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Our ref

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Dear Tax Division

Consultation on the Tax Treatment of Interest in Ireland

Matheson welcomes the opportunity to respond to the paper "*Consultation on the Tax Treatment of Interest in Ireland*" issued by the Department of Finance on 27 September 2024 (the "**Consultation Document**"). This submission is made on our own behalf.

Introduction

The Irish regime for taxing interest has evolved over decades, sometimes in response to taxpayer behaviour and sometimes in response to the development of international standards. This leaves taxpayers with a series of disconnected rules to analyse in the context of any debt-funded transaction. The Irish regime is overly complex and often does not allow deductions for interest incurred on loans drawn down for a commercial purpose. As a result, the Irish regime is uncompetitive and causes Ireland to lose out on investment.

We therefore consider that the rules on taxing interest (at least for companies) should be rewritten. An important policy principle that should form the basis of the modernisation is that **interest is a legitimate cost of doing business**. As such, interest that satisfies a general commercial purpose test should be deductible.

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The **existing framework for taxing interest is no longer coherent** and gives rise to outcomes that are not typical in other jurisdictions. This undermines the competitiveness of Ireland's offering and can result in Ireland missing out on investment. For example, in most jurisdictions it tends to be the case that interest expense can be offset against interest income (indeed, the interest limitation rule was developed based on this principle). However, in Ireland, that is not generally not the case when interest expense is incurred outside of an active trading business. From a policy perspective, that outcome is hard to rationalise. **We would strongly urge a policy position that permits deductions for interest in cases where the investment gives rise to taxable income**.

In line with that policy position, we strongly recommend, and it is the core of our submission, **replacing section 247 TCA with a general commercial purpose rule**. The provision is wholly anachronistic and is no longer fit for purpose. It includes arbitrary conditions that have no connection with the commercial purpose of the loan and in our view serve no policy purpose (for example, the requirement to have a common director).

An interest deductibility rule based on commercial purpose would be a significant improvement and make the Irish offering more competitive. Moving to a rule based on commercial purpose would require **a number of policy decisions** to be made:

- In the first instance, we consider that provided the commercial purpose threshold is met, the **default rule should be that interest expenses should be deductible against taxable income**, regardless of whether that income is trading or non-trading. That approach would reflect that, in principle, interest is a legitimate cost of doing business.

- Consideration should be given, from a policy perspective, to guardrails that might be applied where **interest expenses are connected with income that is not directly taxable**, such as franked investment income or foreign dividends that qualify for the participation exemption. We think this matter requires focus on two separate situations:

  - First, where an interest expense arises on debt borrowed to fund equity investments in Irish resident companies. We submit that such interest should generally continue to be deductible (as is currently the case under section 247) with appropriate guardrails in place.

  - Second, where an interest expense arises on debt borrowed to fund equity investments in non-Irish resident companies when the shareholdings in those subsidiaries qualify for the participation exemption. Again, we submit that such interest should generally continue to be deductible (as is currently the case under section 247) with appropriate guardrails in place.

We have provided more detail and perspectives on those considerations in our answer to question 7.

As noted above, the deductibility of interest should be subject to appropriate guardrails. Over the past decade, a number of **guardrails based on internationally agreed standards** have been implemented to limit base erosion through interest under Irish law. Those rules (the interest limitation rule, the anti-hybrid rules, the transfer pricing rules and the outbound payments rules) protect the Irish tax base and should remain core features of the regime for taxing interest.

Broader Policy Considerations

Question 27

Should Ireland introduce a commercial business purpose test, or any other basis, for the deduction of interest expense? In explanation of your answer, please consider each of the issues noted above and any other issues you consider to be relevant, noting both the benefits and any adverse consequences of same.

Please provide examples of regimes in other jurisdictions, and consider, and include in your analysis, the broader corporate tax regime in that country within which the interest provisions operate.

We are starting our submission with our answer to question 27 as we believe it is the most important question in the public consultation paper. We note that the review of the tax treatment of interest is expected by the Department of Finance to "*require a significant body of work to be carried out over a multi-year timeframe*". That being the case, we believe the first step in any such process should be to **identify the principles underpinning the taxation of interest in Ireland**. The existing framework ought then to be examined in light of those principles. Identifying the core principles that underpin (or ought to underpin) the regime should help to develop a resilient regime for taxing interest (one of the stated aims of the review).

Another stated aim of the review is to support competitiveness. Simplification of the existing regime would be a good step in that direction. However, **meaningful simplification** can only be achieved by developing a framework for taxing interest based on core policy principles, rather than individually focusing comments on existing rules (or blocks of rules) and asking how those can be enhanced or simplified. While examining each set of rules individually may lead to moderate improvements, it will not simplify the taxation of interest framework in any meaningful way. Taxpayers entering debt-funded transactions will remain in the onerous position of being required to analyse a series of disconnected rules to confirm the appropriate tax treatment. This situation is putting Ireland at a material competitive disadvantage, when competing for investment when compared with most other EU Member States.

In broad terms, we consider that the **core principles** that the Irish rules on the taxation of interest should adhere to are:

- Recognition that interest is a legitimate cost of doing business and should generally be deductible provided the financing satisfies a general commercial purpose test.
- Recognition that interest on financing that satisfies a general commercial purpose test should be deductible against taxable income, whether trading or non-trading.
- Recognition that additional guardrails may be required for intra-group financing – in this respect the transfer pricing rules, the interest limitation rule and the anti-hybrid rules play an important role.
- Recognition that Ireland has agreed to be bound by international standards in the area of taxation of interest which also serve to protect the Irish tax base, including the interest limitation rule and the outbound payments rules which bolster the withholding tax regime (which operate as a backstop to the rules on deductibility).

