Building a better working world

Ernst & Young
Business Advisors
Harcourt Centre
Harcourt Street
Dublin 2
D02 YA40
Ireland

Tel: + 353 1 475 0555
Fax: + 353 1 475 0599
ey.com

Hybrids and Interest Limitation - Public Consultation
Tax Division
Department of Finance
Government Buildings
Upper Merrion Street
Dublin 2
D02 K728

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Email: ctreview@finance.gov.ie

Public Consultation - Hybrids and Interest Limitation

Dear Sirs/Madams

EY welcomes the publication of the EU Anti-Tax Avoidance Directive ('ATAD') Implementation Hybrids and Interest Limitation Public Consultation ('The Consultation') by the Department of Finance.

About EY

EY is a global leader in assurance, tax, transaction and advisory services with over 247,000 people based in over 730 offices in 150 countries. In EY's tax team we have senior professionals who through their work in EY gain a clear understanding of the subtleties of a range of tax issues and of the complexities of how tax systems interface with one another. In our work as tax advisors for large multinationals, domestic PLC's and SME's we assist our clients on a variety of international tax issues. This work includes assisting clients understand the impact of changes to tax law, including changes arising from the OECD[1] BEPS[2] initiative and the implementation of the ATAD, and helping those clients in meeting their tax compliance obligations around the world. As such, we feel well placed to comment on the relevant issues and welcome the opportunity to participate in The Consultation.

Technical Background

In response to the need for a more fair and equitable taxation system, the European Commission, in its communication of 17 June 2015 set out an action plan for fair and efficient corporate taxation in the EU. The final reports on the 15 OECD Action Items against BEPS were released to the public on 5 October 2015. The European Council conclusions emphasised the need for common yet flexible solutions at the EU level. Member States will have to be proactive in taking strategic actions and discouraging tax

[1] Organisation for Economic Co-operation and Development
[2] Base Erosion and Profit Shifting

avoidance activities. The laws enacted into domestic legislation should aim to provide taxpayers with legal certainty.

Action 4 of the BEPS Action Plan ('AP4'), entitled 'Limiting Base Erosion Involving Interest Deductions and Other Financial Payments' seeks to address the sophisticated means by which certain payments can avoid restrictions on deductibility. The purpose of the interest limitation rule is to limit the deductibility of taxpayers' exceeding borrowing costs by putting in place a ratio for deductibility which refers to a taxpayer's taxable earnings before interest, tax, depreciation and amortisation ('EBITDA'). As indicated in the Consultation document, Ireland's existing targeted rules for addressing BEPS risks, while structurally different to the ratio-based approach in Article 4 of ATAD, are, in the view of the Department of Finance, equally effective in addressing interest limitation. However, as noted in the Corporation Tax Roadmap, the EU Commission are adopting a strict ratio-based approach in assessing whether national targeted rules are equally effective to the ATAD interest limitation rule and, for this reason, Ireland has initiated a consultation process so that legislation is ready to be enacted in the event that agreement with the EU Commission is not obtained.

Action 2 of the BEPS Action Plan ('AP2'), entitled 'Neutralising the Effects of Hybrid Mismatch Arrangements' was been incorporated into ATAD[3] and ATAD2[4], which oblige Ireland to introduce anti-hybrid rules by 1 January 2020 (1 January 2022 in the case of reverse hybrid mismatches). Hybrid mismatch rules are arguably the most complex aspect of ATAD and their implementation will need to be carefully considered. Indeed The Tax Strategy Group Paper on Corporation Tax noted that 'the implementation of these rules will be extremely complex' and warranted a consultation process.

We welcome the Irish Government's commitment to seeking input from interested parties before implementation of these actions to enable policymakers, legislators, the Revenue Commissioners and taxpayers with sufficient time to prepare for such updates in the context of both interest limitation and anti-hybrid rules. We would like to reiterate our recommendation from the submission we made in January 2018 in relation to Mr Coffey's *Independent Review of Ireland's Corporation Tax Code* that we believe that the introduction of a notional interest deduction would go a long way in maintaining Ireland's competitiveness and achieving coherence in Ireland's response to the ATAD changes.

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[3] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market.
[4] Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries.

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We see no compelling Irish tax policy reason to implement rules which go beyond the minimum standard set down in the ATAD. We note this is consistent with Ireland's overall position on the OECD BEPS recommendations. It is crucial that any resulting changes to Irish tax legislation are made through the lens of competitiveness, stability and certainty.

We believe that the vision for the future of the Irish financial services sector laid out in the *IFS 2020 A Strategy for Ireland's International Financial Services Sector 2015-2020 Action Plan 2018* should be given credence and the ATAD should be implemented in the context of Ireland's importance as a key location for international financial services activity. Indeed the Action plan specifically singles out banking & payments, funds, insurance and reinsurance, investment and asset management, and aircraft leasing & financing[5].

Lastly, EY has not answered all the questions set out in the Consultation paper. However, we as a firm have been fully engaged with the consultation process and continue to be involved in ongoing dialogue with Revenue and the Department of Finance.

Yours faithfully

Ernst & Young

[5] https://www.finance.gov.ie/wp-content/uploads/2018/01/180130-IFS2020-Action-Plan-2018.pdf

Detailed responses to the consultation questions

Anti-Hybrid Rules

Entities within scope

Question 1 of the consultation is as follows:

What entities should be within the scope of Ireland's anti-hybrid regime?

