



ATAD Implementation *(Article 4 Interest Limitation)*

**KPMG Response to Department of Finance Consultation
on behalf of our Renewable Energy Clients**

8 March 2021

Your Partner For What's Next

8 March 2021

ATAD – Implementation – Interest Limitation Feedback Statement
Tax Division
Department of Finance
Government Buildings
Upper Merrion Street
Dublin 2
DO2 R583

Dear Sir,

Re: Interest Limitation – Public Consultation

KPMG is delighted to respond, on behalf of our renewable energy clients, to the public consultation on Ireland's implementation of the ATAD Interest Limitation rules ("ILR") which was launched in December 2020. We have listed our clients who are supportive of our submission in Appendix 1.

While KPMG is also preparing a more comprehensive response dealing with all of the questions in the consultation document, this submission, made on behalf of our renewable energy clients, is focussed on Question 16 (potential approaches to the criteria relevant to the "long-term public infrastructure" project exemptions), one aspect of Question 8 (possible approach to the operation of the ILR) and one aspect of Question 5 (possible definitions of "taxable interest equivalent" and "deductible interest equivalent").

In the course of this submission we want to explain (a) the urgent need that Ireland has to continue to promote large scale capital expenditure in the renewable energy sector and (b) the important role that tax policy decisions (such as decisions on the ILR rules) have to play in the promotion of renewable energy investment.

The contact point for this submission is Paul O'Brien (paul.jp.obrien@kpmg.ie) and Sinead Kelly (sinead.kelly@kpmg.ie).

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

Yours faithfully,



Paul O'Brien
Partner



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01

Background

The Government published the Climate Action and Low Carbon Development (Amendment) Bill in October 2020. This legislation will commit Ireland, in law, to move to a climate resilient and climate neutral economy by 2050. In addition, the Programme for Government commits to a 7% average yearly reduction in overall greenhouse gas emissions over the next decade, and to achieving net zero emissions by 2050.

The Climate Action Plan in 2019 set a new target of 70 per cent renewable electricity by 2030. This is indicatively comprised of:

- at least 3.5 GW of offshore renewable energy,
- up to 1.5 GW of grid-scale solar energy, and
- up to 8.2 GW total of increased onshore wind capacity

It is also anticipated that 15% of electricity demand would be met by renewable sources contracted under Corporate PPAs. The Climate Action Plan recognises that ensuring increased levels of renewable generation will require very substantial investment in new infrastructure, including wind and solar farms, grid reinforcement, storage developments and interconnection. It is widely acknowledged that private sector investment is a critical part of our path to reaching our renewable energy targets and that this cannot be funded by the public sector alone.

A critical component to deliver on Ireland's renewable energy ambition is ensuring that the country has a policy environment that attracts low cost of capital investors, such as institutional investors and pension funds, to invest on a long-term basis in renewable energy projects.

This has the benefit of both lowering the overall cost of deployment of projects, which in turn should reduce costs to the consumer through lower electricity prices, as well as contributing to national energy generation resilience and security.

While there have been an increased number of institutional investors attracted to the Irish renewable energy market in recent years, a key driver of this has been low levels of inflation and negative interest rates. We have seen the cost of capital of unlevered projects fall from 7.0% in 2017 to 5.0% today for many operational projects. Whilst this is positive for the immediate term and has coincided with the recent RESS auctions, this downward movement is likely to be tempered going forward by a number of increasing risks both within the Irish market and the wider global economy.

We have seen material energy price volatility and increasing levels of curtailment¹ which is likely to only get worse as higher renewables penetration is reached over the coming years. Couple with an eventual return to inflation, this will result in investor' costs of capital increasing and a risk that certain forms of capital will no longer be attracted to the market. Ireland needs to utilise the policy levers that it has at its disposal (including tax policy) to ensure that the country remains attractive to investors. Decisions made now on the design of the ILR are an important component of that tax policy.

¹ In electric grid power generators, curtailment is the deliberate reduction in output below what could have been produced, in order to balance energy supply and demand or due to transmission constraints



02 Standard Funding Model for Renewable Energy Projects

Renewable energy projects require a substantial initial capital outlay and often support very high levels of debt which are tied to the cash flows of the project. Generally, projects are financed in phases – shorter term finance which carries more risk during the development phase of the projects and longer-term finance (typically 15-20 years) to fund the construction and operational phase of the project. Cash flows over the life of the projects generally allow financiers and owners to recoup their original investment and generate a return on investment which compensates them for the level of risk assumed. Cash flows tend to be stable and predictable (due to government supports such as REFIT or RESS).

