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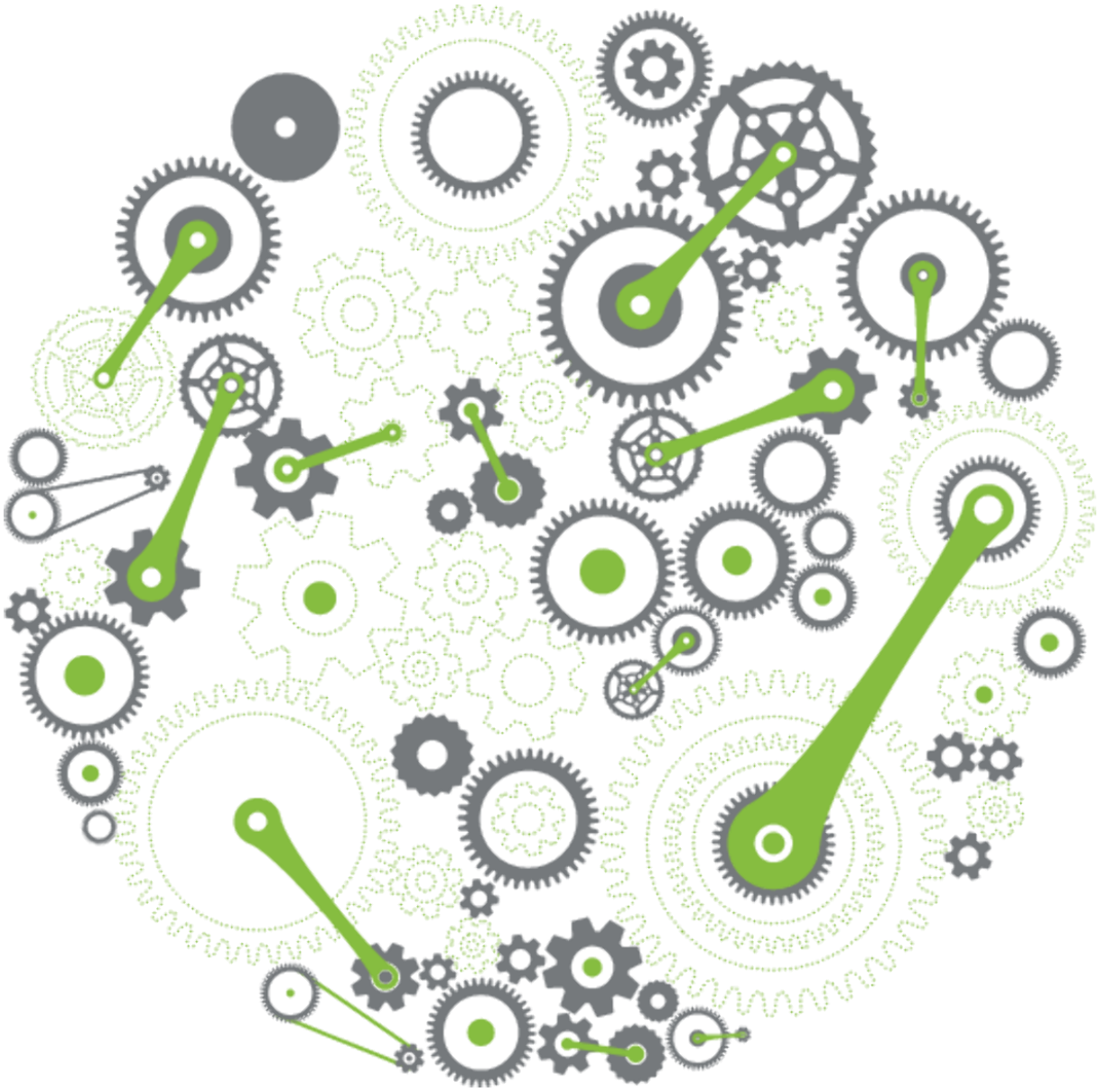

Article 4 Interest Limitation

Public Consultation Response

8 March 2021

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8 March 2021

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

VIA EMAIL: ctreview@finance.gov.ie

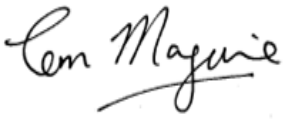
Dear Sirs/Mesdames:

We are pleased to submit comments on behalf of Deloitte in response to your Feedback Statement on 23 December 2020. We appreciate this opportunity to share our views and trust that you will find our comments valuable to the discussion.

We look forward to continued collaboration with the Department of Finance on this and other tax initiatives, and are available to discuss anything in this document, as needed. In the meantime, if you have any queries, please do not hesitate to contact us at 01-417-2200.

Yours sincerely,

Lorraine Griffin
Partner
Head of Tax and Legal



Tom Maguire
Tax Partner

Contents

1. Executive Summary

This document outlines our thoughts on the detail of the proposed legislation as outlined in the Feedback Statement. We appreciate that by its nature the Feedback Statement does not contain the full proposed legislation and therefore some of the comments included in this document may already be addressed in the wider proposed law. However, we would emphasise the following points:

- As a general matter, the interest limitation rules need to take account of international best practice on the adoption of the OECD BEPS Action 4 report. However, and as noted in our previous consultation response in 2019, broad reform to the current domestic interest deductibility provisions to align with and facilitate the introduction of these new restrictions is in our view an imperative. Ireland's existing tax regime in relation to interest deductibility is highly complex, particularly the s.247 TCA 1997 regime. Ireland views that its current interest deductibility rules are equally effective to the ATAD interest limitation rule. Accordingly, in terms of Ireland's tax and general business competitiveness, and taking into account a comparative analysis of many other EU and OECD countries, layering the ATAD interest limitation rule onto the existing Irish interest deductibility provisions would in our view be a missed opportunity and impact negatively from a competitiveness viewpoint.

  We recommend as an urgent priority the simplification of the interest deductibility rules, discussed further in this submission, which could be achieved in a reasonably short timeframe. Providing certainty of approach and timelines on this issue is a critical consideration.

- We would recommend that clarity be provided as early as possible on the policy options, as permitted under the ATAD, which may be taken/rejected by the Department of Finance to permit specific industries sufficient time to consider the ramifications for their businesses; for example, the implications for restricted interest deductibility for non-bank financial institutions. If possible, early announcements should be communicated regarding specific exclusions being adopted e.g. the long-term public infrastructure and grandfathering exclusions.

  In relation to the deductibility of interest generally, we would like to highlight that the purpose of the changes is to limit base erosion through artificial means rather than to necessarily limit the overall deductibility of genuine finance costs. This can be seen through the provisions allowing consideration of the overall net debt or net finance cost of the parent group when deciding what limitation should be placed on an individual entity. Equally, we note the suggestion to exclude banks and other regulated financial institutions from the ambit of the rules but suggest further consideration of the position of subsidiary companies of bank and certain other non-bank financial institutions. We have also

highlighted a range of specific considerations that must be considered in order to ensure Ireland's securitisation regime is not adversely impacted.

- It is important that measures taken in the enacting of these complete rules do not go beyond what is necessary to implement the Directive in that this has the capability to interfere with our competitiveness vis-à-vis other countries. Their enactment should avoid complexity and additional administrative burdens as much as possible. We have highlighted in our response certain proposals in the consultation document which suggest broadening the scope and implementation of the interest limitation rule beyond what is required in the ATAD. In our view, it is critical that such measures and proposals are realigned to what is required by the directive and does not go further.

- The potential use of a Case IV charging mechanism to effectively restrict interest deductions is complex and may give rise to unintended consequences and we would suggest that consideration be given to restricting interest expense rather than the deemed income approach.. Indeed, we have also highlighted broader policy considerations in relation to Ireland's group relief and loss carry forward/utilisation rules, which should be considered more generally in order to evolve and ensure Ireland's corporate tax regime is competitive taking into account the significant changes which have occurred in recent years following the OECD BEPS process and in adoption of the ATAD.

- Finally, Ireland as an open economy needs to be cognisant of the tax policies of other nations which seek foreign direct investment. In this regard, it is clear that countries such as the UK and Germany which have had EBITDA-related interest restrictions in place for some time, each make provision for regard to be had to the global debt position of relevant corporate groups and not just the position of local subsidiaries. This is recognised in recital 7 of the Directive and this is developed throughout this submission. We would strongly recommend that similar provisions and approach is incorporated into Ireland's adoption of the interest limitation rules.

- We welcome the point made in the Feedback statement that the next consultation in this process will be published mid-2021 "containing draft legislative approaches to the ILR provision as a whole, including all the group and exemption options". In the interests of ensuring clarity, we would strongly recommend that this consultation period be as early as possible to allow for sufficient time for a considered discussion and stakeholder input prior to Finance Bill 2021.

2. Overview of proposed approach

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?

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.)

