that the cost of raising finance is a legitimate cost of doing business and any legislation that has the effect of denying a tax deduction for a legitimate cost of business should be carefully considered, having particular regard to the overall purpose of such provisions.

As is evident from the wording "Anti-Tax Avoidance Directive", these rules are aimed at curbing tax avoidance. It should therefore not have the effect of going further than is intended and interfere with legitimate debt raising activities. We would like to make some important observations that should be considered in parallel with the specific answers:

- It is notable that the rules under ATAD, as presently enacted, will apply to all debt, including third party debt, directly and indirectly provided by banks and corporate bondholders and investors. In our experience this debt is generally raised for legitimate business purposes. It represents an economic cost of doing business and financing investment and growth and generally does not have a tax avoidance motivation because it is generally subject to tax in the hands of the banks and bondholders.

- The inclusion of third-party borrowings in the measure of interest can only be considered to be general disallowance of interest expense and an increase in the effective tax rate for borrowers. Our belief is that this measure will disproportionately impact smaller economies, like Ireland, where the tax adjusted measure of income ("**EBITDA**") will naturally be lower. The effect will be a reduction in the competitiveness of the 12.5% tax rate as the effective tax rate here will move up and the gap with other larger economies will narrow. This disallowance of interest expense will particularly increase the costs for Irish headquartered and indigenous multinationals that seek to grow internationally.

- We would therefore advocate that the measure of EBITDA is widely interpreted within ATAD to address the vagaries of a smaller island economy that increasingly seeks to expand outbound internationally and whose valuation and success is linked to important financial measures such as earnings per share and return on capital employed.
- While we acknowledge the intention to conduct a second consultation process regarding the consolidated group relief provided for in ATAD we believe this should be commenced and concluded urgently.
- The Irish tax code has provided a measure of tax relief for interest costs associated with investment and growth under general trading principles or specifically for example under S247. In recent years the deductibility of interest expense has become increasingly complex and unwieldy through law and guidelines. The implementation of the ILR under ATAD will likely further restrict that measure of relief. These complex rules coupled with two corporate tax rates, and a distinction between trading and non-trading (that does not exist elsewhere within the EU) contributes to make Ireland one of the more complex tax regimes in which to determine with certainty if legitimate interest expense is deductible. This is not however a matter only of complexity but of actual cost.
- We would urge the Minister to implement a broader review of Ireland's interest regime that considers all facets and one that is not focused on piecemeal measures such as ATAD. The abolition of the 25% tax rate (or at a minimum the application of a 12.5% tax rate to financing) and an expeditious review of S247, all in the context of Ireland moving to harmonised EU based rules for interest expense, would be welcomed by our members and would go some way to ensure that the 12.5% remains available as an effective tax rate.

Our perspective in responding to this Feedback Statement is not to comment on the detailed tax technical aspects of the interposition of these rules as such, but to share a corporate treasurer's perspective with the aim of ensuring that these rules do not needlessly interfere with the raising of finance or the management of the cost of finance.

1. Question 4:

Comments are invited on this possible definition of "interest equivalent"

The definition of "interest equivalent" is at the heart of the ATAD ILR and of vital importance. We submit that the definition should be clear and unambiguous and should be in compliance with the ATAD. However, it should not go further than that intended by the ATAD if a consequence of expanding the meaning will adversely impact on Ireland as a corporate treasury location and / or have the effect of needlessly increasing the cost of finance.
The proposed definition includes a provision at the end which states that "interest equivalent" will 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.*" Of particular importance from a corporate treasury perspective is clarity on foreign exchange movements as well as the treatment of hedging instruments (e.g. interest rate swaps, cross-currency swaps, FX forward swaps, total return swaps etc.), and whether related items in the profit and loss account will fall within this expanded meaning of "interest equivalent".

In this regard, 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...*" (Our underlining). It is our contention that foreign exchange movements on loan principal, as well as foreign exchange movements on hedging instruments that does not arise directly on the cost of a borrowing (i.e. interest or something that is economically equivalent to interest) should not fall within the meaning of "borrowing costs". This is because such foreign exchange movements arise on the borrowing itself (e.g. on the translation of a foreign currency denominated outstanding loan principal into the functional currency of the taxpayer) as opposed to on the cost of the borrowing (e.g. the interest on a loan). As a result, such movements should also not fall within the meaning of "interest equivalent" for the purposes of the Irish definition. The ATAD allows for such an exclusion by the use of the word "*certain*", which serve to limit the type of foreign exchange gains and losses to be restricted, and clearly intends to restrict the ambit to that which should be regarded as a "borrowing cost".

Based on the current proposed Irish definition, however, it is not clear whether such foreign exchange movements are included or not. We suggest that it be considered for the definition to specifically exclude foreign exchange movements to the extent not arising on the cost of a borrowing, for the avoidance of doubt. Also, it is not clear whether the interest component reflected in the profit and loss account under IFRS 16 in the accounts of the lessee under an operating lease falls within the above definition. We suggest that this be clarified as well, preferably in legislation to ensure consistency of application in practice.

2. **Question 8:**

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

This section of the Feedback Statement sets out the proposed mechanism whereby the restriction of the interest expense is done in the form of a deemed Case IV income inclusion (and cash taxation) as opposed to the disallowance of the excess net interest expense. We understand that the reason for this particular mechanism (as opposed to the mechanism envisaged in the ATAD and as was widely expected in Ireland) is to cater for the fact that Ireland has the two different tax rates on income, namely the 12.5% and 25% tax rates for corporation tax purposes.

As you may be aware, the differing rates of taxation can give rise to complexities in a treasury taxation context with respect to the taxation of interest at either the 12.5% or 25% tax rate, as well as the taxation of hedging instruments. Instead of transposing the ATAD in an unusual and unexpected manner to cater for the unique dual Irish corporation tax rate system, we suggest that this be seen as an opportunity to instead re-evaluate the possibility of moving Ireland to a single corporate tax rate of 12.5% to be in-step with the rest of the EU. We would have a concern that the unique Case IV cash taxation mechanism may have unforeseen consequences and result in an unnecessary competitive disadvantage for Irish taxpayers.

We welcome the opportunity to discuss any of our comments above in further detail, should this be required.

Yours Sincerely,

Keith Lynch
President
The Irish Association of Corporate Treasurers