# Aircraft Leasing Ireland

## ATAD Implementation
## Article 4 Interest Limitation
## Feedback Statement
## December 2020

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

8 March 2021

**ATAD Implementation Article 4 Interest Limitation Feedback Statement December 2020**

Dear Sir / Madam

As representatives of the aircraft leasing industry, we welcome the opportunity to respond to the public consultation by the Department of Finance on the implementation of Article 4 Interest Limitation under the EU Anti-Tax Avoidance Directive ("ATAD").

Aircraft Leasing Ireland (ALI) was launched in July 2018 as Ireland's first representative body for the aircraft leasing industry. Comprising 32 members, ALI's primary objectives are to maintain and develop Ireland's position as the leading global centre for aircraft leasing and to be the central representative voice on behalf of the industry; this includes to co-ordinate relevant stakeholder input in formulating industry positions.

The aircraft leasing industry supports approximately 5,000 jobs across the island of Ireland and accounts for a contribution of more than €500m to the local economy[1]. Aircraft leasing has been a growing industry and despite the challenges presented by Covid-19 to air travel in 2020 and 2021, aircraft leasing presents an opportunity to tackle challenges facing the airline industry, including on sustainability issues.

As a constituent part of Ireland's international financial services (IFS) industry, aircraft leasing is unique in having most global decision-makers based here, managing over 60% of the world's leased fleet. In this context, we believe it is important that Ireland continues to maintain the highest standards in international taxation through the implementation of measures agreed under the OECD Base Erosion and Profit Shifting (BEPS) project and ATAD, while at the same time retaining an attractive and internationally competitive taxation environment.

We hope that the points outlined below will be of assistance. Please feel free to contact us if you would like us to elaborate on or clarify any of the issues raised.

Yours faithfully,

Declan Kelly

ALI Chairman

[1] Source: PwC 'Taking Flight' report January 2018

## Introduction

In this submission, we have sought to share our thinking on how the new Interest Limitation Regime (ILR) could be implemented in Ireland and provide some specific feedback on the questions set out in the December 2020 Feedback Statement.

While the membership of ALI is comprised of leasing groups who differ greatly in terms of size and ownership structure, there are some unique features of a leasing sector which will need to be taken into consideration when drafting these new laws.

- Typically, leasing groups tend to have a significant number of subsidiaries (upwards to 400 companies would not be uncommon). It is normally a requirement of external lenders and financiers to hold assets in ring-fenced entities for security and bankruptcy remoteness purposes. In other cases, it is necessary to ring-fence the commercial or credit risk associated with certain customers. For these reasons, high numbers of group companies are a fundamental feature of the aircraft leasing business.
- Aircraft leasing is a capital-intensive industry which is capable of borrowing high levels of debt to finance its operations. Similar to large infrastructure projects, these high levels of debt are justified by the relatively predictable cashflows generated by the aircraft and the security which lenders can take over the asset. Due to these high debt levels, the limitation on the deductibility of interest to 30% of EBITDA will disproportionately impact a significant number of aircraft leasing companies. In effect, interest expenses are a core operating overhead for aircraft leasing companies.
- Incrementally, COVID-19 has had a very significant impact on the aviation finance sector, and aircraft leasing companies in particular. COVID-19 has resulted in an unprecedented restriction in air travel that has greatly restricted the income of airlines (the customers of aircraft leasing companies) and in turn has put material pressure on the ability of airlines to pay lease rentals to lessors. Several airlines have been pushed to bankruptcy by COVID-19, and depending on the level of air travel allowed in Summer 2021, there is a risk that more could follow. To this end, the International Air Transport Association (IATA) estimated that global passenger traffic will not return to pre-COVID-19 levels until 2024. This depression in passenger numbers, reduced number of global airlines and robust aircraft manufacturing pipeline with manufacturers mean that aircraft lessors will have a surplus of aircraft capacity compared with passenger demand. This capacity will press adversely on lease rental rates and reduce earnings, meaning that fixed interest costs will constitute a higher percentage of EBITDA. In this context, the ILR could have a disproportionate impact on aircraft lessors compared to other sources of aviation finance.
- An important point from an Irish tax perspective is that leased aircraft are eligible for capital allowances. In this context, the tax profile of leasing companies is that they tend to make current tax losses in the early years (lessors build up a deferred tax liability and typically pay corporation tax on their cumulative accounting profits as capital allowances expire). This tax depreciation means that aircraft leasing companies often do not get the full benefit of interest deductions until the latter years of aircraft ownership.

Hence, we have two overarching suggestions:

(1) That the regime will be as simple as possible to implement, bearing in mind the large number of companies in aircraft leasing groups. Irrespective of what grouping regime is introduced, any ILR calculation will be required to be computed at an entity level (for accounting purposes if not for tax purposes), and therefore, we would suggest that the "grouping" methodology adopted would not result in additional computations and calculations needing to be performed.

(2) Where possible, the regime should contain as much optionality and flexibility as is allowed by ATAD to minimise the impact on all Irish taxpayers, particularly given the comprehensive rules in Ireland which already protect against base erosion using interest (see below).

We note and we share the view of the Department of Finance that Ireland has existing strong targeted rules governing interest which already afford equivalent protection to the interest measure in ATAD. Added to these existing provisions, Ireland has adopted OECD compliant transfer pricing rules (including the 2020 OECD Financial Transactions Paper) for transfer pricing which should further reduce any possible risk of eroding the tax base. On the assumption that these rules take priority to the proposed ATAD ILR rules, we would suggest that introducing the most flexibility in Irish tax law does not automatically require significant anti-avoidance legislation – at its simplest if there is no base erosion, introducing complex rules to cover all possible scenarios should not be required, thus avoiding additional complexity and costs for Irish tax payers in an already difficult and tax complex environment. There are also inherent challenges with incorporating the ATAD into Irish tax law given Ireland's multiple corporate tax rates and our separate tax filing system (whereas many EU countries have a consolidated tax filing system). It would therefore seem reasonable that Ireland would introduce ATAD in a flexible manner whilst still satisfying the overall objective of preventing base erosion.

