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

BY EMAIL TO: ctreview@finance.gov.ie.

Re: **Response to Article 4 Interest Limitation Feedback Statement December 2020**

A Chara

1. Introduction

We welcome the opportunity to respond to the Department of Finance's (the "**Departmen**t") Article 4 Interest Limitation Feedback Statement (the "**Statement**"). As a policy matter, we consider it hugely beneficial that the Department engages in regular and detailed consultations and feedback statements, on a broad range of tax policy matters. Taking this proactive approach will ensure a more reflective principled approach to tax policy in Ireland.

We note that the Statement does not include full draft legislation in respect of <u>all</u> matters consulted on in respect of the interest limitation rule ("**ILR**") of Council Directive (EU) 2016/1164 of 12 July 2016 ("**ATAD**"). Given that the subject matter of the Statement will result in major legislative changes which are very technical in nature, we would encourage the Department to publish all draft tax legislation arising in full for technical consultation with interested stakeholders. This could occur in the second round of the ILR consultation. To ensure the feedback statement process is worthwhile, the Department should provide an appropriate period in which to consult with stakeholders on the entire draft legislation, that is, at least six months in advance of publication of the Finance Bill. This would better achieve the aims of the legislation in question and would avoid the need to make subsequent amendments to the law to deal with unanticipated consequences. Such consequences could include job losses in businesses that are adversely affected as a result of the additional tax costs. Furthermore, engaging in such a process will ensure that Ireland maintains an open, transparent, stable and competitive corporate tax regime with best in class, fully considered legislation and would not interfere with the parliamentary process as the Oireachtas can choose to enact, amend or reject any bill.

2. Reform of the Irish Corporate Tax System

2.1 Evolution of the Irish Corporate Tax System

We have made suggestions as to the shape of the future corporate tax system in previous submissions and only those relevant to the implementation of the ILR are included below. In paragraph 4, we have set out our responses to the specific questions raised by the Statement.

Irish policy makers deserve credit for developing an efficient tax collection system with streamlined filing requirements. In prior submissions, we observed that much of the underlying architecture of the Irish tax system tax reflects social norms and business processes from more than a century ago (and in the case of stamp duty more than three centuries ago). Irish tax policy has often been reactive and incremental and this has served the country well in an international tax environment where there was slow predictable change. ATAD, Base Erosion and Profit Shifting ("**BEPS**") and other developments have, however, resulted in (and will continue to result in) major changes internationally. These changes, in many cases, reflect the architecture of other tax systems for which they were developed. We fear that we are quickly reaching the point at which parts of the Irish corporate tax system are becoming unwieldy and practically unusable. This would undo the fine work of Irish tax policy makers over the years.

Since the rate of change over the last few years has been unprecedented, we are strongly of the view that a fundamental review of the structure and legislative basis of the Irish corporation tax system should be undertaken. To this end, we would strongly advocate that the Department convene an expert group of tax lawyers, tax accountants and economists from different jurisdictions (including Ireland) to map out the future direction of the Irish corporate tax system post-ATAD and post-BEPS. We welcome that the Minister for Finance announced a new Commission on Taxation in his Budget 2021 speech. We look forward to wide terms of reference and a diverse profile of the members.

In addition, when reviewing the Irish corporation tax system it is critically important that the incorporation of positive enhancements and the associated potential benefits continue to be considered rather than just restrictions such as the ILR. It would be disappointing if the only outcome was increased complexity and compliance costs for taxpayers and an opportunity for simplification and efficiency were lost. By seizing this opportunity, Ireland could maintain its competitiveness and reputation amongst the wider world while complying with its EU obligations. As further outlined at 2.4, we look forward the upcoming consultation on moving to a territorial regime and suggest that due consideration be given to the introduction of an elective participation regime.

2.2 Simplifying Interest Deduction

The fundamental objective of companies is to earn profit for their shareholders and to take into account their other stakeholders. The development of joint stock companies with limited liability in the nineteenth century led to a significant increase in living standards and the ease with which one can set up and operate a company has been shown to correlate directly with a country's wealth. To make companies less profitable (i.e. less effective in achieving their fundamental objective) is likely to reduce wealth in a country. The ILR appears to do this in a very blunt way and seems to lack a clear policy justification.

From a commercial perspective, it is immaterial whether debt is borrowed for the purpose of trading (including "Irish" trades taxed at 12.5% and "non-Irish" trades taxed at 25%), for activities that fall within Section 247 of the Taxes Consolidation Act 1997 ("**TCA**") or for other commercial activities. The Irish corporate tax system, however, splits this commercial continuum into separate arbitrary categories. If one were to imply a value system from this structure (and ignoring property investment for the purposes of illustration), one would conclude that a trade carried on in Ireland is superior to a trade carried on outside Ireland (as an aside this rate differential causes freedom of establishment concerns). Also, one would conclude, due to the restrictions in Section 247/249 of the TCA, that trading directly is superior to indirectly trading though subsidiaries (again a seeming breach of freedom of establishment as established in *ICI v Colmer*[1]). In particular, the "recovery of capital" rules specifically target overleverage in group structures so are no longer needed. Finally, one would conclude that any other commercial activity is discouraged. Not only does this value system reflect archaic thinking, but it leads to an overly complex tax system.

[1] CJEU Case C-264/96

The solution is simply to permit a deduction for interest on debt incurred for genuine commercial purposes, subject to the normal restrictions such as transfer pricing, anti-hybrid and now interest limitation. One could introduce a wholly and exclusively concept (similar to Section 81 of the TCA) for all expenses in line with the current deductibility test for trading expenses. A better approach would, however, be a "to the extent" approach, i.e. expenses should be deductible "to the extent" that they are incurred for the purpose of earning taxable profit.

2.3 Simplifying the Taxation of Corporate Groups

The current group relief rules are overly complex and unsuited to modern group structures. Most jurisdictions operate corporate consolidation systems i.e. the US consolidated group concept, the German *organschaft* concept, the Dutch fiscal unity etc. Ireland should introduce a consolidation system similar to one of these examples. This would simplify administration (like an Irish VAT group) and prevent temporal mismatches arising within corporate groups. For example, currently a loss in Company A can become "stranded" unless a group company has profits in the same year as the loss arose in Company A. As a result, the corporate group can makes an economic loss but can make a taxable profit and pay tax. This could be achieved in a simple manner by altering the application of the existing group relief rules so that, instead of being able to surrender losses, the companies could elect to be consolidated. Other consolidation systems could be examined to develop an efficient and effective system for Ireland. This would also resolve the question of how to approach the grouping rules in the ILR.

2.4 Simplifying Tax Credits – Moving to a Territorial System

We welcome the publication of the Corporate Tax Roadmap and, in particular, the announcement that a consultation will be opened on moving to a territorial system. Our view that the current foreign tax credit system is unnecessary since the controlled foreign company rules were introduced as well as being unwieldy, arbitrary and, in many instances in breach of EU law has been articulated in prior submissions. An elective participation exemption system should be introduced in the very short term.

2.5 Ensuring Symmetry of Treatment and Simplicity

When one of the rules (including ILR) is invoked to deny or defer an interest deduction, one needs to consider what happens to the recipient of that payment. This consideration is absent from the ATAD so the Irish state has the opportunity to remedy this omission. In principle, where the recipient is an Irish person, that person should not be taxed on that receipt until a deduction is no longer denied as otherwise double taxation arises. The current system does this in many cases by rendering certain non-deductible payments to be "distributions". We note that Section 817C of the TCA imposes symmetry when the taxpayer would otherwise benefit so there seems to be no issue in principle with addressing a lack of symmetry when the State benefits from asymmetry in the corporate tax system. Without a coherent way of ensuring that symmetry is present in the tax system, the ILR risks creating an effective tax burden in Ireland that is in excess of the statutory rate. Since this would be poor tax policy, we assume that introducing a proper symmetry rule would be uncontroversial.