Renewable energy construction is generally financed with “non-recourse” project finance – the lenders rely only on cash flows generated by the asset to service and repay the loans. The debt financing is typically credit scored as investment grade and offers low-risk returns to funders with a limited chance of default (and is therefore cheaper than the equity component of the funding, bringing down the overall public cost of the asset).

However, external project finance is only one part of the funding mix. The owners will have to provide additional debt or equity to fund the construction of the project and where the capital spend is large, this requirement can be significant. Mezzanine lenders who provide higher risk, higher cost funding to bridge the gap between the owner’s equity and the project finance loan, form a key part of the funding mix.

Furthermore, owners may also provide shareholder loans to partly finance construction which facilitates cash extraction from projects who may have a lack of positive distributable reserves (due to the depreciation profile of these projects, it is not uncommon for projects generating cash to lack the reserves required to distribute this cash to owners and investors).

Therefore, it is possible that the significant capital expenditure on the projects may be funded by 2-3 different forms of debt (i.e. senior project finance, mezzanine debt and shareholder debt) as well as equity capital provided by the owners/investors.

The standard funding profile, as outlined above, may result in renewable energy projects breaching the 30% of EBITDA threshold in the early years due to the high level of debt (supported by the profile of projects) which is required to fund the significant upfront capital outlay.



03

Impact of Interest Restriction Rules on Development of Renewable Energy Projects

The critical factors in support of our request to allow renewable energy projects to fall within a public benefit infrastructure ("PBI") exemption are as follows:

- Finance costs are an integral and recurring expense in the development of any renewable electricity generation project. If there is a restriction on the ability of renewable energy companies to claim tax deductions for interest costs, we believe this will have an impact on the capital cost of renewable energy projects.
- As a result of the large capital expenditure incurred in these projects, many projects pay limited corporate tax in the early years of operation (due to the availability of capital allowances). However, this is solely a timing issue and the corporate tax tends to be payable at the back-end of the project as capital allowances expire. At the same time, the interest costs of projects tends to be highest in the early years and slowly reduces over time. Even where a policy choice is made to allow for indefinite carry forward of excess borrowing costs, the disallowance of interest expenses in the early years may represent an absolute cost for renewable projects due to the profile of certain projects i.e. it may not be possible for the projects to ultimately use the restricted interest in certain instances. We are happy to provide more detailed modelling showing the profile of renewable energy companies and how it is impacted by the interest restriction if you thought it helpful.
- Even where the interest restriction in the early years is only a timing issue (which is likely to be the case in most instances), it potentially impacts upon the cashflow profile of these projects. Where cash is returned later in the life cycle of the project to investors and funders (rather than earlier), it raises the capital cost as all cashflows in these projects are discounted for the time value of money when being financed.
- The capital cost of a renewable energy project is a key factor for renewable energy developers when considering bid prices for the Renewable Electricity Support Scheme ("RESS"), which ultimately impacts the cost of electricity for Irish consumers. Restrictions on the ability to claim tax deductions for interest costs will place upward pressure on bid prices and the cost of electricity to Irish consumers.



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- For context, we understand that wind farms in the Nordic Region are delivering prices of €30 per MWh (CPI linked), which is significantly lower than the weighted average strike price of provisionally successful offers in the recent RESS 1 auction of €74.08 per MW (not CPI linked), even taking the differential due to inflation into account. We also understand that these renewable energy developers in the Nordic region are already making the case to large energy users that they can provide clean power at a cheaper rate than is available in Ireland.
 - It is also becoming critically important (and, as noted above, is recognised in Government policy) that there are actions that need to be taken to encourage and develop the corporate PPA (“cPPA”) market in Ireland. Unlike most other developed countries, the cost of implementing a corporate PPA structure in

Ireland is generally prohibitive which is why so few transactions have been entered into to date. There will be significant pressure from global corporations with operations in Ireland for cPPA enabling legislation in Ireland – in particular the focus will be to reduce the costs of implementing cPPAs in Ireland. Introducing interest limitation rules in Ireland for renewable energy projects would increase and not decrease the cost of implementing cPPAs in Ireland and would continue to make Ireland uncompetitive when compared to our peers elsewhere in Europe. Allowing an exemption from the interest limitation rules for renewable energy projects should not result in a material tax cost to the exchequer. In most cases, the rules should defer and not deny a tax deduction for interest costs to that it is essentially a timing issue.



