KPMG

Consultation on the Tax Treatment of Interest in Ireland

January 2025

Contents

Executive Summary

Ireland's tax regime for businesses must be best-in-class if it is to compete for inward investment in the global tax environment. Our tax regime must also work for indigenous Irish businesses seeking to raise finance to support growth and scale up operations. Debt is a critical driver of growth. If relief for interest is not available, investment will move elsewhere.

As will be noted throughout our response, removing redundancy and cutting complexity in our interest deduction regime must be the objective in the design and administration of our tax system.

All businesses, but particularly large multinational businesses, have been subject to unprecedented levels of change in the area of tax in recent years. This change has almost exclusively had the effect of adding complexity, constraining business practices, increasing administrative burden and increasing the cost of doing business. Cumulatively, this trend has the potential to stifle growth and reduce the competitiveness of our economy. We believe that it is essential that Ireland streamlines the Irish tax code by eliminating provisions that are no longer necessary in light of those changes.

It is crucial that all future changes to the tax regime are framed by a growth mindset and designed in collaboration with businesses and practitioners. Positive changes to Ireland's regime must be married with certainty for businesses so that we compete effectively for foreign investment and support indigenous businesses. Recognising that the relative stability of Ireland's tax regime over many decades has been a major benefit for Ireland's economy and the businesses operating here, fundamental reform of the taxation of interest should be undertaken with the greatest caution and transparency. Consequently, throughout our response we recommend that a process of substantial simplification of the tax treatment of interest is first undertaken. Any changes to the tax system arising from this process should then be allowed to become well embedded and their effects understood before a more broadscale reform of the regime is contemplated.

We have made several recommendations on how best to fundamentally simplify the tax treatment of interest. Our key recommendations are as follows:

Taxation of interest income

- Apply the 12.5% rate of corporation tax to passive interest income
- Simplify the treatment of interest income ancillary to a trade
- Expressly provide for the deduction of expenses (including interest) incurred in the earning of passive income against that income
- Provide Revenue guidance, based on caselaw, on the principles used to establish the source of interest for tax purposes
- Remove or better focus the anti-avoidance provisions contained in Sections 812, 813 and 817B
- Reduce the 2-year holding exception in Section 815 to 12 months

Deductibility of interest expense

- Retain the wholly and exclusively principle for deduction of interest expense
- Enhance Ireland's qualifying financing regime
- Reform the provisions applying to the deductibility of interest expenses in determining rental profits
- Retain but substantially simplify and streamline the relief afforded for interest as a charge on income under Section 247. Also, the recovery of capital rules in Section 249 require radical simplification
- Remove duplication and simplify the CGT relief given to companies for interest and allow a deduction for interest expense incurred on the acquisition of land

ATAD interest limitation rule

- Remove the cliff-edge effect when applying the de minimis exception
- Clarify the application of the rules for partnerships
- Ensure fair treatment of capitalised interest
- Broaden the definition of "large-scale asset" to better align it with Ireland's strategic development goals

Targeted anti-avoidance

- Remove Sections 254 and 817C and Section 126 SDCA 1999 which have been superseded by the interest limitation rules
- Remove Section 840A or at least focus its application so that it does not preclude genuine commercial reorganisations
- Condense the provisions which over-ride Section 130 into a single section
- Broaden the exceptions provided for in Sections 452 and 845C
- Remove the 80% cap on interest expense under Section 291A
- Remove Section 437 which has become outdated
- Retain the domestic transfer pricing exemption
- Provide clarity on the application of the anti-hybrid rules to partnerships

Financial services transactions

- Broaden the exceptions provided for in the taxation of stock lending and repo transactions and the taxation of securities
- Enhance Section 110

Interest withholding tax

- Simplify the withholding tax exemptions in Section 246
- Provide parity of treatment between foreign and Irish paying agents in Section 64
- Clarify the application of Section 845C to non-banks
- Abolish encashment taxes

Reporting obligations

- Substantially reduce the unnecessary administration and compliance burden on taxpayers
- Eliminate the requirement for reporting under Sections 36, 64, 76E, 891, 891A and 891B
- Ireland should actively engage with the European Commission in its review of DACs

2. Outline of current legislative provisions

2.1 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?

Yes, we believe that there should be closer alignment of the rules regarding the taxation of trading and passive interest income. Achieving this objective would simplify the tax system, enhance competitiveness, and potentially boost economic growth. The changes which we recommend are as follows:

- ***Apply the 12.5% rate of corporation tax to passive interest income***

  Currently, Ireland applies different rates of corporation tax rates to trading income (12.5%) and passive income (25%). We believe that the rates should be aligned so that passive interest income would also be taxed at the 12.5% rate of corporation tax. This would offer a number of significant benefits:

  - ***Simplification of the tax system***: Alignment of the rates would simplify the tax system, making it easier for businesses to navigate and reduce the administrative burden.
  - ***Competitiveness*****:** Most of our international peers do not differentiate between passive and trading income for corporate tax purposes. Aligning the tax rates would bring Ireland's tax system into line with our international competitors.
  - ***Economic growth***: Extending the 12.5% rate to passive income would make Ireland even more attractive as a place to invest, potentially boosting economic growth.
  - While it might be suggested that reducing the corporation tax rate on passive interest income to align with the trading rate could give rise to a loss of tax revenue for the exchequer, any such cost should be far out weighted by the benefits set out above. Also, the proposed change could actually increase exchequer receipts as Ireland becomes a more attractive location for international groups. Attracting treasury operations to Ireland may lead to other follow-on investments.

- ***Simplify the treatment of interest income ancillary to a trade***

  Should it not prove possible to apply the 12.5% rate of corporation tax to all passive interest income, then we would suggest that the 12.5% rate should at least be applied to ancillary interest earned by trading companies.

