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

5 March 2021

Dear Sir/Madam,

Subject: ATAD Implementation Article 4 Interest Limitation – Public Consultation

We are writing to you in response to your invitation for submissions on the "ATAD Implementation - Article 4 Interest Limitation" Feedback Statement document as published by the Department of Finance on 23 December 2020.

First and foremost, we welcome the publication of the Feedback Statement document by the Department of Finance. The public consultation, prior to implementing interest limitation rules, reflects Ireland's continued efforts to promote a business environment characterised by certainty and clarity, thereby giving confidence and foresight to key stakeholders in a time of unprecedented change in the international taxation arena.

Irish Institutional Property is the voice of institutionally financed investors and real estate providers with significant local and international backing in the Irish real estate market. The mission of the IIP is to promote the development of a progressive world class real estate sector in Ireland, which benefits members, the economy, and wider society. IIP members are backed by a diverse group of investors, including irish and international pension funds, among others.

As the representative body for institutionally financed property investors and real estate providers, we can draw on the experience of our members to reflect our views and insights with regard to the implementation of the interest limitation rules under the Anti-Tax Avoidance Directive ("the Directive").

We welcome the opportunity to discuss the matters outlined below at your convenience.

Yours faithfully,

Pat Farrell
CEO Irish Institutional Property

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.)

We note that Article 1 of the Directive provides that it shall apply to taxpayers that are subject to corporate tax in a Member State and that, similarly, the feedback statement also makes a number of references to ‘corporation tax’, including in a number of potential definitions.

However, as you may be aware, Section 1034 Taxes Consolidation Act (“TCA”) 1997 provides that entities which hold Irish real estate, but are not themselves resident in the State, are subject to Irish income tax on their net rental income in respect of such holdings, as opposed to corporation tax. We would request clarification as to whether the interest limitation rules (“ILR”) should apply to non-resident landlords in receipt of Irish rental income or if the application of the ILR is limited only to entities in the charge to corporation tax.

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

The aim of ATAD with regard to interest limitation is to limit the amount of deductible interest to 30% of EBITDA but only on a net basis. As a result, interest equivalent should be symmetrical between “borrowing costs” and “taxable interest".

We note that the proposed definition of ‘interest equivalent’ is, in the context of borrowing costs, narrower than provided for in the Directive definition and would advocate that this be corrected while preserving the symmetrical approach on the revenue side, such that the provision for interest equivalent borrowing costs in the Irish legislation transposes the full breadth of such costs contained in the Directive. This will impact the statutory definition of interest equivalent and we would suggest that it should include the full definition of financing return in section 835AH and not just paragraph (c).

In terms of “amounts economically equivalent to interest”, we make the following specific points:

<u>Capitalised Interest</u>

- While we note that the definition of borrowing costs in the Directive refers to ‘capitalised interest’ included in the balance sheet value of a related asset, or the amortisation of ‘capitalised interest’, neither the Directive nor the feedback statement clarify at what point in time capitalised interest should be included in the ILR calculations.
- As you may be aware, under IFRS accounting standards, the circumstances under which an entity may capitalise interest are very limited in scope. IAS 23 Borrowing Costs provides that;

  > *An entity shall capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset [being an asset that takes a substantial period to get ready for its intended use or sale] as part of the cost of that asset. An entity shall recognise other borrowing costs as an expense in the period in which it incurs them.*

  In practice, and within the context of Irish real estate, the application of this standard requires that an entity will capitalise interest on borrowings used to fund the construction of a building until that building is ready for use or sale, after which point any interest accruing on those borrowings will be recorded as an expense in the income statement of the entity.
- The nature of the real estate and construction industry means that it is not uncommon for a number of years to elapse between the acquisition of a site and that site being developed to an

extent that income may be generated from it. During this interim period, it is common that an entity engaged in construction or development would have a negligible EBITDA but significant annual capitalised interest, depending on the size of the development.

