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18 January 2019

Hybrids and Interest Limitation - Public Consultation
Tax Division
Department of Finance
Government Buildings
Upper Merrion Street
Dublin 2

BY EMAIL TO: ctreview@finance.gov.ie

Re: Response to Hybrids and Interest Limitation Public Consultation

Dear Sir/Madam

1. Introduction

We welcome the opportunity to respond to the Department of Finance Public Consultation on Hybrids and Interest Limitation (the "**Consultation**"). As a policy matter, we consider it hugely beneficial that the Department engages in regular and detailed consultations, on a broad range of tax policy matters. We welcome the comments in the Department's publication titled Ireland's Corporation Tax Roadmap, that public consultations on moving to a territorial regime and changes to the transfer pricing rules will be held in early 2019 and further consultation is likely on the reverse hybrid rules in advance of the 1 January 2022 deadline. Taking this proactive approach will ensure a more reflective principled approach to tax policy in Ireland.

Given that the subject of the Consultation will result in future major legislative changes which are very technical in nature, we would encourage the Department to publish all draft tax legislation arising from the Consultation in relation to Council Directive (EU) 2016/1164 of 12 July 2016 ("**ATAD**") as amended by Council Directive (EU) 2017/952 of 29 May 2017 ("**ATAD2**") in full for technical consultation with interested stakeholders. The short timeline and incomplete manner in which the draft legislation for the CFC rules was published did not provide an opportunity for thorough analysis and full commentary. To ensure the consultation 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. 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. Executive Summary

Major changes to the Irish corporate tax system have already been implemented and will continue to be implemented over the coming years as a result of both EU and OECD tax policy measures. 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 BEPS. We have set out our initial views in relation to the reform of the Irish corporate tax system in paragraph 3 of this letter. In paragraphs 4 and 5, we have set out our responses to the specific questions raised by the Consultation.

3. Reform of the Irish Corporate Tax System

Irish tax policy seems to go through spurts of principled policy-making followed by extended periods of "sticking plaster" amendments. This "punctuated equilibrium" approach to taxation ought to be replaced by a wider strategic approach to corporate tax policy in Ireland.

For example, stamp duty was introduced in the late 17th century and has retained its fundamental structure of a document-based tax ever since. Developments have of course occurred, such as Part 6 of the Stamp Duties Consolidation Act 1999 (the "**SDCA**") and e-stamping, but the fundamental structure and scope of the charge remains the same. Similarly, income tax was introduced in the late 18th and early 19th centuries to fund the Napoleonic wars. It was heavily influenced by the social context at the time, i.e. the schedular system was introduced to ensure that a Revenue inspector would not see the full extent of a "gentleman's" income. Consequently, income was artificially split into different categories. One of the more arbitrary distinctions is between the charge to tax under Case I for trades and under Case II for professions (traditionally Law Medicine and the Church but in reality wider in the modern world so leading a lack of clarity). Tax on capital gains introduced in the 1970s imperfectly interacts with income tax and corporation tax thereby creating mismatches between capital and income transactions. VAT was introduced in the early 1970s with the accession of Ireland to the European Union (as it is now known) and has not be fundamentally amended since that time.

The fundamental changes that are being introduced due to ATAD requires Irish policy makers to step back and fundamentally reconsider the taxation of corporate entities. Other jurisdictions have already done so in the recent past, in whole or in part. For example, the UK introduced loan relationships/financial instruments taxation rules and fundamentally changed its stamp duty system. Recent US tax reform is another example of an approach to principles based reform of old taxation structures. The reform of the New Zealand tax system in the 1980s was hugely successful. Ireland and its policy makers deserve credit for developing an efficient tax collection system with streamlined filing requirements compared to other jurisdictions, but we consider that it is an opportune time to review the underpinnings of the tax system to reduce technical complexity and ensure that the legislative framework mirrors commercial reality. As noted above, we would strongly advocate that the Department convene an expert group of tax lawyers, tax accountants and economists from a number of different jurisdictions (including Ireland) to map out the future direction of the Irish corporate tax system post-ATAD and BEPS. One could go further and examine the rebalancing of the tax system away from more economically destructive taxes (income and corporation tax) to less economically destructive property and environmental taxes. This is not a comment on the amount of tax raised from the economy, but merely the balance of how tax should be raised. Leaving that aside, some suggestions as to the shape of the corporate tax system are set out below.

3.1 Simplifying the Taxation of Income

Many of the challenges that are addressed in these suggestions arise due to the fundamental assumptions that are present in other EU tax systems and, therefore, influenced ATAD but are not present in the Irish system. For example, many systems have a coherent system for taxing debt and other financial instruments but Ireland does not. Most systems do not operate multi-rate structures for corporate taxation but Ireland does. Very few systems operate a schedular system of taxation but tax "ordinary income" as a coherent whole or split it into only two categories (passive and active). Some systems do not distinguish between income and capital. Most systems operate a group consolidation system; Ireland's is only a partial and patchy group relief system.

Ireland has "schedules" and "cases" within schedules that are targeted at taxing different forms of income. As noted above, this is rooted in late 18th and 19th century social philosophy. It is no longer appropriate in the 21st century. Accordingly, the schedular system of taxation should be abolished. The objective of this reform is to reduce the complexity of analysing taxable income of corporates into Schedule D Case I, Case II, Case III, Case IV and Case V and Schedule F.

If it is desired to retain our current corporation tax rate structure (and we would advocate a single low rate) there should be only two "buckets of income": passive income and active income. Active income could continue to be taxed at the 12.5% tax rate and passive income at the 25% tax rate. Active income could be defined as trading and professional income (as currently conceived and including "foreign" trades)[1] and passive income would be defined as all other income.

To remove mismatches between the taxation of capital and income, any item of capital expenditure that is incurred wholly and exclusively for the purposes of the business but will not be recognised as giving rise to "base cost" (either because it is excluded from the narrow definition of what constitutes "base cost" in Section 552 of the Taxes Consolidation Act 1997 (the "**TCA**") or is expended, for example, on a wasting asset), would be treated as deductible against income. The principle here is that proper business expenses should be deductible whether against income or capital profits and "tax nothings" should cease to exist.

