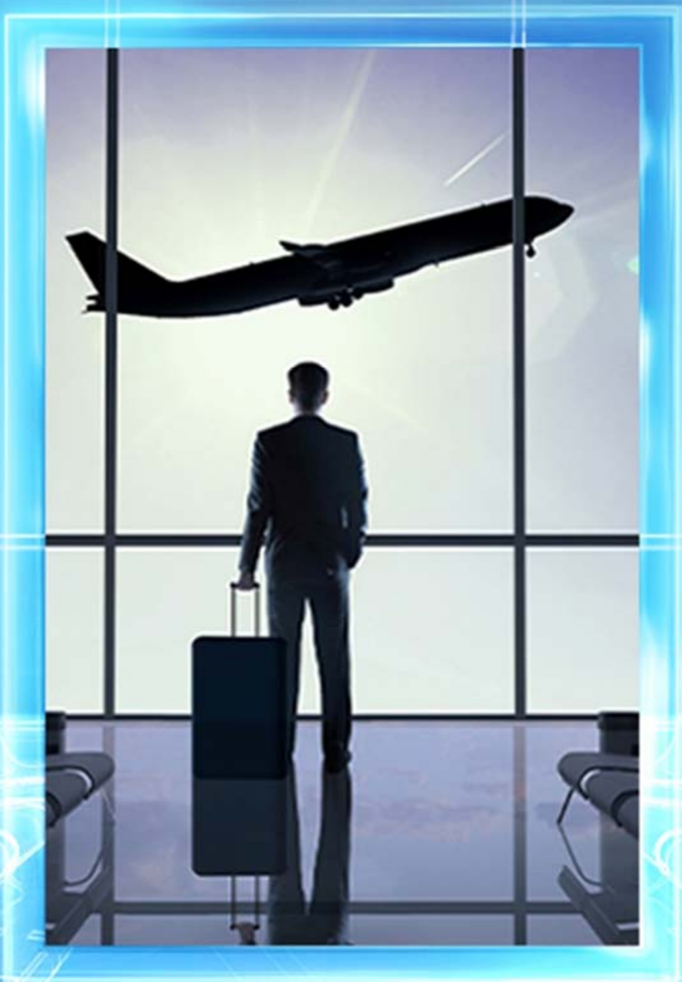
# Interest Limitation Feedback Statement

**Submission to the Department of Finance in respect of the Aviation Finance sector**



**8 March 2021**

KPMG

Private and confidential
ATAD Implementation – Interest Limitation Feedback Statement
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8 March 2021

Dear Sir / Madam,

**Interest Limitation Rule – Impact on Aviation Finance**

**Introduction**

We are writing in response to the Department of Finance's Feedback Statement on the implementation of interest restrictions under the EU Anti-Tax Avoidance Directive ("the Directive" or "ATAD"). In the following pages, we provide our responses to the questions put forward in the Feedback Statement regarding the proposed Interest Limitation Rule ("ILR").

We are of the view that Ireland's existing regime, as recently amended with the introduction of comprehensive anti-hybrid rules and updates to Ireland's transfer pricing regime, provides strong protection against base erosion and is already complex for taxpayers to navigate. We therefore agree with the Department that the introduction of the ILR legislation as part of Finance Bill 2021 should seek to address the requirements of ATAD, but should do so in a way that minimizes additional administrative burdens for businesses.

Aviation finance is a capital-intensive industry in which it is commercially feasible to borrow significant levels of debt. Similar to public infrastructure, such high levels of debt are justified by the reliable cash flows generated by the asset and the security which lenders can place over aircraft and other aviation assets. In this way, aviation finance is a margin business whereby profitability is calculated with reference to return above cost of finance. The limitation on the deductibility of interest to 30% of EBITDA will drive up the effective cost of funding of lessors through higher effective tax rates and consequentially reducing their earnings per share, making Ireland less attractive as a centre of excellence for leasing activities. This is particularly relevant in the current environment due to two extraneous factors:

(i) other jurisdictions are seeking to capture some of Ireland's market share in the aviation finance sector, in particular Hong Kong and Singapore. It is therefore important that Irish lessors are not disproportionally impacted by the ILR when compared to their competitors in other jurisdictions (both in the EU and elsewhere).

(ii) COVID-19 has significantly impacted the aviation finance sector, including aircraft leasing companies, due to the unprecedented reduction in air travel which it has caused. This has pushed airlines (the customers of aircraft leasing companies) in to record losses, putting extreme pressure on the ability of airlines to pay lease rentals to lessors. Numerous airlines have entered bankruptcy as a result of COVID-19 and, depending on the levels of air travel permitted across the world throughout the remainder of 2021, there is a risk that more could follow. To this end, the International Air Transport Association (IATA) have estimated that global passenger traffic will not return to pre-COVID-19 levels until 2024. This depression in passenger numbers, coupled with the reduced number of airlines, could result in aircraft lessors having surplus aircraft capacity. This issue will adversely impact lease rental rates and reduce earnings of aircraft leasing companies, meaning that fixed interest costs may constitute a higher percentage of EBITDA for aircraft leasing companies. In this context, the ILR could have a disproportionate impact on aircraft lessors compared to other sources of aviation finance.

As a result, we believe it is critically important that, in implementing Article 4 of the ATAD, Ireland allows for as much flexibility and optionality as is permitted within the parameters of ATAD to help support the business case for continued investment in Ireland.

In framing our responses to the questions set out in the Feedback Statement, we have sought to ensure that proposals outlined below are consistent with the requirements of the Directive and also the approach taken by other EU member states. We would be happy to discuss the approach taken by other EU countries in detail with you.

The legislative references below, unless otherwise specified, are to the Taxes Consolidation Act, 1997.

**Key policy recommendations**

We outline below our recommendations on the key policy choices that Ireland should make as part of the implementation of the ILR in order to balance its implementation with the needs of taxpayers, including the need for legal certainty and ease of administration.