04

Potential Approach to Criteria Relevant to Public Infrastructure Project Exemption



Taking all the above into account, in our view the following criteria should be taken into account in defining and implementing a public infrastructure project exemption to the interest limitation rules:

4.1. Definition of “Public Infrastructure Project”

We recommend that the meaning of “public infrastructure project” should include both infrastructure which is procured by a public body and infrastructure used in a regulated activity overseen by a public body or could be regulated by an infrastructure authority if the authority exercises any of its powers. This would therefore extend to the production of electricity.

As noted in the Feedback Statement, ATAD 1 provides that a long- term public infrastructure project must be a “project to provide, upgrade, operate and /or maintain a large- scale asset that is considered in the general public interest by a Member State”.

ATAD1 does not provide a definition of “public” infrastructure. However, a 2017 paper on public infrastructure in Europe prepared by the Council of Europe Development Bank (EU Development Bank) describes public infrastructure in a general sense as meaning infrastructure that is in public ownership, semi-public ownership (e.g. public private partnership) or private ownership but publicly mandated or operated under a public concession.

The UK Corporate Interest restriction (“CIR”) rules include a Public Benefit Infrastructure exemption which extends to include infrastructure which is used in the course of a regulated activity or could be regulated by an infrastructure authority if the authority exercises any of its powers. This includes renewable energy assets in the UK. Like Ireland, investment in renewable energy assets in the UK is

primarily from the private sector and the UK energy market is regulated by Gas and Electricity Markets Authority (GEMA), supported by Ofgem. At the time of introduction of the CIR rules in the UK it was accepted that the public benefit test was met in the context of energy assets, in particular because it was recognised that they were part of the solution to address the challenges of ensuring ongoing generation, transmission and distribution of affordable, secure and low-carbon energy.

The public benefit aspects of renewable energy generation in Ireland are well documented. Individual consumers and businesses in Ireland ultimately bear the cost of funding renewable energy assets over time via electricity bills as a consequence of the regulatory regime which passes costs through to users in order to enable funders/owners of the underlying asset to earn a risk-adjusted return on their funding.

Given the underlying costs are ultimately borne by taxpayers and consuming households, government and regulatory practice means that renewable projects have had to raise funds (i.e. establish their capital structure) in the cheapest possible way to provide long term value to the taxpayer/consumer.

The main investment in renewable energy in Ireland has been and will continue to be from the private sector. The energy sector is regulated in Ireland by the Commission for Regulation of Utilities (CRU”), Ireland’s independent energy and water regulator.

Taking all the above into account, we would strongly recommend that meaning of “long-term public infrastructure project” should include both infrastructure which is procured by a public body and infrastructure used in a regulated activity overseen by a public body or could be regulated by an infrastructure authority if the authority exercises any of its powers.

4.2. Definition of “Long Term”

We recommend that “Long Term” should include assets that have an economic life of at least 10 years.

Generally, renewable energy assets (or projects) involve long duration contracts, stretching to 15 to 20 years or even longer in some cases. As renewable technologies continue to develop, the overall asset life extends, which has resulted in many market participants now assuming 35-40 year asset life for technologies such as solar where the underlying panel manufacturers provide guarantees for up to 25 years.

We noted that the period of a project is not defined in ATAD1, nor is a definition of “long term” provided. OECD guidance in its Action 4 report suggests that the asset should last not less than 10 years.

The UK public infrastructure exemption from its CIR rules states that an infrastructure asset should have an economic life of at least 10 years in order to qualify. We would therefore recommend that the meaning of “long term” should be defined to include assets that have an economic life of at least 10 years.

4.3. Definition of “Eligible Loans”

We recommend that “eligible loans” should include both third party and related party loans.

This is to ensure that there are no barriers to the deployment of long-term capital and to ensure that there is a competitive market and level playing field for all investors in renewable energy assets (therefore avoiding any potential “tax subsidy” for investors that are willing to accept higher levels of external leverage and the resulting increase in volatility and risk).

The special features of renewable energy assets (i.e. large initial funding outlay, stable and predictable cash flows linked to asset revenues, competitive tension, etc.) mean that very high levels of debt funding are commercially supportable, normal and desirable in the interests of reducing the cost of public benefit infrastructure to taxpayers and users. As noted on page 2-3 of this submission, there are many different types of debt that can be included in the typical funding mix for a renewable energy project (including project finance debt, mezz debt and shareholder loans). Irish transfer pricing rules will also ensure that interest expenses are arms-length and not excessive. As debt is cheaper than equity, it forms a vital part of long-term infrastructure funding.