- Therefore, the implementation of the ILR should clarify that capitalised interest should be included in the borrowing costs of an entity in the year in which the asset to which such interest relates is disposed of. The year of disposal is also the year in which capitalised interest would, indirectly as part of either cost of sales or the base cost of the asset, be deductible.
- On the basis that a tax deduction is not taken for depreciation or amortisation, the inclusion of interest capitalised when depreciation or amortisation is reflected in the profit and loss would not be consistent with the ILR approach that only interest which is deducted for tax purposes should be restricted.
- Furthermore, any gain/profit arising on the disposal where the disposal of the asset would be the disposal of a chargeable asset for the purposes of capital gains tax or corporation tax should be allowed to be included in the EBITDA calculation in order to preserve symmetry.

Operating Leases

- As you may be aware, under IFRS 16 a lessee is required to allocate a portion of the amounts payable under an operating lease to finance expenses. A symmetrical approach should be taken in respect of this finance expense amount, such that the lessee's treatment of the finance expense portion of a lease should be mirrored in the application of the ILR to lessors. It is reasonable that the amount which is regarded as finance expense in the financial statements of the lessee should be regarded as interest equivalent income in the hands of the lessor for the purposes of the ILR.

Other

- We believe that non-performing loan gains should be included as "interest equivalent" i.e a gain on the uplift in value from the cost of the loan (discounted gains).
- Can you confirm that hedging costs are considered "interest equivalent" and captured under part (c) of the definition
- There are a significant amount of costs that are incurred in raising finance associated with the acquisition and development of real estate. We note that the feedback statement specifically refers to guarantee fees, and arrangement fees but given the broad range of costs which may be incurred, clarity is required as to which costs should be included. We would not expect costs such as tax, legal, valuations, agent fees to be considered costs of raising finance. The costs should directly relate to costs incurred with lending and costs which are payable to lending institutions.
- We would request that Revenue provide practical examples of what is and is not expenses incurred in connection with raising finance.

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

The feedback statement does not provide a definition of relevant profits although we do note that page 10 of the feedback statement states that a possible definition will be included in the next feedback statement. We recommend that the definition of relevant profits should include any gain/profit arising on a disposal where the disposal of the asset would be the disposal of a chargeable asset for the purposes of capital gains tax or corporation tax.

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

We would welcome the inclusion of option (c) of Article 4 (6) of ATAD. The ability to carry forward net interest is extremely important for the real estate sector given the capital requirements of the industry. Furthermore, option (c) provides that unused interest capacity can be carried forward for a period of five years. As you may appreciate, the real estate sector can be cyclical in nature and it could be argued that it took longer than 5 years to emerge from the financial crisis. As a result, we would recommend that this restriction is removed in respect of unused interest capacity.

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.

We would welcome the inclusion of the de minimis of €3 million which is in line with the Directive. We would also recommend that in a group context that taxpayers have the flexibility to allocate the threshold as they see fit within their own group.

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.

A 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.*" Examples should include bankruptcy remote Section 110 entities. Assuming these are not "*part of a consolidated group for financial accounting purposes"* and have no permanent establishment, the only question is whether they have any "associated enterprise".

While a standard SPV may have a 100% shareholder, the shares have limited economic value (but must exist for company law purposes) and a trustee will generally hold the shares on trust for charitable purposes. This is done for good commercial reasons (including as a requirement of the European Central Bank, rating agencies, and commercial lenders) so that, from an economic and insolvency perspective, the SPV is not part of a larger group (and is not in any group with the share trustee).

It would seem that this fact pattern is precisely what a "standalone entity" should be. Accordingly, so long as it is not "part of a consolidated group for financial accounting purposes" and has no permanent establishment, a normal SPV, all of the shares of which are held on trust for charitable purpose for bona fide reasons should be a "standalone" entity for the purposes of the rules. We would request clarification that orphan Section 110 entities should be considered stand alone entities for ILR purposes.

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.

We note that the legacy debt provisions per the Directive refer to "loans which were concluded before 17 June 2016, but the exclusion shall not extend to any subsequent modification of such loans' and the feedback statement states that a legacy debt is a security within the meaning of Section 135 (8) TCA 1997. We would recommend that debt is not defined in accordance with Section 135 (8) TCA 1997 as it is over complicating the position and similar to Section 541 TCA 1997, debt is not defined per the legislation.

Real estate investments are typically financed using revolving facilities and, given the nature of the facility, debt may be drawn down, repaid and subsequently drawn down again. As a result, clarification is being sought as to the treatment of such facilities where they are in place prior to 17 June 2016. On the basis that the facility was in place prior to 17 June 2016, we are of the view that the debt drawdown under the facility should continue to be considered legacy debt.