3. Irish Policy Approach to Sovereignty over Corporate Tax Policy

The viability of a state is dependant on its ability to set its own tax policy and raise its own taxes to fund its activities. For millennia, writing itself was used largely to facilitate the practice of accounting and tax raising. This reflects the long-standing need of states to record transactions so that they could be taxed to fund the activities of the state. It highlights the fundamental relationship between political power in a state and the ability to levy taxation. History shows that an entity that does not have the power to levy taxation can rarely continue to function as a "state". By agreeing to ATAD, Ireland ceded, along with other Member States, a significant amount of direct tax autonomy in the field of corporation tax. This was at odds with Ireland's previous approach which was to maintain control over Irish corporation tax policy.

ATAD was developed in a relatively short period and, as a result, there was little public debate in Ireland about this fundamental change in Irish tax policy. Ireland's previous approach had been extremely successful over the last four or five decades, along with many other good policies such as investment in education and an open economy. The success was evident by the significant lifting of living standards and the lowering of unemployment and emigration rates in the period.

A greater level of public discussion may have led to a wider understanding of the reasoning behind the adoption of the new approach. To some, it now appears that Ireland will agree to the European Union setting positive rules of law in a corporation tax context. With post-Brexit Ireland being geographically peripheral to and separated from the EU, it could be argued that the historically successful policy of flexibility and autonomy should have been retained. In addition, Irish policy makers have potentially imposed a direct cost on Irish residents through the potential for fines if Ireland fails to implement ATAD in the manner that the Commission interprets. In fact, the Commission has previously taken the first and second steps in infringement proceeding process against Ireland and other Member States for the failure correctly or fully to implement ATAD. Accordingly, better public understanding of the reasoning underlying this significant policy shift by the Irish policy makers would be very useful.

It is noted that many of the provisions of ATAD mirror OECD BEPS recommendations, such as a general anti-avoidance rule (GAAR), CFC legislation, anti-hybrid rules and exit taxation. One measure which is not a BEPS recommendation is the interest barrier rule or ILR. This is merely a recommendation regarding best practices in the design of rules to prevent base erosion through the use of an interest expense, but clearly there are other ways of achieving the same objective (i.e., our existing rules). Accordingly, why was this provision included in ATAD?

In February 2016, the German Federal Court of Finance published a decision which suggested that the German interest limitation rule was in breach of the German Constitution because it violates the principle of equality. The issue was that a taxpayer has a right to deduct expenses that are effectively connected with a taxable activity. There was no justification to depart from that principle as the interest limitation rule could not be justified as an anti-avoidance measure. Tax avoidance is not a requirement of the rule. In particular, in that (purely domestic case) there was no risk that any tax revenue was shifted from Germany to another jurisdiction. Nevertheless, ATAD contained the ILR despite the fundamental issues with an interest limitation rule and it being unclear how Ireland benefited from its adoption given the Department considered that Ireland had equivalent measures in place.

The well-rehearsed policy problems with an interest limitation rule include:

- There is no tax avoidance requirement and no connected party requirement, i.e. a deduction is deferred or denied for genuine third party interest on arm's length terms, if it happens to exceed an arbitrary level.

- The deferral will be permanent (i.e. a deduction will be denied permanently) if the business decides that it should operate in the medium to long term with a higher debt level resulting in a higher interest level than the arbitrary rule.

- Businesses that have hard assets (such as real estate, factories and plants) or have a long credit history can borrow more cheaply than those that don't so the ILR discriminates against technology/knowledge based businesses and in favour of incumbents, thus discouraging innovation.

- It impacts on countries where bank debt is more expensive than those in which bank debt is cheaper. Per ECB statistics, cheaper bank debt has historically been available to businesses in Germany when compared to Ireland. For example, as of November 2020, the average interest rate available to companies on small loans for terms greater than five years was 4% in Ireland

and 1.96% in Germany.[2] To achieve the same economic effect as in Germany, Ireland should adopt a 60% rule if Germany adopts a 30% rule. This highlights the importance of adopting a code of practice approach and why the principle of subsidiarity should be observed in taxation matters.

- The ILR seems to act against companies that are wholly/partially using debt to expand their businesses. Any investment funded by debt will take time to generate taxable income. In the meantime, the company risks a deduction being deferred for legitimate interest expense. If the investment does not perform as expected the interest may be permanently denied. It is odd that a rule that appears to discourage investment and business expansion was adopted.

- It is economically counter-cyclical. In "good" times when EBITDA is rising, the interest capacity of groups (30% of EBITDA) increases. In bad times while EBITDA falls, the same amount of interest will be denied if it exceeds the 30% limit. All that has happened is the profits have fallen; there is no increase in interest burden. Similarly, when interest rates rise, the applicable percentage of EBIDTA should also change. For example, suppose business loans carrying average interest rate of 3%, if the economic environment changes and average interest rates rise to 4%, the percentage of EBIDTA should also rise from 30% to 40%. If it does not, businesses with the same income but an increased interest cost burden through no fault of their own suffer non-deductibility. This is a particularly worrying effect as the bond markets seem to be pricing in an interest rate increase over the medium term.

- Similar to the German constitutional question, the ILR arguably breaches the freedom of companies to establish themselves in different Member States and align their gearing/funding approaches to local environments. For example, for commercial purposes, a business may have a higher debt level in one Member State than another. Doing so, however, may result in a restriction of interest in one Member State that cannot be offset against the lower interest burden in the other Member State. This would not be the case if, instead the two areas were, for example, regions within a single Member State.

- If deductibility of an interest payment if denied/deferred under the ILR, we do not believe that there is a proposal to defer the tax payable by the recipient until a deduction is given by the payer. We consider that no tax should be payable by the recipient until the payer obtains a tax deduction so that double taxation is avoided.

- ATAD does not materially take account of the principle of subsidiarity. Not all Member States have the same mix of businesses nor do they have the same underlying economic or legal attributes. Accordingly, it would make more sense to have a general statement of principles that is not binding to enable Member States to adjust the implementation of an interest barrier rule (in the event it is deemed to be a worthwhile idea) to their local facts and circumstances.

With these issues in mind and with a view to transparent future corporate tax policy making, we would suggest that a full disclosure of all the Irish policy papers leading to the important and practically irreversible, decision to accept this rule should be published for public discussion. It is suggested that, in future policy considerations of proposed directives on direct taxation, there is a full public discussion of the policy implications and alternatives which is undertaken in public. This is a transparent and objective way of debating the merits of any measure.

A better approach to the interest limitation question would be, in our view, to have adopted the interest limitation rule as a Code of Conduct. This has been and remains a successful method of introducing

[2] Euro Area interest statistics are available here.

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common approaches among Member States, without giving rise to fundamental changes in the delicate balance of power between Member States and the Commission.

4. **Responses to Questions raised in the Statement.**

Question 1: *What, if any, limited adaptations of the existing legislation could be introduced in Finance Bill 2021, to assist in effectively integrating the Anti–Tax Avoidance Directive ("**ATAD**") ILR ("**ILR**") with existing domestic rules?*

It is the Government's stated position that our existing interest deductibility rules are equally effective as the ATAD ILR provisions. Our existing provisions are complex and layering ILRs over these provisions will place a significant additional compliance burden on Irish corporate taxpayers. We appreciate that this has the effect of reducing the level of policy analysis that the Department is required to undertake as part of the introduction of the ILR, but we assume that this was not material to the decision. As discussed above, significant reform of the Irish tax system should be undertaken to bring our system into line with European tax systems for which the ATAD provisions were designed. Details of our proposals specific to interest provisions are dealt with at Question 2 below.

The following are some immediate changes which could be made in Finance Act 2021 at the same time as the ILR is implemented.