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

## Outline of Submission

Our submission is divided into 6 key sections:

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| Part A: | Steps 1-7 of the ILR Calculation |
| Part B: | ATAD Exemptions |
| Part C: | Group Ratios |
| Part D: | Group - Definition & Methodology |
| Part E: | Interaction between Group Ratios & Definition of Local Group |
| Part F: | Other Comments |
| Appendix I: | Definition of Exceeding Borrowing Costs (and Economically Equivalent to Interest Income) |
| | Examples of Implicit Interest Return in Lease Income (i) and (ii) |
| Appendix II: | Example – Case IV Calculations in a Loss-Making Company and Lost Interest Capacity |

## Part A: Steps 1-7 of the ILR calculation

From ALI's perspective, the two key concerns arising from the proposed methodology are:

- The ILR rules should be drafted to take into consideration that taxpayers can be tax loss making in a year (whether these losses are driven by tax depreciation or simply by economic losses). Similarly, there may be tax losses in the wider group which would ordinarily be available to share via the group relief mechanism. Where a company is making losses that are not driven by an 'excessive' interest deduction, then no cash tax should arise until the year the 'excessive interest' deduction would effectively be used. We include below some suggestions regarding how this might work. We have also included some specific considerations regarding the leasing ring-fence.
- The definition of 'interest equivalent' should incorporate a measure of the interest return inherent in operating lease rentals.

We set out our thoughts on the Feedback Statement questions below and some suggestions as to how our concerns could be addressed. Our comments below are made on the basis that the Feedback Statement is framed in the context of a single entity approach. The comments below may need to be updated when clarity is available on the implementation of the local group approach.

| **Question** | **Requirement** | **Rationale** | **ATAD Compliant** |
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| Q 3 | We would suggest some amendments to steps 1-7 to address loss making companies.<br><br>In due course, amendments will also be required to take account of the local group approach and the application of the group ratio reliefs (discussed further below). | To ensure the ILR rules and the proposed Case IV approach work equitably, particularly for companies (or groups) which have tax losses before deducting excess interest. | Yes |
| Q 4 | Definition of interest equivalent includes 'any amount economically equivalent to interest'. There are two key points to consider in the legislation:<br><br>(i) In our view, 'any amount economically equivalent to interest' would include the | Please see A.2 below.<br><br>We have also set out our more detailed comments as to the implicit interest arising in operating lease rentals in Appendix I along with some sample calculations. | Yes – see commentary on OECD Action 4 Paper in Appendix I. |

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| | implicit interest element of aircraft operating lease payments. We believe that this can be shown as compliant with the OECD Action 4 Paper.<br><br>(ii) It is important that taxpayers have legal certainty as to the scope of this definition. Reliance on subsequent guidance alone could give rise to some uncertainty. | | |
| Q 5 | 'Relevant Profits' should be defined as tax adjusted profits.<br><br>'Relevant entity' should be defined as either (i) a company or (ii) a local group. | | Yes |
| Q 8 | The Feedback Statement is clear that the ILR is designed to be a deferral of deductibility. It is important, particularly for aircraft leasing, 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 losses position. Such a cash tax charge would impose a potentially material cash flow impact on aircraft leasing businesses 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.<br><br>See A.1 below. | To ensure the ILR rules and the proposed Case IV approach work equitably, particularly for loss making entities. | Yes – the suggested changes are designed to ensure that the Case IV mechanic does not give rise to unintended consequences |

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| Q 10 | In order to mitigate the impact of the 5-year limit on 'excess interest capacity' carry forward having an inequitable impact where the company in question is in a tax loss-making position in its early years, we suggest 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 exceeds the entity's restricted interest credit. | Excess interest capacity can only be carried forward 5 years – which is in line with the ATAD. However, the tax credit / Case IV mechanism may result in entities, such as leasing companies, that may be in a tax loss-making position to lose this carry forward capacity before it is utilised. This position would not have arisen if a deduction restriction mechanism (rather than a credit mechanism) had been utilised.<br><br>See A.3 below.<br><br>See Example in Appendix II. | Yes – this anomaly is inadvertently caused by the methodology being adopted in Ireland and solutions to address this should absolutely be in accordance with the intent of ATAD. |

## A.1 How calculations might work for a loss-making company

It is important for aircraft leasing, which will typically be in a tax loss position in the initial years due to the availability of capital allowances on purchased aircraft, that the proposed Case IV charging approach proposed in the Feedback Statement does not inadvertently accelerate a charge to cash tax under Case IV notwithstanding that the company is in a Case I tax loss position (before any deduction for restricted interest). 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 have outlined some suggestions below:

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). This assumes that all other amounts and reliefs, including capital allowances, are deductible in priority to interest. 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 (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. As noted below, similar provision will need to be made to carry forward unutilised interest capacity in a way that does not unduly impact loss-making companies.

We have illustrated this approach in the Example in Appendix II.

In addition, the provision should be amended to allow tax losses 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 to utilise ring-fenced 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".

### A.2 Definition of interest equivalent

We refer to our more detailed comments in Appendix I and illustrative examples of the interest component of fixed and floating rate leases below. In summary however, the following key points should be noted from an aircraft leasing perspective:

- We have proposed that Ireland 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. This reflects the inherent financing return earned by trading lessors and is consistent with the evolution of accounting standards (e.g. IFRS 16). Indeed, the aircraft lease rentals charged by aircraft lessors are directly linked to the interest expense payable by the lessor. Often, the lease rentals will be floating (i.e. the operating lease rentals will increase/decrease in line with prevailing interest rates) in order to ensure a consistent financing margin for a lessor. Where an aircraft lessor receives a fixed (rather than floating) operating lease rent, a lessor will generally seek to ensure its interest expense is also fixed.
- 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, the report recognises that there can be circumstances where it is reasonable to recognise 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, give rise to amounts which are economically equivalent to interest*."

- 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 in Appendix I, 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).

