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ATAD Implementation – Interest Limitation Feedback Statement
Tax Division
Department of Finance
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By email: ctreview@finance.gov.ie

Response to Feedback Statement II

Dear Sir/Madam

EY welcomes the publication of the second Feedback Statement in relation to the EU Anti-Tax Avoidance Directive ("EU ATAD") Implementation Article 4 Interest Limitation ("the Feedback Statement") by the Department of Finance.

About EY

EY is a global leader in assurance, tax, transaction and advisory services with almost 300,000 people based in over 730 offices in 150 countries.

In EY's capacity as tax advisors to our large and diverse client base (including large multinationals, domestic PLCs, SMEs and financial services organisations), we assist our clients on a variety of international tax issues. Our work includes assisting clients understand the impact of changes to tax law, including change arising from the ongoing OECD BEPS initiative and implementation of the EU ATAD, and helping those clients in meeting their tax compliance obligations around the world.

Our clients' legitimate choices around how to finance their business activities, acquisitions, and other business projects are an important aspect of what we do. Those choices will be directly affected by the implementation of EU interest limitation rules ("EU ILR") in Ireland. We are therefore well placed to comment on the relevant issues and welcome the opportunity to comment further on the Feedback Statement in line with our participation in other public consultations on the BEPS process.

Our response should be considered in conjunction with our submission of 8 March 2021 on the first Feedback Statement. Furthermore as we are feeding directly into submissions made through other bodies and are aware of technical clarifications provided by the Department of Finance and Revenue on an information call with stakeholders, for the purpose of this submission our feedback will focus on our key observations.

Background

At the outset we reiterate that in our experience, borrowings by Irish companies generally arise from a legitimate choice of funding methods for genuine commercial reasons. The obtaining of an interest deduction in Ireland has not historically been a major driver of the type of base erosion and profit shifting activities which the OECD BEPS initiative and EU ATAD seek to counteract especially given that

Ireland's comparatively low corporation tax rates generally make the base erosion of Ireland far less attractive.

Given the complexity of the subject matter and its interaction with existing rules, it is important that Ireland's approach takes cognisance of potential compliance costs and implementational difficulties likely to be encountered by companies seeking to apply the new rules. While published guidance from the Revenue Commissioners will be required as soon as possible after enactment of the relevant legislation we believe it is important that maximum clarity is contained in primary legislation. We also recommend that comprehensive and timely consultation continue post publication of legislation and with respect to the development of any guidance from the Revenue Commissioners.

Recommendations

Commencement

It is understood that implementation of EU ILR will commence on 1 January 2022. For operational reasons we believe that EU ILR should apply for accounting periods beginning on or after 1 January 2022.

This would be consistent with the commencement provisions that applied to Part 35A (transfer pricing) and Part 35B (controlled foreign company rules). This is essential in the context of calculations that are dependent on data extracted from accounts with respect to profits, interest equivalents, tax, total assets and equity not only of a single entity, but also multiple entities in an interest group and consolidated accounts of a worldwide group.

Group rules

We note that the Feedback Statement at Part 4.1 envisages that amounts comprising the results of all members of an interest group will require the disregarding of transactions between members of an interest group. The Feedback Statement notes that disregarding transactions between members of an interest group '*may be complex and administratively difficult for some groups'*.

We believe the proposed disregard approach to 'comprising the results of all group members' would be disproportionate and could represent a significant compliance burden for many groups with more than a handful of intra-group transactions. Tax group consolidations are not prepared as a matter of course and for most groups with multiple members, the workings of consolidated financial statements (normally prepared at parent entity level) would be insufficient to identify all transactions between specific entities in an Irish tax group.

We suggest that a more proportionate response to achieving the same result would be to allow the option of aggregating the results of members of an interest group. This would naturally offset intra-group transactions. It is not clear to us where an exchequer risk would arise under such an approach. We believe that any material risk of overstatements of EBITDA due to asymmetrical treatment is unlikely in practice as this would be accompanied by an increase in taxable profits and resultant tax at entity level. If concerns persist, targeted measures focusing on identifiable risks might be considered as an alternative to requiring consolidation in all instances.