The parts of Section 130(2)(d) of the TCA dealing with:

- Convertible debt (Section 130(2)(d)(ii)); Results dependent interest (Section 130(2)(d)(iii)(I)), Special rules for 75% non-EU, non-trading debt (Section 130(2)(d)(iv), Section 130(2B) Section 452 and 452A and Section 845A) and "stapled" debt rules (Section 130(2)(d)(v)) should be abolished as anti-hybrid rules supersede these principles.

- Section 247(4A) & (4E) of the TCA should be abolished and recovery of capital rules should be temporarily relaxed to allow for restructuring of debt related to ILRs, the extension of transfer pricing rules etc. but such relaxation could be limited to cases without a tax avoidance purpose. The ILRs would limit the interest deductions available. In addition, the general Section 247 provisions should be simplified where possible to reduce complexity for taxpayers e.g. the common directorship requirement should be removed

- With the additional layer of protection afforded to the tax base by ILR, the multiple specific anti-avoidance provisions relating to interest are unnecessary. As an initial step pending a more detailed review of interest provisions, Sections 817A, 817C and 840A of the TCA should be removed.

- Section 291A caps the current year relief for interest expense and capital allowances at 80% of the tax adjusted income from specified intangible assets. Following implementation of ILR, this restriction of interest (with its own carried forward rules) should no longer be required and should be removed.

Question 2: *What, if any, further adaptations of the existing legislation could be considered in later Finance Bills?*

As set out above, interest on, or costs associated with, any debt incurred for the purposes of earning taxable income should be deductible as it accrues in the statutory accounts, subject to anti-avoidance and other rules. One could introduce a wholly and exclusively concept (similar to Section 81 of the TCA) for all expenses in line with the current deductibility test for trading expenses. As noted above, a better approach would be a "to the extent" approach, i.e. expenses should be deductible "to the extent" that they are incurred for the purpose of earning taxable profit. An expanded test would be needed for

expenses of management as these benefit associated companies as well as the company incurring the expenditure.

Effectively, specific rules for deductibility of expenses for each "Case" and the "charge on income concept" including Section 247 of the TCA would be abolished and deductibility rules would be aligned with the general deductibility rules.

In addition to the proposed amendments at Question 1 above, the following provisions should be amended or repealed to legislate for these proposals:

- Section 81 TCA – general rule as to deductions – interest provisions should be replaced by a general interest deduction for interest to the extent that it was incurred for the purpose of earning taxable profit.

- Section 76(5)(b) TCA – computation of income – application of income tax principles should be abolished.

- Sections 243 and 247 TCA – interest relief as a charge should be abolished and replaced by general interest deduction for interest to the extent that it was incurred for the purpose of earning taxable profit.

- Section 249 TCA - this provision denies interest deduction where there is a recovery of capital, i.e. the investment using the debt is sold/returned. Since the effect of this would be to reduce EBITDA, it is likely no longer needed.

- Section 97 TCA – computation rules and allowable deductions interest provisions should be replaced by a general interest deduction for interest to the extent that it was incurred for the purpose of earning taxable profit.

- Section 254 TCA – interest on borrowings to replace capital withdrawn in certain circumstances from a business should be abolished.

- Section 552 TCA – acquisition, enhancement and disposal costs interest provisions should be replaced by a general interest deduction for interest to the extent that it was incurred for the purpose of earning taxable profit.

Question 3: *Comments are invited on the possible seven step approach, including whether any other matters should be considered in the transposition process. (More detailed questions relating to each step are contained later in this paper, so responses to this question should focus on the general approach.*

Subject to our comments above, given the complexities of the Irish tax system and, in particular complexities around interest relief which may be claimed as part of the computation of income of schedule/case, as charge on income or as part of a group relief claim it would not be practical to apply the restriction in calculating the interest to be claimed. The proposed seven step approach would appear to be a practical approach to carry out the interest restriction calculation after all other matters have been dealt with in the tax computation including R&D tax credits and Schedule 24 double tax relief claims so that these elements of the computation are unaffected.

Where a Case IV charge is imposed under the ILR and the related non-deductible interest is carried forward but remains unused due to excess interest charges in later years the tax payable under ILR will become a permanent tax charge. In such circumstances there should be an option to revisit the original tax computation and calculate items such as R&D tax credits and Schedule 24 based on the total tax paid including under ILR.

Further consideration needs to be given to the carry-forward/carry-back of losses. For example, in year 1 a company has no interest deductions and incurs a loss. The economy improves and in year 2, it borrows money to invest in the business and becomes profitable, after it's interest cost. The trading loss from year 1 is carried forward to eliminate that profit. Accordingly, the company suffers a restriction on the interest deductibility in year 2 because its EBITDA has fallen. This is solely because of the loss carry-forward. This is an incorrect outcome because in no year did it exceed the 30% of EBITDA rule. This is a likely outcome in 2022 as COVID recedes.

Similarly, consideration needs to be given to the carry-back of trading losses to the prior year and also to terminal loss relief where losses can be carried back three years. We consider that EBITDA should be calculated before any such losses and that such losses should be capable of being offset against the tax charge under the ILR.

As a separate point, in order to reduce complexity for taxpayers, we suggest that the entry date of an ILR pursuant to ATAD should only apply for financial years commencing on or after 1 January 2022. This approach will ensure that the newly introduced rules apply to full financial years only and straddle periods for taxpayers with divergent financial years will be prevented.

Question 4: *Comments are invited on the possible definition of 'interest equivalent'.*

The importance of providing for a workable definition of "interest equivalent" cannot be overstated. Given the complexity which these rules will introduce to an already over-engineered tax code, it is imperative that taxpayers have clarity about exactly what is "interest equivalent" (both taxable and deductible).

Article 2(1) of ATAD does define "borrowing costs" quite widely to include the items referred to in the proposed definition of "interest equivalent", along with a number of specific inclusions. We note that those specific inclusions have not been incorporated into the proposed definition of "interest equivalent" (e.g. there is no reference to amounts under Islamic finance arrangements which are referred to in ATAD). We assume that it is intended that the definition of "interest equivalent" be interpreted in line with the ATAD definition of "borrowing costs" and that this will be confirmed in the implementing legislation or Revenue guidance to ensure the Irish rules appropriately capture the EU provisions. We are unclear why different terminology is used in the Irish legislation than in the directives but the meaning cannot be different.

Notwithstanding the above assumption in relation to those specific inclusions, there are a couple of areas where in our view the definition of "interest equivalent" should be expressly expanded to ensure the rules accurately capture the terminology used in other parts of the Irish tax code and to ensure activities considered to form part of financing transactions undertaken by Irish entities (such as "qualifying companies" under Section 110 of the TCA) are correctly captured.

These points are as follows – with the suggested updated drafting of "interest equivalent" needed to capture these provisions as set out below.

1. **Premium and other returns on debt**: On the basis of case law which has considered premium on a debt to be in the nature of interest (*Davies v Premier Investment Co Ltd*), we assume it was intended that premiums would be considered to fall within the 'interest' limb of the "interest equivalent" definition. However, given the varying definitions of interest in case law and throughout the Irish tax code, it is important for taxpayers to have certainty with respect to how premiums are to be assessed so it should be expressly included. The same applies to other returns on debt in excess of the amount advanced or paid for a debt (e.g. make whole premiums on high yield debts, early termination fees, etc.).

