

Irish Interest Limitation Rule

Finance Act 2021 was signed into Irish law on 21 December 2021. It implements, for the first time in Ireland, the interest limitation rule (“**ILR**”) under the Anti-Tax Avoidance Directive (“**ATAD**”), and it is now effective for accounting periods commencing on or after 1 January 2022.

We are pleased with the way in which the legislation has been drafted. Although there is no financial undertaking exemption as had been anticipated, the expected standalone exemption has been incorporated. Most Section 110 Companies should fall outside the scope of the ILR by virtue of being standalone entities or being part of a “single company worldwide group”. For those falling outside of this (e.g. Section 110 Companies which are subsidiaries), helpfully, the definition of “interest equivalent” has been widely drafted. We believe it includes all flows of funds through a Section 110 company.

How the ILR is to be implemented in Ireland

Subject to specific group and equity ratio provisions and other exclusions, the ILR limits corporation tax relief on net interest expenses of companies to the higher of 30% of EBITDA (Earnings Before Interest Tax Depreciation and Amortisation) or EUR 3 million. ILR adjustments are to be calculated using a nine step approach:

1. Identify the **relevant entity** (either a company or interest group).
2. Calculate the relevant entity’s **relevant profit or loss** on a value basis before the interest limitation.
3. Identify the relevant entity’s **taxable interest equivalent** (which should include any income, profits or gains arising in a section 110 company).
4. Identify the relevant entity’s **deductible interest equivalent** (the amount in respect of interest equivalent that is deducted in calculating the relevant profit or loss).
5. Based on previous steps, calculate:
 - 1) **exceeding borrowing costs** (where net interest equivalent is greater than or equal to zero); or
 - 2) **interest spare capacity** (where net interest equivalent is less than zero); and
 - 3) **EBITDA** (the greater of zero and an amount calculated to include:

- relevant profit or loss +
- net interest equivalent +
- foreign tax deducted +
- [(capital allowances – the amount of deductible interest equivalent referable to those capital allowances) –
- capital charges - the amount of deductible interest equivalent referable to those capital charges)] +
- the amount of deductible interest equivalent in respect of legacy debt.

6. Apply the **equity ratio rule** (equity over total assets). Step 8 is not relevant if the equity ratio rule applies).
7. Calculate the **allowable amount** (EBITDA x 30%) and compare it to **exceeding borrowing costs**.
 - i. Where the **exceeding borrowing costs** are greater, the excess will be a **disallowable amount**.
 - ii. **Limitation spare capacity** will arise where the exceeding borrowing costs are less than the **allowable amount**.
8. Reduce the **deductible interest equivalent** by the **disallowable amount** and calculate the taxable profit accordingly.
9. Carry forward any **disallowable amount** as a **deemed borrowing cost**, or the sum of **interest spare capacity** and **limitation spare capacity** as **total spare capacity**.

If there is a **disallowable amount** in a succeeding accounting period, the **disallowable amount** may be reduced by **total spare capacity** carried forward.

If there is interest spare capacity and/or **limitation spare capacity** in a succeeding accounting period, any **deemed borrowing cost** carried forward may be deducted from taxable profits to the extent that the **disallowable amount** would have reduced the tax payable in the period that it arose, were it not for the application of the ILR. Where the **disallowable amount** would have resulted in a loss in the period that it arose, were it not for the application of the ILR, the **deemed borrowing cost** will be treated as a loss in the first mentioned accounting period and relief for that loss may be given in accordance with the existing loss relief provisions.

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Exemptions and exclusions adopted:

1. A de minimis exemption for interest expenses below EUR 3 million.
2. An exemption for standalone entities as they do not make payments of interest to associated entities.
 - A. Standalone entities are taxpayers that are not part of a consolidated group for financial accounting purposes and do not have any associated enterprises or permanent establishments.
 - B. These entities can fully deduct exceeding borrowing costs. This reflects the aim of ATAD to limit interest deductions in relation to intra-group debt arrangements. It was never intended that third party debt should come within the scope of the ILR.
3. Exemption for legacy debt in place before 17 June 2016 and not modified since then.
4. An exemption for interest income and expenses relating to long-term infrastructure projects.

Importantly, Irish resident group companies can elect to be treated as an “interest group” and accordingly, can be treated as one “relevant entity” for the purposes of the ILR calculation.

Financial Undertaking Exemption - Not adopted:

Under ATAD Member States were permitted to exclude certain specific financial undertakings from the scope of ILR, including where such financial undertakings form part of a consolidated group for financial accounting purposes. This exemption was not adopted as industry advisors expressed a wish to adopt the exemption on an optional basis only. To adopt the exemption in this way would have been contrary to ATAD.

We are not disappointed that this exemption has been excluded from the Finance Act as we consider that it should not be required. Section 110 companies, even when within the scope of the ILR, should rarely be subject to an adjustment as the definition of “interest equivalent” and “taxable interest equivalent” have been drafted in such a way as to encompass what we believe to be all flows of funds through a Section 110 company.

The definition of “interest equivalent”

The legislation defines “interest equivalent” as:

- a) *interest,*
- b) *amounts economically equivalent to interest including –*
 - i. *a discount, where securities are issued at a discount,*
 - ii. *the finance element of finance lease payments,*
 - iii. *the finance income element and finance cost element of non-finance lease payments of a company that carries on a trade of leasing that is treated for the purposes of the Tax Acts as a separate trade distinct from all other activities carried on by such company under section 403(2),*
 - iv. *amounts under derivative instruments or hedging arrangements directly connected with the raising of finance, and*
 - v. *such portion of the profit or loss on-*
 - i. *a financial asset (within the meaning of section 76B), or*
 - ii. *a financial liability (within the meaning of section 76B),*
the coupon or return on which principally comprises interest or one or more of the amounts referred to in this paragraph, to the extent that it would be reasonable to consider that such amount is economically equivalent to interest,
- c) *any amounts referred to in paragraph (a) or (b) claimed by a claimant company under section 420(6),*
- d) *amounts incurred directly in connection with raising finance, including –*
 - i. *guarantee fees,*
 - ii. *arrangement fees, and*
 - iii. *commitment fees,*
- e) *foreign exchange gains and losses on interest or amounts economically equivalent to interest, and*
- f) *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.*

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The definition of “*taxable interest equivalent*” is relevant too. It is defined as:

*“the amount in respect of interest equivalent that is **income, profits or gains** included in the calculation of the relevant profit or loss of a relevant entity, including a reversal of deductible interest equivalent.”*

What does this cover?

We believe that this definition should cover all flows of funds through a Section 110 company including the following:

- Sharia compliant income that is economically equivalent to interest. This should be covered under limb (f).
- Discounts are specifically included at limb (b)(i).
- Trade receivables purchased at a discount to face value should be covered under limb (b)(v).
- Profit on bonds which increase in value should also be covered under limb (b)(v).
- FX gains and losses on interest or amounts economically equivalent to interest are covered under limb (e).
- Returns on commodities should be covered under limb (f).

Revenue Guidance

The Revenue Commissioners intend to publish guidance on the ILR in Quarter 2 of this year.

Amongst other things, the guidance will cover the interpretation of “interest equivalent” which should provide some welcome reassurance. We are feeding into submissions to Revenue on the priority areas where guidance would be helpful and look forward to the publication.

Conclusion

We expect that generally the ILR will not adversely affect Section 110 companies.

Key contacts



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