3.2 Simplifying Expense/Cost Deduction

The rules for deductibility of expenses associated with the different "Cases" of Schedule D differ and the ability to offset losses arising in one "Case" against income of another "Case" is inconsistent and overly restrictive. Instead, losses and expenses should be fully available against all categories of income. If the current two rate structure of corporation tax is to be retained, loss utilisation can be on a value basis, i.e. if passive expenses/losses are utilised against active income they are done at a rate proportionate to the tax rate differential and vice versa. Since companies are engaged in earning money for their shareholders and other stakeholders (this is their fundamental objective) then all expenses incurred for the purposes

[1] It is highly debatable whether a "foreign" trade taxable under Case III exists or not. The case law creating this concept is pre-independence UK case law; is based on the fact (as it was then) that corporation tax is collected at a local/parish level and that there was a remittance basis for non-UK trades. The UK has effectively limited the scope of foreign trades in their system to passive investment in non-UK limited partnerships that carry on the trade. Charging to tax at 25% a trade carried on by an Irish resident company in an EU Member State other than Ireland (where the same trade carried on in Ireland is taxed at 12.5%) is clearly illegal under EU law.

of that business should in principle be deductible on an accruals basis against all taxable profit or, if a two rate structure is retained, against the "bucket" of income to which it relates. The "charge on income concept" and Section 247 of the TCA should be abolished in its entirety and 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 so that the deductibility test is currently the case for trading expenses. 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. This would interact with a consolidation and territorial system as described below. Payments by companies to individuals that are taxed as income of the individuals should be automatically deductible so that double taxation does not arise.

As is currently the case, an expanded test would be needed for expenses of management as these benefit associated companies as well as the company incurring the expenditure (but see comments below on an expanded participation exemption and territorial system). Effectively, specific rules for deductibility of expenses for each "Case" would be abolished and deductibility rules would be aligned with the general deductibility rules.

It is only when one considers this proposal that the anti-hybrid rules contained in ATAD make sense. A fundamental assumption behind the anti-hybrid rules is that expenses are deductible otherwise no mismatch can occur. This is not the case in Ireland due to the convoluted structure of the tax system and the complex rules relating to deductibility of interest which differs significantly depending on whether it is on debt incurred for trading purposes or not.

3.3 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 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" if group Company B has profits but not in the same year as the loss arose in Company A. It would be utilisable if it arose in a single company. As a result the corporate group makes an economic loss but can make a taxable profit. 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 ensure that opportunities for avoidance are eliminated.

3.4 Simplifying Tax Credits – Moving to a Territorial System

The long and tortuous FII litigation[2] in relation to the taxation of dividends ended with a statement of principle from the European Court of Justice that dividends from one EU Member State should be treated in the same way as domestic dividends. The judgment defined an outcome to be achieved rather than methodology for achieving that outcome. Ireland taxes foreign dividends but exempts Irish dividends. The credit system is acknowledged to be imperfect so a move to a full exemption system seems inevitable. The deductibility of interest and other expenses related to shares will need to be considered.

[2] Case C-446/04 - Test Claimants in the FII Group Litigation v Commissioners of Inland Revenue

The Irish taxes code historically only taxed distributed profits of subsidiaries (subject now to CFC rules). In the light of *ICI v Colmer*[3], there is no justification for distinguishing between branches and subsidiaries in this context, i.e. non-Irish branches should be exempt from tax in Ireland in the same way that subsidiaries are exempt. When these two principles are fully integrated, the outcome must result in a branch exemption in the same way as the subsidiary exemption applies and also the elimination of tax on dividends paid by EU resident subsidiaries to an Irish company. Similar arguments can be made under free movement of capital (subject to the dominant influence question). From a practical perspective, we understand that Ireland generates very little tax from the foreign operations of Irish companies. This is a correct outcome as Ireland should tax activities in Ireland and not elsewhere. The economic rationale is because these activities utilise the infrastructure of the state and therefore ought to contribute to the cost of that infrastructure where its activities outside of Ireland do not use the infrastructure of the state and therefore need not contribute to that infrastructure; whereas activities outside that State do not use such infrastructure. It is also consistent with long-term Irish tax policy of taxing substantive activities and not merely letterbox companies.

As we alluded to in our submission on the CFC rules we will be submitting in the future consultation on a territorial system that Ireland should move to a full territorial system. This would mean only taxing profits of foreign corporates and foreign branches under the CFC rules and not otherwise. As noted above, the preference for trading over non-trading activities is a historical anomaly. It seems odd that it should be retained in the Irish capital gains tax participation exemption by virtue of the trading test in Section 626B of the TCA. In our view, this test should be removed. Also, the group consolidation test gives rise to odd results when downstream debt of corporate groups is in place. In those circumstances, the entities to be consolidated for the purpose of Section 626B may not be “wholly or mainly” trading, even where the actual corporate group is clearly trading. It is unlikely that this would lead to a decrease in tax yield as Section 590 of the TCA addresses “enveloping” capital gains in corporates owned by Irish residents.

The outcome of these changes would be to move Ireland’s taxation of subsidiaries/branches to a more normal European style tax system. As far as we are aware, Ireland is the only EU country that still imposes a tax and credit system for dividends. Also, absent the UK which will no longer be in the European Union post-Brexit, it is the only EU country that imposes a “trading” test in relation to its participation exemption as the concept of trading does not exist in many other tax systems. The CFC rules would provide adequate protection for the artificial diversion of profits away from Ireland to non-Irish subsidiaries and Irish resident companies are taxed so the rationale for a capital gains tax on share disposals is now even weaker.

3.5 Ensuring Symmetry of Treatment

When one of the rules (such as anti-hybrid, anti-avoidance, transfer pricing or interest limitation etc.) is invoked to prevent the deduction of any expense, whether interest payments on a financial instrument or other expense, one needs to consider what happens to the recipient of that payment. In principle, where the recipient is an Irish person, that person should not be taxed on that receipt, otherwise double taxation arises. The current system partially does this by rendering certain non-deductible payments to be “distributions”. This is not uniformly applied so the current system creates mismatches in taxation on a regular basis by denying deductibility to a payer but taxing the recipient. ATAD implementation will increase this problem. With the advent of OECD BEPS compliant anti-hybrid rules and the implementation of the EU anti-hybrid rules, this principle should extend to non-Irish recipients.

