KPMG

Response to Department of Finance consultation on the Interest Limitation Rule

March 2021

KPMG

1 Stokes Place
St. Stephen's Green
Dublin 2
D02 DE03

1 Harbourmaster Place
IFSC
Dublin 1
D01 F6F5

Telephone +353 1 410 1000
Fax +353 1 412 1122
Internet www.kpmg.ie

Tom Woods
Head of Tax and Legal
t: +353 1 410 2589
e: tom.woods@kpmg.ie

Gareth Bryan
Partner, Tax
t: +353 1 410 2434
e:
gareth.bryan@kpmg.ie

Brian Daly
Partner, Tax
t: +353 1 410 1278
e: brian.daly@kpmg.ie

Alan Bromell
Partner, Tax
t: +353 1 700 4177
e: alan.bromell@kpmg.ie

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

Email: ctreview@finance.gov.ie

8 March 2021

Dear Sir,

Interest Limitation – Public Consultation

KPMG is pleased to respond to the public consultation on ATAD implementation – Article 4 Interest Limitation Feedback Statement.

The ATAD rules will add protections from base erosion involving interest deductions and other financial payments to those already in Ireland's corporation tax regime. The framework of the existing regime already provides a strong basis for protection from base erosion. In order to readjust the balance of protections from base erosion provided under Ireland's corporation tax regime, we have suggested that a redesign of Ireland's corporation tax regime for taxing interest and other financial payments should be done in tandem with implementation of an Interest Limitation rule. It is imperative that the recovery of capital rules applicable to interest as a charge and the interest limitation rules narrowing interest deductions on group borrowings to acquire certain group assets are substantially amended in Finance Act 2021 so as to keep business operating in Ireland competitive at an international level.

For this reason, we have summarised our findings from a review of the protections from base erosion that exist in Ireland's regime. We have suggested how a redesign of that regime could be achieved by mapping the changes required to the existing regime in combination with proposed changes upon implementation of the Interest Limitation rule in order to outline a revised regime which contains a readjusted balance of protections.

In forming our responses, KPMG has reviewed the technical requirements of the ATAD measures and supplementary

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IFSC
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guidance available from the Organisation for Economic Cooperation and Development (OECD) which is set out in final reports under its plan to counteract Base Erosion and Profit Shifting (BEPS). The related guidance is set out in the OECD's final reports under Actions 4 of its BEPS Plan.

We have also reviewed the detailed implementation of interest limitation measures in other jurisdictions' regimes which have features in common with Ireland's regime. We have taken soundings from KPMG member firms in other EU Member States in order to understand the choices made by those Member States in implementing the ATAD measures.

Finally, we have taken soundings from businesses based in Ireland in order to understand the potential impact upon them of implementation of the measures. Throughout our responses, we have addressed points for consideration in relation to the practical implementation of the measures so that, insofar as possible, the intended effect of these very complex measures can be understood and achieve certainty for business. We also believe it is critically important that Ireland allows for as much flexibility and optionality as is permitted within the parameters of ATAD to help support the business case for investment in Ireland.

The contact point for this submission is Tom Woods. Tom's contact details are:

Email: tom.woods@kpmg.ie ; Direct telephone: (01) 410 2589.

Should you wish to discuss any aspect of the attached submission please do not hesitate to contact us.

Yours faithfully,

Tom Woods

Partner

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Key Policy Recommendations

KPMG welcomes the opportunity to respond to the consultation and to provide feedback on the range of issues we have identified for consideration by the Department of Finance upon introduction of the Interest Limitation Rule.

We outline below our recommendations on the key policy choices Ireland should made upon implementation of the interest limitation rule. The framework for the interest limitation regime must balance protection from base erosion with supporting businesses operating in Ireland and maintain Ireland's competitiveness at an international level.

To date, Ireland has asserted that it has a comprehensive interest deduction regime that targets base erosion. Layering an interest limitation rule on top of the pre-existing targeted interest measures necessitates an interest limitation rule that provides flexibility for the taxpayer so as to not give rise to business distortion, unnecessary compliance burden and unintended consequences.

Appendix 1 contains a comprehensive list of all the recommendations KPMG makes throughout this submission in response to the questions asked in the Feedback Statement.

Simplify existing interest deduction measures

The ATAD rules will add protections from base erosion involving interest deductions and other financial payments to those already in Ireland's corporation tax regime. The framework of the existing regime already provides a strong basis for protection from base erosion. In order to readjust the balance of protections from base erosion provided under Ireland's corporation tax regime, we have suggested that a redesign of Ireland's corporation tax regime for taxing interest and other financial payments should be done.

In the immediate term, it is imperative that the recovery of capital rules that apply to connected parties when seeking a deduction for interest as a charge and the interest limitation rules narrowing interest deductions on group borrowings to acquire certain group assets are substantially amended in Finance Act 2021 so as to keep businesses operating in Ireland competitive at an international level.

Flexibility within the regime is key

Throughout ATAD several options are provided to Member States to adopt. We recommend where these options arise, Ireland introduce them on an elective basis, allowing the taxpayer choice to avail of the option or not. Businesses operating in Ireland are diverse in nature and their funding requirements vary substantially depending on the sector they are in, the jurisdictions they operate in, regulations they must adhere to and how they have grown. With inherent limitations to amend pre-existing financing structures within a group, flexibility within the Interest Limitation Rule will be key to prevent disrupting businesses or distorting competition. In regard to choices in the interest limitation rule, we recommend Ireland provides the following;

- ✓ Flexibility to offset the restricted interest credit against tax arising on any taxable profits in future years.

- ✓ Defer any cash tax liability arising from the application of the ILR until the entity is profit making or has utilised its losses forward.
- ✓ Include chargeable capital gains / losses in determining EBITDA under the fixed ratio rule.
- ✓ Apply the five-year time limit on unused capacity only to the extent the capacity tax credit exceeds the entity's restricted interest credit.
- ✓ Flexibility within ILR to allow groups the choice as to whether to form a notional local group or not.
- ✓ Provide a choice to avail of the debt equity ratio or the fixed ratio rule to groups seeking to avail of relief under a group ratio.
- ✓ Flexibility within notional local groups to allocate the de minimis exemption, surrender restricted interest credits, excess capacity and allocate restricted interest within the group.
- ✓ Provide choice to notional local groups to appoint a 'group remitter' allowing the ILR to be centralised for notional local groups.
- ✓ Choice to opt in or out of the legacy debt exemption.
- ✓ Choice to opt in or out of applying the financial undertaking exemption.

A regime that is practical to implement

Introducing a new regime as complex as the Interest Limitation rule will give rise to additional complexities and administrative burdens for businesses operating in Ireland. The existing interest deduction regimes are quite complex and difficult to navigate so the necessity for an ILR that is practical is crucial.

Acknowledging the protection already afforded under the existing corporation tax regime against base erosion, there is scope to apply the ILR on a simplified and practical basis. In regard to choices upon implementation of the interest limitation rule, we recommend the following;

- ✓ Provide clear guidance on the definition of interest and interest equivalent acknowledging the practical difficulties with regard to foreign exchange, derivatives and traders of debt.
- ✓ Do not require taxpayers who are confident that their relevant interest expense will not exceed the de minimis threshold to carry out a detailed computation in order to evidence their entitlement to that relief.
- ✓ Accept accounting standards that are equivalent to IFRS and FRS and are acknowledged as equivalent under Irish company law and EU regulations.
- ✓ Apply the group ratio rule based on accounting consolidated groups. Requiring an international group to apply the group ratio rules based on Irish tax legislation will render the relief inoperable.
- ✓ Where an exemption is claimed, do not require the group to exclude the results of the exempt entity/debt when applying the group ratio rule in recognition of the low risk of base erosion of these types of entities/debt.

Public Benefit Infrastructure Exemption is a necessity

To ensure Ireland can secure the broadest range of funding sources for long term public benefit infrastructure (PBI), Ireland needs a PBI exemption. In addition, such exemption needs to be defined wider than public private partnership (PPP) models and should include investor-owned debt.

The principles of a flexible and practical regime apply equally to the PBI exemption. Certainty should be provided in relation to the scope of eligible infrastructure and relevant parties such as public bodies by publishing

lists. Taxpayers should be afforded the flexibility to avail of the exemption without being required to elect into the regime for a set period of time.

Given Ireland's economic and social policy needs for investment in property, eligible infrastructure might also include defined property assets rented to third parties.

Eligible loans should include both third-party and related party loans. If related party loans are excluded, grandfathering should apply to pre-existing loans to prevent potential damage to existing projects.

REITs should be outside the scope of ILR.

Align with the requirements in ATAD but do not go beyond these requirements

As mentioned, the introduction of an ILR into the Irish corporation tax regime will give rise to additional complexity for the taxpayer. In recognition that the ILR will be in addition to the already complex targeted provisions that apply to interest expense deductions, we recommend that Ireland does not go beyond the requirements in the Directive.

If specific issues are identified in the future as needing further refinement, we would suggest that these are best addressed after they have been identified and determined to be sufficiently material to necessitate action. In the meantime, we recommend introducing the legislation in as simple a manner as the directive allows so as to allow taxpayers time to adjust to these new rules.

We note (and agree) with the government's position that Ireland's existing rules provide a high degree of protection with respect to base erosion. As these rules are to be retained, they should provide ample protection (as they do at present). Given the very significant change to the Irish regime that the introduction of these new rules will entail, we strongly recommend that the government does not introduce new restrictions or complexities beyond that mandated by the directive.

Overview of proposed approach to ILR

The ATAD interest limitation rule alongside the other measures included in ATAD will add protections from base erosion involving interest deductions and other financial payments to those already in Ireland's corporation tax regime. As the government has pointed out, the framework of Ireland's existing regime already provides a strong basis for protection from base erosion. In order to readjust the balance of protections from base erosion provided under Ireland's corporation tax regime, we suggest that a redesign of Ireland's corporation tax regime for taxing interest and other financial payments should be done upon implementation of an Interest Limitation rule.

Should there be insufficient time to review and redesign all of these rules prior to the implementation of an Interest Limitation rule, we would nevertheless recommend that a review of certain aspects of the existing rules be expedited so that their modification can happen concurrently with the introduction of the Interest Limitation rule. In particular, it is imperative that the recovery of capital rules applicable to interest as a charge and the interest limitation rules narrowing interest deductions on group borrowings to acquire certain group assets are substantially amended in Finance Act 2021 to keep business operating in Ireland competitive at an international level.

In the summary of the main risks of base erosion involving interest deductions and other financial payments, the OECD described the main risks of base erosion as arising in three basic scenarios:

1. Groups placing higher levels of third-party debt in high tax countries,
2. Groups using intra-group loans to generate interest deductions in excess of the group's actual third-party interest expense, and
3. Groups using third party or intra-group financing to fund the generation of tax-exempt income.

Taking account of the ATAD measures already introduced, the proposed interest limitation regime and the existing tax regime for interest deductions, the introduction of the interest limitation rules on top of the existing regime for taxing interest deductions will result in undue restriction of interest and go beyond that which is necessary to address the main risks of base erosion through interest deductibility.

To substantiate keeping the existing rules that limit a deductible tax expense whilst also introducing the ILR, the consultation notes that the ILR is a deferral of an interest deduction as opposed to a permanent disallowance. Whilst theoretically this is the objective of ILR, in practice, the restriction may give rise to a permanent disallowance of interest expense. Furthermore, while the directive aspires to ensure that third-party debt will be deductible, the manner in which it facilitates this is unsophisticated and wanting in many respects. Consequently, in order to achieve the objective that the ILR gives rise to a deferral of an interest deduction rather than a permanent disallowance, it will be important to maintain as much flexibility within the regime whilst being compliant with ATAD. This can be achieved through allowing groups to freely allocate disallowed interest, excess capacity and any carry forward interest or capacity. Even with this flexibility, the complexity in calculating the ILR can result in no deferred tax asset being recognised under accounting standards. This will result in an increase in a company's effective tax rate, and a consequential reduction in the earnings per share despite nothing changing in the company's profitability.

As previously outlined in our 2019 submission, the taxation framework of Ireland's current corporation tax regime related to interest expense and similar payments already has a number of measures to address the main risks of base erosion outlined above;

- ✓ **A 12.5% rate of corporation tax** applicable to income from a trade – the class of income with the broadest base for financing expense deductions. This rate of tax is comparatively low in international terms and reduces the comparative risk of the Irish operations of a multinational entity (MNE) bearing disproportionate or excessive debt levels in comparison to the level of third-party debt borne by the group as a whole.

- ✓ **Withholding tax of 20%** on yearly interest paid to non-residents. Reliefs for payments to non-resident group members are confined to lenders resident for corporate income tax purposes in the EU or tax treaty jurisdictions with a tax regime that generally subjects such foreign receipts to tax.

- ✓ **The automatic characterisation of interest paid to a non-resident 75% group member as a non-deductible distribution** – with limited overrides which generally confine the override to restore the interest deduction to borrowers engaged in the conduct of a trade who are borrowing from EU or tax treaty residents. In the case of lenders who are not resident either in the EU or in a tax treaty jurisdiction, the extent of the override of distribution treatment is limited either to circumstances where Irish withholding tax at 20% is deducted or the lender company is taxed at a rate of at least 12.5%.

  In practice, interest paid by Irish residents to 75% group members who are not resident in tax treaty jurisdictions will either be subject to withholding tax at 20% or subject to tax in jurisdictions with a tax rate of at least 12.5%.

- ✓ **No offset of interest expense against non-trading interest income.** Essentially this is interest income arising outside a financial services trade[1].

- ✓ **No offset of interest expense against capital gains** (taxed at 33%).

- ✓ **No offset of interest expense against tax exempt income.**

In the case of **interest expense potentially deductible at 12.5%:**

- ✓ The borrowing must be incurred wholly and exclusively for the purposes of the trade,
- ✓ The expense must be revenue and not capital in character, and
- ✓ The loan arrangement must be priced on arm's length terms in accordance with OECD guidelines. The transfer pricing regime provides for upward adjustments only. There is no basis to deduct a notional expense by reference to a market rate of interest where the income is not taxed on the lender.

Additional 'ring fencing' measures potentially apply to **cap current period relief for interest incurred on the provision of specified intangible assets** under section 291A, TCA 1997. The relief for interest expense and capital allowances on the assets is capped at 80% of current period (pre-interest and capital allowances) tax-adjusted profits from a deemed separate trade encompassing the management, development and exploitation of the specified intangible assets.

Anti-avoidance measures applicable to interest and financing expense related to borrowings used for the purposes of the trade:

- ✓ Deny a deduction where the borrowing is from a connected person and used to acquire an asset from a connected person. Exceptions apply for borrowings used to fund the acquisition of trading stock and certain intangible assets. If the assets acquired represent a trade previously not taxed in Ireland, interest deductions are capped at the Irish taxable profits of the acquired trade.
- ✓ Deny a deduction for the interest expense, where the borrowing replaces capital previously withdrawn.
- ✓ Defer a deduction for interest otherwise deductible on an accruals basis if and until the income is taxed where there is a connected lender which is Irish resident or the lender is a non-Irish resident and is controlled by Irish residents.
- ✓ Deny a deduction (by re-characterising interest payable as a distribution) where a loan has 'equity type' characteristics.
- ✓ For closely held companies, cap interest payable on loans advanced by director shareholders (broadly defined) and their associates.
- ✓ Deny a deduction where one of the main purposes of the borrowing is to obtain a reduction in tax due to tax relief for the interest.
- ✓ Deny a deduction under the General Anti-Abuse Rule (GAAR), where a tax advantage arises under a tax avoidance

[1]The profits of securitisation companies are measured under the tax principles applicable to the conduct of a trade.

transaction which represents an abuse or misuse of the relief.

Interest deductible under the 'interest as a charge' regime is confined to interest solely when paid on borrowings to acquire a material interest in shares of companies which meet defined conditions and in lending to such companies. The conditions to avail of the relief which allow interest to be offset against current period taxable group profits are prescribed and complex. They must be met not just at the date of the borrowing but throughout the period that interest is paid on the loan.

The relief is denied for connected party borrowings used to acquire shares already held by connected persons; for circular lending arrangements; and for borrowings to fund loan advances unless there is equivalent additional income taxed in the Irish group. Disposals of any shareholdings or intra group debt trigger 'recovery of capital' measures which deny a deduction for 'interest as a charge' by deeming borrowings to be repaid (even if the financing is unrelated to the recovery event).

Relief is available for interest expense against rents from immovable property but is **confined to interest expense incurred on the purchase, improvement or repair of a rental property** (or refinancing such loans).

Outside the rules applicable to trading and rental profits, there is limited scope to deduct interest expense.

Outside the rules applicable to trading profits, there is also limited scope to deduct different types of financing expense which are included within the scope of the ATAD interest limitation rule as expenses that are economically equivalent to interest and other costs related to borrowing. These include loan discount and premium expense, expense on interest-based derivatives, loan guarantee fees and loan arrangement fees.

A separate regime applies to shari'a finance which broadly operates to apply the principles associated with deducting interest expense under trading principles to defined payments under shari'a finance arrangements.

Separate rules apply under the securitisation regime for qualifying companies taxed under Section 110, TCA 1997. Section 110 generally applies taxing principles used to measure the profits from a trade to the measure of profits and gains of a qualifying company under section 110.

We suggest that, in tandem with the introduction of an Interest Limitation rule, Ireland changes its corporation tax regime for deductions involving interest expense and other financial payments by:

- ✓ Broadening the base of deductible interest and other financial payments by applying a general standard of deducting expense to the extent it is expenditure incurred 'wholly and exclusively' for the purposes of both trading and non-trading profits of the business,
- ✓ Permitting the offset of interest expense against interest income,
- ✓ Dis-applying the capital versus revenue distinction to permit deductions for both types of expenditure,
- ✓ Simplify the provisions related to 'interest as a charge' under section 247, Taxes Consolidation Act 1997 (TCA 1997) and the recovery of capital rules contained in section 249 TCA 1997, and
- ✓ Broadening the scope of existing relief from withholding tax on payments of yearly interest.

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?

Analysis

Interest as a charge provision

Our experience from seeing corporate groups comply with earnings stripping measures in other counties is that they typically seek to ensure that the largest borrowers in their group manage their debt levels and forecasted interest costs during the taxable period so as not to exceed the [30% of EBITDA] earnings limitation under the measures.

Where the group overall has debt levels and interest expense within the 30% EBITDA ceiling, it seeks to reduce the risk of exceeding this threshold and to minimise the uncertainties arising from potential reliance on reliefs to mitigate excess interest limitation amount in the period.

Although the design of measures enacted internationally (as well as those in ATAD2) typically include provisions to carry forward excess disallowed expense in one period to future periods, there is always uncertainty surrounding the capacity of the group to use these reliefs in future. The adverse current business environment arising from the impact of the COVID-19 virus is a case in point. This uncertainty can mean that carried forward amounts are not off-settable or their offset is deferred until a return to projected levels of profitability.

Failure to deduct the disallowed expense can mean an unexpected increase in the effective tax rate of the group for the period. A deviation from expected results for the period can affect the perceived performance of the company and its business from a markets, shareholder and debt investor perspective.

In practice, this means that groups focus on minimising the risk of 'surprises' arising from unforeseen excess interest amounts.

To do this, it is likely that groups operating in Ireland will need to restructure existing debt flows. This means that the debt is consolidated into and is focused on companies which have the highest capacity to absorb the expense. Individual executives responsible for the management of those business units within the wider group can then monitor and take responsibility for adhering to the debt limitation rules.

In order that taxpaying groups can be put in a position to ready themselves for compliance with a 30% of EBITDA interest limitation rule, we suggest that the recovery of capital provisions pertaining to connected parties contained in section 247 and section 249 should be adjusted to provide for an additional relief from their application. This relief would apply where flows of capital and debt restructuring occur with the intention of enabling the group to comply with the interest limitation measures.

Section 840A

As the interest limitation rule applies the limitation cap not only on interest and borrowing costs associated with third party debt but also on financing costs associated with group debt, we do not consider that the provisions under section 840A are required in an environment where there is already a limitation on deducting borrowing costs on group debt. We recommend that these should be disapplied as they are no longer required once the new interest limitation rules are put into effect.

Key Recommendation

- ✓ Simplification of the recovery of capital rules applying to interest as a charge to allow companies to comply with the interest limitation regime without an unexpected increase to the effective tax rate of the group
- ✓ Remove section 840A but preserve the relief for unused and carried forward expense off-settable under section 840A against profits from an acquired trade

Question 2

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

Analysis

In the table that follows, we have summarised the main measures that currently apply under Ireland's corporation tax regime that affect the tax treatment of interest, expenses (such as discount and premia) that are economically equivalent to interest as well as borrowing related costs. These are the categories of expense that are treated as 'borrowing costs' within the scope of the Interest Limitation rule under ATAD1.

The existing measures include a range of targeted and purpose-based tests that provide protections from base erosion principally by narrowing the base of deductible 'borrowing costs'.

We have suggested changes to the scope of existing measures to rebalance the effect of protections afforded within the existing corporation tax regime.

Finally, we have looked ahead to describe the main measures affecting the tax treatment of 'borrowing costs' and taxable 'interest income' in a corporation tax regime post-implementation of ATAD measures.