1. Simplify existing legislative measures limiting the payment and deductibility of interest. This would recognise the significant added protection from base erosion that will arise from the ILR.

2. The implementing legislation for the ILR should make clear that the operation of the ILR should not impose a cash tax charge on taxpayers who are otherwise in a tax loss position. Any charge to tax under the proposed Case IV approach should arise only when the taxpayer utilises the benefit of interest deductions after relief for tax losses.

3. ATAD provides several options for the implementing legislation. We recommend where these options arise, the legislation should provide taxpayers with a choice on an elective basis. This approach would recognise the diverse nature of businesses operating in Ireland and the inherent limitations that can arise for both pre-existing and future financing structures.

**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?***

Due to the significantly increased protections afforded by the ILR, we suggest that a comprehensive review is undertaken of the existing measures in Irish tax law governing the tax deductibility of interest. We suggest that the following initial changes which could be implemented under Finance Bill 2021 in relation to existing rules under Irish tax legislation limiting interest deductions:

1. We have proposed below that profits arising to a securitisation company (i.e. companies taxable under Section 110) should be considered interest income for the purposes of the ILR. This approach would acknowledge the legislative intention that such entities would be tax neutral.

2. In the absence of this recommendation being implemented, we note that Finance Act 2007 specifically expanded the definition of "qualifying asset" for the purposes of Section 110 to include plant and machinery, thereby allowing securitisation companies to hold leased aircraft and other assets. The implementation of the ILR will disproportionately impact leasing groups who have utilised Section 110 entities to hold aircraft. Provision should therefore be made for a loss transition mechanism for companies electing out of the Section 110 regime, such that any Case III losses can be carried forward as Case I losses.

   A further option in this scenario is that, for tax purposes, there could be a deemed market value disposal of the aircraft occurring on the election out of the Section 110 regime. Such an approach would be helpful in ensuring that tax losses carried forward (primarily relating to capital allowances on the aircraft) would not be unfairly foregone.

   We recommend that both the above approaches should apply on an elective basis.

3. We propose the removal of the automatic treatment as a distribution for interest paid to a non-resident 75% group member which is not otherwise within the scope of section 130 measures targeted at interest on debt with equity characteristics. This would facilitate the removal of Sections 130(2B), 452, 452A and 845A.

4. We propose that the stamp duty charge arising under Section 126 SDCA is removed for payments of interest that are reclassified as a distribution under Section 130. Interest that is reclassified as a distribution and that is paid between two Irish companies does not create any risk of base erosion. This provision can result in an unfair stamp duty charge for payments of profit participating interest between Irish group companies, which arises for commercial reasons to facilitate the repatriation of cash and does not seek a tax deduction for the payments being made.

**Question 2:** ***What, if any, further adaptations of the existing legislation could be considered in later Finance Bills?***

Taking in combination the ATAD measures which have already been introduced in Ireland, the proposed interest limitation regime and the existing regime for regulating interest deductions, it is clear that the introduction of the interest limitation rules on top of the existing regime will result in undue restrictions on interest deductibility and go beyond that which is necessary to address the main risks of base erosion. This is particularly relevant in an aviation finance context, where interest expenses are a core overhead when funding long term capital assets.

We therefore recommend that the implementation of the ILR be taken as an opportunity to simplify Ireland's existing interest deduction regime. Our suggest changes to Ireland's interest deduction regime over the medium term are set out in Appendix I.

**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.)***

The proposed Case IV approach should not impose a cash tax charge where the company may otherwise be in a tax loss position. This is particularly important for aircraft leasing groups, which generally generate tax losses in their early years of trading due to capital allowances but become cash tax paying at a later date, either on the sale of the aircraft or once capital allowances and tax losses carried forward have been utilised.

We suggest that where a company is in a tax loss position that is not driven by an 'excessive' interest deduction, no cash tax should arise until the period in which the 'excessive interest' deduction would effectively be used. We have commented on this point in more detail below.

As a broader comment, it will also be important that the final drafting is widened to incorporate the operation of the local notional group concept and the group ratios.

Finally, to manage the administrative burden of implementing Ireland's interest limitation rules, all formulae should use inputs which can be readily taken from a company's corporation tax computations and financial statements.

**Question 4:** ***Comments are invited on this possible definition of 'interest equivalent'.***

In defining "interest equivalent", we believe that the following should be considered:

a) The leasing of aircraft and similar assets is fundamentally a financing business, whereby the profitability of the business is dictated by the excess of the interest return implicit in a lease over the cost of funding that asset. For this reason, "interest equivalent", and in particular the 'any amount economically equivalent to interest' should include the implicit interest element of aircraft operating lease payments. We believe that this can be shown as compliant with the OECD Action 4 Paper.

b) As mentioned above, the profits of a securitisation company should be treated as interest income so as to preserve the integrity of the cash flows available to the company to service the debt secured on its assets;

In relation to (a) above, we refer to our more detailed comments in Appendix II and illustrative examples of the interest component of fixed and floating rate leases in Appendix III below. In summary, the following key points should be noted from an aviation leasing perspective:

- We have proposed that Ireland should consider allowing part of the lease rental income earned by lessors <u>carrying on a trade of leasing plant and machinery</u> (including aircraft) to be treated as economically equivalent to interest. This reflects the inherent financing return earned by trading lessors and is consistent with the evolution of accounting standards (e.g. IFRS 16).

- 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.

- While the OECD's BEPS Action 4 report suggests that operating lease rentals should not generally be subject to the deduction restriction (when such rentals are booked as an expense), the report recognises that there can be circumstances where it is reasonable to recognise such payments as economically equivalent to interest (see extract below).

  *"However, any payment (including those listed above) may be subject to limitation under the best practice approach where they are used as part of an arrangement which, taken as a whole, gives rise to amounts which are economically equivalent to interest."*

- The examples cited in the Action 4 report refer to short term assets (such as office equipment) and are framed from the perspective of the lessee. As will be clear from our comments in Appendix I, the lessee's position can be distinguished from the position of a lessor which leases long-life assets. It seems unlikely that the OCED specifically considered the treatment of lessors which enter leases for long-term assets (such as aircraft / engines) with a view to financing the asset over its life. Indeed, the leasing of long-term assets (such as aircraft / engines) is a relatively specialist area which is centred in a small number of global hubs (with Ireland being a key global hub for aircraft leasing and the only such hub in the EU).