2. **Certain financing instruments**: In relation to amounts that are economically equivalent to interest, there are certain financing instruments used regularly in practice which are not stated

to include a concept of 'interest' in the legal documents covering such arrangements but which have the same function of interest on a debt (i.e. compensation for the use of funds advanced or made available under the arrangement). The two arrangements where this arises most commonly are:

a. Derivatives, swaps and hedging arrangements: We note that notional interest expenses under derivatives and hedging arrangements are referred to in the definition of "borrowing costs'". As you may be aware, ISDA and other market standard form swap documents only provide for a net payment. This is deliberate for insolvency purposes. How will this be approached? For example, will net payments under, say, a fixed or floating interest rate swap be treated as the amount of "interest equivalent" under the ILR. What will happen when one side of the swap is "interest equivalent" but the other is not? It would be difficult to see how one would unwind the overarching commercial architecture of the swap arrangement recognised under most systems of international law to "de-net" the single net payment. Derivative, swaps or hedging arrangements typically will not refer to "notional interest".

b. Manufactured payments due under stock borrowing, stock lending or repurchase agreements: The Irish tax code contains specific provisions which treat these arrangements as financings in accordance with their substance. Where these rules do not apply (and their application is narrow), they are taxed in accordance with their form. This approach does not align with the international tax treatment of such arrangements due to the narrow application of the rules which treat these arrangements as financings. Legislation should confirm that the definition of "interest equivalent" includes payments under such arrangements, particularly as they would be considered 'interest' in other EU jurisdictions. Also, this should not be tied back to the existing definitions in the TCA or the SDCA as they omit a wide variety of such arrangements.

Given the difference between the legal effect of the market standard documentation used to implement these arrangements and the economic effect, it is important that these items are expressly incorporated into limb (b) of the definition of "interest equivalent" to ensure that taxpayers can enter arrangements with certainty as to their tax consequences.

3. **Financial activities undertaken by securitisation companies, banks and leasing companies**: It is important to ensure that any amounts that are taxed as interest or equivalent income under Irish tax rules should be included in the definition of "interest equivalent". This should include all income of qualifying companies for Section 110 purposes (e.g. income from leasing of plant and machinery, income from commodity trading) and all income of banks that is related to their lending activity (e.g. commitment fees and facility fees and all income of other financial traders). It should also include all income of leasing companies to the extent that the leasing companies are debt funded. The objective of this wide definition is to achieve symmetry so that tax mismatches do not arise or are limited in scope. In addition, Ireland must be conscious of the proportionality principle that it is required to uphold in implementing ATAD.

Our proposed revised definition to address these points is as follows (with changes in bold and underlined):

"interest equivalent" includes any amount of —
(a) interest **or premium or other returns on debt in excess of any amount advanced by way of debt or paid for the acquisition of debt**,
(b) amounts economically equivalent to interest including —
(i) discounts, ~~**and**~~
(ii) amounts referred to in paragraphs (c) of the definition of financing return in section 835AH,

(iii) notional interest amounts or any net payments under derivative instruments, swaps or other hedging arrangements or specified agreements (as defined in section 110),
(iv) manufactured payments and any other payments which are economically equivalent to interest under stock borrowing or lending arrangements or under repurchase agreements,
(v) any rental amounts payable under plant and machinery leases where the lessor is funded by way of financing the return on which would constitute interest equivalent within the meaning of this definition, and
(vi) all return from "financial assets" of a qualifying company within the meaning of section 110 and any return generated by a company dealing in commodities or commodities-backed securities as part of a business of dealing in or holding such commodities or securities where the company is funded by way of debt the return on which would constitute interest equivalent within the meaning of this definition, and

(c) expenses incurred in connection with raising finance, including —
(i) guarantee fees, ~~and~~
(ii) arrangement fees, ~~and~~
(iii) commitment fees,
(iv) facility fees,
(v) early termination fees, and
(vi) all fees similar thereto, and

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."

In addition to the above, we would be grateful for clarity in relation to the interaction of the ILR with the existing regime for the deduction of interest and other expenses relating to financing under Schedule D Case 1 (Trading) Principles and also by extension to financial traders and also for "qualifying companies" for the purposes of Section 110 TCA. For these companies, taxable profit starts with the accounting result. It is only where, pursuant to Section 76A TCA, an adjustment is authorised or required by law that a departure from the accounting result occurs (assuming that there are no non-trading activities). For this purposes, please assume that absent the ILR, there are no non-deductible costs).

For example, a company borrows 100 to acquire financial assets (advancing loans, entering into derivatives etc.). In year 2, the value of the financial assets falls to 80 and, in accordance with IFRS, we understand that the value of the debt will also fall to 80 (assuming no equity). Up until now, this has no effect as there is a corresponding debit and credit that offsets. Under the ILR it is unclear what will happen. For example, the reduction in the value of the assets is likely to be treated as a trading deduction. Would that be treated as an interest expense if the underlying assets are debts? This seems unlikely. The reduction in the debt amount would be treated as income in the P&L account. Would this be treated as interest income for ILR purposes? If both are treated symmetrically, there would be a net zero for ILR purposes.

In the following year the assets recover their value to 100. This results in 20 profit in the P&L due to the increase in asset value. Will this be treated as interest income? Also the uplift in the debt amount will be treated as a deduction. Will this also be treated as interest income? An alternative view is that notional/non-cash movements in asset and liability values should be ignored until cash moves.

The costs associated with the raising of finance also raise interesting issues. For example, we understand that if a bond is issued for 100 but the underwriters charge a 2% commission the company is regarded as having borrowed 98. The underwriters' commission is added to the interest expense over the life of the transaction. We presume this would all be treated as interest expense over the life of the bond as it would be an amount that is economically equivalent to interest. Lastly, all income derived

from the activities of treasury companies (e.g. guarantee fee income, derivatives, factoring, hedging etc.) should be treated as interest equivalent given the overall aim of treasury companies is to create interest equivalent income.

As a separate point, the implementation of the proposed carry forward regime for excess interest requires further consideration. Due to companies having limited cash-flows as a result of the ongoing Covid-19 pandemic, it is likely that interest payments incurred in both 2021 and in 2022 will be discharged in 2022 as the impact of the pandemic lessens. Companies being deemed to be in breach of the ILR in 2022 as a result of being unable carry forward excess interest capacity from 2021 is a clear disconnect from the intention of the interest limitation rules and should be avoided.

Question 5: *Comments are invited on the possible definitions of 'taxable interest equivalent' and 'deductible interest equivalent'.*

In relation to the definition of "taxable interest equivalent", we do not understand the rationale for limiting the definition to income chargeable to corporation tax. In circumstances where the Irish tax code continues to retain a distinction between capital and income for companies, capital gains chargeable to corporation tax form part of the taxable receipts of a company and as such should be incorporated into the definition of "taxable interest equivalent". We do not think that the reference in Recital 6 of ATAD 1 to "only taxable income should be taken into account in determining how much interest may be deducted" should be applied restrictively here in circumstances where many countries do not distinguish between capital and income when it comes to the taxation of companies. As a result, restricting this definition to income only result in an odd outcome, where interest on financing an asset is "interest equivalent" but only part of the profit from the asset is "taxable interest equivalent" (e.g. the profit on the sale of a bond between interest payment dates). This approach would cause Ireland to be an outlier compared to systems that do not distinguish between income and capital. It must be recalled in this context that the distinction between income and capital is grounded in nineteenth century trust law and has largely been removed from most accounting system in favour of treating all profit in the same way. The reliance on outdated concepts in the Irish tax code remains an enduring barrier to sensible tax policy.

In relation to the definition of "deductible interest equivalent", it is difficult to comment on this definition in the absence of the proposed definitions of "relevant profits" and "relevant entity". As such, we may have further comments once those proposed definitions are available but by way of preliminary comments:

1. Limb (iii) of the definition should incorporate the appropriate provision to deal with situations where the taxable interest equivalent is subject to corporation tax on chargeable gains, as per our recommendation above.

2. Paragraph (c) refers to borrowing costs rather than "deductible interest equivalent". This should be rectified to avoid confusion as borrowing costs is not defined.

Question 6: *Comments are invited on the possible definitions of 'exceeding borrowing costs' and 'exceeding deductible interest equivalent'.*

These definitions appear to work as intended, provided our recommendations in respect of the relative components (i.e. interest equivalent, taxable interest equivalent, deductible interest equivalent, legacy debt and the de minimis amount) are taken into account.