- In this respect, we would suggest the following:
    - 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 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.

### A.3 Trapped 'interest capacity' can be lost

Excess capacity can only be carried forward for 5 years under Option C of ATAD. If the loss is not utilised within five years, this excess capacity will be lost. We have illustrated this approach in Appendix II.

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 5-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 5-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 the example in Appendix II, it can be seen that the 5-year clock starts in 2024, 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 5-year clock instead commenced in 2030 in the example contained in Appendix II.

## Part B: ATAD Exemptions

On the basis that Ireland's position is that its existing domestic interest limitation rules are equally effective to those set out in ATAD, in the context of layering the proposed rules over the existing interest limitation rules, we view the proposed adoption of the various exemptions permitted by ATAD as a positive action. We note also that a significant number of EU countries have also implemented similar exemptions under ATAD.

From ALI's perspective, our main concern with the implementation of the various ATAD exemptions is in connection with the exemption for legacy debt. We set out our related thoughts on the Feedback Statement questions below and our views on how our concerns could be addressed. We do separately encourage the introduction of an exemption for public infrastructure debt and have included some commentary on this matter below.

| Question | Requirement | Rationale | ATAD Compliant |
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| Q 15 | Guidance required on what constitutes modifications – to specify that only modifications that impact on the amount of interest/interest equivalent that would be payable are captured (excluding amendments for LIBOR, and excluding any additional amounts which arise as a result of an <u>existing term</u> in the documentation as at 17 June 2016).<br><br>See B.1 below. | Ensuring that technical adjustments which may be required to loans, some of which are prevalent in the aviation industry, are not unduly affected by the ILR. | Yes |
| | Post 17 June 2016 drawdowns on facility agreements in place prior to 17 June 2016 not to have any negative impact on legacy debt treatment.<br><br>See B.2 below. | Ensuring that facility agreements, although not fully exercised at 17 June 2016, are not unduly affected by the ILR. | ATAD silent on 'facilities', but other EU countries have adopted this position (Luxembourg most recently). |

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| | Confirmation that definition of security (with regard to legacy debt) does not exclude secured loans. We understand this is not the intention but it would be useful to clarify.<br><br>See B.3 below. | Secured loans are widely used in the leasing industry and we are seeking clarity on the language in section 135(8). | Yes |
| Q 16 | Ensuring that long-term infrastructure definition is wide enough to include aircraft and aircraft engines, to the extent they satisfy the exemption.<br><br>See B.4 below. | The aviation industry is a significant contributor to the economy and no doubt will play a large part in the recovery of the economy post-COVID-19. It would be therefore beneficial that Irish based leasing companies be in a position to avail of this exemption in respect of aircraft (and engines) where they can satisfy the conditions. | Yes |

### B.1 Confirmation on technical modifications on pre-existing loans

We are fully supportive of the inclusion of an exemption for legacy debt entered into prior to 17 June 2016 to ensure the new legislation is not applied retrospectively. We commend the intended approach which we understand is to focus only on an increase in the "interest equivalent" on "legacy debt" but also encourage the provision of as much certainty as possible to taxpayers. As such, we recommend that guidance is provided in the Tax and Duties Manual on the meaning of "modification".

The approach to the application of the exemption included in the Feedback Statement appears to work such that any amendments to legacy debt will only result in a limitation on the "interest equivalent in respect of legacy debt" to the extent that they increase the interest payable on such legacy debt. We welcome this approach as it should enable an array of technical amendments to be made to legacy debt without unduly triggering some form of restriction. However, for clarity, we set out below some common amendments which, even if such were to result in an increase in the interest payable on legacy debt, we would view as not constituting a modification;

1. The mere drawdown of debt pursuant to a loan facility or commitment entered into before 17 June 2016 (see also below B.2),

2. An interest rate change applied to an existing loan <u>within the existing terms of the loan</u> such as swapping from floating to fixed interest rates, or an increase due to the decline in credit rating of a borrower due to the current crisis,
3. Loan amendments where banks have specific collateral against particular aircraft for:
    a. replacement aircraft if a delivery is delayed,
    b. changes to the underlying leases that also need to be reflected in the loan documents, or
    c. if substituting an aircraft out of the facility if the airline goes bankrupt before or during the period of the loan.
4. Exercising permitted flexibility within the loan facility e.g. banks often have the right to syndicate their share of the loan. This requires borrower consent and a loan amendment to facilitate syndication between the banks or the introduction of a new lender.
5. Updating loan agreements for changes in law.
6. Dealing with specific issues relating to Covid-19, such as technical covenant amendments etc.

It is unlikely that the technical amendments referenced in items 3 to 6 above would result in an increase in the interest payable on legacy debt in any case. However, items 1 and 2 may well result in interest in excess of that which would have arisen if the changes had not been made, hence, if such amendments are regarded as a modification, a limitation may apply to the application of the legacy debt exemption. Guidance in the Tax and Duties Manual on this area will be important to ensure that there is clarity for taxpayers in the application of these legacy debt provisions.

To the extent this guidance requires a further definition of "modification", we would recommend that modification is defined as it is in the ATAD preamble, i.e. "*any increase in the amount or duration of the loan other than in accordance with the original terms*", . This should also be accompanied by clear indication that the new interest limitation rules would only apply to any interest resulting from the modification - the current reference to "interest equivalent in respect of legacy debt" is helpful in this regard.

## B.2 Drawdowns on facility agreements

As alluded to above, our view is that the amount of interest equivalent on any drawdown of debt pursuant to a loan facility or commitment entered into before 17 June 2016 should also be considered interest equivalent in respect of legacy debt regardless of the date of drawdown.

It is common in the aircraft leasing industry for facilities to be in place, with both group and third-party lenders, for extended periods of time. Given the nature of the industry and on-streaming of assets, the terms of the loan can be agreed in advance, with the actual drawdown delayed until such a time as commercially appropriate. This delay will invariably be market dependent. The terms of the facility can often remain unaltered in that time, with the only variable being the amount drawn down on the facility (up to the amount agreed within the facility).

