Irish Funds
Ashford House,
18-22 Tara Street
Dublin 2 D02 VX67
t: +353 (0)1 675 3200
e: info@irishfunds.ie

6th Floor,
Square de Meeûs 37
1000 Brussels
t: + 32 (0)2 791 7693
w: irishfunds.ie

By email: ctreview@finance.gov.ie

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Dear Sir / Madam

Consultation on Interest Limitation Rules

Irish Funds appreciates the opportunity to make this submission to the Department of Finance ATAD Implementation – Article 4 Interest Limitation Feedback Statement n Interest Limitation Rules published on 23 December 2020.

1 **QUESTION 1**

What, if any, limited adaptions of the existing legislation could be introduced in Finance Bill 2021, to assist in effectively integrating the ATAD ILR with existing domestic rules?

- We do not see any limited adaptions that could be carried out in Finance Bill 2021. In our view, wholesale changes are warranted.
- In the event that the Government decides against a full review of existing rules prior to implementing ILR, we recommend that - at a minimum - the existing rules which restrict the deductibility of interest on loans from connected parties are reviewed with a view to removing those rules that are no longer necessary in light of the ATAD ILR. This is because ILR is intended to allow deductions for third-party interest (provided it is not disproportionately allocated to one jurisdiction over another). While allowing deductions for third-party debt is imperfectly provided for in ATAD, given this general intent many of Ireland's existing rules may become redundant.

2 **QUESTION 2**

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

- We submit that the entire system for allowing deductions for interest needs overhauling, and simplification. It is getting very complicated, and

administratively expensive, to operate. In particular, the following features should be progressed in later Finance Bills:

- Abolish section 247. The complexity of dealing with interest deductible as a 'charge on income' is now even greater, in the application of the ILR.

- Permit companies taxable under Case III to claim a deduction for interest costs incurred wholly and exclusively for the purposes of earning Case III income.

3 QUESTION 3 – A POSSIBLE SEVEN STEP APPROACH

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.)

- Overall, we agree it makes sense to apply the ILR after a company has prepared its corporation tax computation in the normal way. However, we would emphasise the need to keep the ILR rules as simple as possible.

- The application of the ILR does create a timing challenge, because it will take a period of time after the end of an accounting period to calculate the corporation tax computation in the normal way. It will then take further time to determine the impact of the ILR on the tax payable by the company or group of companies. We would suggest that there should be, at least initially, an extended period of time within which to apply the ILR which could post-date the normal corporation tax return filing dates. This would, at least initially, allow groups the time to assess and update their corporation tax calculations.

- For the same reason, the requirement to account for any additional tax due by reason of the ILR should be expressly excluded from the charge to preliminary tax.

4 QUESTION 4 – INTEREST EQUIVALENT

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

We would suggest the following:

- The term '*interest*' is used instead of '*interest equivalent*'. There are other places in the TCA where the term 'interest' is given a broader meaning (eg, section 812) and it leads to a more succinct key term for the entirely of the ILR regime. However, it should be clear this definition of 'interest' only applies for the purpose of the ILR, and not more broadly in the Corporation Tax Act.

- The language of section 835AH is replicated here, rather than use a cross-referral, especially is that paragraph (c) itself cross-refers to another definition.

- Inserting the other elements of 'borrowing costs' referenced in ATAD 1, so that it is clear that any income arising under these headings falls to be treated as 'interest'.

- Deleting the final paragraph, as it seems to cover the same ground as paragraph (c) of the definition of financing return in section 835AH.

Our suggested amendments are as follows:

For the purposes of this [Chapter]

"**interest** ~~**equivalent**~~" includes any amount of –

(a) interest,

(b) amounts economically equivalent to interest including –

(i) discounts, and

(ii) amounts **equivalent to interest under an arrangement where it is reasonable to consider that the arrangement is equivalent to an arrangement for the lending of money, or money's worth at interest** ~~referred to in paragraphs (c) of the definition of financing return in section 835AH~~

(c) payments under profit participating loans, including payments pursuant to securities where the consideration given by the borrower is to any extent dependent upon the results of the borrower's business or any part of its business,

(d) the finance cost element of finance lease payments

(e) the finance cost of debt factoring arrangements

(f) amounts measured by reference to a funding return under transfer pricing rules

(g) notional interest amounts under derivative instruments or hedging arrangements related to a company's borrowings

(h) foreign exchange gains and losses on borrowings and instruments connected with the raising of finance

(i) ~~(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.]**[this final provision may be duplicative of paragraph (b)(ii)]**

5 **QUESTION 5**

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

For the definition of '*taxable interest equivalent*', we would suggest the following:

- The term '*interest*' is used instead of '*interest equivalent*'. It makes the definition more readable and loses nothing in accuracy.