Furthermore, the current international standard funding models for renewable energy investment allow equity and debt providers to hold different proportions of each, according to their investment requirements, and for these to change throughout the long asset life, as required. Some investors, including pension and sovereign funds, see external debt as a risk and are prepared to accept lower overall returns on their investment by owning the debt themselves. This is becoming increasingly common in renewables and having a greater number of wholly equity funded generation assets in a country is to be welcomed from an energy security and resilience perspective.

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

In order to access the widest sources of institutional and investor funding for renewable energy assets, it is important that Irish policy choices follow the market practice of facilitating the natural capital structure of renewable energy assets and recognises the commonly accepted framework that defines the ‘debt-financeable’ component allowed by the cash flows from the project that support that debt.

The introduction of third-party debt into the capital funding structure for a project would mean that these investors would sit ‘one notch below’ the external lender in terms of priority ranking and access to cash flows. This increases the risk associated with the balance of the investment and also defers much of the investors’ access to the cash flows until the debt has been repaid.

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



Finally, value to taxpayers/consumers improves where there is competition and a level-playing field between as diverse as possible funding sources attracted to the stable cash flows of such assets.

For the reasons outlined above and in particular to ensure that there is a competitive market and level playing field for all investors in renewable energy assets, we recommend that “eligible loans” include both third party and related party debt.

4.4. Grandfathering

If related party loans are to be excluded from the definition of “eligible loans”, we recommend that grandfathering should apply to pre-existing loans in order not to prevent potential damage to existing projects.

If related party debt is excluded from the scope of a PBI exclusion, it is imperative that grandfathering of existing loans is included upon implementation so as to prevent increased costs for existing long term projects (which will typically already have long term debt arrangements in place for periods of 10-15+ years) and also to protect against a loss of investor confidence affecting the future cost of funding infrastructure.

Without grandfathering, those who have funded projects with pre-existing sub-ordinated debt will suffer an unanticipated cost and that, as the life cycle of these assets can be quite long, these investment decisions may have been made well in advance of any ILR being

contemplated. Changing tax laws in this manner reduces investor confidence and results in future investors pricing risk into their investment decisions. This will lead to both higher costs to consumers/taxpayers (from a lower debt and higher equity mix) and a disincentive/competitive disadvantage to long term investors.

4.5. Definition of “Infrastructure”

We recommend that the definition of “infrastructure” should accommodate projects at different stages, i.e. during the development, construction and operational stages. It should also extend to holding and funding structures which involve loans to and shares in qualifying infrastructure companies as well as interests in qualifying infrastructure projects held through joint ventures and partnerships.

Renewable energy assets generally evolve from the perspective of investor risk throughout their ‘lifecycle’ of development and construction stages (with shorter-term and higher risks of non-completion or cost overruns) into the operational stage (longer-term and lower risk with generally stable and predictable cash flows).

The UK has adopted an approach of defining its PBI exemption by reference to the income and assets of a qualifying infrastructure company. To qualify, the company’s income and assets must be referable to activities related to ‘public infrastructure assets’ and be fully taxable in the UK.

The income/ asset requirement is that all but an insignificant proportion of a company's income or value of its assets (being tangible assets, financial assets, etc.) is derived from qualifying infrastructure activity. This includes shares in, or loans with, a qualifying infrastructure company. It is common practice in the Irish renewable energy industry to establish an Irish holding company which will then lend money to subsidiary companies which carry on renewable energy trades. Therefore, a holding company of a qualifying infrastructure company should be eligible to avail of the PBI exemption.

There are also provisions in the UK to accommodate structures that include transparent entities such as partnerships as well as joint venture arrangements. These are also used in the Irish renewable energy market. Companies who hold significant interests in transparent entities (e.g. partnerships) that carry on qualifying infrastructure activities in the UK are to take this into account for the purposes of the asset test where the company holds the interest in the transparent entity on its balance sheet and the value of the transparent entity is derived from the qualifying infrastructure activities.

The income/ asset requirements also include provisions that allow a company to qualify where it has no income/ assets, which should enable infrastructure projects to qualify during the development and construction phases where income has yet to be generated.

We recommend that similar provisions should be included within the Irish ILR.

