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

10 August 2021

Dear Sir/Madam,

Subject: ATAD Implementation Article 4 Interest Limitation – Public Consultation

We are writing to you in response to your invitation for submissions on the "ATAD Implementation - Article 4 Interest Limitation" Feedback Statement document as published by the Department of Finance on 2 July 2021.

First and foremost, we welcome the publication of this second Feedback Statement document published by the Department of Finance. The publication of this document, prior to implementing interest limitation rules, reflects Ireland's continued efforts to promote a business environment characterised by certainty and clarity, thereby giving confidence and foresight to key stakeholders in a time of unprecedented change in the international taxation arena. We would ask that you continue in this vein and publish the draft legislation in advance of Finance Bill 2021 (the Bill) being published, in order to allow sufficient time for further stakeholder engagement given the short timeframe for amendments as the Bill moves through the legislative process.

Irish Institutional Property is the voice of institutionally financed investors and real estate providers with significant local and international backing in the Irish real estate market. The mission of the IIP is to promote the development of a progressive world class real estate sector in Ireland, which benefits members, the economy, and wider society. IIP members are backed by a diverse group of investors, including irish and international pension funds, among others.

As the representative body for institutionally financed investors and real estate providers, we can draw on the experience of our members to reflect our concerns and insights with regard to the implementation of the interest limitation rules under the Anti-Tax Avoidance Directive ("the Directive").

We welcome the opportunity to discuss the matters outlined below at your convenience.

Yours faithfully,

Pat Farrell
CEO Irish Institutional Property

***Question 1***
***Comments are invited on this possible approach, including whether any other matters should be considered in the transposition process.***
***(Please note: more detailed questions relating to each step are contained later in this paper, so responses to this question should focus on the general approach.)***

We note that Article 1 of the Directive provides that it shall apply to taxpayers that are subject to corporate tax in a Member State and that, similarly, the feedback statement also makes a number of references to 'corporation tax', including in a number of potential definitions.

However, as you are aware, Section 1034 Taxes Consolidation Act ("TCA") 1997 provides that entities which hold Irish real estate, but are not themselves tax resident in Ireland, are subject to Irish income tax on their net rental income in respect of such holdings, as opposed to corporation tax. We would request clarification as to whether the interest limitation rules ("ILR") should apply to non-resident landlords in receipt of Irish rental income or if the application of the ILR is limited only to entities within the charge to corporation tax.

**Question 2**
**Comments are invited on these possible definitions of 'relevant entity' and 'interest group' and, in particular, how the possible definition of an 'interest group' interacts with the group ratio rules.**

**Interest group**

*General*

We broadly welcome the alignment of the definition of an interest group to the corporation tax losses group currently defined in Section 411 TCA 1997.

The ability to elect out of an interest group is welcomed as this is often required from a banking security perspective.

*Multiple lenders*

The definition of a corporation tax losses group is reasonably widely defined and so some corporation tax losses groups could include a number of investments which are funded with multiple lenders (for example Lender A is funding investment A and Lender B is funding investment B and so on). The inclusion of all members of a corporation tax losses group within an interest group would result in all banking security groups forming a single interest group for ILR. We would request that the definition of an interest group be modified to allow for two or more interest groups within a corporation tax losses group as this is required to prevent crossover between banking security groups.

*Sub funds of a platform investment undertaking*

As noted in our response to Question 4 below, we would be in favour of excluding the financial undertaking exemption and our response to this question assumes that this exemption is excluded.

Platform investment undertakings with multiple sub funds are commonly seen in the market. The most common of these is a platform ICAV with multiple sub-funds, and sometimes the ICAV / sub-funds have subsidiaries.

In most cases the investors in one sub-fund of a platform ICAV are completely unconnected to the investors in another sub-fund. The current definition of an interest group would appear to mean that all sub-funds and all of their subsidiaries would form an interest group. While a sub-fund or subsidiary may be able to elect out of the interest group, an opt out approach creates additional administrative burden on the sub fund / subsidiaries and creates a fictional situation that the sub funds are in a group acting together when in most cases they are not.

*REITs*

We would request confirmation that Real Estate Investment Trusts ("REITs") should not be within the scope of ILR on the basis that a REIT's property rental business is not chargeable to tax and they are already subject to prescribed statutory leverage restrictions within the REIT tax regime.

A REIT is not chargeable to tax in respect of the income of its property rental business or on any chargeable gains accruing on the disposal of assets of the property rental business, provided that the conditions of the REIT regime are satisfied.

Per the feedback statement, the ILR has the effect of limiting a taxpayer's ability to deduct 'exceeding borrowing costs', being the amount by which the deductible interest equivalent exceeds its taxable interest equivalent.

Where an entity is exempt from tax, no deduction in respect of interest for tax purposes arises. Therefore, where no deduction is taken in respect of borrowing costs, a tax-exempt entity should have exceeding borrowing costs of NIL and should therefore not be within the scope of the ILR. As a result, ILR should not apply to a REIT's property rental business.

This treatment would also preserve the intended symmetrical approach to implementing the ILR as, per the Directive, tax exempt income is excluded from the EBITDA of the taxpayer. It follows then that expenses arising in respect of exempt income, which will not be included in EBITDA, should not be included in the calculation of exceeding borrowing costs.