Question 7: *Comments are invited on the possible definition of 'EBITDA'***.**

The Statement defines EBITDA as follows:

'EBITDA', in respect of an accounting period, shall be calculated as follows:

$$\frac{P + I + DA}{}$$

Where:

- P is the relevant profits of the relevant entity.
- I is the portion of the exceeding borrowing costs of the relevant entity that is referable to exceeding deductible interest equivalent referred to in paragraph (a)(i) and (ii) [in the possible definition of deductible interest equivalent – see 4.3 of the feedback statement].
- DA is allowances in respect of capital expenditure under Part 9 or Part 29, made to or on a relevant entity in computing that entity's relevant profits less any amount of those allowances which are referable to deductible interest equivalent.

Relevant Profits

The definition of "relevant profits" is a fundamental component of the EBITDA and we note that this definition has not yet been provided.

In our view relevant profits should include dividend income other than dividends which benefit from the exemption under Section 129 TCA. This should be the case even where dividends are subject to a relief (e.g. double tax relief) on the basis that the complexity of the Irish tax system, including the foreign tax credit regime, is such that it would be difficult to devise general rule to exclude dividends which benefit from full relief without also excluding dividends which do not. Relevant profits should also include chargeable gains on the basis that, as discussed at Question 5 above, such gains would be included in the tax EBITDA calculations of other EU countries.

See under Question 3, our comments in relation to the use of losses forward/back.

EBITDA

Exceeding borrowing costs referable to deductible interest equivalent are added back to relevant profits in the proposed EBITDA formula. In the Statement the proposed formula excludes legacy debt and de minimis amount from the calculation of these exceeding borrowing costs. While it is correct to exclude these amounts the calculation of the amount on which the ILR is based, it does not appear to be necessary to exclude them from the add back to EBIDTA on the basis that they form part of the exceeding borrowing costs.

Their exclusion from the add back reduces the EBITDA amount on which the ILR will be based and thus will increase the Case IV charge where the relevant ratio is exceeded. Article 4(4) of the directive specifically includes provisions the interaction of EBITDA and the long-term public infrastructure exclusions but there are no similar provisions for legacy debt and the de minimis amount and on this basis, in our view, for the purpose of calculating EBITDA the legacy debt and de minimis amounts should be included in the EBITDA calculation.

Question 8: *Comments are invited on the possible approach to the operation of the ILR to a single company.*

We agree with the general approach of the application of the ILR to a single company as proposed in the Statement based on the complexities of the Irish tax system including the different rates of tax applicable to profits. As mentioned in previous submissions, we support a single low rate of tax on all corporate profits as companies have a singular profits line and the multiplicity of tax rates in Ireland is at odds with this. However there a number of points which should be addressed.

Firstly, the excess amount which is taxable must be split between amounts which were deducted against 25% income and amounts which were deducted against 12.5% income. The draft provisions do not specify how this split should be carried out. For example, where there is mixed taxable income of €100 against which interest of €70 is claimed (directly against individual Schedules/Cases and as a deduction against total income) and an excess amount of €40 is taxable under ILR. How will this €40 be split between 12.5% and 25% income? In our view the taxpayer should be allowed to allocate the €40 against 12.5% income first.

Secondly, the ILR should operate so that any incremental tax payable is equivalent to that which would have been paid if the excess interest had been disallowed. Therefore, where a company was in a loss position or had available losses forward, or group relief could have been claimed, those losses/group relief claims should be taken into account in calculating the incremental tax payable as a result of ILR. The proposed provisions in the Statement do not allow for any such loss or group relief offset.

Question 9: *Comments are invited on the possible approach to the effective carry forward of non-deductible 'exceeding borrowing costs'.*

The draft provision in paragraph 7.1 of the Statement includes the following:

*"*the relevant entity shall be entitled to reduce the corporation tax payable that is referable to its relevant profits, but for the application of this section, in subsequent accounting periods by the amount of the interest tax credit.*"*

There is no provision for a situation where the interest tax credit creates or augments a tax adjusted loss in the accounting period and such provisions should be included. A taxpayer in this situation should be allowed to carry such a loss forward or back or surrender the loss as group relief as would normally be the case where a loss arises.

Question 10: *Comments are invited on the possible approach to carrying forward 'excess interest capacity'*

The "excess interest capacity" may be carried forward for a period of 60 months from the end of the accounting period in which it arose. How will this 60 months rule be applied where an accounting period straddles this deadline? In our view, the carry forward should apply to any accounting period which commences within 60 months of the end of the accounting period in which it arose.

Question 11: *Comments are invited on the possible approach to the de minimis exemption, and on the potential need for anti-avoidance provisions to accompany such an exemption.*

We agree that the de minimis exemption should be adopted by Ireland. We have no comments in related anti-avoidance provisions as we consider that they will rarely be relevant in practice.

Question 12: *Comments are invited on the possible definitions of "standalone entity", "worldwide group", "ultimate parent", "ultimate consolidated financial statements", "associated enterprise" and "enterprise" including how single companies not coming within the ATAD definition of "standalone entity" could be treated.*

ATAD defines a "standalone entity" as a taxpayer that is not part of a consolidated group for financial accounting purposes and has no associated enterprise or permanent establishment. We agree with the suggested definition of "standalone entity" as it follows the definition set out in ATAD.

We note that both "a consolidated group for financial accounting purposes" and "associated enterprises" are concepts which are also used in the anti-hybrid rules set out in ATAD. However, the draft legislation has opted to follow the Irish implementation of the anti-hybrid rules with respect to the "associated enterprises" point, but not the "consolidated group for financial accounting purposes" point. We see no

reason for the difference in approach as using a different approach simply adds complexity for taxpayers.

The definition of "standalone entity" could be simplified to:

> "standalone entity" means a company which under Section 26(1) is chargeable to corporation tax on all of its profits wherever arising and that:
>
> (i) has no associated enterprises; and
> (ii) does not have a permanent establishment in a territory other than the State.

The definition of "associated enterprises" should be by reference to the definition in Section 835AA (1)-(4) TCA, without excluding subsections (2)(e) and (2)(f). For good order, we note that in order to align with the structure of the definition of "associated enterprise" in Section 835AA (2) TCA, the definition of "associated enterprises" in this new section/part should read as follows:

> "In this [section/part], two enterprises shall be "associated enterprises" in respect of each other if they would be associated enterprises in respect of each other under subsections (1) to (4) of section 835AA."

See below in our response to Question 13 in relation to the difference in accounting standards permissible under the ILR.

The definitions of "worldwide group", "ultimate parent" and "ultimate consolidated financial statements" would then no longer be needed.

If there is a preference to include a different test for consolidated entities than the test under the anti-hybrid rules, we would note that the suggested definition of "worldwide group" which includes the language that the entities are "fully included" is unsatisfactory unless a definition of "fully included" is also provided. Again, as this issue has already been dealt with under Part 35C, we see no reason to take a different approach here.

Question 13: *Comments are invited on how Ireland might implement ATAD Articles 2(10) and 4(8), having regard to the different accounting standards and State Aid rules.*

As outlined in our response to Question 12, the definition of "consolidated group for financial accounting purposes" is the same as that used for the anti-hybrid rules and so the definition outlined in Section 835AA TCA should be use for the new ILR legislation as well.

One difference between the anti-hybrid rules and the ILR under ATAD is that the anti-hybrid rules require the consolidated financial statements to be prepared under IFRS or the national financial reporting system of a Member State, but the interest limitation rule (Article 4(8)) permits other accounting standards.

This is easily resolved by following the approach outlined above in our response to Question 12 but providing that for the purposes of the ILR, the following new subparagraph (III) to 835AA(2)(e) TCA should apply:

> "any other recognised generally accepted accounting practice."

