

ATAD Implementation

Implementation of Hybrid and Interest limitation rules

January 2019

EXECUTIVE SUMMARY

The American Chamber of Commerce Ireland's priority is that Ireland remains a unique transatlantic trade and investment hub and an inclusive location-of-choice for talent and innovation with global impact.

As Ireland continues to implement further ATAD provisions, we encourage the Government to remain cognisant of the many competitive challenges facing Ireland and adopt the remaining ATAD provisions in a manner that will sustain competitiveness for inward investment and employment. The American Chamber has consulted with its membership on this consultation and remains grateful for the opportunity to engage in another important public consultation focused on ensuring the Ireland's taxation code is certain, transparent and competitive.

In this submission the American Chamber advocates that the Hybrid and Interest rules are implemented in a clear and competitive manner with a focus on the following:

1. Continuing to support a competitiveness agenda by implementation of any new tax measures in a manner that helps future-proof Ireland's economy within the scope of the ATAD provisions themselves.
2. Delivering certainty of application for taxpayers. Unnecessary complexity should be avoided, and provisions adopted should seek to minimise the cost of compliance and mitigate the administrative burden where possible.
3. Drawing from the experience of other jurisdictions that have already implemented these tax rules. Most notably, the UK has already legislated for many of the issues raised in this consultation.
4. With respect to the interest limitation provisions, taking the opportunity to overhaul and simplify the basis on which tax relief for interest incurred on debt used for genuine business purposes is permitted, in line with other competitor jurisdictions. In addition, consideration of pre-existing creditor/debtor commitments has been an important features of Ireland's reform process and this should continue, respecting the legitimate expectation of investors.

This submission from the American Chamber is focused on the areas of member's priorities and hence does not provide answers to all questions raised in the consultation document. However, members remain open to further engagement in assisting the Department develop its framework. Likewise, given the complexities of existing and potential provisions and their interaction with each other, the American Chamber would welcome continued dialogue as the Department develops its approach before the next Finance Bill.

Hybrid Rules (Questions 1-30)

Question 1: Entities

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

Rather than defining entities which are to be within the ambit of the anti-hybrids regime, it would be more practicable to define the anti-hybrids rules as "applying for the purposes of corporation tax".

Question 2: Foreign / Local taxes

What foreign taxes should be considered as equivalent to Irish taxes for the purposes of establishing whether or not a mismatch outcome arises? For example how should municipal taxes, local taxes, taxes on profits under CFC regimes etc. be treated?

As a general principle, the American Chamber is in favour of a business-friendly approach consistent with maintaining Ireland's competitiveness. Our preliminary view is that a broad view should be taken as to equivalence, ideally building on existing concepts. However, we may review this position as matters develop.

Question 3: Subject to tax

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?

ATAD2 is clear that guidance can be taken from the BEPS Action 2 Report. Consistent with the latter document's approach, Ireland should ensure that anti-hybrid rules only address mismatches caused by hybridity, and not those caused by tax rate differentials. The fact that a party to a transaction is resident in a low tax jurisdiction should not of itself result in the transaction being treated as a hybrid. We have an open mind as to whether this is clarified through the "subject to tax" wording or elsewhere.

Question 4: Timing of inclusion

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?

In implementing provisions dealing with the issue of deduction/non-inclusion outcomes for financial instruments, it is important that regard be had not only to a temporal mismatch between the payee and payer jurisdictions (whether that be 12 months or the "reasonable period of time" suggested in recital (21)) but also to the requirement that: *"the mismatch outcome is attributable to differences in the characterisation of the instrument or the payment made under it"*.

Question 5: Disregarded PEs

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?

The American Chamber believes this matter is best dealt with as part of the public consultation referred to in the question.

Question 6: Disregarded PEs

Where the profits of an otherwise disregarded PE are subject to tax, e.g. under a switchover rule or a CFC charge, is that sufficient for them to then be treated as a PE, rather than a disregarded PE? What are the relevant considerations to deciding whether or not Ireland should implement the defensive rules on disregarded PEs?

Subject to our comments on Question 5 above, the American Chamber may wish to engage further on this topic as part of a public consultation and as the legislative process progresses.

Question 7: Other defensive rules

What are the relevant considerations to deciding whether or not Ireland should implement the defensive rules in the context of these hybrid mismatches?

The American Chamber believes that in the interests of competitiveness and ease of administration Ireland should avail of the facility not to implement the optional defensive rules.

Question 8: Charge to tax

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.