"**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 of a relevant entity.

For the definition of '*deductible interest equivalent*', we would suggest the following:

- The term 'interest' is used instead of 'interest equivalent'. It makes the definition more readable and loses nothing in accuracy.

(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~~ **amount** 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~~ **amount** 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~~.

- If a 'Case IV approach' is to be maintained, we understand there is an intention to defer the imposition of a Case IV charge until the interest subject to an ILR restriction is actually used (whether directly or through a claim for losses comprising (in whole or in part) such deductions, etc). Achieving this aim will need careful implementation and, in particular, will be affected by how "relevant profits" are defined. If defined with respect to taxable profits at an entity level then this could result in a Case IV charge arising even where the activities to which the interest expense relates is loss-making; whereas, if it is applied at a taxable business line / Case basis, this could require separate

tracking of attributes and restrictions within the same entity which would be administratively burdensome. Whatever approach is adopted, we strongly urge that the methodology ensures that any Case IV charge cannot arise until or unless the interest deduction concerned is actually used in reducing cash tax (while, at the same time, not being administratively complex).

6 QUESTION 6 – 'EXCEEDING BORROWING COSTS' AND 'EXCEEDING DEDUCTIBLE INTEREST EQUIVALENT'

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

We would suggest the following:

- The two definitions can be merged into one, as set out below. This would helpfully reduce the number of defined terms (having a different - but similar - meaning) being involved in the regime, without impacting the accuracy of the regime in any way.
- A few more words should be added to the term for 'legacy debt', to make it clear the figure to use is the interest cost arising from such legacy debt, as set out below.

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

~~D - E~~

A – (B + C + D)

Where –

A is the amount of the deductible interest ~~equivalent~~

B is **the** ~~an~~ amount **of deductible interest** in respect of legacy debt

C is the de minimis amount

D is the amount of taxable interest ~~equivalent~~

~~"**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~~

~~**A** is the amount of deductible interest equivalent~~

~~**B** is an amount in respect of legacy debt~~

~~**C** is the de minimis amount~~

7 QUESTION 7 – CALCULATION OF EBITDA

Comments are invited on this possible definition of EBITDA

For the definition of '*EBITDA*', we would suggest the following:

- For the reasons outlined above, we would suggest the omission of the word 'equivalent' from 'interest equivalent'.
- The reference to the word 'exceeding' in the term 'exceeding deductible interest' in the definition of "I" seems unnecessary. The 'exceeding borrowing costs' will be a single figure. There is no reference to 'exceeding' in the concept of 'deductible interest.
- Interest arsing on legacy debt should be added back to P to arrive at EBITDA. Article 4(4) of ATAD only excludes interest on 'legacy debt' from the interest restriction in Article 4(1). The interest on such debt is still 'exceeding borrowing costs' and so should be added back to EBITDA in Article 4(2).

"**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], 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~~.

8 QUESTION 8 – APPLYING THE ILR TO A SINGLE COMPANY

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

We would suggest the following:

- We submit that a deemed Case IV charge substantially increases complexity and that there is a better way to proceed. There are five main reasons for this:
  - A Case IV charge will create difficulties for the claiming of foreign tax credit for shareholders in Irish companies, as this additional tax is not being applied to the profits of the trade or business, but instead to notional profits.
  - Carried forward losses will not be available to set off against Case IV.
  - A Case IV charge could create a cash tax charge for a company with a significant current year or brought forward loss.
  - A Case IV charge creates close company surcharge consequences.
  - Conceptually, it goes against the general intention of *denying a deduction* as set out in ATAD, and we are not aware of any other EU member state which has adopted an approach of deeming notional income to arise.
- Instead, we suggest that there is a notional recalculation of the tax computation, denying a deduction for the 'excess amount' of the interest expenses (but without changing the figures for foreign tax credits, capital allowances or any other element). The denial of the 'excess amount' would be allocated between the three classes of deductions (deductible expenses, charges and surrendered losses) on a proportionate basis. We have set out below some possible drafting that may achieve this objective.