- In this respect, we would suggest that in order to apply equivalent treatment to that part of hire purchase and lease income that is economically equivalent to interest income, lessors engaged in a trade of plant and equipment leasing should be permitted 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.

In relation to both of the above suggestions, we consider it reasonable to only include the interest element of operating lease rental payments in respect of leasing income which is subject to the leasing ring-fence under section 403, so as to not also include lease income from other sources which may not be desired to be included in this definition, e.g. real estate leases, which are taxed on a different basis to other forms of leasing activity and, in particular, the tax treatment associated with the letting of real estate assets differs from the leasing of tangible moveable property.

Finally, given the high levels of debt which are commercially sustainable in the aviation finance industry, it is important to have a clear understanding of what is included in the definition of 'interest equivalent' for these purposes. Article 2(1) of ATAD provides a broad definition of '*borrowing costs*', therefore the meaning of 'interest equivalent' in the Irish interest restriction legislation should be sufficiently broad to match this definition.

We suggest that taxpayers would prefer the legal certainty provided by a prescribed definition of 'interest equivalent' in the legislation, to be supplemented with clarificatory guidance if needed.

**Question 8:** ***Comments are invited on the above possible approach to the operation of the ILR.***

*Restriction on excess interest*

In responding to this question, we firstly note for completeness that the 'relevant profits' & 'relevant entity' definitions under this proposed Step 4 have been deferred to the next consultation. We suggest revisiting the provisions that depend on these definitions once final definitions have been proposed.

The Feedback Statement is clear that the ILR is designed to be a deferral of deductibility. It is important, particularly for aviation finance, that the means of applying the Case IV charge does not result in an upfront (or accelerated) cash tax charge for entities that are otherwise in a tax loss position. Such a cash tax charge would impose a potentially material cash flow impact on leasing businesses, would increase their effective cost of finance and would reduce the competitiveness of Ireland as a hub for aviation finance. It would also impact other capital-intensive industries with a similar tax profile to aviation leasing.

We understand based on our reading of the definition of "deductible interest equivalent" that an accelerated cash tax charge is not the intended outcome from the proposed rules. To give certainty to this position, we propose two potential approaches:

1. One approach would involve defining "relevant profits" with reference to EBITDA. Thereafter and referring to the proposed drafting included in Section 6 of the feedback statement (Question 8 refers), Subsection (4) could be amended to allow tax losses and other reliefs (including tax losses surrendered via group relief) to be offset against the Case IV charge. Referring to Question 31 of the feedback statement, this approach should also provide for leasing companies that undertake a "trade of leasing" for the purposes of Section 403 TCA 97 to utilise losses arising from excess capital allowances against the Case IV charge.

   This approach would require some amendments to the current definitions as proposed including to the definition of "deductible interest equivalent", which currently could give a "nil" answer where there are tax losses. However, the overall effect would be to trigger a Case IV charge, allow it to be offset with tax losses (crucially this should include losses falling within the Section 403 ring-fence) and therefore effectively "convert" a portion of tax losses into a Case IV credit to be utilised when the taxpayer has interest capacity.

   We have illustrated this approach in Example 1 under Appendix III.

2. Alternatively, and referring to the current drafting of "deductible interest equivalent", we understand that a company that has tax losses excluding interest charges (i.e. a negative tax-adjusted earnings before interest and tax, or EBIT) should not have an amount of "deductible interest equivalent" (i.e. the amount would be nil). On this point, we suggest it is made clear that when assessing whether relevant profits are reduced below zero, a taxpayer should first deduct all other allowable expenses and allowances. This approach in turn would result in "nil" being included in the formula for exceeding deductible interest equivalent and exceeding borrowing costs, and therefore no interest restriction arises (i.e. no Case IV charge).

   In this instance, we assume that provision would need to be made to calculate an amount that *would be* restricted if the company was not in a loss-making position and for this measure of non-deductible interest to be carried forward, with the restriction to apply in future years. This approach would achieve the same goal of not triggering a Case IV current tax charge for a loss-making company but may be administratively more burdensome to track for taxpayers.

We have illustrated this approach in Example 2 under Appendix III.

In addition to the above, we suggest that where an interest restriction arises for a company, clarity is provided that the restricted interest that is deemed income chargeable under Case IV is not estate or investment income for the purposes of the close company surcharge, as defined in section 434.

Finally, as this is new legislation is to take effect from 1 January 2022, we suggest that it is made clear that the legislation does not have any retrospective effect for taxpayers with an interest component in any tax losses carried forward.

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

We note that the proposed approach involves taxpayers needing to make a claim to carry forward non-deductible interest to future accounting periods. We suggest that such carry-forward should be automatic each year in line with Ireland's existing corporation tax loss relief rules.

**Question 10:** ***Comments are invited on this possible approach to carrying forward 'excess interest capacity.***

As per Question 9 above, we note that the proposed approach involves taxpayers requiring to make a claim to carry forward excess interest capacity to future accounting periods. We suggest that such carry-forward should be automatic each year in line with Ireland's existing corporation tax loss relief rules.

Excess capacity can only be carried forward for five 5 years under Option C of ATAD. If the loss is not utilised within five years, this excess capacity will be lost. If a deduction methodology (rather than a credit methodology) had 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.

Illustrating the above point with reference to Example 2 under Appendix III, it can be seen that the five-year clock starts in 2022, notwithstanding that the company is in a loss-making position and is therefore unable to utilise the capacity in the years that immediately follow. We therefore propose that the five-year clock instead commenced in 2030.