Outside of those core principles, a number of other policy decisions are required, including:

- The extent to which guardrails are required where interest is deductible against income that is not directly taxable (primarily, Irish dividends and foreign dividends to which the participation exemption applies);

- Whether under a revised regime that permits interest to be deducted based on a commercial purpose test, other guardrails, beyond those based on international standards, are required.

With respect to the additional questions detailed in question 27:

a) *The basis for a new interest deduction rule and how it would differ from the existing tax regime;*

- We support a rule that is based on a general commercial purpose test.

b) *Whether an accruals or payments based interest deduction regime should be adopted;*

- We support an accruals based regime for Irish corporation tax purposes (both on income earned and income expenses) – this would have the benefit of aligning with accounting practice and the Pillar Two rules. We see considerable merit in retaining a payments based interest regime for Irish income tax purposes (for individuals earning passive income and incurring interest expenses in connection with such passive income).

c) *The requirement, or otherwise, for enhanced transfer pricing legislation with regard to intra-group financial transactions, in conjunction with any new interest deduction rule;*

- We consider that the OECD Transfer Pricing Guidelines ("**OECD TPG**") are comprehensive with respect to taxing intra-group financial transactions and we do not believe that there are any specific gaps that would need to be addressed domestically. Further, we would note that applying rules that are inconsistent with the OECD TPG would breach Ireland's commitments as an OECD member and under Ireland's double tax treaties.

d) *The treatment of interest-based derivatives (e.g., swaps, hedging instruments etc.) and amounts equivalent to interest under any new interest deduction rule;*

- Generally such derivatives are entered into by companies in the course of a trade, and are taxed in accordance with their accounting treatment. We believe this regime generally works well.

- In some cases, such derivatives can be entered into by companies in respect of passive income and we believe that legislative amendments would do much to clarify their treatment in respect of Case III income in particular. Broadly, we submit that such derivatives should be taxed in the accordance with their accounting treatment in a Case III or Case IV context, subject (under a new regime) to a general commercial purpose test. The interest limitation rule provides an important guardrail where any income payable under such derivatives is 'interest equivalent'.

- More broadly, we see can see the benefits of treating amounts equivalent to interest in the same way as interest as is already the case under the interest limitation rule.

e) *The requirement, or otherwise, for thin capitalisation rules to be introduced in conjunction with any new interest deductibility rule i.e., restriction of the deductibility of interest in cases where the company is overly debt financed as compared to its equity funding;*

- The OECD TPG give the same outcomes as those that can be achieved under thin capitalisation rules. We are therefore opposed introducing separate thin capitalisation rules.

f) *The requirement or otherwise of a rule that takes into account the level of taxation of the recipient;*

- Such rules are challenging to apply in practice, particularly when the parties are not related. Further, Ireland already has a number of rules that operate to deny deductions or impose withholding tax when the recipient is not taxable (including the anti-hybrid rules and the outbound payments rules).

g) *The requirement for new rules to prevent abusive transactions relating to any new interest deduction rule, in particular the requirement for targeted or principles based anti-avoidance rules;*

- We agree that developing appropriate guardrails to protect the Irish tax base is an important part of any modernisation of the rules on taxing interest. We think that the parameters of those guardrails will only begin to become apparent once the basic architecture of a new regime is determined.

h) *The requirement, or otherwise, for new rules regarding the characterisation of financial instruments as debt or equity;*

- We consider that the OECD TPG can and are intended to apply for the purposes of characterising financial instruments as debt or equity and do not think that additional rules are required.

i) *Whether the deductibility of interest (or interest equivalent) expenses could, or should, be linked or matched to the income earned from the use of the debt finance, taking into account the different rates of tax applicable to different sources of income in Ireland;*

- Given the differing Irish corporate tax rates, we believe it is necessary to 'match' interest expenses with interest income. However, matching interest expenses with particular sources of interest income can be overly burdensome from a compliance perspective – in particular we note that this has been a factor in limiting the uptake of the treatment under section 76E TCA. Therefore, we would suggest that interest expenses should be 'matched' with Cases of income only (and deductible against all income earned under that Case), rather than linked particular sources of income within a Case.

j) *The interaction of relief under any new interest deduction rule with relief for losses and group relief;*

- We believe that excess interest expenses (creating losses) under Cases III, IV and V should be available for set-off or surrender, on a current year value basis, against income from other Cases earned by that company or by other group companies in that year. From a policy perspective, we can see no basis for discriminating against Case III, IV and V losses, in comparison to Case I losses.

k) *The requirement for, or structure of, any transitional rules on the adoption of a new interest deduction rule*

- We expect that transitional rules will be required and the design of those rules will begin to become apparent once the basic architecture of a new regime is determined.

Taxation of interest income

Question 1

Should there be closer alignment of the rules regarding the taxation of trading and passive interest income?

What would the benefits and any adverse consequences of alignment be?

We see merit in aligning the rules for taxing trading and passive interest income. **Both should be taxed on an accruals basis** for corporation tax purposes. That should reflect accounting practice and may also make some of the anti-avoidance provisions redundant, e.g. section 817C TCA.

If the outcome of this review is meaningful simplification of the rules for taxing interest, there should be **limited differences to the rules that apply to determine whether interest is deductible for trading or non-trading purposes**. Under such an approach deductions for interest should always be available if the debt satisfies a broad commercial purpose test with appropriate guardrails, where required.

We think this question leads into a **much broader topic that merits discussion at policy level**, particularly in a post-Pillar Two environment – whether the rules regarding taxation of *all* trading and passive income should be aligned. The difference in treatment between trading and passive income (including the differences in rate for corporate taxpayers) brings an additional layer of complexity to the Irish system and should be the subject of a much broader policy discussion.