Question 14: *While 'standalone entities' generally present a low risk of BEPS, the OECD notes that, in certain cases, they may be large entities held under complex holding structures involving trusts or partnerships, meaning that a number of apparently unrelated entities are in fact controlled by the same investors. What is your assessment of how the ILR could apply to such entities?*

There is plenty of legislation, domestic and international (e.g. DAC 6, CRS, beneficial register requirements), which should mean it is possible to identify the beneficial owners behind any Irish corporate entity. Any tests that operate by share ownership will pick up the beneficial owner of those shares (in line with existing tax legislation). This should be sufficient to identify the true owners of the company in question.

There are circumstances in which an SPV may be established with its entire issued share capital held on trust for charitable purposes. This is done for reasons including as a requirement of the European Central Bank, rating agencies and commercial lenders, rather than to obscure its beneficial ownership or for any tax avoidance purpose (as has acknowledged by Revenue in its published guidance). As long as an SPV 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 ILR. It cannot be the case that the term standalone entity has no practical application as this approach would undermine the policy of the ATAD and result in an overbroad interpretation of a policy that is targeted at multinational groups and not, financing or assets holding entities that are deliberately structured to be bankruptcy remote for good commercial reasons.

Where such entities are not considered "standalone entities" for the purpose of ILR we consider that Ireland should adopt the UK "group of one" concept. Under the UK rules, the ultimate parent must be a relevant entity (i.e. a company), and it cannot be a consolidated subsidiary of another relevant entity. In the case of an ultimate parent with no consolidated subsidiaries, the ultimate parent is treated as a Single-Company Worldwide Group ("**SCWG**"). Provisions within the UK legislation including application of group ratios which apply to worldwide groups, also have application for a SCWG.

Question 15: *Comments are invited on the approaches to defining and exempting "legacy debt" and more generally on the concept of a 'modification' in the context of legacy loans.*

As a starting point, it is important to emphasise that the Directive envisages modifications to the "terms" of a loan, not to borrowing costs. Therefore, only modifications made to the terms of the loan agreement itself are relevant here. It is interesting to note that the Belgian tax authorities refer to "important" and "fundamental" modifications so that non-material changes do not have the untended and disproportionate effect of invoking the ILR.

Although all changes to a legacy loan should be examined on a case-by-case basis, it would be useful if Irish taxpayers were provided some examples of what is considered is and what is not a "modification" in the context of legacy loans. For example, other tax authorities have already issued guidance confirming that the following may be considered as a "modification":

- A change to the duration of the loan, where this change was not originally provided for in the loan.

- A change to the rate of or calculation of interest, where this change was not originally provided for in the loan.

- A change to the principal under the loan.

Similarly, other tax authorities have already issued guidance confirming that the following should be not be considered as a "modification" and we consider that it would be appropriate for a similar approach to be taken in Ireland's implementation of ILR:

- A change to the duration of the loan, where this change was originally provided for in the loan and does not require the agreement of the parties, i.e. this change happens automatically under the terms of the loan.

- A change to the rate of or calculation of interest, where this change was originally provided for in the loan.

- A change in the frequency of payment under the loan.

- A minor administrative change, such as the account into which the parties pay.

- A change in the legal status or address of one or more of the parties.

- Certain changes to the commercial guarantee on a loan.

- An assignment of the loan by the borrower where the terms and conditions of the loan are unchanged.

- Drawdown of funds on a pre-existing facility. The Directive refers to modifications to the "terms" of a loan. In simple terms, this means that the on-going operation of a loan, as initially agreed, does not amount to a "modification" for the purposes of the grandfathering clause. The grandfathering rule applies for so long as the loan remains in place, as initially agreed. It follows therefore that a drawdown on a loan facility that was concluded prior to 17 June 2016 does not change the terms of the loan, as initially agreed. In fact, it is quite the opposite as a drawdown is doing exactly what was initially agreed and envisaged prior to 17 June 2016. Accordingly, a drawdown on a loan facility concluded prior to 17 June 2016 should not be regarded as a modification where this drawdown is in accordance with the terms, as initially agreed. This is a logical conclusion and should be provided for in Ireland's adoption of the ILR. Both the Belgian and the Luxembourg tax authorities have confirmed this in respect of drawdowns within the terms of the loan and within the pre-agreed credit line limit.

In addition, the Belgian tax authorities have provided a carve out for changes to the payment terms of a legacy loan between June and December 2020, such that a change to the payment terms is not considered as a "modification" where the taxpayer can prove that they were experiencing difficulties with payment due to Covid-19 and the change to the payment terms was approved by a financial institution. A similarly pro-active approach should be taken by Ireland.

Where a legacy loan has been modified, the exemption should continue to apply to interest paid under the original conditions of the legacy loan before the modification. This approach is consistent with the Recital (8) of the Directive.

Question 16: *Comments are invited on potential approaches to the criteria relevant to the 'long-term public infrastructure project' exemption.*

We consider that it is very important that Ireland includes a long-term public infrastructure project exemption in its implementation of ATAD. Mobilisation of private capital to finance public infrastructure projects will continue to be crucial to allowing Ireland to achieve its climate and energy obligations and to implement its infrastructure plans set out in Project Ireland 2040 and elsewhere in the Programme for Government. Project and infrastructure financing transactions are premised on the ability of project operators to use stable, long-term contracted cash flows to service relatively high levels of debt, such that applying ILRs to these operators would significantly adversely affect the returns of investors/developers in the sector. In the case of public-private partnership projects in particular, restrictions on interest deductibility would result in such projects becoming more expensive for the State (through higher unitary charges which are the primary source of cash flows for PPP operators).

Investors and developers require certainty from the outset of any investment in public infrastructure will benefit from an exemption from ILR, noting that planning and procurement timelines mean that

their initial investment may take place several years before any third party financing is raised. For this reason, we consider that the Irish exemption should set out clear definitions of the requirements to avail of the long-term public infrastructure project, which are not reliant on the relevant project obtaining Ministerial approval once the developers are seeking to raise private financing at a later stage.

Therefore we consider that it would be helpful to follow the approach taken by the United Kingdom in its implementation of ATAD (in the amendments to the Taxation (International and Other Provisions) Act 2010 implemented via the Finance Act (No.2) Act 2017). This legislation sets out definitions of what constitutes "qualifying infrastructure activity" by reference to the provision of public infrastructure asset(s) or activities ancillary to such provision, where a public infrastructure asset:

- Is part of the infrastructure of the UK or the UK section of the continental shelf (the legislation includes a non-exhaustive list of what constitutes infrastructure by reference to industry sectors (utilities, energy infrastructure, social infrastructure (such as health/education/courts/prisons) and types of assets, such as buildings occupied by public bodies).

- Meets a public benefit test (meaning that the asset is or will be procured by a relevant public body or is or will be used in the course of a regulated activity (i.e. regulated by an infrastructure authority (which are those listed in the legislation, together with any other public authority which has functions of a regulatory nature exercisable in relation to the use of tangible assets forming part of UK infrastructure) or could be regulated by an infrastructure authority if it exercised its powers).

- Has or has had an expected economic life of at least 10 years.

- Meets a group balance sheet test (such that, broadly, it is recognised on the balance sheet of a company or an associated company and that company or associated company is within the charge to corporation tax).

We consider that this legislative approach provides sufficient certainty as to what will constitute a long-term public infrastructure project while also addressing the "general public interest" requirement set out in ATAD itself. In addition, it is a requirement of the single market that Ireland applies similar rules to projects located in any Member State (as is provided for in ATAD) and not just in Ireland.

We further note that the UK legislation also recognises that the same considerations regarding high levels of debt financing apply to real estate investments and the ability of special purpose vehicle companies to service debt from long-term contracted cash flows, including cash flows from local authorities in the case of social housing.