We would ask that aircraft lessors who have such facilities in place prior to 17 June 2016 are able to avail of the legacy debt exemption in full for all interest equivalent arising on the debt up to the loan facility or commitment principal amount agreed prior to 17 June 2016. Other EU countries, most recently Luxembourg, have indicated that they intend to follow this approach with the interest equivalent on funds drawn down under a credit arrangement agreed prior to 17 June 2016, in accordance with the terms and conditions of such agreement and, in particular, up to the credit limit provided for therein prior to 17 June 2016, being grandfathered.

### B.3 Definition of legacy debt as a security within Section 135(8)

Legacy debt is defined as "a security, within the meaning of *section 135(8)*...". We understand that this is intended to be the widest possible definition of security for Irish tax purposes, however, we believe that trying to define the term debt is an unnecessary exercise that may overcomplicate this rule for taxpayers. We note that debt is not defined for the purposes of section 541 and would suggest following this precedent.

Section 135(8) defines security as including "securities not creating or evidencing a charge on assets…" and we note that existing Revenue guidance on this sub-section indicates that the intention of this definition is to ensure that any loan capital (whether secured or not) is capable of being considered a security. As you may be aware, secured debt is a reasonably common feature in the aircraft leasing industry where debt is secured on underlying aircraft or shares in a company which owns aircraft. Given the wording in section 135(8), we wish to ensure that such debt would not be precluded from being considered "legacy debt" simply by virtue of the underlying security arrangement. For the avoidance of doubt, we would recommend that this issue be dealt with directly in the legislation or at a minimum in Revenue guidance on this topic.

### B.4 Long term infrastructure projects

We welcome the inclusion of a long-term infrastructure exemption within the proposed Irish interest limitation rules.

ATAD Article 4 defines long-term public infrastructure to mean "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". The definition references a "long term", "large-scale asset" that is considered in the "general public interest". In our view, aircraft fit squarely within the definition given by ATAD in that they are; (i) long term (an aircraft's useful life is in excess of 25 years), (ii) large-scale (can cost well over €100m in some cases) and (iii) for general public interest (people need to, and should travel, by aircraft, for work and leisure and indeed, aviation will likely be key to the restart and recovery of most EU member state economies post COVID-19).

A number of other EU member states have included this exemption within their interest limitation rules, but broadly speaking, they have not specifically mentioned the assets that qualify, rather allowing governments to determine what long-term infrastructure means for each of them and presumably this also allows for changes to infrastructure requirements over time. The transposition of a broad definition into their rules is positive and in the absence of an explicit exclusion for transportation assets (e.g. rolling stock, aircraft etc.) from those rules, the implication is that an open dialogue / guidance can be provided in due course on whether and then, what transportation assets can be included within the scope of the exemption. We would ask that Ireland adopt a similar approach, adopting a broad definition of long-term infrastructure, and allowing further clarity to be set out in guidance.

Ultimately, long term infrastructure projects can be all manner of projects, ranging from roads, hospitals, bridges, wind farms, modes of transport such as aircraft and rolling stock and everything in between. It is impossible to be exhaustive. In addition, what is not technically considered public infrastructure now may well be considered public infrastructure in years to come. As such, we believe that the definition of public infrastructure should be broad and be as flexible as possible as it will likely evolve over time. We also believe that there should be no requirement for the infrastructure to be State-owned or operated. This requirement is not included within ATAD and is illustrative of the fact that the private sector can generate and produce public infrastructure.

## Part C: Group Ratios

From ALI's perspective, in order to make the 'group ratios' available and workable for Irish taxpayers, the following is relevant:

- Most Irish leasing groups do **not** prepare consolidated accounts consisting solely of the Irish group members. Therefore, the calculations for the group ratios will need to take this into consideration.
- Group consolidated accounts for leasing groups are typically prepared under accounting standards other than IFRS and Irish GAAP.
- Our key ask is to permit maximum flexibility (i.e. taxpayers have access to both ratios) and simplicity (specifically that all numbers needed for these tests would be readily available from either the single entity or the group consolidated financial statements).

We have set out our thoughts on the Feedback Statement questions below and some suggestions as to how our concerns could be addressed.

| Question | Key requirements | Rationale | Compliance with ATAD |
|---|---|---|---|
| Q 13 | Taxpayers have access to GAAPs other than IFRS and Irish GAAP to calculate the group ratios.<br><br>See C.1 below. | Group consolidated accounts for leasing groups are typically prepared under accounting standards other than IFRS and Irish GAAP and requiring a restatement of same to avail of group ratio escapes would likely result in a level of discrimination and mean the group ratios would not be available to this category of taxpayer whereas other peer companies whose consolidated accounts are prepared under Irish GAAP/IFRS would benefit. | Yes, Article 4(8). |
| Q 18 | Access to both ratios will be required. Each 'relevant taxpayer' should have a choice as to which ratio it might apply. | ALI has surveyed its members on this point. Due to different group profiles and wider global group structures, there is no clear consensus on which group ratio rule is preferred (each rule is | Yes. Recital 7 and Paragraph 5 of ATAD indicates that both can be allowed. |

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| | See C.2 below. | applicable for only c. 50% of ALI members). It is impossible to choose a preferred ratio and ATAD clearly permits the selection of both. The taxpayer should be allowed the maximum amount of flexibility. | Note that while we understand that some but not all EU member states have implemented both, that would not appear to be a determining factor in providing additional optionality to Irish taxpayers. |
| Q 20 | Group EBIDTA should be based on accounting numbers <u>not</u> tax-adjusted values.<br><br>See C.3 below. | For any large global groups, it is impossible to recalculate these EBITDA and interest costs according to tax principles (either using Irish tax principles or applying the rules across multiple jurisdictions). In practice, a tax EBITDA would make the relief totally unusable. | Yes, and also supported by Commentary in OECD BEPS Action 4. The use of accounting numbers has been adopted in other EU countries. |
| Q 21 | Allow any interest booked to the consolidated accounts and disclosed as external debt for the worldwide group to constitute third party borrowings.<br><br>See C.4 below. | In our view, anything that is classed as external debt in the consolidated accounts should be classed as third-party borrowings. It is important that the group ratios operate as efficiently as possible and do not give rise to significant administration for taxpayers (particularly those who may be subsidiaries to wider multinational groups that may not have the ability to interrogate balances and payments in the wider corporate group outside Ireland). Using the interest costs booked to the consolidated group accounts maximises the viability of the reliefs and eases taxpayer | |