The ATAD provides that the rules should apply to corporate taxpayers in a Member State. We do not believe that it was intended that non-resident entities within the charge to Irish tax in respect of income tax and capital gains tax be included, which is borne out by the examples in AP2.

Regulated funds (referred to as investment undertakings) are not subject to corporation tax and are therefore not a corporate taxpayer. The anti-hybrid rules would not in any event apply in respect of any payments made by an investment undertaking as it does not have tax deductible expenditure. These entities should therefore be excluded from the scope of the rules.

The aims of the anti-hybrid rules could be easily achieved by providing that the taxpayer should be within the charge to Irish corporation tax.

Foreign/local taxes

Question 2 of the Consultation is as follows:

What foreign taxes should be considered as equivalent to Irish taxes for the purposes of establishing whether or not a mismatch outcome arises?

The definition of foreign taxes should be as broad as possible to ensure that the rules do not in actual fact create double taxation.

Question 3 of the Consultation is as follows

Taking account of the foreign taxes to be included, what outcomes should be included within the concept of "inclusion"? What timings should apply to that test?

Ireland already has a concept of "subject to tax" contained in Section 110 Taxes Consolidation Act 1997 ("TCA") which refers to "*a tax which generally applies to profits, income or gains received in that territory from sources outside that territory*". This particular provision was also aimed at hybrid mismatch scenarios, and the examples contained in Part 04-09-01 of the Tax and Duty Manual illustrates helpful guidance which could also be drawn upon for the purposes of the current test.

"Included" should be defined such that subject to tax in any jurisdiction and not that of the jurisdiction of the recipient (for example under CFC or similar rules or the global intangible low taxed income (GILTI) regimes. Income included in the taxable profits of another entity in the same jurisdiction should also be treated as included.

ATAD and AP2 makes clear that a hybrid mismatch should not arise where the non-inclusion relates to the status of the payee (for example, a tax exempt pension fund) or the context in which the instrument is held. It also makes clear that a no tax outcome due to the fact that the particular jurisdiction does not levy corporate income tax is not within scope.

Throughout AP2, there is a clear causal link between the hybrid entity or instrument and the mismatch result. This causal link should be clearly incorporated in the legislation. Incorporating such a link will naturally ensure that no tax outcomes not intended to be within the scope of the rules are not inadvertently caught by the implementing provisions.

Timing of inclusion

Question 4 of the Consultation is as follows:

There are a number of ways that timing mismatches can be dealt with on the implementation of ATAD2. Different methods may be more appropriate for different hybrid mismatches. What issues should be considered when deciding how to treat timing mismatches?

AP2 intends to bring indefinite deferrals[6] within the scope of the rules. It provides for a safe harbour by providing that "*a payment should not be treated as giving rise to a mismatch if it will be required to be included by the payee in the ordinary income in an accounting period if that commences within 12 months of the end of the payer's accounting period*". AP2 then goes on to state that a payment should be

[6] We note that recently implemented US Anti Hybrid rules allow for a period of 36 months after the end of the date of the US taxable year in which the US entity makes the payment.

included in a reasonable period of time and refers to an arm's length type benchmark in assessing whether the instrument is really agreed on commercial payment terms. It may be possible to incorporate a concept of structured arrangement in catering for this concept in the legislation.

We suggest that the legislation contain a safe harbour and also an arm's length benchmark in considering whether any possible deferral is within scope.

To the extent that a deduction is denied based on a timing difference, it would be logical that the deductible amount could be carried forward until such time as the payment was included in the recipient jurisdiction.

Disregarded PE's

Question 5 of the Consultation deals with disregarded PE's as follows:
Q5 As set out in Ireland's Corporation Tax Roadmap, a public consultation on moving to a territorial regime is to be held in early 2019. If Ireland were to move to a territorial regime what are the relevant considerations to implementing a disregarded PE rule?

If Ireland implements the defensive rule to prevent disregarded PEs being established in Ireland will to a large extent depend upon whether Ireland does in fact move to a territorial regime. We strongly support the move to a territorial regime and we assume that as part of the consultation process that the ATAD will be factored in.

Other defensive measures

Q7 What are the relevant considerations to deciding whether or not Ireland should implement the defensive rules in the context of these hybrid mismatches?
We recommend that the implementing legislation should not go further than that required by the ATAD. If there are policy reasons for implementing these optional defensive measures, these should be articulated through a consultation process.

Charge to tax

Question 8 of the Consultation is as follows:

How should these amounts of income be taxed? A number of options exist, such as including them as a Case IV amount chargeable to corporation tax, charging them to income tax, or having different treatment for different anti-hybrid rules.

The charge to tax should follow the relevant charging provisions and applicable rate for the equivalent income earned in Ireland under normal Irish tax principles. We understand that there is precedent for this approach in the recently enacted controlled foreign corporation legislation.[7]

Imported mismatches

Question 9 of the Consultation is as follows:

What factors should be considered in relation to the implementation of the rules to prevent imported mismatches, specifically in relation to their application where the Irish taxpayer is transacting with a person in an EU country which has implemented ATAD2?