Most trading businesses need to set aside cash to fund ongoing investments in their businesses, meet their obligations during periods of uncertainty and meet unexpected trade related expenses. Businesses should not be penalised for prudent financial management, by taxing interest earned on liquidity set aside for that purpose. Taxation of such interest at the higher rate discourages trading businesses from maintaining healthy cash buffers, which are essential for financial stability and protection of jobs, particularly in times of economic uncertainty.

- ***Deductibility of expenses incurred in earning passive interest income***

  Generally, a deduction is not available for expenses incurred in connection with the earning of passive interest income. From an economic perspective, whether interest income is classified as trading income or passive income, it would be common for expenses to be incurred (such as interest on loans, management fees, and other operational costs) in the course of earning interest income. The denial of a deduction for expenses incurred in earning passive interest income ignores this economic reality and places an inequitable tax burden on those earning passive interest income. Also, it conflicts with the principle of horizontal equity. Taxpayers with similar income levels should be taxed similarly.

  Allowing a deduction for expenses incurred in earning passive interest income would reflect the economic reality and align with the principle that taxes should be levied on net income (income after expenses), not gross income.

- ***Exchange movements – treasury activities***

  Where currency exchange movements arise on cash balances held by a company for a treasury activity, otherwise than in the course of a trade, the company's functional currency should be followed in recognising the amount of any exchange movement arising and Case I principles applied.

Key recommendations

- Apply the 12.5% rate of corporation tax to passive interest income
- Simplify the treatment of ancillary interest income
- Broaden the tax deductibility of expenses incurred in earning passive interest income

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.

Section 18 provides that non-resident persons are subject to income tax on Irish source interest under Schedule D, Case III. The principles to be applied when determining the source of interest for tax purposes are derived from a series of decided cases (including Westminster Bank Executor and Trustee Company (Channel Islands) Ltd v National Bank of Greece SA [1970] (46

TC 472) and Ardmore Construction Ltd v Revenue and Customs Commissioners [2018] EWCA 1438).

The application of these principles can give rise to significant uncertainty for taxpayers across a range of common scenarios. It would be helpful if Revenue could engage in discussions with practitioners and stakeholders via TALC on how the principles should be applied to a range of common scenarios.

Key recommendations

- Provide Revenue guidance, based on case law, on the principles used to establish the source of interest for tax purposes

Question 3

Are there any simplification measures which could be taken in respect of the above mentioned anti-avoidance provisions? Please explain, noting both the benefits and any adverse consequences of same.

From a policy perspective, targeted anti-avoidance measures should act to guide taxpayer behaviour away from specific avoidance behaviours, while not impacting other commercial activities and arrangements. As a result, the drafting of targeted anti-avoidance provisions needs to navigate the difficult path of ensuring that they are effective against specific behaviours but not disruptive of other business practices.

Despite being drafted to counter specific tax avoidance arrangements, various provisions in Chapter 2 of Part 33 TCA 1997 were loosely drafted such that their scope extends far beyond that intended. Viewed through a modern lens, it is clear that these provisions were introduced in the context of a commercial landscape and an Irish tax regime which is far removed from that in place now. It is highly unlikely that the same approach would be used if these provisions were to be redrafted today. Accordingly, we believe that these provisions need to be withdrawn or focused.

Section 812

This provision was brought in prior to the introduction of capital gains tax in 1975. As a result, this anti-avoidance provision was intended to counteract practices which could see profits fall outside the scope of Irish tax, whereas today the sale or transfer of the right to receive income would be treated as a part disposal and subject capital gains tax at an effective rate of 33%, if not otherwise subject to tax as income.

The need for this provision in the context of Ireland’s present regime is therefore greatly reduced. This is particularly the case for corporate entities, where the rate of tax payable on Case III and Case IV interest income is lower than the effective rate applicable to chargeable gains. Accordingly, consideration should be given to the removal or significant simplification of this section, in particular as it applies to Irish companies.

In addition, the application of Section 812 can give rise to double taxation. This runs contrary to the principle of fairness in taxation, which aims to tax income/gains only once. For example, differences in tax laws and interpretations between jurisdictions can lead to double taxation where income deemed to arise under Section 812 is taxed on receipt in another country. Section

812 should not apply where the person that acquires the right to receive the income is subject to tax in Ireland or elsewhere upon receipt of the income.

The provisions of Section 812 are disapplied where the profits of the taxpayer concerned are taxed under Schedule D, Case I or II. We recommend that the exception be modified to clarify that it will also apply where the taxpayer's profits are taxed under Case I or II principles.

Section 813

Revenue's notes for guidance on Section 813 highlight that this provision was needed following the imposition of restrictions on the amount of interest which could be deducted for tax purposes by an individual. It counteracted a practice involving the transfer of securities by a borrower to their lender (or connected party(ies)) in consideration of the credit received by the borrower. In this way, the lender was remunerated for the credit provided, while the borrower was not subject to tax on the income arising on the securities over the period of the loan.

A number of issues arise with respect to the current drafting of this section, particularly as it applies to companies:

- Although intended to counteract aggressive tax planning by individuals following the restriction of interest deductions available under Chapter 3 of Part 8 TCA 1997, it applies more broadly to all "persons". As a result, it applies to corporate entities despite such taxpayers not being the intended target of the provision.

- In addition, the rules are likely redundant in the corporate context, given the operation of the interest limitation rules. Specifically, the benefit of transferring a taxable income stream to the lender may be (wholly or in part) offset by the impact this would have on the company's EBITDA and/or net interest equivalent under the rules.

- Though not intended, specific provisions in the section could arguably apply to bona fide debt restructuring or waiver transactions. Such transactions are essential if Irish businesses are to be provided the opportunity to recover from periods of illiquidity or insolvency. Section 813 should be amended to include a provision which would expressly disapply its application where a loan is waived or written for bona fide commercial reasons.

As a result, consideration should be given to refining the scope of this section, such that it does not apply to Irish corporates.

