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08 March 2021

By email to: ctreview@finance.gov.ie

Re: ATAD Implementation Article 4 Interest Limitation Feedback Statement

To whom it may concern,

I hope this letter finds you well. I am writing regarding the ATAD Implementation Article 4 Interest Limitation Feedback Statement. Ibec as evidenced through its previous submissions and engagement on OECD BEPS, ATAD and the Corporate Tax Roadmap supports an open, transparent and competitive tax regime that has the alignment of profit with substance at its core. As such, we welcome the opportunity to input on this feedback statement. In the sections to follow we will seek to present the views of business on the key issues, where there is a clear agreement between members.

Competitiveness

The interest limitation rules in ATAD limit the tax deduction for net interest costs to 30% of EBITDA. It appears to us that the application of a fixed ratio approach can be best regarded as an expedient methodology to limit interest deductibility and in the process generally address concerns regarding base erosion or profit shifting without the need to introduce more complex targeted measures. This is evidenced by the fact that interest paid on bona-fide commercial terms to independent lenders is included in the interest that must be tested. In our experience, this debt is generally raised for legitimate business purposes. It represents an economic cost of doing business and financing investment and growth and does not have a tax avoidance motivation.

However, the ATAD then introduces measure of relief and exemption to address the shortcomings of such an approach and to deal with diverse facts and circumstances including an important exemption that should, in the present low interest rate environment, exclude many businesses in the SME sector. ATAD allows the EU Member States a reasonable degree of latitude and optionality in implementing interest restriction rules.

As an overall view, many of our members have shared the view that the impact of this ratio may disproportionately impact smaller countries, like Ireland, where the tax-adjusted measure of income ("EBITDA") will naturally be lower due to our smaller market. The net effect of this will be a reduction in the competitiveness of the 12.5% tax rate for some companies relative to larger economies.

As such, we are in favour of Ireland adopting the full range of potential flexibilities available under ATAD. The intention to include the de minimis exclusion is welcome to the SME sector and the adoption of all options under the Group Ratio is very important to Irish businesses which are internationally focused for their growth, including the Irish outbound multinational sector

Existing rules (Q1-3)

Given the global context on corporate tax, the direction of ongoing discussions at BEPS and the complexity of the existing system we believe this iterative process must not happen in a vacuum. This review should be cognisant and consider all facets rather than just stand-alone measures such as the transposition of ATAD.

The Irish tax regime has provided a measure of tax relief for interest costs associated with investment and growth under general trading principles or specifically for example under S247. In recent years, the deductibility of interest expense has become increasingly complex and unwieldy through new law and guidelines. At present, the transfer pricing rules as enacted will result in double taxation for companies for what can only be considered to be normal financing liquidity transactions among Irish group members. The stated intention in the Feedback Statement to layer on the new rules under ATAD is unhelpful and will mean that Ireland will have the most complex rules in the EU to determine with certainty if legitimate interest expense is deductible. This is not a matter only of complexity but of actual cost for business.

The resulting overly complex rules coupled with two-tier tax corporate tax rates applicable to interest, a distinction between trading and non-trading (that does not exist elsewhere within the EU) but impacts interest deductibility and the recently introduced transfer pricing rules that have resulted in double taxation for common Ireland-to-Ireland commercial transactions is clear evidence that the layering on of new legislation on the old legislation is not an acceptable methodology. It will in our view lead to unintended and negative consequence for Irish companies.

It is therefore important that Ireland judiciously maximizes the optionality allowable under ATAD to limit the impact of these measures on the Irish economy and seek to move quickly to reduce the complexity that is evident within the current regime in time for Finance Act 2021.