Paragraph 25 of the preamble to ATAD2 sets out the rationale for the concept of an imported mismatch. It refers to the shifting of a "hybrid mismatch between parties in third countries into the jurisdiction of a Member State". This indicates that danger is viewed as originating outside of the EU.

We have referred later in this submission to the importance of including a burden on taxpayers which is can be discharged in a reasonably practical matter, i.e. the rules should encompass a level of reasonable awareness as one of the steps in ascertaining whether there is an in scope hybrid mismatch. We note that the UK has a concept of "reasonable to suppose" that there is a hybrid mismatch in assessing whether an adjustment under their equivalent rules should be made.

It would be reasonable to suppose that there is no hybrid mismatch in the funding chain where the payment is made to another EU Member State. EU Member States rely on the implementation of rules in other EU Member States in terms of regulatory supervision and it would make sense therefore that they can also rely on other EU Member States once those Member States have implemented the ATAD. We

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[7] Section 835R(6) TCA

assume that the EU Commission will take enforcement action in the event that a Member State has not properly implemented the ATAD.
Taxpayers would benefit from detailed examples providing guidance on the level of investigation that Revenue anticipate will be required in such a scenario. Detailed examples would be particularly helpful in this regard.

Dual inclusion and financial instruments

Question 10 of the Consultation is as follows:
What factors should be considered in relation to the concept of dual inclusion income being incorporated into the application of the financial instrument anti-hybrid rules to avoid those rules resulting in double taxation of the same income?

The dual inclusion safeguard should apply across all hybrid mismatch arrangements. In order for there to be dual inclusion in this context, in our experience there would also be a payment by a disregarded hybrid entity, which results in the dual inclusion outcome. The transaction is in substance a disregarded hybrid payment. To exclude financial instruments from the dual inclusion safeguard would result in economic double taxation. While this may not often arise in practice (most likely the payment would simply be a disregarded hybrid payment), there are particular instances where it may arise and to deny the deduction would be inconsistent with the aim of the ATAD, i.e. to prevent deduction non-inclusion outcomes or double deduction outcomes.

Dual inclusion income and deferrals

Question 11 of the Consultation is as follows:
While there is a symmetry in allowing the deferral of an adjustment, the practicalities of tracking deferred adjustments must be considered. How could such timing differences be dealt with, from a practical perspective, in the implementation of the anti-hybrid rules? This question is linked to the question on timing issues in 'subject to tax' above.

There should be consistency in the application of the "included" test and the concept of dual inclusion. Where the timing differences are reasonable, there should be no hybrid mismatch.

Financial trader exemption

Question 12 of the Consultation is as follows:
What factors should Ireland consider when determining, as permitted, whether or not to apply the deduction without inclusion rules to such trades by financial traders?

We believe that the financial trader exclusion should be incorporated into Irish law. Financial traders carrying out their transactions in the ordinary course of business should not be caught by such rules.

Associated enterprises

Question 14 of the consultation is as follows:

What factors should be considered when implementing the concept of consolidations accounting groups in hybrid mismatch measures?
Should a version of section 432 Taxes Consolidation Act 1997 ("TCA") be used to define associated enterprises? Or, rather than referring to section 432 relevant accounting standards, should the concepts of a group under accounting principles be imported into docmestic legislation, for example, section 7 Companies Act 2014 as a template?

The anti-hybrid rules will apply to transactions between 'associated enterprises. We believe that the use of a modified version of section 432 TCA definition of 'associated enterprises' to define who may be 'associated enterprises' would broaden the scope of the anti-hybrid rules well beyond what is contemplated by the ATAD and has the potential to unintentionally damage Ireland's financial services industry by introducing restrictions that are broader than those contemplated by the ATAD.

This approach to defining 'associated enterprises' could, if adopted, result in Irish companies being 'associated' with their non-bank lenders for ATAD purposes and all arrangements with non-bank lenders falling within the scope of the anti-hybrid rules. This 'control' test under section 432 TCA is already one of the most complicated concepts in Irish tax law and is amongst the most difficult to apply in practice. It casts a very wide net and creates a concept of control significantly beyond the normal meaning of that

term. The problem arises because, in the vast majority of cases, a non-bank lender will be treated as controlling a company under section 432 TCA (by virtue of the 'assets on winding-up test') and would be treated as an associated enterprise as a result. This would be the case even though the lender is not associated with the Irish company in any conventional understanding of that term - in particular it will generally not hold any shares, will not have any voting rights and will have no entitlement to distributions. This is an issue for all Irish companies that raise debt-finance from sources other than banks, although it will impact Irish companies operating in the financial services sector.

Companies in the financial services industry, such as securitisation and aircraft leasing companies, are often highly-leveraged. As a result, such companies are commonly treated as being 'controlled' by one or more lenders by virtue of section 432 TCA, even though such lenders may not have voting control, cannot appoint directors and have no positive authority over the company's affairs. Furthermore, it is generally impossible to determine who (if anyone) may control a company as a loan creditor where debt-finance is raised through the issuance of bonds that are held in a clearing system. In those cases, companies do not know who their bondholders may be and so cannot conclude on who may control them. This is commonly the case for securitisation companies.