Section 815

This section applies where securities are sold before the payment of interest such that the interest accrues to the holder as a capital gain rather than as income. Where this is the case, the seller of securities is liable to tax on the interest deemed to have accrued up to the date of sale. This rule does not apply if the security has been owned continuously by the same owner for at least 2 years or if the seller is a securities dealer whose trade profits are taxed under Schedule D Case I.

We recommend that the section be simplified by revising the 2-year rule to reduce complexity and improve certainty for businesses. Consideration should be given to reducing the 2-year rule to 12 months.

In addition, there is an exclusion for the person making the disposal where they are a securities trader that is subject to tax on profits under Schedule D Case I. In our view this treatment should be extended to any person that is taxed under Case I principles with respect to its disposal of the securities.

Section 817B

This section provides that interest received early by a lender is to be taxed when it is received rather than when it accrues. The effect of this is to ensure that the interest will be taxed in the hands of the lender at the same time as tax relief in respect of it is given to the borrower.

The scope of the section is very broad, applying to loans between unconnected parties as well as connected parties. As a result, the provision can apply to loans advanced under market terms by banks and other lenders in the ordinary course of their business. This places an inordinate obligation on such lenders to track instances where early payment of interest may arise and adjust their taxable income accordingly.

Given the provision merely impacts the timing of when income under such arrangements should be taxable by the lender and not the overall tax payable on such profits, we believe the measure should be limited to transactions between connected parties. This would align the section with related provisions in Section 817C, which adjust when certain interest payments between connected parties are deductible.

Key recommendations

- Remove or focus Sections 812 and 813 so as not to apply to corporates
- Amend the 2-year rule to a 12-month test under Section 815 and extend the exception for securities dealers to apply to all disposals taxable under Case I principles
- Remove Section 817B or focus its application to connected party loan arrangements

2.2. Interest Deductibility

2.2.1 Interest as a trading expense

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.

The general principles underlying the general tax deductibility of trading expenses, including interest, are very well understood and work well. In particular, the operation of Section 76A (in the case of a company) and Section 81 are well understood. The relevant provisions of Section 81 in particular, have stood the test of time for over a century and benefit from an extensive body of decided case law. Accordingly, we would counsel against making any significant changes to the core rules regarding the deductibility of interest as a trading expense.

However, in practice, businesses engaging in financial activities do encounter uncertainty as to whether those activities amount to the conduct of a trade taxable under Schedule D Case I. This in turn can give rise to uncertainty as to whether a deduction is available for the interest incurred on the funding of those activities as a trading expense. To alleviate this uncertainty, which has the potential to stifle productive economic activity in Ireland, we recommend that:

- express provision should be made for the deduction of expenses (including interest) incurred in the earning of passive income against that income, as set out in our response to Question 1; and

- the provisions of Section 76E, which deals with qualifying finance companies, should be enhanced, as set out in our response to Question 9.

It should be clarified that the tax deductibility of debt issuance costs will follow the treatment of the interest on that debt where the interest is deductible in computing the profits of a trade. This would involve the simplification and codification of the position set out in Revenue Tax and Duty Manual (TDM) 04-06-21.

Key recommendations

- Retain the wholly and exclusively principle for deduction of interest expense
- Enhance Ireland's qualifying financing regime
- Expressly provide for the deduction of expenses (including interest) incurred in the earning of passive income against that income

2.2.2 Interest as a deduction against rental income

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.

Landlords play a crucial role in the Irish economy. Residential landlords provide access to essential housing for many of the population. On the other hand, commercial landlords contribute to economic stability by providing businesses with access to the infrastructure necessary for economic growth and job creation.

Over recent years, many landlords have exited the Irish rental market leading to a reduction in the available supply of real estate. This has in part resulted from the significant tax burden placed on landlords. While we advocate a broad reform of the tax treatment of landlords, we acknowledge that consideration of a broad reform falls outside the scope of this consultation. Nonetheless, we believe that reform of the tax treatment of landlord funding costs would make a positive difference.

In accordance with Section 97(2)(e), a deduction is available against rental income for interest on borrowed money employed in the purchase, repair or improvement of a rental property. Section 97(3) goes on to provide that the amount of the deduction available is to be limited to the amount that would be available if Case I (trading) principles applied.

In our view, the scope of the deduction permitted by Section 97(2)(e) is too narrow and does not reflect the economic realities of letting real estate. We believe that the rules need to be simplified and modernised. We have the following recommendations:

- ***Legislate for deductibility of interest on borrowings to fund rental expenses***

  Currently, Section 97(2)(e) only permits a deduction to be taken for interest on borrowed money employed in the purchase, repair or improvement of a rental property. A deduction should also be allowed for interest (and interest equivalents, discussed further below) incurred on financing used to meet overhead expenses incurred in the course of the business of letting real estate.

- ***Legislate for the deductibility of interest on replacement loans***

  Where a loan employed in the purchase, improvement or repair of a rental premises is replaced by another loan, interest incurred on the replacement loan does not fall squarely within the provisions of Section 97(2)(e). While it is the practice of the Revenue to treat such interest on a replacement loan as deductible, we believe that this treatment should be placed on a legislative footing to provide certainty for taxpayers.

- ***Clarify the treatment of interest equivalents***

  The treatment of interest and interest equivalent (as that term is defined in Section 835AY subsections (a), (b)(i), (d), and (e)) are aligned for the purposes of the interest limitation rules. Accordingly, it would be logical to treat interest equivalent as deductible in computing taxable rental income for Irish tax purposes in the same manner as interest, to ensure consistency and fairness in tax treatment.

  While it is the practice of the Revenue to treat certain interest equivalents as deductible, we believe that this treatment should be placed on a legislative footing, to provide certainty for taxpayers.

- ***Simplify the treatment of pre-letting expenses***

  Section 105 TCA 1997 restricts the deductibility of expenses, including interest (otherwise deductible under Section 97(2)(e)) where the interest is incurred prior to the first occupation of the premises by the lessee for the purposes of a trade or undertaking or for use as a residence. There is some relaxation of this rule in the case of certain vacant premises provided for in Section 97A.