To facilitate a fair implementation of the ILR a principle of symmetry between lender and borrower should be followed. In this regard, consideration should also be given to applying the 12.5% standard tax rate and the introduction of an automatic corresponding deduction on financing arrangements among Irish group members once a business purpose is evident. This would eliminate some of the complications and uncertainty that are evident even in the proposals in the Feedback Statement and it will allow for the elimination of double taxation arising from recently enacted transfer pricing rules when addressing the ILR

In making the case for the deferral for the ATAD ILR introduction to 2024, the Department has already rightly made the point to the European Commission that our interest rules are extensive and given that the ILR is, in principle, designed to restrict the deduction of interest expense on related-party debt, it is reasonable and appropriate for Finance Act 2021 to remove as many of the current provisions that restrict the deduction of interest on related-party debt – specifically the recovery of capital rules that apply to connected parties (sections 247 and 249) and the interest limitation rules on group borrowings to acquire certain group assets in section 840A in favour of a broader business purpose test that is evident in other EU countries including Germany where ILR is well established.

To simplify existing rules, consideration should also be given to the abolition of the 25% tax rate. There are also broader considerations in the context of a changing corporate tax landscape that would be welcomed by our members including a discussion on either moving to a participation exemption for dividends or a territorial tax regime. Decisions made on foot of this review must be cognisant of those ongoing debates.

We believe it is opportune for Ireland to both sustain and reimagine its competitive offering considering the changing international environment. We have noted the references to “later Finance Bills” and would strongly support a review process that targets the introduction of simplifying competitive measures in Finance Act Bill 2021 and Finance Bill 2022.

Interest and interest equivalence (Q4-6)

A detailed definition of borrowing costs is set out in ATAD, which includes costs 'economically equivalent to interest' and expenses incurred in connection with the raising of finance as defined in national law.

It is not unreasonable to expect that symmetrical treatment would apply to expense payments and receipts so that an expense that is treated as 'deductible interest equivalent' in one company would be recognised as 'taxable interest equivalent' in the receiving company. This may however require modifications to the Irish tax rules dealing with trading and non-trading and the elimination of the tax rate differential from our two-rate system.

In our view, the definition of 'interest equivalent' should consider the specific circumstances of the taxpayer as certain income/expenses may be 'economically equivalent to interest' for one taxpayer but this may not necessarily be the case for all taxpayers. We believe there is a risk that that too broad definition would lead to the inclusion of a range of income and expenses unintentionally. The definition should be unambiguous and should be drawn as narrowly as possible and preferably it would be an exhaustive list. For example, guarantee fees and factoring fees will likely have a direct bearing on the availability and cost of borrowing and is therefore arguably an interest equivalent whilst the same cannot be said of arrangement, transaction or commitment fees. There is no doubt they are a commercial cost of borrowing but they are not an interest equivalent and they are unlikely to have a base erosion or avoidance motivation.

An important point would be clarity on foreign exchange movements as well as the treatment of hedging instruments (e.g., interest rate swaps, cross-currency swaps, FX forward swaps, total return swaps etc.). Particularly whether related items in the profit and loss account will fall within any expanded meaning of "interest equivalent". The definition of "borrowing costs" in the ATAD includes "… notional interest amounts under derivative instruments or hedging arrangements related to an entity's borrowings, certain foreign exchange gains and losses on borrowings and instruments connected with the raising of finance…".

We believe that only foreign exchange movements or hedging instruments directly linked to interest rates should only be included in the definition of interest equivalent. Specifically, instruments hedging loan principals or movements on the translation of the loan principal itself should not be considered to be economically equivalent to interest.

Further consideration should be given to the complications posed by IFRS16 for the lessee and the lessor.

EBITDA (Q7)

It is our view that the measure of EBITDA should be widely interpreted within ATAD to address the limited existing EBITDA base of a smaller island economy. This would mean that EBITDA should be calculated pre capital allowances and before the use of any losses forward.

This definition should be sufficiently broad to recognize that we have different businesses including (i) wholly domestic businesses; (ii) Irish headquartered companies with significant outbound international presence and (iii) inbound foreign direct investment. The definition should consider all their income sources, including repatriated earnings that are subject to tax to ensure as fair a measure of the tax base is aligned with their substantive operations and activities in Ireland.