Therefore, we consider that the concept of 'control' in section 432 TCA is unworkable in practice, particularly in the financial services industry and should not be used to define 'associated enterprises' for ATAD purposes. At the very least, it would have to be considerably altered in order that it is consistent with the ATAD and workable for taxpayers in practice.

We believe a more simplified version of associated enterprises should be preferred, with section 11 TCA as the appropriate starting point and amended as necessary to make it consistent with the ATAD.

The ATAD requires that the definition of an associated enterprise includes 'an entity that is part of the same consolidated group for financial accounting purposes as the taxpayer, an enterprise in which the tax payer has a significant influence in the management or an enterprise that has a significant influence in the management of the taxpayer'.

The ATAD does not further define 'significant influence'. We suggest that section 7 of Companies Act 2014 would be a good starting point in addressing and defining this point.

The ATAD goes on to further define a 'consolidated group for financial accounting purposes' to mean a group consisting of all entities which are fully included in consolidated financial statements drawn up in

accordance with the International Financial Reporting Standards or the national financial reporting system of a Member State.

ATAD therefore, does not specifically require consolidated accounting principles of a jurisdiction outside of the EU (other than IFRS) to be considered in defining an associated enterprise. However, it does require that national financial reporting systems of other EU member states are included, to the extent the taxpayer is consolidated into those group accounts.

We suggest using section 7 of the Companies Act 2014 as a starting point, and broadening to include taxpayers consolidated into EU and IFRS consolidated group.

Hybrid entities: Clarification of the tax treatment of entities

Question 14 of the Consultation reads as follows:
Is the current case law clear enough to give taxpayers certainty on the treatment of an entity, when it comes to applying the anti-hybrid rules?

We fully agree that to apply the anti-hybrid rules, taxpayers must have certainty on the classification of entities under Irish law.

In principle, we agree that legislation for the position would provide taxpayers with the most certainty. Given the importance and complexity of this area, significant consultation with industry / advisers would be required.

In the interim, a published list of previous Revenue conclusions on the tax status of an entity would be helpful. Another interim option which aid assistance to taxpayers would be if Revenue were to publish their views on their interpretation of Quigley v Harris[8] and to what extent they view this as consistent or otherwise with the UK jurisprudence on this point.

Investor/Payee jurisdiction

Question 15 of the Consultation reads as follows:

[8] [2008] IEHC 403

Should a single concept be used to encompass both investor and payee when determining both if a payment has been deducted and included in income?

We fully agree that a single concept should be used and should be clearly defined. For our part, we have found some of these concepts as outlined in AP2 vague and difficult to apply in practice.

We note that the concept as defined should not cut across the fact that "included" could mean inclusion in another entity or another jurisdiction and not simply included in respect of the entity receiving the payment.

Financial instruments

Question 17 of the Consultation reads as follows:
What rules could be described as Ireland's rules for taxing debt, equity or derivative returns? Is it sufficient to describe them as debt, equity or derivative instruments? There are a number of definitions of "financial assets" in the TCA: should they be used as a basis for this definition? Alternatively, could financial instruments be defined in line with IAS 39?

The definition of "financial asset" in Section 110 TCA could be used in the context of the anti-hybrid rules.

Structured arrangements

Question 18 of the Consultation reads as follows:
Recital (12) recognises that to ensure proportionality, ATAD2 should only apply to cases where there is a substantial risk of avoiding taxation through the use of hybrid mismatches. What factors should be considered in implementing the awareness test and the value test? What practical difficulties may be encountered in establishing whether or not a structured arrangement exists?

The purpose of the structured arrangement definition is to capture those taxpayers who enter into arrangements that have been designed to produce a mismatch in tax outcomes while ensuring taxpayers will not be required to make adjustments under the rule in circumstances where the taxpayer is unaware of the mismatch and derives no benefit from it.

ATAD II defines a Structured Arrangement as "*an arrangement involving a hybrid mismatch where the mismatch outcome is priced into the terms of the arrangement or an arrangement that has been designed to produce a hybrid mismatch outcome, unless the taxpayer or an associated enterprise could not reasonably have been expected to be aware of the hybrid mismatch [the awareness test] and did not share in the value of the tax benefit resulting from the hybrid mismatch [the value test]*".

It is difficult to see how the awareness test could be anything other than an objective standard using reasonableness as the standard. We would welcome a number of examples in the guidance accompanying the legislation in order that taxpayers may have a benchmark in order to assess what circumstances Revenue would view a taxpayer as having such awareness.

In relation to the value test, the taxpayer must have actually shared in the value of the hybrid mismatch, i.e. there must be a clear shared economic benefit priced into the notes or interest component of the notes which takes account of the tax benefit to the lender. Careful consideration should be given as to how the "value of the tax benefit" is defined. It is not sufficient in our view that the investment is simply more marketable due to its tax treatment, the value of the tax benefit should be priced into the investment.

Capital market transactions

Question 19 of the Consultation reads as follows:

Taking account of recital (12), should provision be made such that the anti-hybrid rules only apply where it would be reasonable to consider that the Irish taxpayer was aware it was party to a hybrid transaction? What are the relevant considerations?

The EU Capital Markets Union policy must be respected and normal market deals which do not involve tax avoidance cannot be adversely affected.