Building a better working world

Interaction with s.291A TCA97

We note the proposal outlined at 5.1 with respect to the interaction of EU ILR with s.291A TCA97.

In the majority of situations, a relevant entity would likely wish to benefit from such additional capital allowances. Under the proposed approach in the Feedback Statement there is a possibility that an interest disallowance may arise some years after time limits for making claims have expired or technical claims for allowances may be overlooked.

The balance of convenience would appear to favour not requiring a claim to be made to increase capital allowances to compensate for any interest disallowance but instead the capital allowances should adjust automatically. Alternatively, the default should be that capital allowances will automatically increase, with an election, if necessary, to opt out of this.

Self-assessment

It is likely that the extensive information required to accurately compute disallowable interest will not be available in all instances at the time of filing a relevant entity's Form CT1. Given the number of entities involved in groups and the interaction with consolidated financial statements, no restrictive time limits should apply to adjustments required to disallowable interest calculations. At a minimum, amendments to returns and self-assessments should be facilitated at any time within the normal four-year time limits for amending self-assessments under s.959V TCA97.

In the context of an interest group, it would appear reasonable to also provide that any adjustment to a disallowable amount or taxable interest equivalent of an interest group may be allocated to a specific entity, irrespective of the amounts (if any) previously allocated or deemed to be applied automatically on a proportionate basis. This would avoid the necessity to amend returns and self-assessments for all members of an interest group if computational adjustments are required at group level, thus reducing administrative costs from both a relevant entity and Revenue Commissioners perspective.

Preliminary tax may be particularly problematic given the inherent uncertainties of utilising information coming from other group companies and group allocations. To alleviate some of the risk arising from expectations differing from actual, we believe a provision similar to s.959AT could be considered for the interest group (unnecessary if the interest group and local tax group are one and the same). Also, to provide greater certainty for preliminary tax calculations, the utilisation of prior year group ratios could be considered as a proportionate response to the compliance difficulties likely to be encountered by group companies in particular.

Interaction with de-minimis exemption

The ATAD allows Member States to introduce a de-minimis exemption for net interest expense up to €3m per taxpayer per period. It is understood that it is intended that deductible interest expenses are to be 'value based'. A consequence of this is that €3m actual interest deductible against profits taxed at 25%, for example Case V interest, would be grossed up to €6m in computing deductible interest expense. While Case V income would also be grossed up to enable a 'like with like' comparison for allowable amount calculation purposes, this grossing up does not apply to the fixed de minimis amount of €3m.

The de minimis exemption is an administrative relief for smaller amounts of interest. ATAD envisages that in the above circumstance, €3m Case V interest should be fully within the scope of the de minimis exception. It would seem appropriate to factor value basing into the application of the €3m de minimis exemption.

Interest Group

Aligning the definition of an "interest group" with that of a corporation tax group for loss relief purposes under s.411 TCA 97 is helpful in that this is a definition which taxpayers in Ireland are familiar. However, using the same definition does present some obstacles for taxpayers that wish to apply an interest group for all Irish taxpayer companies that are within the same 75% shareholding group.

Under s.411 TCA 97 companies can only be members of a group where the 75% shareholding relationship is traced through companies which are tax resident in an EU Member State or a country that Ireland has a Double Tax Treaty with (known as a "relevant territory" for this purpose). We are aware of numerous groups with Irish taxpayers that are within a 75% ownership group but where the ownership is traced through an entity which is not tax resident in a relevant territory. This may arise where there has been an acquisition of operations that remain segregated for business reasons. It would seem unfair and not aligned with the intention of an interest group as provided for in the EU ATAD to have such businesses be adversely impacted by not allowing them to treat all Irish taxpayers within a 75% shareholding group as one interest group for this purpose. As such, we recommend that the definition of an "interest group" be expanded to remove the requirement that the 75% ownership relationship needs to be traced through companies that are tax resident in a relevant territory.