**Question 11:** ***Comments are invited on this possible approach to the de minimis exemption, and on the potential need for anti-avoidance provisions to accompany such an exemption.***

We agree with the proposed implementation of the "de minimis amount". By way of an incremental comment to ease the burden of administration on taxpayers associated with the ILR, we suggest that provision is made such that taxpayers who are confident that their relevant interest expense will not exceed the €3 million de minimis amount should not be required to carry out a detailed computation in order to evidence their entitlement to that relief.

**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.***

It is common for Irish headquartered lessors to be owned by non-Irish groups. Indeed, some of the world's largest aviation finance businesses have their headquarters in Ireland and some are ultimately subsidiary groups of large multinational conglomerates based in the US or Asia.

Therefore, to avail of the group ratio reliefs one would need to consider the national accounting standards applicable in the home jurisdiction of their ultimate parent, whose consolidated financial statements may not be prepared under IFRS or the local GAAP of an EU Member State. In this regard, it would not be uncommon for leasing groups to prepare their group accounts under the national GAAPs of Canada, Japan, China, India, Korea and the USA.

We suggest that, in defining the foreign GAAPs that may be considered when defining a taxpayer's worldwide group, local accounting standards that are considered equivalent FRS and IFRS (as it applies in Ireland) are included.[1]

**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?***

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).

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[1] 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.
Generally Accepted Accounting Principles of Japan;
Generally Accepted Accounting Principles of the United States of America.
Generally Accepted Accounting Principles of the People's Republic of China;
Generally Accepted Accounting Principles of Canada;
Generally Accepted Accounting Principles of the Republic of Korea.

The following should not be considered “associates” of a standalone entity for these purposes so as not to eliminate the availability of this exemption:

- Nominee/legal title shareholders who do not have a beneficial interest in shares of a company; and
- Companies which are held by transparent entities, such as partnerships.

**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.***

Firstly, we suggest that implementing guidance includes 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). This would help to ease the administrative burden on taxpayers from such reforms.

Lessors generally raise long term debt finance in order to ensure that debt obligations match the nature of their capital commitments. In particular, aircraft lessors may arrange for the purchase of aircraft from manufacturers, but those assets may only deliver 4-5 years later. Due to the material capital commitments faced by lessors and the need to plan for same in advance, it is likely that lessors may have arranged and entered into debt facilities on or before 17 June 2016 but that these were only drawn down and/or utilised after this date. Therefore, we suggest that provision is made to confirm that interest arising on facilities agreed before 17 June 2016 but drawn down after that date should be considered interest incurred on legacy debt.

Finally, we suggest that this grandfathering exclusion should be made available at the election of taxpayers.

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

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. Therefore, rather than restricting taxpayers to only one of the two “group ratios”, we suggest that the full flexibility provided for under Recital 7 and Paragraph 5 of ATAD should be implemented by allowing for a choice of the Equity Ratio Rule and Group Ratio Rule.

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. This is very relevant in a leasing context, where some taxpayers may be part of wholly Irish groups, some may be part of large multinational groups and some may have different capital structures as a function of the capital structure of the rest of the group (e.g. an Irish lessor funded largely by the capital markets may have a very different capital structure to one owned by a foreign bank).

In this context, the Equity Ratio Rule may not be appropriate in all instances (e.g. where the lessor can commercially bear a materially higher level of debt when compared to the wider consolidated group). Similarly, the Group Ratio Rule may not be appropriate in all cases (e.g. certain lessors which are owned by US or Chinese bank / financial services groups).

By allowing both potential group reliefs, Ireland would provide maximum flexibility to taxpayers with different funding and capital structures whilst remaining consistent with both the wording and spirit of the Directive.

**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?***

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).

It would be practically difficult (or not possible at all) for Irish taxpayers to 'tax adjust' consolidated financial statements given that local Irish entities may not always have the ability to interrogate worldwide group results on an entity-by-entity basis. In addition, consolidated financial statements net off related party transactions and therefore give a clear picture as to total third-party interest expenses.

**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?***

As outlined above, we suggest that the interest income and interest expense is taken from the consolidated worldwide 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.

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 are 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 tax 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.

The Directive sets out clearly that the group ratio reliefs should be based on consolidated accounting groups and does not indicate that entities outside of these groups should be added in or that entities within these groups should be excluded. It is a corollary that third parties must be any persons not within the group and attempts to frame the situation differently 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) should be determined based on the group consolidated accounts without further modification. Given the very significant change to the Irish regime that the introduction of these new rules will entail, we strongly recommend against the introduction of new restrictions or complexities beyond that mandated by the Directive.

**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'?***

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

While we appreciate that this approach may not be perfect, we recommend against an overly complex approach that might result is the group ratio reliefs being effectively unusable for many taxpayers. For example, if a financial undertaking(s) 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 significant deterrent and would, therefore, result in Ireland being a less attractive jurisdiction in which to do business.

**Question 23:** ***Comments are invited on the possible definitions of notional local group (including how consortia and joint ventures should be treated).***

The ability to apply the ATAD measures on a local group basis would be important for aircraft leasing groups which tend to have a significant number of entities in their groups for various commercial reasons, including:

- A requirement of external lenders to hold assets in standalone entities for security and bankruptcy remoteness purposes;
- Facilitation of the sale of the shares in entities rather than assets, avoiding a costly novation of the underlying lease agreement with the airline; and
- Various other operating and risk management reasons, including managing the risk of lessee default and to ring-fence liabilities associated with the aircraft.

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 be subject to corporation tax in Ireland. We also propose that a group basis should be optional rather than mandatory.

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 ILR adjustments (which are allocated to the remaining group members).

**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?***

The interest limitation regime will impact groups differently. Certain groups, such as conglomerates, may operate entities separately and not coordinate with the wider 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.

Rather than restricting taxpayers to the group approach once an election has been made, we suggest that the full flexibility provided for under the ATAD should be implemented by allowing for a choice to elect out of the group approach and return to the single approach in certain circumstances, e.g. future mergers, acquisitions, etc. This would be beneficial for the aircraft leasing industry in particular, where aircraft lessors frequently trade portfolios of aircraft and aircraft owning entities with one another, therefore flexibility is required.