We believe that a broader relaxation than that provided for in Section 97A is required. We recommend that pre-letting interest should be allowed as a deduction against rental income, in a similar manner to pre-trading interest under Section 82. As a result of the restriction in Section 105, interest on money borrowed to carry out improvements or refurbishment to a premises after purchase but prior to its first occupation is not deductible. Similarly, a commercial delay between the draw down of a loan to purchase a premises for lease and the grant of a lease, would result in a disallowance of a deduction for interest for that period.

Key recommendations

- Legislate for the deductibility of interest on borrowings to fund rental expenses
- Legislate for the deductibility of interest on replacement loans
- Clarify the treatment of interest equivalents
- Simplify the treatment of pre-letting expenses

2.2.3 Interest as a charge

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.

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.

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.

The relief available for interest as a charge on income under Section 247 is a very important relief for businesses. It fosters economic growth and stability supporting investment in trading and rental activities. As businesses invest and grow, their economic and social contribution increase. Investments in such businesses drive economic growth and innovation and lead to the creation of new jobs and a stronger economy.

Over the last 20 years, the provisions of Section 247, and the related recovery of capital provisions in Section 249, have been the subject of a number of very complex amendments. As a result, the provisions are unwieldy and unnecessarily complex to administer. Given that many of those amendments were concerned with issues that are now more than adequately addressed by the introduction of the interest limitation rules, the outbound payment rules and plethora of other similar changes, the requirements of Sections 247 and 249 should be fundamentally simplified.

- ***Section 247 (3) - The common directorship requirement***

  We recommend the removal of the common directorship requirement in Section 247(3). It places an unnecessary compliance burden on businesses, which serves no obvious purpose.

  The common directorship requirement was introduced in Finance Act 1974, at a time when corporate structures and business models were much simpler. Modern businesses now operate in an era of globalisation involving complex and dynamic corporate structures. When appointing directors, companies should be focused on the commercial needs of the business rather than an outdated common director tax requirement.

- ***Section 247 (2) - Defray monies apply***

  Section 247 (2) requires the borrowed monies to be defrayed for relief to be available. In many cases, this can give rise to a requirement for cash to be transferred between the bank accounts of several entities involved in a transaction. In many cases it would be much more straight forward commercially, to give effect to the payments by means of a net settlement arrangement whereby the first entity in the chain would make a payment to the last entity in the chain to give effect to the net settlement arrangement. We believe that provision should be made to allow this approach to be adopted.

- ***Section 247 (2) – capital contributions***

  Broadly speaking, Section 247 provides for monies borrowed to acquire ordinary shares in or lend to a qualifying company. Given that the provision of a capital contribution may in some cases be commercially preferable, the relief should be extended to allow money borrowed to be defrayed in making a capital contribution to another company where the other requirements for relief are satisfied.

- ***Section 249(2)(aa) – reinvestment***

  This provision provides that where the “company concerned” applies what would otherwise amount to a deemed recovery of capital for a qualifying purpose, a recovery of capital will not be deemed to have arisen for the purposes of Section 249. While the rationale and need for this provision is self-evident, it is unclear why the same treatment would not apply to an equivalent application of the recovered capital by the borrower or an intermediate company. We believe that the rules should be amended to allow for that, to provide groups with greater flexibility.

- ***Section 249(2)(ab) – reorganisations***

  This section provides where the company concerned is involved in a reorganisation, a deemed recovery of capital will not arise, provided certain conditions are met. The commercial need for this provision is clear. However, it is unclear why the same treatment would not apply where the investor company is involved in a reorganisation where the investor company meets equivalent criteria. We believe that the rules should be amended to allow for that, to provide groups with greater flexibility.

- ***Section 249(2)(ac) – intermediate holding companies***

  The deemed capital recovery provisions in Section 249(2)(ac) which apply where there are intermediate holding companies are poorly drafted and very difficult to apply in practice. In our view, they are unnecessary given the protection afforded by the other capital recovery provisions contained in Section 249. We believe that removal of this provision would align with the stated aims of the consultation.

Key recommendations

- Remove the common directorship requirement
- Allow for direct transfer of funds by the bank to the company concerned or in case of refinancing, between lenders
- Allow capital contributions to qualify
- A deemed recovery of capital should not apply where the borrower or intermediate company meets the eligible criteria in s249(2)(ab)
- Recovery of capital rules will not apply where the investor company reinvests the funds for an eligible purpose
- Remove the recovery of capital provisions relating to intermediary holding structures contained in section 249

2.2.4 Interest paid by certain qualifying financing companies

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 Qualifying Financing Company ("QFC") regime provided for by Section 76E has the potential to play a more effective role in establishing Ireland as a treasury and cash pooling centre. Having a practical and fit for purpose QFC regime would enhance Ireland's attractiveness as a headquarter location for international businesses. However, the current configuration of the QFC regime is overly complex and difficult for businesses to use.

We recommend that the following changes be made to Section 76E:

- ***Clarify that QFCs will be deemed to be carrying on a trade***

  There is no bright line test for determining when a company will be considered to carry on a trade. To provide greater certainty, consideration should be given to deeming the lending activity undertaken by a QFC to be carried on in the course of a trade which is taxable under Schedule D Case I. This measure would reduce uncertainty and increase Ireland's attractiveness as a location to establish treasury and cash pooling operations.

  Should this not be possible, then the law should at least provide that a QFC will be taxable on an accrual basis in its functional currency.

- ***Remove the 'external loan' restriction***

  Under Section 76E, no relief for interest is available for interest on loans borrowed by the QFC on loans other than "external loans". Given the protections afforded by transfer pricing, outbound payment, ILR, and anti-hybrid rules, we can see no policy rationale for this restriction. Also, it precludes a QFC which is a member of a banking group or other institution from borrowing from an associated enterprise that also lends to third parties in the ordinary course of its business. This restriction results in an unnecessary layer of complexity which should be removed.