Question 2

Are there any simplification measures or enhancements which should be made in respect of non-resident persons? Please explain, noting both the benefits and any adverse consequences of same.

We have **no substantive comments** on the tax treatment of interest paid to non-residents, save for the overarching position that if the outcome of this review is meaningful simplification of the rules for taxing interest based on a set of core principles, there should be limited differences to the rules that apply to Irish residents and non-residents. In this respect, you will note our response to question 15.

We further note that the combination of **withholding taxes and the outbound payments rules act as a backstop** and help to protect the Irish tax base by ensuring collection of Irish tax from lenders resident in zero and no-tax jurisdictions and jurisdictions with which Ireland has not agreed mutual administrative assistance provisions.

Question 3

Are there any simplification measures which could be taken in respect of the above-mentioned anti-avoidance provisions (sections 812 to 815 TCA and section 817B TCA)? Please explain, noting both the benefits and any adverse consequences of same.

We have no substantive comments on these provisions.

Interest deductibility

Question 4

Are there any aspects of relief for interest as a trading expense which could be enhanced or simplified? Please explain, noting both the benefits and any adverse consequences of same.

We think the rule allowing deduction for interest as a trading expense **is well-understood and generally facilitates the deduction of interest paid** on amounts borrowed in the course of a trade.

If deductions for interest under Case I were instead subject to a commercial purpose test, we would expect that the **outcomes should be the same**.

Question 5

Are there any aspects of relief for interest incurred in relation to the provision of Irish rental property which could be enhanced or simplified? Please explain, noting both the benefits and any adverse consequences of same.

We think that the rules for deduction of interest on amounts borrowed to fund the purchase, improvement or repair of Irish rental property **are broadly well-understood**.

One aspect of the rules that warrants review are the **restrictions on deductions for interest paid during a pre-letting period**. Currently, those deductions (including interest) are limited to a 12 month period and cannot exceed €10,000 per premises. In the current environment, these limits are overly restrictive.

If deductions for interest on loans used for Irish rental property were instead subject to a commercial purpose test, we would expect that the **outcomes should be the same, save for interest expense incurred during the pre-letting period**, where the revision would likely allow more flexibility. If, as a policy matter, Government was opposed to permitting that flexibility, it could be managed with guardrails similar to those included in the existing legislation.

There are a number of provisions in section 97 of the Taxes Consolidation Act 1997 ("**TCA**") that are **now redundant and could be deleted** with a view to stream-lining the provision (e.g., subsections 2A to 2F and subsections 2H, 2J and 2K).

Question 6

Other than with respect to anti-avoidance provisions (set out in further detail below), are there any aspects of relief under section 247 TCA which could be enhanced or simplified? Please explain, noting both the benefits and any adverse consequences of same.

The '**interest as a charge' provisions are wholly anachronistic and not fit for purpose** for a small trading nation aiming to foster an entrepreneurial, robust business environment.

Sections 247 and 249 impose **conditions which are arbitrary and do not appear to support any obvious policy principle**. For example, none of the following requirements serve any meaningful purpose relevant to the commercial nature of the borrowing and as a result have become traps for the unwary:

- the requirement to have a common director on the board of the investing company and the investee company. Given Ireland's objective to support Irish businesses in overseas expansion, this is an unnecessary and costly hurdle, serving no policy purpose;

- the requirement to have a 5% common shareholding;

- the requirement to 'defray money applied' for very specific purposes. We see no reason why a delay in applying the borrowed funds (or an interim use of the funds for a short-term purpose) should impact on the deductibility of the interest expense;

- the requirement that interest be 'yearly interest'. Again, we see no reason why short term funding of a holding company should deny the ability to claim a deduction for a genuine business expense;

- the treatment of the deduction as a 'charge' on income, rather than a normal deductible expense. While this 'charge' treatment does confer some advantages, it results in more complex tax compliance administration costs. We believe a straightforward deduction, combined with flexible 'group surrender' rules, would be much more preferable for Ireland's perceived 'ease of use' for multinational corporate groups and international investors.

The Irish tax code, and Ireland's business environment for investment, would be **greatly enhanced and simplified by replacing section 247 TCA with a commercial purpose test**. Such a test would allow taxpayers to fund their business expansions and acquisitions without the need to take detailed technical tax advice (which currently is always the case for section 247 TCA), thereby materially encouraging decisions to make investments in Ireland, rather than other jurisdictions.

Guardrails could be developed with respect to intra-group financing. In designing those guardrails a number of policy decisions would be required:

- In the first instance, we consider that provided the commercial purpose threshold is met**, interest on a debt should always be deductible against taxable income**, regardless of whether that income is trading or non-trading. Such an approach would reflect that, in principle, interest is a legitimate cost of doing business.

- Consideration should be given to guardrails in particular, where **interest expense is incurred with respect to income that is not directly taxable** such as Irish dividend income or foreign dividends that qualify for the participation exemption. We think this aspect raises the following policy considerations:

    - First, where an interest expense is incurred on debt borrowed **to fund equity investments in Irish resident companies**. We submit this should generally continue to be deductible, as is the case where section 247 is availed of. The investment indirectly generates Irish taxable income (the business income of the acquired subsidiary). This approach does not require the borrower to on-lend to the acquired subsidiary. Importantly, the interest limitation rule will always apply as a baseline to limit deductions for interest to 30% of EBITDA.