[3] [1999] UKHL J1118-3 - Imperial Chemical Industries v Colmer (Her Majesty's Inspector Of Taxes)

Accordingly, we would advocate that any payment that is rendered non-deductible by any of the various anti-hybrid, interest limitation, anti-avoidance, transfer pricing and other similar rules would be treated as a "distribution" for the purposes of the payer and the recipient but not for withholding tax purposes. The reason is that a payment of, say, an expense that is rendered a distribution under one of these rules should not trigger dividend withholding tax as it is not actually a dividend. In most cases, dividend withholding tax would be eliminated by the filing of the appropriate V2B form so a refund could be claimed. This is a practical approach to removing withholding taxes which, as recognised in the 1920s in the League of Nations Convention on Taxation, is the most destructive form of taxation in terms of discouraging cross border trade.

Following the implementation in full of ATAD, many other quirks of the Irish tax system are inappropriate and should be removed:

- Section 127 of the SDCA is a historic anomaly.
- 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 452 and 452A) and "stapled" debt rules (Section 130(2)(d)(v)) should be abolished as anti-hybrid rules supersede these principles;
    - Interest exceeding a reasonable commercial return (Section 130(2)(d)(iii)(II)) should be abolished as transfer pricing rules incorporate this principle.
- Section 247(4A) & (4E) of the TCA - subject to the introductory comments.
- The multiplicity of anti-avoidance rules covering the same ground should be reconsidered so Sections 817A, 817C and 840A of the TCA should be removed.

3.6 Ensuring Consistency of Tax Rate

As noted above, we are not commenting on whether the rate differential between active income (12.5%) and passive income (25%) should be retained. To clarify, we do not support any increase in corporate tax rates as it is the least economically effective way of raising a unit/euro of tax. Also we support a single low rate of tax on all corporate profits. A separate point is the significant rate differential between the trading rate of tax (12.5%) and the capital gains tax rate (33%) which is causing significant difficulties for corporates. The categorisation of assets as "trading" or "capital" or payments as "revenue" or "capital" is a historical hangover from trust law. More practically, it is not a clear distinction and this leads to the possibility of significant disputes and uncertainty. This results in the situation where assets that are used wholly and exclusively for the purposes of a trade of a company are treated, on disposal, as "capital" and, therefore, the gain is subject to tax at 33% instead of 12.5%. This anomaly fundamentally undermines the coherence and effectiveness of the Irish tax system. For example, where a company disposes of an asset that is used in its trade, the commercial result is a gain or loss from the business irrespective of its tax classification. From a tax perspective the largely theoretical exercise of categorising the asset into trading or capital must be undertaken to determine not only the rate of tax but also the quantum of the profit as different amounts are deductible depending on the outcome of the categorisation exercise. The result can be that the aggregated trading result from a commercial perspective (including the asset disposal) may be a loss, but from a tax perspective there is a (bigger) "trading" loss and a capital profit taxed at 33%. This can lead to a largely arbitrary fluctuation in the effective tax rate for a business.

In order to resolve this, we would suggest that all assets that are used wholly and exclusively for the purposes of a trade of a company should, on disposal, be treated as the disposal of a trading asset, triggering tax at 12.5% on any gain. All of the "base cost" would be deductible as a trading expense. As a result, any loss should be deductible against income taxed at 12.5% so that there is symmetry. In order to address the potential for sheltering assets in corporates by Irish resident individuals, we would advocate that a look through provision would be imposed to deem a gain to arise to Irish resident shareholders in these corporates in proportion to their shareholding. For example, Section 590 of the TCA could be extended to Irish resident close companies to either deem the gain to arise to individuals (all individuals for assets specified in Section 29TCA and Irish resident individuals for all other assets) or better still reduce their base cost in their shareholding, including to a negative amount, so that the gain is triggered on disposal of the shares. Credit would be given for tax paid at 12.5% by the company making the disposal so that only the rate differential would be payable by the shareholder.

4. Responses to Questions on the Anti-Hybrid Rules

Question 1: Entities **-** *What entities should be within scope of Ireland's anti-hybrid regime?*

All entities that are subject to corporation tax on income should be subject to Ireland's anti-hybrid regime. This is a corporation tax measure targeted at multinational groups and therefore should not be applicable to non-corporate tax payers.

Financial undertakings (as defined in the directive) can be excluded from the interest limitation rule and from the anti-hybrid rules. In many EU jurisdictions, it is a breach of the banking monopoly rules to make loans. This is not the case in Ireland where the regulated activity is deposit taking. Accordingly, large parts of the non-bank sector are not regulated as banks in Ireland (other regulation applies to them) but are so regulated in the rest of the EU. In order to prevent a distortion of the single market and a breach of the competition rules, therefore, any exclusion for financial undertakings should also apply to any entity that undertakes retail or commercial lending activity. This would include loan origination activities of "qualifying companies" for Section 110 purposes, LO-QIAIFs, treasury companies etc. In addition, an Alternative Investment Fund ("**AIF**") and a UCITS may be excluded. We would advocate that Ireland exercises full discretion to exclude these global financial services/regulated entities from the ambit of the anti-hybrid and interest limitation rule. The rules are largely targeted at multinational corporate groups rather than financial services entities. As noted above, in order to provide a level playing field and to avoid a breach of competition law, entities that perform similar functions to an AIF (but are differently regulated) must also be excluded. This would include FVCs (Financial Vehicle Corporation) and companies that subject to non-FVC reporting to the Irish Central Bank. The rational for these regimes is that the entities can be economically equivalent to an AIF and therefore the level of information provided to the Central Bank ought to be equivalent. We would also suggest, for similar reasons, excluding any company that falls within the EU Securitisation Regulation[4].

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?*

In determining what should be considered "foreign taxes" for the purpose of Ireland's anti-hybrid regime, the Department should take a broad approach. Different countries structure their tax systems in different ways and this ought to be respected. Many countries have federal systems as opposed to our unitary system and tax levied at any of the different governmental levels should be treated in the same way. Accordingly, all taxes on income, whether federal, municipal or local taxes should be treated as equivalent for the purposes of determining whether a mismatch outcome arises. In addition,

[4] Regulation No. 2017/2402/EU

CFC and other attribution type taxes should also be included. The purpose is to ensure that only cases of actual non-inclusion are targeted by these anti-avoidance rules. If this was not so then cases in which there is no avoidance would be targeted by the rules and this does not seem to meet with the policy objectives of ATAD.