- ***Qualifying subsidiary***

As currently drafted, Section 76E provides that a QFC may only lend to '*qualifying subsidiaries'* or '*indirect qualifying subsidiarie*s'. This is unnecessarily restrictive and does not take account of the commercial reality of how most groups are configured. A QFC should be permitted to on-lend to any other member of its group, including sister companies.

- ***Deductibility of expenses***

  While Section 76E(s) addressed the deductibility of interest, it should also confirm the deductibility of other expenses typically incurred by a QFC including debt issuance, hedging costs, loan servicing costs, f/x movements etc.

- ***Disregard dormant and other subsidiaries***

  Under the QFC definition provided for in Section 76E(1), a group financing company cannot be a QFC if it owns shares in companies other than qualifying subsidiaries, including a dormant subsidiary. This restriction serves no purpose and creates an unnecessary barrier to financing companies accessing the QFC regime. Shareholdings in dormant companies and other non-qualifying subsidiaries arise as part of the normal business lifecycle. We recommend that the prohibition on the holding of shares in companies other than qualifying subsidiaries be removed to ensure that financing companies are not unnecessarily prevented from accessing the QFC regime.

Key recommendations

- Clarify that QFCs will be deemed to be carrying on a trade. The law should also be amended to provide that a QFC will be taxable on an accrual basis in its functional currency
- Permit a QFC to lend to any member of its group, not just its direct or indirect subsidiaries
- Remove the 'external loan' restriction
- Confirm the deductibility of lending related expenses
- Ownership of shares in companies that are not qualifying subsidiaries should not be precluded

2.2.5 Interest as a deduction against capital gains

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.

Relief for interest is only available for CGT purposes in the limited circumstances set out in Sections 552(3) and 553. We recommend that the following simplifications and enhancements be made to those rules:

- Consideration should be given to merging Sections 552(3) and 553 with a view to eliminating any unnecessary duplication.

- The relief available under Sections 552(3) and 553 should not be confined to companies.

- The requirement for the interest to have been "charged to capital" in Sections 552(3) and 553 is unnecessary and should be removed. The requirements that the interest is on borrowings out of which the relevant capital expenditure was defrayed, and that no deduction is otherwise taken or available for the interest (see the proviso to Section 553(3) and Section 554(1)) should offer sufficient protections in this regard.
- Relief should be extended to allow for interest on funds used to finance the acquisition of land on which buildings are constructed that fall within scope of Section 553 or Section 552(3).

Key recommendations

- Consider eliminating any unnecessary duplication
- Extend the relief under Sections 552(3) and 553 beyond companies
- Remove the requirement for the interest to be charged to capital
- Relief should be extended to allow interest on funds used to finance the acquisition of land on which buildings are constructed

Question 11

(a) Are there any ways that the interaction of the above five areas of relief for interest 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?

(b) Commercial scenarios where tax relief for interest expense is not currently available for businesses under existing legislation, where tax relief should be available:

- ***Address anomalous outcome under the ILR rules for property developers***

  Property developers are required to capitalise interest incurred throughout the course of a building project on their balance sheet. Once the building project is completed, the capitalised interest is unwound to the property developer's income statement as an interest expense in that accounting period. Building projects, which typically take place on a phased basis, can last for extended periods of time. As a result, the interest expensed to the profit or loss can represent interest incurred in multiple periods. The interaction of this with the interest limitation rule (ILR) means the ILR will apply to the entirety of the capitalised interest when it is unwound.

  As noted in our response to Question 12, the rules should be amended to provide that the interest is not restricted by the ILR in the year in which it is unwound to the extent that the interest would not have been restricted in the year in which it was incurred.

Key recommendations

- Interest should not be restricted by the ILR in the year in which it is unwound to the extent that the interest would not have been restricted in the year in which it was incurred

2.3 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.

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.

For the most part, the policy choices available under the ATAD that were made when ILR was introduced into Irish law were appropriate. Also, we believe that the approach followed on the adoption of the ILR provisions into Irish law adequately protects the position of the Exchequer. Nonetheless, we believe that there are opportunities to simplify the operation of the ILR rules without undermining that position. These are set out below:

- ***Operation of the de minimis exemption***

  Currently, the de minimis allowance for €3 million of net interest equivalent rule operates with a cliff edge. This gives rise to anomalous outcomes and unnecessary complexity. This approach is not aligned with the approach followed by many other EU countries who adopted the EU Anti-Tax Avoidance Directive and should be reformed.

  Under the Irish adoption of the ILR, a taxpayer that incurs €3 million of deductible interest expense is eligible for a full interest deduction under the de minimis rule whereas a taxpayer that incurs €3,000,001 of interest, cannot benefit from the de minimis rule. In contrast, other EU Member States, including: Spain, France, Germany, Netherlands, Austria, Greece and Luxembourg, would allow the net interest equivalent up to the de minimis threshold in those circumstances. This is permitted by Article 4(3) of the Directive which provides that, by derogation, taxpayers may be entitled "*to deduct exceeding borrowing costs up to EUR 3 000 000*". Where the 30% of EBITDA ratio provides for a deduction greater than the de minimis amount, then 30% of EBITDA threshold should apply.

- ***Associated enterprises - partnerships***

  The rules for the determination of whether two companies are "associated enterprises" for ILR purposes, in circumstances where there is an intermediate partnership, can give to anomalous outcomes and unnecessary complexity. As set out below, the current approach is not aligned with the intent of the EU Anti-Tax Avoidance Directive and should be reformed and simplified.

For ILR purposes, two enterprises are treated as "associated enterprises" where there is a 25% relationship between the enterprises in terms of share capital / voting rights / profits. While it can be a complex exercise in the ordinary way to determine whether various enterprises are associated enterprises, the assessment can become particularly challenging where a partnership holds an interest in a company.