Conceptually it would seem that income that was recognised only as a result of an anti-hybrid rule should be taxed according to the current divisions of income within the Irish tax code (Schedular system) in accordance with the circumstances in which it arose, as with other sources of income i.e. if the income could be construed as trading income then it should be taxed as such in accordance with Case I of Schedule D. A deduction denied under an anti-hybrid rule would seem to simply mean an increase in the taxable amount of the relevant source of income against which the deduction would otherwise be allocated.

Question 9: Imported mismatches

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?

The American Chamber is concerned about the administrative burden involved in tracing transactions to which the Irish taxpayer is not a party. Therefore, in the interests of competitiveness and ease of administration, and to the

extent permitted by ATAD2, we believe that the Irish taxpayer should not be required to analyse for imported mismatches when dealing with a party resident in a country with effective anti-hybrid rules.

Question 12: Financial trader exemption

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?

It is appropriate for Ireland to incorporate all relieving provision permitted under ATAD2, so as not to disadvantage those entities vis-à-vis those resident elsewhere.

Question 13: GAAP

What factors should be considered when implementing the concept of consolidated 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 or relevant accounting standards, should the concepts of a group under accounting principles be imported into domestic tax legislation using, for example, section 7 Companies Act 2014 as a template?

In the view of the American Chamber, consideration should be given to the definitions of control under Section 10/11 and Section 432 TCA 1997.

The definition in Section 432 TCA 1997 is very broad and was drafted with determining control from a close company perspective in mind and to identify whether there are "participators" in a company. The definition considers a person to be a "participator" even where that person cannot direct how the affairs of a company can be carried on. This 'control' test is currently a complicated concept in Irish tax law. It can cast a very wide net and create a concept of control significantly beyond the normal meaning of that term.

Section 11 TCA 1997 defines control by the ability of a person to direct that the affairs of the company are conducted in accordance with the wishes of that person. This ability is evidenced by the person's holding of shares, voting rights or by powers conferred by the articles of association and similar documents.

We have also considered the definition of "subsidiary" as outlined in Section 7 of the Companies Act 2014. This definition is more in line with Section 10/11 TCA 1997, again focusing on the ability to direct the company by holding of shares, voting rights and the company's articles. Section 7 goes further and considers the right to exercise dominant influence over the company (right to give direction with respect to operating and financial policies that the directors are obliged to comply with) the makeup of the board of directors.

In addition, Section 7 has removed certain types of holdings from being treated as "held or exercisable" when determining control, such as, where a company's ordinary course of business includes the lending of money and the shares are so held by way of security, or where the shares are held in a fiduciary capacity.

The American Chamber is ultimately of the view that Section 11 TCA 1997 would be the most appropriate definition to use in this context and is in line with ATAD requirements.

Question 14: Hybrid entities

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?

The American Chamber is of the view that this question is key in the context of the drafting and implementation of the legislation.

As outlined in the question, the current approach in determining the treatment of an entity is based on case law. In our view, more certainty is required given the importance of this analysis.

There are several possible solutions to dealing with this question and we strongly recommend that the various solutions are carefully considered prior to the implementation of the legislation. We would be happy to discuss the potential solutions with the Department.

For example, consideration could be given to following the foreign entity's tax treatment that is applied in the jurisdiction of the entity. In addition, consideration could also be given to producing a list with the most common forms of entities and detailing whether such entities are tax transparent or tax opaque for the purposes of the Anti-Hybrid legislation.

Question 15: Investor / payee jurisdiction

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?

In our view, a single concept being used should simplify the interpretation of the Irish legislation for both Revenue and the taxpayer.

Question 17: Financial instruments

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 American Chamber is initially of the view that the definition of "debt, equity or derivative instruments" should be enough. However, it is important that there is no uncertainty as to the application or not of the hybrid rules. It is important that the definition is clear that non-debt, non-equity or non-derivative instruments are not considered for the purposes of this legislation and we would be of the view that any guidance issued on the legislation should make this clear.

Question 19: Capital market transactions

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 American Chamber is of the view that the Anti-Hybrid provisions should apply in a capital market scenario if it was reasonable to consider that the Irish company was specifically aware of the mismatch. In our view, any broader approach, would result in a compliance burden and implications for Irish companies engaged in capital market transactions which would simply be too high in comparison with competing jurisdictions.

From our perspective, the most reasonable approach would be to consider using a wording similar to that included in Section 110 TCA 1997 in respect of certain payments made under a “specified instrument”.