Redesign of Ireland's corporation tax regime for interest

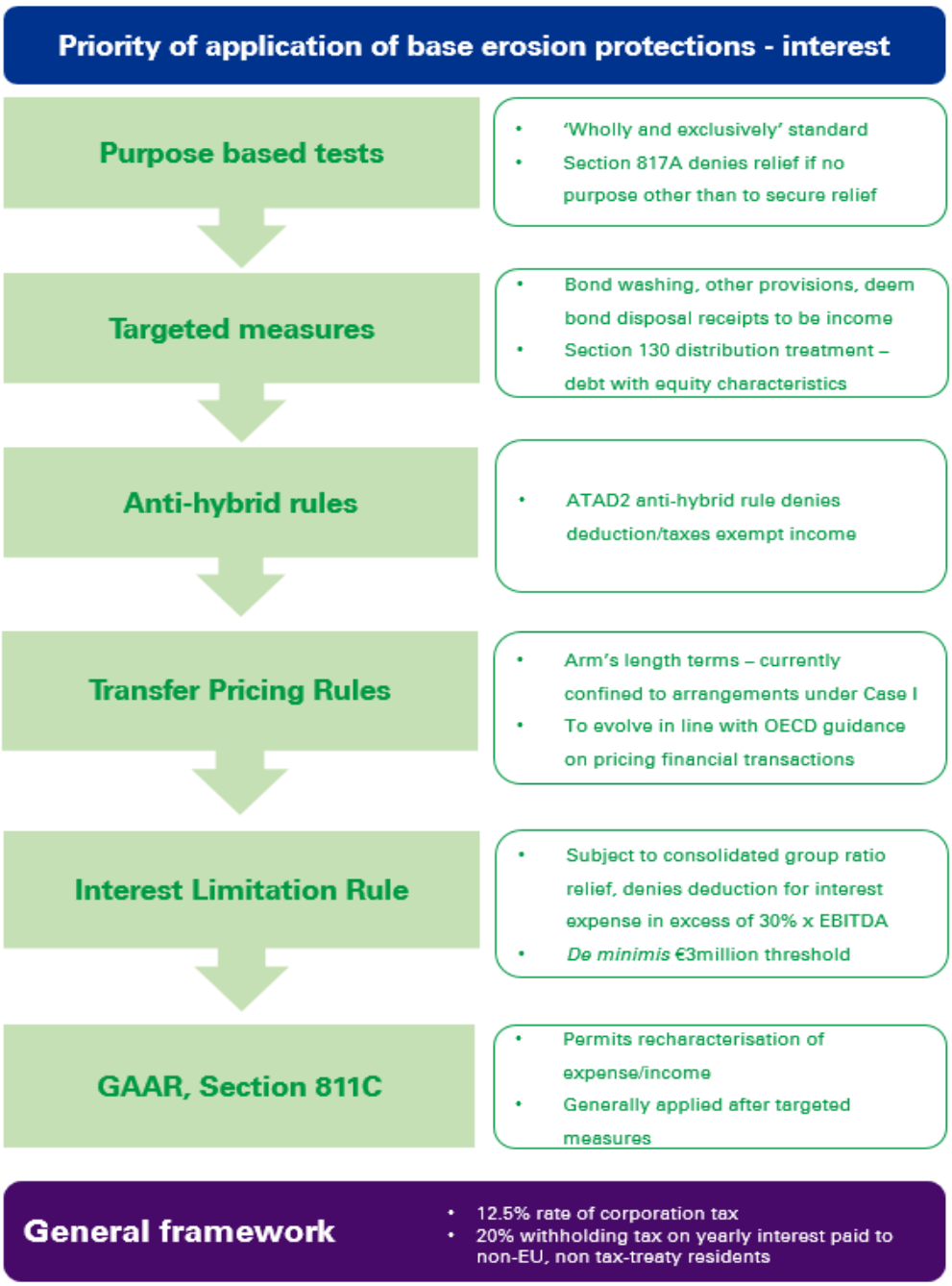
Existing measures	Change	Corporation tax regime for deducting interest expense post-ATAD Implementation
'Wholly and exclusively' test for deduction of broad base of interest and expense economically equivalent to interest as well as borrowing costs (if revenue and not capital in character) under Section 81. Expense is generally deductible in accordance with the measure and timing of recognition of the expense in the income statement prepared in accordance with recognised accounting standards.	**Broaden scope of eligible expense deductible against non-trading income using purpose-based test** e.g. 'wholly and exclusively' to the extent incurred for the purposes of the business. **Disapply revenue/capital distinction** to permit deduction of borrowing costs even if capital in character. **Follow accounts-based recognition** of the expense. **Remove section 76(5)(b)** which generally prevents a deduction for yearly interest amounts.	Taxpayer is entitled to deduct interest, expense economically equivalent to interest and a broad range of borrowing costs in computing the taxable measure of both trading and non-trading income to the extent the expense has been incurred 'wholly and exclusively' for the purposes of the taxpayer's business, following an accounts basis recognition of expense. It is assumed that the trading/non-trading income distinction is retained so that the expense is deductible separately against trading income and classes of non-trading income. This could include deductions of interest expense against non-trading interest income and foreign dividends.
Interest as a charge (Sections 243, 247, 249, et al.)	**Simplify the requirements to qualify and the recovery of capital provisions.**	Enable groups to restructure debt without falling in scope of onerous recovery of capital provisions due to the protection already afforded by the introduction of an interest limitations regime.
Section 130(2)(d)(iv) automatic treatment as a distribution for interest on	**Remove automatic treatment as a distribution** for interest paid to a non-resident 75% group member	Interest on debt with 'equity type' characteristics may be re-

Redesign of Ireland's corporation tax regime for interest		
Existing measures	**Change**	**Corporation tax regime for deducting interest expense post-ATAD Implementation**
debt without any 'equity' characteristics where it is payable to a non-resident 75% group member (disapplied for EU residents by section 130(2B)). Sections 452, 452A and 845A provide for elections to override this distribution treatment. Section 130 also characterises interest as a distribution where the terms of payment of the interest or the underlying debt have equity type characteristics.	which is not otherwise within the scope of section 130 measures targeted at interest on debt with equity characteristics. Remove sections 130(2B), 452, 452A and 845A as no longer relevant where distribution treatment no longer applies.	characterised as a distribution for tax purposes.
Section 817B applies to ensure that interest income potentially taxable in 2 periods is taxable in the earlier period.		Section 817B applies to ensure that interest income potentially taxable in 2 periods is taxable in the earlier period.
Section 840A narrows the scope for deduction of interest expense on group borrowings which are used to acquire certain types of assets already held by the group.	**Remove section 840A** as the Interest Limitation rule applies to both group and third party borrowings. Preserve relief for unused and carried forward expense off-settable under section 840A against profits from an acquired trade.	
Section 291A caps current period relief for interest expense and capital allowances against 80% of the tax adjusted income from specified intangible assets.	**Remove interest expense from scope of the 80% capping measures** as subject to the 30% of EBITDA cap under the Interest Limitation rule. Preserve relief for excess and unrelieved carried forward interest under section 291A, treating it as interest expense deemed to be incurred in the period.	80% cap for current period deductions under section 291A confined to capital allowances on specified intangible assets.
Section 254 denies an interest deduction on a borrowing drawn down within 5 years if capital is withdrawn from a trade / business.	**Remove** for corporation tax purposes as broader scope of interest deductions would apply under the general-purpose rule.	
Section 817C denies deduction for accruing interest expense of borrower (until and if) taxed in hands of connected party lender.	**Remove section** as Interest Limitation rule provides for deferral of deduction of excess expense of the period. **Preserve relief for previously denied expense,** treat as expense subject to Interest Limitation rule in claim period.	

Redesign of Ireland's corporation tax regime for interest		
Existing measures	**Change**	**Corporation tax regime for deducting interest expense post-ATAD Implementation**
Section 817A denies a deduction if a scheme or arrangement has been put in place and the sole or main benefit is to obtain a reduction in tax.		Section 817A denies a deduction if a scheme or arrangement has been put in place and the sole or main benefit is to obtain a reduction in tax.
Section 97 provides for deducting interest expense related to the purchase, repair or improvement of rental property. Accounts based recognition of the deductible expense already applies through the application of Case I principles.	**Replace section 97(2)(e) with the general deductible purpose test.** Existing debt eligible for relief under the provisions presumed to meet the general deductible purpose test upon first application of the new regime.	Interest, payments economically equivalent to interest, and a broad range of borrowing costs are deductible in taxing property rental income to the extent the related expense is incurred wholly and exclusively for the purposes of the property rental business activity.
Section 437 applies to limit deductible interest payable to directors/participators in closely held companies.	**Remove** as the Interest Limitation rule applies to limit interest deductions above the *de minimis* threshold. It is assumed the rule will not apply to standalone companies (but these exclude companies where an individual shareholder owns more than 25% of the company).	Smaller companies (many of which are closely held companies), in practice are expected not to be subject to the Interest Limitation rule where net interest expense does not exceed the *de minimis* threshold of €3 million per annum.
Section 542 denies relief for interest expense in computing capital gains.	**Preserve** where the distinction in treatment between capital gains and income profits is retained.	Section 542 denies relief for interest expense in computing capital gains.
Bond washing provisions under Part 28 operate to deny deductions for certain 'purchased interest' expense where tax exempt income.	**Preserve** to retain protection from deductions related to such 'purchased interest' expense.	Bond washing provisions under Part 28 operate to deny deductions for certain purchased interest expense where tax exempt income arises on securities.
Bond washing provisions (section 812), anti-avoidance provisions related to securities transactions at section 813, 814 and 815 deem income to arise in circumstances where it might otherwise fall within the scope of capital gains tax provisions.	**Preserve** where the distinction in rate of tax remains between profits taxed as capital gains or income.	Bond washing provisions (section 812), anti-avoidance provisions related to securities' transactions at section 813, 814 and 815 deem income to arise in circumstances where it might otherwise fall within the scope of capital gains tax provisions. Such income to be treated as 'interest income' under the Interest Limitation rule.
Chapter 35C denies tax relief on certain payments where there is a mismatch on the taxation of the cross-border payment	**Preserve Anti-hybrid rule under ATAD1**.	Deduction denied for expense to counteract D/NI and D/D outcomes. Exclusions for bank loss-absorption instruments and certain 'on market' transactions in securities by financial traders.
Transfer pricing provisions apply to adjust upward	Feedback from stakeholders should be obtained to consider	Transfer pricing denies deductions for excessive 'interest expense' and

Redesign of Ireland's corporation tax regime for interest		
Existing measures	**Change**	**Corporation tax regime for deducting interest expense post-ATAD Implementation**
taxable profits to apply an arm's length price to arrangements taxable under Case I including financing arrangements.	aspects of Ireland's future transfer pricing regime which might include clarifying the scope of the domestic transfer pricing exemption	reduces scope of interest expense subject to the Interest Limitation rule or recognises higher 'interest income' within scope of Interest Limitation rule, as appropriate.
	Interest Limitation rule under ATAD1.	Apply a 30% of EBITDA limitation on net interest expense above a €3 million *de minimis* threshold, applied on a local group basis. Additional relief potentially available under a consolidated group ratio rule. Excess interest expense to be carried forward indefinitely with excess interest capacity carried forward for 5 years.
Section 811C general anti-abuse rule (GAAR) can apply to deny reliefs under a tax avoidance transaction where the transaction was arranged primarily to give rise to a tax advantage.		Section 811C general anti-abuse rule (GAAR) can apply to deny relief for interest expense under a tax avoidance transaction where the transaction was arranged primarily to give rise to a tax advantage.
Section 246 applies withholding tax at 20% to yearly interest paid by companies with relief available under section 246(3)(h) where the interest is payable in the ordinary course of the business of the company to another company resident in a EU/tax treaty jurisdiction that generally taxes foreign source interest.	**Review broadening scope of exemption from withholding tax** for interest payable by companies under section 246(3)(h) e.g. extend relief to non-resident counterparties resident or subject to tax in jurisdictions that meet international tax governance and transparency standards.	Withholding tax at 20% potentially applying to payments of interest subject to reliefs with broadened scope (e.g. under section 246, 246A, 64 and under tax treaty arrangements).

The redesigned regime set out in the table above still includes an extensive range of protections from base erosion involving interest deductions and other financial payments. In the chart below, we have illustrated the order of priority in which these protections against base erosion would operate in the redesigned regime.



Key Recommendation

We recommend changes to the scope of existing measures to rebalance the effect of protections afforded within the existing corporation tax regime.

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.)

Analysis

The approach included in the consultation will operate on a single entity basis. However, it will require additional steps in taking into consideration its application to a notional local group or where the group ratio is applied to obtain relief beyond 30% of EBITDA. It is difficult to comment on the approach on a single entity basis as its application to businesses will be limited where the standalone exemption is available. Furthermore, clarification of a number of important definitions will only be provided in the second feedback statement. These include the definition of relevant entity, the definition of relevant profits, details of the 'worldwide group' rule being adopted and whether and how a notional local group may operate. However, we have provided below some high-level responses taken into account this approach will be extended to groups.

We consider the methodology outlined in steps 1 to 3 are appropriate but we think further consideration is needed in respect of step 4.

In applying the ILR at a notional group level, Step 5 should take into consideration the consolidation at a notional local group level of exceeding borrowings and EBITDA.

Step 6 should be further expanded to include application of the group ratio, being the group ratio rule or the equity ratio rule.

Step 6(a) should be the calculation of the restriction under the Fixed Ratio Rule.

Step 6(b) should be the calculation of the restriction under the respective group rule, if relying upon the group rule.

Step 6(c) should take account of any interest restricted by application of (a) or (b) and allow the restricted interest where excess capacity has been carried forward in the entity or exists elsewhere in the group.

Step 6(d) should take account of any restricted interest carried forward to be utilised where there is excess capacity within the notional local group.

The timing and method by which the above will be carried out will be dependent on how the notional local group rules will be applied, either at a consolidated level or at a single entity level.

Step 7 provides for the carry forward of any restricted interest or excess capacity.

Key Recommendation

Approach will need further consideration so as to incorporate the group aspects. Further consultation on this approach should be sought during the second feedback statement.

Questions arising from proposed approach to ILR

Interest equivalent – steps 2 to 4

Question 4

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

Analysis

The suggested definition of 'interest equivalent' does not refer to all of the items included in the definition of 'borrowing costs' in Article 2 of ATAD1. We have analysed scenarios where taxpayers face complexity in identifying borrowing costs and have addressed each of these matters in turn below. We suggest that the wording of definition of 'interest equivalent' should be more aligned with the wording provided in ATAD1 and expressly deal with some of the more complex issues outlined below. We have suggested alternative wording for the definition at the end of the response to this question.

The definition of 'borrowing costs' in ATAD1 is identical to the wording adopted by the OECD in its best practice recommendations for a fixed-ratio rule that were set out in its October 2015 final report on Action 4 (and repeated in its 2016 update report). The description of borrowing costs set out by the OECD in its best practice recommendations for a fixed-ratio rule encompass three types of costs:

(i) interest on all forms of debt;

(ii) payments economically equivalent to interest; and

(iii) expenses incurred in connection with the raising of finance.

The definition goes on to include a non-exhaustive list of items which should be treated as economically equivalent to interest, some of which are referred to below.

Foreign exchange movements

Under ATAD1, borrowing costs include *"certain foreign exchange gains and losses on borrowings and instruments connected with the raising of finance".* In its commentary on the inclusion of foreign exchange gains and losses on borrowings as part of borrowing costs at para 37 of its Action 4 report, the OECD recognises that foreign exchange gains and losses on borrowings and instruments connected with the raising of finance are not generally economically equivalent to interest. It appears that its recommendation to include '**certain**' exchange gains and losses recognises that *"a country may however wish to treat some or all foreign exchange gains and losses on these instruments as economically equivalent to interest, in line with local tax rules and to reflect the economics of currency exposure."*

Ireland's corporation tax regime does not treat foreign exchange gains and losses on borrowings in the same manner as interest expense. Foreign exchange gains and losses on assets and liabilities (including broadly defined monetary liabilities[2]) are taxed in accordance with the relevant taxing provisions related to the holding, disposal and/or purpose or use of the asset or liability. It would represent a change to the current approach under Irish tax rules to include as amounts that are economically equivalent to interest, foreign currency movements on interest related debtors, loan principal amounts and financial instruments to take on or hedge a currency exposure related to such debts. Such a change would not seem to fit within the wider framework for taxing foreign currency movements under Ireland's tax rules.

In addition, in the global economic environment in which Ireland's open economy operates, political choices and other global events that affect economic performance have contributed to and are continuing to influence significant volatility in currency exchange rates

[2] See for example, section 79, TCA 1997.

in the currencies in which Irish based business operates. Unlike the past, these foreign currency exchange movements are not closely correlated with changes in interest rates or other borrowing costs.

To exclude foreign exchange movements on debts and financial instruments related to hedging or taking on currency risks from the scope of an Interest Limitation rule would seem to be consistent with the scope of such costs recommended by the OECD and adopted under ATAD1.

Foreign currency exchange movements which are inherently reflected in the measure of the deductible interest expense in the income statement of the taxpayer appear to us to be the appropriate scope for inclusion of foreign currency exchange effects in "borrowing costs" related to *"certain foreign exchange gains and losses"*.

The UK Corporate Interest Restriction (CIR) regime specifically excludes foreign exchange movements on loan principal from the measure of net interest expense in computing restricted borrowing costs. This is in recognition of the fact that such movements are not equivalent to interest.

The UK regime includes foreign exchange movements on interest expense.

Practical considerations

Foreign exchange movements in relation to loans and other forms of debt and debt equivalents (i.e. instruments, contracts and other arrangements on which amounts economically equivalent to interest arise) can be enormously volatile and move in ways that are in no way related to the underlying cost of finance. It does not, therefore, appear rational to include them within borrowing costs for the purpose of an Interest Limitation rule. As foreign currency movements are outside the control of the taxpayer and unpredictable, including such movements within the measure of borrowing costs or interest income will pose significant uncertainty for taxpayers seeking to comply with the limits on net borrowing costs set out under the measures. A foreign exchange movement can occur at any point in time. Where it occurs at the close of an accounting period, its impact can be a multiple of the amount of the interest expense on the related borrowing for the year.

Ireland is a small open economy. Foreign investment represents an unusually high percentage of economy activity. In addition, Irish based businesses have had to access foreign markets to raise debt to fund their business. To access finance which is as cheap as possible can mean raising debt or debt equivalents in the preferred currency of investors in that marketplace – which means taking on foreign currency exposures related to the repayment of that debt / debt equivalent in a foreign currency.

The business sector in Ireland therefore is more exposed to foreign exchange movements than business sectors in most other countries. Needlessly bringing such movements within the scope of an Interest Limitation rule – which is not required by ATAD1 – would be detrimental to business with no material offsetting benefit for the economy.

- ✓ Foreign currency exchange movements which are inherently reflected in the measure of the deductible interest expense in the income statement of the taxpayer appear to us to be the appropriate scope for inclusion of foreign currency exchange effects in "borrowing costs" related to *"certain foreign exchange gains and losses"*.
- ✓ Exclude foreign exchange movements on loan principal from the measure of net interest expense in computing restricted borrowing costs.

Foreign currency movement on derivative contracts

As with foreign exchange movements on loan principal, the UK CIR regime specifically excludes derivative contracts in respect of foreign currency exchange from the measure of net interest expense in computing restricted borrowing costs. This is in recognition of the fact that such movements are not equivalent to interest.

The underlying subject matters of derivative contracts which are included are:

- Interest rates,
- Any index determined by reference to income or retail prices,
- Currency, and
- An asset or liability representing a loan relationship.

A derivative with any other underlying subject matter other than those listed above will still be a relevant derivative contract if that subject matter is either subordinate in relation to any of the above or of small value in comparison with the value of the underlying subject matter as a whole. This is determined at the point at

which the company either enters into or acquires the contract.

Broadly, this means that the general rule under the CIR is that debits and credits related to derivative contracts, whose underlying subject matter is financial in nature, are included in the measure of interest expense and interest income, respectively, for the purposes of applying a restriction to net interest expense under the Fixed Ratio Rule (FRR). Derivative contracts which hedge other costs of the business such as utilities or commodity prices, for example, are excluded.

However, the CIR measures expressly exclude derivative contracts in respect of foreign currency exchange losses or exchange gains as well as those in respect of impairment losses.

The practical considerations noted above in relation to foreign currency exchange gains and losses on loan principal amounts (or the principal amounts of debt equivalents) equally apply to derivative instruments in respect of foreign currency gains and losses. We suggest that needlessly bringing such movements within the scope of an interest limitation rule – which is not required by ATAD1 – would be detrimental to business with no material offsetting benefit for the economy.

- ✓ Also echoing our recommendation noted above, derivative contracts which relate to interest rates and amounts which are inherently reflected in the measure of the deductible interest expense in the income statement of the taxpayer appear to us to be the appropriate scope for inclusion of derivative instruments with respect foreign currency exchange effects in "borrowing costs".
- ✓ We suggest that Ireland should expressly provide that gains or losses that arise from derivative instruments in respect of foreign currency exchange fluctuations on assets or liabilities that form part of financial instruments that give rise to borrowing costs and well as those related to impairments should not be included in the measure of exceeding borrowing costs that is subject to the Interest Limitation rule.
- ✓ It is acknowledged that for taxpayers who have limited exposure to foreign currency exchange movements, the administrative burden associated with identifying and adjusting the computation of exceeding borrowing costs for comparatively insignificant amounts of foreign currency exchange movements may be considered to be disproportionate. We suggest that in such cases, implementing guidance might confirm that such taxpayers could apply the interest limitation rule by including such foreign currency exchange movements in the measure of interest income and exceeding borrowing costs – provided that this approach is adopted and applied consistently from one tax accounting period to the next.

Derivative instruments unrelated to funding the capital structure e.g. instead related to costs such as commodities, utility prices, etc.

It appears clear from the OECD commentary[3] on borrowing costs that they should not include amounts under derivative instruments or hedging arrangements which are not related to borrowings, e.g. commodity derivatives.

It can be a complex matter to separately identify the cash flows and related accounting impact for derivatives related to interest costs and other non-borrowing related operating costs.

- ✓ We suggest that derivative instruments unrelated to funding the capital structure of the company should be excluded from the scope of the Interest Limitation rule. This would leave derivatives related to other operating costs, such as commodities, that are unrelated to borrowing costs out of scope of the Interest Limitation rule.
- ✓ It is suggested that the manner in which this is done should not be expressly legislated for but left to the taxpayer to identify a reasonable basis for identifying and tracing such amounts on a consistent basis from one period to the next.