Therefore the UK legislation provides that a building or part of a building will be a "public infrastructure asset" in relation to a company if:

- The company or another member of its group carries on a UK property business consisting of the building.

- The building is let on a lease with an effective duration of 50 years or less and does not fall within provisions of applicable legislation dealing with certain types of finance arrangements.

- The building has/has had an expected economic life of at least 10 years.

- The group balance sheet referred to above is met.

Given the focus on improving building infrastructure and in particular attracting private capital to fund the development or acquisition of social housing in Ireland, we consider that this would also be a helpful feature of the long-term public infrastructure project exemption in Irish legislation.

Question 17: *Comments are invited on the financial undertakings exemption generally and the possible definition of 'financial undertaking'.*

"**financial undertaking**" means —

(a) a credit institution as defined in Article 4(1) of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013,

(b) an investment firm as defined in point (1) of Article 4(1) of Directive 2004/39/EC of the European Parliament and of the Council,

(c) an alternative investment fund manager, as defined in point (b) of Article 4(1) of Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011,

(d) a UCITS management company, as defined in point (b) of Article 2(1) of Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009,

(e) an insurance undertaking, as defined in point (1) of Article 13 of Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009,

(f) a reinsurance undertaking, as defined in point (4) of Article 13 of Directive 2009/138/EC of 25 November 2009,

(g) an institution for occupational retirement provision (IORP) falling within the scope of Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 as amended by Directive (EU) 2016/2341 of the European Parliament and of the Council of 14 December 2016,

(h) a pension institution operating pension schemes which are considered to be social security schemes covered by Regulation (EC) No 883/2004 of the European Parliament and of the Council and Regulation (EC) No 987/2009 of the European Parliament and of the Council as well as any legal entity set up for the purpose of investment of such schemes,

(i) an alternative investment fund (AIF), that is either managed by an AIFM as defined in point (b) of Article 4(1) of Directive 2011/61/EU or supervised under the applicable national law;

(j) a UCITS, in the meaning of Article 1(2) of Directive 2009/65/EC,

(k) a central counterparty, as defined in point (1) of Article 2 of Regulation (EU) No 648/2012 of the European Parliament and of the Council, and

(l) a central securities depository, as defined in point (1) of Article 2(1) of Regulation (EU) No 909/2014 of the European Parliament and of the Council.

The definition of "financial undertaking" should also include any subsidiaries of a financial undertaking which are subject to the same regulatory capital and supervision requirements as the parent financial

undertaking. We understand that this approach has been taken in other EU Member States, including Spain.

The exemption for financial undertakings should be an elective one, i.e. an entity that is a financial undertaking can elect whether to be treated as such for the purposes of the ILR.

Question 18: *If Ireland were to provide only one of the two "group ratios", which would be preferred?*

We note that Article 4(5) of ATAD clearly allows EU Member States to provide tax payers with the choice of the two options set out in that article. Accordingly, we would strongly advocate that Ireland should make this choice available to taxpayers and that both options should be legislated for. By allowing both potential group ratios, Ireland would provide maximum flexibility to taxpayers with different funding and capital structures.

Given that both options have advantages and disadvantages depending on the taxpayer's particular factual circumstances and debt profile, a group of taxpayers should not be adversely impacted through the implementation of one of these methods over the other, especially when the OECD considers both methods to be equally effective in combatting BEPS. For example, one company may choose to lease its real estate on non-finance lease terms and thereby have a lower true debt burden whereas another company may choose to own or finance lease its real estate and increase its "borrowings costs". These two strategies are, broadly, economically equivalent although they give rise to different tax outcomes under the interest limitation rule.

Adopting only one of the options in circumstances where ATAD clearly allows for both would be too blunt an instrument with regard to the objective to be achieved. This is particularly the case given Ireland's assertion that it already has a broad range of rules equivalent to the ILR, therefore, the addition of another layer of rules should be legislated for in a manner that causes minimal impact on taxpayers complying with the already restrictive domestic regime.

Question 19: *Noting that the same definition of 'worldwide group' applies for the "group ratios" and the definition of 'standalone entities', does that alter your response to Question 12 above? Also, how could entities such as joint ventures be treated for the purpose of the "group ratios"?*

This does not alter our response to the above.

In relation to join ventures, where a joint venture entity ("**JV**") is controlled by one of the joint venture partners (such as when such partner holds a 55% stake), the JV will typically be included in the consolidated financial statements of the controlling group. It will therefore form part of this group for the purposes of applying a group ratio rule ("**Group JV**"). However where no investor has overall control of a JV (such as where each partner holds a 50% stake), each investing group will generally include the JV in its consolidated financial statements using equity accounting (which means that the profits earned by the JV are assessed and these profits are brought in by the investor in proportion of the investor's share of the JV). The JV is not consolidated into either investing group and will not form part of these groups for the purposes of a group ratio rule ("**Non-Group JV**"). Depending on the profitability and interest costs of a Non-Group JV, this may distort the group ratio.

To allow for flexibility and align treatment between Group JVs and Non-Group JVs, Ireland should allow for an election for a Non-Group JV to be treated as part of the investor group and afforded similar treatment to a Group JV.

Question 20: *Technical analysis is invited as to whether the "Group Ratio Rule" (third-party interest divided by EBITDA) should be calculated based on the group's consolidated accounts or using tax-adjusted values. The accounting figures for EBITDA and borrowing costs may bear little resemblance to the Irish tax concepts while the tax-adjusted values give rise to practical difficulties such as how to*

treat intragroup transactions and negative EBITDAs. Taking account of the provisions of ATAD Article 4(5) (b), and the issues identified above, how could this aspect of the "Group Ratio Rule" be designed?

Acknowledging the complexities around designing the "Group Ratio Rule" either using consolidated accounts which bear little resemblance to the Irish tax concepts or tax-adjusted values which give rise to computational difficulties, particularly in disregarding group transactions we would favour an approach whereby a taxpayer can calculate the Group Ratio based on either of these methods once the ratio is calculated consistently from year to year and across the notional local group.

Question 21: *How might third-party borrowings be defined for the purpose of the "Group Ratio Rule"? Should it be borrowings excluding amounts borrowed from other members of the 'worldwide group'? Taking account of the definition of 'standalone entity', which recognises that BEPS can occur between 'associates', should it also exclude borrowings with 'associates'? Accounting standards require that transactions with related parties are disclosed: should borrowings with a related party be excluded?*

Existing legislative definitions of third party debt (for example those set out in the Irish Real Estate Fund ("**IREF**") rules) are not an appropriate starting point in the context of interest limitation. Due to the policy concerns surrounding taxation of income/gains from land in the State, the carve outs from what is considered 'third party debt' under the IREF rules are extremely broad. Such broad carve outs are not appropriate in the context of ILR where various domestic measures already restrict deductibility. The IREF rules are anti-avoidance rules. Because the ILR are not aimed at avoidance transactions, the IREF rules are not an appropriate place to start in defining 'third-party borrowings'.

A better approach might be to utilise ILR principles and to define "third party borrowings" as all debt from entities other than members of the taxpayer's "worldwide group". The definition of a "worldwide group" for this purposes should be based on the consolidated group for financial accounting purposes. The consolidated group would therefore include a parent company and all entities which are fully consolidated on a line by line basis in the parent's consolidated financial statements.

Question 22: *How would the application of "group ratios" work, in practical terms, where an exempt 'financial undertaking' (see 8.5) is a member of a 'worldwide group'?*

Maximum optionality should be allowed to taxpayers in this context. Ideally, where a company in a "group" is a "financial undertaking", the group should be allowed to elect to treat the group as a whole as a financial undertaking.

Otherwise, the group should be allowed to either (i) exclude or (ii) include the "financial undertaking" entity when computing its "group ratio". There will be circumstances where the inclusion of the "financial undertaking" when computing a group ratio will negatively impact those calculations. However, other circumstances may arise in which there could be negative consequences to not including such an undertaking. Therefore, legislation should provide for maximum flexibility in this regard.