As part of our response to the Hybrids and Interest Limitation – Public Consultation in 2019 we advocated that consideration be given to the broad reform of the Irish Corporation Tax Code provisions dealing with the tax treatment of all aspects of corporate finance. Such legislation need not be lengthy or unwieldy and would compare favourably with the difficulties of integrating these new rules within the current complex framework. We would suggest adopting a principles-based approach for legislation to be considered in the context of interest relief. Such an approach, whereby tax relief is permitted for finance costs measured on an accounts basis where the monies have been applied for business and commercial purposes of the taxpayer concerned would not extend tax relief in an inappropriate or undue manner. This approach can then be effected subject only to the measurement limitations prescribed in ATAD which provide a bulwark against excessive interest burdens. The purpose and intended effect of reform in this area would not be to increase the quantum or availability of relief but to bring simplicity and certainty for Revenue, taxpayers and advisers alike. Such clarity should reduce the necessity for private Revenue opinions. The UK's rules specify that funding costs (i.e. primarily fees and interest) are broadly deductible on an accounts basis subject to their own interest restriction rules. Ireland has an opportunity to assert clarity on our position. Such a principles-based approach could be supplemented with a main benefit test.

A reform of our interest rules is an opportunity to provide clarity to the taxpayer during the current unstable environment. Having said that, in our view, such an opportunity should be taken in the same Finance Bill as the ILR. For example, the evolution of S247 TCA97 has been such that it now encompasses a range of complex anti-avoidance provisions which many taxpayers find unwieldy and requiring significant ongoing monitoring. While we would recognise the inherent complexity in removing such provisions, this is a great opportunity to consider which targeted anti-avoidance

provisions are necessary and the removal of some would be recommended where no longer required. In this regard we would argue that that it would be timely to simplify the legislative requirements for interest deductions by reference to a "main benefit" test. Such a modification would take into account the changes brought about by Finance Act 2019 with respect to transfer pricing and the requirement to assess not only an arm's length interest rate but also the debt capacity of the parties. Such an assessment would, in our view, likely provide sufficient safeguards for the interest relief provisions.

For the sake of comparison, the UK's corporate interest restriction legislation consists of 155 pages which implements the provisions of Article 4 of ATAD. By contrast, Ireland's specific provisions dealing with interest consist of a few pages which will likely make it more complex to enact the specific restrictions which ATAD mandates if a comprehensive reform on the taxation of corporate finance is not forthcoming. As Ireland will be legislating in an environment where the quantum of relief is to be limited by reference to fixed limitations based on business income, we believe it should be possible for more concise legislation to be brought forth. Such amendments may be introduced in a limited way in Finance Bill 2021, with further change to follow in later Finance Bills or perhaps in secondary legislation if facilitated as part of the Finance Act.

In response to Question 1 and adaptations to existing legislation, we would recommend at a minimum that amendment be made to TCA97 s247 to provide that such relief should be available on an accruals rather than on a paid basis. Currently, the requirement that such interest relief be restricted to amounts actually paid differentiates it from interest deductible elsewhere in law (e.g. TCA97 s97 or s81). Such a requirement, in our opinion, provides an additional layer of complexity for taxpayers. Consideration, as part of a transitional rule, would have to be given to allowing for continued relief for interest accrued on such loans in accounting periods prior to the Finance Act but paid thereafter.

Additionally, consideration should be given to removing the "common director" requirement that exists in TCA97 s247(3)(b) given this poses an administrative burden without an easily discernible policy rationale for allowing a deduction for interest as a charge. Further, TCA97 s291A(6) places a restriction on the amount of interest and capital allowances that may be claimed under that section. Consideration should be given to removing the interest restriction in that section if the interest concerned is to be restricted in accordance with the ILR.

Further, in terms of further limited adaptations to existing legislation (referred to in Question 1), we would recommend amendments be made to existing group relief provisions in TCA97. In an Irish context, the framework surrounding the deductibility of interest for corporate financing essentially requires the use of a debt financed holding company to either make an acquisition or to engage in onward lending to ensure that relief is available under s247 TCA97 for any interest expenses incurred. Additionally, it can be a requirement of certain financing arrangements that debt be isolated in a special finance company to ensure that lenders have access to the appropriate security. In such cases, a common feature of corporate financing and the effective use of such interest would feature the surrendering of either losses or charges

on income created by such expenses to other companies within the tax group[1]. Under current group relief provisions, the ability to surrender and claim between group members is limited only to current year losses and charges incurred. As such, unused amounts may not be surrendered in later years.

This level of inflexibility may give rise to issues where there is a carry forward of exceeding borrowing costs above the allowable level, or where there is a carry forward of unused interest capacity in an entity that cannot be surrendered to other group members in the year in which the interest was incurred. Where it is envisaged (as appears to be the case per the Feedback Statement) that the operation of the ILR to a standalone entity should respect existing group relief provisions and also that previously disallowed interest or excess interest capacity may be carried forward, we would be of the view that such existing provisions require amendment to remove the limitation on group relief to solely current year losses and/or charges on income. This could be achieved with relative ease through amendment to existing group relief provisions, to identify exceeding borrowing costs previously disallowed (or as this Feedback Statement suggests, an interest tax credit) and/or interest capacity carried forward as being a separate category of tax attribute to losses and/or charges but surrendered and claimed in the same way in the corporation tax returns of the companies in question.

Further amendments in later Finance Bills could, in our opinion, build on the limited adaptations suggested in Question 1 to further simplify the existing regime for interest relief in Ireland. However, in our view, the opportunity should be taken in Finance Bill 2021, as part of legislating for the ATAD interest limitation rules, to overhaul and simplify Ireland's interest deductibility rules. We believe this can be achieved in the timeframe between now and the publication of Finance Bill 2021, given that the existing transfer pricing debt capacity rules, the impact of the interest limitation rules under the ATAD (which we view as effectively equivalent to our existing rules), and if necessary the inclusion of a main benefit type test in reframing Ireland's tax code relating to interest.

As a general point, and to address Question 3, we would be of the view that any changes to existing legislation should be made clear to relevant stakeholders prior to implementation. In this regard, any changes to be made either to existing interest relief provisions or in the introduction of the ILR must prioritise simplicity, as overly burdensome and complex rules may negatively impact on investment at a time when economic activity may look to accelerate in a post COVID19 world.

[1] Provided for under S420A and S420B TCA 1997

3. Interest equivalent

3.1 Interest equivalent

"***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'.

"Interest equivalent" is arguably the most critical definition for the purposes of the ILR in that it will determine the application or not of the rule. Therefore it should be:

(1) Made as clear as possible without regard to guidance (although acknowledging that guidance on these complex provisions would be welcome); and
(2) Should not interfere with Ireland's competitiveness vis-à-vis other jurisdictions.

On point (1) it may be necessary to defer to guidance on what is meant by "economically equivalent to interest". This is a difficult term in itself and the BEPS Action report 4 explains it as follows *"Payments that are economically equivalent to interest include those which are linked to the financing of an entity and are determined by applying a fixed or variable percentage to an actual or notional principal over time. A rule should also apply to other expenses incurred in connection with the raising of finance, including arrangement fees and guarantee fees".*

Each of the BEPS Action 4 report and the EU ATAD illustrated suggested definitions of "borrowing costs" which, while imperfect, provide additional clarity on the matter. Given that the interest limitation rules are designed to provide a level playing field and consistent treatment across Member States and OECD members, we would suggest a consistency of approach with the ATAD.

This is especially true as, in our view, the proposed definition is unlikely to capture the full gamut of costs which might be incurred in relation to financing. For example, one derivative contract which might be used by companies is an interest rate swap which would be utilised for a variety of commercial purposes in relation to financing. Payments under an interest rate swap are calculated by reference to interest rates but do not comprise interest as a matter of law. Neither are costs under interest rate swaps necessarily incurred in relation to the "raising of finance" as they can pre-date or post-date the raising of finance. It is undoubtedly the case that interest rate swaps are conflated with finance and we would generally expect that the costs/income arising under them should come within the ambit of the interest limitation rules. While the reference to the definition of "financing return" is TCA97 s835AH might be expected to deal with this matter, that reference relies also on the term "equivalent to interest" such that it does not entirely clarify the definition.

A similar issue arises in relation to other costs which might be recognised as finance costs for accounting purposes such as with the treatment of operating leases under IFRS16. An element of rentals (whether for business premises, equipment assets etc) is now accounted for as if it were a finance cost rather than rent. No finance is raised and, in contrast to the position of the finance element of finance lease rentals, it is not included within the definition of "borrowing costs" in EU ATAD. As noted below, it is specifically excluded from the concept of borrowing costs in the BEPS Action 4 report. Clarity on the treatment of operating leases would be welcome.

The first limb of the proposed definition recognises a computational element for a payment to be "economically equivalent". This is not too dissimilar from the definition that was used in the UK's TIOPA10/S263(6) and as HMRC Manual CFM90718 Definition Of Relevant Liabilities explains "a return as economically equivalent to interest if it is reasonable to assume that it is calculated by the time value of money, is at a rate that is reasonably comparable (but not necessarily identical to) to the interest rate in comparable circumstances and it is practically unlikely that it will not be paid unless the person by whom it falls to be produced is prevented (by insolvency or otherwise) from producing it". The requirement for some form of calculation by reference to a particular "rate" is clear. In our view, such an approach should be taken in connection with the interpretation of "economically equivalent to interest" in our legislation.