Fair value movements on financial assets and liabilities

Fair value movements on financial assets and liabilities may have links to interest rates but would not seem generally to represent gains or losses that are economically equivalent to interest from the borrower's perspective. Such fair value movements can generally only be realised by the lender as a gain or loss upon sale of the debt.

[3] Para 39, OECD final report Action 4, October 2015 and in updated 2016 report.

✓ We suggest therefore that fair value movements on financial assets or liabilities are expressly excluded from the scope of the definition of 'interest equivalent'.

Profit participating debt

Fair value movements on debt are to be distinguished from profit participating interest which clearly remains potentially within scope of the Interest Limitation rule where it is a tax-deductible expense. In many cases, under Ireland's corporation tax regime, profit participating interest is treated as a non-deductible distribution for tax purposes[4].

✓ We suggest that provisions which treat interest as a non-deductible distribution should be applied in priority to the Interest Limitation rule. Where interest on profit participating debt is a non-deductible distribution, it should be excluded from the Interest Limitation rule.

Adjustments related to the amortisation of capitalised interest expense

The accounting treatment of interest expense is not determinative of its treatment for Irish tax purposes. Interest expense, e.g. in relation to capitalised development expenditure can be recorded as part of the carrying value of an asset capitalised in the balance sheet of the company and then amortised and recognised as an expense in the income statement of the company in accordance with the accounting amortisation policy of the company.

✓ We suggest that, in order to align the application of the Interest Limitation rule with the taxpayer treatment of capitalised interest expense, the expense should be dealt with under the Interest Limitation rule in the period in which it is deductible for tax purposes.

Bad debt impairment

Impairment losses on bad debts do not appear to be equivalent to interest. Provisions for impairment of bad debts including loans do not fall within the three categories of expense listed in ATAD1 within the scope of the Interest Limitation rule.

✓ We suggest that impairments should not be included in the definition of borrowing costs on the basis that such losses do not appear to be economically equivalent to interest.

Transfer pricing adjustments referable to a funding return

Borrowing costs under ATAD1 include *"amounts measured by reference to a funding return under transfer pricing provisions where applicable"*. The OECD commentary in para 39 of the October 2015 final report on Action 4 notes that, in general, a fixed-ratio rule should not limit deductions for royalties or operating lease rentals.

Funding return deductions generally do not arise under Irish transfer pricing provisions[5] under Part 35A, TCA 1997 as the regime operates to apply arm's length pricing so as to adjust upwards the measure of taxable profits (or reduce the measure of tax losses). An exception to this might arise in the context of a transfer pricing corresponding adjustment amount which arises where a transfer pricing adjustment has increased the taxable profits of a counterparty to an arrangement.

✓ In implementing the Interest Limitation rule, it would be useful to expressly confirm that any reference to funding return under transfer pricing provisions in the context of the definition of borrowing costs does not include transfer pricing adjustments to royalties or operating lease rentals but rather transfer pricing based deductions for a funding return on debt or debt equivalents.

✓ More specifically, it would be useful to expressly exclude royalty payments and operating lease rental payments from the scope of 'borrowing costs' subject to the Interest Limitation rule.

Interest income and amounts equivalent to interest income

In most cases, it can be expected that a symmetrical treatment would apply to expense payments and receipts so that an expense which is recognised as a 'borrowing cost' under the Interest Limitation rule should be considered to be an 'interest income' receipt.

For example, it can be expected that a guarantee fee payable by a borrower is included in borrowing costs and the guarantee fee income is included in interest income by the guarantor company. Similarly, discount expense borne by a borrower on a zero-coupon bond and included in its borrowing

[4] See section 130, TCA 1997 which can re-characterise certain returns on debt, including profit participating interest, as a distribution for tax purposes.

[5] See Part 35A, TCA 1997.

costs should be regarded as 'interest income' for the bond holder.

However, we can foresee enormous practical difficulties in applying this symmetry of treatment in the case of certain payments – mainly arising in the financial services sector where the context in which the payments arise can mean that certain receipts can be said to be economically equivalent to interest because of the integral nature of interest expense and income in the context of the trade conducted by the financial services entity. Such income or expense may not arise in an equivalent context for a counterparty entering into the arrangement outside the context of a financial services trade. We have identified these circumstances as including:

Profits arising for providers of credit

We have suggested above that

(i) fair value movements on debt and debt equivalents (and gains or losses arising on the disposal of securities),

(ii) foreign exchange movements on debt and debt equivalents, and

(iii) foreign exchange movements on derivative contracts

should not, under general principles, be considered to be economically equivalent to interest and therefore should not be included in borrowing costs or interest income for the purposes of the Interest Limitation rule.

However, where such profits or losses arise to a company which engages in a trade of, or involving, providing credit such that the profits/losses form part of its trade, the interest income or coupon arising on the loan / debt equivalent forms such an integral part of the overall gain or loss on the security that it would seem more appropriate to treat the entirety of the profit as interest income, and losses as deductible borrowing costs, under the Interest Limitation rule. This would be relevant to a range of businesses such as banks and other financial institutions, other providers of commercial and consumer credit provider (e.g. car loans), retailers selling goods on credit (hire purchase, finance lease), and other similar business. If this treatment were not applied, such businesses would be obliged to disintegrate the fair value movements on their portfolios of loans, leases, credit contracts etc. to identify those components related fair value movements on principal and foreign exchange would be monumental undertaking and would hugely increase the compliance obligations for these taxpayers.

This, for example, is the treatment of such gains or losses under the UK CIR regime. Like Ireland's corporation tax regime, the UK corporation tax regime more generally draws a distinction between the tax treatment of such fair value movements and profits or losses realised in a trading and a non-trading context.

- ✓ Where profits from an activity taxed under Case I principles involves the income from the provision of credit, such that the profits/losses form part of its trade, the entirety of the profits (including valuation movements and foreign exchange movements) should be treated as interest income, and losses as deductible borrowing costs, under the Interest Limitation rule.

Profits arising for traders and dealers in debt and debt equivalents

As with the providers of credit discussed above, where profits or losses arise to a company which engages in a trade of trading or dealing in loans (or debt equivalents) such that the profits/losses form part of its trade, the interest income or coupon arising on those loans / debt equivalents forms an integral part of the overall gain or loss on those assets, it would seem more appropriate to treat the entirety of the profit as interest income, and losses as deductible borrowing costs, under the Interest Limitation rule.

This would include fair value gains / losses and foreign exchange movements on those debt instruments (and debt equivalents). It would also include gains (or losses) on debt instruments (and debt equivalents) which are purchased at a discount to their face value.

In our view, it would be contrary to the intent of the framers of ATAD1 and the overall framework of the interest limitation rule to impose an interest restriction in a scenario where a company which is in the business of providing finance and/or investing in debt (where earning a return by reference to interest is an intrinsic part of its business) could find itself with a net borrowing costs limitation.

Debt instruments which carry a rate of interest may, nevertheless, trade at above or below the par value of the debt principal (the face value of the debt).

This may be due to a change in market conditions and/or a change in the circumstances of the borrower/issuer. Where

such an instrument trades below its face value, this discount reflects the higher interest expense which would be applied in the market if the borrower/issuer tried to refinance that debt (i.e. by borrowing new money to pay off the old debt). As such, it reflects the market's view of the economic borrowing cost associated with that debt instrument at the time of sale of that instrument. For this reason, we believe it is logical to treat such discounts as amounts economically equivalent to interest for the purposes of the Interest Limitation rules.

We note that (as with the treatment of valuation and foreign exchange movements for credit providers discussed above) if the discount on interest bearing loans was not treated as equivalent to interest, the complexity of disentangling discount from interest would be further compounded by the possibility that debt instruments might be issued partially at a discount but yet carry some level of interest (i.e. both interest bearing and having an imputed interest return at the date of issuance). Where such an instrument is traded at a discount, to treat separately the discount and interest expense, one would need to legislate for an appropriate methodology to determine the treatment of all or part of the discounted value. Furthermore, it may not be obvious to purchasers of such debt that the original debt was issued at a discount.

- ✓ Where profits from an activity taxed under Case I principles involves the income from holding, trading in, or dealing in debt or debt equivalents, such that the profits/losses form part of its trade, the entirety of the profits (including gains and losses, valuation movements and foreign exchange movements) should be treated as interest income, and losses as deductible borrowing costs, under the Interest Limitation rule.
- ✓ It should be possible to frame the legislation in a manner which limits the treatment of such discounts as amounts which are economically equivalent to interest to those situations where the taxpayer concerned is computing its profits under trading principles. That said, it is not obvious to us that such an additional complication in designing the measures is warranted given that there would not be, in our view, significant activity of a non-trading character in this space[6]. However, if it were felt necessary to do so such a policy design choice potentially could be applied.

Profits arising to securitisation companies

Where securitisation companies have issued debt to third parties, they do not present a significant risk of base erosion due to interest deductions as they are merely the vehicle by which the cash flows used to fund the debt pass between the third party debt holders and the originator of the financial assets held by the securitisation company.

We recommend in Question 23 that the Interest Limitation rule should be applied on a notional local group basis with the group membership including companies that are part of a common accounting consolidated group. Where the group bears the risk related to the residual profits of the securitisation company, the company may be included in the accounting consolidation with other group members.

As the securitisation company is designed to be tax neutral so as to preserve the integrity of the cash flows available to service the debt secured on its assets, we suggest that the profits of the securitisation company should be treated as interest income under the Interest Limitation rule. This is subject to adjusting this profit by the amount of any operating costs such as management fees deducted in arriving at the net taxable profit of the company.

This treatment is purely for the purposes of the Interest Limitation rule and is not suggested to replace or supersede other limitations on deductions that might apply under section 110, TCA 1997 in measuring the taxable profits of the company for the period.

- ✓ We suggest that the profits of the securitisation company should be treated as interest income under the Interest Limitation rule. This is subject to adjusting this profit by the amount of any operating costs such as management fees deducted in arriving at the net taxable profit of the company. This treatment is purely for the purposes of the Interest Limitation rule and is not suggested to replace or supersede other limitations on deductions that might apply under section 110, TCA 1997 in

[6] To do so would also, for example, require consideration of the treatment of taxable profits chargeable to tax under Case IV and arising from transactions in certificates of deposits and other assignable deposits under section 814, Taxes Consolidation Act 1997 together with the treatment of other returns arising from transactions in securities and dealt with under sections 81, 813 and 815.

measuring the taxable profits of the company for the period.

Plant and equipment lease and hire purchase receipts arising to lessors engaged in a trade of leasing

The features of a trade of leasing plant and machinery are set out and defined under section 403, TCA 1997. Although the general position of companies engaged in the conduct of a trade is to follow the timing and measure of income recognised in accordance with accepted accounting practice in the income statement of the company, these general principles are dis-applied under section 76D, TCA 1997 in the case of finance leases which are not subject to the provisions of section 80A, TCA 1997. The lease payment receivable is treated as forming part of the receipts of the trade of the lessor - which results for the lessor in an equivalent corporation tax treatment for finance lease and operating lease receipts.

For the plant and equipment lessor engaged in the conduct of a leasing trade, the provision of lease finance can result either in the recognition of a finance lease or an operating lease for accounting purposes, depending on a number of factors which include the term of the lease, the economic life of the asset under lease and the expected manner in which the lessor realises its overall return from leasing and/or disposing of the leased asset at the end of the lease term.

For operating leases, the part of the operating lease rental that is economically equivalent to interest (the lease finance income) is not separately recognised for tax purposes in the hands of the lessor. It is separately recognised for accounting purposes in the hands of the lessor in the case of lease arrangements that are categorised as finance leases under generally recognised accounting standards.

- ✓ In order to apply equivalent treatment to that part of hire purchase and lease income that is economically equivalent to interest income, we suggest that lessors engaged in a trade of plant and equipment leasing should be required to include as interest income (and as borrowing costs) the finance income part of hire purchase and lease rental payments.

  Where the accounting treatment of the lessor does not require this split of its lease rental receipts, we suggest that it would be appropriate to identify the finance income/expense amount by applying the same principles governing the lessee treatment of the lease rental profile under IFRS 16 which requires a split of the lease rental payments into a finance element and right of use amount.

Interest income arising in a Public Private Partnership (PPP)

Where projects such as PPPs are accounted for as ‘financial assets’ from public bodies for the purposes of paragraph 34.12 of FRS102 or IFRIC 12 (IFRS), the project company books an amount receivable from the public sector which is repaid over the concession period and reflects the payments from the public sector as comprising an interest income element. The principles are similar in economic terms to loans and investments in finance leases. The company accounts for cash receivable from the public sector which will be repaid over an agreed period and on which interest is accrued.

- ✓ We recommend that interest income arising on the financial asset is recognised as interest income.

Key recommendation:

We suggest the following wording for the definition of 'interest equivalent' to align with the definition in ATAD1 and deal with the complexities outlined above:

"interest equivalent" includes any amount of —

(a) interest,

(b) amounts economically equivalent to interest including —

(i) discounts,

(ii) in the case of companies which are taxed under Case I principles in respect of their debt (or debt equivalent) assets, gains and losses, fair value movements, and foreign exchange movements on those debt (or debt equivalent) assets,

(iii) payments under profit participating loans, but not including interest treated as a distribution under section 130,

(iv) amounts referred to in paragraphs (c) of the definition of financing return in section 835AH,

(v) imputed interest on instruments such as convertible bonds and zero coupon bonds,

(vi) the finance cost element of finance lease payments,

(vii) for lessors taxed under Case I principles in respect of the leasing of plant and equipment leasing, the finance income component of hire purchase and lease rental payments,

(viii) capitalised interest included in the balance sheet value of a related asset, or the amortisation of capitalised interest,

(ix) amounts measured by reference to a funding return under transfer pricing rules where applicable, and

(x) notional interest amounts under derivative instruments or hedging arrangements related to an entity's borrowings,

(xi) for the purposes of this Part, profits arising to a qualifying company under section 110,

(xii) amounts under alternative financing arrangements, such as Islamic finance,

and

(c) expenses incurred in connection with raising finance, including —

(i) certain foreign exchange gains and losses on borrowings and instruments connected with the raising of finance, but such gains and losses shall not include foreign exchange or net deductions (or movements) that arise by reason of foreign currency exchange fluctuations,

(ii) guarantee fees for financing arrangements,

(iii) arrangement fees and similar costs related to the borrowing of funds,

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 but, except where expressly provided, shall not include foreign exchange movements on loan principal (or principal on debt equivalents).

Question 5

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

Analysis

4.2 Taxable interest equivalent

In line with the OECD principles to prevent base erosion where corporation tax groups deduct interest used to fund activities that are exempt from tax, the aligning of interest income with the charge to corporation tax will achieve this aim.

As the term relevant profits and relevant entity are not defined in this consultation, we recommended this definition is reconsidered in the second consultation. However, some of our following observations are relevant in this regard.

4.3 Deductible interest equivalent

Aligning the application of the interest restriction rule with the tax deductibility of the interest expense is welcomed. It will ensure that the interest limitation regime remains aligned with the taxation of business profits.

The definition of deductible interest equivalent provides that no amount is treated as deductible, and so outside the scope of the interest restriction regime, where it reduces the relevant profits below zero or reduces the tax chargeable below zero. If 'relevant profits' were defined as some measure of taxable profits (before any ILR adjustment) this would mean that there would be no interest restriction applied to any interest where the relevant company is in a tax loss position (from a loss forward, allowances, etc,). This would necessitate computing what the restriction would have been in any event and tracking it as part of the losses, etc. carried forward of which it forms a part such that when that part of those losses is used, a restriction calculation will be done and, to the extent there is sufficient capacity, a Case IV charge would be triggered.

Alternatively, if 'relevant profits' were defined as EBITDA, this would mean a restriction only applying where there is positive EBITDA and would mean that you could have cash tax liability arising in years when losses and allowances forward would otherwise have sheltered the amount (noting the proposal in 6(4) of the consultation not to allow the use of any reliefs against a Case IV chargeable amount). This would appear to be inconsistent with the general intent to delay an imposition of a Case IV charge only when the deduction for the restricted interest is used. Consequently, it would suggest that 'relevant profits' should be defined as some measure of taxable profits (before any ILR adjustment).

If relevant profits were defined as the total taxable profits of the relevant entity, then a cash tax charge could still arise even where the interest deduction is not being 'used'. For example, if a relevant entity had excess interest funding a Case I trade with losses forward but also had taxable Case V income, it would have positive relevant profits. Thus, a Case IV charge would be triggered notwithstanding that the Case I activity against which the excess interest is restricted is not giving rise to a cash tax position. This too would seem to be inconsistent with the general intent to delay an imposition of a Case IV charge only when the deduction for the restricted interest is used.

This issue could be addressed by allowing the use of available reliefs against the Case IV charge (which would require that the proposal in 6(4) of the consultation not to allow the use of any reliefs against a Case IV chargeable amount be dropped). That said, there is a related question as to whether any and all reliefs could be used against that Case IV charge or whether it would be limited to only reliefs that could have been used to shelter taxable profits from the business / trade / Case that the restricted interest related to. For example, if in the above example the relevant entity also had unused Case III losses could they be used to shelter the Case IV charge instead of the Case I losses?

If the use of reliefs is to be limited to only reliefs that could have been used to shelter taxable profits from the business / trade / Case that the restricted interest related to, this will increase administrative complexity.

Irrespective of whether the use of such reliefs is streamed or not, in the above example, an interest restriction credit would be generated (notwithstanding that no cash tax had been paid). This could be used against any taxable profits in a future years, subject to having interest capacity.

For example, if the above-mentioned relevant entity repaid all of its debt on the first day of the next tax year such that it had no interest expense that year, it would then have interest capacity and could claim all / part of the restricted interest credit in that year. If the Case I activity is still sheltered by losses forward then no claim could be made with respect to it, but a claim could be made against the Case V charge that year. The overall effect of this, is that Case I losses forward have been converted into a credit in year 1 and used against Case V income in year 2. This would represent an effective widening of Ireland's loss relief rules albeit in a very limited way (i.e. only to the extent the ILR applies).

Assuming such an approach is considered acceptable from a policy standpoint there may be a simpler way to implement this aspect of ILR. Instead of only applying a restriction when cash tax arises, the alternative basis for defining 'relevant profits' mentioned above could be used i.e. define 'relevant profits' as EBITDA. This could trigger a Case IV charge even when a company is loss making; however, if the proposal in 6(4) of the consultation (not to allow the use of any reliefs against a Case IV chargeable amount) were dropped, this would ensure cash tax does not arise to the extent that the company has any available reliefs / credits. This would ensure consistency with the general intent to delay an imposition of a Case IV charge only when the deduction for the restricted interest is used.

Broadly, this has the same effect defining relevant profits as all taxable profits but allowing the use of other reliefs against the Case IV charge. However, it is substantially simpler, as it does not require a separate tracking of what component of loss forward, etc. comprises restricted interest. Instead, restricted interest credits are generated when the excess interest is deducted even if reliefs are used to shelter the Case IV charge. As explained above, this would represent an effective partial widening of Ireland's loss relief rules but only in a very limited way (i.e. only to the extent the ILR applies). This would appear to be a reasonable requital in respect of additional restrictions (particularly as many other Member States do not stream their losses and reliefs to the extent that Ireland does).

Whatever approach is taken, we recommend that the methodology is designed to ensure that a cash tax liability only arises where the restricted is actually used to reduce otherwise payable cash taxes (whether that is by means of direct deduction, interest-as-a-charge relief, or comprising losses forward or in group relief).

As noted where a deduction for restricted interest is allowed (because of the absence of cash tax in the year of deduction) and, consequently, is included in a loss not yet utilised, an additional administrative burden will be placed on businesses requiring them to track the portion of losses that pertains to the unrestricted interest expense. As outlined in our recommendation contained in Question 8, it is important to address how the carry forward of interest expense contained in a loss interacts with excess capacity in a year when the loss has not been utilised.

We recommend that the availability of loss relief or tax credits should be available as deduction against any charge arising in relation to the restricted interest.

As this is new legislation, it will be important to not inadvertently apply the regime retrospectively by limiting the availability of using any reliefs that are carried forward prior to 1 January 2022, for example, losses or credits carried forward.

As the term relevant profits and relevant entity are not defined in this consultation, it is recommended this definition is reconsidered in the second consultation.

Key Recommendation

Continue to align the application of the interest limitation regime with the taxation of interest income and interest expense.

Clarify interaction with reliefs but aim to ensure deferral of cash tax liability until the entity is profit making or has utilised the loss.

Exceeding borrowing costs and EBITDA – Step 5

Question 6

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

Analysis

Exceeding borrowing costs is defined in the directive as *the amount by which the deductible borrowing costs of a taxpayer exceed taxable interest revenues and other economically equivalent taxable revenues that the taxpayer receives according to national law.*

Exceeding borrowing costs

The directive provides that exceeding borrowing costs may be calculated at the level of the group. This formula is capable of being applied by consolidating the taxable interest equivalent and the exceeding deductible interest equivalent at the notional local group level to arrive at the exceeding borrowing costs of the notional local group.

Legacy Debt

The Directive further provides that exceeding borrowing costs in respect of legacy debt and loans in relation to public benefit infrastructure are eligible, if the Member State so decides, to be outside the scope of exceeding borrowing costs when applying the interest restriction regime. The exceeding deductible interest equivalent is arrived at by reducing the exceeding deductible interest equivalent by the interest on the legacy debt amount. This will result in lower exceeding borrowing costs, as expected and in line with ATAD. However, it may also result in a reduction in EBITDA. EBIT is defined as the 'relevant profits' which, we assume, is the tax adjusted profit and, consequently, would be net of a deduction for the interest expense from both debt within scope of the restriction and the legacy debt. As per the feedback statement, to arrive at EBITDA, the portion of interest expense added back to relevant profit does not include deductible interest expense on legacy debt. This would result in lowering the EBITDA of businesses with legacy debt and does not appear to be intended by the directive.