We note that in a normal capital markets transaction, the issuer will not usually have any way of identifying the holder of the bonds (with the exception of the risk retention holder) and therefore will have no way of identifying if there is a hybrid mismatch. We also note that in a typical capital markets structure, there is unlikely to be a noteholder with the relevant connection to the issuer that would make it an associated enterprise. The notes would typically be widely held and even considering the risk

retention holder, the issuer and originator / other retention holder, would not be part of the same consolidated accounting group.

Assuming therefore that the transaction is not a structured arrangement, it is difficult to see how he issuer could reasonably be aware (or that it was reasonable to suppose) that it was a party to a hybrid mismatch arrangement.

We request that an objective standard of reasonable awareness be included in the legislation when considering whether an SPV engaging in a capital markets transaction is a party to a hybrid mismatch arrangement. This will ensure that the legislation can be applied by taxpayers in a reasonably practicable manner.

We note that there are likely to be circumstances where the taxpayer could not reasonably have been aware of the hybrid mismatch outcome, even in cases where the benefit of the outcome has in fact been priced into the arrangement to some extent. In the UK, Her Majesty's Revenue & Customs ('HMRC') guidance provides an example of such a situation and in these cases absolves the taxpayer from applying the rules where a company raises funds on a "plain vanilla" basis. This is also relevant to the discussion on imported mismatches. See Over-arching arrangements and third-party borrowing - INTM559230, p.408 HMRC Guidance.

HMRC acknowledge that a taxpayer should not be obliged to make "disproportionate enquiries". The UK legislation implementing the ATAD has incorporated a concept of reasonableness in terms of the inquiries that the taxpayer should make, i.e. that it is "reasonable to suppose" that a hybrid mismatch would arise. This is justified by the ATAD imposing an objective standard.

What is tested for hybridity?

Question 20 of the Consultation is as follows:
Should regard be had to the transaction, to the actual circumstances of the taxpayer or to the laws of the foreign jurisdiction? Should this vary depending on the type of hybridity being neutralised?

In general, in our view regard should be had to the laws of the jurisdiction where the payee / investor is resident in order to assess hybridity. This is consistent with the requirement of reasonable awareness (or whether it is reasonable to suppose) that the taxpayer is a party to a hybrid mismatch arrangement.

However, there may be cases where it is appropriate to consider the tax treatment of the specific investor, for example, where the payee / investor is a tax exempt entity.

Interaction with existing domestic provisions

Question 21 of the Consultation is as follows:
Bearing in mind both the interest limitation and anti-hybrid requirements of ATAD, what amendments, if any, should be made to these domestic provisions?

While we agree that the interaction with existing domestic provisions should certainly be carefully considered, we would need additional time to fully think through the interaction. In this regard, specific consultation should be undertaken on this point. The interest limitation provisions contained in ATAD will also require careful consideration in this regard and the consultation should cover both work steams concurrently.

Treatment of disallowed payments

Question 23 of the Consultation is as follows:
Should adjustments under the anti-hybrid rules cause payments to be treated as distributions or simply as non-deductible expenses?

We note that while Ireland has traditionally treated disallowed interest expense as a distribution, there is precedent in the TCA for treating such as a non-deductible expense (see [9]provisions relating to a specified property business in Section 110 TCA). Treating such expenses as non-deductible would allow the charging provisions and exclusions for interest withholding tax to apply. To do otherwise would be to treat payments to different investors differently in respect of the same tranche of debt for example requiring differing representations and documentation requirements making it unworkable in practice.

Order of application

Question 24 of the Consultation is as follows:

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[9] Section 110(5A)(d)

In what order should the rules in ATAD and ATAD2 apply? Are there any other order of applications issues which should be considered in the implementation of ATAD and ATAD2?

In principle, we would agree that the ordering mechanism contained in AP2 we incorporated into Irish law. The point though will require further consideration on our part.

Impact of foreign anti-hybrid rules on Irish legislation

Question 25 of the Consultation is as follows:
Are there any domestic tax provisions which should be amended to ensure that they are not regarded as hybrid entities, for example, by foreign jurisdictions?

While hybrid mismatches may arise due to the differences in tax treatment of Irish entities as compared to foreign jurisdictions (for example, a foreign jurisdiction may view a partnership as opaque), it is difficult to see how changes to domestic law could rectify this. At this point, we do not believe that changes to domestic law are required.

Leases, stock lending and repo transactions

Questions 26 and 27 of the Consultation deal with leases, stock lending and repo transactions as follows:
Q 26 What domestic legislative changes may be required to the taxation of leases to clarify how they will be treated under both the anti-hybrid and interest limitation rules in ATAD and ATAD2?

Q27 What domestic legislative changes may be required to the taxation of stock lending and repo transactions to clarify how they will be treated under both the anti-hybrid and interest limitation rules in ATAD and ATAD2?

As a first point, we note that the existing tax treatment of such transactions should be put on a legislative footing where this is not already the case. We assume that there will be consultation on this point and in the context of that consultation we can consider whether the current treatment could result in hybrid mismatch outcomes. For the most part, the Irish tax treatment reflects the substance of the transaction (and accounting treatment) as opposed to the legal form but it is possible that how some of these transactions interact with other jurisdictions may produce and inadvertent mismatch outcome. This will have to be specifically considered in detail.