Question 20: What is tested for hybridity?

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?

The general approach in Irish tax legislation in similar scenarios is to consider the relevant laws of the foreign jurisdiction. It would seem reasonable to continue with this same approach to test hybridity as it places the most manageable compliance burden on the taxpayer.

This approach should be extended to consider the transaction in question in some circumstances. For example, it may need to consider whether the actual instrument in question is debt or equity under the foreign jurisdictions’ laws and if equity, does that foreign jurisdiction provide for an exemption for equity returns. Hybridity should not arise merely because an instrument is debt in one jurisdiction and equity in another. It should arise if there is a difference in both classification and tax treatment e.g. debt returns are taxable, but equity returns are not.

In addition, it does not seem appropriate to look at the circumstances of the taxpayer itself. For example, payments made to a taxpayer who may be tax exempt due to their own circumstances e.g. pension funds, government entities, certain US partnerships, etc. should not be treated as hybrids merely because of the recipient’s tax status.

Question 21: Existing domestic provisions

Bearing in mind both the interest limitation and anti-hybrid requirements of ATAD, what amendments, if any, should be made to these domestic provisions? (See also, Question 44)

There are a wide range of Irish tax provisions which must be considered considering the interest limitation and anti-hybrid requirements (these include sections 130, 247, 291A, 452, 452A, 817A-C, 840A and 891A of the Taxes Act).

The changes suggested by the American Chamber to the regime applying to interest deductions are discussed in response to question 44.

On a broader level, given the future introduction of interest limitation and anti-hybrid rules, and the protections to base erosion which they will afford, the American Chamber believes this provides an opportunity to review and remove surplus provisions within the Taxes Act which apply to interest and hybrids (e.g. s.130 and s.247 TCA 1997).

Question 22: Existing domestic anti-hybrid provisions

Should the domestic anti-hybrid rules be maintained in their current form or should they be amended and replaced with a single anti-hybrid rule which applies to both cross border and domestic transactions?

Please see response to question 21. The American Chamber suggests that the other domestic provisions which apply to hybrid mismatches be maintained and that the anti-hybrid rules apply to cross-border transactions only, consistent with the requirements under ATAD2.

Question 23: treatment of disallowed payments

Should adjustments under the anti-hybrid rules cause payments to be treated as distributions or simply as non-deductible expenses?

The American Chamber recommends that adjustments under the anti-hybrid rules should be treated as a non-deductible expense for Irish tax purposes. Such expenses should retain their character for Irish tax purposes (e.g. interest which is treated as a hybrid and is non-deductible retains its characteristic as interest for tax purposes).

Question 24: order of application

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?

The American Chamber believes that the anti-hybrid rules should apply in priority to the interest limitation rules. This ensures that any workings on potential interest restrictions is applied only to payments which are respected as tax deductible payments under Irish tax law.

It is suggested that existing Irish anti-hybrid provisions which are maintained (e.g. s.130 TCA 1997) should apply in advance of the ATAD2 anti-hybrid rules.

In addition, the American Chamber suggests that Ireland's transfer pricing regime and the CFC rules should apply after the ATAD2 anti-hybrid rules but before the interest limitation rules are applied. This ensures that such rules are not unnecessarily applied to payments which are treated as non-deductible under the ATAD2 anti-hybrid rules.

Question 26: Leases

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?

The American Chamber recommends that operating leases should not be within the scope of the anti-hybrid rules, which is consistent with both ATAD 2 and BEPS Action 2.

Question 27: Stock lending and repo transactions

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?

Consideration could be given to legislating for the tax treatment of stock lending and repo transactions as set out in Revenue Tax and Duty Manual at 04-06-13.

Question 28: Part 8A TCA

Are any domestic law changes necessary to Part 8A TCA, or any special considerations necessary to the implementation of the anti-hybrid and interest limitation rules to ensure that those measures apply to Part 8A TCA equivalent transactions?

We suggest that no domestic law changes are necessary to Part 8A, TCA 1997.

Question 29: The reverse hybrid rule

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?

The American Chamber currently considers that the language “subject to tax” would be appropriate, but we would welcome the opportunity to engage on this further as the legislative process progresses.

Interest Limitation Rules (Questions 31 – 44)

Question 31: Application to groups

What are the relevant considerations in determining whether Ireland should implement Article 4 in such a manner as would allow application of the interest limitation rule on a local group basis?