The BEPS Action 4 paper goes on to list out circumstances which are regarded as "economically equivalent" which comprises those outlined in the meaning of "Borrowing costs" in ATAD1. It also goes on to outline what is *not* to be regarded as economically equivalent as follows*:*

"…the rules set out in this report should not limit deductions for items such as:

- *foreign exchange gains and losses on monetary items which are not connected with the raising of finance*
- *amounts under derivative instruments or hedging arrangements which are not related to borrowings, for example commodity derivatives*
- *discounts on provisions not related to borrowings*
- *operating lease payments*

- *royalties*
- *accrued interest with respect to a defined benefit pension plan."*

Such clarity may be forthcoming in guidance, but in our view it would be helpful if the legislation were drafted in accordance with that outlined in the ATAD (given that the directive has direct application in any event) and with the exclusions outlined in BEPS Action 4's paper.

It can be seen from the ATAD's definition of "borrowing costs" which was taken from BEPS Action 4 that reference is made to "the finance cost element of finance lease payments". Clarity on the treatment of operating leases would be welcome.

Further, the proposed definition above allows regard to be had to an overall arrangement in determining whether an amount economically equivalent to interest arises. This has its source in the BEPS Action 4 paper which specifically outlines that *"any payment (including those listed above* [that list is copied earlier in this section of the response under what is *not* to be regarded as economically equivalent for the purposes of BEPS Action 4]*) may be subject to limitation under the best practice approach where they are used as part of an arrangement which, taken as a whole, gives rise to amounts which are economically equivalent to interest".* The EU's ATAD chose not to include that as part of the directive and as such it is curious that Ireland's ILR goes beyond the application of the ATAD. This is particularly the case seeing that it is intended that the ILR is to be overlaid upon existing rules. In that regard, such an approach could impact on Ireland's attractiveness as a financing jurisdiction and we would recommend its removal given the "mechanical" approach adopted by the ATAD. It should be noted that a review of a series of transactions is already permitted by TCA97 S811C in determining whether or not a transaction has been entered into for the primary purpose of achieving a tax advantage.

To use an example of a simple bond (such as an Irish government bond): On 1 January 20X0, an entity acquires a bond for €900, incurring transaction costs of €50. Interest of €40 is receivable annually, in arrears, over the next five years (31 December 20X0 to 31 December 20X4). The bond has a mandatory redemption of €1,100 on 31 December 20X4.

	Carrying amount at beginning of period €	Interest income at 6.9583%[2]	Cash inflow	Carrying amount at end of period
20X0	950.00	66.11	(40.00)	976.11
20X1	976.11	67.92	(40.00)	1,004.03
20X2	1,004.03	69.86	(40.00)	1,033.89
20X3	1,033.89	71.94	(40.00)	1,065.83
20X4	1,065.83	74.16	(40.00)	1,100.00
			(1,100.00)	0.00

[2] The effective interest rate of 6.9583 per cent is the rate that discounts the expected cash flows on the bond to the initial carrying amount: $[40/(1.069583)^1 + 40/(1.069583)^2 + 40/(1.069583)^3 + 40/(1.069583)^4 + 1,140/(1.069583)^5] = 950$

The €40 cash inflow per year represents the interest coupon payable in respect of the bond whereas the amounts varying from €66.11 to €74.16 are the amounts representing the interest income on the security using the "effective interest method" which is common in FRS102 and IFRS9 and are the amounts which will be credited to P&L for the relevant periods (and thus included in the computation of case I profits). We would welcome confirmation that the entirety of the interest income represents "interest equivalent", i.e. the combination the interest coupons payable and the premium on redemption.

3.2 Taxable interest equivalent and deductible interest equivalent

> ***"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].

> (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'.

As noted in response to Question 4, we have concerns that the proposed definition of "interest equivalent" deviates from the ATAD standard and, in the event that there is a change to the proposed definition, we consider it important to ensure that parity of treatment is retained.

In relation to companies within the financial services industry, particular issues arise as interest and finance costs/income are often embedded in the instruments and contracts which are traded by the relevant institutions. This is especially true where fair value accounting is used for both assets and liabilities. In such circumstances, companies are not necessarily required to separately identify interest in their published accounts as they will recognise the changes in the fair values in the assets/liabilities which will include finance costs/interest aggregated with items which reflect the value of the loans/bonds – i.e. . in accounting for these instruments, a single P&L account entry may be made (whether for an asset or liability) reflecting the change in the value of the instrument rather than recognising separate amounts in respect of interest income/expense and other factors (foreign exchange, default, credit risk etc). As a consequence, accounting systems will not be designed to separately identify "interest" as a category and the proposed restriction would be impossible to implement. In our view, an alternative approach be adopted to facilitate compliance in this limited sector.

When faced with a similar quandary, the UK applied its equivalent Corporate Interest Restrictions for such companies on the basis that all income/expenses and gains/losses arising on financial instruments (including loans, securities and derivatives) accounted for on a fair value basis is to be taken into account in computing "tax-interest" for UK corporation tax purposes. While this will have included items which were not strictly related to interest/borrowing costs, we expect that HM Treasury was able to accept this approach as it reflected the commercial measure of profits/losses as reflected in the relevant financial statements. Such an approach would be an appropriate solution and approach for Ireland to adopt also as it would act to limit the additional compliance burdens which will be placed on taxpayers and Revenue through implementing these rules. Whether this approach is introduced on a mandatory or optional basis, it would be important to ensure that it is applied equally to revenues and costs such that the spirit of ATAD is adhered to. We would strongly submit that such an amendment be brought about on an optional basis.

a) Definition of taxable interest equivalent – Relevant Profits

We note that the definition of taxable interest equivalent refers to income taken into account in computing relevant profits of the entity, and would suggest that this could result in an unintended consequence in connection with para (a)(iii) where relevant profits are defined as accounting profits. In this submission we have assumed "relevant profits" comprise profits subject to tax in Ireland.

It is important that the meaning of "relevant profits" in the definition of "taxable interest equivalent" refer to the profits for tax purposes and not profits for accounting purposes.

b) Definition of deductible interest equivalent – connection with "relevant profits"

We note from the Feedback statement that "relevant profits" are to be determined in the next consultation phase. In the definitions of both taxable and deductible interest equivalent, the definitions of "relevant profits" and "relevant entity" are critical and therefore the comments that follow may have to be revisited depending on how these are construed.

In the interim, we have taken the view that "relevant profits" is akin to profits subject (before deduction of charges, given the reference to "interest equivalent deductible from the relevant profits" in the definition of "deductible interest equivalent") to Irish corporation tax and "relevant entity" is the company chargeable with respect to such profits. (We would note that this is consistent with the ATAD Article 4(2) definition of EBITDA) which speaks of "income subject to corporate tax in the Member State of the taxpayer"). We would note that it remains to be seen whether the concept of "relevant profits" should take into account any relief for losses forward from prior years which may be availed of under TCA97 s396. Where relevant profits are construed narrowly and do not take account of such losses forward, this may give rise to difficulties in applying the ILR through the deeming of Case IV income. Further commentary and a worked example of same is included later in this paper on this issue.

In essence, it would seem that both definitions for taxable and deductible interest equivalent require that they be taxable or deductible in computing taxable profits. We make this point because interest payable between an Irish resident subsidiary and its parent may be reclassified as a distribution under TCA97 s130(2)(iv) and as such would generally not be deductible in the hands of the payor companies. In that instance, it would be curious if either receipt or payment would be considered as part of the calculation of the ILR.

Looking to para (b), consider the following examples in companies A and B which are both trading companies and interest income in each is chargeable to tax under Schedule D, Case III.

		Company A		***Company B***
Sales		100		100
Interest income		10		10
		110		110
Trading expenses	Nil		125	
Trading interest exp	120	120	120	245
Loss		(10)		(135)
Excess deductible interest		110		110

Company A - The question must be asked as to what amount of interest equivalent reduces the relevant profits and tax chargeable below zero. There is a case I loss in this instance of €20, being €100 (Sales) less €120 (Interest expense). If we assume that a claim is made under TCA97 s396B then that would appear to be calculated as follows:

Case III interest	€10	
Tax at 25%		€2.50
Trading loss (due to interest exp.)	€20	
Value based at 12.5%		€2.50
Excess		Nil

In that instance there would be no amount that would reduce the relevant profits below zero. Therefore the deductible interest equivalent should be €110 i.e. interest expense of €120 reduced by interest income of €10.

Company B - the same question must be asked here i.e. what amount of interest equivalent reduces the relevant profits and tax chargeable below zero. It is difficult to answer this question as it cannot be said whether it is the interest expense of €120 or trading expenses of €125 which reduces the relevant profits and tax chargeable below zero. In our view, it is open to a taxpayer to determine for themselves the order of priority which should be given to any other deductible expenses compared to interest expenses/relief such that the interest restriction is only invoked by legislation for an amount of interest that is taken into account in reducing taxable relevant profits to zero. See for example dicta of Pollock MR in his decision of *The Sterling Trust*[3] at the Court of Appeal where he, having referenced previous decisions concludes "*…where you are considering the business of a company which has two sources of income, the one subjected to tax and the other not, you are entitled to assume and deem that it has paid the money that it ought to pay according to the most businesslike way of appropriating the revenue to the expenses; further, that even though that has not been done in fact by any separate allocation of the money, as was done here in the later years by putting it at a special bank, still you are entitled to treat the money as having been paid out of the fund which is most favourable to the company, which is, in this case, the taxpayer."*

In Company B's example, there would be sufficient trading expenses to reduce the profits to zero i.e. a case I loss (ignoring interest) of €25 which if value based at 12.5% would allow a tax credit of c€3 which could reduce a tax charge on the case III income of €10 of €2.50. On that basis there would be no interest deduction to restrict. We would welcome such clarification.