Reverse hybrids

Question 29 of the Consultation is as follows:

The language used in Article 9a is that the profits are taxed, which is different to the language used in relation to income being included. In keeping with the objective of ATAD2 which is to neutralise hybrid mismatches, would it be reasonable to use the same "subject to tax" definition for reverse hybrids as for all other hybrid mismatches?

Our working assumption is that the same subject to tax test should be included for reverse hybrids as for other types of hybrids. To the extent possible, consistency in interpretation would help simplify what could be a very complex piece of legislation.

Ireland should implement the provisions of the ATAD to collective investment vehicles as provided for in ATAD2.

Interest Limitation Rules

Borrowing costs under the ATAD and the definition of interest income

Article 2(1) of the Directive defines borrowing costs as:

> *"interest expenses on all forms of debt, other costs economically equivalent to interest and expenses incurred in connection with the raising of finance as defined in national law, including, without being limited to, payments under profit participating loans, imputed interest on instruments such as convertible bonds and zero coupon bonds, amounts under alternative financing arrangements, such as Islamic finance, the finance cost element of finance lease payments, capitalised interest included in the balance sheet value of a related asset, or the amortisation of capitalised interest, amounts measured by reference to a funding return under transfer pricing rules where applicable, notional interest amounts under derivative instruments or hedging arrangements related to an entity's borrowings, certain foreign exchange gains and losses on borrowings and instruments connected with the raising of finance, guarantee fees for financing arrangements, arrangement fees and similar costs related to the borrowing of funds."*

Article 2(2) defines 'exceeding borrowing costs' as the amount by which the deductible borrowing costs of a taxpayer exceed taxable interest revenues and other economically equivalent taxable revenues that the taxpayer receives according to national law.

The Directive does not include a definition for interest income. Given the broad definition provided for borrowing costs, we would propose that when the ATAD is transposed into Irish law that a symmetric approach is taken to define 'interest revenue and other economically equivalent taxable revenues' thereby mirroring the broad definition of borrowing costs. This approach would also align with the OECD commentary that in identifying whether an amount is economically equivalent to interest 'the focus should be on its economic substance rather than its legal form'[10]. In this regard, though seeking some consistency, the OECD is also seeking to ensure flexibility in giving countries options in terms of implementation.

The UK recently introduced interest restriction rules[11] which impose a fixed ratio rule similar to the ATAD Interest Limitation rule and, indeed, BEPS Action 4. Interestingly, and rather helpfully, the UK rules provide guidance and precedent in terms of the definitions included therein.

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[10] Chapter 2, Paragraph 35, BEPS Action 4, Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, 2016 Update

[11] The loan relationship rules apply to periods of account commencing on or after 1 April 2017.

The UK rules apply the concept of 'tax interest'. The 'tax-interest expense' and 'tax-interest income' amounts are the amounts brought into account for tax which comprise amounts of interest or amounts economically equivalent to interest. These amounts are aggregated to derive the 'net tax-interest expense' or 'net tax-interest income' of a company for a group's period of account[12].

Tax-interest expense amounts include:

- Relevant loan relationship debits;
- Relevant derivative contract debits; and
- Implicit financing costs in amounts payable under a relevant arrangement or transaction.

Tax-interest income amounts include:

- Relevant loan relationship credits;
- Relevant derivative contract credits;
- Implicit financing income in amounts receivable under a relevant arrangement or transaction; and
- Consideration received for the provision of a guarantee.

We believe that economically equivalent taxable revenues or taxable interest revenues should include dividends or other distributions from companies whose income is predominantly derived from interest and other interest equivalents. In addition, interest which is not deductible under Irish law should be expressly excluded from the definition of borrowing costs.

In our view, Ireland should ensure that the definition of interest income should mirror the definition of borrowing costs and should be sufficiently widely worded to encapsulate all amounts which are economically equivalent to interest.

Financial undertakings

The ATAD contains a detailed definition of financial undertakings which may be scoped out of the interest limitation rules. The definition focuses on regulated banks, insurance entities, UCITS, AIF's etc.

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12 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/684353/CIR_Guidance.pdf

A very limited interpretation of the definition of financial undertaking could cause difficulties and excessive and disproportionate restrictions on the interest expense of many Irish financial services entities. This point is covered by question 39 of the Consultation:

What factors should be taken into account in determining whether or not to apply the interest restriction to financial undertakings? If the exemption is to apply, should it apply only to regulated financial undertakings or should it apply also to non-regulated undertakings which carry on the same activities?

We agree that the interest limitation restriction should not apply to financial undertakings.

In our view, entities carrying on banking or financing activities should qualify as financial undertakings for the purposes of the interest limitation rules irrespective of their regulatory status. As you are aware, it is not always a regulatory requirement to hold an Irish banking license (or indeed an EU passported banking license) to carry out an intra-group financing/treasury trade or a broker-dealer trade including SWAP transactions, stocklending and REPO transactions etc. Indeed, many financial services entities carry out such activities under a MiFID license which is less onerous from a regulatory perspective but nevertheless provides the necessary regulatory approvals to carry out a treasury, financing or broker dealer trade. Although traditionally, many of these types of entities may well have applied to the Central Bank of Ireland to obtain an Irish banking license, it is now increasingly difficult to obtain and maintain a banking license and, thus, unless necessary from a regulatory perspective, many financial services entities will opt not to obtain one. Other types of financing business should also be included, such as, factoring and leasing business. For example, modern aircraft lessors (while not regulated) are providers of commercial aviation financial services to airlines and offer access to a wide range of aviation financing solutions, including operating and finance leases, secured debt financing and sale and leaseback transactions. These are often though not exclusively part of a wider banking group.