- Furthermore, to make the 'carry forward' calculations more straightforward, we would suggest that if the 'excess amount' consists in part of surrendered losses, those surrendered losses should be automatically returned to the surrendering company (rather than seeking to carry them forward in the relevant entity). This This should make it a lot easier to compute and track the loss-carried forwards. We have also suggested some drafting to this effect below.

- We also suggest the exemptions from the rule (eg, standalone entities, financial undertakings) be listed in a separate sub-section, and not in the operative sub-section. This will allow an easier amendment of these in future years, if the exemptions are altered.

(1) In this part:

"**allowable amount**" means an amount calculated as 30 per cent of EBITDA.

"**excess amount**" means the amount by which the exceeding borrowing costs is greater than the allowable amount.

"excess expense" means the portion of the excess amount that is attributable to the amount (if any) described in paragraph (i) of the definition of 'deductible interest [equivalent]'.

"excess charge" means the portion of the excess amount that is attributable to the amount (if any) described in paragraph (ii) of the definition of 'deductible interest [equivalent]'.

"excess group relief" means the portion of the excess amount that is attributable to the amount (if any) described in paragraph (iii) of the definition of 'deductible interest [equivalent]'.

(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~~

~~(b) the relevant entity is not a financial undertaking, and~~

~~(c)~~ the relevant entity has an excess amount in respect of the accounting period.

(b) ~~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 + 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 the excess amount was deducted (referred to as the "standard rate profits").~~

~~(1) 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~~

~~© which shall not be reckoned in computing the relevant entity's total income for the accounting period.~~

(3) Where this section applies, a relevant entity shall:

(a) compute its liability to corporation tax for the accounting period without taking account of the limitation imposed by this section [XXX];

(b) allocate, in accordance with subsection (4), the excess amount between the deductible interest [equivalent] of the relevant entity for that accounting period;

(c) re-compute its liability to corporation tax for the accounting period, with all figures to be taken into account remaining unchanged except that:

(i) the amount of interest which is deductible in computing the relevant profits of the relevant entity shall be reduced by the excess expense, and:

(A) the excess expense shall itself be fairly allocated between interest amounts deductible by the relevant entity under each Case of Schedule D, and

(B) if the relevant entity carries on more than one trade or profession within the charge to corporation tax, the excess expense shall be fairly allocated between expenses of each such trade or profession;

(ii) any amount of interest which is deductible from the relevant profits of the relevant entity shall be reduced by the excess charge,

(iii) any amount deductible from corporation tax chargeable on the relevant entity shall be reduced by:

(A) to the extent the amount is deductible from the tax chargeable on the relevant profits of the relevant entity which is referable to an interest amount where those profits are taxable at the rate specified in section 21(1)(f), one-eighth of the excess group relief, and

(B) to the extent the amount is deductible from the tax chargeable on the relevant profits of the relevant entity which is referable to an interest amount where those profits are taxable at the rate specified in section 21A(3)(a), one-quarter of the excess group relief.

(4) The excess amount shall be allocated between excess expenses, excess charges and excess group relief in proportion to the amount the deductible interest [equivalent] of the relevant entity for the accounting period that falls under sub-paragraphs (i), (ii) and (iii) of the definition of 'deductible interest [equivalent]'.

(5) This section shall not apply to a relevant entity for an accounting period (or part of an accounting period) where the relevant entity is:

(a) a standalone entity,

(b) a financial undertaking, unless the relevant entity has made the election under section [XXX] for this section to apply to it for the accounting period, or

(c) [the equity escape rule applies]

- The following suggested drafting could be used to automatically 'return' excess surrendered losses back to the surrendering company:

If subsection (3) applies to a relevant company and all or part of the 'excess amount' is referable to excess group relief, the amount which had been surrendered to the relevant entity pursuant to section 411 referable to the excess group relief shall be deemed for the purposes of the Corporation Tax Act never to have been surrendered, and any payment made by the relevant entity that is described in subsection (5) of section 411 must be repaid to the relevant entity within [xxx] days.