    - Second, where an interest expense is incurred on debt borrowed **to fund equity investments in non-Irish resident companies where the shareholdings in those subsidiaries qualify for the participation exemption**. We submit this should generally continue to be deductible, as is the case where section 247 is availed of. We note that AmCham Ireland has researched the tax regimes of other jurisdictions and

confirm in their submission that interest on such investments by German companies would be deductible. We think there are good policy reasons to continue to allow deductions of interest on such borrowings, in particular supporting the critical objective of overseas expansion by Irish businesses (particularly in EU and EEA Member States and in double tax treaty partner jurisdictions). Most importantly, the interest limitation rule would apply as a baseline to limit deductions for interest to 30% of EBITDA (and the foreign dividend income would not be included in the computation of EBITDA for these purposes). Just like in Germany, we submit that the interest limitation rule should operate as a sufficient guardrail for such interest expenses.

Question 7

Are there any aspects of the anti-avoidance provisions contained in section 247 TCA which could be simplified or are no longer required? Please explain, noting both the benefits and any adverse consequences of same.

The anti-avoidance measures within section 247 TCA are notoriously **difficult to navigate.**

The complexity of these rules means that multinational groups frequently no longer even consider Ireland has a potential jurisdiction in which to engage in their investments and borrowings. Even for wholly domestic businesses who have no choice but to make their investments and borrowings through an Irish company, the complexity of these rules means that they often, in our experience, **require a submission to Revenue to confirm their treatment under the anti-avoidance provisions**. For a system that operates on a self-assessment basis, this clearly illustrates that section 247 is not fit for purpose.

Section 247(4A)(h) TCA

- Section 247(4A)(h) TCA applies to transactions where newly issued share capital that was subscribed for using funding that would otherwise qualify for relief under section 247 TCA is used to repay certain debt provided by the original lender or a person connected with them.
- The parameters within which that provision applies can be unclear where the capital subscribed is used to repay pre-existing section 247 funding.
- In such cases, our approach is to seek Revenue confirmation that the anti-avoidance within subsection 4A(h) does not apply. Typically such confirmations are granted, however, that a submission is required at all illustrates the challenges of relying on the relief.

Section 247(2B) TCA

- In addition, the anti-avoidance provision in subsection 2B is notoriously difficult to apply in cases where a taxpayer acquires an intermediate holding company. It is drafted on much broader terms than it is applied by Revenue (who restrict it to the purpose of the purchaser).
- It is unclear what additional avoidance it targets that would not otherwise be covered by section 817A TCA (or indeed section 811C TCA). The layering of anti-avoidance provisions in this way is unduly restrictive.

Finance Act 2017

- The anti-avoidance measures introduced by Finance Act 2017 in respect of sections 247 TCA and 249 TCA and intermediate holding companies have complicated the availability of relief under section 247 TCA unnecessarily. The rules are overly complex and do not reflect the commercial realties in domestic or international groups.

In a new regime based on a general commercial purpose test, any guardrails based on these anti-avoidance rules need to be materially streamlined to ensure that they are understandable and clear, appropriately targeted and limited to the key concerns.

It is important to stress that, since the introduction of the interest limitation rule, the need for many of these anti-avoidance rules has been removed (or, at least, significantly reduced).

Finally, section 811C TCA remains available to combat abusive transactions but we note from interactions with the Department of Finance and Revenue on other recent public consultations that there is some discomfort with this approach.

Question 8

Are there any aspects of the provisions in section 249 which could be simplified or are no longer required? Please explain, noting both the benefits and any adverse consequences of same.

- Section 249 is one of the most difficult and prohibitive aspects of the 'interest as a charge' provisions.

- The recovery of capital provisions are **hugely and unnecessarily restrictive and continuously stifle normal corporate activity of Irish businesses**. The rules assume that in all cases the only commercially rational option on repayment of a loan further down the chain is to repay the loan that was used to fund it. This is inaccurate as a commercial matter; there are many other normal commercial approaches that may be preferable, rather than repaying the loan used to fund it.

- When companies within a group that has claimed section 247 relief **transfer shares as part of a group reorganisation effected for bona fide commercial reasons**, a recovery of capital equal to the market value of the subsidiary is deemed to occur (even where no consideration may be paid in respect of the transfer, and where the transferee will become, or continue to be, an intermediate holding company to which the rules apply). We cannot see any policy rationale for this.

- In some cases, the application of section 249 TCA can result in **double recoveries of capital** being recorded as a result of one transaction. This often occurs when a group has more than one set of funding arrangements in respect of which relief under section 247 TCA is claimed. Repayment of one set of section 247 funding arrangements can, on a strict reading of the provisions, be understood as giving rise to a recovery of capital on the other set of section 247 funding arrangements. In such cases, we have sought confirmation from Revenue that the rules in such cases should not be read to give rise to double recovery of capital. That confirmation is required illustrates the challenges in applying the rules.

- Another example of when the recovery of capital rules could be applied strictly is when an intermediate holding company that was part of a section 247 funding arrangement transfers all of its assets and liabilities to a another group company (for example as part of a group re-

organisation) and is **voluntarily struck-off**. Section 247(2)(ac)(iii)(IV) TCA provides that there would be no recovery of capital in such a case if the intermediate holding company was dissolved with or without going into liquidation. As voluntary strike-off is a different legal process to dissolution, transactions involving voluntary strike-off require a submission to be made to Revenue to confirm that section 247(2)(ac)(iii)(IV) TCA can apply.