De Minimis

This formula would need to be capable of applying at the notional local group level so as to ensure that the €3million de minimis threshold is only deducted once per notional local group. This could be achieved by permitting the notional local group to allocate this amount between group members as it sees fit (with a possible default to a *pro rata* allocation between members).

As noted above, based on definition of EBITDA, by reducing the exceeding deductible interest equivalent by the de minimis threshold, it could result in a lower EBITDA.

Key Recommendation

We recommend the definitions to be amended so that they will operate as intended on a group level and to ensure that EBITDA is not reduced in a manner not intended by the directive.

Question 7

Comments are invited on this possible definition of '*EBITDA*'.

Analysis

EBITDA includes the relevant profits of the relevant entity. As the definition for 'relevant profits' and 'relevant entity' are not provided in this feedback statement, it is recommended that consultation on the definition of EBITDA should be sought in the second consultation in mid-2021.

Definition of 'relevant profits'

For the operation of the Fixed Ratio Rule and to align with ATAD, the definition of relevant profits should be the tax adjusted profits of the company. EBITDA should include taxable income and exclude exempt income.

Given the complexity of determining a general rule that might operate to exclude a dividend which is subject to a wide range of reliefs which vary from taxpayer to taxpayer, and only some of which relate to foreign tax credits, foreign dividends that remain subject to corporation tax in Ireland should be included in relevant profits[7].

Should Ireland move to adopt a more territorial regime in future which includes a foreign dividend exemption regime, the class of tax-exempt dividends to be excluded from the measure of EBITDA can be expanded to include such tax-exempt dividends.

EBITDA should be calculated on an entity-by-entity basis with the allocation of capacity and utilisation of 'exceeding borrowing costs' credits managed at the notional local group level.

Consideration needs to be given to the calculation of EBITDA when entities within the group are loss making and claim loss relief on a value basis, offset against profits of a prior period, carry forward losses for offset against future taxable profits. We would suggest that all such reliefs should be taken into account in determine a relevant entity's EBITDA.

Furthermore, we recommend that EBITDA also include chargeable capital gains as this would be consistent with the overall schema of the directive and would ensure Ireland is aligned with other Member States who do not distinguish between income and gains in the manner that Ireland does.

Interest expense

ATAD requires that EBITDA is calculated by adding back to the income subject to corporate tax (relevant profits) the tax-adjusted amounts for exceeding borrowings. Regarding the 'I' in EBITDA, it is unclear from the consultation what is intended by "*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*". Further guidance on this would be welcomed.

The 'I' in the formula provided in the consultation should include the full tax-deductible interest expense and any tax-deductible interest expense arising on legacy debt.

As noted above, legacy debt and the de minimis should not reduce EBITDA.

Public Infrastructure Benefit

Where long term infrastructure loans are excluded, both the net interest expense and the related EBITDA from the infrastructure project should be excluded from the relevant entity's interest expense and EBITDA. If the public infrastructure exemption does not provide for related party interest expense to be excluded, then similarly a proportionate part of the qualifying infrastructure company's EBITDA should also not be excluded.

Allowances

ATAD requires that EBITDA is calculated by adding back to the income subject to corporate tax (relevant profits) the depreciation and amortisation of the relevant entity. The 'DA' in

[7] Dividends exempted under Section 21B would be excluded.

the formula provided in the consultation does not clearly address how balancing charges should be dealt with.

As balancing charges effectively represent a reversal of a prior capital allowances claim, it is assumed that the intention is for these to be netted against allowances claimed.

Key Recommendation

Relevant profits should include taxable income, such as taxable foreign dividends.

Deductible interest expense arising on legacy debt should be added back to arrive at EBITDA.

The definition of interest should be amended to ensure it complies with ATAD.

EBITDA should be calculated on an entity by entity basis the allocation of capacity and utilisation of ‘exceeding borrowing costs’ credits managed at the notional local group level.

Applying the ILR to a single company - Step 6

Question 8

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

Analysis

Case IV / Credit system

Applying the fixed ratio rule to a tax system which operates different rates of taxation to trading and non-trading income gives rise to substantial amount of complexity. Where interest expense is restricted, there is a need to maintain the value of the restriction whilst maintaining flexibility within the entity/group to obtain the tax relief for the interest expense in future periods. This could also be achieved by allowing a deduction and adjusting the quantum of the deduction, similar to the method applied in calculating the credit. From a tax compliance administrative perspective, it is generally the case that taxpayers' preference would be to make the fewest adjustments possible to the annual corporation tax compliance process to give effect to the restrictions imposed under an interest limitation rule. It is suggested that this could be done using a credit relief model which is calculated on an entity-by-entity basis and administered at the level of the interest limitation group. We recommend that cash tax liability should only arise where there is a positive EBITDA. This prevents a cash tax liability arising in a company with a loss before interest and depreciation. (A corollary is that no unused capacity arises in this situation.)

Case IV charge offset

As the provision is currently written, when a restricted interest charge arises it is taxed as income under Case IV. However, the provisions do not allow for the offset of any other relief from the Case IV charge. Where the group has loss relief (not arising from interest expense), or tax credits, we recommend that these should be available for offset against the tax arising on the Case IV income. This would allow for an offset of any potential cash tax liability where the entity is overall loss making or has a carry forward of credits available to offset.

For example, a relevant entity might have some taxable income from one activity (and hence relevant profits) but its excess deductible interest equivalent might arise in connection with an unrelated loss-making activity (with those losses unavailable to offset the taxable income from the first-mentioned activity). This would trigger a Case IV charge and if relief for those losses against the chargeable amount, a cash tax liability would be generated in respect of interest funding a loss-making activity. This would not be consistent with an objective of only creating a tax liability when the excess interest expense concerned reduces taxable profits below zero.

Losses

Under the current provisions contained in the feedback statement, where a company has a trading loss arising from an interest expense, the expense is not restricted until the loss is tax deductible. This aligns the potential cash tax liability arising on the restriction of the interest expense with the tax deductibility of the loss. As the loss may be partially generated from other deductions (e.g. capital allowances, commercial losses, etc), it will be necessary for taxpayers to track what component of that loss is attributable to the excess interest expense that would have triggered a Case IV charge had the entity had positive taxable profits. Provision for this would need to be reflected in the legislation. In addition, we would recommend that when the entity uses some but not all of its losses, it be given the option as to whether that

component generated form the excess component or the other constituents.

Capacity credits

As the interest restriction will be imposed by means of a Case IV charge with an equivalent tax credit generated for that charge, we suggest that consideration is given to providing for the excess capacity is carried forward as a credit (at 25%) which can be used as a credit against any Case IV charge arising in respect of restricted interest in future periods (effectively allowing a deduction for the excess interest deducted in that period).

In addition, where the loss is carried forward, the loss (and associated interest) can only be offset against income of the same trade. Should the company have a positive EBITDA due to income arising outside the trade, for example rental income, in the following period, excess capacity to deduct interest expense arises. However, where the company does not have a profit in the trade, the loss (which includes the interest expense) is not deductible.

Excess capacity can only be carried for five years. If the loss is not utilised within five years, this excess capacity will be lost. This does not appear to be in line with ATAD because had a deduction methodology (rather than a credit methodology) been applied, the capacity could have been utilised in the years it arose notwithstanding that the company is loss-making (this is because a deduction could have been taken in the year the capacity arose for the historic restricted interest, thereby increasing the loss for the period). We recommend that the legislation is formulated such that unused excess capacity is only subject to a five year life to the extent that the tax value of that unused capacity (at 25%) exceeds the entity's restricted interest credit. This effectively means that the five year limit only applies to that amount of unused capacity that would not have been utilised had a deduction system been enacted.

Key Recommendation

Allow a relevant entity to shelter a Case IV charge in respect of restricted interest with any and all other reliefs available to it.

Allow a company which has restricted interest trapped within a loss which also has components arising other than from restricted interest to choose which component of its loss it uses.

Carry forward unused capacity as tax credits usable against future case IV interest restriction charges.

Apply the five year time limit on unused capacity only to the extent the capacity tax credit exceeds the entity's restricted interest credit.

Carry forward/back options - Step 7

Question 9

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

Analysis

We consider that Option 3, the carry forward of unused excess interest expense indefinitely and unused excess capacity for a maximum of five years is an appropriate fit for Ireland's corporation tax regime. Although calculating and tracking the carry forward of unused excess restricted interest credit and interest capacity can involve additional compliance complexity for taxpayers, we believe it is an important mechanism to protect against undue restriction of interest expense applied on a period on period basis where there is volatility in the earnings of entities. It also affords protection from a permanent disallowance of interest expense where interest expense and EBITDA arise in different periods, e.g. where interest expense incurred in one period in making a long-term investment to expand the business only results in EBITDA or increased EBITDA in later periods.

Carry forward of interest – practical considerations

With regard to the operation of the carry forward of the disallowed interest, taxpayers should not be required to make an additional claim to be eligible to carry forward the restricted interest. The carry forward of disallowed interest should be automatic.

Certain interest expenses must be included in the tax return in order to avail of the relief. If the taxpayer is required to make a claim to carry forward restricted interest, a second claim must now be made to available of the deductibility of the interest expense. As the entity must use the relief in the first subsequent accounting period, the carry forward of the credit should be automatically provided for under legislation. It is recommended that the wording in this section is amended from '*may make a claim to carry forward*' to '*shall carry forward'*.

It should remain a matter for the taxpayer to retain records to support the computation of when the restricted interest credit is used. Details of the quantum of interest restricted can be contained in the return in the year in which the restriction applies.

As discussed in our response to question 8, we recommend that unused capacity is carried forward as a credit. For consistency there may be some merit in treating current year capacity as a credit as well such that it could be set off in the current year against any Case IV charge arising in the period (either in the same entity by means of surrender to other groups entities).

Key Recommendation

Amend provisions to provide for the automatic carry forward of restricted credit and excess capacity.

Align the rate in which trading and non trading taxpayers can claim the restricted interest credit

Question 10

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

Analysis

Regarding practical issues related to the operation of an Interest Limitation rule, in designing a carry forward relief, it would be important not to impose an obligation on taxpayers to calculate excess interest capacity unless it is needed e.g. a group might not experience an interest limitation for a number of periods because of the application of the de minimis threshold but might seek to use the benefit of past period unused interest capacity if it is faced with a limitation in a later period.

As discussed in our response to question 8, we recommend that consideration is given to providing for unused capacity to be carried forward as a credit which can be used as a credit against any Case IV charge arising in future periods (effectively allowing a deduction for the excess interest deducted in that period).

Furthermore, as discussed in our response to question 8, excess capacity can only be carried for five years. If the loss is not utilised within five years, this excess capacity will be lost. This does not appear to be in line with ATAD because had a deduction methodology (rather than a credit methodology) been applied, the capacity could have been utilised in the years it arose notwithstanding that the company is loss-making (this is because a deduction could have been taken in the year the capacity arose for the historic restricted interest, thereby increasing the loss for the period). We recommended that the legislation is formulated such that unused excess capacity is only subject to a five-year life to the extent that the tax value of that unused capacity (at 25%) exceeds the entity's restricted interest credit. This effectively means that the five-year limit only applies to that amount of unused capacity that would not have been utilised had a deduction system been enacted.

It should remain a matter for the taxpayer to retain records to support the computation of the claim for relief, if required.

On the assumption that Ireland applies the Interest Limitation rule on a notional local group basis, the greatest administrative simplicity could be achieved where carry forward attributes such as disallowed excess interest expense or excess interest capacity are retained and tracked at an Interest Limitation rule notional local group level e.g. by a nominated central group entity. This could still permit the allocation, period on period, of disallowances of excess interest expense or interest capacity attributes for use as needed by different members within the Interest Limitation group.

Key Recommendation

Amend provisions to provide for the automatic carry forward of restricted credit and excess capacity.

Carry forward attributes such as disallowed excess interest expense or excess interest capacity can be retained and tracked at a notional local group level e.g. by a nominated central group entity.

Carry forward unused capacity as tax credits usable against future case IV interest restriction charges

Apply the five year time limit on unused capacity only to the extent the capacity tax credit exceeds the entity's restricted interest credit.

ATAD exemptions

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.

Analysis

We agree with the suggested approach to include a €3 million de minimis threshold. This threshold would apply to the total exceeding borrowing costs of the notional local group.

The OECD's final report under Action 4 of the BEPS Plan on Limiting Base Erosion Involving Interest Deductions and Other Financial Payments notes[8] that certain entities may pose comparatively low risk of base erosion due to excessive deductions for interest expense. In order that measures such as a fixed-ratio rule have proportionate effect, the report suggested that countries should consider applying a *de minimis* threshold. The adoption of a *de minimis* threshold should mean that taxpayers with higher burdens of financing expense which inherently present a higher risk of excessive base erosion due to interest deductions are the focus of the measures.

The computation of a fixed-ratio interest limitation across individual tax group members can add significantly to the complexity and tax compliance cost burden for corporate groups. In balancing the risk of undue base erosion due to interest expense with the tax compliance burden associated with computation of an Interest Limitation rule for corporate groups, it appears reasonable to apply a *de minimis* threshold as set out under ATAD1.

In reviewing the manner of implementation of the UK £2 million *de minimis* threshold, we found that the UK has also considered the proportionate burden on taxpayers of compliance with the CIR regime. Under the UK CIR regime, taxpayers who are confident that their relevant interest expense will not exceed the £2 million *de minimis* amount do not have to carry out a detailed computation in order to evidence their entitlement to that relief.

They are entitled to not apply any interest restriction on the basis that it is reasonable to assume they would be eligible for the £2 million *de minimis* threshold. The standard of evidence is left for the taxpayer to meet. It should be possible to meet by a high-level review of interest expense e.g. based on the financial statements or tax computations prepared for other purposes.

In addition to adoption of a *de minimis* threshold of €3 million for an Irish Interest Limitation rule, the compliance obligation associated with availing of this relief should also be proportionate and designed so that companies can easily avail of a *de minimis* threshold. In this regard, it will be necessary to ensure that the €3 million *de minimis* threshold is only deducted once per notional local group. This could be achieved by permitting the notional local group to allocate this amount between group members as it sees fit (with a possible default to a *pro rata* allocation between members).

Both general and targeted anti-avoidance provisions already contained in the Irish corporation tax regime deny relief where a transaction is a tax avoidance transaction.

Guidance would be welcomed on time apportionment requirements where some entities within the group may have a shorter accounting period, such as upon acquisition.

[8] Paragraph 54, OECD report on Action 4 of its BEPS Plan, October 2015 and repeated in 2016 update report.

Key Recommendation

We agree with the provision for a €3 million *de minimis* threshold.

Taxpayers who are confident that their relevant interest expense will not exceed the *de minimis* amount should not be required to carry out a detailed computation in order to evidence their entitlement to that relief.

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.

Analysis

ATAD provides that 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. The definition included in the consultation provides for the additional requirement that all profits of the entity must be chargeable to corporation tax. Where a company is in receipt of exempt income, all of the profits are not chargeable to corporation tax. Dividends received from an Irish company are not chargeable to corporation tax under section 129, TCA 1997. As such, a company in receipt of dividends from another Irish company where it owns less than 25% ownership in another Irish company will not qualify as a standalone entity. Furthermore, if a participation exemption is subsequently introduced on foreign portfolio dividends, a similar issue will arise. The risk of base erosion for companies with portfolio holdings is low.

- ✓ We recommend the definition is amended to provide where a company is liable to corporation tax instead of all of its profits being within the charge to corporation tax.

Associated enterprises

The proposed definition of 'associated enterprise' in the consultation is broader than in the directive as it includes persons who 'act together' and enterprises with significant influence over the management of another enterprise. ATAD only applies an 'acting together' test and 'significant influence' test for the associated enterprises within the scope of the anti-hybrid rules and not for any of the other ATAD measures[9]. Consequently, we recommend that the definition of 'associated enterprise' is amended accordingly.

We note that if these criteria were to remain, depending on how broadly the term 'acts together' is interpreted it could mean that otherwise independent investors co-investing in widely held collective investment funds could be associated enterprises of the underlying entities in which the fund has invested.

This is of particular concern in the case of private equity or alternative asset fund structures where a corporate group or a series of wholly owned special purpose vehicles (SPVs) can be held under a fund holding structure. In these cases, it may be impracticable to identify and/or test for inclusion each of the ultimate investors in the fund if they are considered to be associated enterprises only because of them investing in the same fund vehicle with the corporate group or local asset holding SPV held under the fund.

In addition, the concept of 'significant influence in the management of' is also of concern to the funds sector in case it could encompass delegated authority to a third party manager to 'manage' the fund within parameters set down, for example, by the board of a fund in corporate form or by the trustees of a unit trust. It is hoped by specifying the highest level of governing body of the entity that the authority delegated to the fund manager should be said to derive from this authority and that the fund manager performs its functions as manager under the 'significant influence' of the board of directors/trustee.

Insofar as the question of how to treat single companies which are not standalone entities is concerned, it is worth considering that the standalone entity exception in ATAD is, essentially, a simplification of the group ratio reliefs. Those reliefs effectively allow a deduction for the third-party debt of a group (subject to that debt not being disproportionately allocated to one entity / jurisdiction). The simplification afforded by the standalone exception is warranted because, by definition, a standalone entity only has

[9] Art 2(4) defines an associated enterprise based on direct or indirect 25%+ voting rights, capital ownership, or profits. It expands this definition to include an 'acting together' test, a 'significant influence' test, and an accounting consolidation test; however, these apply only for the purposes of Art 9 (hybrids) and Art 9A (reverse hybrids). The 'standalone entity' definition brings in an equivalent of the accounting consolidation test but not the other tests.

third-party debt and that debt cannot disproportionately spread between entities or jurisdictions.

It would seem inequitable if a single company which was not a standalone entity were denied access to the group ratio reliefs simply because it falls between the definition of standalone entity and a possible definition of 'group' for the group ratio reliefs which might be framed as assuming there are two or more entities in a given group. Furthermore, there is nothing in the directive which necessarily presumes otherwise.

As such we recommend that single entities which are not standalone entities are afforded the same reliefs as entities in an accounting group and thus qualify for group ratio reliefs. This can be achieved by modifying the proposed definition of 'worldwide group' as follows:

'worldwide group' means:

(a) an entity which is neither an ultimate parent nor an entity that is fully included in ultimate consolidated financial statements; or
(b) 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

The definition of standalone entity could then be modified to refer to part (b) of the above definition only.

Key Recommendation

Amend the definition of standalone entities to include companies that are liable to corporation tax on profits.

Amend the definition of standalone entities to align it with that used in ATAD.

Amend the definition of worldwide group to include single companies.

Provide guidance on the application of the associated enterprise test to fund structures.

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.

Analysis

Many of Ireland's largest corporation taxpayers operate internationally (whether as part of Irish or foreign parented groups) and are subsidiaries within corporate groups whose parent entity prepares consolidated financial statements. The figures in these financial statements may form the starting point for reliefs available under the Interest Limitation Rule which are based on group ratios drawn from the consolidated financial statements of groups of which Irish taxpayers are members.

KPMG took soundings from other member firms on adoption of other GAAPs outside IFRS or EU GAAPs. For the purposes of the ILR, Germany and France both allow the use of consolidated financial statements drawn up in accordance with US GAAP.

KPMG also took soundings from audit and accounting colleagues in order to identify if the application of the groupwide tests using consolidated financial statements prepared under a different international accounting standard to IFRS or FRS could potentially lead to a disproportionate effect on Irish taxpayers who are members of a group which has prepared consolidated financial statements using a GAAP other than IFRS / FRS.

On the question of the comparability of different GAAPs from the perspective of their approach to the definition of subsidiaries for inclusion in group consolidated financial statements, we found that there are differences in the approach to the consolidation i.e. in the detailed wording for those tests. We undertook detailed discussions on the manner in which tests to identify a subsidiary are applied, for example, under IFRS, FRS (e.g. FRS102) and US GAAP. It was clear from these discussions that, although there may be different starting points and wording used in the application of the tests, when applied in the context of the typical ownership rights of a parent over its subsidiaries in a multinational group, there is a very high likelihood of the same outcome i.e. the entity in question is regarded as a subsidiary of the parent to be included in the group consolidated financial statements prepared under the accounting standards adopted by the parent. At the margins, the differences in approach to classifying a subsidiary can mean that some entities would be included in a set of consolidated financial statements under one GAAP but not under another. Our soundings suggest that such cases are more likely to arise in respect of investment entities.

The experience of our colleagues suggests that the degree of overlap of entities identified as a subsidiary across the GAAPs is very high. Our soundings suggest that it is very much 'at the margins' that these differences arise. However, it would seem necessary to recognise that there will be instances where entities are potentially includable as subsidiaries in a group consolidated financial statements prepared under one GAAP but not under the GAAP adopted by the parent company.

We suggest that, in defining the foreign GAAPs that may be considered to be equivalent to FRS and IFRS (as it applies in Ireland), it would be appropriate to draw upon definitions and approaches that are in place for accounting purposes. In this manner, there would be no need to change or update tax legislation to take account of future developments in accounting standards.

Under company law in Ireland, this equivalence test for parent companies outside the EEA is set out in section 300. Subsection (4) of section 300 lists out the accounting standards of the parent that could mean the sub-holding company is eligible for an exemption from consolidation. Subparagraph (iv) refers to an equivalence standard which was developed by the EU and forms part of the Directives which govern the requirements for a prospectus issued by companies seeking to list securities on regulated markets in the

EU. Such companies must have financial statements prepared in accordance with IFRS or an equivalent GAAP. Regulation 1569/2007 referenced in subparagraph (iv) is the mechanism which provides for setting this standard of equivalence. A third country which wishes to have its GAAP recognised as an equivalent GAAP by the EU must apply to have its GAAP recognised as meeting this equivalence standard.

Those third country GAAPs that have met this equivalence standard are set out in Article 35 of Regulation (EC) No 809/2004. From reviewing the list of GAAPs of foreign countries which meet the equivalence standards under Irish law and EU Directives, it appears to us that this list, taken together with IFRS, covers the most common accounting standards used by large multinational groups operating in Ireland. These are outlined below.

c) Generally Accepted Accounting Principles of Japan;

(d) Generally Accepted Accounting Principles of the United States of America.