Question 23: *Comments are invited on the possible definitions of notional local group (including how consortia and joint ventures should be treated). In particular:*

(i) How should the notional local group be defined? Should it be based on an existing definition (such as that used for group loss relief) or be a new definition?

The notional local group should be a newly defined concept for interest limitation purposes albeit in a manner consistent with many of our existing grouping rules. The definition should be based on a wide definition of control (e.g. 51% control by reference to share capital, profits and assets available for distribution on a winding up).

We would propose that taxpayers should have optionality in respect of the inclusion of financial undertakings within the notional local group and any Irish companies that are

within the same consolidated group for financial accounting purposes should be allowed to elect in.

(ii) If a new definition is adopted, are there issues relating to the interaction of a new notional local group for ILR purposes and existing group reliefs?

We have no comments on this question.

(iii) Does the way in which the notional local group is defined impact on your views on any of the other issues raised in respect of local groups?

We have no comments on this question.

(iv) What considerations should be given to the operation of the two "group ratios" where the notional local group approach is adopted? For example, it is relatively easy for a single company to compare its balance sheet to the group consolidated balance sheet, in order to calculate if relief is available under the "Equity Ratio Rule (as detailed in section 9.3). But what difficulties might a notional local group encounter in carrying out that comparison, particularly where it does not prepare local audited consolidated accounts?

There may be such difficulties where a group does not prepare local audited consolidated accounts. We recommend that both options are legislated for maximum flexibility and to ensure that a group is not adversely impacted through the implementation of just one rule above another.

Question 24: *Where an optional "group approach" is provided, the following questions arise:*

(i) Should a group election be irrevocable or for a finite period only?

To maximise flexibility for taxpayers, a group election should: (i) not be limited to a finite period; and (ii) be revocable at any stage.

(ii) What is the best way to manage carried forward amounts held both prior to the formation of the group and immediately before the cessation of the group?

Taxpayers should be given as much flexibility as possible. Subject to the application of anti-avoidance rules, in circumstances where an entity leaves/joins a group the group should be in a position to nominate where the carried forwards amounts go such that: (i) a company joining a group can bring with it any interest allowance (including from a time during which it was a member of a different group) and; (ii) a company leaving a group can bring with it any interest allowance from that group.

(iii) What type of anti-fragmentation rules, if any, might be required?

We do not consider that any are required as the de minimis level is so small that it is unlikely to be worthwhile fragmenting a corporate group for the small benefit and also our ATAD compliant GAAR would address any such planning.

Question 25: *Would a mandatory but less complex "group approach" be preferable to an optional "group approach"?*

No. The ATAD rules should be introduced with as much optionality for taxpayers as possible.

Question 26: *Is it practical to make a single company responsible for reporting information to Revenue on behalf of the notional local group and allocating amounts (including excess interest capacity and amounts carried forward) among group members?*

Yes, this would be the most practical approach.

If so, the following questions arise:

(i) *What criteria should be used to determine the reporting company?*

Criteria might include the following: (i) the reporting company must not be dormant, and must be subject to corporation tax in Ireland for at least part of the return period; and (ii) the reporting company may be appointed by the ultimate parent of the group, but the appointment must be authorised by at least 50% of the eligible companies in the group. Notification of the appointment should be made to Revenue.

(ii) *How should changes in group structures that alter the position of a reporting company in a group (mergers, acquisitions etc.) be managed?*

A new appointment could be made (where necessary) and notified to Revenue subject to similar criteria as proposed at (i) above.

(iii) *What information should be returned to Revenue by the reporting company? Should any information be reported at an entity level?*

The following information might be returned: (i) details of the composition of the group; (ii) the computation of any interest limitation restriction; and (iii) an allocation of restrictions to the Irish group companies for their Corporation Tax accounting periods that coincide with or overlap the group's period of account. Any matter or fact that is reported to Revenue under any other reporting obligation should not need to be reported again.

(iv) *Is there an alternate manner in which information reporting should be dealt with?*

We have no comments on this question.

Question 27: *How should intragroup transactions be treated for the purpose of calculating the consolidated 'EBITDA' and 'exceeding borrowing costs' of the notional local group? ATAD Article 4(1) provides that the results of the notional local group should "comprise the results of all its members". Should the ILR be applied to the notional local group by reference to the amalgamated results of its members, or by reference to the results of the group having disregarded all intragroup transactions (akin to how an accounting consolidation is prepared)? How would this work, in practical terms, where an exempt 'financial undertaking' is a member of the notional local group?*

This question involves some complex accountancy modelling considerations and we favour an approach that offers the most flexibility for corporate groups whereby a taxpayer can calculate the "EBIDTA" and "exceeding borrowing costs" based on either of these methods (i.e. amalgamated results of its members, or by reference to the results of the group having disregarded all intragroup transactions) once the methodology is applied consistently from year to year and across the notional local group.

Question 28: *How should ILR restrictions be allocated among members of the notional local group?*

We would recommend an approach that offers flexibility for groups.

In particular:

(i) How should the notional local group allocate its exceeding deductible interest to the members of the group?

We would recommend reviewing the UK's Fixed-Ratio Rule, which allows flexibility for a nominated group entity to allocate adjusting amounts to group members to give effect to the 30% of tax-EBITDA ILR on a local group basis, whilst permitting the capping of allocations to designated group members at the election of those group members.

(ii) What should happen in scenarios where the notional local group as a whole has negative EBITDA but some of its members have positive EBITDA?

EBITDA should be calculated by computing EBITDA for each group company, adding the positive and negative amounts to arrive at an overall group EBITDA. Where the overall group EBITDA is negative, the EBITDA should be treated as nil. In this case, the local group should be entitled to deduct the de minimis threshold amount of net interest expense for the period.

(iii) How should excess interest capacity carried forward and/or deductible interest carried forward be operated in a notional local group scenario – should these amounts be carried at an entity or a group level?

The amounts that are brought forward are group attributes so these should be carried at a group level and should be freely allowable between group members.

(iv) How should the charge (calculated under Step 6 in section 6 of this paper) be dealt with when applying the ILR to a notional local group? For example, should it be applied at the head of the group or at entity level?

We favour an approach that allows the group to nominate whether the charge applies at the head of the group or at entity level.

(v) How should changes in membership of the notional local group be dealt with?

When companies join/leave the group, we favour an approach that allows the group to nominate the company which will carry forward interest.

Question 29: *Would the answers to Question 28 be different for mandatory application of the "group approach" versus optional?*

No. We favour a flexible approach.

Question 30: *Where there are different accounting period end dates throughout the group, what approach should be taken to standardise and apportion group transfers of 'exceeding borrowing costs' and interest capacity?*

We believe the UK approach is practical in this regard and would recommend a similar approach.

Where the parent draws up financial statements for the group, then that accounting period is taken as the group's period of account.

Where the parent draws up financial statements for itself, but not for the group, then the period of account for the parent is taken as the group's period. An election can be made by the parent that this rule does not apply.

Where the parent does not draw up accounts for itself or the group, it is necessary to determine the "accounts free period" i.e. the period during which no accounts were prepared. If the accounts free period is less than 12 months, it is taken as the default period of account. Where it is greater than 12 months, it is broken into 12 month periods. An election may be made to alter this default period (e.g. it might not coincide with year-end and thus cause a large compliance burden).

Question 31: *There are provisions throughout the Tax Acts which provide for the order in which certain reliefs are deemed to be used, such as in section 403 TCA 1997. How should the interaction of the ILR and such rules be dealt with?*

See our answers to Questions 3 and 8 above.

Question 32: *Comments are invited on any other technical issues that may require consideration.*

We have no additional comments.

Yours faithfully

ARTHUR COX LLP