Article 4(1) of the ATAD states that “*exceeding borrowing costs shall be deductible in the tax period in which they are incurred only up to 30 percent of the taxpayer’s earnings before interest, tax, depreciation and amortisation (EBITDA). For the purpose of this Article, Member States may also treat as a taxpayer:*

- (a) An entity which is permitted or required to apply the rules on behalf of a group, as defined according to national tax law;*
- (b) An entity in a group, as defined according to national tax law, which does not consolidate the results of its members for tax purposes.*

In such circumstances, exceeding borrowing costs and the EBITDA may be calculated at the level of the group and comprise the results of all its members”.

The BEPS Action 4 report describes a local group to be “*group entities in the same country*”. From our perspective, when looking at the available interest-bearing capacity (EBITDA-based) of Irish resident companies, it would be appropriate to have regard to the Irish group as those companies which are eligible to claim and surrender group relief between themselves rather than having regard to the inclusion within a consolidated accounting group.

Existing mechanisms exist for group relief (and potentially consortium relief) claims and surrenders which could be used in a modified manner to ensure that the appropriate measure of interest is borne.

A group ratio rule, although a worldwide group rule would be preferred, needs to be implemented for several reasons, notwithstanding that this will inherently make the rules more complex for all stakeholders. A group ratio rule will help reduce (but not eliminate) the risk that groups will suffer a disallowance of third-party finance costs, which could distort commercial behaviour. The group ratio should be an optional test for groups. If the complexity of the calculations is not justified by the additional finance costs which could be claimed, a group would be able to opt out of such rule. This opt out we propose to be done on an accounting period by accounting period basis.

Question 32: Application to groups

As Ireland does not have tax consolidation for groups, what are the practical issues that might arise in applying the interest limitation rule on a group basis? For example, how should the allowable quantum of interest deductions, after the application of the interest restriction, be allocated to the group members? How should companies joining and leaving groups during an accounting period be dealt with? What happens if members of the local group do not have corresponding tax periods? What filing obligations should each member of the local group have?

It is the American Chamber’s view that applying the interest limitation rule on a group basis will make the position more complex, but the denial of a deduction of a genuine economic cost will have far more adverse consequences.

The quantum of interest deductions, after the application of the interest restriction should be simply allocated to group members by a method similar to group relief. Like the application of group relief of losses per S.420A/B, it

should be the taxpayer's option to allocate the deductions where they choose to apply them. All groups will have companies with differing characteristics such that the interest allocation requirements will vary from group to group. It would be fundamentally distortive to allocate the ability to deduct interest mechanically between such businesses rather than permitting relief for the reduced amount of relief as determined by the limitations.

The concept of allocation of losses for companies joining/leaving groups already exists in our domestic legislation per S.423 TCA, 1997. By virtue of this provision, group relief will only be granted if the surrendering company and the claimant company are members of the same group throughout the whole of the surrendering company's accounting period and the claimant company's corresponding accounting period.

Where a company joins or leaves a group, all the companies in the group are deemed to close an accounting period at that date. The corresponding accounting period rules in S.422 TCA 1997 are then applied using the notional accounting periods.

The American Chamber recommends utilising the existing group relief framework and mechanics to govern the allocation of interest relief in these circumstances.

Similar to the above, the filing obligations should follow the treatment of group relief such that the surrender and claiming of interest will be included in both companies' CT1 returns. Given the potential complexities involved, we would advocate a single joint return to be submitted on behalf of all relevant group members to facilitate the compliance process for Revenue and taxpayers alike.

Question 33: Application to groups

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?

The use of a consolidated accounting approach has been used in Ireland for Country by Country Reporting which has also derived from the OECD BEPS project. We infer that consolidated accounting groups are preferred for BEPS purposes as it is recognised that MNE groups place a strong emphasis on reported profits.

It is not necessarily important that a single definition of a group is used for all aspects of the interest rules. What is important is that appropriate group definitions be used at the appropriate level. When considering the application of the rules in determining the interest capacity and interest costs of Irish resident group members, an approach could be adopted to take account of the members of the Irish tax group or to hypothesise an Irish accounting group comprising Irish resident members of the ultimate parent group. While the latter approach may have attractions to certain individual taxpayers, if it was mandatorily applied, it would likely cause significant compliance difficulties for members of complex multinational groups which may have disparate operationally-unrelated members based in Ireland whose only connection is to be owned by a joint ultimate parent company. It should be noted that in many cases, that ultimate parent would not account under IFRS nor FRS102. If such an Irish accounting-based approach was to be used, it should be optional to an approach based on Irish tax grouping rules.