The challenge stems from the fact that an Irish partnership does not have separate legal personality and cannot itself own assets. Any partnership property is instead treated as held by the partners as tenants in common. As set out in the Revenue's ILR guidance, this means that every partner in the partnership should be treated as owning an undivided share in every partnership asset. As a result, where an Irish partnership holds at least 25% of the ownership rights in a company, each partner should be individually deemed to hold those ownership rights (in effect equivalent to each partner being treated as individually holding at least a 25% ownership interest in the underlying company). This gives rise to an anomalous outcome where a partner has an economic interest and voting rights of less than 25% in the partnership (or the company in which the partnership holds an interest).

In our view, this approach is not aligned with the intent of the EU Anti-Tax Avoidance Directive and is unnecessarily restrictive. It would be more appropriate to treat the partnership as a separate entity for the purposes of the associated enterprise test, with the result that partners would only be associated with a partnership (and any subsidiaries) in scenarios where the partners have more than a 25% economic interest in the relevant entity. We recommend that a legislative amendment be made to provide for this outcome.

- ***Capitalised interest – property developers***

  Property developers typically capitalise interest incurred on building projects on their balance sheet throughout the course of the project, with the capitalised interest subsequently unwound to the income statement when the project is completed. Under the interest limitation rules, where the unwind of the interest expense exceeds €3 million in that accounting period, a restriction may apply to the amount of deductible interest expense notwithstanding that not all of the interest was incurred in that accounting period.

  We believe that the rules should be amended to provide that the deduction of such interest will not be restricted by the ILR in the year of unwind to the extent that the restriction would not have applied in the accounting period during which the interest was capitalised.

- ***Long-term public infrastructure project exemption***

  The long-term public infrastructure project exemption under ILR was introduced to support the financing of essential infrastructure projects that are crucial for national development and public benefit. We believe that these rules will need to be broadened to support the delivery of Project Ireland 2040.

  Project Ireland 2040 set out the Irish government's long-term strategy aimed at making Ireland a better place for everyone by 2040. Amongst others, it included ambitious targets for housing, job creation, climate action and digital connectivity. Our ability as a nation to deliver the infrastructural ambitions of Project 2040 across housing, energy, transport, roads, health, and climate action, will require substantial investment by the private sector. The economic viability of such projects will be significantly impacted by restrictions placed on the deductibility of interest incurred on borrowings used to fund such projects.

Within the limitations set out in the ATAD, which defines a “long term public infrastructure project” as “*a project to provide, upgrade, operate and/or maintain a large-scale asset that is considered in the general public interest by a member State*”, we believe that the long-term public infrastructure project exemption under ILR should be broadened to support the development goals of Project 2040. In particular:

- Given the ambition to deliver 550,000 new homes by 2040, residential units developed with the intention of being leased (otherwise than under a long-lease) to unrelated tenants, should be brought within scope of the exemption. A developer who intends to sell the units should not be prevented from qualifying for the exclusions to the extent that the units are sold on terms that it will ultimately be leased out by the purchaser.

- Eligible infrastructure should also extend to development of commercial property, such as offices, retail units, logistics facilities and other assets which serve a public need and contribute widely to meeting social, economic and environmental needs.

- Given that digital connectivity is a core theme of Project Ireland 2040, telecommunication assets should be brought within scope of the exemption.

Key recommendations

- Net interest equivalent up to the de minimis threshold should be tax deductible per taxpayer / group
- Eliminate the scope for two interpretations of the associated persons test to properly align the Irish legislation with the intent of the Directive when applying to partnerships.
- Interest limitation rules should be amended to address the treatment of capitalised interest.
- Broaden the definition of qualifying project contained in Long Term Public Infrastructure Project

2.4 Anti-avoidance provisions and other restrictions

2.4.1 Targeted Anti-Avoidance Rules

Question 14

Are there any aspects of the targeted anti-avoidance measures outlined above which could be enhanced, simplified or removed? Please explain, noting both the benefits and any adverse consequences of same.

Ireland's interest deductibility rules are complex and cumbersome and difficult for businesses to navigate. Much of that complexity has resulted from the layering on of targeted anti-avoidance provisions without any process to revisit their continued need when subsequent measures are introduced.

Over the last couple of years, a raft of new measures have been introduced which make a number of the targeted anti-avoidance measures redundant. These include the introduction of transfer pricing, the interest limitation rules, the anti-hybrid rules and the outbound payment measures. Against that backdrop, it is essential that Ireland simplifies its interest expense provisions to remain internationally competitive.

- ***Section 254***

  Section 254 denies an interest deduction on a loan drawn down within five years if capital is withdrawn from a trade or business.

  Modern businesses require dynamic and flexible financial management to adapt to a rapidly changing business environment. The rigid provisions of Section 254 do not align with the need for businesses to remain nimble. They need to be afforded the flexibility to manage their capital structure and finances as they see fit.

  For those reasons we believe that Section 254 should be removed. The position of the Exchequer is adequately protected by the interest limitation rules and the other provisions mentioned above.

- ***Section 817A***

  We do not have any comments on Section 817A at this time.

- ***Section 817C***

  There is a significant level of overlap between Section 817C and ILR given that they both operate to limit the amount of interest that can be deducted. Given the comprehensive scope of the interest limitation rules, which effectively address the concerns targeted by Section 817C, we do not believe that there is a continuing need for Section 817C.

- ***Section 840A***

  Section 840A restricts the deductibility of interest on borrowings provided by a connected party in certain circumstances. In our experience, it impedes reorganisations which are required for genuine commercial reasons and gives rise to unnecessary complexity. The rules hinder the ability of businesses to restructure when needed to respond to the rapidly changing business environment.

With the introduction of the Interest Limitation Rules under the Anti-Tax Avoidance Directive (ATAD), which comprehensively address concerns related to excessive interest deductions, we believe that Section 840A has become redundant and should be removed. The ILR rules put in place a very effective framework for the regulation of interest deductions.