A similar comment could be made in respect of para (a)(II) of the definition of "deductible interest equivalent". This refers to the amount of the value-based loss based on 4 or 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" depending on the tax rate applicable to the "relevant profits". The question arises as to how one quantifies the amount of deductible interest equivalent within a loss which is value based to reduce the tax chargeable on relevant profits. As with interest as an expense in our view priority should be given to any other deductible expenses within that value-based loss that is taken as reducing the tax payable on the relevant profits. It is noteworthy that reference is made in para (a)(II) to value based deductible interest equivalent which reduces tax chargeable below zero. It is not clear as to why such reference is made given that such value-based losses eliminate tax payable and do not, of themselves, create a tax refund.

[3] The Sterling Trust, Ltd v The Commissioners of Inland Revenue; The Commissioners of Inland Revenue v The Sterling Trust, Ltd [1925][12 TC 868]

c) Definition of deductible interest equivalent – interaction with group relief provisions

We note that the proposed definition of "deductible interest equivalent" has a number of limbs, namely:

i. Any amount which is deductible in computing the relevant profits (taken in our view to refer to interest to be treated as an expense and deductible as same)
ii. Any amount which is deductible from the relevant profits (taken in our view to refer to charges on income i.e. TCA97 s247 interest); and
iii. An amount calculated as either 8 or 4 times the amount deductible from the tax chargeable on the relevant profits taxable at either 12.5% or 25% respectively (taken in our view to refer to relief on a value basis which may be claimed by a company).

The wording of the above categories, in our view, addresses for the most part the mechanisms by which a deduction may be claimed for interest expenses incurred in a single entity. The definition does not, however, encompass instances where relief is claimed from other companies pursuant to S420A and S420B TCA 1997. Where the intention of the legislation, as we expect is the case, is to impose a restriction on the use of interest relief or expenses in the company that obtains value for such deductible amounts (whether by incurring the expense directly or via a group relief claim), then amendments may be required to the existing group relief provisions to account for same.

Under S420A(3)(a) TCA 1997, where a company incurs a relevant trading loss and/or an excess of relevant trading charges on income then that loss or excess may be claimed by another company against the other company's relevant trading income or other income specified in TCA97 s21A. The exact reference in legislation to this act of surrendering and claim by the group companies refers to the amounts being "set off" rather than being deducted. In our view, there is an inherent difference between a deduction and an amount being set off, the former having the ability to create a loss while the latter can at most bring the profit down to zero.

Similarly, S420B TCA 1997 allows for relief on a value basis in such a way that the amounts claimed by the recipient company are limited to the tax on certain income (i.e. the relief cannot be used to reduce the tax liability below zero).

Nonetheless, group relief, as currently written, only deals with losses and not exceeding borrowing costs or interest capacity and we suggest later on in the paper that such group relief provisions be amended to take account of such matters. For completeness we note that TCA97 s396B speaks of "reducing" a taxpaying company's liability rather than the value-based loss being "deducted" from the taxpaying company's corporation tax liability. In that instance to read "deductible" in the definition of "deductible interest equivalent" as being other than a reduction of tax payable would make the definition unworkable and likely a court would have to construe the matter in a workable manner.

Ignoring the concept of group EBITDA thresholds (which we understand will be addressed in later consultation), we would expect that the ILR should be layered over

existing interest relief provisions including group relief under S420A and S420B. We would therefore expect that interest costs and charges on income should continue to be surrendered to group companies subject to the individual interest capacity in each company – however, the definition of deductible interest at present does not appear to take into account instances where relief is claimed as an offset rather than a deduction.

The interaction between group relief and the ILR can be seen from the following example:

	A Case I	B Case I	C Case III	Total
Sales/Income	300	200	200	700
Interest expense		160	50	210
S247 interest	200			200
Interest deduction	200	160	50	410
Profit	100	40	150	290
30% EBITDA	90	60	60	210
Interest deduction	200	160	50	410
Excess borrowing costs	(110)	(100)	10	(200)

In this instance, the group has an allowable restriction (on a 30% EBITDA) test, and this example looks to the group EBITDA as the method of restricting the interest relief. Company C is allowed take an interest reduction of €60 but is only taking a deduction of €50, so arguably it could take some of the excess from A or B in order to adhere to the allowed group EBITDA. If it does that then the matter turns to which one does it take the excess from i.e. A or B or both. A has TCA97 s247 interest which can reduce all income and B's interest was taken as a Sch D case I deduction which for these purposes has a taxable value at the 12.5% rate. Either way that would require a surrender and the question of potential value basing of interest reliefs arise. We understand that this is a matter for the subsequent feedback statement but mention this difficulty here to demonstrate the potential for updating the loss group relief provisions to take account of the surrender of excess interest.

d) Definition of "deductible interest equivalent" - Mixing of euro for euro and value-based relief

As noted in our commentary in (c). the proposed definition of "deductible interest equivalent" has a number of limbs and includes amounts deductible in relevant profit s (taken as an expense), amounts deductible from relevant profits (charges on income) and amounts calculated at either 4 or 8 times the amount deductible from tax chargeable (referring to value based relief).

The construction of the last category in the proposed definition is unclear to us, in particular the reference in (iii)(A) to "8 times any amount which is deductible from 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)". On the assumption that the rate of tax referred to (being 12.5%) refers to the tax on the relevant profits, the proposed definition appears to envisage some form of value

based relief against trading income, whereas trading income is not relieved on a value basis. It is therefore unclear to us as to the purpose of (a)(iii)(A) in the proposed definition and we would welcome a discussion with the Department of Finance on same.

4. Exceeding borrowing costs and EBITDA

4.1 Exceeding borrowing costs and exceeding deductible interest equivalent

> '***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]

> "***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'.

Nothing further occurs at this time on the above, but we would note one technical comment on the interaction of EBITDA and the exceeding borrowings cost definition at part 4.2 below.

4.2 Calculation of EBITDA

'***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*'.

The ATAD states in Article 4, paragraph 1 that "exceeding borrowing costs and the EBITDA may be calculated at the level of the group and comprise the results of all its members" and in paragraph 2 states "the EBITDA shall be calculated by adding back to the income subject to corporate tax in the Member State of the taxpayer the tax-adjusted amounts for exceeding borrowing costs as well as the tax-adjusted amounts for depreciation and amortisation".

This would suggest that one adds back the deductions for "I" and "DA" which are taken in computing "P" whether "P" is positive or negative. We mention this point here because it can be seen that the definition of "I" above speaks of "*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…"*. It is therefore assumed that such portion of (a)(i) and (ii) referred to above refer only to the mention of those sub-paragraphs and not to the adjustments made to those amounts which are mentioned later in (a)(I) and (II) regarding adjustments which bring relevant profits and tax chargeable below zero. Consider the following example, a company which is carrying on a trade and has no other income recognises an allowable loss as follows:

	€
Sales	10,000
Interest expense	11,000
Trading loss	(1,000)

In this instance, EBITDA would be €10,000 being (P + I + DA) i.e. -1,000 + 11,000 + nil = €10,000. This would be used later to calculate the "allowable amount" of 30% of EBITDA i.e. €3,000 and the restriction would be applied to the "exceeding borrowing

costs" of €10,000 being the "interest equivalent which is deductible in computing relevant profits" of €11,000 reduced by €1,000 being the amount of such interest equivalent "which reduces the relevant profits below zero".

We note that the Feedback document has suggested that the next consultation and feedback phase will focus on possible definitions of the term "relevant profits". In the interim, we would note our initial view that such a term should be defined as the profits, gains or losses which are assessed as being subject to tax in the period in which the interest restriction rules are being applied. Such an approach would be in line with Article 4(2).

Additionally, we would note that the proposed definition of EBITDA is calculated as a function of relevant profits, exceeding borrowing costs and allowances in respect of capital expenditure. Of note is the inclusion of exceeding borrowing costs referable to exceeding deductible interest equivalent. The proposed method for calculating exceeding borrowing costs takes into account an amount referred to as the "exceeding deductible interest equivalent". The latter, in turn, takes into account reductions for legacy debt and a de minimis threshold amount. We would expect that in the calculation of EBITDA for the purposes of identifying the base line for the "allowable amount" of 30%, no regard should be taken of the legacy debt or de minimis amounts in identifying exceeding borrowing costs. Clarity on such an approach would be welcomed.