The application of the group rule on an accounting basis can be made workable and need not be unwieldy or complex. The criteria should be based on two requirements, 1) They are in a consolidated group per the accounting standard adopted by the accounting group and 2) The companies are within the charge to Irish corporation tax.

In consideration of what constitutes a group, the American Chamber urges that this is on an election/opt-in basis to apply the group rule such that the taxpayer can determine the optimal approach in consideration of its pertinent circumstances.

Question 34: De Minimis threshold

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

Article 4(3) of ATAD 1 states that *“the taxpayer may be given the right to deduct exceeding borrowing costs up to EUR 3 000 000...”*. The American Chamber advises that this de minimis threshold is included in our domestic legislation and would see its inclusion as imperative.

To provide a form of additional certainty of application to a company’s tax affairs with respect to lending, consideration should be given to whether a grace/lead in period will be afforded to companies such that in instances where a company breaches the de minimis threshold for a second consecutive taxable period, only then the interest limitation rules may apply. This will prevent a ‘cliff-edge’ effect. Fluctuations in interest rate on floating borrowings and other factors are often out of a company’s control, resulting in an increased interest expense arising out of no tax motive whatsoever. It would therefore provide certainty and stability to a company’s tax affairs if a lead-in period can be provided.

Question 36: Pre-existing loans

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?

Paragraph 4 of Article 4 of ATAD 1 states that *“Member States may exclude from the scope of paragraph 1 exceeding borrowing costs incurred on...(a) loans which were concluded before 17 June 2016, but the exclusion shall not extend to any subsequent modification of such loans...”*. The preamble notes at paragraph 8 that *“Member States could provide for a grandfathering clause that would cover existing loans to the extent that their terms are not subsequently modified i.e. in case of a subsequent modification, the grandfathering would not apply to any increase in the amount or duration of the loan but would be limited to the original terms of the loan”*. This grandfathering clause is provided *“to facilitate the transition to the new interest limitation rule”*. Consideration of pre-existing creditor/debtor commitments has been an important features of Ireland’s reform process and this should continue, respecting the legitimate expectation of investors. Thus, it is imperative to incorporate this grandfathering clause into our legislation on interest limitations to ensure that loan financing taken out prior to the issue of the EU Directive is not impacted by these rules. Applying interest limitation rules retrospectively to a pre-existing loan is unnecessary in the context of an existing regime which Ireland has advocated is equally effective as the proposed interest limitation rules.

Furthermore, the American Chamber suggests that clear guidance is provided with respect to the meaning of “modification”. For example, within international financial markets, there is to be a move to a new benchmark for floating rate loans. As a result of the LIBOR and related controversies, new international benchmarks are being

established from the end of 2021. The practicalities of the end of LIBOR and similar benchmarks will result in existing loans (pre-17 June 2016) tied to the antecedent benchmark will be treated as having a new benchmark applied. This variation is not tax driven nor BEPS driven. We urge the Department of Finance to consider the practicalities of this grandfathering rule and the appropriate legislation to provide for such circumstances so that a modification is not triggered.

A modification should involve a material alteration to the terms of the loan in terms of parties, payment, collateral, term and currency. For example, if a borrower in a situation where the security of a loan is changed from one asset to a similar asset and of similar value should not be regarded as a modification of the loan.

If the Department of Finance consider a rate change to be a modification, we request clear guidance on the operation the interest limitation rule. For example, if the pre 17 June 2016 loan attaches a rate of interest of 4% and the terms change such that the interest rate is changed to 5% in 2019, if the Department of Finance would consider this to be a “modification” such that the interest limitation rules apply, confirmation should be provided that such limitation of interest is only applied to the excess i.e. 1%.

Notwithstanding the above, due regard and respect should be applied to the arm’s length rate principle, a concept applied in every BEPS Action except this one. Where a loan interest rate changes and the interest applied is at an arm’s length rate, a modification of the loan should not apply given that the intention of the taxpayer is not one to generate base erosion advantage.

Question 37: Long term infrastructure

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?

Article 4(4) of ATAD 1 states that “*Member States may exclude...exceeding borrowing costs incurred on...loans used to fund a long-term public infrastructure project where the project operator, borrowing costs, assets and income are all in the Union*”. The ATAD outlines a long-term public infrastructure project to be “*a project to provide, upgrade, operate and/or maintain a large-scale asset that is considered in the general public interest by a Member State*”.