In addition to standards referred to in the first subparagraph, from 1 January 2012, third country issuers may present their historical financial information in accordance with the following standards:

(a) Generally Accepted Accounting Principles of the People's Republic of China;

(b) Generally Accepted Accounting Principles of Canada;

(c) Generally Accepted Accounting Principles of the Republic of Korea."

Furthermore, FRS 100[10] sets out the overarching framework that governs the FRS suite of accounting standards adopted by the United Kingdom and Ireland. It includes FRS 102, for example. FRS is derived from IFRS and is considered to be equivalent to IFRS. FRS100 includes guidance on the equivalence to FRS of other GAAPs that are not IFRS accounting standards. In the context of assessing the equivalence of GAAPs of third countries in the context of providing an exemption for a sub-holding company from the requirement to prepare group consolidated accounts under FRS, the FRS100 guidance expressly references and mirrors the equivalence test that is applied in the EU for IFRS under the Prospectus regulations. AG7 in the FRS 100 guidance notes that:

***AG7** A mechanism to determine the equivalence of the Generally Accepted Accounting Principles (GAAP) from third countries was established in 2007. Subsequently, the European Commission has identified as equivalent to IFRS the following:*

GAAP Applicable from:

- *GAAP of Japan 1 January 2009*
- *GAAP of the United States of America 1 January 2009*
- *GAAP of the People's Republic of China 1 January 2012*
- *GAAP of Canada 1 January 2012*
- *GAAP of the Republic of Korea 1 January 2012*

Further, third country issuers shall be permitted to prepare their annual consolidated financial statements and half-yearly consolidated financial statements in accordance with the Generally Accepted Accounting Principles of the Republic of India for financial years starting before 1 April 2016. For reporting periods beginning on or after 1 April 2016, in relation to GAAP of the Republic of India, equivalence should be assessed on the basis of the particular facts."

In commenting on a group ratio rule under an interest limitation rule, the OECD recommends as follows at paragraph 123 of its 2016 update report under Action 4.[11]

"*123. It is recommended that, as a minimum, countries should accept consolidated financial statements prepared under local Generally Accepted Accounting Principles (GAAP) and the most common accounting standards used by large listed multinational groups (i.e. International Financial Reporting Standards (IFRS), Japanese GAAP and US GAAP). In order to enable non-listed groups to prepare a single set of consolidated financial statements for use in all countries in which they operate,*

[10]To view FRS 100, click on the icon.

FRS-100-Application-of-Financial-Reporting

[11] The Action 4 report was first released in October 2015 and updated in 2016 by expanding on the 2015 report. It addresses Limiting Base Erosion Involving Interest Deductions and Other Financial Payments.

countries should consider accepting consolidated financial statements prepared under other accounting standards, but it is left to each country to determine which accounting standards to accept (e.g. taking into account the geographical region and main sources of foreign investment).”

- ✓ We recommend that in circumstances where worldwide group exceptions apply under an Interest Limitation Rule, the measures could refer to group consolidated financial statements drawn up under IFRS and FRS as well as equivalent accounting standards. In setting the standard of equivalence, we suggest that Ireland accepts as equivalent those standards which are considered to be equivalent under Irish company law and EU regulations as described above.

State Aid rules

Under the ILRs, where an entity is part of a consolidated group, there is scope for the entity to deduct a higher amount of interest expense where certain conditions are met. The ILRs define consolidated group for financial accounting purposes as “a group consisting of all entities which are fully included in consolidated financial statements drawn up in accordance with the International Financial Reporting Standards [IFRS] or the national financial reporting system of a Member State”.

Article 4(8) of ATAD provides that a taxpayer may be given the right to use consolidated financial statements prepared under accounting standards other than the International Financial Reporting Standards or the national financial reporting system of a Member State. A number of multinational groups operating within Ireland do not prepare consolidated group financial statements under IFRS or the local GAAP of a Member State but rather under the local accounting standards of the Parent Entity jurisdiction.

While financial statements prepared under such GAAPs do not fall strictly within the definition of “consolidated group for financial accounting purposes”, through Article 4(8) of ATAD, the framers clearly envisaged the use of such accounting standards.

Does permitting the use of group financial statements prepared under other GAAPs constitute State aid under Article 107 TFEU?

Article 107 TFEU defines State aid as “… any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States …”. For a provision to be considered State aid, the provisions must fulfil four conditions:

- The support is granted by the State or **through State resources**;
- It favours one or more undertakings — there is a **selective advantage**;
- The support distorts or has the potential to **distort competition**; and
- It **affects trade between EU countries**.

Whilst permitting the use of financial statements prepared under an accounting standard other than IFRS / FRS could be said to be selective in nature (in that it derogates from the general regime), it does not confer an advantage. We consider that it merely provides for equal treatment between groups operating in Ireland.

If such permission was not available, then the affected entities would be required to either prepare consolidated group financial statements under IFRS / FRS (which would impose a significant compliance burden) or else they could find that a lower level of interest deductions was available to them when compared with entities that are consolidated under IFRS / FRS. The effect[12] therefore of denying the use of financial statements not prepared under IFRS / FRS could be to confer a disadvantage upon such groups.

Proportionality and administrative burden argument

As noted above, the exclusion of group consolidated financial statements prepared under accounting standards other than IFRS / FRS from the definition of “*consolidated group for financial accounting purposes*” would pose

[12] We note that the CJEU found in the case of Banco Santander, SA and Santusa Holding, SL v European Commission Case T-399/11 that a measure can constitute illegal State Aid where the effect of the measure is to grant a selective advantage on a particular cohort of taxpayers - CURIA - Documents - http://curia.europa.eu/

a significant administrative burden on such entities in order to fully comply with the ILRs if they were required to prepare consolidated group financial statements under IFRS / FRS.

The European Commission has previously concluded, in its State aid decision[13] in relation to the UK's CFC Group Financing Exemption, that a derogation from general rules or a *priori* selective measure can be allowed where it allows for the measure to be manageable and to ease the administrative burden for the taxpayers and the tax authority and that derogation is proportionate. The Commission noted in its decision that … "*the Commission considers the a priori selective character of the contested measure justified and therefore not selective, to the extent that the identification and quantification of the CFC charge under Chapter 5 would be exclusively based on the UK connected capital test under Section 371EC of Chapter 5 of TIOPA, which would require a disproportionately burdensome tracing exercise*."

Therefore, a derogation from general rules can in principle be compatible with State aid rules where it ensures that taxpayers and tax authorities are not required to undertake a disproportionately burdensome exercise to apply the measure. We note that the recitals to ATAD expressly refer to proportionality in the context of a CFC regime. However, the concept of measures being proportionate to the risk of base erosion applies to the Directive in its entirety as is evidenced by the comment in the recitals that "*In accordance with the principle of proportionality, as set out in that Article* [Article 5 of the Treaty of the European Union]*, this Directive does not go beyond what is necessary in order to achieve that objective."*

In our view, the above evidences that the European Commission and indeed Courts would consider that the use of accounting standards other than IFRS / FRS would be a proportionate derogation from the general ILR rules to the extent that there is a derogation at all – noting that Article 4(8) of ATAD expressly permits such an approach. Moreover, to the extent that there is a derogation, it does not confer an advantage but rather parity of treatment.

We suggest that implementing guidance would confirm that Accounting Standards recognised in AG7 / those set out in Article 35 of Regulation (EC) No 809/2004 would be at a minimum accepted.

Key Recommendation

Ireland accepts as equivalent to Irish GAAP those standards which are considered to be equivalent under Irish company law and EU regulations as described above.

[13] EU Commission State aid decision SA.44896: EUR-Lex - 32019D1352 - EN - EUR-Lex - https://eur-lex.europa.eu/

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?

Analysis

As discussed in our response to question 12, the proposed definition of 'associated enterprise' in the consultation is broader than in the directive as it includes persons who 'act together' and enterprises with significant influence over the management of another enterprise. ATAD only applies an 'acting together' test and 'significant influence' test for the associated enterprises within the scope of the anti-hybrid rules and not for any of the other ATAD measures. Consequently, we recommend that the definition of 'associated enterprise' is amended accordingly.

Where the ATAD definition is followed, this should remove some of the uncertainties for entities held under complex holding structures involving trusts or partnerships and would clearly be aligned with the intent of the framers of the directive (given that the broader definition of associated enterprise used for hybrids was clearly not intended to be used with respect to the interest limitation rules).

As a general matter, we recommend that the question of association between entities held in such complex holdings structures is determined with reference to the beneficial interest attributable to each of the underlying investors. Thus, for example, where an investor in a trust or partnership structure has a beneficial interest in 25%+ of the shares of a company held through that structure then that entity would not be a standalone entity. However, where no investor has a 25%+ interest, it would not be appropriate to deny standalone status to such an entity.

Furthermore, in a situation where two entities happen to be held through the same partnership or trust structure, the question as to whether those entities are related should be ascertained on the same basis i.e. by reference to whether there are any investors with a 25%+ beneficial interest in both entities.

An important aspect of applying the above is to ensure that the test is applied in a manner that reflects the true beneficial interests of investors. Thus where legal title to shares are held by a trust (e.g. in an investment trust structure), by a general partner in partnership structure, or by a trustee in a bankruptcy remote structure, the test should be applied with reference to underlying beneficiaries as otherwise the 25% threshold might be inadvertently passed because legal title to all of the shares is held by a single person even though the real economic interest are widely spread.

As noted above, as the 'acting together' and 'significant influence' criteria for association do not apply to interest limitation rules there should not be a concern with respect to ensuring the directive is properly implemented.

Furthermore, we note (and agree) with the government's position that Ireland's existing rules provide a high degree of protection with respect to base erosion. As these rules are to be retained, they should provide ample protection (as they do at present). Given the very significant change to the Irish regime that the introduction of these new rules will entail, we strongly recommend that the government does not introduce new restrictions or complexities beyond that mandated by the directive.

Key Recommendation

Amend the definition of standalone entities to align it with that used in ATAD.

When addressing complex investment structures, assess standalone status with respect to the positions of underlying investors.

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.

Analysis

Article 4(4) of ATAD1 provides that Member States may exclude from the scope of the Interest Limitation rule exceeding borrowing costs incurred on loans which were concluded before 17 June 2016, but the exclusion shall not extend to any subsequent modification of such loans. 'Exceeding borrowing costs' are essentially net interest expense.

We suggest that this grandfathering exclusion should be made available at the election of taxpayers.

We can foresee that taxpayers may seek to revise borrowing arrangements in response to a range of future tax measures which could affect the deductibility of interest expense for tax purposes. These include the possible redesign of Ireland's regime for deducting interest expense as well as possible future changes to transfer pricing provisions.

We consider that the approach included in the feedback statement is aligned with the approach in ATAD. ATAD1 states that the exclusion "shall not extend to any subsequent modification of such loans", meaning that the legacy debt with the terms that existed as at 16 July 2016 should qualify for the exclusion. The exclusion does not include any expenditure arising from a modification of that loan. Where a loan has been modified, a calculation will be required to establish the expense relating to changes to the duration of the debt, the principal drawn down or the interest rate, etc., which will be included in the calculation of exceeding borrowing costs. Such revisions will not render the existing borrowings ineligible for grandfathering relief.

We suggest that the clarification by the Department of Finance in the consultation document that a loan entered into before 17 June 2016 would not be regarded as having been modified, and the Interest Limitation rule 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) is set out in implementing guidance, to ease the administrative burden on taxpayers from such reforms.

In addition, consideration may need to be given to how to address loan facility arrangements where some amounts are drawn down before 17 June 2016 and some afterwards; in such a scenario, a determination would need to be made as to whether a subsequent partial repayment relates to the legacy debt or new debt.

Key Recommendation

"legacy debt" should 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 and has made an election for the security to be treated as legacy debt.

Question 16

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

Analysis

In order that Ireland can secure the broadest range of funding sources for long term public benefit infrastructure (PBI), we suggest that Ireland adopts a PBI exemption. In addition, such exemption needs to be defined to cover non-public private partnership (PPP) models for providing PBI and include investor-owned debt.

The attraction of capital into large Irish projects is critical to Ireland achieving its ambitions under Project Ireland 2040[14] which will include hundreds of thousands of new jobs, new homes, and heightened cultural and social amenities, enhanced regional connectivity and improved environmental sustainability.

Large infrastructure and construction projects are by their nature capital intensive and require and attract material debt funding.

The costs of that debt finance feed into the pricing of such projects. This in turn impacts the overall economics of these projects. Financial models will look at the after-tax cost of bringing these projects to completion. Therefore, if a tax deduction is not available for financing costs this increases a developer's cost. Ultimately, if interest restrictions apply to such large-scale projects, it could make them economically unviable. Because much of the capital funding for these projects is from institutional investors abroad, and Ireland is competing with other countries for that capital, this could lead to a deployment of that capital in infrastructure projects in other more competitive jurisdictions.

It is therefore critical that Ireland not only introduces a PBI exemption as provided for by the Directive but does so in a manner which ensures interest restrictions are not an obstacle to the effective delivery of long term infrastructure in Ireland.

Having regard to Ireland's infrastructure needs over the coming years to meet social, economic, environmental, cultural and other requirements, we outline below several recommendations Ireland should adopt.

Defining qualifying projects

We recommend that the criteria for determining a qualifying asset should be set as widely as possible. ATAD1 provides at Article 4(4)(b) that exceeding borrowing costs incurred on loans used to fund long term public infrastructure projects may be excluded from the restriction where:

- the project is a long term public infrastructure project;
- the project operator, borrowing costs, assets and income are all in the Union.

For the purposes of the Directive, a long term public infrastructure project must 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".*

A 2017 paper on public infrastructure in Europe by the Council of Europe Development Bank[15] (EU Development Bank) describes public infrastructure in a general sense as meaning infrastructure that is in public ownership, semi-public ownership (e.g. public private partnership) or private ownership but publicly mandated or operated under a public concession.

- ✓ **We recommend that the meaning of public benefit should include both infrastructure which is procured by or regulated by a public body (e.g. roads, renewable energy projects) as well as infrastructure approved by a public body** (i.e. all real estate projects must be approved by local authorities).
- ✓ **It is imperative that housing is included** as a qualifying infrastructure asset – there

[14] gov.ie - Project Ireland 2040 - https://www.gov.ie/

[15] Council of Europe Development Bank. Investing in Public Infrastructure in Europe, A local economy perspective. February 2017.

is a dire need for continued development of housing projects to meet the shortfall in supply. At a minimum this should include social housing (i.e. housing stock leased to a Housing Authority) but there are strong arguments for privately let housing stock to also qualify.

✓ **Eligible infrastructure should also include other real estate leased on a short-term basis (leases of 50 years or less) to unrelated tenants**. As well as housing, real estate assets such as commercial offices, logistics facilities, windfarms and retail each serve a public need and contribute widely to meeting social (e.g. leisure), economic (e.g. attracting FDI through commercial office space, social and cultural amenities for employees, etc) and environmental (green energy) objectives. The UK has recognised the public benefit of both commercial and residential letting through the inclusion of the short-term letting of real estate in the public benefit infrastructure exemption[16]. A developer which intends to sell the asset should not be prevented from qualifying from the exclusion and claiming interest deductions against trading profits so long as the asset is ultimately leased – i.e. the focus should be on the asset rather than the parties. This is important in the context of the impact interest restrictions would have on developers' costs and therefore the economic viability of such projects.

✓ Similar to the UK, we recommend that **a non-exhaustive list of qualifying classes of assets is included in legislation**. This would help provide clarity to investors on certain projects, while allowing flexibility for new emerging classes of infrastructure to qualify for exemption. Such a list might initially include the following:

- Water, electricity, gas, telecommunications (including broadband) assets
- Railway facilities, roads or other transport facilities
- Renewable energy assets including windfarms and solar farms
- Housing
- Court or prison facilities
- Health facilities
- Educational facilities
- Real estate which is leased on a short- term basis (i.e. less than 50 years)

Long term

The period of a project is not defined in ATAD1, nor is a definition of "long term" provided.

OECD guidance in its Action 4 report suggests that the asset should last not less than 10 years.

The UK CIR regime has a public infrastructure exemption (summarised in more detail below) which states that an infrastructure asset should have an economic life of at least 10 years in order to qualify.

✓ We suggest that the meaning of long term should include assets that have an economic life of at least 10 years.

Project operator, borrowing costs, assets and income are all in the Union

The ATAD1 provisions require that the operator, borrowing costs, assets and income are all in the Union. The OECD guidance on an option for a public benefit infrastructure exemption suggests that the operator, the project assets and income arising from the project are all in the same country.

Under the UK CIR regime, there is a territorial test requiring the asset to be *"a tangible asset forming part of the infrastructure of the UK".*

Qualifying infrastructure company

We recommend that a similar approach to the UK could be followed whereby a "qualifying infrastructure company" ("QIC") is defined, and it is then loans advanced to such companies that come within the proposed exclusion. To qualify, the company's income and assets would have to be referable to activities related to 'public infrastructure assets' and be fully taxable in Ireland.

[16] Under the UK CIR, any UK tangible asset forming part of UK infrastructure or the UK sector of the continental shelf can be a public infrastructure asset if it has an expected life of at least 10 years and is procured by a public body or its use is, or could be, regulated by an infrastructure authority. This includes a building used in a UK rental business where it is let (or sub-let) on a short term basis (maximum lease term 50 years) to non-related parties.

- ✓ The income/ asset requirement would be that more than 50% of a company's income or value of its assets (being tangible assets, service concession arrangements, etc) is derived from qualifying infrastructure activity. This includes shares in, or loans with (see below), a qualifying infrastructure company. **Therefore, a holding or financing company of a qualifying infrastructure company should be able to qualify for the exemption**
- ✓ The income/ asset requirements should also include provisions that allow for a company to qualify where it has no income/ assets, **which should enable large projects to qualify during the construction phase.**
- ✓ Pubic infrastructure activity includes acquisition, design, construction, conversion, improvement, operation or repair.
- ✓ In the context of real estate assets, loans to companies developing such assets should qualify where it is the intention that the completed asset will be leased on a term not exceeding 50 years.
- ✓ For banking and legal reasons, it is common for debt financing to be advanced to a company ("borrowing entity") other than the company carrying out the infrastructure activities (the "project company"). For example, a holding company will borrow and then finance the project company as a subsidiary. Alternatively, a sister company of the project company will do so. Interest expense will arise in the borrowing entity and be available under Ireland's corporation tax loss group relief rules to surrender against the taxable profits of the project company. It is therefore important that such financing and holding companies themselves qualify as qualifying infrastructure companies.

The standard funding model for long term infrastructure projects

Our insights below on the features of infrastructure assets and the type of funding model that has emerged in response to these features draw on insights presented by The Infrastructure Forum (TIF) in the context of UK soundings taken when the UK implemented its CIR regime. They also draw upon insights from KPMG teams advising businesses operating internationally and investing in classes of infrastructure assets including energy, utilities, transportation and more generally, real property assets.

The special features of infrastructure assets mean that very high levels of debt funding are commercially supportable, normal and desirable in the interests of reducing the cost of public benefit infrastructure to taxpayers and users. These same features that operate to optimise the cost of infrastructure also restrict the levels of interest arising on the funding and mean that interest expense cannot be excessive.

Companies providing public benefit infrastructure assets commonly have fairly stable cash flows and generate only a small profit margin over their funding costs. For such companies, the Interest Limitation rule would effectively mean limited or no interest deductions in the earlier phases of projects because of their high debt levels and low, deferred profitability. The availability of a consolidated group ratio rule could benefit some joint venture/consortium projects to the extent they use third party debt. However, we can foresee that even with the benefit of a consolidated group ratio relief, there is still likely to be restrictions applicable to infrastructure finance which we believe would have the effect of increasing the cost of capital associated with such projects.

The reason for this is explored below.

In the analysis below, we have identified the features and commercial risks common to long term infrastructure projects and the standard funding model that different classes of investor (whether state-backed, institutional or private investors) adopt when structuring their investment in these projects.

In order that Ireland can secure the broadest range of funding sources for long term public benefit infrastructure (PBI), we suggest that Ireland adopts a PBI exemption. In addition, such exemption

needs to be defined to cover non-public private partnership (PPP) models for providing PBI and include investor-owned debt.

Infrastructure assets (or projects) have various distinct and unique characteristics. These are summarised as follows. They:

- require a substantial initial capital outlay to build (and in many cases large ongoing capital outlays to maintain),
- evolve from the perspective of investor risk throughout their 'lifecycle' of development and construction stages (with shorter-term and higher risks of non-completion or cost overruns) into the operational stage (longer-term and lower risk with generally stable and predictable cash flows),
- are generally fixed, immobile, 'domestic' assets, generating entirely the cash flows needed for funders and owners to recoup their original investment plus a return that compensates them for the level of risk assumed,
- involve long duration contracts, stretching to 25 or 30 years or even longer in some cases,
- yield stable and predictable long term cash flows that can support significant debt levels, and
- need to satisfy dual objectives of ensuring financial sustainability and meeting user needs and public, economic and social policy objectives.

Over time, these characteristics have combined to drive what can be termed a commonly applied funding structure, or 'capital structure' for financing an infrastructure asset. This capital structure has evolved in response to the inherent features of long term infrastructure assets outlined above. The capital structure frames the investment decision making choices for all infrastructure funding participants (whether sovereign states, banks, companies, pensions, sovereign wealth funds, insurers or managed funds).

Infrastructure assets are often financed with 'non-recourse' funding, meaning that lenders rely only on cash flows generated by the asset to service and repay their loans. Lenders will generally insist on lending to an entity which holds the asset directly, or to an entity in the same jurisdiction which has the sole purpose of on-lending to that entity and do not seek recourse to assets of the shareholders. The lender may take security over shares in the entity which holds the asset or over its holding entity.

In general, the lending arrangements provide that borrowings cannot be applied to any other purpose and income from the asset must be applied to servicing and repaying the lender, in priority to being available to owners of equity.