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| | | administration. | |
| Q 32 | As 'Irish local group' consolidated accounts will typically not exist, the calculation for the Equity Ratio Rule should be capable of being done using an 'aggregation approach' based on all the single entity financial statements in the Irish "taxpayer" group. | It would be inequitable if the choice of ratio rules were not available to all Irish taxpayers. | Detail not dealt with in ATAD, but we assume that the intention of the EU was that these ratios could be available to all taxpayers. |

## C.1 Alternative GAAPs

It will be important to provide flexibility to the taxpayer with regard to the use of appropriate GAAP in calculating the group ratios considering the international nature of many aviation finance groups which operate in Ireland.

At a practical level, to require any business that is not using IFRS or Irish GAAP for example, to restate financial consolidated numbers at a group level into IFRS/Irish GAAP to avail of a group escape clause will be either extremely time consuming, costly or in some cases, practically not feasible given the size and diversity of operations within some groups. Given the international nature of the industry in Ireland in terms of ultimate ownership and thus, the potential variety of accounting GAAPs being used for financial consolidation purposes, we encourage flexibility being granted to use a taxpayer's existing financial accounting GAAP. This should also ensure that peer companies are placed on an equal footing.

We understand that (in line with the list in OECD's Report on the Pillar Two Blueprint[2]), current thinking is that the national GAAPs of Canada, China, Japan, India, Korea and the USA should also be accepted for the calculation of group ratios. We view this as being very helpful as any limiting of appropriate GAAPS to IFRS and Irish GAAP could exclude many of our members as it would mean that in practical terms, the potential benefit of group ratios might not be accessible to many of them.

## C.2 Preference for one of the two potential group ratios

As mentioned in our previous submission, ALI cannot put forward a recommendation for the use of one particular group ratio over another in the context of its members as the application of these group ratios are dependent on the facts within particular leasing groups. We believe the same is likely to

[2] https://www.oecd.org/tax/beps/tax-challenges-arising-from-digitalisation-report-on-pillar-two-blueprint.pdf, Page 57, para 171

hold true across most industries and therefore, across most taxpayers.

Taking the current climate alone, the impact of COVID-19 is going to deliver huge volatility in the earnings and interest costs of our members and an escape based on earnings could make it difficult to forecast the impact and cost of lending over an extended period. Asset values in this industry are also likely to be less stable for certain asset types which may mean that the asset escape may not be applicable or easy to forecast for certain lessors, in particular those lessors which form part of large diversified groups which hold various businesses/assets classes (not least in the context of the current COVID-19 environment where there may be significant fluctuations in asset values or large asset impairments).

Given ATAD (and its recitals) explicitly provides for optionality[3] to be provided to taxpayers, and given the detailed anti-abuse provisions that Ireland believes its existing rules incorporate, we would strongly recommend that Ireland provide that flexibility to taxpayers and allow a taxpayer to determine what approach it should follow. Overall, it is positive that consideration is being given to providing for both "group ratios" and allowing the choice of ratio to be at the discretion of the taxpayer.

A number of EU member states have already allowed this choice and while there are some who have not, or indeed, have not introduced any group ratio at all, this is likely to be the case because they had existing thin capitalisation rules or broad existing consolidated tax reporting in their domestic legislation already and had no need to introduce a further rule such as this. In contrast, Ireland does not have a consolidated tax reporting concept, and the proposed fixed ratio rule will be an additional burden which warrants availing where possible of the flexibility permitted within ATAD.

If the earnings based Group Escape is applied, it would seem reasonable that the ILR should not apply where the overall consolidated group has net interest income in order to ensure consistency between the application of the fixed ratio to the local Irish group and also the application on the consolidated reliefs.

## C.3 Calculation of group ratio rule using EBITDA - tax or accounting concept

We understand there are two different concepts at play here.

Firstly, in determining the fixed ratio rule, it is clear from Article 4(2) and Recital 6 that the measure of EBITDA should be a tax based EBITDA (i.e. excluding exempt income) as we are considering the impact of an interest expense restriction in the context of calculating taxable income.

Subsequently, in considering the impact of the paragraph 5 options for reducing the level of interest expense restriction, there are two further references to EBITDA. In our view, the reference at Article (4)(5)(b)(i) is to an accounting EBITDA and not a tax EBITDA. This distinction is supported by the commentary in 2015 and 2016 from the OECD on their BEPS Action 4 which clearly states that when calculating group EBITDA, *"it should be calculated using figures which are readily available from a*

[3] The language in paragraph 5 of ATAD states : "*Where the taxpayer is a member of a consolidated group for financial accounting purposes, the taxpayer may be given the right to either:..*" This differs from the language in paragraph 6 *"The Member State of the taxpayer may provide for rules either..:"*

*group's consolidated financial statements"* and as a starting point, should be profit before tax plus net third party interest expense, depreciation and amortisation (including impairment charges)[4]. The latter part of Article (4)(5)(b)(ii) brings back the concept of tax EBITDA, so again, it seems clear that the EU also intended the group EBITDA to be an accounting-based concept.

As a practical matter, for many groups, it would not be possible to calculate tax adjusted EBITDA's per entity (using Irish tax principles) and then aggregate them. ATAD allows safe harbours in the form of two worldwide group ratios – in our view, it cannot be consistent with EU ATAD policy and intent to introduce safe harbours that are unworkable in practice. In addition, the UK Corporate Interest Regime ("CIR") regime uses consolidated accounting numbers for its group earnings ratio. This approach has also been followed by other member states which have implemented this ratio for the purposes of ATAD.