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?*

Most tax systems aggregate profits, losses, expenses etc. to a single "bucket" or into a small number of "buckets" and tax the net outcome. Accordingly, any inclusion of the relevant payment into a "bucket" should be considered to be an inclusion whether or not it results in any actual tax being paid. It may often be the case that losses, costs or expenses from other activities may result in no tax actually being paid but this does not amount to avoidance and, therefore, should not be targeted by the legislation. Whilst it is accepted that an indefinite deferral is the same as the avoidance of tax, it raises the issue as to what to do if a deduction is denied but later on the payment is actually included. Ireland could either recognise this fact by permitting a deduction and respecting the other state's tax system in recognising when an inclusion is treated as rising for their purposes as a matter of their particular tax policy. Alternatively, Ireland could deny a deduction but then retrospectively grant a deduction to the extent of the inclusion. A failure to grant deductibility despite the fact that a payment is included at some stage goes further than the stated aim of the anti-hybrid rules which is to prevent double non-taxation. The outcome of a policy of denying a deduction where there is, in fact, an inclusion would result in double taxation. That is not the intended effect of ATAD and is, therefore, disproportionate. Accordingly, those rare cases that result in an indefinite deferral equating to tax avoidance should be addressed by the general anti-avoidance rule as opposed to by a specific anti-hybrid legislation.

The timing of "inclusion" is set out in Article 2(9)(a) as follows: "*a payment under a financial instrument shall be treated as included in income within a reasonable period of time where: (i) the payment is included by the jurisdiction of the payee in a tax period that commences within 12 months of the end of the payer's tax period; or (ii) it is reasonable to expect that the payment will be included by the jurisdiction of the payee in a future tax period and the terms of payment are those that would be expected to be agreed between independent enterprises*". In our view, this definition is appropriate as it includes both a 12 month fixed period of time and, alternatively, a reasonableness test which takes into account the arm's length principle. If the definition only included a fixed period of time it would fail to appreciate the commercial reality of many transactions / group relationships / practical scenarios where it may not be possible for the payment to be included by the jurisdiction of the payee within the 12 month fixed period of time. Furthermore, the approach set out in Article 2(9)(a) of ATAD is also in line with the recommendations in the OECD BEPS Report on Action 2.

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?*

See question 3.

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?*

We do not believe that it is necessary to address disregarded PEs at this point until a territorial regime is introduced. In addition, the defensive rule required to address disregarded PEs on the implementation of a territorial system in Ireland would need to be considered based on the scope and structure of that system.

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?*

See question 5.

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?*

We have no comments in relation to this but may do so in the context of the move to a territorial system.

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.*

The rules in the OECD BEPS Report on Action 2 refers to income being included in "ordinary income" of the company. We disagree with the comment in the Consultation[5] that the Irish tax system does not have a concept of "ordinary income". Section 21 of the TCA defines the rate of tax on all income that is subject to corporation tax. Section 21(1) of the TCA states that "*corporation tax should be charged on the profits of companies at the rate of... 12.5%...*". An exclusion to this general principle is set out in Section 21A(3)(a) of the TCA which states that "*notwithstanding Section 21... corporation tax shall be charged on the profits of companies in so far as those profits consist of income chargeable under Case III, IV or V of Schedule D or of income of an accepted trade at the rate of 25%...*". Accordingly, the statutory scheme in Ireland is that the default corporation tax rate is 12.5% with an exclusion from that general treatment for certain categories of income. On this basis the 12.5% rate of tax is the tax on rate applicable "ordinary income".

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 purpose of the imported mismatches rules in ATAD2 is to prevent the avoidance of tax by the utilisation of hybrids. The imported mismatches rule has traditionally caused difficulties and therefore must be considered carefully. The risk is that one imposes an administrative regime that is costly, practically impossible to comply with and creates a disproportionate amount of tax uncertainty for taxpayers and for Revenue. A simplification (without altering the substance of the avoidance rule) is to exclude from the imported mismatch rule any payment to a person that is resident in an EU Member State. It should be assumed in all cases (as we believe would in fact be the case) that each EU Member State will implement ATAD2 properly and in accordance with the prescribed timeframe. If an EU Member State does not implement ATAD2, that is a matter for the Commission to take proceedings against that EU Member State; it is not for Ireland to unilaterally introduce rules that punish that EU Member State by applying the imported mismatch rules. If this was not the case, taxpayers would have to investigate not only whether the payee was resident in an EU Member State (a relatively simple matter) but whether the detail of the imported mismatches rules as implemented in that EU Member State complied with all aspects of ATAD2. Irish taxpayers ought not to be required to form a judgement on the minutiae of another country's tax system. In addition, BEPS Action 2 is to be implemented in many jurisdictions outside the EU. For the same reasons, therefore, payments to countries that have implemented BEPS Action 2 should not be subject to the imported mismatch rules. Again it should be recalled that the anti-hybrid rules are avoidance rules which should not

[5] Page 13, Paragraph 4.3.5.

apply where there is no avoidance motive, i.e. payments have been made to a country that has implemented a similar imported mismatch rule.

***Question 10: Dual inclusion income and financial instruments** - What factors should be considered in relation to the concept of dual inclusion income being incorporated into the application of the financial instrument anti-hybrid rules to avoid those rules resulting in double taxation of the same income?*

We advocate that the concept of dual inclusion ought to be introduced in as flexible and purposeful manner as possible. Recalling that ATAD2 is targeted at tax anti-avoidance through the use of hybrids, where there is dual inclusion in a substantive way then there is no avoidance. Accordingly, the dual inclusion exception should be introduced in a broad purposeful way and should include financial instruments.

***Question 11: Dual inclusion income and deferrals** - While there is a symmetry in allowing the deferral of an adjustment, the practicalities of tracking deferred adjustments must be considered. How could such timing differences be dealt with, from a practical perspective, in the implementation of the anti-hybrid rules? This question is linked to the question on timing issues in 'subject to tax' above.*

We have no comments in relation to this question.

***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?*

We understand that it is Irish government policy to implement the directives fully but to choose not to "gold plate" those directives. Financial traders typically enter into a large volume of on-market transactions; all of which are disclosed due to their on-market nature. There are significant disclosure obligations under FATCA, CRS, etc. imposed in this area. Also, Irish Revenue have extensive investigative powers so should not lack any information in relation to the trades entered into by financial traders. The anti-hybrid rules in ATAD and the OECD BEPS Report on Action 2 are designed largely with the multinational sector involved, i.e. payments between related party enterprises. A financial trader executing an on-market transaction will, by definition, be entering into an arrangement the terms of which are market standard. The counterparty may or may not be a related party, or it may be impossible to determine whether or not the counterparty is a related party. On this basis, because it would be largely impossible or highly difficult to comply with any application of the rules to financial traders, we would advocate that the financial trader exemption should be introduced in full. The general anti-avoidance rule in Section 811C of the TCA in compliance with the ATAD GAAR rule would enable the Revenue to counter any avoidance by particular financial traders in relation to particular instruments.