It can be seen from the definition of EBITDA that the definition of "DA" there refers to capital allowances and certain other reliefs for capital expenditure "…less any amount of those allowances which are referable to deductible interest equivalent." It is presumed that this deduction refers to any financing costs which are included within the capital expenditure incurred for which a deduction is not given separately in computing income. This is on the basis that presumably the latter would be included within "I" of EBITDA and to do so would double count the addback of the deductible interest equivalent which reduces relevant profits. Further, clarification would be welcome on whether "DA" includes amounts for balancing allowances and charges for respective assets.

5. Applying the ILR to a single company

(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 —

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

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.

It is understood that the restriction of the interest expense is done in the form of deemed Case IV income to cater for the differing tax rates of 12.5% and 25% for corporation tax purposes. The matter could be dealt with by restricting interest deductions in the computation itself rather than imposing such deemed income and then carrying the tax value of those disallowed deductions forward as an interest tax credit. The use of the deeming provisions is not without difficulties. We would argue that this deemed case IV income mechanism may not operate perfectly in circumstances where a company has case I losses forward and current year interest expense included in the computation of the current year case I result. (Please see

out detailed example set out below.) In such circumstances, this mechanism would act to impose a cash tax charge (on the deemed case IV income) rather than simply reducing the accumulated losses forward which would be in line with ATAD principles.

In cases where a company is profit making or in a break-even scenario, the operation of deemed income subject to Case IV would appear to have the same effect as disallowing a deduction for interest expenses. However, in cases where the company carries trading losses from prior years, such deemed income could conceivably create a cash tax liability where one would not otherwise exist. An example of one such cash tax charge which could be imposed is outlined below:

Baseline assumptions

	€
Revenue	6,500,000
Interest expenses	(900,000)
Other trade expenses	(5,000,000)
Profit/(Loss) before tax	600,000

- No legacy debt;
- Trading losses carried from prior years are assumed €2,000,000;
- Interest income is assumed to be nil;
- Interest is assumed to be deductible as a trading expense;
- Ignore standalone entity exemption and de minimis threshold;
- "Relevant profits" are assumed to be equivalent to profits chargeable to corporation tax (i.e. €600,000); and
- Assume no capital allowances

Steps in ILR calculation:

Step 1: Identify tax liability before interest limitation

- In this case, the company has no tax liability prior to the application of the ILR, as any trading income is sheltered in full by way of losses forward from prior years (S396(1))

Step 2: Identify "interest equivalent income" and "interest equivalent expense"

- Interest equivalent income is nil, while interest equivalent expense is assumed to be €900,000.

Step 3: Identify company's "taxable interest equivalent"

- This is nil.

Step 4: Identify the company's "deductible interest equivalent"

- Assuming that the interest expense is allowed as a deduction (TCA97 s81), the deductible interest equivalent is equal to €900,000.

Step 5: Calculate "exceeding borrowing costs" and EBITDA.

- In this instance, the calculation of exceeding borrowing costs is relatively simple, being equal to €900,000.
- EBITDA is equal to €1,500,000, being equal to the relevant profits of €600,000 (which we assume isprior to any claim for losses forward from prior years) plus the exceeding borrowing costs of €900,000.

Step 6: Identify the "allowable amount" and any excess non-deductible interest

- The allowable amount is equal to €450,000 (being 30% of €1,500,000) The excess, disallowable amount is therefore €450,000. The operation of the ILR requires an amount of €225,000 to be deemed Case IV income (Being S/2 in the above formula) subject to tax at 25%.
- This results in a tax charge of €56,250 on the company, in a case where a tax charge would otherwise not have arisen due to a sufficient level of trading losses carried from prior years.

As outlined by the example above, where a company accumulates trading losses carried forward from a prior period, Ireland's loss offset rules would need to be amended to permit the offset of such losses against the case IV deemed income as to do otherwise would be to impose a cash tax liability where none should exist. Such amendment to the carry forward provisions should prevent a cash tax charge being imposed, we would not expect this change to result in a weakening of the carry forward provisions which would otherwise limit the use of such losses to income from the same trade.

Lastly, consideration should be given to either expanding on the proposed section or to amend the existing Close Company provisions in TCA97 to ensure that the deemed Case IV income in question cannot be treated as undistributed investment income for the purposes of a close company surcharge calculation.

6. Carry forward/back options

6.1 Carry forward of non-deductible interest

(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*'.

While the carry forward of any disallowed interest expense (whether by tax credit or carrying individual expense items) would be welcome from the perspective of taxpayers incurring significant interest expenses for bona fide reasons, the absence of a group tax consolidation in Ireland poses real challenges to the ability of companies to utilise carried forward interest deductions. In similar circumstances, in implementing similar restrictions, the UK has chosen to effectively refresh carried forward amounts each year to allow them to be available for grouping with other group members. This is akin to the treatment which would be available in countries with a

consolidation regime and we recommend that it be considered. Existing infrastructure in TCA97 allows for group relief in respect of trading losses and charges on income, and we would suggest that such infrastructure could be leveraged off in legislating for the carry forward of previously disallowed interest expenses (whether by way of carry forward and "refreshing" of the value of the expenses or by way of an "interest tax credit").

For example, TCA97 s83(3) which deals with the tax treatment of investment companies explains that "Where in any accounting period of an investment company the expenses of management deductible … together with any charges on income paid in the accounting period wholly and exclusively for the purposes of the company's business, exceed the amount of the profits from which they are deductible, the excess shall be carried forward to the succeeding accounting period, and the amount so carried forward shall be treated for the purposes of this section, including any further application of this subsection, as if it had been disbursed as expenses of management for that accounting period." In effect, excess management expenses and charges carried forward from one account to a subsequent accounting period are "refreshed" in the latter accounting period and are treated as such in that accounting period. A similar form of wording could be utilised for excess exceeding borrowing costs, if such an approach were to be adopted.

In our view, the interest credit forward takes the tax value of the previously disallowed exceeding borrowing costs and does not look to the individual components which may include a combination of interest allowable as an expense (S81) and interest as a charge (S247). As noted in our responses to Questions 1, 2 and 3 we have recommended a review of the existing regime for interest relief in Ireland. Where changes are made to the existing interest relief regime, it may prove difficult for taxpayers reviewing their carried forward interest to assess whether such relief meets any new conditions.

In the context of deferred tax, accounting and valuation issues exist in how appropriately and correct it would be to recognise a deferred tax asset for the carried forward interest deductions. We mention this for completeness and to convey the additional commercial impacts of an interest limitation rule.

In our view, the carry forward provisions also need to take into account potential cases where the attribute carried forward could be lost due to the carry forward measure being narrowly legislated for. In our view consideration should be given to deeming the carried forward of an interest expense similarly to a loss on a trade where appropriate such that it can be treated similarly for terminal loss relief purposes under TCA97 s397. Such existing infrastructure may also be modified where the carry forward is structured as an interest tax credit, as suggested in the feedback statement. A similar provision similar to TCA97 s400/401 should also considered to allow the unused interest expense and capacity to be transferred in the instances of change of ownership subject to anti-avoidance provisions.

6.2 Carry forward of excess interest capacity

(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'.

The salient points made with respect to Question 9 and the carry forward of previously disallowed interest are, in our view, equally applicable to the treatment of unused interest capacity. In particular, the absence of a consolidation system of taxation in Ireland creates issues for group relief in the context of such carry forward amounts. Depending on the results of the group, excess interest capacity in a given year may not be capable of being fully utilised, even where it is apportioned/surrendered/shared with other group companies as discussed in our response to Q5. In these cases, a balance of interest capacity may be carried forward to later years but current group relief provisions prohibit the surrender and claim of amounts carried forward.

Similarly, consideration should be given to instances where interest capacity may be lost due to reorganisations or restructurings. Similar to our comments on the carry

forward of interest expenses, existing infrastructure in the way S.400/401 could be also considered to allow the unused interest capacity to be transferred in the instances of change of ownership subject to anti-avoidance provisions.

Lastly, with respect to the draft sections noted, we would suggest that the reference in draft subsection (3) should be to subsection (2) and not subsection (1) as the former contains the provision for making the claim for carry forward referred to.

7. ATAD exemptions

7.1 De minimis exemption

> "***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.

Article 4(3) provides that the taxpayer may be given the right to deduct exceeding borrowing costs up to €3m, but the Directive does not require any specific anti avoidance provisions to be considered. Unless explicitly required and provided for in the Directive, additional anti avoidance provisions to be applied to the de minimis amount of €3million could make our regime less competitive than competitors that do not apply such measures. Existing general anti avoidance provisions in TCA97 which are a prescribed part of the ATAD in any event, would, in our view, be sufficient.

Based on a Deloitte survey of other EU Member States, it is clear that the dominant portion of them have inserted this de minimis threshold into their domestic legislation. This should indicate that there is no barrier to Ireland doing likewise.

7.2 Excluding standalone entities

> "***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.

'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.

"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?