We accept that this means that there is an inconsistency between the fixed ratio rules which are based on a Tax EBITDA and this particular group ratio rule which should in our view be based on an accounting EBITDA. We believe that it would not be practical or indeed, feasible in a large consolidated group as mentioned to determine the tax EBITDA for a group for this purpose and accordingly, this inconsistency may need to be adopted.

### C.4 Definition of 'borrowings' for the group ratio rule

In the context of Question 21 and what third party borrowings should capture, we recommend, that in line with the approach to determining Group EBITDA in this context, that a taxpayer be permitted to follow the consolidated accounts for the purpose of determining the group interest position. As these rules are not Ireland's primary defence against BEPS (as we have very complex targeted rules), we encourage simplicity and as such following the consolidated accounts to the greatest extent possible for items such as third-party borrowings. In our view, anything that is classed as external debt in the consolidated accounts should be classed as external borrowings. Any concern about associate enterprises should be dealt with by our existing interest deductibility specific anti-avoidance rules.

[4] Paragraph 141 and 142, OECD/G20 Base Erosion and Profit Shifting Project, Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4: 2015 Final Report

*141. EBITDA is an objective measure of economic activity in a group, which can be applied to groups operating in most sectors (with the exception of the banking and insurance sectors, which are considered in Chapter 10). EBITDA is not generally included on the face of a group's consolidated income statement, but for the purposes of applying a group ratio rule, it should be calculated using figures which are readily available from a group's consolidated financial statements.*

*142. Within a best practice, as a starting point group EBITDA should be profit before tax plus net third party interest expense, depreciation and amortisation (including impairment charges). To avoid double counting, where net third party interest expense has been adjusted to include capitalised interest (or the amortisation of capitalised interest), depreciation and amortisation should be adjusted to strip out any amounts that represent the amortisation of interest included in the value of capitalised assets. Further work will be conducted to refine the definition of group EBITDA, including for example whether or not it should exclude items such as dividend income (and whether this should be dependent on if the dividends would be taxable if received in the country applying the rule), other finance income and expense not included in net third party interest expense, one-off items resulting from restructurings and mergers, and the share of profit from associates and joint venture entities which are included in the consolidated financial accounts under equity accounting but are not part of the group for group ratio rule purposes.*

# Part D: Group – Definition & Methodology

As outlined in our original submission, the ability to apply the ATAD measures on a local group basis is particularly important for aircraft leasing groups which tend to have a significant number of entities in their groups for various reasons, including:

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

From ALI's perspective, the key requirement for the grouping methodology is simplicity – as it needs to be workable for a group who may have upwards of 400 subsidiaries.

## D.1 Proposed construct of a notional local group

In light of our discussions and historic correspondence, we have attempted to outline our construct for the notional local group approach and note that the comments below address some but not all the questions that have been raised in the Feedback Statement.

We welcome further engagement with the Department in the coming months as this part of the Feedback Statement is evolved in greater detail and in particular when the proposed revisions to the Case IV approach are clarified (Question 28(iv)).

From an ALI perspective, the following is relevant:

- A 'grouping' concept is needed to enable 'tax attributes' to be shared between members of the group and a 'group reporting' mechanism does offer some administrative benefits. However, it is critical that any 'membership of a group' or any 'sharing of tax attributes' is optional as companies in aircraft leasing groups can be legally restricted from both and for larger groups with different divisions which are operationally independent, 'optional sharing of tax attributes is necessary from both a practical and commercial perspective.
- Irrespective of the 'grouping' mechanism implemented, our expectation is that in order to meet the accounting requirements, each individual company will need to ultimately compute its own interest limitation 'tax attributes' and account for them in its individual financial statements. Therefore, it is critical that additional computational work is not required in order to report the ILR at the group level. This could arise if a consolidated approach was imposed on all companies – as most aircraft leasing companies do not prepare Irish consolidated accounts and therefore it would be significant administrative burden to also compute such calculations for reporting.

At a high level, we believe there are 3 potential options available in defining the members of the group, namely:

***Option 1:*** Companies in a CT loss group

***Option 2:*** Companies in a CT loss group + any other Irish companies in a consolidated group for accounting purposes – in other words, all Irish tax resident companies in a worldwide consolidated group for accounting purposes. At inception of the ILR rules, there should be the potential for a once-off election by a sub-group within this group to create its own local group and remain outside this local group.

***Option 3*:** Ability to elect into a group that would be comprised of some or all of companies in a consolidated group for accounting purposes (similar to a VAT group mechanism)

While we have considered the various options, ALI's preference would be for Option 2. We would envisage Option 2 requiring the following features in order to make it workable:

| | **Feature of notional local group – Option 2** | **Question in Feedback Statement** |
|---|---|---|
| A | In the context of what the notional local (Irish) group should encompass, there are 2 potential approaches here:<br><br>1. Ireland's existing corporation tax regime already has tax group arrangements which recognise the common economic ties of members of a group by permitting the surrender of excess tax losses and other tax reliefs by means of group relief. We believe that as it stands, the definition of a corporate tax group as defined under section 411 (a "Section 411 group" for this purpose) could be the starting point for determining what the notional local group would be. To this we would add any Irish taxpayer entities which are consolidated for financial accounting purposes in the same worldwide group.<br>2. The alternative approach would be to start with the concept of a worldwide consolidated group and then limit that to the Irish tax resident entities in that worldwide group.<br><br>Under both approaches, where any of these consolidated entities form a separate section 411 loss group, then the notional local group provisions should permit those entities to leave the notional local group and form a separate notional local group. In such a case, that new notional local group/separate section 411 group would become a separate interest limitation group for this purpose and in joining one notional local group, a | Q 23(i) |