- In our experience there are **exclusions from the recovery of capital rules for deemed recoveries that do not apply to actual recoveries of capital**. For example, sections 249(2)(ab)(ii) TCA and 249(2)(ac)(iv) TCA allow investing companies and intermediate holding companies to elect that a share for share exchange should not give rise to a deemed recovery of capital. However, a similar election cannot be made by an investing company in respect of an actual recovery of capital. That difference in treatment is difficult to rationalise. In addition, where there is more than one set of funding arrangements in respect of which relief under section 247 TCA is claimed, a deemed recovery by an intermediate holding company might be 'saved' by the provisions of section 249(2)(ac)(iii) TCA for one set of arrangements, whereas it would not apply in respect of an actual recovery of capital, notwithstanding that there would continue to be a funding arrangement to which the provisions of section 247 and 249 TCA would apply. At a minimum, these provisions should be available to 'companies concerned' in addition to intermediate holding companies.

If section 247 TCA was replaced with a rule that allowed deductions for interest on loans in place for commercial purposes, the recovery of capital rules could be removed.

Question 9

Are there any aspects of relief for interest paid by QFCs which could be enhanced or simplified? Please explain, noting both the benefits and any adverse consequences of same.

The introduction of section 76E TCA was the subject of a reasonable level of engagement with industry. The policy underpinning the provision (facilitating the establishment of an in-group lender outside the confines of section 110 TCA) was widely welcomed. However, a number of restrictions incorporated into the provision (many of which are based on 'interest as a charge' concepts) have meant **that for most taxpayers, the relief is unworkable**. It is widely regarded as a missed opportunity. This is disappointing for industry and, no doubt, for those in the Department of Finance and Revenue who developed the provision.

The limitations of section 76E TCA have been discussed at TALC and we believe are well understood. However, for completeness, in our experience the main reasons taxpayers have not established qualifying financing companies ("**QFCs**") are:

- The relief applies if the QFC borrows from third parties only. This is unnecessarily restrictive and does not reflect the commercial reality of how large multinational groups typically fund their operations. As well as third party debt, multinational groups need the flexibility to engage in normal intra-group lending, and need any group company which is engaged in 'group lending' to have the flexibility to borrow both from third parties and group companies. This is the main reason, in our view, why the QFC is currently not been availed of.

- Restricting the activities of the QFC to holding shares in qualifying subsidiaries, on-lending and activities ancillary to those activities is too limiting for the relief to be useful to many groups in practice. It's hard to see how holding shares in a non-trading company or providing administrative services to group entities would undermine the integrity of an entity such as a

QFC. This restriction forces taxpayers to establish two separate sub-groups which seems unnecessary. The same outcome could be achieved by ring-fencing the QFC activities within the entity (a technique frequently used in other parts of the Taxes Acts).

- Requiring QFCs to hold at least 75% of the shares in qualifying subsidiaries or through an intermediate holding company is overly-rigid in practice for many groups. If a QFC held say 70% of a subsidiary directly and held the remaining shares through an intermediate company, the QFC would not be eligible to apply section 76E TCA. It is not clear what the policy rationale for that approach is.

- The requirement to match loans and repayments on loans is administratively burdensome and further discourages the use of QFCs.

If the rules on deductibility of interest were replaced with a commercial purpose test, a provision like section 76E TCA may be superfluous and if so, could be removed.

Question 10

Are there any aspects of relief for interest for CGT purposes which could be enhanced or simplified? Please explain, noting both the benefits and any adverse consequences of same.

We submit that interest that is capitalised for accounting purposes should generally be permitted as a deduction for CGT purposes. Again, this is a real commercial expense incurred by the company and it should be taken into account in determining whether the company made a gain or loss on the disposal of its capital asset. We do not see any policy basis for discriminating against capital assets other than buildings.

Question 11

(a) Are there any ways that the interaction of the above five areas of relief for interest (trading expense, rental expense, interest as a charge, QFC, CGT) could be enhanced or simplified? Please explain, noting both the benefits and any adverse consequences of same.

(b) Are there any commercial scenarios where tax relief for interest expense is not currently available for businesses under existing legislation, where tax relief should be available in your view?

- As noted throughout our answers above, we consider that the optimal way to enhance and simplify the five areas of relief for interest is **to apply a single commercial purpose test** to all five types of debt financing. The existing rules are overly-complex and result in taxpayers incurring outsized compliance costs and undermine Ireland's competitiveness as a location for investment.

- A recurring approach of the Irish rules on deductibility of interest is that they **apply much higher thresholds to interest paid to connected parties**. The design of the domestic provisions on interest deductibility disregard parallel safeguards against base erosion that were implemented to satisfy internationally agreed standards (e.g., the interest limitation rule, transfer pricing, the anti-hybrid rules and the outbound payments rules). In some cases deductions for interest paid to related parties are entirely denied (e.g. section 76E TCA). The rules **do not reflect how debt-funding is typically raised in large international groups** (with third party debt typically being raised centrally in the jurisdiction and in the entity which is most efficient, taking into account non-tax factors such as credit rating, currency and access to capital markets; and where

those entities then on-lend the borrowed funds within the group to where it is used to fund the group's economic activities) and puts Irish sub-groups at a disadvantage when compared to their international counterparts.

ATAD Interest Limitation Rule

Question 12

Are there any aspects of the ILR which could be enhanced or simplified, within the confines of ATAD? Please explain, noting both the benefits and any adverse consequences of same.

We think the rules implementing the ATAD interest limitation rule are **well-understood and operate as intended**. We have no suggested changes.

Question 13

When implementing ATAD, Ireland made policy choices, based on pre-existing domestic rules, in the following areas:

a) treatment of a group as a single taxpayer,

b) application of a de minimis exemption,

c) application of a standalone entity exemption,

d) application of a legacy debt exemption,

e) application of long-term public infrastructure project exemption,

f) application of an equity ratio and group ratio rule,

g) rules relating to the carry forward/back of restricted interest and spare capacity,

h) application of a financial undertakings exemption.