Carry-Forward/Back (Q9-10)

Concerning options on Carry-Forward/Back there is not a single view amongst our members but the majority support option c) and a minority supporting option b). When it comes to group ratios, there is no single view with the majority opinion that firms should be given the maximum flexibility possible.

The Feedback Statement considers that there is no disallowance of interest expense just a deferral. It is important to note the indefinite carry-forward of interest, which is largely in line with our EU partners, will result in an immediate increase in the effective tax rate for Irish companies if it cannot be demonstrably supported that it is probable that the deferred amount will be used, and an associated deferred tax asset recorded. This matter is not free from doubt and there will be a negative impact on important investment metrics such as earnings per share, return on capital employed and an increase in the effective tax rate.

Exemptions (Q11-17)

The BEPS Action 4 Report recommended the inclusion of such a de minimis threshold on the basis 'that certain entities may pose a sufficiently low risk that excluding them from a fixed ratio rule and group ratio rule would be appropriate'. ATAD allows a de-minims threshold of borrowing costs up to €3 million and an exemption for financial undertakings and standalone entities. A broad introduction of these elections makes sense given the objective to balance compliance costs, genuine economic activity, with minimal BEPS risks.

For instance, non-regulated entities such as lessors should be included as a 'financial undertaking' within the meaning of the legislation where they carry on similar activities to regulated entities. It might also be preferable to allow financial undertakings to choose whether to avail of the exemption or not and that all profits in securitisations be accepted as being interest or interest equivalents.

The exclusion of stand-alone entities from the rules will be particularly welcome in the SME sector but the current definition proposed in the Feedback Statement will require further consultation if it is to be effective.

It is also the clear view of our members that all pre-existing loans, including those with small technical amendments after 2016, should be excluded from the interest limitation rules. This would both be in line with the provisions of ATAD and should be confirmed early in the process to allow companies to plan with some certainty. A clear and exhaustive definition of modification should be provided if the certainty of treatment is to be achieved.

Finally, the exemption for long-term public infrastructure as defined under ATAD as "a project to provide, upgrade, operate and/or maintain a largescale asset that is considered in the general public interest by a Member State" should not be limited to a narrow range of infrastructure projects with direct state involvement (i.e. PPPs) but should also apply to broader public infrastructure delivered by private companies (i.e broadband, transport assets, energy projects, housing and other utilities.)

It is our clear view that it is permissible, by any reasonable interpretation of the language of the Directive, to allow optionality for taxpayers. As such, we would strongly support the provision for both "group ratio" options with the choice of ratio to be at the discretion of the taxpayer.

Group Ratios (Questions 18 to 22, 24 and 25)

It is our clear view that it is permissible, by any reasonable interpretation of the language of the Directive, to allow optionality for taxpayers. As such, we would strongly support the provision for both "group ratio" options with the choice of ratio to be at the discretion of the taxpayer.

While we acknowledge the intention to conduct a second consultation process regarding the consolidated group relief provided for in ATAD we believe this should be commenced and concluded as early as possible. The design of this permitted relief in ATAD is an acutely important matter particularly for companies that have a significant outbound business and global presence but with a relatively small EBITDA base in Ireland due to its market size and those that have an economically substantive headquarters currently located in Ireland.

Questions of what information to base the Group Ratios on are complex and will require time and further consultation. However, it appears to us that trying to recalculate tax-adjusted values under Irish principles across a worldwide group is likely to render the Group Ratio relief inoperable.

Notional Tax Groups and intra group transactions (Questions 23, 26-29)

We believe this is best addressed in the next consultation but as a general matter we consider that stand-alone definitions applicable to the ILR are preferable if we are to avoid an unwieldy and cumbersome set of rules that are crossed referenced to other definitions in the TCA 1997.

Conclusion

We look forward to an early response from the Department on these matters and both Ibec and its members remain available to work with you and your team over the coming months on this and any other areas which arise.

Kind regards,

Gerard Brady,

Chief Economist

Ibec