Modification of an existing arrangement is being defined wider than is required by the Directive and we would recommend that it be amended to align with it. Other Member States have also confirmed that additional draw downs under a legacy facility do not constitute a modification. Modifications made that were provided for within the legacy arrangement and corporate restructurings should not impact grandfathering. We would also request that the novation or assignment of debt does not constitute a modification for the purposes of the legislation.

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

Paragraph 4 of Article 4 of the Directive provides that a public infrastructure project "means a project to provide, operate, upgrade, operate and/or maintain a large-scale asset considered in the general public interest". Accordingly, it is clear that this definition would include classes of assets typically deemed to be infrastructure, such as roads, hospitals, bridges.

The concept of infrastructure should be broad in nature, and should encompass any manner of assets which provide amenities to the public, enhance public life, or are regarded as essential goods or services, regardless of whether such outputs or provided free of charge or available for sale. Furthermore, the definition should be able to cater for the changing needs of society, for example broadband etc.

In this regard, any definition of public infrastructure projects should be sufficiently broad so as to include certain classes of housing for example, social/affordable developments.

In relation to the planning system, there is a concept of strategic infrastructure assets which is set out in Schedule 7 of the Planning and Development Acts. Projects which are considered significant in a planning context, such as those noted in Schedule 7, should represent the same concepts which can be classified as public infrastructure projects. Projects can also be considered for the general public interest irrespective of whether they are privately owned or whether a fee is charged to the public for their use.
In relation to housing, it is notable that in an Irish context, housing has been subject to specific planning provisions, under the Strategic Housing Regulations which derive from the Planning and Development (Housing) and Residential Tenancies Act 2016. In a housing context, from a public policy perspective, it is notable that the State has determined that there is a public interest in the development and supply of housing. Given how public housing policy has developed, there is a strong argument for the inclusion of certain housing as part of the public infrastructure exemption.

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

We welcome the intention to provide an exemption for financial undertakings. This is an important exemption given the holding vehicles which are used in the real estate sector.

We would request confirmation that Real Estate Investment Trusts ("REITs") should not be within the scope of ILR on the basis that a REIT's property rental business is exempt from tax and they are already subject to prescribed statutory leverage restrictions.

A REIT is not chargeable to tax in respect of the income of its property rental business or on any chargeable gains accruing on the disposal of assets of the property rental business, provided that the conditions of the REIT regime are satisfied.

Per the feedback statement, the ILR has the effect of limiting a taxpayer's ability to deduct 'exceeding borrowing costs', being the amount by which the deductible interest equivalent exceeds its taxable interest equivalent.

Where an entity is exempt from tax, no deduction in respect of interest for tax purposes arises. Therefore, where no deduction is taken in respect of borrowing costs, a tax-exempt entity should have exceeding borrowing costs of NIL and should therefore not be within the scope of the ILR. As a result, ILR should not apply to a REIT's property rental business.

This treatment would also preserve the intended symmetrical approach to implementing the ILR as, per the Directive, tax exempt income is excluded from the EBITDA of the taxpayer. It follows then that expenses arising in respect of exempt income, which will not be included in EBITDA, should not be included in the calculation of exceeding borrowing costs.

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

We would recommend that both group ratios are introduced given that a taxpayer may have different fact patterns which may positively or negatively impact them using one ratio over another.

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?

A lender in a real estate context may demand that financing is arranged with an entity in a group that is a parent of the entity where the borrowings will be deployed. For example, a lender might require that the financing is provided at the level of a holding company which holds a number of property-owning entities, rather than lending to one of these property-owning entities directly. This is a reasonably common requirement, as it can provide the lender with security over a greater number of assets, rather than having security solely over the asset to which the lending directly relates.

Where this is the case, the third-party financing is generally then onlent to the entity holding the property to which the proceeds of the financing will be directed. The implementation of the ILR should cater for this scenario, such that financing provided by a genuine third-party lender such as a bank or private lending institution should not lose its character as third-party financing simply as a result of being routed through a related party or associate i.e. in determining whether borrowings are third-party for the purposes of the ILR, reference should be given to the ultimate, rather than immediate, source of the funds.