Long-term public infrastructure projects need certainty of treatment, especially as any unforeseen costs can be borne by the State. The American Chamber believes that the interest restrictions should not apply to long-term infrastructure loans as the imposition of a restriction on long-term infrastructure loans will inevitably discourage planned and future projects by making them more expensive.

Given the importance of infrastructure to Ireland and to continue to attract investment from overseas, it is essential that tax barriers are not increased.

Question 38: Consolidated group ratio rule

What are the relevant considerations in determining whether Ireland should make provision for a consolidated group ratio rule? What are the key factors to consider in determining which consolidated group ratio rule should be implemented in Ireland?

The ATAD at paragraph 5 of Article 4 provides optional implementation of one of two group ratio rules, specifically, the taxpayer may be given the right to either:

- (a) fully deduct net interest where its equity/total assets ratio is not more than 2% lower than the equivalent ratio for the consolidated group (being the consolidated group for financial accounting purposes); or
- (b) Deduct net interest up to the consolidated group's external borrowing/EBITDA ratio.

These ratios are based on the consolidated group as a whole and are a necessary building block in ensuring that tax relief for interest not be denied where the interest genuinely reflects the financial conditions of the consolidated group. 'Group escape clauses' (as these are often termed) are common in other tax systems in the EU. The German and French interest limitation rules both have a similar clause.

It is important that both are included to ensure that regard is had to the total leverage in capital and income terms as otherwise the effects of high interest rate currencies can be distortive.

In considering the possibility of whether the ATAD allows for "dual inclusion" of both (a) and (b) above, one must consider other areas of the ATAD where optionality is afforded to the Member State. On implementing Controlled Foreign Company (CFC) rules as required by Article 7 of the ATAD, the European Commission regarded its non-applicability of the CFC rules as an "either/or" test, the wording of the directive being "...the Member State of the taxpayer shall include in the tax base (a)... or (b)...". In respect of this consolidated group rule, laid out in paragraph 5 Article 4 of ATAD 1, "...the taxpayer may be given the right to either (a)... or (b)...". Juxtaposing both provisions, the consolidated group rule is distinctively more flexible than how the CFC provision was included in the ATAD. We advocate that both are included such that the optionality is afforded to the taxpayer. A taxpayer should be allowed to opt for one option in a particular tax year and may choose the other if their circumstances change.

There will be practical difficulties in imposing a consolidated group ratio rule in instances where accounting standards change given the intended reliance on accounting definitions to determine a consolidated group. It must also be considered that it could prove difficult to obtain the necessary information to prepare the required calculations for any group rule and flexibility has to be provided to address this. An optional 'group escape clause' would allow the taxpayer to make a decision on whether the practicalities of getting to a position to benefit from the escape clause justified the increased compliance burden.

Question 40: Carry forward

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

Article 4, paragraph 6 of ATAD 1¹ states that *“The Member State of the taxpayer may provide for rules either:*

- (a) to carry forward, without time limitation, exceeding borrowing costs which cannot be deducted in the current tax period under paragraphs 1 to 5;*
- (b) to carry forward, without time limitation, and back, for a maximum of three years, exceeding borrowing costs which cannot be deducted in the current tax period under paragraphs 1 to 5; or*
- (c) to carry forward, without time limitation, exceeding borrowing costs and, for a maximum of five years, unused interest capacity, which cannot be deducted in the current tax period under paragraphs 1 to 5.*

In consideration of the three options, a competitiveness lenses will be an important factor. The very existence of interest limitation rules puts Ireland at a disadvantage vis-à-vis our European colleagues from the starting line due to the non-existence of deductions on investments in Irish law (i.e. several EU Member States provide for deductions on equity investments).

The OECD Action 4 report provides for the carry forward of disallowed interest deductions as the method and mechanism to prevent double taxation. The existence of carry forward rules will be welcomed but the insertion of carry forward rules should not be looked on as hugely beneficial and a reason to go beyond the ATAD in other areas as the carry forward rules generate several difficulties for companies that do not prevent double taxation as suggested in the report. In particular, the absence of group tax consolidation in Ireland poses very real challenges to the ability of companies to utilise carried forward interest deductions. In similar circumstances, in implementing similar restrictions, the UK has chosen to effectively refresh carried forward amounts each year to allow them to be available for grouping with other qualifying group members. This is akin to the treatment which would be available in countries with a consolidation regime and we recommend that it be considered in an Irish context.