However, the lack of a banking license does not negate the fact that such entities are in fact financial undertakings. Therefore, we believe that the definition of financial undertaking should be sufficiently widely worded to include financial services entities that are carrying on a banking, treasury or financing business irrespective of their regulatory status, in addition to including a subsidiary of a financial undertaking (for example, a subsidiary of a bank). We believe that the focus should be on the Irish business activities of the entity rather than just narrowly focusing on their regulatory status.

Furthermore we believe that there should be an opt-in clause available for financial undertakings as to whether they want to be included within the interest limitation rules.

Pre-existing loans

Question 36 of the Consultation is as follows:

What factors should be taken into account in determining whether or not to apply the interest restriction to loans entered into prior to 17 June 2016?

Under Article 4(4) of the ATAD EU Member States can choose not to apply the interest restriction to loans entered into prior to 17 June 2016. However, the exclusion will not apply where such loans are modified on or after that date.

In our view, it is imperative that the grandfathering provision is adopted into Irish tax legislation in the context of the new interest limitation rules. It would provide a level of comfort and certainty of treatment for loans entered into prior to 17 June 2016.

The Irish tax legislation/guidance should provide confirmation that technical amendments to any loans (e.g., those which do not change the commercial features of the loan such as principal amount, interest rates and maturity), subsequent draw-downs on facility loans or transfers of loans (which are already permitted under the terms such loans) or a change of lender should not result in 'grandfathering' being lost.

Groups

Question 33 of the Consultation is as follows:

Ireland has a number of different definitions of 'group' within our national tax law. Taking account of paragraph 4.4.1 above, how should a 'group' be defined for the purposes of implementing Article 4? Should a local group include those members of a consolidated group that are within the charge to Irish corporation tax or should other criteria apply for determining the existence of a group?

Article 4 of the ATAD provides for a restriction on the tax deductibility of interest where a taxpayer's net interest costs exceed a fixed ratio up to 30% of its earnings before interest, tax, depreciation and amortisation (EBITDA). Article 4(1) provides that the interest restriction can be applied at the level of a

group, rather than on a company by company basis, and that group for these purposes should be defined with reference to national tax law. This may also include an entity within a group that does not consolidate its results for tax purposes. The taxpayer should have the option of applying the 30% EBITDA test on a group basis. The taxpayer should also have the option of availing of either 9(a) or (b) in paragraph 5.

Under section 411 TCA 1997 two companies are members of the same group if one is a subsidiary of the other or both are subsidiaries of a third company, the parent/subsidiary relationship being determined according to the test of not less than 75 per cent ownership of the ordinary share capital. The companies involved must be resident in a relevant territory, being an EU Member State, an EEA Member State with which Ireland has entered into a double tax agreement or any other jurisdiction with which Ireland has entered into a double tax agreement. Under the UK corporate interest restriction rules, this threshold is 25%.

We believe that a clear definition such as the one contained in section 411 TCA 1997 should be provided for on the transposing of the interest limitation rules into Irish tax legislation.

Standalone entities

Question 35 of the Consultation is as follows:

What are the relevant factors that should be taken into account in defining a "standalone entity"?

Article 4(3) of the ATAD provides a derogation from the above rules and provides the option to deduct exceeding borrowing costs up to €3,000,000 (across the entire group) or fully deduct exceeding borrowing costs if the taxpayer in question is a standalone entity. The ATAD specifies that a standalone entity for this purpose is a taxpayer that is not part of a consolidated group for financial accounting purposes and has no associated enterprises or permanent establishment. Article 2(4) of the ATAD defines associated enterprise for this purpose as:

- an entity in which the taxpayer holds directly or indirectly a participation in terms of voting rights or capital ownership of 25 percent or more or is entitled to receive 25 percent or more of the profits of that entity
- an individual or entity which holds directly or indirectly a participation in terms of voting rights or capital ownership in a taxpayer of 25 percent or more or is entitled to receive 25 percent or more of the profits of the taxpayer.

In this regard, it should be specified in the legislation that capital ownership refers to equity capital only.

We believe that the Irish legislation should provide clarity on the meaning of the term 'standalone entity'. In particular, we would like to see some clarity on the treatment of bankruptcy remote vehicles where, for example, the shares of the entity are held on trust for charitable purposes. Bankruptcy remoteness may be required for a variety of commercial and regulatory reasons.

In these instances, there may be a requirement to consolidate the results of the entity into a wider group for example, the entity/group holding the debt instrument issued by the entity may be required under IFRS to consolidate the results of the entity albeit the holder of the instrument would not hold the share capital or the voting rights of the entity.

In addition, the bankruptcy remote vehicle may have an 'associated enterprise' as its shareholder (holding the nominal shares) which will be associated by virtue of the fact that it will have a 25% or greater association. It should be made clear that trustee or nominee shareholding arrangements, including the holding of rights to profits by one or more registered charities, where the shareholder has no economic participation in the entity, should be ignored in determining whether an entity is a 'standalone entity'.