We would welcome confirmation that REITs are excluded from the scope of the ILR.

**Question 3**
**Comments are invited on these possible definitions of 'standalone entity', 'associated enterprise', 'enterprise' and 'entity'.**

A standalone entity is an Irish tax resident taxpayer that is not consolidated for financial accounting purposes in a parent's financial statements and which has no associated enterprise or permanent establishment other than in Ireland.

Examples should include bankruptcy remote Section 110 entities. Assuming these are not "*part of a consolidated group for financial accounting purposes"* and have no permanent establishment, the only question is whether they have any "associated enterprise".

While a standard SPV may have a 100% shareholder, the shares have limited economic value (but must exist for company law purposes) and a trustee will generally hold the shares on trust for charitable purposes. This is done for good commercial reasons (including as a requirement of the European Central Bank, rating agencies, and commercial lenders) so that, from an economic and insolvency perspective, the SPV is not part of a larger group (and is not in any group with the share trustee).

It would seem that this fact pattern is precisely what a "standalone entity" should be. Accordingly, so long as it is not "part of a consolidated group for financial accounting purposes" and has no permanent establishment, a normal SPV, all of the shares of which are held on trust for charitable purpose for bona fide reasons should be a "standalone" entity for the purposes of the rules. We would request clarification that orphan Section 110 entities should be considered stand alone entities for ILR purposes.

**Question 4**
**Comments are invited on the exclusion for financial undertakings generally and this possible definition of ‘financial undertaking’.**

Taxpayer groups containing regulated financial undertaking entities often also have non regulated entities in their structures. The regulated entities often have net interest income while the non regulated entities may have a net interest expense. Therefore we would be in favour of excluding the financial undertaking exemption.

Certain financial undertakings or sub-funds of a financial undertaking (as the case may be) are considered Irish Real Estate Funds (IREFs). Finance Act 2019 introduced new rules such that where an IREF is funded with debt, an annual Irish income tax charge at 20% can arise on a portion of the interest expense in a given year where certain ratios are breached. There is a carve out for third party debt but this is subject to a number of conditions which can cause issues in practice, meaning that an income tax charge can often arise in respect of genuine third party debt.

It is very important that IREFs do not suffer an income tax charge in respect of an amount of interest which is restricted under ILR and so we would request that the interaction between the IREF income tax provisions and the ILR take this into account.

**Question 5**
**Comments are invited on this possible approach to defining a ‘long-term public infrastructure project’, including by reference to the legislation and regulation. In responding to this question, please also comment on any potential considerations relevant to State aid compatibility**

Paragraph 4 of Article 4 of the Directive provides that a public infrastructure project “means a project to provide, operate, upgrade, operate and/or maintain a large-scale asset considered in the general public interest”. Accordingly, it is clear that this definition would include classes of assets typically deemed to be infrastructure, such as roads, hospitals, bridges.

The concept of infrastructure should be broad in nature, and should encompass any manner of assets which provide amenities to the public, enhance public life, or are regarded as essential goods or services, regardless of whether such outputs are provided free of charge or available for sale. Furthermore, the definition should be able to cater for the changing needs of society, for example broadband etc.

In this regard, any definition of public infrastructure projects should be sufficiently broad so as to include certain classes of housing for example, social/affordable developments.

We welcome the suggestion that the definition of ‘qualifying long term infrastructure projects’ could be defined by reference to existing legislative definitions, such as “Strategic Infrastructure Developments” under the Planning and Development Acts, the Roads Acts and the Transport (Railway Infrastructure) Act.

In relation to housing, it is notable that in an Irish context, housing has been subject to specific planning provisions, under the Strategic Housing Regulations which derive from the Planning and Development (Housing) and Residential Tenancies Act 2016. In a housing context, from a public policy perspective, it is notable that the State has determined that there is a public interest in the development and supply of housing. Given how public housing policy has developed, there is a strong argument for the inclusion of certain housing as part of the public infrastructure exemption.

While it may be difficult to include a precise definition of a long-term public infrastructure project by reference to legislation and regulation, the solution could be for the Minister of Finance to periodically publish a list of approved projects.

**Question 6**
**Comments are invited on this approach to the application of the ILR and to this possible definition of 'relevant profit or loss'.**

Most companies disposing of investment real estate assets are subject to corporation tax on chargeable gains, and the profits so charged should be included within the proposed definition of Relevant Profit or Loss.

The definition does not currently appear to include profits arising on disposals of real estate assets which are subject to capital gains tax (CGT). This includes disposals of development land held as an investment asset or disposals of an investment asset by a non Irish resident company. We request that such profits are included in the definition.

***Question 7***
***Comments are invited on these possible definitions of 'interest equivalent', 'taxable interest equivalent' and 'deductible interest equivalent'.***

The aim of ATAD with regard to interest limitation is to limit the amount of deductible interest to 30% of EBITDA but only on a net basis. As a result, interest equivalent should be symmetrical between "borrowing costs" and "taxable interest".