This 'optimises' costs of funding to the project and keeps down the final cost of the asset in the hands of the taxpayer or ultimate user. Government (i.e. the taxpayer) and individual consumers (i.e. households) ultimately bear the cost of funding public benefit infrastructure over time.

Taxpayers bear this through annual service payments made by government bodies to, for example, PPP projects (e.g. roads). Households bear this through electricity and water bills as a consequence of regulatory regimes which pass costs through to users in order to enable funders/owners of the underlying asset to earn a risk-adjusted return on their funding.

Given the underlying costs are ultimately borne by taxpayers and consuming households, government and regulatory practice means that infrastructure projects have had to raise funds (i.e. establish their capital structure) in the cheapest possible way to provide long term value to the taxpayer/consumer. **Value to taxpayers/consumers improves where there is competition and a level-playing field between as diverse as possible funding sources attracted to the stable cash flows of such assets.**

The typical equity: debt split when funding infrastructure

For the above reasons (i.e. large initial funding outlay, stable and predictable cash flows linked to asset revenues, competitive tension, etc.), infrastructure assets support (and seek) high levels of debt. As debt is cheaper than equity, it forms a vital part of long term infrastructure funding.

The funding requirement of a typical infrastructure asset can be divided into 85-90% being supportable with debt and 10-15% requiring equity, depending on the project. In some cases where the cash flows are highly secure, projects can support up to 95-99% gearing levels. The debt financing is typically credit scored as investment grade, may be secured on physical assets or contracts, and offers low-risk cash-based returns to funders with a limited chance of default (and is therefore cheaper than the equity component of the funding, bringing down the overall public cost of the asset).

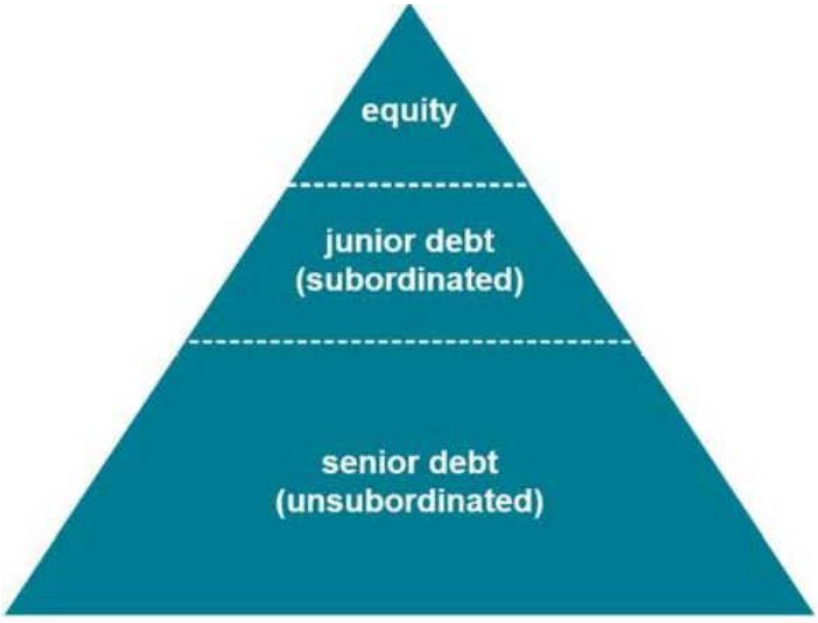
The debt funding component of an infrastructure asset commonly subdivides further into two distinct 'tranches' – senior debt and junior, (i.e. 'subordinated' to senior) debt ("sub-debt").

This subdivision caters for multiple types of investors within an infrastructure funding market depending on their differing levels of risk appetite and of funds available for deployment. This allocation of risks between various potential stakeholders or investors in an asset helps to widen the funding sources for infrastructure as different classes of investor have different risk appetites.

- **Senior debt** refers to debt that is in 'first-lien' position. In the event of a default and subsequent liquidation, the senior lender (often, but not always, a commercial bank or institutional lender) has first priority in recouping its investment. This makes it the lowest-risk portion of the funding and attracts a cheaper (i.e. lower) interest rate.
- **Junior debt**, also known as mezzanine or sub-debt is a second-level of debt. Sub-debt is often referred to as subordinate, because the debt providers have subordinate status in relationship to the senior debt. Because of this, subordinated debt is a higher-risk investment for the lender compared to senior debt and commands a higher interest rate.
- **Equity** provides the 'cushion' for the debt and takes the residual (or 'first loss') risk. Upon a default, the senior lender is first to be repaid, then subordinated debt holders, then equity holders.

The only substantive difference between senior debt and sub-debt is the priority in which payments are made upon an event of default. This is often implemented contractually through the concept of a "cash flow waterfall" which guarantees lenders' priority access to the asset's cash flow.

The 'dividing line' between the debt tranches and the equity tranche in infrastructure assets is that infrastructure debt does not participate



Typical capital structure of an infrastructure asset

Risk profile

in the 'upside' of the underlying infrastructure asset cash flows. Infrastructure debt is therefore less risky and has lower returns on average than infrastructure equity, which receives the disproportionate share of the upside. However, a holding of infrastructure equity benefits from control and is responsible for the management of the asset, which enables it to protect against the corresponding downside that does not impact lenders.

The above factors, in turn, influence the different risk profile of an investment across different parts of the capital structure (senior debt – lowest; equity – highest; sub-debt – in between lowest and highest) enabling, as mentioned above, optimal access to funding sources from a variety of different investors in the market.

Long term, reliable access to stable cash flows attracts investors with a preference for fixed debt-like returns such as pension funds and insurers (whose long-dated pension and insurance pay-out liabilities are a good match for the asset's long term underlying cash flows) as well as sovereign funds, who see the long term stable cash flows as a 'defensive' investment in line with their purpose of long term wealth preservation. This also drives establishment of pooled debt funds into which institutions with little in-house expertise can invest where independent managers originate and execute senior and junior debt investment opportunities for them.

To summarise, 'investment' into infrastructure assets is essentially a means by which investors obtain a market-based funding return sourced only from the cash flows generated by the asset. Investment is predominantly in the form of senior and junior debt, given the ability of the low to medium risk portion of those cash flows to fully service returns to debt holders.

In developed markets, there is an active and competitive external market for infrastructure senior and sub-debt (helping to keep the cost of infrastructure down). The attractiveness of infrastructure debt lies in its dependability as an asset that delivers fixed returns. The recovery of most developed economies (including Ireland) after the 2007 – 2009 global financial recession means that there is a growing economic and social policy imperative to invest in infrastructure as well as increased interest and capacity of investors seeking investment opportunities in infrastructure assets.

The quality of the owner/financing provider is very important to Government and taxpayers and it would be hard to source the equity tranche from large institutional investors if they are prevented / disadvantaged from also holding the debt tranche by the manner in which a long term infrastructure project loan exemption is implemented.

The main policy choices on the design of a long term and public benefit infrastructure (PBI) exemption that are likely to influence the range of funding participants for future PBI projects are:

(i) whether or not the public benefit aspect of an exemption is confined to PPP models or also encompasses privately funded assets whose use falls under the regulatory authority of a public body; or

(ii) includes related party as well as third party debt.

The current international standard funding models for infrastructure investment allow equity and debt providers to hold different proportions of each, according to their investment requirements, and for these to change throughout the long asset life, as required. As is explored further below, some investors, including pension and sovereign funds, see external debt as a risk and are prepared to accept lower overall returns on their investment by owning the debt themselves.

'Investing across the capital structure' for lower risk 'blended' returns

In some cases, but not always, an infrastructure asset may also be 'owned' by the debt investor (meaning it has also invested in the highest risk equity tranche of the asset). However, and importantly, whether or not the asset is 'owned' by the same investor who has invested in the debt does not change or 'taint' the market based, arm's length investment paradigm that connects the investor and the asset in relation to the 'debt-financeable' component of the capital structure.

In order to access the widest sources of institutional and investor funding for

infrastructure, it is important that Irish implementation policy choices follow the market practice of respecting the natural capital structure of infrastructure assets and recognises the commonly accepted framework that defines the 'debt-financeable' component allowed by the cash flows that support that debt.

There is no economic or tax rationale for ownership (i.e. investing in the 'equity tranche') of an asset to result in the inclusion or exclusion of debt from the scope of a PBI exemption from the Interest Limitation rule.

In infrastructure, ownership and equity funding are *not* interchangeable concepts. This is because some owners, particularly those with larger amounts of funds to deploy, 'invest across the capital structure' (meaning they do not limit their investment to just equity, but also the sub-debt, and in some cases, senior debt tranche).

Investing across the capital structure is common amongst institutional investors such as pension funds, sovereigns and insurers. The more funds an owner deploys within the capital structure, the more 'hats' it wears (i.e. it is an equity, sub-debt and senior debt investor all at once) but importantly, the more its overall return lowers as a consequence. This allows the investors to achieve, in reality, a blended debt-like return on its overall investment as opposed to a higher, pure equity-like return.

A pension fund, insurer or sovereign will have a long term horizon and will want low risk and debt-style cash yield returns over that period to match its long-dated pension / insurance liabilities or preserve its wealth. Due to their overall low cost of funds, their objective when investing across the whole capital structure of an infrastructure asset is often to exceed the types of returns they might otherwise earn when investing in, say, a fixed income security where the current low interest rate environment means that returns are very low.

The introduction of third party debt into the capital funding structure for a project would mean that these investors would sit 'one notch below' the external lender in terms of priority ranking and access to cash flows. This increases the risk associated with the balance of the investment and also defers much of the investors' access to the cash flows until the debt has been repaid. Whilst this can be priced into a higher return, if the objective is merely to earn an improved return over fixed income securities and access the asset's cash flows as early as possible, an investor will not want to introduce bank debt simply for a higher equity return.

As these investors are typically not constrained in terms of funds, they prefer deploying more of their own funds in exchange for priority access to cash flows and accept a lower overall risk and return, based on the overall risk associated with their owned cash flows.

If the only category of debt that is eligible for a PBI loan exclusion from the Interest Limitation rule is third party debt, it would make the use of externally sourced debt a 'must-have' for tax purposes if an institutional bidder (who prefers to deploy more capital for lower debt-like returns) wants to have any chance of successfully competing against another bidder who is funding constrained and/or more comfortable with the risk of introducing externally sourced debt.

Institutional investors have strict regulatory constraints which preclude them from borrowing in many circumstances, so they would conclude that it is not worth bidding due to their disadvantaged tax position. The OECD itself has recognised the importance of increasing the number of bidders in reducing the cost of infrastructure projects.

Aspects of the OECD guidance in its Action 4 report on options to exclude debt related to certain public benefit projects used language that refers to PPP funding models that are not aligned with the funding models found in developed markets for infrastructure funding where there is greater diversity of participants in infrastructure investment other than the public body ultimately using or operating the asset.

The main difference is the OECD reference[17] to interest that *"is payable by the operator on a*

[17] OECD, Paragraph 66 of OECD guidance on an option to exclude certain public-benefit projects in its final report under Action 4 on Limiting Base Erosion Involving Interest Deductions and Other Financial Payments. October 2105 and 2016 update.

loan or loans obtained from and owed to third party lenders". As explained above, this suggested design choice for a public-benefit project exclusion by the OECD is not aligned with the current market experience of funding infrastructure projects.

The analysis outlined above suggests that the features of debt that is eligible for exclusion under a PBI exemption that are common across PPP and other infrastructure capital funding structures are the 'limited recourse' linkage of the debt to the project cash flows.

Other project specific matters including taking security over shares in the project entity, provision of funding guarantees or other operational guarantees e.g. performance guarantees related to the construction or use of the asset, should not exclude a loan from being an eligible loan.

Funding – related and third party

We recommend that both third party and related party loans should be eligible for the exclusion provided all other conditions are met. In our view there is no economic or tax rationale for ownership (i.e. investment in the equity tranche) of an asset to "taint" the eligibility of a loan from qualifying for the exclusion.

As explained earlier, there is a standard funding model for large infrastructure projects which sees a high proportion of the overall capital requirements being met through a combination of senior and subordinated debt, and the balance with equity.

It is often the case that equity investors also invest in the debt funding, so that they are invested "across the capital structure". This is attractive to many investors (in particular pension funds, infrastructure funds and sovereign funds) who prefer to own the debt themselves than to rank behind 3rd part secured lenders. They see this as reducing the riskiness of their overall investment. This does not change the overall level debt raised on the project – it is just that an element of the debt happens to be advanced by an investor who also holds equity. Some pension and sovereign fund investors see external debt as a risk and are prepared to accept lower overall returns on their investment by owning the debt themselves. Irish transfer pricing rules will ensure that the end-result is an arm's length level of interest expense. In our view this should be sufficient protection against base erosion, in particular bearing in mind the significant other measures currently in the Irish tax code dealing with interest deductibility. As acknowledged in the Feedback Statement and the OECD Action 4 report public infrastructure projects present little or no base erosion or profit shifting risk. This is consistent with the points made above.

If the only category of debt that is eligible for the exemption is third-party debt, then bearing in mind the importance of a tax deduction to the economic viability of these projects it would make the use of external party debt a 'must-have' for tax purposes if an institutional bidder on a project (who prefers to deploy more capital for lower debt-like returns) wants to have any chance of successfully competing against another bidder who is funding constrained and/or more comfortable with the risk of introducing externally sourced debt. As institutional investors have strict regulatory constraints which preclude them from borrowing in many circumstances, they would conclude that it is not worth bidding due to their disadvantaged tax position.

If despite the above the exclusion does not extend to related party loans, the new interest restriction regime would leave existing owners/lenders exposed to major losses on their investments in Irish infrastructure. This includes many Irish and overseas pension investors. **Grandfathering of existing investor-owned debt will be required to avoid loss of confidence in the sector and risk to availability of new investment for Ireland.**

It is expected that income of a qualifying infrastructure company will be excluded from the measure of EBITDA in the interest restriction calculation. However, if the public infrastructure exemption does not provide for related party interest expense to be excluded, then **similarly a proportionate part of the qualifying infrastructure company's EBITDA should also not be excluded**.

Flexibility within the regime

Flexibility should be afforded to groups, so they are eligible to opt in on annual basis to avail of the exemption. Availing of the PBI

exemption should not be required for a set finite period. Placing a minimum period of operating within the exemption will restrict groups from being able to take any necessary action required to respond to changes in the marketplace. This flexibility will allow groups to restructure their financing when necessary and avail of the worldwide group ratio, providing a lower overall cost to fund the project resulting in the likelihood of the project being completed.

REITs

REITs are generally exempt from corporation tax and are already subject to an interest cover test. Imposing a further requirement to comply with the interest limitation rules for their REIT activities would cause unnecessary administrative burden, given that REIT profits are already exempt.

Key Recommendation

Taking together the balance of insights that we have drawn from our review of the standard funding model in infrastructure, the widely accepted meaning of infrastructure used by various international bodies, the meaning of public benefit as well as insights as to the long term period that is appropriate to set for such assets, we suggest that:

- ✓ long term should require an asset to have an economic life of not less than 10 years,
- ✓ the meaning of public benefit should include both infrastructure which is procured by or regulated by a public body
- ✓ given Ireland's economic and social policy needs for investment in property, eligible infrastructure should also include defined property assets rented to third parties,
- ✓ eligible loans should include both third-party and related party loans. If related party loans are excluded, grandfathering should apply to pre-existing loans in order not to prevent damage to existing projects and Ireland's reputation for providing stability,
- ✓ eligible infrastructure projects should be large scale and tangible assets, located in the EU but with profits taxable in Ireland. The definition of infrastructure should also accommodate projects at different stages including construction. It should include holding and funding structures which involve loans to and shares in qualifying infrastructure companies as well as interests in qualifying infrastructure projects held through joint ventures and partnerships,
- ✓ certainty should be provided in relation to the scope of eligible infrastructure and relevant parties such as public bodies by publishing non-exhaustive lists,
- ✓ if a loan is excluded from the Interest Limitation rule, the related EBITDA should also be excluded from EBITDA as it applies both for the local group test and for a consolidated group ratio test,
- ✓ eligible loans should have repayment obligations tied to the cash flows of the qualifying infrastructure project,
- ✓ Availing of the exemption should not be required for a set finite period,
- ✓ REITS should be outside the scope of the ILR.

Question 17

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

Analysis

Article 4(7) of ATAD1 provides that Member States may exclude financial undertakings from the scope of Interest Limitation rule, including where such financial undertakings are part of a consolidated group for financial accounting purposes. We suggest that Ireland provides taxpayers with the option to exclude financial undertakings from the scope of the Interest Limitation rule.

The OECD found[18] that there are many factors that suggest that financial undertakings present a reduced risk of base erosion involving interest deductions and related financial expense. This was chiefly because of the regulated environment in which they operate. The regulatory environment serves to protect against excessive levels of debt being assumed by such companies.

ATAD1 suggests that where the financial undertaking exclusion under Article 4(7) is availed of by Member States, the exclusion should only apply to individual entities that are financial undertakings (as defined). In practice, however, financial services groups that include regulated financial undertakings also include non-regulated entities. Generally speaking, the non-regulated group members are included within the scope of overarching capital requirements or solvency requirements that apply on a consolidated basis to the group as a whole. This means that these subsidiaries also operate in a regulated environment where there is a reduced risk of base erosion due to excessive deductions for interest expense on a group basis.

Notwithstanding the protections against base erosion that are present in this regulatory environment, there does not appear to be flexibility under Article 4(7) to exclude an entire sub-group, comprising a financial undertaking and its subsidiaries, from the scope of the Interest Limitation rule.

In 2019, we conducted a survey of KPMG Member firms in 27 EU Member States to understand whether those Member States have chosen to exclude financial undertakings from the intended application of the Interest Limitation rule. We received 16 responses to questions on the local treatment of financial undertakings in this context.

Member States choosing to exclude financial undertakings: Belgium, Croatia, Cyprus, the Czech Republic, Denmark[19], Finland, France[20], Italy, Luxembourg, Slovakia and Spain.

Member States choosing to not to exclude financial undertakings: Germany, the Netherlands, Romania, Sweden and the UK.

Our findings suggest that there is a mix of approaches amongst Member States with a number not applying the exclusion. These choices have been made in the context of different regulatory environments applying in individual Member States to a range of financial services activities.

For example, countries such as Belgium and France have a broader scope of regulation which imposes regulated requirements on a wider range of financial services activities than that found in other Member States including Ireland and the UK. This can mean, in practice, that adoption of a financial undertaking exclusion which extends to regulated entities has a broader scope of application to entities engaged in financial services activities in some Member States as compared to others.

In our responses to Question 23, we agree that Ireland should apply the Interest Limitation rule on a group basis. We believe that allowing a group to apply the Interest Limitation rule to the group's financial undertakings can achieve continued relief for interest expense in a manner that is consistent with the reduced risk that those groups present of base erosion due to excessive debt.

[18] Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 – 2016 update, OECD 2017.

[19] Taxpayer option to include - Financial companies, cf. article 2(5) of the ATAD, are excluded from the Danish EBITDA-rule unless included by the groups own choice.

[20] Under the local group basis, individual financial undertaking entities must be excluded from group net interest expense and EBITDA.

In applying the Interest Limitation rule to certain companies operating in the financial services sector, we have suggested in our responses to Question 4 on defining interest income and borrowing costs that some differences in the scope of meaning of interest income might apply to certain profits of companies engaged in activities such as share dealing, etc. that might not be relevant for other taxpayers realising such profits in a different business context, where interest income/expense is not an integral part of the trade.

Key Recommendation

We suggest that Ireland allows the group the choice to elect to either exclude or apply the Interest Limitation rule to the group's financial undertakings.

Providing "group ratios"

Question 18

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

Analysis

In our reading of Article 4(5) of the Directive, we consider that Member States have the option under the Directive of offering taxpayers a choice of the two group ratio rules set out under subparagraphs (a) and (b) of Article 4(5). This appears to allow a Member State the flexibility to afford taxpayer a choice of reliefs in the same manner as Article 4(3). The choice of relief under Article 4(5) is framed as one which a Member State may provide to taxpayers. This contrasts with the different formulation of wording applied to other adoption choices under the Interest Limitation Rule such as that set out under Article 4(6) which are framed as a choice of one of three approaches which must be made at the level of a Member State. For example Article 4(6) provides that "*The Member State of the taxpayer may provide for rules either: (a)..; (b)..; or (c)..*"

Offering taxpayers only one option of a consolidated ratio rule will necessarily mean that some taxpayers, whose circumstances better fit the respective rule, will benefit in comparison to others. Making both options available, at the choice of taxpayers, in line with ATAD1, will afford businesses in different sectors the ability to meet the requirements of the consolidated ratio rule without risk of creating a distortionary impact on any particular sector.

There is a difference in outcome for the taxpayer under the two reliefs as applied under ATAD1. If the equity-to-assets ratio is met (or within a 2% margin), the entirety of the net interest expense is deductible. In contrast, if the consolidated group earnings-based ratio is applied, the taxpayer may claim a deduction for net interest expense up to the level of the consolidated group earnings-based ratio.

An earnings-based approach will inherently adjust for different interest rates available to groups that borrow in different currencies and different markets; it accommodates variations year on year in group profitability; and it also captures changes in interest rates applying to debt over time.

An equity-to-assets based ratio relief might be easier to implement, as the taxpayer is not required in applying the relief to recompute the quantum of the relief once the ratio is met. It is likely to afford a broadly similar outcome to an earnings-based relief where the interest rate applying to a group's borrowings are not significantly influenced by local market shifts or currency variations which change the relative borrowing costs associated with different tranches of debt. However, it affords less protection for taxpayers potentially affected by future volatility in profits or rapid changes in borrowing costs.

We recommend Ireland implements both consolidated reliefs so as to afford businesses in different sectors the ability to claim relief under consolidated ratio rule without risk of creating a distortionary impact on any particular sector.