The above looks to "single companies" which do not come within the definition of standalone entity and the question arises as to the meaning of a single company. To be a "standalone entity" the company must (1) be chargeable to corporation tax on its worldwide income (2) not be a member of a worldwide group (and the latter definition requires full consolidation), (3) not have any associated enterprises and (4) not have a permanent establishment (PE) outside the State. Arguably, a "single company" could pass tests (2) and (3) in any event such that the matter comes down to points (1) and (4). A company held as an investment or available for sale in a worldwide group would not be fully consolidated and this would mean that it could pass tests (1) to (4) depending on the circumstances. If the single company is not within the charge to Irish tax in the first instance then there should be no interest to restrict and therefore would adhere to the purpose of the "standalone entity" exception in the ATAD. Finally, if the single entity has a PE in another jurisdiction then it would be subject to two tax codes and depending on how that PE is treated in the other jurisdiction then the question of deduction and taxability of cross border payments will arise. As such, provided the financing arrangements between the entity and the permanent establishment are at arm's length without a main purpose of tax avoidance then consideration could be given to not applying the ILR given that the borrowings remain within one entity (being the head office and the PE).

Paragraph 3 of Article 4 of ATAD 1 states that "By derogation from paragraph 1, the taxpayer may be given the right…(b) to fully deduct exceeding borrowing costs if the taxpayer is a standalone entity". The ATAD states that the meaning of standalone entity is "a taxpayer that is not part of a consolidated group for financial accounting purposes and has no associated enterprise or permanent establishment".

Paragraph 8 of the ATAD preamble notes the optional exclusion of standalone entities from the scope of the interest limitation rule given the limited risks of tax avoidance. In an analogous situation, in the EU Commission's decision on the excess profit exemption State aid scheme implemented by Belgium, the Commission at paragraph 79 acknowledges, in the context of the Belgian tax scheme that "standalone entities cannot be confronted with double economic taxation, they are in a different factual and legal situation from multinational companies…". A similar viewpoint can be shed in consideration of providing for a carve-out of standalone entities as Article 4 and the preamble prescribes. To reconfigure the previous line and sentiments of the Commission, interest limitation rules are being implemented to prevent BEPS risks on the presumption that excessive interest payments are a key player in tax avoidance. The fact that standalone entities do not prevent a risk in using interest as a tax avoidance measure leads to the conclusion that the definition of "standalone entity" needs to fully capture all companies that do not present a BEPS risk that are standalone entities rather than a fractured definition that incorporates some but not all standalone entities notwithstanding that none of which present BEPS risks.

As outlined in the BEPS Action 4 report at page 35, countries need to consider when designing domestic rules to limit their "…possible negative impact on situations not involving base erosion or profit shifting". The report acknowledges that in respect of a standalone entity which is "any entity which is not part of a group…the risk of base erosion and profit shifting involving interest is likely to be relatively low". In addition to the above, a foreign company could have a permanent establishment in Ireland and would not, on the above basis, be regarded as a standalone entity, even if it were not

part of any corporate group. Consideration should be given to broadening the definition appropriately given that there is only one taxpayer entity.

The definition of "associated entity" adopted here is by reference to the definition as part of the hybrids legislation which includes, matters such as "significant influence" etc. which are not present in the ATAD definition of "associated enterprise". This has the potential of narrowing the definition of "standalone entity" and therefore we would argue that the definition of "associated enterprise" not go beyond that in the ATAD.

Ireland has a world-renowned securitisation regime which will be exposed negatively to interest limitation rules. A strategic priority outlined in the Government's IFS 2020 action plan report is to "Develop job-creation opportunities from emerging IFS sub-sectors & new markets" and "drive continuous improvement in the operating environment & competitiveness of Ireland's IFS sector". Securitisation in general terms is essentially the unbundling of risk and re-packaging of cashflows to fit investors' preferences in respect of yield, maturity, liquidity and risk. It provides the originator of the assets with an effective financing method which allows it to raise lower cost funding. Where an interest deduction is restricted in these circumstances, the whole regime may become "broken". Care needs to be taken in how the securitisation sector is considered in the context of the rules. In particular, such entities are generally organised as bankruptcy remote entities with no controlling shareholder. Where, as a matter of company law, shares must be issued, they generally do not carry any significant economic rights. As such it is important that such companies can be regarded as "standalone entities" and such can be achieved under the ATAD definition of that term which is expressed in clear statutory language. By contrast, the introduction of significant influence as a factor introduces uncertainty in an arena where uncertainty creates risks.

With respect to Question 13 and the implementation of such articles, we would reiterate our comments previously outlined in our 2019 submission on the hybrids and interest public consultation. ATAD Article 4(8) provides that the consolidated group for financial accounting purposes consists 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. The taxpayer may be given the right to use consolidated financial statements prepared under other accounting standards. Furthermore, Article 2(10) provides that "consolidated group for financial accounting purposes" means 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. In our previous response in 2019, we had noted that in many cases, the group accounts may be prepared under a GAAP other than IFRS or that of an EU member state (for example the GAAPs of the US, China, India, Japan, South Korea and Canada can be utilised under the UK's corporate interest restrictions rules). Accordingly, in any implementation of Articles 4(8) and 2(10), we would recommend that reference is also made to "any corresponding provision of the law of a territory outside Ireland".

Question 14 speaks to certain standalone entities. The ATAD is clear on standalone entities and going beyond what it is the directive could put Ireland in an anti-competitive position vis-à-vis other ILR's.

7.3 Exempting "legacy debt" (if not modified)

> ***"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.

> 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.

> **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.

Paragraph 4 of Article 4 of ATAD 1 states that "Member States may exclude from the scope of paragraph 1 exceeding borrowing costs incurred on…(a) loans which were concluded before 17 June 2016, but the exclusion shall not extend to any subsequent modification of such loans…". The preamble notes at paragraph 8 that "Member States could provide for a grandfathering clause that would cover existing loans to the extent that their terms are not subsequently modified i.e. in case of a subsequent modification, the grandfathering would not apply to any increase in the amount or duration of the loan but would be limited to the original terms of the loan". This grandfathering clause is provided "to facilitate the transition to the new interest limitation rule". It is imperative to incorporate this grandfathering clause into our legislation on interest limitations so as to ensure that loan financing taken out prior to the issue of the EU Directive is not impacted by these rules. Applying interest limitation rules retrospectively to a pre-existing loan is unnecessary in the context of an existing regime which is equally effective as the proposed interest limitation rules.

The non-inclusion of a grandfathering rule would negatively impact many creditor/debtor relationships and as such we welcome the inclusion of the concept of "legacy debt" in the ILR provisions.

We would suggest that clear guidance is provided with respect to the meaning of "modification" to provide taxpayers with greater clarity.

For example, 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 (for example, due to LIBOR being phased out).”

In our view, a modification should involve a material alteration to the essential components of the loan being the parties, payment, term and interest. For example, a situation where the security of a loan is changed from one asset to a similar asset and of similar value should not be regarded as a modification of the loan.

In light of the revised Transfer Pricing rules brought about by Finance Act 2019[4], it is expected that a number of groups will look to bring existing intercompany loan arrangements in line with the new rules either by applying an arm’s length pricing (assuming no domestic exclusion applies) or by revising existing pricing to take into account of the shift to the 2017 OECD Transfer Pricing Guidelines. Due regard and respect should be applied to the arm’s rate principle, a concept applied in every BEPS Action except this one. In our view, where a loan interest rate changes and the interest applied is at an arm’s length rate, consideration should be given to the extent of application of the “modification rule” in that instance given that the intention of the taxpayer is not one to generate base erosion advantage. Indeed, had the loan had an arm’s length rate applied from inception then it would have been within the legacy debt exception.

7.4 “Long term public infrastructure project” exemption

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

Article 4(4) of ATAD 1 states that “Member States may exclude…exceeding borrowing costs incurred on…loans used to fund a long-term public infrastructure project where the project operator, borrowing costs, assets and income are all in the Union”. The ATAD outlines a long-term public infrastructure project to be “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”.

Certain industries and indeed certain corporate bodies bear proportionately greater debt burdens than others, including those operating in the infrastructure sector. Indeed, in the infrastructure sector it would not be unusual to have interest burdens closer to 100% of EBITDA, as opposed to the 30% under the ILR.

Long-term public infrastructure projects need certainty of treatment, especially as any unforeseen costs can be borne by the State. We believe that the interest restrictions should not apply to long-term infrastructure loans for several reasons. The imposition of a restriction on long-term infrastructure loans will inevitably discourage planned and future projects by making them more expensive. Worryingly, current projects will too be put at risk and the continued viability of such projects may not be sustainable which could require the cost of continuity to be borne by public finances. Long term infrastructure projects are by their nature capital intensive which requires a significant level of debt and certainty of cashflows in order for finance to be raised at the lowest

[4] Effective for accounting periods commencing on or after 1 January 2020

cost. Many projects involve both private and public sector investment often with Government backing. To impose restrictions on these projects would decelerate investment in infrastructure in Ireland.

This exclusion from interest limitation needs to avoid a situation where there is a narrow interpretation such that only Public Private Partnerships and Private Finance Initiative arrangements could qualify for the exclusion. On legislating for this exclusion, the Government needs to adopt a wide definition such that projects passing a public benefit test should qualify. For example, this would mean that projects that have significant public sector involvement such as social housing, energy generation, waste treatment and development of information technology and communication systems among many other areas, should all benefit from this exclusion. It is important to consider from a practical application that taxpayers should be able to request and obtain advance clearance from the relevant authority that their project is for a public benefit, and thus passing a key test to claim this exclusion.