9 QUESTION 9 – CARRY FORWARD OF NON-DEDUCTIBLE INTEREST

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

If the Case IV approach is maintained, we would suggest the following:

- The carry forward of the non-deductible interest should be automatic, rather than dependent on making a claim. This is the situation for the carry-forward of losses. We would suggest a small amendment to subsection (1) to reflect this point, as set out below.

- The reference to the word 'exceeding' in the term 'exceeding deductible interest' in the definition of "I" seems unnecessary. The 'exceeding borrowing costs' will be a single figure. There is no reference to 'exceeding' in the concept of '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.

If our alternative to the Case IV approach is adopted, we would suggest the following:

- it should be possible to carry forward these amounts as a form of carried-forward losses (namely interest expenses and interest as a charge), as the group relief would be returned to the surrendering company. This could simplify the carry forward mechanism.

10 QUESTION 10 – CARRY FORWARD OF EXCESS INTEREST CAPACITY

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

If the suggested Case IV charge (and deemed income) is retained, we submit that much of the proposed language may need adjustment. Instead of carrying forward an amount equal to the amount of the tax chargeable, the 'excess capacity' itself should be carried forward. By way of example, if an entity has 10 of excess interest capacity in year 1, but 20 of restricted interest in year 2, it should be able to reduce the amount of restricted interest by 10 in year 2 (assuming all amounts taxable at the same rate).

11 QUESTION 11 – DE MINIMIS EXEMPTION

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.

- We agree with the proposed definition.
- We do not see the need for any additional or new anti-avoidance provisions. As Ireland is not proposing to remove any of the existing Irish anti-avoidance provisions relating to interest, there should be sufficient protections in place.

12 QUESTION 12 – EXCLUDING 'STANDALONE ENTITIES'

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

Comments on the proposed definitions

- The definition of 'associated enterprise' for the ILR does not need to include the concept of 'significant influence'. This is only introduced by ATAD 2 for the purposes of Article 9 of ATAD, namely the anti-hybrid rules. We have suggested an amendment below to address this point.

- Similarly, the ATAD ILR does not require the application of the 'acting together' provision set out in ATAD 2, which is enacted in section 835AA(3). Again, this only applies to Article 9 of ATAD. We have suggested an amendment below to address this point.

> ***"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)~~ **, (f) or (g)** of section 835AA(2)**, and subsection (3) of section 835AA shall not apply for the purposes of determining of an enterprise is associated with another enterprise.**

General comments

- The OECD Action 4 Report envisaged that a company owned by a single individual *would* be a standalone entity. On page 99, an example is stated as follows "*D Co is a standalone entity and is not part of any group. D Co is controlled by an individual who owns 100% of the ordinary shares of the company*". It is unclear whether the ATAD ILR requires a different conclusion, given its definition of an '*associated enterprise*' expressly includes an individual who owns 25% or more of the shares of a company. We do not see any logic in this approach. A single individual owning a single company operating solely in Ireland cannot engage in any base erosion through allocating borrowing costs. We would suggest that it appears illogical, unsound and contrary to the OECD's intention to conclude that a company owned by a single individual is not a 'standalone entity'. However, if a conclusion is reached that a single company with a single individual

shareholder cannot be a 'standalone entity', we recommend that the point is highlighted to the EU Commission as a flaw in the ATAD ILR which needs to be remedied; there is clearly no risk of BEPS in this context.

- We agree that there must be a solution for companies that are not standalone entities but are not a member of a consolidated group. Otherwise, many single-company businesses will have a higher effective tax rate on their profits than multi-company groups carrying on exactly the same business. We believe this arbitrarily and unfairly provides a tax benefit to businesses with more complex corporate structures. We believe there is therefore a real doubt whether such a situation could be compliant with EU State Aid rules.

- We therefore would suggest that companies that are not standalone entities but not part of a consolidated group for financial accounting purposes should, nevertheless, be permitted to apply the group ratio rule and the equity escape rule as if they were part of a consolidated group. We would suggest that this entitlement would be set out in a separate provision, rather than incorporated into the Irish enactment of Article 4(5) (as Article 4(5) is does not envisage single companies). This separate provision could cross-refer to the relevant group ratio and equity escape rules and extend their scope to such single companies. This should ensure there is no State Aid benefits accorded to businesses which have chosen to organise themselves as a corporate group, over those that remain operating as a single company.

13 **QUESTION 13 – EXCLUDING 'STANDALONE ENTITIES'**

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.