Should the policy choices made in respect of above be re-evaluated as part of this review process? Are there areas where the ILR, as implemented in Ireland, could be strengthened so as to provide greater protection to the Exchequer, thereby allowing other interest related provisions to the removed or simplified? Please explain, noting both the benefits and any adverse consequences of same.

We think the rules implementing the ATAD interest limitation rule are **well-understood and operate as intended**. We have no suggested changes to the policy changes made at the time of implementation.

Anti-avoidance provisions and other restrictions

Question 14

Are there any aspects of the targeted anti-avoidance measures outlined above (section 254 TCA, section 817A TCA, section 817C TCA, section 840A TCA) which could be enhanced, simplified or removed? Please explain, noting both the benefits and any adverse consequences of same.

- The five year period specified in **section 254 TCA is arbitrary and creates a cliff-edge effect** that requires reconsideration.

- We do not agree that section 817A TCA is a targeted anti-avoidance measure. Section 817A TCA is in the nature of a general anti-avoidance provision that **replicates the application of the general anti-avoidance rule in section 811C TCA** to transactions involving relief under Part 8 TCA. Further, there appears to be a clear double-up in the operation of section 247(2B) TCA and 817A TCA.

- We think that there is a strong case for replacing the existing anti-avoidance measures (particularly those that are general in nature) with **a single general anti-avoidance rule targeted at debt-funded transactions**. In our view, section 811C TCA should be sufficient for this purpose but we note from interactions with the Department of Finance and Revenue on other recent public consultations that there is some discomfort with this approach.

- As a general comment, that the anti-avoidance measures in relation to interest are **scattered throughout the Taxes Acts is unhelpful** and an initial consolidation of the applicable measures would be welcomed.

Question 15

Are there any aspects of the provisions relating to the treatment of interest as a distribution, and associated exemptions outlined above, which could be enhanced, simplified or removed? Please explain, noting both the benefits and any adverse consequences of same.

- We believe that**, from a policy perspective, a number of the provisions of section 130(2)(d) TCA should be deleted** given Ireland's implementation of transfer pricing rules, the incorporation of the OECD TPG into domestic law and the implementation of the anti-hybrid rules. The OECD TPG apply not only to determine whether the pricing of a loan is at arm's length but may also be applied to determine whether funding can be respected as debt or should be treated as equity. There is a clear **overlap between the provisions of section 130(2)(d) TCA and the transfer pricing rules** which should be rationalised. Further, if a payment of the type described was treated as an exempt distribution in the recipient jurisdiction, **the anti-hybrid rules would apply to neutralise the mismatch**.

- In addition, we note that **subsection (2)(d)(iv) in particular is difficult to justify** in a modern cross-border trading world. Even where domestic exemptions do not apply, it is subject to override in many cases given the non-discrimination article in double tax treaties. **It is anachronistic and should be deleted**.

Question 16

Are there any aspects of the above provisions (section 291A TCA, section 437 TCA, Part 35A TCA, Part 35C TCA) relating to other interest restrictions which could be enhanced, simplified or removed (within the confines of Ireland's international obligations)? Please explain, noting both the benefits and any adverse consequences of same.

- We have no comments on the operation of the interest restriction in **section 291A TCA** which we think is well-understood and operates as intended.
- We think the rules implementing the **ATAD anti-hybrid rules and the transfer pricing rules** are well-understood and operate as intended. We have no suggested changes to those provisions.
- Interest deductions paid by a close company to a director or an associate of a director are restricted to what the consultation paper describes as a "reasonable limit" under section 437 TCA. In our experience **the limit included in section 437 TCA is arbitrary and should be revisited**. Typically, the limit will apply by reference to the company's nominal issued share capital which, in practice, can be very restrictive. We would recommend revisiting the limit so that it permits deduction of an arm's length rate of interest.

Financial services transactions

Question 17

Are there any aspects of the provisions relating to the deductibility of interest in respect of a qualifying company as defined in section 110 TCA which could be enhanced, simplified or removed? Please explain, noting both the benefits and any adverse consequences of same.

- Section 110 TCA is a complex provision to apply and is another part of the Taxes Acts where anti-avoidance provisions are layered on top of anti-avoidance provisions. The operation of the provision should be reconsidered if a decision is taken to permit deductions for interest in cases that satisfy a commercial purpose test. **Such an approach might facilitate the simplification of section 110 TCA**.
- Some of the anti-avoidance provisions that were introduced are designed to deny deductions for **interest payments made to certain 'specified persons'**. The operation of those provisions can, in some cases, cut across non-discrimination rules in the EU Treaties (for example if the interest is paid to an EU pension fund, the outcome can be different to cases where interest is paid in similar circumstances to an Irish pension fund) and non-discrimination provisions included in Ireland's double tax treaties. We recommend that section 110 TCA is revised to eliminate the discrimination inherent in its application.
- In addition, in practice the administrative requirement to **file a section 110 notification form within eight weeks can be missed giving rise to disproportionate consequences for the taxpayer** (complete failure to qualify for the treatment). Explaining the consequences of such an administrative slip to international clients is giving rise to reputational issues for Ireland internationally.
- Similarly, the **EUR 10 million day one requirement can be overly-rigid** and have equally disproportionate consequences for taxpayers who make administrative errors (e.g., transferring a small amount of money to the company's bank account in advance of the transaction date to

confirm it is operational). We suggest that the EUR 10 million test is applied on the first balance sheet date, and that if there is an inadvertent failure to meet the condition, the consequences are not 'all or nothing' but instead the company can qualify for treatment under section 110 from the time it first meets the EUR 10 million condition.