Key Recommendation

We recommend Ireland implements both consolidated reliefs so as to afford businesses in different sectors the ability to meet the requirements of the consolidated ratio rule without risk of creating a distortionary impact on any particular sector.

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"?

Analysis

As set out in our response to question 12, insofar as the question of how to treat single companies which are not standalone entities is concerned, it is worth considering that the standalone entity exception in ATAD is, essentially, a simplification of the group ratio reliefs. Those reliefs effectively allow a deduction for the third-party debt of a group (subject to that debt not being disproportionately allocated to one entity / jurisdiction). The simplification afforded by the standalone exception is warranted because, by definition, a standalone entity only has third-party debt and that debt cannot disproportionately spread between entities or jurisdictions.

It would seem inequitable if a single company which was not a standalone entity were denied access to the group ratio reliefs simply because it falls between the definition of standalone entity and a possible definition of 'group' for the group ratio reliefs which might be framed as assuming there are two or more entities in a given group. Furthermore, there is nothing in the directive which necessarily presumes otherwise.

As such we recommend that single entities which are not standalone entities are afforded the same reliefs as entities in an accounting group and thus qualify for group ratio reliefs. This can be achieved by modifying the proposed definition of 'worldwide group' as follows:

'worldwide group' means:

(a) an entity which is neither an ultimate parent nor an entity that is fully included in ultimate consolidated financial statements; or
(b) 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

The definition of standalone entity could then be modified to refer to part (b) of the above definition only

Insofar as the question of how to treat entities such as joint ventures is concerned, the directive sets out clearly that the group ratio reliefs should be based on accounting consolidated groups and does not indicate that entities outside of these groups should be added in or that entities within these groups be excluded. As such, it is our recommendation that the group ratio reliefs be determined based on the group consolidated accounts without further modification. This approach is wholly in line with the directive and the intent of its framers. Given the very significant change to the Irish regime that the introduction of these new rules will entail, we strongly recommend that the government does not introduce new restrictions or complexities beyond that mandated by the directive.

We note that this may result in some situations where there are entities which are not standalone entities but not included in the accounting consolidation. As noted above, this can be addressed (at least in part) by allowing single companies to have access to the group ratio reliefs.

We appreciate that this approach may not perfectly address every possible scenario; however, we recommend against an over-engineered approach which, while well intentioned, might result is the group ratio reliefs being effectively unusable for many taxpayers. For example, if some adjustment to the group accounting results had to be made for JV interest, this could easily prevent large multinational groups from using the relief as they would have to identify every such instance on a worldwide basis and then make whatever adjustment to the consolidated results is deemed necessary. Such a requirement would be a huge deterrent and would, therefore, result in Ireland being a less attractive jurisdiction in which to do business.

If specific issues are identified in the future as needing further refinement, we would suggest that these are best addressed after they have been identified and determined to be sufficiently material to necessitate action. In the meantime, we recommend introducing the legislation in as simple a manner as the directive allows so as to allow taxpayers time to adjust to these new rules.

As noted elsewhere, we note (and agree) with the government's position that Ireland's existing rules provide a high degree of protection with respect to base erosion. As these rules are to be retained, they should provide ample protection (as they do at present). Given the very significant change to the Irish regime that the introduction of these new rules will entail, we strongly recommend that the government does not introduce new restrictions or complexities beyond that mandated by the directive.

Key Recommendation

Amend the definition of worldwide group to include single companies.

Implement the group ratio reliefs be determined based on the group consolidated accounts without further modification.

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?

Analysis

Article 4(2) contains a definition of EBITDA. It is clear, in our view, from the language of the Directive that this definition is solely for the purpose of calculating local Member State EBITDA for the purpose of the Article 4(1) restriction calculation. In particular we note Article 4(2) refers to 'the' EBITDA rather than EBITDA generally and is clearly referencing 'the EBITDA' in paragraph (1). As such, we do not believe this definition is relevant for the purpose of the group ratio test.

The matter is made very clear by the language in Article 4(5)(b). It can be seen that in subparagraph (i) the reference is to "EBITDA of the group" whereas in subparagraph (ii) the reference is to "EBITDA of the taxpayer ***calculated pursuant to paragraph 2***" (emphasis added). If the EBITDA definition in paragraph 4(2) had been intended to apply to the entirety of Article 4 it would not have been necessary to have included the highlighted words in subparagraph (ii) of Article 4(5)(b). These words are specifically included in subparagraph (ii) and specifically not included subparagraph (i). It makes sense to bring in the Article 4(2) definition into subparagraph (ii) of Article 4(5)(b) because it involves a Member State only calculation. It also makes sense that the Article 4(2) definition was not brought into subparagraph (i) of Article 4(5)(b) because it involves a global calculation.

Furthermore, the use of an accounting measure of EBITDA at a group level can be inferred from the main body of Article 4(5)(b) which, when referring to the higher percentage that be used, states "This higher limit to the deductibility of exceeding borrowing costs ***shall refer to the consolidated group for financial accounting purposes in which the taxpayer is a member*** …" This clearly intends the test to be based on the interest charge in the consolidated accounts and it follows that if the interest expense is an accounting measure then the EBITDA used in the calculation should be based on the same measure. Combining an accounting measure of interest and a tax measure of EBITDA would be wholly inconsistent and irrational. Had the framers of the directive intended to use a tax measure of EBITDA then, logically, they would have also used a tax measure of interest (which would have had to be calculated to get the tax measure of EBITDA).

Mixing the concepts would give rise to incongruent results. For example, group EBITDA would be computed by adding back only tax-deductible interest whereas the interest would be all interest (tax deductible or not) in the consolidated accounts. Another issue that would arise is that because the interest charge in the accounts would be computed under an accounting consolidation methodology, intra-group transactions would be eliminated; in order to have consistency, one would need to create some form of consolidation method for the tax EBITDAs (which would be a wholly novel idea) and if the tax measures were to be computed using the tax rules in each entity's jurisdiction of tax residence (which would be the only logical approach as applying Irish tax rules to foreign entities would not accurately reflect their taxation position) this consolidation technique would have to reconcile the differences in taxation treatment in those jurisdictions.

Further insight on the EBITDA number to be used in the group earnings ratio test can be found in the 2016 Update to the OECD Action

4 guidance[21]. The guidance recommends that a best practice approach will ensure that the rule can be reasonably simply to apply by groups and tax authorities. It recommends that the group information required to apply a group ratio rule should be taken from a group's consolidated financial statements.

It would not be possible for international groups to calculate tax adjusted EBITDA's per entity in the world and then aggregate these to arrive at group EBITDA. The manner of design of the interest limitation measures under ATAD is to allow safe harbours in the form of two worldwide group- based reliefs – it cannot be consistent with ATAD policy and intent to introduce safe harbours that are unworkable in practice.

Negative EBITDAs

Where a notional local group basis is adopted, the group may be entitled to deduct a higher amount of net interest expense for the period if a higher ratio applies based on a consolidated group ratio test. We have suggested that the consolidated group ratio test that is adopted is based on a consolidated accounting group earnings ratio.

If the notional local group has positive EBITDA but the consolidated group has negative accounting EBITDA, the consolidated group relief ratio relief becomes meaningless because it is not possible to apply an earnings based ratio to a negative or nil earnings amount. In that scenario, we suggest that the group's EBITDA is simply treated as nil. Following the OECD recommended approach, we suggest that the contribution made by the notional local group to the overall group's results should be recognised by affording the notional local group a deduction equal to the lower of the actual interest expense of the notional local group or the net third party interest expense of the consolidated group.

If the notional local group has negative EBITDA (which is treated as a nil amount) but the consolidated group has positive EBITDA, it is suggested that the relief outlined above is applied to the notional local group as there is no opportunity to apply further relief using an EBITDA formula because the consolidated group ratio is still applied to a notional local group EBITDA nil amount.

Finally, in its consideration of loss-making entities on the operation of a group ratio rule, the OECD suggested that the general approach of affording relief for net interest expense up to the ratio applicable to the consolidated group might need to be limited in a case where the consolidated group has positive EBITDA but this amount is net of loss-making entities. The concern is that the consolidated ratio of net interest expense to EBITDA could be overstated by the impact of the loss-making entity on the consolidated EBITDA. It was suggested by the OECD that this risk could be dealt with by applying a general principle that places an upper limit on the deductible net interest expense of the notional local group equal to the net third party expense of the entire group.

When applying a consolidated group ratio test based on consolidated group earnings, the consolidated accounting measure of EBITDA should include adjustments to exclude 'interest income' and 'borrowing cost amounts' as well as depreciation and amortisation amounts together with asset impairment amounts.

Other amounts which might be adjusted at the consolidated accounting level (so as to better align the consolidated accounting measure of EBITDA with the scope and measure of local group tax EBITDA) include:

- profits/losses applying to employee pension schemes,
- EBITDA related to long term infrastructure projects where the related loans have been excluded from the Interest Limitation rule,
- income from concessions which is treated as interest income under the Interest Limitation rule,
- EBITDA related to group members included in the accounting consolidation but which are included as portfolio investments (and not as fully consolidated entities).

[21] Action 4 of the OECD's Plan to counteract Base Erosion and Profit Shifting (BEPS) addresses Limiting Base Erosion Involving Interest Deductions and other Financial Payments.

Key Recommendation

The group ratio should use the accounting EBITDA of the consolidated group.

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?

Analysis

As outlined above, we suggest that the interest income and interest expense is taken from the consolidated global accounts. Using the consolidated accounting amounts will eliminate any intragroup interest income / interest expenses. We suggest that an entity by entity calculation of borrowing costs for the group earnings ratio is not practical – something recognised by the OECD and followed by the UK in its adoption of its regime. We also believe there is no material policy gain from an entity by entity methodology.

UK CIR regimes uses numbers from the consolidated global accounts in order to derive the net of interest expense and interest income (i.e. the exceeding borrowing costs) number. Adjustments are made to the accounting figures in the consolidated accounts which are specified under the UK CIR to better align the measure of the net interest expense under the worldwide group test, which is based on consolidated accounts, with the scope of interest and amounts equivalent to interest that are subject to the corporate interest restriction regime for tax purposes.

These adjustments to the consolidated accounting based measure of interest income and expense include: -

- excluding the effect of foreign currency exchange gains and losses arising on debt balances (defined as loan relationships),
- excluding the effect of certain derivative instruments (e.g. those used to hedge foreign currency exchange and non-financial amounts),
- excluding the effect of impairment losses (e.g. bad debts) and profits from reversal of impairment losses,
- including financing income and expense arising from finance leases and debt factoring transactions,
- excluding amounts recognised in the consolidated financial statements but which reflect separate assets and liabilities of pension schemes.

The OECD BEPS Action 4 Plan suggests that third party interest expense should be obtained from the group's consolidated accounts. Any amendments to this amount was advised to be kept at a minimum. In considering whether related party debt should be excluded, the report notes that where targeted rules are already in place in domestic provisions, the risk of base erosion from interest payments to related parties is low. Ireland already has sufficient rules to deny deductions on payments to related parties that are above the market value of interest. Should Ireland overhaul its interest expense regime, this particular issue may be reconsidered at that time. We would consider that the above similarly applies on borrowings from associated entities.

It is important in applying the group ratio rule, which seeks to afford additional relief beyond the fixed ratio rule, that Ireland does not go beyond that which is required in the Directive.

As stated in response to previous questions relating to the group ratio reliefs, the directive sets out clearly that the group ratio reliefs should be based on accounting consolidated groups and does not indicate that entities outside of these groups should be added in or that entities within these groups be excluded. It is a corollary that third parties must be any persons not within the group and attempts to frame the situation different would be inconsistent with the intent of the framers of the directive. As such, it is our recommendation that all elements of the group

ratio reliefs (including the definition of third parties) be determined based on the group consolidated accounts without further modification. This approach is wholly in line with the directive and the intent of its framers. Given the very significant change to the Irish regime that the introduction of these new rules will entail, we strongly recommend that the government does not introduce new restrictions or complexities beyond that mandated by the directive.

We note that this may result in some situations where there are entities which are not standalone entities but not included in the accounting consolidation. As noted above, this can be addressed (at least in part) by allowing single companies to have access to the group ratio reliefs.

We appreciate that this approach may not perfectly address every possible scenario; however, we recommend against an over-engineered approach which, while well intentioned, might result is the group ratio reliefs being effectively unusable for many taxpayers. For example, if third-parties were defined as excluding certain parties who are not in the accounting consolidation and consequently, some adjustment to the group accounting results had to be made for interest on loans form such persons, this could easily prevent groups from using the relief as they would have to identify every such instance on a worldwide basis and then make whatever adjustment to the consolidated results is deemed necessary. Such a requirement would be a huge deterrent and would, therefore, result in Ireland being a less attractive jurisdiction in which to do business.

If specific issues are identified in the future as needing further refinement, we would suggest that these are best addressed after they have been identified and determined to be sufficiently material to necessitate action. In the meantime, we recommend introducing the legislation in as simple a manner as the directive allows so as to allow taxpayers time to adjust to these new rules.

As noted elsewhere, we note (and agree) with the government's position that Ireland's existing rules provide a high degree of protection with respect to base erosion (including limiting interest deductions from certain connected parties). As these rules are to be retained, they should provide ample protection (as they do at present). Given the very significant change to the Irish regime that the introduction of these new rules will entail, we strongly recommend that the government does not introduce new restrictions or complexities beyond that mandated by the directive.

Key Recommendation

Calculate group borrowings by reference to the group consolidated financial statements. Any adjustments should be minimal.

Existing targeting interest provision in Ireland's domestic regime safeguards from base erosion on borrowings between associates and related parties.

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'?

Analysis

ATAD1 suggests that where the financial undertaking exclusion under Article 4(7) is availed of by Member States, the exclusion should only apply to individual entities that are financial undertakings (as defined). In practice, however, financial services groups that include regulated financial undertakings also include non-regulated entities.

Generally speaking, the non-regulated group members are included within the scope of overarching capital requirements or solvency requirements that apply on a consolidated basis to the group as a whole. This means that these subsidiaries also operate in a regulated environment where there is a reduced risk of base erosion due to excessive deductions for interest expense on a group basis.

Whilst the OECD Report recognises that base erosion can arise in certain financial undertakings, this risk is stated to more likely arise where the group operates in more than one country. The protection already afforded under the measures in ATAD, the limitation on types of entities within scope of the exemption (as provided for under ATAD), and the elimination of intragroup payments/ balances on consolidation lowers the risk of base erosion through interest expense.

As such, even where the group does avail of the financial undertakings exemption, it should not be required to remove from the group ratio EBITDA or borrowing costs the elements that pertain to the financial undertaking. Balancing the low risk of base erosion arising in these regulated entities and the additional complexity that will arise to recalculate the group's consolidated financial statements excluding exempt financial undertakings, the group ratio is recommended to retain financial undertakings.

We appreciate that this approach may not be perfect; however, we recommend against an over-engineered approach which, while well intentioned, might result is the group ratio reliefs being effectively unusable for many taxpayers. For example, if financial undertakings had to be eliminated from group results, this would be a very significant undertaking and would not only involve eliminating its results but also unpicking intra-group consolidation adjustments posted in those group accounts. This could easily prevent groups with such undertakings from using the relief. Such a requirement would be a huge deterrent and would, therefore, result in Ireland being a less attractive jurisdiction in which to do business.

If specific issues are identified in the future as needing further refinement, we would suggest that these are best addressed after they have been identified and determined to be sufficiently material to necessitate action. In the meantime, we recommend introducing the legislation in as simple a manner as the directive allows so as to allow taxpayers time to adjust to these new rules.

As noted elsewhere, we note (and agree) with the government's position that Ireland's existing rules provide a high degree of protection with respect to base erosion (including limiting interest deductions from certain connected parties). As these rules are to be retained, they should provide ample protection (as they do at present). Given the very significant change to the Irish regime that the introduction of these new rules will entail, we strongly recommend that the government does not introduce new restrictions or complexities beyond that mandated by the directive.

Key Recommendation

Where the group does avail of the financial undertakings' exemption, it should not be required to remove from the group ratio EBITDA or borrowing costs the elements that pertain to the financial undertaking.

Treating a notional local group as a single 'taxpayer'

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?

Analysis

(i) Definition of notional local group

To be included in a group on a local basis, we suggest that the company must be both included in the consolidated accounts of the ultimate parent and subject to corporation tax in Ireland. This would include both Irish resident companies (currently taxable on their worldwide income) as well as non-resident companies who are engaged in the conduct of a trade in Ireland through a branch or agency.

On the practical issues arising in applying an Interest Limitation rule on a local group basis, we reviewed aspects of the operation of the UK CIR regime. That regime includes companies in the local group that are included in the consolidated accounts of a parent (on the assumption that IFRS applies to identify the ultimate parent and the group's constituent members). A consolidated group can include members where there is less than the 75% common ownership interest that applies in determining the membership of a tax loss relief group.

The UK regime has protections in place whereby the central reporting company nominated by the group under the CIR regime cannot make disproportionate allocations of disallowed interest expense to non-consenting members of the CIR tax group. This operates to protect the interests of minority shareholders and joint venture shareholders in CIR tax group members.

It should be possible under a group approach to carve out the making of group based expense disallowance allocations to any consolidated accounting group member which may not otherwise have a common shareholding or direct ownership link with the group. This can arise in the case of debt issuance or securitisation vehicles where the conditions for attracting external investors for the debt may require ring fencing the cash flows and legal obligations of such companies. This can mean that, although technically, they form part of a common consolidated accounting group, for legal and commercial purposes, it is desirable to ring fence their

obligations and commitments from those of other consolidated accounting group members.

This might be done, for example, by having an elective mechanism for such companies to effectively exclude them from allocations of group-based expense and other Interest Limitation rule adjustments (which are allocated to the remaining group members).

The objective is to achieve a balance of protection for minority shareholders and to meet commercial and legal requirements to ring fence legal liabilities in relation to the cash flows of certain group members.

In referencing accounting standards to determine the membership of a group, the UK CIR regime excludes companies that are included in the consolidated accounts but are effectively treated as portfolio investments instead of their results being included in a line by line consolidation in the consolidated financial statements. This appears consistent with the Irish approach of excluding from tax loss relief groups companies where a profit on sale of the shares would be a trading receipt.

We suggest that, if Ireland adopts a local group approach that extends to consolidated accounting group members subject to corporation tax, such companies included in the accounting consolidated statements are similarly included in the local group for the purposes of the Interest Limitation rule.

(ii) Issues with existing relief

Any intra-group payments made for use of unutilised interest capacity should be ignored for tax purposes (in the same way that payments for group relief are ignored for tax purposes).

This is in line with Corporation tax group loss relief and recognises that certain groups act as one entity.

The group ratio is wider than the group loss requirement of 75% ownership. Whilst it may give rise to some further complications, the notional local group rule is aligned with accounting standards and should be capable of implementing without further administrative burden.

(iii) Impact of definition of notional local group impact elsewhere

The definition of local group should be aligned with the definition used in the standalone entity exemption provision.

Consideration should be given as to how the de minimis relief is provided where a group election is not made.

(iv) Interaction with group ratio rule

In the context of applying the group ratio rule, defining the notional local group in line with the definition the accounting definition of a group for consolidation purposes will significantly ease the burden of administration. It is important to bear in mind that the group ratio rule is to afford additional relief for the entity for interest on third-party borrowings and so should not be applied so as to further restrict relief or make it unworkable in practical terms. Application of the group ratio rule to provide additional relief to a notional group could be considered on an entity by entity basis. The group ratio is determined by financial statements of the entire consolidated group. The resultant ratio is then applied to each entity within the notional local group. These are then consolidated and compared to the fixed ratio rule.

As stated in response to previous questions relating to the group ratio reliefs, the directive sets out clearly that the group ratio reliefs should be based on accounting consolidated groups and does not indicate that entities outside of these groups should be added in or that entities within these groups be excluded. It is a corollary that if we define the notional local group as entities within this group that are subject to Irish corporation tax then no further modification of this definition should be made.

This approach is consistent with the directive and the intent of its framers. Given the very significant change to the Irish regime that the introduction of these new rules will entail, we recommend introducing the legislation in as simple a manner as the directive allows so as to allow taxpayers to adjust to these new rules.

Key Recommendation

A notional local group should contain entities included in the consolidated accounts of the ultimate parent and subject to corporation tax in Ireland.

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?

Analysis

(i) Group election

The interest limitations regime will impact groups differently. Regardless of whether they are within the same sector, or business, the impact will depend on the facts and circumstances of each group and how the group operates as a whole. Furthermore, certain groups, like conglomerates may operate entities separately and not coordinate within the group. It is important that any group approach is not mandatory and instead may be available by election. It is understood that whilst it would be preferable to make the election for a finite period, any requirement to operate as a group for a finite period must accommodate entities leaving and joining the group.

Even where a notional local group election is made, flexibility needs to be provided on how the restriction is operated so that certain entities can ring fence their obligations and commitments from those of other consolidated accounting group members. This is important for securitisation vehicles. Although technically, they form part of a common consolidated accounting group, for legal and commercial purposes, it is desirable to ring fence their obligations and commitments from those of other consolidated accounting group members.

(ii) Carried forward amounts

The option should be given to the notional local group to centralise the carry forward capacity and credit or to allocate it to each entity. Where an entity joins a group with carry forward restricted interest or capacity, this quantum should be available for use against future restricted interest calculations of the notional local group.

Quantifying the interest restriction for a notional local group is complicated and certainty of use of a restricted interest credit or capacity is in practice, difficult to predict. In these instances, a deferred tax asset is not recognised as it is uncertain as to whether a tax benefit from the carry forward interest restriction credit or capacity will materialise. Due to this, the risk associated with entities purchasing companies for its interest restricted credit or capacity is low. To protect against any distortionary behaviour, a provision could be introduced preventing the surrendering to other group members of interest restricted credit or capacity carried forward where there is a change in ownership and a material change in business of the newly acquired entity. Where the restriction is applied centrally, it will be necessary to allow any entity joining the group to be able to surrender the capacity or credit carried forward to prevent undue administrative burden on the taxpayer.