- We recommend that commonly-used international GAAPs beyond IAS should be permitted. More specifically, we suggest that the GAAPs permitted for ICAVs should be permitted here. Section 116 of the ICAV Act provides that:

> "*The annual accounts may be prepared in accordance with—*
> *(a) generally accepted accounting practice in the State,*
> *(b) international financial reporting standards, or*
> *(c) subject to subsection (5), an alternative body of accounting standards.*
> *(5) To the extent that the use of any alternative body of accounting standards does not contravene any provision of this Part, a true and fair view of the assets and liabilities, financial position and profit or*

loss of an ICAV may be given by the use by the ICAV of those standards in the preparation of its annual accounts.
(6) In this section "alternative body of accounting standards" means standards that accounts of bodies corporate are to comply with which are laid down by any such body or bodies having authority to lay down standards of that kind in—
(a) the United States of America,
(b) Canada,
(c) Japan, or
(d) any such other country or territory as may be prescribed by regulations made by the Minister,
as may be prescribed by regulations so made."

- If this approach was not followed, we believe there is doubt as to whether the ILR rule would be compliant with State Aid requirements, as it would give a selective advantage for those international groups which use non-IAS GAAPs. This advantage would be met out of Ireland's resources, and this could materially affect trade within the European Union (e.g. by giving additional tax reliefs to groups with IAS over groups using other GAAPs).

- When applying the 'associated enterprise' definitions to partnerships, we recommend that this is done with reference to the partners as these are the entities which would be the relevant taxable persons. For example, if a partnership fund had one or more partners with a 25%-plus interest in a company, those partners would be associates of the entity; whereas if none of the partners has 25% interest, we would submit that no investors would be associates of the entity.

14 QUESTION 14 – EXCLUDING 'STANDALONE ENTITIES'

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?*

We do not see any risk of the concerns mentioned by the OECD arising in respect of Irish companies.

15 QUESTION 15 – EXEMPTING 'LEGACY DEBT'

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.

- The ATAD ILR applies to both interest and amounts equivalent to interest. Therefore, we would recommend that the exemption for legacy debt equally apply to interest payments and amounts equivalent to interest. For this reason, we suggest that the reference to section 135(8) is better replaced by a more general term. We have set out a proposed amendment below.

> ***"legacy debt"*** means **an arrangement** ~~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~~.

- We have also suggested a clarification on the proposed 'modification' clause. If a lender had agreed before June 2016 to lend a certain amount to a borrower and the borrower then drew-down the loan in instalments over the subsequent (say) four years, those draw-downs are not 'modifications'. In contrast, if the lender agreed to increase its loan facility post-June 2016, that increase would be a 'modification'.

> 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 **legacy** debt on or after 17 June 2016, including modifications to the duration of the debt, the principal **made available to be** drawn down or the interest rate on that legacy debt.

16 **QUESTION 16 – 'LONG-TERM INFRASTRUCTURE PROJECT' EXEMPTION**

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

We believe the approach suggested by the OCED in the Action 4 Report, with the criteria set out in the Action 4 Report, should form the basis of Ireland's approach.

17 **QUESTION 17 – EXCLUDING 'FINANCIAL UNDERTAKINGS'**

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

- We support the adoption of this exemption for 'financial undertakings'. We do not believe Irish financial undertakings have been a cause of base erosion and profit shifting.

- We strongly submit that Irish companies that are wholly-owned subsidiaries of Irish regulated UCITS and AIFs (QIAIFs) should be treated as part of the UCITS or AIF (as the case may be) for the purpose of this rule. There are many Irish regulated funds that have wholly-owned subsidiary Irish companies. These subsidiaries must comply with the Central Bank's UCITS or AIF rulebook in everything they do. To all intents and purposes, they are treated as part of the regulated fund. In addition, some subsidiaries may qualify as an 'AIF' managed by an AIFM and therefore qualify as a 'financial undertaking'. It critical that wholly-owned subsidiaries of QIAIFs are given every opportunity to benefit from the 'financial undertaking' exemption as provided for in the ATAD ILR. The purpose of the exemption for UCITS and AIFs would be frustrated if they were treated for the purposes of the ILR in a way that was different to the fund entity itself:

  - the ATAD ILR rule clearly envisages that AIFs can be taxable companies (rather than only tax-exempt entity)

  - Irish funds should not be disadvantaged merely because Irish funds themselves are generally tax-exempt when a subsidiary entity, wholly subject to the same regulatory rules, is a taxable entity. Ireland should interpret the ATAD ILR to apply the 'financial undertaking' exemption to those taxable fund subsidiaries, as otherwise Irish regulated funds would be at a disadvantage in the application of the ILR to AIFs in other EU jurisdictions which are taxable entities.