***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?*

The primary aim of the rules is, as noted above, to prevent avoidance by multinational groups. It is simply not true to say that a lender of a loan on normal commercial terms (i.e. not profit dependent, no excessive interest and on arm's-length terms) is by definition a related party. It is simply a lender. Accordingly, all "normal" debt relationships should be specifically excluded from the related party rules. If this is not the case, then both banks and non-bank lenders by simply carrying out normal lending activities could become related parties to a large number of different corporate groups and may make those disparate corporate groups related although in all real senses they are unrelated. Again, the objective of the legislation is to counter avoidance and lending on arm's-length normal commercial debt terms does not render the lender a related party to the borrower in any meaningful sense and therefore should not trigger the application of the rules. As noted in our submission on CFC rules, Section 432 of the TCA is inappropriate in these cases and causes Ireland to be non-compliant with EU state aid rules since its grants a preference to bank lenders over non-bank lenders.

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 current caselaw is not clear enough to enable tax payers to determine whether an entity is a hybrid entity or not. The Irish caselaw (*Harris v Quigley*[6]) which has accepted UK caselaw on the topic looks exclusively at the commercial law categorisation of the entity. That may be appropriate in a common law jurisdiction which conflates limited liability and legal personality. In many jurisdictions, however, legal personality and limited liability are viewed quite correctly as separate concepts. Therefore, the taxing rules in different jurisdictions can pick one or other of those (or other factors) to determine whether an entity is treated as a corporate under their tax rules or not. Also by separating the entity/non-entity test from locally applicable tax rules creates hybrid entities where none actually exists and ignores hybrid entities where they do actually exist. The objective of the anti-hybrid rules in relation to hybrid entities is to address mismatches between how entities are treated for tax purposes as opposed to how they are treated for corporate law purposes. A simple example would suffice. Where an Irish company transacts with a US LLC, applying *Harris v Quigley*, the US LLC is treated a corporate. Where the US LLC is "checked" as a pass through entity then the tax classification differs from the corporate classification. From an anti-hybrid rules perspective, it is the tax classification that is relevant and not the corporate law classification in this case. If, however, the LLC was checked as a corporate then both the tax and the corporate law regime align and there should be no hybrid entity. By contrast, certain non-corporate entities can be treated as corporations for French tax purposes and we would treat them as pass through entities under *Harris v Quigley*. This by definition creates a hybrid.

The objective of the rules is to counter tax hybrids and not merely mismatches in corporate rules. Accordingly, we would advocate that a statutory rule is introduced for the purposes of the anti-hybrid rules (or perhaps even wider) that would treat any non-Irish entity as corporate or transparent by following its local tax classification, i.e. the tax classification in its jurisdiction of formation. If it is formed in a jurisdiction that has no meaningful tax system (i.e. a tax haven) but it is treated as a resident of a different jurisdiction and as a corporate in that jurisdiction it should be treated as a corporate for Irish anti-hybrid rules. Where there is no applicable tax system, i.e. an entity that is resident in a tax haven, then it should be treated as a pass through or a corporate depending on its legal form since there is no applicable tax form to apply. We do not think that a list will work practically as the number of entities globally is huge and we doubt that it is a good use of scarce Revenue resources to maintain such a list.

There will be transitional issues for entities that have been treated in different ways under historic Revenue rulings. This can be addressed by providing a transitional period for tax payers to adjust their treatment, restructure or elect into the new treatment as the case may be. In summary, simply following the existing Irish caselaw will lead to hybrids existing where none in fact exist or for hybrids to be ignored where they do in fact exist. Accordingly, we believe that implementation of a statutory rule is the only meaningful way to achieve the objectives on this point in ATAD2.

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?*

We have no comments in relation to this question.

[6] [2008] IEHC 403

***Question 16: Payment / deemed payment** - The Irish tax regime does not have deemed payments, as such, but under the accruals basis can there be events (e.g. forgiveness of debt) which could come within the scope of these provisions?*

We do not believe that any relevant deemed payments of this nature exist in Irish tax law.

***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?*

As we noted, Ireland does not have specific rules for the taxation of debt, equity or derivative instruments. In order to apply the ATAD2 anti-hybrid rules correctly, we believe that the definition "financial assets" should be specific to the purposes and effects of the ATAD legislation. It would, therefore, include any debtor creditor relationship, any equity/share instrument and also derivative instruments. Only the latter category needs to be separately defined as debt and shares have their existing commercial meaning under Irish law and we do not believe that it needs to be changed. There has been historic difficulties in defining a derivative instrument but perhaps the term "specified agreement" in Section 110 of the TCA ought to be that definition.

***Question 18: Structured arrangements** - Recital (12) recognises that to ensure proportionality, ATAD2 should only apply to cases where there is a substantial risk of avoiding taxation through the use of hybrid mismatches. What factors should be considered in implementing the awareness test and the value test? What practical difficulties may be encountered in establishing whether or not a structured arrangement exists?*

In our view, a knowledge test is required to ensure that the principle of proportionality contained in EU law is respected. ATAD2 recognises the principle of proportionality in Recital (27) which states that "*the objective of this Directive is to improve the resilience of the internal market as a whole against hybrid mismatches… in accordance with the principle of proportionality, as set out in that Article, this Directive does not go beyond what is necessary in order to achieve that objective*". As noted in the consultation, in Recital (12) of ATAD2 it states that "*in order to ensure proportionality, it is necessary to address only the cases where there is a substantial risk of avoiding taxation through the use of hybrid mismatches*".

It is essential that, in order to ensure that the anti-hybrid rules only apply where they ought to apply and do not become impossible to manage, the exclusion for awareness and share in the value of the tax benefit must be imported properly into Irish rules. The definition of "structured arrangement" involves an assessment of whether there is an arrangement, whether it involves a hybrid mismatch and whether the mismatch outcome is priced into the terms of the arrangement or is put in place to produce a hybrid outcome. The directors of any company filing an Irish tax return must be able to balance the interest of its shareholders/stakeholders and its tax obligations. They cannot simply agree to pay tax which is not due as other shareholders/stakeholders would be adversely effected and they would be in breach of their fiduciary obligations. Similarly they must comply with tax law otherwise they would be potentially subject to sanction. Accordingly, where there is knowledge or information that is beyond what they ought reasonably be able to obtain bearing in mind their position, they cannot be placed in an impossible dilemma: should they break their obligations to one stakeholder (bondholders by assuming there is a hybrid where none likely exists) or another (therefore by assuming deductibility).