In terms of the operation of the group approach, 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. 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.

**Question 25:** ***Would a mandatory but less complex "group approach" be preferable to an optional "group approach"?***

We do not recommend a mandatory approach is introduced. Further, we note that companies can sometimes have financing and/or security related banking and legal constraints which would not allow them to form a consolidated tax group as is proposed.

Similar to our response at Question 23, in order to ensure that the 'notional local group' concept can be implemented in a practical manner which minimises the additional administrative burden, we suggest allowing the notional Irish group entities to amalgamate / aggregate their individual financial results.

**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?***

Many Irish leasing groups do not prepare consolidated accounts that encompass only those entities that would be contained in a notional local group, therefore a proposal to use consolidated accounts would impose a high compliance burden and additional cost on Irish taxpayers.

We have set out a simple example of the aggregation approach in Example 3 under Appendix III.

**Question 28:** ***How should ILR restrictions be allocated among members of the notional local group?***

We suggest that under the 'notional local group' option there is an <u>option</u> for the interest limitation rules to be applied and administered at the level of the nominated reporting company. Using this approach, groups would have the option to monitor capacity and disallowances/credits at a central level.

Any group interest restrictions or capacity could arise to the reporting entity, which it thereafter allocates to the relevant individual group entities to ensure that an individual company can use its cash to pay any tax arising (so as to not require the reporting party to have a funding requirement for the overall amount payable). The administration of group credits for tax paid could be administrated and allocated in a similar manner.

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

We recommend that further soundings are taken on the operation of the group approach as part of the second consultation on the ILR later this year.

**Question 29:** ***Would the answers to Question 28 be different for mandatory application of the "group approach" versus optional?***

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 and commitments of securitisation vehicles from those of other consolidated accounting group members.

**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?***

We would suggest time apportioning tax-EBITDA and net interest expense/income amounts referable to companies joining and/or leaving the group during the period in addition to adjusting for non-co terminus accounting period ends amongst members of the local group.

**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?***

The general schema of the proposed 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 utilisation 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 credits are frequently restricted in 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.

**Question 32:** ***Comments are invited on any other technical issues that may require consideration.***

We suggest that clarity is provided on how the interest limitation rule will interact with Ireland's updated transfer pricing regime (in particular the quantum of debt concept under the 2017 OECD transfer pricing guidelines) and separately with the leasing ring fence in respect of capital allowances on leased plant and machinery, which includes aircraft.

**Conclusion**

We would welcome an opportunity to discuss the above with you.

In the meantime, if you have any questions or comments, please do not hesitate to contact us.

Yours sincerely

Joe O'Mara

Joe O'Mara
*Partner, Head of Aviation Finance*

## Appendix I

### Proposed simplification of Ireland's corporation tax regime for interest

We have set out below our recommended priorities for the redesign and simplification of the Irish interest regime as applicable for aviation finance companies as part of a legislative process after Finance Bill 2021.

| Redesign of Ireland's corporation tax regime for interest | | |
|---|---|---|
| **Existing measures** | **Change** | **Corporation tax regime for deducting interest expense post-ATAD Implementation** |
| 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 an 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). |
| '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.<br><br>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.<br><br>**Disapply revenue/capital distinction** to permit deduction of borrowing costs even if capital in character.<br><br>**Follow accounts-based recognition** of the expense.<br><br>**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.<br><br>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. |
| 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 | **Remove section** as Interest Limitation rule provides for deferral of deduction of excess expense of | |

| Redesign of Ireland's corporation tax regime for interest | | |
|---|---|---|
| **Existing measures** | **Change** | **Corporation tax regime for deducting interest expense post-ATAD Implementation** |
| borrower (until and if) taxed in hands of connected party lender. | the period. **Preserve relief for previously denied expense,** treat as expense subject to Interest Limitation rule in claim period. | |
| Transfer pricing provisions apply to adjust upward taxable profits to apply an arm's length price to arrangements taxable under Case I including financing arrangements. | Feedback from stakeholders should be obtained to consider aspects of Ireland's future transfer pricing regime which might include clarifying the scope of the domestic transfer pricing exemption | Transfer pricing denies deductions for excessive 'interest expense' and reduces scope of interest expense subject to the Interest Limitation rule or recognises higher 'interest income' within scope of Interest Limitation rule, as appropriate. |

## Priority of application of base erosion protections - interest

**Purpose based tests**

- 'Wholly and exclusively' standard
- Section 817A denies relief if no purpose other than to secure relief

**Targeted measures**

- Bond washing, other provisions, deem bond disposal receipts to be income
- Section 130 distribution treatment – debt with equity characteristics

**Anti-hybrid rules**

- ATAD2 anti-hybrid rule denies deduction/taxes exempt income

**Transfer Pricing Rules**

- Arm's length terms – currently confined to arrangements under Case I
- To evolve in line with OECD guidance on pricing financial transactions

**Interest Limitation Rule**

- Subject to consolidated group ratio relief, denies deduction for interest expense in excess of 30% x EBITDA
- *De minimis* €3million threshold

**GAAR, Section 811C**

- Permits recharacterisation of expense/income
- Generally applied after targeted measures

**General framework**

- 12.5% rate of corporation tax
- 20% withholding tax on yearly interest paid to non-EU, non tax-treaty residents

**Appendix II**

**Definition of Exceeding Borrowing Costs (and Economically Equivalent to Interest Income)**

We have proposed that Revenue and the Department of Finance consider allowing part of the lease rental income earned by lessors carrying on a trade of leasing plant and machinery (including aircraft) to be treated as economically equivalent to interest.

The success of aircraft leasing is ultimately measured by the financing return earned over their funding costs as measured over the life of the aircraft. In this regard, an implicit interest rate is included in the operating lease rentals charged to airlines by aircraft lessors. The implicit interest/finance cost in a lease rental has been recognised by recent changes to the international accounting framework (implemented by IFRS 16) which impact lessees of aircraft and other large assets.