| | | |
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| | company would not be permitted to join another notional local group. This would be achieved by virtue of a once-off election at inception of the ILR rules or when such a sub-group joins the worldwide group.<br><br>The rationale for this is that in certain instances, there are commercial and legal impediments (typically under debt arrangements) on entities joining or being part of groups (groups being very widely defined and not just VAT groups). The election mechanism is only intended to deal with this legal restriction.<br><br>Whether approach 1 or approach 2 is taken will determine whether there is an impact on existing group definitions. | Q 23(ii) |
| B | In joining one notional local group, a company would not be permitted to join another notional local group. | Q 23(i) |
| C | The definition of group for the notional local group does not need to impact the definition of group for the "group ratios" – they are and can be accepted to be different concepts.<br><br>See further comments in Part E below. | |
| D | A taxpayer should have the ability to have the fixed ratio rule for that local Irish group determined on either an aggregated basis or consolidated basis (whereby intercompany positions are ignored). This is important as most of our members do not consolidate financial statements at a solely Irish group level, and a consolidated approach would place a huge administrative burden on those members. For those members that do prepare consolidated accounts at an Irish group level, the consolidated approach may be more administratively easier for them for reporting purposes. In either case, we believe that a consistent approach should be applied by the taxpayer. | Q 23(iv) and Q 27 |
| E | Once the group calculations have been done, there should be no mandatory allocation of tax attributes, whether that is interest restrictions or interest capacity (similar to what happens in a loss group now) – because (i) some companies may be restricted legally (due to existing financing contractual covenants) and (ii) commercially, mandatory allocations may not be practical in a group with different operating divisions. The allocation should be optional and at the complete discretion of the taxpayer. | Q 28(i) |
| F | The legislation should provide for payments for relief and vice versa in the same manner as loss group relief. | Q 28 |
| G | The group reporter concept will be important here. This construct assumes that all calculations are done on a group basis, at a "parent entity" level. The restrictions and capacity should be allocated out at the discretion of the taxpayer (and indeed accounting requirements will need to be complied with). Any remaining ("carry forward") attributes either need to be "surrendered" back up to sit at a group level or need to be capable of | Q 26(i) |

| | | |
|---|---|---|
| | being utilised within the group at a later stage to ensure that there is maximum flexibility on a go forward basis – there should be no ring-fencing of the restriction carry forward into any specific member of the group.<br><br>We note that the current construct for the Case IV charge as outlined in Section 6 of the Feedback Statement should be adapted and we would propose to continue this dialogue as to how the group mechanism might work once that matter has been clarified. It is important that Irish groups are not disadvantaged when compared to their EU peers who often file tax returns based on a consolidated tax group concept and also that there is flexibility to ensure that unanticipated mismatches or unintended consequences within Irish groups do not arise. | Q 28(iii) |
| H | In the context of companies entering and leaving the local group, on the basis that the approach is a mandatory grouping one, then at its simplest, <u>current</u> accounting period attributes related to companies entering the local group can be determined on a time apportioned basis (so their portion of interest expense that becomes part of the group calculations will be done on a time apportioned basis as normal). To the extent they hold any carry forward attributes, those attributes should be capable of transferring with the entity in the same way as any other attributes such as loss carry forwards etc. For companies leaving the group, it would seem most efficient that again, it would follow rules akin to our loss rules. This should mean that there is limited need for detailed anti-avoidance provisions dealing with this matter. | Q 28(v) |
| I | This approach avoids the need for an election-in mechanism (aside from the initial election referred to above) or companies opting in and out as it largely creates a mandatory group(s) with no gaps. As noted, it should also remove the need for anti-fragmentation / anti-avoidance rules. | Q 24 |
| J | The information returned by the reporting "parent entity" should be limited to (i) a listing of the members of the local group, (ii) the group calculation of restriction/capacity and (iii) the allocation of that restriction (as applicable) to the relevant taxpayer group member at the discretion of the taxpayer. | Q 26(iii) |
| K | To the extent it arises, which may be rare, where there are different accounting year end dates, the parent entity's accounting period is the reference period and there is a time apportioned calculation of exceeding borrowing costs and EBITDA / interest capacity by reference to that reference period. This can be done in similar ways to which apportionment happens in other facets of tax legislation currently. | Q 30 |
| L | The proposed definition of worldwide group as outlined in Section 8.2 includes the "*ultimate parent and all entities that are fully included in the ultimate consolidated financial statements*". Entities that meet the definition of an investment entity in accordance with IFRS 10, do not consolidate certain subsidiaries and instead measure those investments | Q 23 |

| | | |
|---|---|---|
| | that are controlling interests in another entity (i.e. their subsidiaries) at fair value through profit and loss. Such entities are quite common in the financial services sector and if an entity is regarded as an investment entity then under IFRS it is a requirement that the results of certain subsidiaries are to be consolidated in this manner. The proposed definition of worldwide group based on the requirement to "fully" include the results of an entity could have the undesired outcome of excluding investment entities and their subsidiaries from falling within the scope of a worldwide group. If so, these entities which are in a group which fall under the scope of IFRS 10 would be adversely impacted as they would not be able to adopt a group ratio to assist with limiting the blunt nature of the fixed ratio rule, as permitted by ATAD. This will also be relevant when considering the appropriate definition for a notional Irish group. It will be important therefore, that the definitions of worldwide group and any local notional group include such entities in the context of any definitions that propose to incorporate consolidated entities, results, etc. | |

## Part E: Interaction between Group Ratios & Definition of Local Group

There are probably three scenarios that can arise for Irish companies that are part of a consolidated global group:

i. An individual company prepares its ILR calculation on a single entity basis (i.e. it does not join a group).
ii. A number of Irish companies who report on a 'group' basis that comprises part of all the Irish resident members of a consolidated group (i.e. in a 'subgroup' scenario).
iii. A number of Irish companies who report on a 'group' basis that comprises all the Irish resident members of the consolidated group.

Irrespective of which scenario you are looking at, the two group ratios (and the methodology set out in Part C) should be available.

ATAD allows that where a 'taxpayer' (which can either be a single company or a 'local group') is part of a group that files statutory consolidated accounts, then the two group ratios may be made available to that taxpayer.