While we strongly advocate for the removal of Section 840A in its entirety, should that not be possible, the following issues will need to be addressed:

- Section 840A has the potential to restrict the deductibility of interest on intra-group loans where the borrower and lender become connected after the date the loan is made. This clearly makes no sense. Section 840A should be amended to make it clear that such interest would remain deductible where the parties become connected after the date the loan is made.
- Section 840A applies to certain intra-group loans made on or after 21 January 2011. It does not apply to loans made before that date. Revenue guidance confirms that where a pre-21 January 2011 loan is transferred by novation along with an asset in a bona fide reorganisation that it will remain outside the scope of Section 840A. We believe that Section 840A should be amended to make it clear that such loans will remain outside the scope of Section 840A if they are transferred by novation, assignment or on a merger. This change would remove an unhelpful barrier to reorganisations required for genuine commercial reasons.
- Section 840A(7) provides an exception to the application of the rule where the connected party lender has borrowed externally and on lends to the connected party investing company. The requirement for the lender to be “solely” engaged in on-lending to that borrower is unworkable and needs to be broadened.
- Revenue in eBrief 11/2011 provided some helpful clarifications in relation to the operation of Section 840A. The confirmations that were contained in that eBrief should be reflected in the law.

Key recommendations

- Remove Section 254
- No amendments are required to Section 817A
- Remove Section 817C
- Remove Section 840A or at least focus its application so that it does not preclude genuine commercial reorganisations

2.4.2 Interest treated as a distribution

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.

Our comments are as follows:

- ***Merge the provisions that over-ride Section 130***

The provisions which over-ride the characterisation of certain interest payments as distributions for the purposes of Section 130 are spread across an array of tax provisions including Section 130, Section 133, Section 452, Section 452A and Section 845A. These provisions should be condensed into one section.

- ***Section 130(2)(d)(ii)***

  Section 130(2)(d)(ii) treats as a distribution interest payable on:

  - securities that are convertible into shares; or
  - securities carrying any right to receive shares in or securities of the borrower.

  There is an exception for securities that are quoted on a recognised stock exchange or issued on similar terms as those quoted securities. Section 130(2)(d)(ii) is disapplied where the recipient is within the charge to Irish corporation tax[1]. In light of the anti-hybrid rules, which ensure that hybrid instruments / entities cannot give rise to double non taxation or deduction / non-inclusion outcomes, we believe that Section 130(2)(d)(ii) has become obsolete and should be removed.

- ***Section 130(2)(d)(iv)***

  Section 130(2)(d)(iv) was enacted to counteract double non-taxation outcomes. Subject to certain exceptions and elections, it operates to re-characterise interest paid to certain non-resident 75% group members as a non-tax-deductible distribution. Since it was introduced, a much more comprehensive set of rules have been enacted to prevent double non-taxation outcomes, including the outbound payment defensive measures and the anti-hybrid rules. Accordingly, we recommend that Section 130(2)(d)(iv) be deleted or that the exclusions provided for in Sections 452 and 452A be extend as follows:

  - Allow a Section 452 election to be made to disapply distribution treatment for the payment of non-trading interest to a recipient located in a relevant territory.

  - Allow a Section 452 election to be made to disapply distribution treatment for the payment of short interest to a recipient located in a non-treaty country.

- ***Section 126 SDCA 1999***

  Alongside the changes proposed above to Section 130 TCA 1997, we believe that Section 126 SDCA 1999 should be repealed. The policy objective underpinning that provision is now adequately addressed by the introduction of the interest limitation rules, transfer pricing, and the plethora of other similar changes.

- ***Clarify the application of Section 845C***

  Please see our response to Question 23 with respect to Section 845C in relation to Additional tier 1 instruments.

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[1] See section 133(2), TCA 1997

Key recommendations

- Section 130(2)(d)(ii) is deleted as it is now obsolete
- Delete Section 130(2)(d)(iv) or amend Section 452 to allow for an election to be made to:
  - disapply distribution treatment with respect to the payment of non-trading interest to treaty countries
  - disapply distribution treatment with respect to the payment of short interest to non-treaty countries
- Delete Section 126 SDCA 1999
- Clarify the application of Section 845C

2.4.3 Other interest restrictions

Question 16

Are there any aspects of the above provisions 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 recommend that the following enhancements be considered:

- ***Section 291A – Intangible Assets***

  With the introduction of the interest limitation rules into Irish tax law, the 80% cap placed on the deduction available for interest for the purposes of Section 291A should be removed to eliminate unnecessary duplication.

- ***Section 437 – Limits deductible interest payable to directors / participators***

  Section 437 which applies to limit the deductible interest payable to directors/participators by closely held companies is outdated and should be abolished. Given that such interest is taxable in the hands of the recipient, it gives rise to an asymmetrical outcome which is patently unfair. Close companies should not be discouraged from borrowing from directors/participators to fund their business and develop scale – often, they are the only source of finance available to such companies.

  With the introduction of the ILR rules, there is now a very effective framework in place for the regulation of interest deductions. Accordingly, Section 437 should be removed.

- ***Part 35A – Transfer Pricing***

  Section 835E excludes certain domestic non-trading arrangements from the scope of the Irish transfer pricing rules.

  In the context of interest, the domestic exemption is available where a recipient of interest is subject to tax or would be subject to tax in respect of the interest income, provided the interest income is not trading income. Ireland should retain the domestic exemption from transfer pricing for non-trading arrangements.

- ***Part 35C – Anti-hybrid rules***

  As set out in our response to Question 13. The rules for the determination of whether two companies are "associated enterprises" for ILR purposes, in circumstances where there is an intermediate partnership, can give rise to anomalous outcomes and unnecessary complexity. The same issue arises with respect to the application of the anti-hybrid rules. The amendments that we suggested be made to the ILR rules to address this issue are also required in the anti-hybrid rules.

Key recommendations

- Remove the 80% cap on interest expense under Section 291A
- Remove Section 437
- Retain domestic transfer pricing exemption
- Clarity is needed in applying the anti-hybrid rules to partnerships

2.5 Financial Services Transactions

2.5.1 Securitisation vehicles

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.

