MAPLES

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Hybrids and Interest Limitation - Public Consultation
Tax Division
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Dear Sir or Madam

Response to ATAD Implementation - Hybrids and Interest Limitation: Public Consultation November 2018

1 Implementation date for Article 4 EU Anti-tax Avoidance Directive ("the Directive") – interest limitation rule

The Directive provides at Article 11(6) that EU Member States which have "national targeted rules for preventing BEPS risks at 8 August 2016, which are equally effective to the interest limitation rule set out in [the] Directive, may apply these targeted rules" until 1 January 2024 as a derogation from the Directive, thus deferring the implementation of Article 4 to that date.

Ireland, along with several other EU Member States, has adopted the derogation and the Minister for Finance issued a statement at the time to say "the provisions on interest deductions are deferred until 2024 for countries, like Ireland, that already have strong targeted rules".

This position has been relied on by taxpayers, including international investors, since that date. However, we understand from recent Department of Finance publications that Article 4 could be introduced at an earlier date.

We believe that the technical position adopted by the Department of Finance stands and that the implementation date should be deferred until 2024 as has been publically stated, to provide certainty and consistency of treatment to taxpayers and international investors. The Irish anti-tax avoidance measures on interest deductibility as at 2016 are extensive, long standing and robust and operate to prevent BEPS risks. It is important to note as a legal matter that the Directive does not require the existing measures to be similar to or operate in the same way as Article 4 (i.e. as an interest limitation cap), merely that they are "equally effective" which is the case.

2 Application to groups

Question 31: 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 rules on a local group basis?

As a general comment, we believe that many aspects of the Directive, as EU law, reflects features of tax systems and tax law which are common in other EU Member States (e.g. civil law systems), but which are not a feature of the Irish tax system. This poses considerable challenges to Ireland in implementing unfamiliar concepts from the Directive as compared to other EU Member States.

Many or indeed most EU Member States operate "fiscal unities" or "fiscal groups" whereby a number of companies may be consolidated for tax purposes. Such rules are favourable for companies in those jurisdictions, but Ireland does not operate such a system. Instead, Ireland has a system of "group relief", but still treats each company as a separate taxpayer.

Those EU Member States with "fiscal group" regimes will find it straightforward to implement these rules under their existing rules. We believe that careful consideration is needed in Ireland in adopting what is a new tax concept and that the systems in other EU Member States are carefully studied. It is important that the Directive does not operate to favour EU Member States that already operate such "fiscal group" regimes to the disadvantage of Ireland.

We also recommend that the implementing Irish legislation give an option to the taxpayer to choose between applying the interest limitation rules on a single entity or group basis.

Question 32: As Ireland does not have consolidation for groups, what are the practical issues that might arise in applying the interest limitation rules 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 requirements should each member of the local group have?

Again, many other EU Member States have long operated the concept of a fiscal group for tax purposes and their existing rules will already accommodate these matters. Ireland does not operate the concept of a fiscal group, so it is important that these measures are carefully considered and that the systems in other EU Member States are studied. The Irish implementing measures in this regard should not put Ireland at a disadvantage as compared to other EU Member States and the rules should result in an end result as if the various companies were a single taxpayer.

Question 33: 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?

Again, we refer back to the fact that the concept of a fiscal group is common in other EU Member States.

It would seem to us that the concept of a group should include both a corporation tax group as defined by Section 410 of the Taxes Consolidation Act, 1997 and also a group which is consolidated for accounting purposes. However, we think that it is also necessary to consider more generally the impact of these provisions in the Directive and whether that requires a more fundamental consideration of the efficacy of the current Irish tax group rules.

3 De minimis threshold

Question 34: Are there any reasons why Ireland should not make provisions for a de minimis threshold?

No. This is clearly provided for by the Directive and would impose an unfair administrative and unnecessary burden on SMEs otherwise.

4 Standalone entities

Question 35: What are the relevant factors that should be taken into account in defining a "standalone entity"?

The definition of a "standalone entity" is an important one given the object of the Directive to address aggressive cross border tax avoidance within groups of companies.

As such, it should not inadvertently bring into scope any single company which is widely held, such as by a group of investors, even where they may invest through a consolidating entity. In particular, the Irish tax code has generally always required "beneficial ownership" as being an inherent requirement for taxation and the granting of reliefs etc., and the implementing legislation in this case should make it clear that the shareholding test for a "standalone entity" looks at beneficial ownership, not ownership by a legal holder or nominee.

Also, the preamble to the Directive provides that "*since BEPS in principle takes place through excessive interest payments among entities which are associated enterprises, it is appropriate and necessary to exclude standalone entities which are used as investment vehicles given the limited risks of tax avoidance*'[1]. " Investment vehicles, such as "qualifying companies" discussed below, should accordingly not be adversely impacted by the Directive.

5 Consolidated group ratio rule

Question 38: 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 Directive allows for the introduction of a consolidated group ratio rule and accordingly we believe that the Irish implementing legislation should follow this in order to be consistent with the Directive.