Question 18

Are there any aspects of the provisions relating to Chapter 1 of Part 28 (section 749 to 751A TCA) which could be enhanced, simplified or removed? Please explain, noting both the benefits and any adverse consequences of same.

These sections relate to the rules known as 'bondwashing' and are designed to prevent certain financial dealers in securities and other persons from participating in transactions which create tax losses as a consequence of purchasing securities 'cum-div' and disposing of them 'ex-div'.

The rules have been in place for many years (since 1967). The rules apply where a dealer in securities acquires securities and takes steps to dispose of those securities within a one month period or pursuant to an arrangement made before or at the time the securities were acquired (section 748(3) TCA).

In many financial transactions, a dealer in securities may acquire a security with an intention to dispose of it at a later date after a specific corporate event (which may include the payment of a dividend). The dealer would not enter into any legally binding arrangement to sell the security acquired. The dealer may also enter into other financial transactions (perhaps involving a different security) to hedge its financial exposure to the original security is has acquired. The dealer may then sell the security after the corporate event has occurred.

It appears that the transactions entered into by the dealer should not be such that the original security was disposed of pursuant to arrangements entered into before or at the time they were acquired. However, the legislation or guidance should be updated to make it expressly clear that this is the case and that the bondwashing provisions do not apply to normal commercial transactions in securities of this nature.

Question 19

Are there any aspects of the provisions relating to Chapter 3 of Part 28 (stock-lending and stock repo transactions) which could be enhanced, simplified or removed? Please explain, noting both the benefits and any adverse consequences of same.

The current profile of the law in this area could be considered to be unsatisfactory and uncertain.

For a long time, the operation of the rules was supported by a statement of practice which was relied on by taxpayers. The statement of practice and was designed to ensure that:

- taxpayers dealing in securities were taxed on the economic outcome of their transactions in securities in line with international practice for dealers in securities.
- taxpayers which engaged in securities transactions otherwise than in the course of a trade were not subject to Irish capital gains taxation where the economic profile of the transaction was one of lending rather that a sale or disposal.

The statement of practice was put on a legislative footing in 2019. It has been widely acknowledged that there are a number of technical issues with the legislation which mean that its application in practice is not always clear and in some cases is problematic.

One of the key issues with the legislation is that it applies in principle to financial traders (which would otherwise calculate their profits in accordance with Case I TCA) and should not be in scope of the rules at all. The legislation should be updated to provide that financial transfers should simply tax securities transactions in accordance with Case I principles and section 76 TCA.

More generally, some of the key issues with the legislation relate to:

- the requirement that transactions be equivalent to the lending of money. This may be the case for bond repurchases, but not for (equity) securities lending;
- the definition of 'manufactured payments', which seems to require the payer to receive the underlying interest or dividend. This ignores the reality of securities markets whereby a stock borrower may itself on-lend stock it has borrowed (such that it may not receive the 'true' dividend or interest payment' but may itself receive a manufactured payment);
- potential restrictions on deductibility of 'manufactured payments' for true short positions as a result of the specific provisions of section 753B(2)(c), where the payment is an expense of the taxpayer and is not supported by income from a borrowed security (as the taxpayer necessarily does not continue to hold the security in a 'short' position'); and
- the general application of the legislation provided for in section 753B TCA. The references to 'the Taxes Acts' and section 826(1)TCA in that section appear to impose an inadvertent territorial limit on the legislation as a whole.

Updated guidance from Revenue provided that financial traders were not required to apply the legislation but could be taxed following their financial statements instead. However, this guidance has been absent for a long number of months. There is no indication as to when the guidance will be reinstated or updated. This has left taxpayers operating in the area in an extremely uncertain position and should be rectified as soon as possible.

Prime brokers play a very important role in securities markets and most financial dealers will hold securities in brokerage accounts. The legal relationship between a prime broker, its clients and securities held in custody is a complex area of law, particularly where securities are held in 'omnibus' accounts. The economic substance of transactions is the same for clients who hold securities in an omnibus or segregated account. Taxpayers should therefore not face uncertainty in tax treatment merely because of the specific manner in which they hold securities or the related legal nuances that result from those arrangements. Legislation and guidance in this area should be updated to make it clear that the tax treatment of securities transactions should not be impacted by the holding of securities though segregated or omnibus prime brokerage accounts and that taxpayers should be considered to be the beneficial owner of the securities and income in respect of them in each case. This reflects the economic substance of the transactions.

Overall, there is merit in a careful re-write of this area of law generally to achieve the desired and appropriate outcomes for taxpayers without the need for informal guidance.

Question 20

Are there any aspects of section 845 and 846 TCA which could be enhanced, or simplified? Please explain, noting both the benefits and any adverse consequences of same.

We have no substantive comments on sections 845 and 846 TCA.

Question 21

Are there any aspects of the taxation of the financing income or expense of lessors which should be enhanced, or simplified? Please explain, noting both the benefits and any adverse consequences of same.

We have no substantive comments on the provisions that apply to tax the financing income or expense of lessors.

Question 22

Are there any aspects of the taxation of the specified financial transactions which should be enhanced, or simplified? Please explain, noting both the benefits and any adverse consequences of same.

There are three ways that the rules applying to specified financial transactions could be enhanced:

- As drafted, the rules do not facilitate transactions that involve investment certificates (**sukuks) being issued to a specified person, regardless of their tax profile**. This is overly restrictive and more restrictive than the equivalent rules in section 110 TCA. We would welcome updates to the rules to facilitate such transactions in line with the approach taken in section 110 TCA.

