EY – Tax Alert
Banking & Insurance

Interest Limitation Rules

Finance Bill 2021

1 November 2021

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Interest Limitation Rules (Finance Bill 2021)

Quick recap

- The EU Anti-Tax Avoidance Directive ("ATAD") requires EU Member States to implement a fixed ratio rule, designed to limit the ability of entities to deduct for tax purposes net borrowing costs in a given year to a maximum of 30% of Earnings Before Interest, Tax, Depreciation and Amortisation ("EBITDA").

The Basics

- The interest limitation rules ("ILR") only limit an entity's net interest deductions (i.e. interest expense in excess of interest income). The rules do not restrict the ability of multinational groups to raise third party debt centrally in the country and entity which is most efficient taking into account non-tax factors such as credit rating, currency and access to capital markets, and then on-lend the borrowed funds within the group to where it is used to fund the group's economic activities.

- Broadly speaking, the interest restriction calculation involves the following steps:

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Tax Alert – Update on Interest Limitation Rules

What's new in the Finance Bill?

The Irish Finance Bill ("the Bill") was published on 21 October 2021. The Bill primarily seeks to implement the tax elements of Budget 2022 measures announced on 12 October last. As expected, the Bill included Irish implementing legislation regarding ILR. Some of the key developments regarding ILR contained in the Bill are highlighted below together with comments:

Finance Bill Provision	EY Comments
Effective Date The new rules are effective for accounting periods commencing on/after 1 January 2022.	This allows more time for entities with year ends other than 31 December.
Legacy Debt Per the Finance Bill, loans entered into before 17 June 2016 are "grandfathered" under the rules. In relation to "phased drawdowns" after that date on loans entered into prior to that date, such drawdowns will only be grandfathered where the lender is legally obliged to make such amounts available on the happening of certain milestones set out in terms agreed before 17 June 2016.	The definition is disappointing vis a vis additional drawdowns, amounts drawn down after 16 June 2016 will only be grandfathered in very limited circumstances, even where the loan was entered into prior to then and the terms of the loan provided for additional drawdowns. The only drawdowns that will be grandfathered are those that were scheduled based on milestones. Justification for such a restrictive approach in Ireland is unclear.
Financial Undertakings EU ATAD permitted an exemption from the interest limitation rules for certain regulated vehicles ("financial undertakings"). The Irish Finance Bill does not include this exemption.	The responses from taxpayers / practitioners to the Feedback Statements included mixed views on the inclusion of a mandatory exemption for "financial undertakings"; with an optional exemption being the preferred approach. In certain cases excluding the regulated entity in a Group (which also has non regulated entities) from the rules could impact adversely on the position in the context of the Group ratio reliefs from interest limitation rules (i.e. it may be preferrable in certain specific cases not to exclude the regulated entities from the rules). We understand that the Department of Finance were not minded to implement on an "optional" basis. Instead, the "financial undertaking" carve out has been excluded altogether from the Irish rules in the Finance Bill. While this may be favoured by some taxpayers over the "mandatory" approach, an optional exclusion would have been preferred here for maximum flexibility.

What's new in the Finance Bill? (Continued)

Finance Bill Provision	EY Comments
De Minimis Confirmation that de minimis is €3M per accounting period of 12 months. However, once this de minimis threshold is breached, that the entire amount of the exceeding borrowing costs is subject to restriction (not just the amounts in excess of the limit).	Welcome confirmation that relief should be available on a "per entity" basis (unless the company is part of an interest limitation "group"). However, it is disappointing that, as currently drafted, the €3m de minimis does not apply once the threshold is breached and there is no marginal relief available.
Profits or Losses on Financial Assets and Liabilities Provision for certain profits or losses on financial assets and liabilities to be considered interest equivalent (where reasonable to consider such amounts are economically equivalent to interest).	Positive development that some element of gains on debts, in particular, may be provided for as interest equivalent. However the wording is loose and open to interpretation. Further clarity on this point would be helpful.
"Discounts" Specific provision for "discount" to be included as "interest equivalent" on securities that are "issued at a discount".	Whilst this specifically refers to discounts arising on securities issued "at a discount", in our view this should not prevent "discounts" more generally potentially qualifying as "interest equivalent", where such a discount would otherwise fall within the wider definition (e.g. within the item on profits or losses on financial assets and liabilities as noted above).
Financing Component - Lease Rental Finance component of lease rental included in the definition of interest equivalent for entities carrying on a leasing trade.	Recognises the financing return inherent in leasing businesses. Taxpayers will need to assess exactly how this finance component is calculated from a practical perspective - a formula is provided in the legislation but further clarification may be needed.
Spare Capacity Spare capacity is available to carry forward for 5 years.	This was well flagged in the Feedback Statements so it is not surprising this time limit is included.