Accordingly, since the definition of structured arrangement requires effectively full knowledge of not only facts relating to other parties but also full knowledge of the intent of other parties to determine whether a structured arrangement exists or not, there must be a reasonable exclusion for knowledge of the relevant directors or other decision makers in order to enable them to, e.g. sign the tax return. Just like any other objective test, there would seem to be few factors that would need to be considered in implementing a knowledge test, other than obliging directors to act honestly and reasonably which is the company law standard imposed upon directors. Accordingly, we would advocate that in addition to a knowledge test Irish tax law makes it clear that so long as directors act honestly and reasonably they cannot be (and the company cannot be) sanctioned for making the assessment of whether or not there was a structured arrangement.

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?*

Please see Question 18. In circumstances where it cannot reasonably be known whether there is a hybrid mismatch, there is no risk of avoiding taxation through the use of hybrid mismatches and it is disproportionate to effectively impose tax as if there were a hybrid. This is particularly the case for listed or cleared bonds in market standard capital markets transactions as otherwise the capital markets would cease to function. Therefore, the introduction of a knowledge test for capital markets transactions is required to ensure that the principle of proportionality under EU law is respected and to ensure the continued functionality of the single EU capital market.

Our view is supported by EU policy in this area. As a result of Europe's slow recovery from the financial crisis and the need to identify alternative sources of financing for companies at a time when bank were deleveraging, the EU launched a Capital Markets Union (CMU) project in 2015. The project further develops the free movement of capital principle, one of the fundamental principles on which the EU was built, by aiming to create deeper and more integrated capital markets across the EU. This will be achieved by reducing fragmentation in financial markets, diversifying financing sources, strengthening cross border capital flows and improving access to finance for businesses. The CMU project is fully supported by the Irish government as shown by the shared view it released with Nordic and Baltic countries stating that "*given the challenges facing the European Union, fully delivering the CMU is essential*"[7]. The omission of a knowledge test in our domestic anti-hybrid legislation in the context of capital market transactions would fundamentally undermine this EU policy objective to which Ireland is fully committed.

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?*

As the rules should only apply to avoidance circumstances, a narrow view of hybridity should be taken.

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)*

Please see comments above in relation to the relevant parts of the Irish legislation that ought to be abolished in the light of the implementation of ATAD.

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?*

As set out above, we believe that a fundamental rethink of the technical basis of the Irish tax legislation should be undertaken as a result of ATAD. There should be a single anti-hybrid rule applicable to cross border and domestic transactions and an abolition of obsolete rules that apply. In

[7] Capital Markets Union, Shared View of the Finance Ministers from Denmark, Estonia, Finland, Ireland, Latvia, Lithuania, Sweden and The Netherlands, July 2018.

addition, there should be a restructuring of the recognition of income and the deductibility of expenses (including interest and returns and other financial instruments) particularly for non-trading companies.

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?*

As noted above, disallowed payments should be treated as "distributions" but they should not be subject to dividend withholding tax. The treatment as distributions ensure symmetry of the tax system both domestically and cross border. The abolition of dividend withholding tax for these categories of distributions would prevent an inadvertent requirement to deduct withholding tax arising on a payment which was not in any sense a distribution. An alternative would be to create a separate category of payments that are quasi distributions but do not trigger withholding tax and arise simply as a result of the application of these rules. With the abolition of much of Section 130 of the TCA, dividends/distributions would therefore be limited to real dividends as opposed to the much broader tax category of distributions. Finally, one policy option is to acknowledge the fact that Ireland is unique in the European Union by imposing both a dividend and an interest withholding tax regime. The obvious conclusion from that fact is that Ireland eliminate one or both of interest or dividend withholding tax.

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?*

We have no comments in relation to this question as the order of application will depend on the policy discussions taken on other points in this consultation.

Question 25: Removing domestic hybridity - *Are there any domestic tax provisions which should be amended to ensure that they are not regarded as hybrid entities, for example, by foreign jurisdictions?*

Please see discussion above for domestic provisions that ought to be amended.

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 rule in ATAD and ATAD2?*

Full consultation with the leasing industry is supported on this point.

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 rule in ATAD and ATAD2?*

Ireland does not have a legislative regime for the taxation of stock lending and repo transactions. The Revenue Tax and Duty Manual TDM 04-06-13 is a practice which has no force of law. Accordingly, it is open to any party to claim to be taxed under existing legislative and caselaw principles which are fundamentally different from the approach set out in the Tax and Duty Manual. Accordingly, Ireland cannot be said to have a regime for tax and stock lending and repo transactions and therefore a discussion of how the regime ought to change in light of ATAD is premature. On this basis, we would recommend that Ireland consults on the taxation of repo and stock lending transactions to develop a coherent regime that includes anti-hybrid and interest limitation rules where required.

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 rule to ensure that those measures apply to Part 8A TCA equivalent transactions?*

We do not believe that there are any specific changes that need to be made to deal with Part 8A TCA. Part 8A TCA operates by altering the tax treatment of transactions that have a separate and different legal analysis. We believe that the anti-hybrid rules would naturally apply to those transactions based on their tax outcome rather than their legal form.

***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?*

For the sake of simplicity and consistency, yes.

***Question 30: Collective Investment Vehicles** - Should Ireland choose, as permitted, not to apply the reverse hybrid rule to these vehicles?*

We believe that Ireland should choose not to apply the reverse hybrid rules to collective investment vehicles. The comments above in relation to government policy and not "gold plating" EU directives applies here. Also a consistent approach should be taken to reverse hybrids and to hybrids.

Responses to Questions on the Interest Limitation Rule

Introduction

It is difficult to understand the policy rationale behind Ireland's agreement to the interest limitation rule at the time ATAD was being negotiated amongst EU Member States. The constitutionality of the German interest limitation rule (on which the ATAD interest limitation rule is structurally based) is subject to a challenge before the German courts and this challenge was initiated before ATAD was agreed. In addition, the interest limitation rule was not one of the minimum standards arising from the OECD BEPS project. This is, however, a moot point but worth considering when determining the appropriate scope of the interest limitation rule to be implemented into Irish domestic legislation.