The carry forward policy needs to be legislated for in the widest possible terms. We advocate option C in that regard but reiterate the importance of how an unused carry forward will be applied in instances such as termination or restructuring.

The Department of Finance should align the carry forward of interest as much as possible to domestic loss rules but allow for the carry forward to be “refreshed” by treating the carry forward as an interest expense in the succeeding period. A similar provision to S.400/401 could be considered to allow the unused interest to be transferred in the instances of change of ownership subject to anti-avoidance provisions.

Question 41: Borrowing costs and exceeding borrowing costs

What are the factors that should be taken into account in defining borrowing costs in Irish legislation? What practical difficulties may arise in applying such a wide definition and what can be done to ameliorate them? What types of income / expenses should fall to be treated as economically equivalent to interest for the purposes of the

¹ <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016L1164&from=EN>

application of the interest limitation rule? Issues raised in the anti-hybrid portion of this document should also be considered in this context.

The basis for calculation of borrowing costs, taxable interest revenues and their economic equivalence need to be carefully drafted to ensure conformity with the scope of ATAD. We have set out our views on changes to existing domestic provisions regarding interest in answer to question 44. Interest can be defined as “...*payment by time for the use of money*”². While interest itself is well understood, with notable exceptions, such as part 8A TCA 1997, Irish tax law does not deal well with economic equivalence. Within a modern commercial and accounting context, the issue of economic equivalence is important given that accounting principles can apply economic substance instead of legal form for transactions when accounting for them, whereas tax law would respect the legal form of a transaction. For example, previously a lessee leasing an asset could have been accounted for as the acquisition of that asset through loan finance (whereas tax would have respected the legal form of the transaction as being the hiring of that asset) due to the increasing prevalence of substance over form in accounting principles.

Therefore, the definition of borrowing costs should be specific in its nature and detailed revenue guidance notes should be given explaining what is and what is not in scope.

Economically Equivalent

Chapter 2 of BEPS Action 4 Report or the ATAD does not provide any indication of what may be considered ‘economically equivalent’, so the definition of same will need to be considered by each Member State. The lack of guidance provided suggests the difficulties that arise from applying a best practice rule to this area. We acknowledge that a best practice rule would prove difficult due to practical issues in defining and extracting payments considered economically equivalent to interest when their treatment is likely to vary under different accounting standards.

Clear guidance must be provided by the Government and Revenue such that certainty is provided to the taxpayer. For example, it should be clear that the interest element related to accounts payable (under normal credit terms) and balance sheets provisions including pension accruals should not be regarded as payments economically equivalent to interest. However, the taxpayer can’t assume this until detailed guidance provides clarity. Similarly, the guidance should be clear on the treatment of foreign exchange gains or losses and payments in relation to derivatives, which may have embedded finance charges.

It is important to legislate in a clear manner and apply the same definition for borrowing costs as one does for taxable interest revenue.

Question 42: EBITDA

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?

The ATAD states in Article 4, paragraph 1 that “*exceeding borrowing costs and the EBITDA may be calculated at the level of the group and comprise the results of all its members*” and in paragraph 2 states “*the EBITDA shall be*

² 10.2.1 Taxing Financial Transactions, Irish Tax Institute

calculated by adding back to the income subject to corporate tax in the Member State of the taxpayer the tax-adjusted amounts for exceeding borrowing costs as well as the tax-adjusted amounts for depreciation and amortisation”.

Clarity in legislation and guidance will be imperative in the definition of EBITDA; in particular the Department needs to factor in (i) how balancing allowances and charges will impact on the tax adjusted EBITDA, and (ii) the impact of any income which is assessed on a receipt rather than accruals basis, such as foreign dividend income. While it is well understood that tax depreciation needs to be adjusted in determining EBITDA, the disruptive effects of balancing charges and balancing adjustments needs to be considered which is likely to be of particular relevance to operating lessors.

Negative EBITDA

In consideration of how a negative EBITDA should be treated, any suggestion that a negative EBITDA could be excluded in computing a Group’s EBITDA would likely be welcomed by taxpayers as it would simplify compliance procedures.

Many groups will have a company or several companies that will have a negative EBITDA and these circumstances should not be used to further restrict the interest deduction. A measured approach to defining EBITDA in conjunction with the Group position would be to disregard an entity from the EBITDA calculation where their EBITDA is ultimately negative.

Question 43: exempt income

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?