What's new in the Finance Bill? (Continued)

Finance Bill Provision	EY Comments
Group Ratio Group Ratio refers to net finance expense in the ultimate financial statements of the group (ultimate parent financial statements under GAAP or alternative standards).	 This is consistent with the Feedback Statements issued by the Department of Finance and means the ultimate consolidated financial statements will be the focus in applying the [Group Borrowing Costs/Group EBITDA] test.
Group & Equity Ratios – Elections. Both the Group and Equity ratios require an election by the taxpayer in advance of the tax return filing deadline.	 This requirement to make an election is new and it would appear it will form part of the tax return filing (in September for December year ends). There does not appear to be anything in the Bill preventing a taxpayer from electing into the Group Ratio in one year and the Equity Ratio in the next. (There is a specific prohibition on electing into both in the same accounting period).
Group of One (or "Single Company Worldwide Group") This concept has been included in the Bill.	 This was flagged in the Feedback Statement and provides relief for an entity that is not a member of a worldwide group, is not in an interest group and is not a standalone entity. It allows such an entity access to the Group Ratio even though it is not a member of a worldwide Group. This could be relevant for orphan s.110 entities.

What's new in the Finance Bill? (Continued)

Finance Bill Provision	EY Comments
Interest Group Concept of "Interest Group" included in the Finance Bill. It requires an election into the Group. The election is for a minimum of 3 years. The "Interest Group" is effectively treated as 1 taxpayer for the purposes of interest limitation rules.	This is as expected per the Feedback Statements. A member of a group can include any company that is within the charge to Irish corporation tax and that is either a consolidated entity in the worldwide group's financial statements or a member of an Irish tax loss group. It appears the intention is that intra group transactions would be effectively ignored for the purposes of calculating any interest restrictions. An interest group could include an Irish QIAIF (Qualifying Investor Alternative Investment Fund) established as a corporate. This may be particularly relevant for example in a s.110 / QIAIF structure. The position is less clear in relation to a unit trust.
Reporting Requirements The Finance Bill contains a list of items which may require reporting by taxpayers by the tax return filing deadline including EBITDA, exceeding borrowing costs, disallowable interest, spare capacity, carry forward amounts and certain details on Group Ratio or Equity ratio claims.	Reporting requirements were expected but the Finance Bill contains more details on items which may require reporting in line with the tax return. We expect more specific details on reporting requirements and format of reporting will be issued later in guidance. This reporting obligation will have a real practical impact for taxpayers.

Key considerations for banking and insurance groups

- The key development for banking and insurance groups is that the option to exempt financial institutions from the interest limitation rules has not been included.
- This means that non-regulated group entities, that would have been in scope regardless, can now include group regulated entities in an interest group and in determining the worldwide group and equity ratios, which may prove helpful.
- However, the inclusion of the regulated entities in the group does bring about an additional administrative burden and will mean that it will be necessary to look at these entities and determine, inter alia, what is 'interest equivalent'. A level of reporting will also be required that may involve a significant amount of analysis.
- The availability of the €3m de minimis threshold on an entity by entity basis (other than within an interest group) is welcome. However, we also note that per the Finance Bill as currently drafted, this de minimis operates as a "cliff edge", where once the exceeding borrowing costs exceed €3m, the entire amount is potentially subject to restriction (not just the excess over €3m). Further guidance may emerge on this point.
- The practical impact of the rules will need to be considered holistically in the context of other changes in Irish tax law in relation to transfer pricing (debt capacity rules).

Next steps

- As noted above, the Finance Bill was published on 21 October 2021. The next stage of the process at which amendments may be tabled is the Committee Stage followed by the Report Stage and the Seanad. It is expected the rules will be signed into law by the end of December.
- As discussed, there are still various uncertainties within the draft legislation and progress on implementation of these rules should be closely monitored. Clients should also consider undertaking modeling exercises to better understand the impact of the rules on their business, including the challenge involved in the reporting obligation, as implementation progresses.

Timeline

- Below is the timeline in relation to implementation of interest limitation rules:

Timeline for transposition	
Finance Bill 2021	Draft legislation - published 21 October 2021
Committee stage	16-18 November
Report stage	30 November - 1 December
Seanad report stage	15 December
President signs Finance Act 2021	Expected by end of December 2021
Rules to take effect	1 January 2022

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