The interest limitation rule, unlike anti-hybrid legislation, transfer pricing rules, CFCs or other anti-avoidance legislation, does not restrict its operation to cases of tax avoidance. This is curious bearing in mind the fundamental objective of ATAD is to target tax avoidance. Accordingly, if the interest limitation rule is applied too bluntly or broadly then it will go beyond the scope of ATAD and have a disproportionate effect. In implementing the interest limitation rule, therefore, Irish policy makers must be conscious of their overriding EU law obligations. Recital (8) in ATAD, in the context of the interest limitation rule, states that "*BEPS in principal takes place through excessive interest payments among entities which are associated enterprises….*" . It is a pity that, in drafting the interest limitation rule, the European Council, the EU Member States and the EU Commission did not limit the scope of the interest limitation rule to related party transactions. Instead it seems to rely on a standalone entity rule which is a different concept.

A blanket 30% rule is too blunt an instrument and is overbroad with regard to the objective to be achieved. For example, in some industries there are typically material "hard" assets which can be secured to back borrowing. As a result, the normal interest capacity of economic operators may be higher than in other industries where the debt capacity is lower. It is puzzling why the interest limitation rule did not acknowledge this factual situation. In addition, different companies may structure themselves in different ways. 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. Similarly, in some EU Member States a multinational group may have higher levels of debt due to historic reasons or the presence of such "hard" assets whereas in other EU Member States it may have a lower debt burden for the same reasons. The failure of the interest limitation rule to operate across a single market, or recognise these differences due to genuine commercial reasons is a fundamental flaw in the rule. In addition, the interest limitation rule has the effect of creating a further difference between the statutory tax rate and the effective tax rate which is not a desirable policy objective. This differential is not a result of a failure by a multinational to price transactions correctly but is based on a blunt and arbitrary 30% figure.

Accordingly, in terms of the scope of the interest limitation rule to be implemented into Irish domestic legislation, we would advocate that Ireland recognise the above concerns by introducing a tax avoidance requirement and also limiting its scope to related party transactions when implementing the interest limitation rule in ATAD. If the concern in excluding a limitation for related party transactions is due to an ability to introduce effective conduit rules then there are plenty of examples in EU Member State tax laws in which conduit rules with proper effect have been implemented. It is strongly arguable that, in implementing the interest limitation rule into an EU Member State's domestic tax law, a failure to introduce a related party test and/or a failure to introduce a tax avoidance requirement amounts to a disproportionate and overly broad restriction on taxpayers in operating across a single market

***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?*

See Question 33.

***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?*

See Question 33.

***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?*

As noted in our introductory comments to this Consultation, Ireland ought to consider the introduction of a consolidated group regime. Our current "group relief" rules result in difficulties in the application of the interest limitation rule because the interest limitation rule assumes a level of group consolidation for purposes. Clearly the application of the interest limitation rule on a company by company basis would lead to unfairness within corporate groups. Accordingly, Ireland must introduce a group aggregation provision which the companies that are grouped can, by election, avail of. The test should be applied at a point in time in the year to avoid administrative complexities as groups do not generally alter their group structure by purchasing and selling companies for tax avoidance purposes. If they did, the GAAR would apply. The test should be applied at a point in time, e.g. the start or end time of any financial period at which the companies within the group are determined and the interest limitation rule should be applied to the year as a whole accordingly. If the groups do not have corresponding tax periods then, in the absence of a true consolidation system, there are a number of ways in which this could be addressed. This would include either ignoring the non-corresponding tax periods or applying the group limitation rules at a point in time. This would be the most administratively simple way of achieving this. A single member of the group should be nominated to comply with all filing obligations.

In relation to defining a "group", there are a number of different options. First the most appropriate way may be to adopt the related party definition from the CFC rules or the anti-hybrid rules. Since it is appropriate, in principal, to treat related parties under those rules as single economic operators then it should also, in principal, be acceptable to treat all such related parties as capable of forming a group for the interest limitation rule. There does not seem to be an economic rationale to treat the two in different ways. A more limited alternative (and one which we would not recommend) would be to utilise the existing relief group rules. Again, this is adopting a "sticking plaster" approach to tax legislation and we do not think this is the correct way to approach it. Finally, accounting consolidation could be used and this is a theme that is present in much of ATAD and so would also seem to be an appropriate option.

***Question 34: De Minimis threshold** - Are there any reasons why Ireland should not make provision for a de minimis threshold?*

There are no reasons why Ireland should not make provision for a de minimis threshold as provided for under Article 4(3) of ATAD.

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

When defining a "standalone entity", provision should be made to include an entity which is "insolvency remote". Insolvency remoteness is a rating agency concept and describes a series of contractual provisions and practical measures that allow the rating agencies to assume at AAA stress scenarios that particular entities will not become insolvent. The requirements vary from jurisdiction to jurisdiction. Alternatively other approaches should be taken, i.e. based on insolvency law.

If this approach is taken, a "standalone entity" would generally include SPVs that are consciously and deliberately isolated from wider group exposures. Structurally, such SPVs usually have a nominal equity share capital which is held by an independent share trustee usually on trust for charitable purposes. This equity structure is designed to ensure that the qualifying company is "insolvency remote", to lower the cost of funding, to achieve a higher rating and to isolate it from risks. Overall the purpose is that the SPV is insulated from the insolvency risk of other parties to the transaction as it does not form part of any other party's group of companies and should, as a result, rightly be considered a "standalone entity".

***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?*

Ireland should choose not to apply the interest limitation rule to loans entered into prior to 17 June 2016 as provided for under Article 4(4) of ATAD. Loans entered into prior to 17 June 2016 are subject to Ireland's targeted anti-avoidance rules in relation to interest which appear to be equally effective as the interest limitation rule in ATAD.

In addition, minor modifications to loans entered into prior to 17 June 2016 should not result in a loss of grandfathering. Recital (8) of ATAD states that "*in order to facilitate the transition to the new interest limitation rule, 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 indicates that the amount or duration of the loan, i.e. the fundamental terms of the loan, is the type of modification that should result in a loss of grandfathering. Irish domestic legislation or Revenue guidance should make clear that minor modifications for example, the interest rate or the monthly payment amount, will not result in a loss of grandfathering.

***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?*

In our view, the exemption from the interest limitation rule in Article 4(4) of ATAD for certain loans to fund long term infrastructure projects should be implemented into Irish domestic legislation.