We note that in our proposed definition of a group for the purposes of ILR as set out in Part D, there would be the ability to include loss group members. To acknowledge a concern specifically addressed in our discussions with Revenue, in the very limited scenarios, where such a member was not part of the consolidated group for accounting purposes, we acknowledge that the two group ratios could no longer be applied to a 'taxpayer' with that specific fact pattern. However, they should still be available to all other taxpayers (who would apply the 'aggregated' method of calculating the numbers as set out in Part C).

## Part F: Other Comments

We appreciate that Government has adopted the position that Ireland's existing domestic interest limitation rules are equally effective to those set out in ATAD and that accordingly, Ireland should not be required to transpose ATAD Article 4 into Irish law until 1 January 2024. While we understand Ireland remains of that view, we are clearly working towards the introduction of interest limitation rules from next January.

We are acutely conscious that our members and all other taxpayers have faced a significant number of material of changes to the corporation tax code in Ireland in recent years including complex areas of tax law and concepts such as Controlled Foreign Company rules, the anti-hybrid mismatch rules, changes to the exit tax regime, mandatory reporting, extended transfer pricing rules to name a few. We are aware that many taxpayers are struggling in many cases to deal with these changes and while we remain of the view that the introduction of interest limitation rules from 1 January 2022 is far from ideal, ALI accepts that this is the date that must be adopted.

A process that has stakeholder engagement at its core is the best way to allay fears over the introduction of the rules and it is clear that this is what is being aimed for here but we do remain concerned with the timing - a second consultation that starts in late summer/mid Q3 is in our view, too close to the Finance Bill process and is both unlikely to give sufficient time to deal adequately with the second consultation and also the more acute matter of layering these new rules over existing already complex legislation for implementation on 1 January 2022.

Given the stated position of Government that Ireland's rules were adequate already, it follows that taxpayers are already subject to a number of rules ensuring that interest deductions do not cause undue erosion of the tax base. In an ideal scenario, we would like to see Article 4 being adopted alongside a comprehensive review of those existing rules, so we achieve the minimum standard approach while also ensuring the overall objective of dealing with base erosion is achieved.

We would therefore, respectfully encourage the Department of Finance and Revenue to take the adoption of these rules forward in 2 key ways: firstly, by introducing the proposed new rules in as flexible as manner as possible, minimising difficulties and administration or compliance for taxpayers and secondly, by also undertaking a full review of the overall rules at the earliest possible opportunity. We have seen a number of EU territories take steps to simplify their approach by eliminating or abolishing existing national rules, both managing to achieve the EU's stated aims for ATAD with a positive message to its own taxpayer community and FDI opportunity. We welcome further engagement with you on both agenda items above.

**END**

# Appendix I - 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). ALI 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 I(i) (cont'd) – Examples of Implicit Interest Return in Lease Income (showing impact of different interest rates/LIBOR changes)

**Floating rate lease rentals - pegged against 3% LIBOR for a typical 12 year lease**

**Years 1-4 of Lease (by way of example)**

| | **USD** |
|---|---|
| Base Rent | 244,383 |
| Lease signed April 2022 | |

| | **2022 (9 month)** | **2023** | **2024** | **2025** |
|---|---|---|---|---|
| Op. Lease Rentals | 2,199,447 | 2,932,596 | 2,932,596 | 2,932,596 |
| Accounting Depreciation | (1,275,000) | (1,700,000) | (1,700,000) | (1,700,000) |
| Interest Expense | (737,801) | (954,266) | (924,905) | (897,172) |
| **Net Profit** | 186,646 | 278,330 | 307,691 | 335,424 |
| | | | | |
| Implicit Interest | 1,135,079 | 1,468,102 | 1,422,931 | 1,380,264 |
| Capital Repayments | 1,064,368 | 1,464,493 | 1,509,664 | 1,552,331 |
| **Sub-total** | 2,199,447 | 2,932,595 | 2,932,595 | 2,932,595 |
| Interest Expense | (737,801) | (954,266) | (924,905) | (897,172) |
| **Net financing return** | 397,278 | 513,836 | 498,026 | 483,092 |

# Appendix I(ii) (cont'd) – Examples of Implicit Interest Return in Lease Income (showing impact of different interest rates/LIBOR changes)

**Floating rate lease rentals - pegged against 5% LIBOR for a typical 12 year lease**

**Years 1-4 of Lease (by way of example)**
**Assumes Lessor can fully pass on higher interest rate to airline customer - may not be the case**

| | **USD** |
|---|---|
| Base Rent | 314,591 |
| Lease signed April 2022 | |

| | **2022 (9 month)** | **2023** | **2024** | **2025** |
|---|---|---|---|---|
| Op. Lease Rentals | 2,831,319 | 3,775,092 | 3,775,092 | 3,775,092 |
| Accounting Depreciation | (1,275,000) | (1,700,000) | (1,700,000) | (1,700,000) |
| Interest Expense | (1,231,106) | (1,596,882) | (1,552,416) | (1,509,970) |
| **Net Profit** | 325,213 | 478,210 | 522,676 | 565,122 |
| | | | | |
| Implicit Interest | 1,894,009 | 2,456,741 | 2,388,333 | 2,323,031 |
| Capital Repayments | 937,310 | 1,318,351 | 1,386,759 | 1,452,061 |
| **Sub-total** | 2,831,319 | 3,775,092 | 3,775,092 | 3,775,092 |
| Interest Expense | (1,231,106) | (1,596,882) | (1,552,416) | (1,509,970) |
| **Net financing return** | 662,903 | 859,859 | 835,917 | 813,061 |

## Appendix II – Example - Case IV Calculations in a Loss-Making Company and Lost Interest Capacity

| | 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 expnses | (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) |

**Dublin (Head Office)**
84/86 Lower Baggot Street
Dublin 2
T: + 353 1 605 1500
E: aircraftleasingireland@ibec.ie

**Limerick**
Gardner House
Bank Place
Charlotte Quay
Limerick

**Brussels**
Avenue de Cortenbergh
89, Box 2
B-1000 - Brussels
Belgium