***Meaning of economically equivalent to interest***

As you are aware, ATAD includes a non-exhaustive list of items which should be treated as economically equivalent to interest. Although framed in the context of "borrowing costs", it is useful to consider the discussion of borrowing costs in ATAD1 on the assumption that there should, insofar as possible and where reasonable, be symmetry, such that an expense which is recognised as a "borrowing cost" by the payor should be considered to be an interest income receipt by the payee. However, see our comments below under *Symmetry of treatment of lease payments by lessor and lessee.*

The list of 'borrowing costs' included in ATAD1 refers to "*the finance cost element of finance lease payments*". While ATAD1 does not reference operating lease payments, the list used in ATAD1 is based on a similar list in Chapter 2 of the OECD Action 4 Report from 2015. The OECD's recommendation is that interest limitation measures should apply to (i) interest on all forms of debt; (ii) payments economically equivalent to interest; and (iii) expenses incurred in connection with the raising of finance.

As with ATAD1, the OECD's discussion is framed around the categorisation and classification of deductible payments that should be within scope of an interest limitation rule rather than considering what should be considered as economically equivalent to interest income. However, it is useful as a starting point in discussing the treatment of operating lease income earned by a company engaged in a trade of leasing.

***Finance lease and operating lease***

The OECD's report also references finance leases in its list but goes on to indicate that there are certain types of payments which should not, in general, be subject to a deduction restriction under this regime, including operating lease payments. However, the report goes on to caveat that general classification with the following statement:

> "*However, any payment (including those listed above) may be subject to limitation under the best practice approach where they are used as part of an arrangement which, taken as a whole, give rise to amounts which are economically equivalent to interest*."

It follows that there can be situations where operating lease income might be treated as giving rise to amounts which are economically equivalent to interest income. Furthermore, the examples cited in the Action 4 report refer to short term assets (such as office equipment) from the perspective of the lessee, which as we outline below, can be distinguished from the position of a lessor which leases long-life assets. It seems unlikely that the OCED specifically considered the treatment of lessors which enter leases for long-term assets (such as aircraft) with a view to financing the asset over its life. Indeed, leasing of long-term assets (such as aircraft) is a relatively specialist area which is centred in a small number of global hubs (with Ireland being a key global hub for aircraft leasing and the only such hub in the EU).

***Long life equipment lessors – trade of leasing***

As mentioned above, ATAD makes clear that the financing element of finance lease payments should be treated as economically equivalent to interest. This makes sense as a finance lease is a form of financing and, therefore, similar to the lending of money from an economic return perspective.

Aircraft lessors consider themselves to be carrying on a financing activity irrespective of how they classify their leases. This can be seen from the descriptions which they commonly use in their promotional material, financial statements, and in how members of the industry discuss their profitability (*i.e.* return on investment, net interest margin on their leases, etc.). Were such lease arrangements viewed in their totality over the life of the leased asset, a clear picture would emerge – one which recovers the lessor's investment in the leased asset along with a financing return.

In this respect, the facts and circumstances of the lessor in the context of a single operating lease agreement is not symmetrical with that of the lessee under the operating lease. A single operating lease for the asset is just one of a number of separate lease arrangements entered into by the lessor for the asset over the life of the asset but it is typically the only lease arrangement with the lessor entered into by the lessee for that asset.

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 in the case of finance leases which have not elected to be taxed in accordance with the provisions of section 80A (which specifically deals with the lease of a short-life assets). 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 long term lessors of plant and machinery. This is a pre-existing example of where Irish tax legislation already aims to align the tax treatment of operating lessors and finance lessors.

The accounting treatment of the lease arrangement as an operating lease simply takes a snapshot of the lease in place at that moment in time in respect of the leased asset and does not take into account preceding or later leases entered into by the lessor in respect of that asset.

***Illustrative example***

For example, in the case of a lease of say, an aircraft, a lessor might buy that asset new from an equipment manufacturer and put it on lease to a number of airlines over the full life of the asset. For instance, the first lease might be for 12 years, the second for 6 years, and then a series of short leases running out to the end of the aircraft's useful economic life (at which point it might be sold for scrap value). Each lease could potentially be with different lessees. The individual lease transactions (perhaps barring the last lease) will be treated as operating leases in the financial records of the lessor. However, if one were to take all of those leases together then it is clear that the true economic nature of the lessor's activities in the course of those lease transactions is (in aggregate) one of a financing activity.

For the above reasons, we believe it is appropriate to consider the exception discussed in the OECD report so as to recognise that a lessor of long-life mobile assets (such as aircraft) is engaged in the provision of finance in respect of a leased asset over the assets life which is akin to a finance leasing or banking business. In addition, it is worth noting that banks compete with aircraft lessors to finance aircraft for lessees/airlines over the life of the aircraft. Bank lenders are unlikely to be impacted materially by the new ATAD interest restriction as they are likely to have a net interest income from a P&L perspective.

***Treatment of real estate lessors***

A further distinction should be made between long term lessors of plant and machinery and long-term lessors of real estate. The taxation of real estate is and always has been taxed on a different basis to other forms of leasing activity and, in particular, the tax treatment associated with the letting of real estate assets differs from the leasing of tangible moveable property. For example, real estate lessors are taxed under Schedule D, Case V (with different rules for income and expense recognition for tax) whereas lessors of plant and machinery are typically taxed under Schedule D, Case I. By its nature, real estate is a fundamentally different asset to plant and machinery (e.g. plant and machinery tends to be depreciated over a short timeframe whereas land/real estate is a long-term permanent asset which cannot be moved).