4.6. Certainty

We recommend that Irish Revenue should publish prescriptive lists of the terms "infrastructure", "infrastructure authority" and "relevant public body" to provide certainty in the market

The UK legislation provides prescriptive lists (albeit subject to further regulations) for the terms 'infrastructure', 'infrastructure authority' and 'relevant public body' which then support the interpretation of the other tests around public benefit infrastructure. This gives an underlying layer of certainty for taxpayers in applying the rules to their own circumstances.

Our recommendation is that Irish Revenue should publish similar lists in law to provide taxpayers with clarity around when the rules should apply.

4.7. Exclusion of EBITDA from the local group test and for a consolidated group test

We recommend that if a loan is excluded from the interest limitation rule, the related EBITDA should also be excluded from EBITDA as it applies both for the local group test and for a consolidated group ratio test.

Under the UK CIR regime, where the PBI exemption applies, any income arising from a qualifying infrastructure project is excluded from the EBITDA of the taxpayer (or the group, as the case may be). PBI exemption interest expense and related EBITDA must also be excluded from consolidated accounts figures used to apply a consolidated group ratio test (if applicable to the taxpayer).

The Irish regime should mirror this aspect of the UK CIR regime and where a loan is excluded from the interest limitation rule, the related EBITDA should also be excluded from EBITDA as it applies both for the local group test and for a consolidated group ratio test



05 Possible Approach to the Operation of the ILR



Question 8: Possible approach to the operation of the ILR

Based on our understanding of the proposed approach set out on page 13 (Section 6 of the Feedback statement), it appears that a company with Schedule D Case I tax trading losses could be required to pay cash tax in situations where there is a recapture of “exceeding borrowing costs” which is to be taxed under Schedule D Case IV.

The example shown on page 13 of the Feedback statement specifically states that the amount chargeable under Schedule D Case IV shall be treated as income

“against which no loss, deficit, expense or allowance may be set off...”

We would suggest amending this approach for the following reasons:

- The “exceeding borrowing cost” will generally be a trade related borrowing cost – it is inequitable not to allow Schedule D Case I tax trading losses to offset the recaptured interest under Schedule D Case IV.

- For renewable energy companies, there is typically significant tax trading losses in the early years or within other group companies (as each project tends to be held in a separate SPV). Imposing a cash tax charge, in this manner, at a time when the companies are loss-making for tax purposes, will place financial pressure on the projects (and will most likely lead to further borrowings to fund the cash tax payments).
- The Schedule D Case IV income may also trigger a close company surcharge liability which should not arise on the basis that the exceeding borrowing costs are not passive income of the company and cannot be distributed to shareholders.

We recommend that the ILR’s should not require cash tax payments where a company has current year Schedule D Case I losses or has Schedule D Case I losses carried forward (where those losses do not include exceeding borrowing costs).

06

Taxable Interest Equivalent and Deductible Interest Equivalent

Question 5:

“Taxable interest equivalent” & “deductible interest equivalent”

Question 5 invites comments on the definitions of “taxable interest equivalent” and “deductible interest equivalent”.

The definition of deductible interest equivalent should specifically provide that it takes into account transfer pricing adjustments under Section 835C TCA 1997. Otherwise it raises the possibility that a company could suffer a transfer pricing adjustment (for example, due to the quantum of its related party debt exceeding an “arm’s length” amount) and also suffer a Case IV charge (under the ILR) on the same amount of interest. This is effective double taxation.

As mentioned earlier in this paper, it would not be uncommon for renewable energy projects to be funded with related party debt in addition to third party debt. This principally serves a commercial function of facilitating cash repatriation from projects which are cash generative but do not have profit reserves. Returning cash earlier to investors improves the returns from the project and makes it a more attractive investment. Conversely, returning cash later (due to lack of reserves) where the project has a surplus of cash on the balance sheet, reduces the investment performance and makes it look less attractive as an investment.



07

Summary & Conclusion

As outlined in more detail above, we believe that the criteria to qualify for a public infrastructure project exemption from the ILR rules should be designed in such a way to ensure that renewable energy projects meeting the criteria will have the choice and flexibility to qualify for the exemption. This is critical if Ireland is to continue to attract investors interest in renewable energy assets here, which in turn is a crucial step on the path to meeting our renewable energy targets on the transition to net zero.



01

Appendix

List of our Renewable Energy Clients supporting this submission

- Amarenco Solar Limited
- Elgin Energy
- Mainstream Renewable Power
- NTR plc
- Shannon Energy
- Simply Blue Group

Contact us



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