- We would also propose that it should be possible to elect out of the exemption (if a taxpayer company desires). This is because the exemption may not extend to all entities in a financial group, even though they are engaged in activities that are intrinsically related to the activities of the 'financial undertaking'. For example, an Irish fund management company may benefit from this exemption, but its holding company, services company and support company may not (if they are not 'financial undertakings'). Rather than having

one company in the group exempted from the rule, it may be preferable for all four group companies to be treated within the ILR (and, apply the group ratio rule). To permit this, the fund management company would need to elect not to be treated as a 'financial undertaking'.

18 **QUESTION 18 – THE TWO 'GROUP RATIOS'**

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

There is no easy answer to this question. For some businesses, the 'equity ratio' rule will be preferable, because it is much easier to administer and provides certainty year-on-year. This will particularly be the case for consolidated groups with only Irish entities. For other businesses (especially those part of a multinational group), the 'group ratio' rule may be preferable, especially if it is relying on the 'group ratio' rule for its group companies in other countries.

The recitals to ATAD clearly envisage that both 'group ratios' may be adopted (see Recital (7) where, after describing the 'group ratio' rule, the Recital states that it "*may also be appropriate to lay down rules for an equity escape provision*" (our emphasis). For this reason, we strongly recommend that Ireland adopts both 'group ratios'.

19 **QUESTION 19 – THE TWO 'GROUP RATIOS'**

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'?

- No, it does not alter our response to Question 12. We suggest that single companies that are not standalone entities need a separate provision, to accommodate State Aid concerns. That provision could apply both the group ratio rule and the equity escape rule, as if they were part of a consolidated accounting group.

- Joint ventures will need to be treated in line with the financial consolidation groupings. In our view, the examples provided by OECD Action 4 report are good examples about how to apply the ILR to joint ventures.

- We would submit that, as permitted by Article 4(8), Ireland allow groups also use US GAAP or other accounting standards which are nationally recognised in a territory for the purposes of determining what is the relevant consolidated group. We would suggest that these other accounting standards be permitted where:

(a) they are recognised in the territory of the ultimate parent company of the consolidated group; or

(b) they are applied for the purposes of preparing the audited accounts of the Irish company (or companies) in the group.

- As a general comment, we strongly recommend that Ireland implements the rules which involve or relate to accounting groups in as straightforward and uncomplicated a manner as possible. To do otherwise risks making these reliefs unusable for many groups and, therefore, risks making Ireland less attractive for international investment.

- If JVs were treated in a manner other than based on whether and how they are included in the relevant group's financial statements, it would essentially impose a requirement on all such groups to conduct a world-wide review to identify all such JVs and the amend / modify their consolidated results for whatever rule is imposed. In practice, this would render the relief functionally obsolete for many groups.

20 **QUESTION 20 - THE TWO 'GROUP RATIOS'**

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 EBTIDAs. 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

- We believe the better approach is to use the group's consolidated accounts for determining the group ratio rule. We see a number of reasons to prefer this approach.

    - This aligns with the Action 4 recommendation of the OECD.

    - It should be easier for multinational groups to calculate this ratio.

    - It would be more likely that a consistent 'group ratio' could applied both in Ireland and in other EU member states which have also followed the same approach.

- The fact that these accounting figures for EBITDA and borrowing costs may be different to the figures recognised for Irish tax purposes should not, in our view, be viewed as a necessarily problematic feature. The simple purpose of these figures is generate a ratio, that approximates the earnings-to-borrowing costs of the global group. Whether it exactly equates to the equivalent Irish tax figures, or not, is not a key purpose of the rule, especially in the context of a large multinational group.