Given the importance of infrastructure to Ireland, it is essential that tax barriers are not increased.

7.5 Excluding "financial undertakings"

'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*'.

The financial undertaking exemption as envisaged above would apply only to certain entities within financial services groups and may be of limited benefit to reducing the compliance burden necessitated by ILR. We note that major European economies such as Germany, France, The Netherlands and the UK have not included this exemption in their equivalent provisions.

In the context of many financial services groups generating interest income (whether these be banks, insurance companies or others), the net interest will generally be receivable by the main operating entities which will likely all be within (a) to (l) whereas holding companies, group service companies, leasing businesses etc are unlikely to benefit from the exemption. These other companies will exist for genuine business purposes, for example holding companies have effectively been imposed on each Irish bank to enact post-financial crisis regulatory reforms.

Accordingly, in terms of allowing full flexibility to taxpayers, we would recommend that the exemption be provided for in domestic legislation on an optional basis and for taxpayers to have the ability to opt in or out. Such an approach would appear consistent with ATAD 4(7) which says that Member States "may" exclude certain financial undertakings from the ILR.

8. Group ratios

8.1 The two "group ratios"

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'?

The ATAD at paragraph 5 of Article 4 provides optional implementation of one of two group ratio rules, specifically, the taxpayer may be given the right to either:

a. fully deduct net interest where its equity/total assets ratio is not more than 2% lower than the equivalent ratio for the consolidated group (being the consolidated group for financial accounting purposes); or
b. Deduct net interest up to the consolidated group's external borrowing/EBITDA ratio.

With respect to Question 18, the ratios outlined at Article 4(5) are based on the consolidated group as a whole and are a necessary building block in ensuring that tax relief for interest not be denied where the interest genuinely reflects the financial conditions of the consolidated group. 'Group escape clauses' (as these are often termed) are common in other tax systems in the EU. The German and French interest limitation rules both have a similar clause.

In our view, Ireland should make a provision for group escape clause incorporating both of the factors encompassed in Article 4(5) of the Directive given that the ATAD explains "the taxpayer may be given the right to either…" i.e. it is the right of the taxpayer as opposed to that of the Member State. Item (a) is a test of the relative quanta of debt on the balance sheet and the consolidated group as a whole whereas item (b) is a test based on the EBIDTA and borrowing costs of the group as a whole. It might be said that item (a) is a Balance Sheet test and item (b) is an Income Statement test. Further, different companies operating in different industries will have different balance sheet and income statement profiles such that this should not be a case of one size fits all and therefore both tests are necessary.

It is important that both are included to ensure that regard is had to the total leverage in capital and income terms as otherwise the effects of high interest rate currencies can be distortive.

In considering the possibility of whether the ATAD allows for "dual inclusion" of both (a) and (b) above, one must consider other areas of the ATAD where optionality is afforded to the Member State. On implementing Controlled Foreign Company (CFC) rules as required by Article 7 of the ATAD, the European Commission regarded its non-applicability of the CFC rules as an "either/or" test, the wording of the directive being "…the Member State of the taxpayer shall include in the tax base (a)… or (b)…". In respect of this consolidated group rule, laid out in paragraph 5 Article 4 of ATAD 1, "…the taxpayer may be given the right to either (a)… or (b)…". Juxtaposing both provisions, the consolidated group rule is distinctively more flexible than how the CFC provision was included in the ATAD. We advocate that both are included such that the optionality is afforded to the taxpayer. A taxpayer should be allowed to opt for one option in a particular tax year and may choose the other if their circumstances change. In that regard, we welcome the statement in the feedback statement that "*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*". In our view, the additional complexity should be small when compared with the benefit of adhering to the wording of the directive vis-à-vis the arguments made above regarding "one size fits all" and indeed adopting an ILR which does not interfere with Ireland's competitive attraction to FDI.

With respect to Question 19, there will be practical difficulties in imposing a consolidated group ratio rule in instances where accounting standards change given the intended reliance on accounting definitions to determine a consolidated group (as in the definition of "worldwide group[5]"). It must also be considered that it could prove difficult to obtain the necessary information to prepare the required calculations for any group rule and flexibility has to be provided to address this. In circumstances of private equity, portfolio companies would not typically have access to information regarding other portfolio investments of the private equity house. Similarly, consolidated financial statements are not required to be prepared for certain large privately held groups, including in relation to private equity. Significant additional work might be required to apply the above rule. An optional 'group escape clause' would allow the taxpayer to make a decision on whether benefitting from the escape clause is proportionately justified on the basis of the increased compliance burden.

It must be acknowledged that a group escape clause may not be regularly used even when available. This may be due to any one or all of the following:

- Difficulty in determining the entities that belong to the group. There are exemptions available to companies not to form part of consolidated accounts so not every entity that could consolidate is included in the consolidation.
- Determination of a point in time for equity/debt/asset ratio. It is not uncommon to have entities in a group with non-coterminous year ends so there may be a requirement to prepare interim financial statements purely for tax purposes.

[5] Meaning the ultimate parent and all entities that are fully included in the ultimate consolidated financial statements.

- There may be differences in figures used across multiple jurisdictions in determining the ratios. There could be differences between IFRS and tax figures such that a misallocation of interest or an unjustifiable disallowance of interest arises.

Every effort should be made to ensure that the results of a joint venture (i.e. equity, assets etc) can be taken into account in calculating the applicability of the group escape clause under Article 4(5)(a) and (b). However, the treatment of joint ventures for the purpose of the "group ratios" creates additional complexity. While joint ventures may not be seen as fully included from a financial consolidation perspective, to the extent that a taxpayer country includes a pro rata share of the JVs total revenue, then that taxpayer should be given the option of including the JVs results for the purposes of the ILR.

Regard may be had to the treatment of joint ventures in other areas involving BEPS risks, namely in OECD guidance on Country by Country reports. The OECD guidance[6] in particular notes the following (underlining is included for ease of reference):

Where pro rata consolidation is applied to an entity in an MNE Group in preparing the group's consolidated financial statements, jurisdictions may allow a pro rata share of the entity's total revenue to be taken into account for the purpose of applying the 750 million Euro threshold, instead of the full amount of the entity's total revenue. Jurisdictions may also allow an MNE group to include a pro rata share of the entity's financial data in its CbC report, in line with the information included in the MNE Group's consolidated financial statements, instead of the full amount of this financial data.

With respect to Question 20, there is an inherent level of complexity involved where the group EBTIDA is to be based on tax adjusted values. Where the group is solely comprised of Irish tax resident companies, we would expect that the calculation of group EBITDA based on tax adjusted values should be relatively straight forward. However, where a group ratio is to be determined based on a worldwide group, this brings with it added complexity both in terms of identifying the tax adjusted amounts in different jurisdictions and in terms of available information to taxpayers in Ireland. It would not be uncommon, depending on the structure of a group, for certain individuals to manage the tax affairs of one particular jurisdiction or territory relating to the corporate group; as such, it may be unfeasible to expect the individuals preparing calculations to support the interest deductions in Ireland to have access to full tax results for the group to apply the Group ratio rule in a meaningful way.

In our view, the ILR is extremely complex and therefore should be made a simple as possible for ease of application within the parameters of the ATAD. If reference to a group ratio rule is to be made then that should be by reference to the group's consolidated accounts rather than to have to source tax computations for each company within that group in order to determine group EBITDA on a "tax basis".

With respect to Question 21, a potential definition of "third party borrowings" could be debts incurred with an entity which does not form part of the worldwide group as defined. The latter includes "entities" that are "fully included" in the ultimate

[6] https://www.oecd.org/ctp/guidance-on-the-implementation-of-country-by-country-reporting-beps-action-13.pdf (Updated December 2019), Part 5.1

consolidated financial statements. In general, that should not include associates and therefore borrowings with associates would be regarded as third party borrowings.

In relation to question 22, it is difficult to envisage a workable solution which would permit the exclusion of financial undertakings when assessing the group ratios on a worldwide basis. An Irish resident subsidiary may not have the ability to recompute the group income statement and balance sheet having first identified those foreign entities which were equivalent to the regulated entities listed in ATAD. This would be particularly exacerbated in circumstances where entities are included in the same consolidated account but whether there is not a 100% relationship between them. In respect of the worldwide group ratios, we believe that regard could only be had to published/audited group financial statements. In this regard, we recommend that the permitted accounts encompass more than IFRS or EU national accounting standards as it may otherwise be unworkable. Other member states have permitted reference to a wide range of financial standards (US, Japan, Canada, China etc).

9. Notional local groups

9.1 Defining a 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?

Question 23(i) to (iii) inclusive

In our view, the "notional local group" can have two purposes (1) to compute EBITA based on a group approach where the group is regarded as the "taxpayer" for the purposes of the ILR and (2) to allow for the group relieving of exceeding borrowing costs and interest capacity.

See responses to earlier questions which outlined the possible adaption of current group loss relief rules to excess interest and capacity. The current rules are known and have been tested through the years. However, consideration should be given to allowing notional local groups be determined by reference to group consolidated financial statements such that the members of the notional local group would comprise companies within the charge to Irish tax. In the absence of such application then regard should be had to the definition of a group for loss relief purposes at a minimum.