Paragraph 2 of Article 4 states that “Tax exempt income shall be excluded from the EBITDA of a taxpayer”. We see no rationale to depart from an assumption that exempt income should be narrowly construed. As a matter of fact, foreign dividend income is subject to Irish tax with a credit for the foreign tax, if available. It would be inappropriate to exclude such income in computing EBITDA in the absence of a formal exemption.

The anti-hybrids provisions will target any abuses from asymmetric treatment where dividends and interest are treated differently in different countries. Denying an interest deduction on this basis would be an undue restriction on relief for interest costs and would limit the ability of indigenous groups to efficiently finance themselves. We therefore advocate that foreign dividends that are fully sheltered from Irish corporation tax by double tax relief be included in EBITDA and not adjusted out.

Question 44: Scheme of relief or interest

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?

The American Chamber urges consideration be given to an overhaul of all existing interest provisions rather than amending same to layer in the ATAD rules. This is likely essential to avoid an imbalance of the Irish corporation tax system.

Interest, by its nature, is generally a revenue expense and when incurred wholly and exclusively for the purposes of a trade is relieved in full for Irish Corporation Tax. Outside a trading context, relief is given only to the extent that an express statutory provision permits relief which remains subject to further limitations. These limitations extend not only to the purpose to which the borrowings are applied but also to the form in which they are raised and applied. The relative advantages of risk management tools such as financial derivatives (i.e. those relating to interest rate and foreign exchange hedging) are, outside treasury operations, reliant on statements of revenue practice rather than statute to determine whether and to what extent relief is available.

In this context, we advocate that serious consideration be given to the broad reform of the Irish Corporation Tax Code provisions dealing with the tax treatment of all aspects of corporate finance. Such legislation need not be lengthy or unwieldy.

Adopting a principles-based approach to legislation whereby tax relief is permitted for finance costs measured on an accounts basis where the monies have been applied for any purposes within the business and other commercial purposes of the taxpayer concerned would not extend tax relief in an inappropriate or undue manner. This approach can then be affected subject only to the measurement limitations prescribed in ATAD which provide a bulwark against excessive interest burdens.

The purpose and intended effect of reform in this area would not be to increase the quantum or availability of relief but to bring simplicity and certainty for Revenue, taxpayers and advisers alike.

Such clarity should reduce the necessity for private Revenue opinions.

Current Provisions

The UK's corporate interest restriction legislation consists of 155 pages which implements the provisions of Article 4 of ATAD. By contrast, Ireland's specific provisions dealing with interest consist of a few pages which will likely make it more complex to enact the specific restrictions which ATAD mandates if a comprehensive reform on the taxation of corporate finance is not forthcoming. As Ireland will be legislating in an environment where the quantum of relief is to be limited by reference to fixed limitations based on business income, we believe it should be possible for more concise legislation to be brought forth.

The UK is a key competitor for foreign direct investment, and so we need to make our tax system as simple and clear where possible. A reform of our interest rules is an opportunity to provide clarity to the taxpayer during the current unstable environment. The UK's rules regarding funding cost deductibility (i.e. primarily fees and interest) are broadly deductible on an accounts basis, even if capital in nature, obviously subject to their own interest

restriction rules. Ireland has an opportunity to assert clarity on our position rather to insert a two-tier interest restriction layer i.e. does the taxpayer get a deduction under a domestic provision for interest (i.e. through S.81, S.97 or S.247)? If so, another layer will be required to each provision to legislate for the limitation rules and the associated provisions contained within.

If the Department of Finance decides not to overhaul the possible second tier of interest rules being our current domestic rules, the Department of Finance may wish to leave the rules the way they are currently but that would trigger a requirement to remove excessive targeted anti-avoidance provisions contained in many of the interest provisions. This is a great opportunity to consider which targeted anti-avoidance provisions are necessary and removal of same would be recommended where no longer required.

We request that interest as defined to be deductible in the first instance and consideration of limiting that interest will then apply.

Concluding Remarks

The American Chamber of Commerce Ireland's priority is that Ireland remains a unique transatlantic trade and investment hub and an inclusive location-of-choice for talent and innovation with global impact.

As Ireland continues to implement further ATAD provisions, we encourage the Government to remain cognisant of the many competitive challenges facing Ireland and adopt the remaining ATAD provisions in a manner that will sustain competitiveness for inward investment and employment.

Given the complexities of existing and potential provisions and their interaction with each other, the American Chamber would welcome continued dialogue as the Department develops its approach before the next Finance Bill.