- We submit it is very important that Ireland implements the rules relating to EBITDA in a straightforward and uncomplicated manner. In the case of calculating EBITDA, requiring an international group to compute EBITDA using tax principals (presumably using local jurisdictional rules) and then adjust those numbers to conform with intra-group consolidation adjustments in the financial statements would be a very significant undertaking. In practice this would render the relief functionally obsolete for many groups and, therefore, risks making Ireland less attractive for international investment.

21 **QUESTION 21 - THE TWO 'GROUP RATIOS'**

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?

- We would suggest that, for so long as Ireland retains all the other domestic interest-focused anti-avoidance rules, there is no need to be exclude borrowings from 'associates' or 'related parties' for the purpose of ascertaining the 'group ratio rule'. The combination of the Irish transfer pricing regime and the domestic anti-avoidance rules should ensure that BEPS does not occur.

- If certain entities that have a connection to the group but are not consolidated in its results (e.g. JVs) were not treated as third-parties, it would essentially impose a requirement on all such groups to conduct a world-wide review to identify all such entities and the amend / modify their consolidated results for whatever rule is imposed. This could be a very significant undertaking. In practice this would render the relief functionally obsolete for many groups

and, therefore, risks making Ireland less attractive for international investment.

22 **QUESTION 22 – THE TWO 'GROUP RATIOS'**

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

This is a challenging issue. The OECD in Action 4 essentially ensured this issue did not arise, by recommending that all group entities which were intrinsically connected with the business of the 'financial undertaking' should benefit from the 'financial undertaking' exemption. As a result, it would only be group companies engaged in other (non-financial) business that would be subject to the ILR. Essentially, the multinational group would be split into two, being the 'financial' group (exempt from the ILR) and the 'non-financial' group (subject to the ILR). This should result in a workable solution.

If it is not possible to extend the 'financial undertaking' exemption under the ATAD ILR to group companies carrying on intrinsically-connected business, then arbitrary and unfair results are likely to arise. We see two steps that could be taken to mitigate these consequences:

- Give an option to the financial undertaking to elect out of the exemption.
- Include the financial undertaking when calculating the 'group ratios', but then only apply the ratio to the other entities in the group (aside from the financial undertaking itself). For the reasons detailed in the Action 4 report, it is unlikely that applying the group ratio in this scenario would give rise to BEPS.

23 **QUESTION 23 - DEFINING THE NOTIONAL LOCAL GROUP**

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 purpose 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 Escape 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?*

General comment

- We strongly support the introduction of the notional local group, and believe it should make the application of the ILR significantly more straightforward for many taxpayers.

How should the notional local group be defined?

- The notional local group definition should be a new definition, similar to that used for group loss relief, but with the following attributes:
  - The threshold should be 51% common ownership (and 51% subsidiaries)
  - All investment undertakings should be deemed companies for the purposes of the group test. This is to accommodate regulated funds that are not in corporate form (ie, authorised unit trusts). Many such funds will have Irish subsidiaries. Taken together, there are no third party borrowings, but there may be a loan owing from subsidiary to the investment undertaking. Therefore, it is important that the investment undertaking and the subsidiary can be grouped together under this notional local group regime, to allow the correct conclusion be reached that there are no third party borrowings, no BEPS, and hence no application of the ILR.
  - There should be no exclusion for shareholdings held where a profit on the sale would be a trading receipt.
  - It should be clear that it is permissible to trace ownership (indirectly) through companies that are not resident in EU or EEA Member States.

Are there issues relating to the interaction of a new notional local group for ILR purpose and existing group reliefs?

- To accommodate the existing loss surrender group relief rules, the ILR notional local group definition needs to be at least as broad as the loss relief group.

Any of the other issues raised in respect of local groups?

- To accommodate the existing loss surrender group relief rules, the ILR notional local group definition needs to be at least as broad as the loss relief group.

What considerations should be given to the operation of the two 'group ratios' where the notional local group approach is adopted?

- For the 'equity ratio' rule, if the method of calculating equity and total assets is relatively straightforward, it should be possible to calculate the 'equity' and 'total assets' of the local group by carrying out a simple computation based on the balance sheets of each company in the local group. In other words, it may not be necessary to prepare a notional consolidated balance sheet for the local group.

- For the 'group ratio' rule, we believe the correct approach in calculating the tax EBITDA of the notional local group is to disregard internal transactions. This is the approach recommended by the Action 4 report. Again, we think this should be feasible by taking the individual tax EBITDAs of each entity in the notional local group and carrying out a calculation on these figures.