Given the long-term nature of such projects and current asset prices, gearing/leverage tends to be much higher for infrastructure financing than on other financings (for example, gearing ratios of 90%+). Therefore, infrastructure financing would potentially be disproportionately affected by an interest limitation rule in comparison to other financings.

More importantly, availability of project finance is key to developing infrastructure. Ireland has a massive infrastructure deficit and addressing this will be key to the future growth of the country. Most infrastructure projects are bid competitively (whether through public contract awards, public private partnerships, renewable support auctions, etc.) or are remunerated on a regulated basis, and costs are ultimately passed through to users/consumers. To encourage activity in this space, it is important that costs are minimised.

In terms of defining a long term infrastructure project, the definition in Article 4(4) of ATAD is a good starting point as it includes a general public interest test. This test should be given a broad interpretation. It should include infrastructure assets which are publicly procured[8], used in the course of an activity regulated by an infrastructure authority, required to be developed in connection with the discharge of any of Ireland's obligations under any EU directive, or which provide an enduring benefit to the general public. It is important that the definition of "infrastructure asset" is non-exhaustive as such assets will continue to evolve over the coming years. One phrase which should be given clarity is "long term". In this regard, we would suggest that a project should be considered "long term" if the asset in question has, or is likely to have, an expected economic life of at least 5 years.

***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?*

We note that Article 4(5) of ATAD allows EU Member States to provide tax payers with the choice of the two options set out in that article. Accordingly, Ireland should make this choice available to taxpayers in its legislation.

***Question 39: Financial undertakings** - 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?*

We would advocate that Ireland exercises full discretion to exclude these financial services/regulated entities from the ambit of the interest limitation rule (and the anti-hybrid rules). The rules are largely targeted at multinational corporate groups rather than financial services entities. As noted previously, in order to provide a level playing field and to avoid a breach of competition law, entities that perform similar functions to an AIF (but are differently regulated) must also be excluded. This would include FVCs (Financial Vehicle Corporation) and companies that subject to non-FVC reporting to the Irish Central Bank. The rational for these regimes is that the entities can be economically equivalent to an AIF and therefore the level of information provided to the Central Bank ought to be equivalent. We would also suggest, for similar reasons, excluding any company that falls within the EU Securitisation Regulation[9].

As mentioned in Question 1, in many EU jurisdictions, it is a breach of the banking monopoly rules to make loans. This is not the case in Ireland where the regulated activity is deposit taking. Accordingly,

[8] Directive2014/23/EU – on the award of concession contracts; Directive 2014/24/EU – on public procurement; Directive 2014/25/EU – on procurement by entities operating in the water, energy, transport and postal services sectors.

[9] Regulation No. 2017/2402/EU

large parts of the non-bank sector are not regulated as banks in Ireland (other regulation applies to them) but are regulated as banks in the rest of the EU. In order to prevent a distortion of the single market and a breach of the competition rules, therefore, any exclusion for financial undertakings should also apply to any entity that undertakes retail or commercial lending activity. This would include all loan origination activities whether carried out by trading companies, "qualifying companies" for Section 110 purposes, LO-QIAIFs, treasury companies etc.

Question 40: Carry forward - *What are the key considerations in deciding which of the three policy options should be implemented in Ireland?*

Ireland should adopt the approach set out in Article 6(c) of ATAD, "*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*". The considerations in relation to the carry forward of exceeding borrowing costs and unused interest capacity are different to the "subject to tax" discussion in Question 3 in relation to the anti-hybrid rules. In this scenario, there is potential for asymmetry which an indefinite carry forward can remedy. It is questionable whether this goes far enough if it results in a denial of a deduction in cases where there is no tax avoidance, as such an outcome would be disproportionate.

In addition, as the interest limitation rule assumes some level of group consolidation there should be an ability to relieve denied exceeding borrowing costs on a group basis. Please refer to our comments on Question 31 in this regard.

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

The definition of "borrowing costs" in ATAD is extremely broad. One should take the same approach to the concept of interest income so that asymmetries do not arise, i.e. matters that would be considered give rise to "borrowing costs" should also, on a symmetrical basis, give rise to interest income. The two definitions should effectively be the same. In addition, any amounts that are taxed as interest or equivalent income under Irish tax rules should be included in the definition of interest income. This would include all income of "qualifying companies" for Section 110 purposes 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.

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?*

We have no comments in relation to this question.

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?*

We have no comments in relation to this question.

***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?*

For consistency, denied exceeding borrowing costs should be treated as a "distribution" for the purposes of the payer and the recipient but not for withholding tax purposes in the same way that a denied payment should be treated under the anti-hybrid rules. It is a disproportionate outcome to deny a deduction in a payer company yet to tax the payee on the same amounts in Ireland or elsewhere. The purpose of ATAD is to prevent tax avoidance not the creation of double taxation and such an outcome would be a disproportionate (and likely illegal) outcome and not within the purposes of ATAD. As the power of the EU Commission is to make rules relates solely to the proper functioning of the single market, it cannot be within the EU Commission's power to mandate a rule that exceeds its jurisdiction. For this reason, we believe that once a deduction is denied under the interest limitation rule then there should be no tax on receipt for the recipient of that payment. If, using a carry forward basis, a deduction is then obtained for the payer of the interest, the recipient should be taxed on that receipt. This is likely only to be capable of being operated in a related party context (see our comments in the introduction to paragraph 5 about the lack of an avoidance requirement/related party requirement in the interest limitation rule) which gives an indication of how the scope of the interest limitation rule should be targeted to the purposes of ATAD and not applied too broadly. Equally this comment applies cross-border within the EU i.e. where a deduction is denied under the interest limitation rule in another EU Member State, the Irish payee should not be taxed on that receipt until a deduction is obtained in that payee Member State. Full information is available to Revenue to verify this under the Mutual Assistance Directive Double Tax Treaties and other information sharing provisions. Under free movement and capital provisions, this principle should be extended to all third countries. The objective of these rules is clearly to provide symmetry and to prevent double taxation. This cannot be objectionable.

As mentioned in paragraph 3.5 above titled "Ensuring Symmetry of Treatment", a payment of interest which is rendered a distribution under the interest limitation rule should not trigger dividend withholding tax because it is not actually a dividend. In most cases, dividend withholding tax would be eliminated by the filing of the appropriate V2B form so a refund could be claimed. This is a practical approach to removing economically damaging (yet unnecessary) withholding taxes.

Yours faithfully

Arthur Cox

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