As a legal matter, we believe that both proposed consolidated ratio rules may be implemented into national law as alternative choices for the taxpayer.

6 Financial undertakings

Question 39: What factors should be taken into account in determining whether or not to apply the interest restriction to financial undertakings? If the exemption is to apply, should it apply only to regulated financial undertakings or should it apply also to non-regulated undertakings which carry on the same activities?

The Directive provides that the interest restriction may not apply to financial undertakings and accordingly we believe that the Irish implementing legislation should follow this in order to be consistent with the Directive. Furthermore, we understand this will be the position adopted by all other EU Member States.

The exemption should apply to both regulated and non-regulated financial undertakings as is expressly provided for already by the definition in the Directive.

It is clear as a legal matter that the term "financial undertaking" is not limited to those entities listed in the definition, so the national implementing legislation may include other entities. We are aware that other EUI Member States have already done this in their national implementing legislation

In particular, when defining the term "financial undertaking", Article 2 of the Directive does not include any words of limitation which could suggest that it is an exhaustive definition.

We note that in other parts of the Directive, the Directive has expressly sought to clarify the practical application of certain definitions to ensure that a specific definition could not be expanded by the Member States when implementing the Directive. This is the case for example in the context of the definition of "hybrid mismatch" which is "*only*" to apply under certain instances and in certain

[1] Recital 8 to the preamble to ATAD 1

circumstances[2]. This is not the case in the definition of "financial undertaking" in the Directive, and accordingly, without this express limiting language, the implementation of the Directive into national law may include other entities provided that is consistent with the Directive.

While the definition of "financial undertaking" includes entities which are defined by reference to specific pieces of European legislation, this cannot in our view be regarded as preventing EU Member States from including in the list undertakings which are in an economically comparable situation, in line with the EU "general principle" of equality.

This is important because the "general principles" of EU law, including the principle of equality[3], are given primacy in the hierarchy of the sources of EU law right (similarly to EU Treaties and the EU Charter of Fundamental Rights).

This means that the exercise of Community competence is subject to the requirement that it complies with the 'general principles' of EC law[4] and, as a collorary to this principle, such principles must also inform the way in which EU Member States implement Directives into their domestic law.

Therefore, Ireland's implementation of ATAD must be guided by the principle of equality which, according to settled EU case law "*precludes comparable situations from being treated differently and different situations from being treated in the same way unless the treatment is objectively justified*"[5] .

We consider that a "qualifying company" as defined by section 110 Taxes Consolidation Act, 1997 is, in particular, in a factually comparable situation to other entities listed in the definition in the Directive, including a bank if it is engaged in a lending activity and an AIF, and as such should be included in the definition of a "financial undertaking" in the Irish implementing legislation.

This is supported by the fact that the definition of "financial undertaking" must be interpreted in the light of the statements contained in the preamble to ATAD 1 which capture the spirit of the Directive. In particular, the language contained at recital 9 of the preamble indicates that "*it is acknowledged*" by the drafter that the financial institutions sector "*present special features which call for a more customised approach*".

Finally, the legislative cross-references included in the definition in the Directive may change over time outside of the Directive, and this demonstrates that the definition cannot be fixed and exhaustive

7 Borrowing costs and exceeding borrowing costs

Question 41: 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 application of the interest limitation rule? Issues raised in the anti-hybrid portion of this document should also be considered in this context.

The Directive provides that items that are "economically equivalent to interest" are to be determined by national law. As a result, we consider that each EU Member State may prescribe what should be treated as falling within this definition.

The implementation of the concept of "economically equivalent to interest" into national law should include all income and gains of "qualifying companies" that are derived from "qualifying assets" as

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[2] See Article 2 "*a hybrid mismatch shall **only** arise under points (e), (f) or (g) of the first subparagraph to the extent that the payer jurisdiction allows the deduction to be set off against an amount that is not dual-inclusion income*" – emphasis added

[3] Cases 117/76 and 16/77 Ruckdeschel [1977] ECR 1753 –para 7 "*the general principle of equality which is one of the fundamental principles of Community law*"

[4] Cases: C-83/83 Racke, C-15/95 EARL and C-292/97 Karlsson

[5] Case 106/83 Sermide SpA v Cassa Conguaglio Zucchero [1984] ECR 4209 at [28]

defined by Irish law. We understand that a comparable approach was adopted in the United Kingdom and is consistent with treating a "qualifying company" as a financing and investment company which is financed with debt.

8 Scheme of relief for interest

Question 44: 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 Irish tax code has extensive, complex and long-standing anti-avoidance provisions relating to interest. The measures in the Directive do not take into account how the Irish tax system operates and creates an "additional layer" which duplicate existing rules in many cases and create unintended complexities and consequences. We believe there needs to be a full review of existing measures to ensure that Ireland is consistent with the highest international standards provided for in the Directive, but does not have additional and unnecessary domestic measures which are not required by the Directive.

We thank the Department of Finance for the opportunity to make this submission and we would be pleased to meet to discuss any of these points in further detail.

Yours faithfully

Maples and Calder