24 **QUESTION 24 – OPTIONAL OR MANDATORY 'GROUP APPROACH'**

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

- We do not see a policy reason as to why a notional local group approach should be irrevocable or for a finite period.

- We have not yet finalised our views on this topic and would welcome the opportunity to provide further comments on this question in the coming months.

25 **QUESTION 25 - OPTIONAL OR MANDATORY 'GROUP APPROACH'**

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

- To maintaining maximum flexibility and due to the complexity of the ILR rules, maximum optionality should be given to taxpayers and as such we submit that optionality is a necessity.

- We have not yet finalised our views on this topic and would welcome the opportunity to provide further comments on this question in the coming months.

26 **QUESTION 26 – PRACTICAL AND TECHNICAL CONSIDERATIONS**

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 structure 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 any entity level?

(iv) Is there an alternative manner in which information reporting should be dealt with?

<u>General comment</u>

- For a notional local group, we believe it is practical – and preferable – to make a single company primarily responsible for reporting information to Revenue. As the notional local group is deemed to be a single taxpayer for the purposes of applying the ILR, it makes sense for there to be a single primary report to Revenue.

What criteria should be used to determine the reporting company?

- We suggest that the reporting company could be determined in a similar way to the remitter for a VAT group. In other words, there would be flexibility for the group itself to decide which company would report the information.

How should changes in group structure that alter the position of a reporting company in a group (mergers, acquisitions etc) be managed?

- Taking a similar approach as to VAT groups, we would suggest that if any companies are added to the notional local group, or removed from the group, in a particular accounting period, the reporting company would be required to notify Revenue of the change in its annual return.

What information should be returned to Revenue by the reporting company? Should any information be reported at any entity level?

- We would suggest that the following information would be reported:
    - The companies in the notional local group for the accounting period
    - The exceeding borrowing costs of the notional local group
    - Whether the notional local group is relying on the 'group ratio' rule or the 'equity escape' rule, and details in that regard.
    - The interest capacity of the notional local group being carried forward into that accounting period and being carried forward into the next accounting period.
    - The allocation of any ILR restriction imposed on the notional local group between the companies in the group. We would suggest that this could be allocated and notified in a similar way to the surrender of losses.
- As each company in the notional local group will also be providing their own 'solo' tax return, we suggest that it will be necessary for some of this information also to be reported in their own tax returns. However, this could be limited to (a) that the company is part of a notional local group, of which a named company is the reporter, (b) whether any ILR restriction is being imposed on that company.

27 **QUESTION 27 – PRACTICAL AND TECHNICAL CONSIDERATIONS**

How should intragroup transactions be treated for the purposes 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?

- We strongly submit that all intragroup transactions should be disregarded. The whole point of the notional local group is to compare the third party borrowings of that group to the EBITDA of that group. The internal transactions are irrelevant to this comparison and should be disregarded.
- Adopting an alternative 'amalgamation' approach would give rise to arbitrary results
- If there is an exempt 'financial undertaking' in the notional local group, we submit that this does not make any difference to the application of the ILR, which is only focused on third-party borrowing costs versus the group's EBITDA. Neither the group's third party borrowing costs nor the group's EBITDA change as a result of there being a financial undertaking in the group.

28 **QUESTION 28 – PRACTICAL AND TECHNICAL CONSIDERATIONS**

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 LIR 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?

<u>How should the notional local group allocate its exceeding deductible interest to the members of the group?</u>

- The group should be given the flexibility to allocate its exceeding deductible interest in the manner it sees fit, in the same way as it can when surrendering losses. From a policy perspective, this should not be problematic given the aims of the ATAD ILR.

<u>What should happen in scenarios where the notional local group as a whole has negative EBITDA but some of its members have positive EBITDA</u>

- We have not yet finalised our views on this topic and would welcome the opportunity to provide further comments on this question in the coming months.

<u>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?</u>

- We have not yet finalised our views on this topic and would welcome the opportunity to provide further comments on this question in the coming months.

<u>How should changes in membership of the notional local group be dealt with?</u>

- We have not yet finalised our views on this topic and would welcome the opportunity to provide further comments on this question in the coming months.

29 **QUESTIONS 29 & 30**

We have not yet finalised our views on these questions and would welcome the opportunity to provide further comments in the coming months.