- The definition of 'investment certificate' (sukuks) requires that the issuer treats them as a financial liability in accordance with generally accepted accounting practices. In practice, sukuks are established pursuant to trust arrangements whereby the holder will have a beneficial interest in the underlying asset held by the sukuk issuer. As a result, **the sukuk may not be treated as a financial liability under generally accepted accounting practices**. Instead, the issuer may not recognise any asset or liability. The Revenue Tax and Duty Manual on Part 8A sought to address this technical point by way of guidance. The legislation should now be updated to put the guidance on a statutory footing.

- The definition of 'finance undertaking' is also problematic. It includes a 'finance company' or a 'financial institution'. A finance company must carry on a business of wholly or mainly engaging in specified financial transactions. **It is not possible to apply this test to a foreign financial instituion (eg, a Middle-eastern Bank) in practice** as foreign jursidctions are not familiar with the concept and would not be able to conduct a full review of thie business to confirm if the 'wholly or mainly' threshold is satisifed. In addition, the definition of 'financial institution' is taken from 891B TCA, which only includes financial institutions regulated in Ireland. This means that it is not possible to apply much of the legislation relating to 'credit transactions' in practice to transactions between taxpayers in Ireland and financial institutions located outside Ireland (such as the Middle East) – being the very circumstance in which the legislation was intended to apply. We would recommend the legislation is updated to focus on the profile of the transaction (being one which is consistent with Islamic finacing) and that criteria relating to the profile of the participants (such as the 'wholly and mainly' requirement mentioned above) be removed.

Withholding tax

Question 23

Are there any aspects of the Irish interest withholding tax provisions which could be enhanced, simplified or removed? Please explain, noting both the benefits and any adverse consequences of same.

- Broadly, we consider that Ireland's regime for withholding tax on interest payments is well-understood and not in need of significant change.

- We also consider that the withholding tax rules combined with the outbound payment rules would continue to provide a **useful backstop to safeguard the Irish tax base** if the rules on deductibility of interest were replaced with a rule that would permit deductions in cases where a commercial purpose test was satisfied.

- One aspect of the rules that causes difficulties in practice is their application to **interest payments made to partnerships that are transparent for tax purposes**. The universal reading of the rules is that the domestic reliefs in section 246 TCA apply when the person *beneficially entitled* to the interest satisfies the relevant conditions. We understand that Revenue's view is that a partnership may be a 'person' for the purposes of these rules (even though it is treated as transparent for all income tax purposes). In Revenue's current view, this can lead to technical difficulties because a partnership generally cannot *itself* satisfy the conditions in section 246(3)(h). Revenue's current practice is to 'concessionally' allow a look-through approach where all of the partners in the partnership can claim relief under section 246(3)(h). However, Revenue's current practice is to refuse relief at source where only a proportion of the partners can satisfy the requirements of section 246(3)(h). This is causing real difficulties in practice, especially given the growth in private lenders in recent years. These private lenders are very often established as fund vehicles constituted as partnerships. The current inability to apply relief on a proportional basis by reference to the partners who are entitled to the relief, means that it is dissuading many international private lenders from lending to Irish businesses, or raising the costs of such lending (by imposing the costs on the Irish borrower of having to lend from a foreign company (rather than partnership) that can avail of relief under section 246(3)(h)).

- We submit there is a **simple solution** to this. As a partnership that is transparent for tax purposes can never be *beneficially entitled* to income, there is scope under section 246 to instead look immediately to the partners, and apply the section 246 tests directly (and in the first instance) to each partner. If a partner in a partnership that is transparent for tax purposes receives interest through the partnership, they should be capable of satisfying the conditions in section 246 TCA to receive the interest income free from withholding tax. This would allow the Irish borrower to deduct withholding tax only from the portion of the interest attributable to any partners that are not tax resident in an EU or treaty jurisdiction.

- For example, based on our understanding of Revenue's guidance, an interest payment to a limited partnership established in the Cayman Islands would be subject to withholding tax even where all of the limited partners are US companies that, had they received the interest directly, would have been entitled to be paid gross, if the general partner was a Cayman Islands company and that general partner has some nominal economic entitlement to the interest. The US limited partners would need to separately apply for a refund of the tax withheld under the Ireland / US

double tax treaty. **Revenue practice in this respect generates unnecessary administration for taxpayers and tax administrations**.

- **Determining the withholding tax position of a partnership that is transparent for tax purposes by looking through to the partners is a reasonable interpretation of the legislation**. In addition, it would be administratively more efficient and should result in the same net position for the Exchequer. We strongly recommend updating Revenue practice to mitigate this unnecessary administrative burden.

Question 24

Are there any aspects of the DIRT provisions which could be enhanced, or simplified? Please explain, noting both the benefits and any adverse consequences of same.

We think the DIRT rules are well-understood and operate as intended. We have no suggested changes to the current rules.

Question 25

Are there any aspects of the encashment tax provisions which could be enhanced, or simplified? Please explain, noting both the benefits and any adverse consequences of same.

As a broad comment, we wonder whether the compliance burden associated with encashment tax is warranted by the current level of collections. It is an antiquated tax which we note has been abolished by the UK. We recommend abolishing or substantially limiting encashment tax. If it is retained, it could be limited to Irish brokers who hold assets on behalf of Irish clients.

Question 26

Observations are requested on the reporting obligations in relation to the payment of interest. Are there any aspects of these reporting obligations which could be enhanced, or simplified? Please explain, noting both the benefits and any adverse consequences of same.

We have no substantive comments on the reporting obligations in relation to the payment of interest.

We would welcome the opportunity to engage further as the review of the taxation of interest progresses.

Yours faithfully

Sent by email, bears no signature

MATHESON LLP