We note that the proposed definition of 'interest equivalent' is, in the context of borrowing costs, narrower than provided for in the Directive definition and would advocate that this be corrected while preserving the symmetrical approach on the revenue side, such that the provision for interest equivalent borrowing costs in the Irish legislation transposes the full breadth of such costs contained in the Directive. This will impact the statutory definition of interest equivalent and we would suggest that it should include the full definition of financing return in section 835AH and not just paragraph (c).

In terms of "amounts economically equivalent to interest", we make the following specific points:

<u>Capitalised Interest</u>

- While we note that the definition of borrowing costs in the Directive refers to 'capitalised interest' included in the balance sheet value of a related asset, or the amortisation of 'capitalised interest', neither the Directive nor the feedback statement clarify at what point in time capitalised interest should be included in the ILR calculations.
- As you may be aware, under IFRS accounting standards, the circumstances under which an entity may capitalise interest are very limited in scope. IAS 23 Borrowing Costs provides that;

  > *An entity shall capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset [being an asset that takes a substantial period to get ready for its intended use or sale] as part of the cost of that asset. An entity shall recognise other borrowing costs as an expense in the period in which it incurs them.*

In practice, and within the context of Irish real estate, the application of this standard requires that an entity will capitalise interest on borrowings used to fund the construction of a building until that building is ready for use or sale, after which point any interest accruing on those borrowings will be recorded as an expense in the income statement of the entity.

- The nature of the real estate and construction industry means that it is not uncommon for a number of years to elapse between the acquisition of a site and that site being developed to an extent that income may be generated from it. During this interim period, it is common that an entity engaged in construction or development would have a negligible EBITDA but significant annual capitalised interest, depending on the size of the development.
- Therefore, the implementation of the ILR should clarify that capitalised interest should be included in the borrowing costs of an entity in the year in which the asset to which such interest relates is disposed of. The year of disposal is also the year in which capitalised interest would, indirectly as part of either cost of sales or the base cost of the asset, be deductible.
- On the basis that a tax deduction is not taken for depreciation or amortisation, the inclusion of interest capitalised when depreciation or amortisation is reflected in the profit and loss would not be consistent with the ILR approach that only interest which is deducted for tax purposes should be restricted.
- Furthermore, any gain/profit arising on the disposal where the disposal of the asset would be the disposal of a chargeable asset for the purposes of capital gains tax or corporation tax should be allowed to be included in the EBITDA calculation in order to preserve symmetry.

Other

- We believe that non-performing loan gains should be included as “interest equivalent” i.e a gain on the uplift in value from the cost of the loan (discounted gains).
- Can you confirm that hedging costs are considered “interest equivalent” and captured under part (c) of the definition
- There are a significant amount of costs that are incurred in raising finance associated with the acquisition and development of real estate. We note that the feedback statement specifically refers to guarantee fees, and arrangement fees but given the broad range of costs which may be incurred, clarity is required as to which costs should be included. We would not expect costs such as tax, legal, valuations, agent fees to be considered costs of raising finance. The costs should directly relate to costs incurred with lending and costs which are payable to lending institutions.
- We also note the following language is included in the proposed definition of interest equivalent *‘...shall also include any amount arising from an arrangement, or part of an arrangement, which could reasonably be considered, when the arrangement is considered in the whole, to be economically equivalent to interest*.’ We request confirmation that this language should be read widely and that the above costs such as valuations and agent fees are included in the definition.

***Question 8***
***Comments are invited on this possible definition of worldwide group and related concepts which are relevant for the operation of the equity ratio rule***

We would request that taxpayers have the option of choosing to apply either the equity ratio rule or group ratio rule. Such a choice could be locked in for a prescribed period of time to prevent taxpayers moving between the two ratios.

While we note that the two ratios are based on accounting concepts, we would note that often a consolidated set of financial statements is not prepared for a local Irish interest group (as proposed to be defined by Section 411 TCA 1997). Preparing consolidated financial statements for the sole purpose of applying the ratio rules will add a significant additional burden for many taxpayers and so we would request that this is taken into account.

**Question 9**
**Comments are invited on the above approach to the transposition of the group ratio rule.**

With regards to ‘single company worldwide groups’, we would request that the definition of ‘related parties’ is the existing definition of an associated enterprise within Section 835AA TCA 1997 as this is the definition already proposed for within a definition of a standalone entity and avoids introducing further definitions into the legislation which will increase complexity.

***Question 10***
***Suggestions are invited concerning appropriate adjustments to the preliminary tax rules, to allow reasonable opportunity for compliance with preliminary tax obligations following the introduction of the ILR.***

We would request a period of leniency following the introduction of the new rules whereby a taxpayer is not penalised for underpaying their preliminary tax liability where they have underpaid solely or mainly because of a disallowance due to ILR.

Specifically in our industry, in the period of sale of a property (whether in a property development or investment property context), it is often difficult to accurately forecast the tax liability for the period or periods of sale (e.g. whether phases of a development are sold straddling two accounting periods). The introduction of the ILR will add additional complexity and uncertainty to forecasting preliminary tax based on the current and prior year accounting period and therefore additional leniency would be most welcomed.