Definition of financial undertaking

We note the definition of financial undertaking in line with that which is provided for under the EU ATAD. We note different stakeholders have differing views on the need for an exclusion for financial undertakings. In order to allow for greater taxpayer optionality, it would be preferable to provide for an optional exclusion whereby taxpayers could choose to apply the exclusion or not (if preferable this option could be locked in for a period of time). This would be particularly helpful when considering both the local group and the group ratios as excluding entities within a group which fall within the definition of a financial undertaking from these calculations could prove particularly burdensome.

Legacy Debt

We welcome the inclusion of a "legacy debt" exclusion as allowed for under Article 4(4)(a) of the EU ATAD whereby loans which were concluded before 17 June 2016 may be excluded from the scope of the interest limitation rules. As noted in the EU ATAD such an exclusion does not apply to any interest arising from a modification of that loan. We understand that a modification in this regard should refer to a material modification of the terms of the loan which were agreed before 17 June 2016 (i.e. an amendment to the amount of principal which can be drawn down under the facility, the interest rate on the loan or the duration of the loan).

When considering a modification for this purpose in the context of both phased drawdowns and revolving credit facilities, we view that any subsequent drawdowns post 17 June 2016 on loan facilities up to a limit the terms of which were agree pre 17 June 2016 should not constitute a modification as the terms in place at 17 June 2016 allowed for it. As noted in our previous submission, other tax authorities in EU Member States have adopted a position that drawdowns on a facility in place at 17 June 2016 should not constitute a modification and they have specifically provided for this in guidance. If a similar approach was adopted in Ireland that would be welcome. Such an outcome would seem to align with the intention of the EU ATAD and should not cause any anti-avoidance concerns as taxpayers did not have the opportunity to restructure their funding arrangements prior to the enactment of the EU ATAD.

Definitions of 'interest equivalent', 'taxable interest equivalent' and 'deductible interest equivalent'.

Taxpayers will welcome the increased certainty provided by the definition of "interest equivalent" as compared with the first Feedback Statement. Certainty in the enacted law through specificity and related guidance as to the meaning of "economically equivalent" will be welcome.

We welcome the inclusion of "the finance cost element of finance lease payments" in the definition of "interest equivalent". However, we note this does not include operating lease payments. In our view, Ireland should consider allowing the financing element of the lease rental income earned by operating lessors carrying on a trade of leasing plant and machinery to be treated as economically equivalent to interest.

We also note that discounts which are economically equivalent to interest should be regarded as "interest equivalent" for this purpose. We would welcome clarity that discount in this context refers to all forms of profit realised for debt which is acquired at a discount.

Technical aspects

A number of technical aspects arising from the Feedback Statement have already been raised by EY and some of these were addressed on the stakeholder call. We will follow up on these matters at TALC as necessary and upon sight of the legislation in Finance Bill 2021. Examples of areas requiring further clarification might include:

- The treatment of value-based reliefs for the computation of EBITDA
- The treatment of s.247 excess interest surrendered via group relief in the context of the computation of both deductible interest expense and EBITDA of a relevant entity, especially a relevant entity that is not an interest group
- The impact of reduced carry back claims on the calculation of flexible deemed borrowing costs (subsection (2)(a) of 3.9.1 of the Feedback Statement only envisages tax payable reductions for a current period)
- The treatment of balancing charges for EBITDA purposes
- The identification of (some or all) deemed borrowing costs as a group attribute, their allocation to other members of an interest group and the methodology of providing the appropriate relief.

We look forward to continued dialogue as the process evolves.

We are at your disposal to discuss the matters raised in this submission in further detail.

Yours sincerely

ERNST & YOUNG