***Symmetry of treatment of lease payments by lessor and lessee***

We note Revenue and Department of Finance's concerns that requiring an Irish lessee to treat part of an operating lease rental payment as an interest expense could be burdensome for certain taxpayers. In our view, the application of symmetry is appropriate when applied to the individual taxpayer concerned and does not necessarily mean that a separate counterparty to the same arrangement would have to be treated in the identical manner. In the case of a lessee which is not itself engaged in a leasing trade; we do not believe there is a requirement to such symmetry of treatment. As outlined above, the extent of the operating lease arrangement between the lessor and lessee from an equipment lessor perspective forms simply part of the totality of lease arrangements entered into by the lessor with respect to that asset over the life of the asset. In contrast, the lessee's operating lease relationship with the lessor is confined to that single lease.

For the lessees, there is not a *financing* arrangement in place under the operating lease with the lessor as they will not ultimately come to own the asset or be entitled to its residual value. Instead, they are *hiring* that equipment for the use in a non-leasing business (e.g. an airline uses the aircraft for its flight operations). This can be contrasted to the position of the lessor who will lease the asset for its full life (subject to the trading discussion above) and, therefore, is essentially providing financing over the equipment asset albeit that the customers who benefit from that financing will be multiple different parties over a period of time.

In the case of cross-border leases (which covers most aircraft leases), it would be for the local authorities in that jurisdiction to determine, for their own purposes, what the treatment should be of the operating lease expense for the lessee. In this regard, we note that certain jurisdictions already apply a taxing concept which requires estimating the finance element of an operating lease for the purposes of applying an interest deduction restriction to lease payments. France has an approach which determines such financing element of operating lease rentals in the context of French rules which limit deductions for financing payments to connected persons. We also understand that several EU countries may seek to include the accounting measure of interest expense arising under IFRS 16 for the lessee in the calculation of net interest expense for local companies when implementing the interest limitation into their local laws. Where this is the case, any restriction on the tax deductibility of the operating lease expense in the lessee jurisdiction (e.g. France) would not result in an offsetting adjustment for the lessor in Ireland unless a portion of the lease rentals received by the Irish lessor is treated as economically equivalent to interest as proposed below.

***Conclusion***

In order to apply equivalent treatment to that part of lease income that is economically equivalent to interest income, we suggest that lessors engaged in a trade of long-life leasing should be given the option to elect to treat as interest income (and as borrowing costs) the finance income component of rental payments. We will be happy to discuss how such an election mechanism might work.

Where the accounting treatment of the lessor does not require this split of its lease rental receipts, we suggest that it might be appropriate to identify the finance income/expense amount by applying similar 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. A simplified mechanical calculation could also be considered (working on the example highlighted in France with some modifications). KPMG Ireland is happy to discuss the mechanics of any such calculation with the Department of Finance and Revenue further, including providing worked practical examples if helpful. In order to mitigate against placing an undue administrative burden on smaller scale lessors which may not be impacted by the interest restriction under ATAD, we would suggest that any bi-furcation of operating lease rentals is optional for a lessor, albeit it should be applied consistently from period to period.

**Appendix III**

**Worked Examples**

**Example 1**

| | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 |
|---|---|---|---|---|---|---|---|---|---|
| Lease rentals | 1,000,000 | 1,000,000 | 1,000,000 | 1,000,000 | 1,000,000 | 1,000,000 | 1,000,000 | 1,000,000 | 0 |
| Operating expenses | (200,000) | (200,000) | (200,000) | (200,000) | (200,000) | (200,000) | (200,000) | (200,000) | 0 |
| **EBITDA** | 800,000 | 800,000 | 800,000 | 800,000 | 800,000 | 800,000 | 800,000 | 800,000 | 0 |
| Capital allowances | (900,000) | (900,000) | (900,000) | (900,000) | (900,000) | (900,000) | (900,000) | (900,000) | |
| Balancing Charge | | | | | | | | | 3,400,000 |
| | (100,000) | (100,000) | (100,000) | (100,000) | (100,000) | (100,000) | (100,000) | (100,000) | 3,400,000 |
| Interest | (400,000) **50%** | (450,000) **56%** | (225,000) **28%** | (225,000) **28%** | (225,000) **28%** | (225,000) **28%** | (225,000) **28%** | (225,000) **28%** | **0%** |
| Taxable profit / (loss) | (500,000) | (550,000) | (325,000) | (325,000) | (325,000) | (325,000) | (325,000) | (325,000) | 3,400,000 |
| *less losses forward* | | | | | | | | | (2,630,000) |
| **Taxable Net Profit** | (500,000) | (550,000) | (325,000) | (325,000) | (325,000) | (325,000) | (325,000) | (325,000) | 770,000 |
| **Tax @ 12.5%** | **0** | **0** | **0** | **0** | **0** | **0** | **0** | **0** | **96,250** |
| **Notional Case IV Tax Charge** | **20,000** | **26,250** | **0** | **0** | **0** | **0** | **0** | **0** | |
| **Less relief for losses in period** | **(20,000)** | **(26,250)** | **0** | **0** | **0** | **0** | **0** | **0** | |
| **Case IV charge** | **0** | | | | | | | | |
| **Less lower of Case IV credit and tax effect of carry forward capacity** | | | | | | | | | **(9,375)** |
| **Total Tax** | | | | | | | | | **86,875** |
| **Irish tax losses** | | | | | | | | | |
| Tax loss carried forward | 0 | (340,000) | (680,000) | (1,005,000) | (1,330,000) | (1,655,000) | (1,980,000) | (2,305,000) | |
| Current year loss | (500,000) | (550,000) | (325,000) | (325,000) | (325,000) | (325,000) | (325,000) | (325,000) | |
| Tax losses offset against Case IV | 160,000 | 210,000 | 0 | 0 | 0 | 0 | 0 | 0 | |
| Losses utilised in the year | 0 | | | | | | | | |
| Closing tax loss | (340,000) | (680,000) | (1,005,000) | (1,330,000) | (1,655,000) | (1,980,000) | (2,305,000) | (2,630,000) | |
| CY Restricted Interest Component | 160,000 | 210,000 | 0 | 0 | 0 | 0 | 0 | 0 | |
| Unused Capacity | 0 | 0 | 15,000 | 30,000 | 45,000 | 60,000 | 75,000 | 90,000 | |
| *Less lapsing capacity (5 years)* | | | | | | | | (15,000) | |
| | 0 | 0 | 15,000 | 30,000 | 45,000 | 60,000 | 75,000 | 75,000 | |
| Tax effect of capacity (@12.5%) | | | 1,875 | 3,750 | 5,625 | 7,500 | 9,375 | 9,375 | |
| **Restricted Tax Credit Carry Forward** | **20,000** | **26,250** | | | | | | | **36,875** |