De Minimis threshold

Question 34 of the Consultation is as follows:

Are there any reasons why Ireland should not make provision for a de minimis threshold?

Under Article 4(3) EU Member States can choose to allow a taxpayer to fully deduct their net interest costs ('exceeding borrowing costs') where the exceeding borrowing costs do not exceed a de minimis threshold of up to €3,000,000. Where the fixed ratio rule is applied on a group basis, the de minimis threshold of up to €3,000,000 applies on a whole of group basis.

Similar to the grandfathering provision raised above, we believe that the Irish tax legislation should contain a de minimis threshold and believe that the maximum amount of €3,000,000 as included in the ATAD should be incorporated.

Long term infrastructure

Question 37 of the Consultation is as follows:

What factors should be taken into account in determining whether or not to apply the interest restriction to long term infrastructure loans? If the exemption was to apply, how should long term infrastructure projects be defined, in Irish legislation, for the purposes of this exemption?

EU Member States can decide not to apply the interest restriction to certain loans used to fund long-term infrastructure projects, which include projects to provide, upgrade, operate and/or maintain a large-scale asset that are considered in the general public interest under Article 4(4). In our view, the legislation should include an exclusion from the application of interest restrictions to loans used to fund long-term infrastructure projects.

Carry forward

Question 40 of the Consultation is as follows:

What are the key considerations in deciding which of the three policy options should be implemented in Ireland?

In our view, there should be no retrograde changes to the Irish rules. We believe that Option 2 outlined in Article 4(6) of the ATAD should be implemented by Ireland, whereby entities may carry forward indefinitely and carry back, for a maximum of three years, net interest that cannot be deducted in the current period.

EBITDA

Questions 42 and 43 of the Consultation are as follows:

Q.42 - What are the key considerations in defining EBITDA in Irish tax legislation, particularly in relation to the application of the interest restriction on a group basis? For example, where a company within the local group has a negative EBITDA, how should this be treated when calculating the EBITDA of the local group?

In our view, EBITDA should be defined by reference to generally accepted accounting practices (in line with section 76A TCA 1997). In calculating overall group EBITDA, the negative EBITDA of a group member should not be taken into account. Such group member's EBITDA should be regarded as nil for these purposes.

Q.43 - Irish companies are exempt from tax on dividends received from Irish companies. As the scheme of double tax relief for certain foreign dividends is designed to effectively mirror that exemption through the availability of credits and additional credits, if Irish dividends are treated as 'exempt income' should foreign dividends that are fully sheltered from Irish corporation tax by double tax relief also be treated as 'exempt' and therefore excluded from EBITDA?

In our view, income which is exempt from Irish tax (e.g. franked investment income or qualifying portfolio dividends in the case of, for example, financial traders) or which does not suffer incremental Irish tax (e.g., because of double taxation relief) should not be excluded from EBITDA.

Interaction with domestic provisions

Question 44 of the Consultation is as follows:

How should the provisions of Article 4 of ATAD interact with existing provisions in Irish tax legislation dealing with qualification for interest relief and with the anti-avoidance provisions relating to interest?

All business interest should be deductible subject to arm's length rule and business purpose rule. In our view the provisions of Article 4 of the ATAD should replace some of the existing interest deductibility restriction[13] provisions currently in the Irish tax code including section 247, section 130, section 110 TCA 1997. We believe that the provisions which will be introduced in response to the ATAD regarding interest limitation will be equally effective to existing provisions in the Irish tax legislation and, therefore, would render these no longer useful. On the basis that the EU Commission has not yet granted Ireland a derogation from introducing the interest limitation rules until 2024, this would indicate that Ireland's existing interest limitation rules may not be sufficiently comparable and, thus, may need to be updated to reflect the ATAD provisions. By introducing the new rules in conjunction with the existing rules, this would only serve to introduce undue complexity into the Irish tax code and potentially result in excessive restrictions on interest deductibility. Furthermore, we propose that where an anti-avoidance provision

[13] This would equally apply to Question 21 of the Consultation

denies a deduction for interest (for example, under section 130), that non-deductible interest should be excluded from calculating the borrowing costs, as a deduction for such interest is being denied already as a matter of Irish law.

We understand that repealing the above well-established provisions in the Irish tax code could cause concern for legislators. However, to alleviate such concerns, we would suggest the inclusion of an 'allowable purpose' rule similar to that adopted in the UK as part of the UK Loan Relationship rules could be helpful.

An unallowable purpose is one which is not amongst the business or other commercial purposes of the company[14]. Two purposes are specifically excluded from being amongst the business or other commercial purposes of the company. These are where:

- any part of the company's activities is not chargeable to corporation tax; or
- the main, or one of the main purposes is a tax avoidance purpose.

The test is the purpose of the loan relationship in the accounting period so a loan relationship may have a business purpose when a company enters into it but have an unallowable purpose at a later date[15]. Of course, arguably section 811C TCA 1997 could work equally as well as an allowable purpose rule but the inclusion of such a targeted rule in addition to a general GAAR may be assuring for legislators.

[14] CTA09/S442(1) & (2)
[15] https://www.gov.uk/hmrc-internal-manuals/corporate-finance-manual/cfm38120