The matter of computing group EBITDA poses a momentary difficulty if such loss groups are used. Such groups can comprise certain non-resident companies and the ATAD specifies as follows:

"For the purpose of this Article, Member States may also treat as a taxpayer

(a) an entity which is permitted or required to apply the rules on behalf of a group, as defined according to national tax

law;

(b) an entity in a group, as defined according to national tax law, which does not consolidate the results of its members for tax purposes.

In such circumstances, exceeding borrowing costs and the EBITDA may be calculated at the level of the group and comprise the results of all its members".

It can be seen that this explains that exceeding borrowing costs and the EBITDA "may" comprise the results of all its members. This could mean combining the tax computations of resident and non-resident companies, presumably having computed such profits under Irish rules. This would be administratively difficult. However the above wording seems permissive in its approach given the use of the word "may" in the last paragraph of the above. On that basis and given that the notional group's second purpose as outlined above is to group relieve exceeding borrowing costs and interest capacity between those companies which are subject to tax it may be preferable to compute EBITDA based on those members of the group that are subject to Irish corporation tax. Arguably, that would put the EBITDA restriction and related group relief on a similar footing from an Irish corporate tax perspective. The existence of certain non-resident companies within the group would be there to determine the existence of a group in the first instance such that the members of the notional group would only comprise the companies subject to Irish tax that are part of a loss relief group. In short the "notional group" would comprise a sub-group of a the accounting group comprising only those companies which were subject to Irish corporate tax. In our view such approach would be permitted by the ATAD given that it allows a group "*as defined according to national tax"* which compares with the requirement specified in the "group ratios" in Art 4(5) which applies where "*…the taxpayer is a member of a consolidated group for financial accounting purposes*".

Question 23(iv)

With respect to Question 23(iv), we are not of the view that the operation of the two "group ratios" should have a significant impact on the concept of a notional local group, where adopted. With respect to the "Group Ratio Rule" contained in Article 4(5)(b), we would not envisage significant difficulties in applying the results to a notional local group, as the revised fixed ratio relies on exceeding borrowing costs relating to third

party loans divided by the group EBITDA (i.e. the consolidated group, not the local notional group).

Our preference would be that the consolidated accounts for the basis of determining the existence of a notional local group. If this was not adopted and a loss group was used as the potential definition then as regards the application of the "Equity Ratio Rule", we appreciate that the notional local group may not prepare consolidated accounts and therefore may not have access to the total equity and assets for the various group members. Where, as a simplification measure, the equity and assets required for the application of the Equity Ratio Rule are limited to just the members of the local group who would qualify for group relief[7], this may result in administrative complexity for the taxpayer and for their tax advisors. For example, Company A (an Irish incorporated, Irish resident entity) may prepare accounts in line with Irish company law and be in a local notional group with Company B (an Irish resident but non Irish incorporated company). It may practically be difficult, depending on organisational structure, for Company A to obtain details of equity and assets held in Company B in cases where accounts are prepared and maintained under foreign company law provisions. This is further complicated in cases of large groups. Such a complexity should not be present, at least to some extent, in the notional local group identifying their exceeding borrowing costs and EBITDA[8], as such information may be more easily identified than full Balance Sheet details. Consideration may need to be given to whether this administrative complexity may be addressed in a practical way for large local notional groups (e.g. by reference to the balance sheets of the notional group).

9.2 Optional or mandatory "group approach"

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"?

Question 24(i)

Where the definition of a notional local group is defined as in previous questions then we would expect the end result to be that deductible interest and/or excess interest capacity or carried forward amounts may be surrendered and claimed between qualifying group members for Irish corporation tax purposes. Under existing group relief provisions, no group election is required prior to surrendering or claiming loss

[7] For the purposes of this paper, taken to mean Irish resident companies and branches of foreign companies within the charge to Irish tax.
[8] In our view, such information may be easily obtained via draft/provisioning tax computations for the entities in question to identify deductible/taxable interest and tax adjusted profits forming EBITDA.

relief; instead, relief is claimed via the corporation tax return (Form CT1) for the surrendering and claimant companies. Accordingly, where the concept of a notional local group applies existing group relief provisions, a group election should not be required. In addition, we can see little practical benefit to making a group election, whether revocable or finite.

It may be the case that an individual company's EBITDA may provide a more favourable EBITDA than that of the notional local group of which it is a member. Therefore, the treating of the company or the notional local group as the taxpayer for the purposes of the ILR should be an annual election given ATAD 4(1) is permissive in its approach to allow Member States to regard certain national groups as taxpayers. In any event, interest will always be restricted by reference to the ILR applied on an individual or group basis.

Question 24(ii)

Current group relief will only be granted where the surrendering company and the claimant company are members of the same group throughout the whole of the surrendering company's accounting period and the claimant company's accounting period. Consideration should be given to implementing provisions akin to TCA97 s401 with respect to carried forward amounts which may continue to be unused at a time when the company holding such balances either exits the group or is the subject of a bona fide liquidation. In terms of amounts held (either excess borrowing costs or excess interest capacity) prior to the formation of a group, or on the movement of a company from one group to another, consideration should be given to allowing such balances to be used subject to anti avoidance provisions. For example, the provisions allowing the use of carried forward amounts prior to the formation of a group could include a condition requiring the movement of the company and/or formation of the group was not carried on with the main benefit or one of the main benefits expected to be a tax advantage.

Question 24(iii)

We are not of the view that anti fragmentation provisions would be required where a local notional group is defined according to existing group relief provisions.

Question 25

As noted previously, we are of the view that a notional local group should rely on existing group relief purposes. Under such provisions the actual relief claimed is optional and is effected by way of filing the Form CT1 for the surrendering/claimant companies. To introduce a mandatory "group approach" would deviate from established principles of group relief which we would not recommend.

9.3 Practical and technical considerations

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?

With respect to Question 26, ATAD does not require Member States to make provision for a "reporting entity" responsible for allocating amounts and reporting information. Therefore, we are of the view that to introduce such responsibilities on companies would be beyond the requirements in ATAD. In any event, where the notional local

group applies the provisions of a loss relief group, any allocation of relief or excess interest capacity should be capable of being identified through the corporation tax returns for the entities in question. In our view, relatively simple amendments to the existing corporation tax returns should be sufficient - the alternative suggested by Question 26 could, in our view, result in increasingly complex compliance processes and increased costs for taxpayers

With respect to Question 27, we would expect that full account would need to be taken of intragroup transactions to identify exceeding borrowing costs. While in most cases interest paid and received between members of a local notional group would net each other out and would be a non-issue, such balances should still be taken into account in computing the full measure of EBITDA. It is not practical, in our view, to rewrite each company's results to eliminate intragroup transactions.

Other than such adjustments in relation to exempt companies it would not appear practical to eliminate intragroup transactions given that in all likelihood the tax effect of the majority of such transactions will cancel themselves out over time. For example, interest paid which is regarded as a distribution to another Irish resident company within the group would be regarded as being exempt in the other company's hands such that the payment and receipt would cancel each other.

It is of course possible that not all intra notional group transactions will cancel each other out, but the administrative burden in looking at each intragroup transaction would be disproportionate to the result to be achieved. In any event, a transaction designed purely to reduce the ILR's effect could be within the application of the general anti avoidance rule.

Question 28(i)

We are of the view that exceeding deductible interest should be classified as a tax attribute akin to losses or charges on income and should be capable of being surrendered to and claimed by group members accordingly, up to the applicable 30% EBITDA limit (or other metric where the group rules are applied).

Question 28(ii)

Interest relief should be surrendered to members of the local notional group subject to their respect capacities for interest; we are not of the view that the presence of an overall negative EBITDA for the group as a whole should impact on this allocation of relief.

Question 28(iii)

We are of the view that excess interest capacity carried forward and/or deductible interest carried forward should be carried at an entity level. In particular, carried forward amounts should be carried by the entity in which the amounts initially arose. This treatment would be akin to the carry forward of losses by a company by whom the losses were originally incurred. However, we would suggest that such carry forwards could be surrendered intra group in future years.

Question 28(iv)

To the extent that a charge arises in respect of disallowed interest amounts, we are of the view that this should be applied at an entity level. As Ireland does not operate a

consolidation tax regime, it would be inappropriate to apply the charge at the notional group level.

Question 28(v)

Please refer to our recommendations with respect to changes in the group at Question 24(ii).

Question 29

We are not of the view that a mandatory application of the group approach would be workable or in line with existing group relief provisions.

Question 30

Under existing group relief provisions, losses may only be grouped against profits of a corresponding accounting period. Non coterminous accounting periods are addressed by TCA97 s422 to provide for apportionment on a time basis. where exceeding borrowing costs and interest capacity are treated similarly to such losses. The existing infrastructure in s422 may be looked to as an example of managing differing accounting groups.

10. 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.

As carried forward interest capacity only subsists for 60 months whereas interest relief itself may be carried forward indefinitely, we are of the opinion that some priority should be given to interest capacity unused from prior years. In addition, the purpose of the ATAD is to restrict interest expense deductions and so any order of application within legislation should respect that purpose.

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