(iii) Antifragmentation rules

The interest limitation rules apply to any entity that is not a standalone entity. Similar to group corporate tax loss relief, entities should be free to surrender to any other entities within the group. The group is still confined by the fixed ratio rule or the group ratio rule.

Key Recommendation

Provide for the election of a notional local group.

Provide for the option to centralise applying the ILR within a notional local group

Question 25

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

Analysis

We do not recommend that a mandatory approach is introduced.

Certain groups will operate across several sectors in many jurisdictions. Where the group operates across several sectors, it may not seek or indeed align with other group members operating in a different sector. Dependent on how the structure is set up in group, certain entities will not have sight or access to the information required to calculated tax EBITDA or exceeding borrowing costs of other entities within the group.

Key Recommendation

Do not apply a mandatory approach

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?

Analysis

It is practical to provide the option of a single entity reporting information to Revenue and allocating to the respective group members. This is similar to the approach available to reporting VAT where a group remitter is appointed in a VAT group.

(i) Criteria

The entity must be within the notional local group. It will be up to the group to appoint a remitter. No additional criteria should be placed on the group remitter. Certain groups centralise their tax functions into one company. If further restrictions are placed on the group remitter, the entity with the tax function may not be eligible to be the reporting entity.

(ii) Reporting entity leaves the group

Where the reporting entity leaves a group, another entity must be appointed prior to the filing of the relevant return. A notification of deregistration of the old remitted and registering of the new remitted should be completed through ROS. In the event a new remitter isn't registered, the default could be that each entity must file their own interest restriction details.

(iii) Reporting information

Details that may be included in the return are those necessary to perform the calculation

- Entities in the notional local group
- Accounting period
- Taxable interest income
- Deductible interest expense
- Exceeding borrowing costs
- Tax adjusted EBITDA
- Excess capacity used
- Confirmation if relying on the group ratio
- Confirmation if relying on the debt equity rule or the group ratio rule
- Group EBITDA
- Group third party borrowings
- Accounting entity EBITDA for the entity
- Restricted interest
- Carried forward restricted credit
- Details of allocation between entities in the group

(iv) Alternative manner in which information reporting could be dealt with

Where an election for a group remitter isn't made, information could be reported on an entity by entity basis in the respective return.

Key Recommendation

Provide the option of a single entity reporting information to Revenue and allocating to the respective group members.

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?

Analysis

The ATAD does not require that intragroup transactions be eliminated through consolidation at the notional local group level.

In practice, a worldwide consolidated group will have Irish entities owned under different holding companies. Where these holding companies are located outside of Ireland, such as in the EU, consolidated accounts will not be prepared in respect of Irish only entities within the group. If Ireland was to introduce this, it would go beyond the directive and make the application of the regime burdensome and unworkable. To comprise the result of all its members is not a requirement to prepare consolidated accounts. To meet the criteria in ATAD, it needs to include all members in the notional local group. These can individually be added together to obtain the results of all the group's members. Similar to corporation tax loss rules, intragroup transactions are not disregarded. There is sufficient protection already within the Irish corporation tax regime to protect against base erosion between group entities.

As previously noted, the financial undertaking exemption should not be mandatory and should be available by way of an election by an entity. Where an entity avails of the exemption, the EBITDA and borrowings should not be included in the notional local group in applying the fixed ratio rule. Where the election is not made, the financial undertaking should be treated similarly to all other entities within the notional local group.

Key Recommendation

Individual entity EBITDA and exceeding borrowing costs should be added together to arrive at the notional local group EBITDA and exceeding borrowing costs. There is no requirement to draft consolidated accounts for Irish entities and eliminate intragroup balances

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?

Analysis

(i) Allocating the restriction

The UK CIR regime ultimately gives effect to a restriction computed at group level on a company by company basis within the group. This can give greater flexibility to group members to balance the effect of the disallowance with other reliefs available to group members such as group tax loss relief and reduces the possibility of permanent disallowances arising due to timing differences in the recognition of net interest expense and EBITDA. The calculation of excess capacity (to absorb additional expense deductions) is done and retained as an attribute at CIR group level (with the ability for the CIRR to nominate different group companies to use the brought forward capacity in a future period).

However, tracking and monitoring aspects of the CIR regime such as disallowed interest on a single company basis is complex from an administrative perspective. In considering how a local group regime might work for an Irish Interest Limitation rule, we suggest it would be worthwhile providing the notional local group with the option to centralise the adjustment and the monitoring of Interest Limitation rule disallowances and attributes, might be done at a group level. Further soundings should be taken from business on the appropriate balance of flexibility and administrative complexity during the second feedback statement in mid-2021.

(ii) Local group negative EBITDA but entity has positive EBITDA

Where a notional local group election is made, then if the overall EBITDA amount for the local group is a negative figure, we suggest that EBITDA for the period is simply treated as nil. In this case, the local group should be entitled to deduct the de minimis threshold amount of net interest expense for the period.

Where a notional local group election is not made, the entity will calculate its interest restricted based on its own EBITDA.

(iii) Carried forward amounts within a notional local group

Even where the notional group election is made, it should be possible to carve out the making of group-based expense disallowance allocations to any consolidated accounting group member which may not otherwise have a common shareholding or direct ownership link with the group. This can arise in the case of debt issuance or securitisation vehicles where the conditions for attracting external investors for the debt may require ring fencing the cash flows and legal obligations of such companies. This can mean that, although technically, they form part of a common consolidated accounting group, for legal and commercial purposes, it is desirable to ring fence their obligations and commitments from

those of other consolidated accounting group members.

This might be done, for example, by having an elective mechanism for such companies to effectively exclude them from allocations of group based expense and other Interest Limitation rule adjustments (which are allocated to the remaining group members).

The objective is to achieve a balance of protection for minority shareholders and to meet commercial and legal requirements to ring fence legal liabilities in relation to the cash flows of certain group members.

(iv) Allocating a charge

Where an election is made to centralise the application of the interest limitation regime, the charge should similarly be centralised.

Groups should be entitled to elect to allocate the charge as they consider appropriate. Consent from all group member should be a requirement to protect minority shareholders.

As with Ireland's loss relief rules, should a group decide to have a single taxpayer discharge the tax liability, Ireland should legislate for any intra-group compensating payments to be ignored for tax purposes.

(v) How should changes in group membership be dealt with

Where an election is made to centralise the application of the interest limitation regime, joiners to the group can submit their excess capacity or interest restricted credit carried forward to the group for allocation. Leavers may be eligible to take carried forward interest restricted credit or excess capacity but is limited to the quantum that as an entity they would have been entitled to if a group election was not made.

If an election to centralise the application of the regime is not made, each entity will already be apportioned its interest restriction credit or excess capacity forward. It will be eligible to take these with them when they join or leave the group.

Key Recommendation

Provide the notional local group with the option to centralise the adjustment and the monitoring of Interest Limitation rule disallowances and attributes.

Question 29

Would the answers to Question 28 be different for mandatory application of the “group approach” versus optional?

Analysis

As noted above, we do not recommend introducing a mandatory group regime. Should one be introduced it would be imperative to facilitate the ring fencing the and commitments of securitisation vehicles obligations from those of other consolidated accounting group members.

Key Recommendation

We do not recommend a mandatory group approach.

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?

Analysis

Joiners and Leavers of the group

In the UK, where members of the UK CIR tax group join or leave during a tax accounting period, the EBITDA and net interest expense/income of the departing or newly acquired company is time apportioned so that the CIR tax group figures include only that portion of the tax-EBITDA and net interest expense/income of the company during the time that it is a CIR tax group member.

Non coterminous accounting period ends

Where tax accounting periods of individual group members are not coterminous with the CIR tax group's accounting period, an apportionment is made of the EBITDA and/or net interest expense/income amounts so that only amounts arising in the period that overlaps with the group's CIR accounting period are included in the CIR tax group aggregate figures for that accounting period. Where the CIR tax group accounting period is less than 12 months, thresholds that apply on an annual basis (e.g. the de minimis exception amount) are proportionately reduced.

We recommend a similar approach is adopted in Ireland, time apportioning for new joiners/ leavers of the group and apportioning for amounts arising in the overlapping periods of entities with non-coterminous accounting period ends.

Key Recommendation

We recommend time apportioning for new joiners/ leavers of the group and apportioning for amounts arising in the overlapping periods of entities with non-coterminous accounting period ends.

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?

Analysis

The general schema of the seven-step approach supposes that all reliefs would be used before a Case IV charge is triggered. This represents a flexible approach for taxpayers as it permits the use of less flexible reliefs first (where possible) before imposing a charge.

A similar approach ought to apply to the utilisations of credits generated form an interest restriction i.e. it should be claimable after the utilisation of any other relief or tax credit. This will also represent a flexible approach for taxpayers as other such reliefs or credit are frequently restricted n their use; whereas, we understand, the utilisation of the interest restriction credit is to be unfettered within a notional local group (subject only to the availability of interest capacity). Thus, leaving these credits to be used after all other reliefs will likely maintain greatest flexibility for taxpayers and taxpayer groups.

Key Recommendation

ILR should be applied after all other reliefs available to taxpayers and taxpayer groups.

Question 32

Comments are invited on any other technical issues that may require consideration.

Analysis

Provide clarity, by way of legislative amendment, that restricted interest that is deemed income chargeable under Case IV is not to be treated as income for tax purposes and, in particular, not treated as estate or investment income for the purposes of the close company surcharge, as defined in section 434, TCA 1997.

Provide clarity that interest income that is deemed to arise to taxpayers under other provisions is to be treated as interest income for the purposes of ILR. For example, section 812, TCA 1997 deems interest on securities sold by a taxpayer to be income of the seller in certain circumstances. Given that this results in that income being taxable in the hands of that person, it seems equitable that it be counted when applying ILR.

Key Recommendation

Clarify that restricted interest deemed to be income for other purposes including being income within scope of the close company surcharge.

Provide clarity that interest income that is deemed to arise to taxpayers under other provisions is to be treated as interest income for the purposes of ILR.

Appendix

Appendix

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?

Key Recommendation

- ✓ Simplification of the recovery of capital rules applying to interest as a charge to allow companies to comply with the interest limitation regime without an unexpected increase to the effective tax rate of the group
- ✓ Remove section 840A but preserve the relief for unused and carried forward expense off-settable under section 840A against profits from an acquired trade

Question 2

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

Key Recommendation

We recommend changes to the scope of existing measures to rebalance the effect of protections afforded within the existing corporation tax regime.

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.)

Key Recommendation

Approach will need further consideration so as to incorporate the group aspects. Further consultation on this approach should be sought during the second feedback statement.

Question 4

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

Key recommendation:

We suggest the following wording for the definition of 'interest equivalent' to align with the definition in ATAD1 and deal with the complexities outlined above:

"interest equivalent" includes any amount of —

(a) interest,

(b) amounts economically equivalent to interest including —

(i) discounts,

(ii) in the case of companies which are taxed under Case I principles in respect of their debt (or debt equivalent) assets, gains and losses, fair value movements, and foreign exchange movements on those debt (or debt equivalent) assets,

(iii) payments under profit participating loans, but not including interest treated as a distribution under section 130,

(iv) amounts referred to in paragraphs (c) of the definition of financing return in section 835AH,

(v) imputed interest on instruments such as convertible bonds and zero coupon bonds,

(vi) the finance cost element of finance lease payments,

(vii) for lessors taxed under Case I principles in respect of the leasing of plant and equipment leasing, the finance income component of hire purchase and lease rental payments,

(viii) capitalised interest included in the balance sheet value of a related asset, or the amortisation of capitalised interest,

(ix) amounts measured by reference to a funding return under transfer pricing rules where applicable, and

(x) notional interest amounts under derivative instruments or hedging arrangements related to an entity's borrowings,

(xi) for the purposes of this Part, profits arising to a qualifying company under section 110,

(xii) amounts under alternative financing arrangements, such as Islamic finance,

and

(c) expenses incurred in connection with raising finance, including —

(i) certain foreign exchange gains and losses on borrowings and instruments connected with the raising of finance, but such gains and losses shall not include foreign exchange or net deductions (or movements) that arise by reason of foreign currency exchange fluctuations,

(ii) guarantee fees for financing arrangements,

(iii) arrangement fees and similar costs related to the borrowing of funds,

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 but, except where expressly provided, shall not include foreign exchange movements on loan principal (or principal on debt equivalents).

Question 5

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

Key Recommendation

Continue to align the application of the interest limitation regime with the taxation of interest income and interest expense.

Clarify interaction with reliefs but aim to ensure deferral of cash tax liability until the entity is profit making or has utilised the loss.

Question 6

Comments are invited on these possible definitions of ‘exceeding borrowing costs’ and ‘exceeding deductible interest equivalent’.

Key Recommendation

We recommend the definitions to be amended so that they will operate as intended on a group level and to ensure that EBITDA is not reduced in a manner not intended by the directive.

Question 7

Comments are invited on this possible definition of ‘EBITDA’.

Key Recommendation

Relevant profits should include taxable income, such as taxable foreign dividends.

Deductible interest expense arising on legacy debt should be added back to arrive at EBITDA.

The definition of interest should be amended to ensure it complies with ATAD.

EBITDA should be calculated on an entity by entity basis the allocation of capacity and utilisation of ‘exceeding borrowing costs’ credits managed at the notional local group level.

Question 8

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

Key Recommendation

Allow a relevant entity to shelter a Case IV charge in respect of restricted interest with any and all other reliefs available to it.

Allow a company which has restricted interest trapped within a loss which also has components arising other than from restricted interest to choose which component of its loss it uses.

Carry forward unused capacity as tax credits usable against future case IV interest restriction charges.

Apply the five year time limit on unused capacity only to the extent the capacity tax credit exceeds the entity's restricted interest credit.

Question 9

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

Key Recommendation

Amend provisions to provide for the automatic carry forward of restricted credit and excess capacity.

Align the rate in which trading and non trading taxpayers can claim the restricted interest credit

Question 10

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

Key Recommendation

Amend provisions to provide for the automatic carry forward of restricted credit and excess capacity.

Carry forward attributes such as disallowed excess interest expense or excess interest capacity can be retained and tracked at a notional local group level e.g. by a nominated central group entity.

Carry forward unused capacity as tax credits usable against future case IV interest restriction charges

Apply the five year time limit on unused capacity only to the extent the capacity tax credit exceeds the entity's restricted interest credit.

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.

Key Recommendation

We agree with the provision for a €3 million *de minimis* threshold.

Taxpayers who are confident that their relevant interest expense will not exceed the *de minimis* amount should not be required to carry out a detailed computation in order to evidence their entitlement to that relief.

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.

Key Recommendation

Amend the definition of standalone entities to include companies that are liable to corporation tax on profits.

Amend the definition of standalone entities to align it with that used in ATAD.

Amend the definition of worldwide group to include single companies.

Provide guidance on the application of the associated enterprise test to fund structures.

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.

Key Recommendation

Ireland accepts as equivalent to Irish GAAP those standards which are considered to be equivalent under Irish company law and EU regulations as described above.

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?

Key Recommendation

Amend the definition of standalone entities to align it with that used in ATAD.

When addressing complex investment structures, assess standalone status with respect to the positions of underlying investors.

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.

Key Recommendation

“legacy debt” should 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 and has made an election for the security to be treated as legacy debt.

Question 16

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

Key Recommendation

Taking together the balance of insights that we have drawn from our review of the standard funding model in infrastructure, the widely accepted meaning of infrastructure used by various international bodies, the meaning of public benefit as well as insights as to the long term period that is appropriate to set for such assets, we suggest that:

- ✓ long term should require an asset to have an economic life of not less than 10 years,
- ✓ the meaning of public benefit should include both infrastructure which is procured by or regulated by a public body
- ✓ given Ireland’s economic and social policy needs for investment in property, eligible infrastructure should also include defined property assets rented to third parties,
- ✓ eligible loans should include both third-party and related party loans. If related party loans are excluded, grandfathering should apply to pre-existing loans in order not to prevent damage to existing projects and Ireland’s reputation for providing stability,
- ✓ eligible infrastructure projects should be large scale and tangible assets, located in the EU but with profits taxable in Ireland. The definition of infrastructure should also accommodate projects at different stages including construction. It should include holding and funding structures which involve loans to and shares in qualifying infrastructure companies as well as interests in qualifying infrastructure projects held through joint ventures and partnerships,
- ✓ certainty should be provided in relation to the scope of eligible infrastructure and relevant parties such as public bodies by publishing non-exhaustive lists,
- ✓ if a loan is excluded from the Interest Limitation rule, the related EBITDA should also be excluded from EBITDA as it applies both for the local group test and for a consolidated group ratio test,
- ✓ eligible loans should have repayment obligations tied to the cash flows of the qualifying infrastructure project,
- ✓ Availing of the exemption should not be required for a set finite period,
- ✓ REITS should be outside the scope of the ILR.

Question 17

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

Key Recommendation

We suggest that Ireland allows the group the choice to elect to either exclude or apply the Interest Limitation rule to the group's financial undertakings.

Question 18

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

Key Recommendation

We recommend Ireland implements both consolidated reliefs so as to afford businesses in different sectors the ability to meet the requirements of the consolidated ratio rule without risk of creating a distortionary impact on any particular sector.

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"?

Key Recommendation

Amend the definition of worldwide group to include single companies.

Implement the group ratio reliefs be determined based on the group consolidated accounts without further modification.

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?

Key Recommendation

The group ratio should use the accounting EBITDA of the consolidated group.

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?

Key Recommendation

Calculate group borrowings by reference to the group consolidated financial statements. Any adjustments should be minimal.

Existing targeting interest provision in Ireland's domestic regime safeguards from base erosion on borrowings between associates and related parties.

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'?

Key Recommendation

Where the group does avail of the financial undertakings' exemption, it should not be required to remove from the group ratio EBITDA or borrowing costs the elements that pertain to the financial undertaking.

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?

Key Recommendation

A notional local group should contain entities included in the consolidated accounts of the ultimate parent and subject to corporation tax in Ireland.

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?

Key Recommendation

Provide for the election of a notional local group.

Provide for the option to centralise applying the ILR within a notional local group

Question 25

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

Key Recommendation

Do not apply a mandatory approach

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?

Key Recommendation

Provide the option of a single entity reporting information to Revenue and allocating to the respective group members.

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?

Key Recommendation

Individual entity EBITDA and exceeding borrowing costs should be added together to arrive at the notional local group EBITDA and exceeding borrowing costs. There is no requirement to draft consolidated accounts for Irish entities and eliminate intragroup balances

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?

Key Recommendation

Provide the notional local group with the option to centralise the adjustment and the monitoring of Interest Limitation rule disallowances and attributes.

Question 29

Would the answers to Question 28 be different for mandatory application of the "group approach" versus optional?

Key Recommendation

We do not recommend a mandatory group approach.

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?

Key Recommendation

We recommend time apportioning for new joiners/ leavers of the group and apportioning for amounts arising in the overlapping periods of entities with non-coterminous accounting period ends.

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?

Key Recommendation

ILR should be applied after all other reliefs available to taxpayers and taxpayer groups.

Question 32

Comments are invited on any other technical issues that may require consideration.

Key Recommendation

Clarify that restricted interest deemed to be income for other purposes including being income within scope of the close company surcharge.

Provide clarity that interest income that is deemed to arise to taxpayers under other provisions is to be treated as interest income for the purposes of ILR.

Glossary of terms

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Action 4	Action 4 of the OECD's Plan which comprises 15 Actions to counteract base Erosion and Profit Shifting (BEPS). Action 4 addresses Limiting Base Erosion Involving Interest Deductions and other Financial Payments.
ATAD (ATAD1, ATAD2)	Anti-Tax Avoidance Directive. In relation to the Interest Limitation Rule, the measures are included in Council Directive (EU) 2016/1164 of 12 July 2016. This is described as ATAD1. In relation to anti-hybrid rules, the measures are included in amending Directive (EU) 2017/952 of 29 May 2017 amending Directive 2016/1164 as regards hybrid mismatches with third countries. This is described as ATAD2.
BEPS	Base Erosion and Profit Shifting.
CFC	Controlled Foreign Company (or corporation) rule. This is a regime which taxes currently profits of a non-resident controlled company on its parent.
CIR	Corporate Interest Restriction. This is the name commonly used to describe the Interest Limitation Rule adopted by the UK.
EBITDA	Earnings before interest, tax, depreciation and amortisation. In certain contexts these figures are based on tax adjusted amounts – in others, they are based on accounting figures in consolidated financial statements.
EU	European Union.
FRS101	Accounting standard (GAAP) which sets out a reduced disclosure framework which addresses the financial reporting requirements and disclosure exemptions for the individual financial statements of subsidiaries and ultimate parents that otherwise apply the recognition, measurement and disclosure requirements of EU-adopted IFRS.
FRS102	The primary standard under Irish and UK GAAP which applies to the financial statements of entities that are not applying EU-adopted IFRS, FRS 101 or FRS 105.
GAAP	Generally accepted accounting practice.
GAAR	General Anti-Abuse Rule. In the case of Ireland, Section 811C, TCA 1997.
HMRC	Her Majesty's Revenue & Customs, the non-ministerial UK government department responsible for taxation.
IAS	International Accounting Standards.

IFRS	International Financial Reporting Standards.
ILR	Interest Limitation Rule
OECD	Organisation for Economic Cooperation and Development.
OECD Recommendation	In its final reports (5 October 2015) under various Actions its BEPS Plan, the OECD set out a series of recommendations related to the design of measures to counteract BEPS.
PBIE	Public Benefit Infrastructure Exemption. Under the ATAD1 Interest Limitation rule, Member States are afforded the choice of excluding from the scope of the rule loans used to fund a long-term public benefit infrastructure project. This is defined under ATAD1 as 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.
PPP	Public Private Partnership
TCA 1997	Taxes Consolidation Act, 1997.
TFEU	The Treaty on the Functioning of the European Union.
UK	United Kingdom.