**Example 2**

| | **2022** | **2023** | **2024** | **2025** | **2026** | **2027** | **2028** | **2029** | **2030** |
|---|---|---|---|---|---|---|---|---|---|
| Lease rentals | 1,000,000 | 1,000,000 | 1,000,000 | 1,000,000 | 1,000,000 | 1,000,000 | 1,000,000 | 1,000,000 | 0 |
| Operating expenses | (200,000) | (200,000) | (200,000) | (200,000) | (200,000) | (200,000) | (200,000) | (200,000) | 0 |
| **EBITDA** | 800,000 | 800,000 | 800,000 | 800,000 | 800,000 | 800,000 | 800,000 | 800,000 | 0 |
| Capital allowances | (900,000) | (900,000) | (900,000) | (900,000) | (900,000) | (900,000) | (900,000) | (900,000) | |
| Balancing Charge | | | | | | | | | 3,400,000 |
| | (100,000) | (100,000) | (100,000) | (100,000) | (100,000) | (100,000) | (100,000) | (100,000) | 3,400,000 |
| Interest | (400,000) **50%** | (450,000) **56%** | (225,000) **28%** | (225,000) **28%** | (225,000) **28%** | (225,000) **28%** | (225,000) **28%** | (225,000) **28%** | **0%** |
| Taxable profit / (loss) | (500,000) | (550,000) | (325,000) | (325,000) | (325,000) | (325,000) | (325,000) | (325,000) | 3,400,000 |
| *less losses forward* | | | | | | | | | (3,000,000) |
| **Taxable Net Profit** | (500,000) | (550,000) | (325,000) | (325,000) | (325,000) | (325,000) | (325,000) | (325,000) | 400,000 |
| **Tax @ 12.5%** | **0** | **0** | **0** | **0** | **0** | **0** | **0** | **0** | **50,000** |
| ATAD Interest Restriction | | | | | | | | | 370,000 |
| *Less current year capacity* | | | | | | | | | 0 |
| *Less carried forward capacity* | | | | | | | | | (75,000) |
| | | | | | | | | | 295,000 |
| **Notional Case IV Tax Charge** | **0** | **0** | **0** | **0** | **0** | **0** | **0** | **0** | **36,875** |
| **Total Tax** | | | | | | | | | **86,875** |
| Loss Carry Forward | (500,000) | (1,050,000) | (1,375,000) | (1,700,000) | (2,025,000) | (2,350,000) | (2,675,000) | (3,000,000) | |
| Restricted Interest Component | 160,000 | 370,000 | 370,000 | 370,000 | 370,000 | 370,000 | 370,000 | 370,000 | |
| Unused Capacity | 0 | 0 | 15,000 | 30,000 | 45,000 | 60,000 | 75,000 | 90,000 | |
| *Less lapsing capacity (5 years)* | | | | | | | | (15,000) | |
| | 0 | 0 | 15,000 | 30,000 | 45,000 | 60,000 | 75,000 | 75,000 | |
| **Restricted Tax Credit Carry Forward** | | | | | | | | | **36,875** |

**Reconciliation**

| | |
|---|---|
| Total Group EBITDA | 6,400,000 |
| Total group interest expense | (2,200,000) |
| % of EBITDA | 34% |
| Expected restriction (under a "deduction" method) | (280,000) |
| Tax effect of expected restriction | (35,000) |
| "Lost" interest capacity | (15,000) |
| Tax effect of "lost" capacity | (1,875) |
| Total tax due | (36,875) |

**Example 3**

| | Company 1 | | Company 2 | | Company 3 | | Company 4 | | Aggregated Irish group |
|---|---|---|---|---|---|---|---|---|---|
| Lease rentals | 3,000,000 | | 4,000,000 | | 2,500,000 | | 1,000,000 | | 10,500,000 |
| Operating expenses | (200,000) | | (200,000) | | (200,000) | | (200,000) | | (800,000) |
| **EBITDA** | **2,800,000** | | **3,800,000** | | **2,300,000** | | **800,000** | | **9,700,000** |
| Capital allowances | (900,000) | | (900,000) | | (900,000) | | (900,000) | | (3,600,000) |
| Balancing Charge | | | | | | | | | 0 |
| | 1,900,000 | | 2,900,000 | | 1,400,000 | | (100,000) | | 6,100,000 |
| Interest | (2,000,000) | **71%** | (950,000) | **25%** | (1,050,000) | **46%** | (225,000) | **28%** | (4,224,999) |
| Taxable profit / (loss) | (100,000) | | 1,950,000 | | 350,000 | | (325,000) | | 1,875,000 |
| *less losses forward* | | | | | | | | | 0 |
| **Taxable Net Profit** | (100,000) | | 1,950,000 | | 350,000 | | (325,000) | | 1,875,000 |
| **Equity %** | 30% | | 25% | | 18% | | 30% | | 26% |
| Exceeding borrowing costs | 1,160,000 | | 0 | | 360,000 | | 0 | | 1,520,000 |
| Unused Capacity | 0 | | (190,000) | | 0 | | (15,000) | | (205,000) |
| **Net group exceeding borrowing cost** | | | | | | | | | **1,315,000** |

**Summary:**

| | |
|---|---|
| Group EBITDA | 9,700,000 |
| Group interest expense | (4,224,999) |
| % of EBITDA | 44% |
| 30% of EBITDA threshold | 2,910,000 |
| Exceeding borrowing cost | 1,315,000 |