The Section 110 regime is a very important feature of the Irish tax regime. Section 110 SPVs play a vital role across a wide range of sectors, including for the securitisation of mortgages by banks and the leasing of aircraft. In addition, Section 110 SPVs are often used as a special purpose debt issuer for trading groups that wish to raise debt financing from international markets.

It is important that the Section 110 regime continues to support the development and growth of these groups in Ireland into the future. In this regard, it will be important that the flexibility and ease of use of Section 110 SPVs is retained.

We believe that the rules as presently drafted, while complex, are generally well understood by businesses and practitioners. The current rules also strike a reasonable balance between facilitating the necessary flexibility in the regime to support the commercial requirements of its users, while also preventing the misuse of the regime. However, there are opportunities to simplify and enhance regime to improve its effectiveness. We therefore recommend the following refinements to the Section 110 regime:

- ***Remove redundant anti-avoidance provisions***

  Finance Act 2011 introduced a form of anti-hybrid rule into Section 110. These rules have been rendered redundant by the introduction of the anti-hybrid and interest limitation rules. We recommend that this unnecessary duplication of the rules be removed.

- ***Clarify the application of Section 452 to Section 110 company***

  Section 452 permits companies paying interest in the ordinary course of a trade to disapply Section 130(2)(d)(iv) which would otherwise deny a tax deduction for interest paid to non-EU 75%+ associated entities.

  Section 110 companies compute their taxable profits using trading principles and it has been the longstanding practice that this permits such companies to make a Section 452 election. However, Revenue have recently questioned the appropriateness of this interpretation where the Section 110 company is not carrying on a trade. We do not think this more limited interpretation was intended and we believe the uncertainty should be resolved by making it clear in Section 452, that an election can also be made by a company required to compute its profits under the provisions applicable to Schedule D Case I.

- ***Other points***

  Given the importance of the Section 110 regime, we reiterate the following more general refinements previously made in our September 2023 response to the public consultation[2] on the Funds Sector 2030:

[2] KPMG response to the consultation submitted on 15 September 2023.

- Extend the franked investment income exemption to the dividend income of a Section 110 company. Given that there is no apparent policy rationale for such a differentiation, we recommend that a technical amendment be made to ensure that the franked investment income exemption also applies to Section 110 SPVs.
- Extend the 8-week election deadline for the submission of an election to be treated as a qualifying Section 110 company. This short timeframe is arbitrary and needlessly punitive in scenarios where human error results in notifications being submitted beyond this date. We recommend that the deadline for submission of the election be aligned with the filing deadline for the company's corporation tax return for the first period to which the election relates.

Key recommendations

- Remove redundant anti-avoidance provisions
- Clarify the application of Section 452 to a Section 110 company
- Extend the franked investment income exemption to the dividend income of a Section 110 company
- Extend the 8-week election deadline

2.5.2 Bond washing – Chapter 1 of Part 28 TCA 1997

Question 18

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

Some of the provisions contain exceptions for dealers in securities. We believe that those exceptions should apply to broader range of financial trades and businesses, where the transaction is entered into in the course of their financial trade or business and the profits are taxable under Schedule D Case I or II, or are required to be computed under the provisions applicable to Schedule D Case I or II.

Key recommendations

- Broaden the exceptions to apply to any trade or profession taxable under Case I or II

2.5.3 Stock lending and repo transactions – Chapter 3 of Part 28 TCA

Question 19

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

An amendment should be made to in Chapter 3 of Part 28 to make to clear that the provisions apply to stock lending and repo transaction rules do not apply where the transaction is entered into the course of a corporate trade. While this has been confirmed in the Revenue's published guidance[3], it should be put on a statutory footing.

Key recommendations

- Clarify in the law that stock lending and repo transactions entered in the course of a corporate trade are chargeable to corporation tax in accordance with accounting profits rather than in accordance with Chapter 3 of Part 28

2.5.4 Section 845 and 846 TCA 1997

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 comments on these provisions at this time.

2.5.5 Leasing companies

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.

- ***Financing income***

  Please refer to our response to Question 1.

  We believe that the 12.5% rate of corporation tax should be applied to passive interest income, including passive income earned by companies operating in the leasing sector. Should it not prove possible to apply the 12.5% rate of corporation tax to all passive interest income, then we would suggest that the 12.5% should at least be applied to ancillary interest earned by leasing companies. Given the nature of their trades, lessors need to set aside cash to manage working capital requirements, finance ongoing investments in assets and meet obligations during periods of uncertainty. Taxation of interest at the higher rate discourages businesses from maintaining the adequate liquid reserves required to maintain financial stability.

- ***Financing expenses***

  The conduct of a leasing business is by its nature very capital intensive business. Therefore, the availability and cost of finance is of critical importance to that sector. Therefore, we recommend that a broad deduction should be available for financing expenses incurred in the

[3] TDM 04-06-13

operation of a leasing trade. We have provided detailed feedback in response to Questions 4 and 9 and these comments apply equally to the leasing sector.

Key recommendations

- Apply the 12.5% rate of corporation tax to passive interest income
- Broaden the eligibility provisions allowing a tax deduction for interest expenses

2.5.6 Specified Financial Transactions – Part 8A TCA 1997

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.

We have no comments on these provisions at this time.

2.6 Withholding Tax

2.6.1 Interest 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.

Section 246 – Interest payments by companies and to non-residents

The exemptions in Section 246(3) provide effective relief from Irish interest withholding tax. Recognising the need for flexibility for business operating internationally, these exemptions could be simplified and made more efficient, particularly in light of the outbound payment defensive measures introduced by Finance (No.2) Act 2023.

- ***Scope of the exemptions***

  A number of the exemptions apply to persons who are resident in a relevant territory, where certain conditions are met. We believe that the definition of a "relevant territory" to be applied for the purposes of the withholding tax exemptions should be extended to include jurisdictions with which Ireland has effective information exchange agreements in place within the meaning of Section 826(1C), given the defensive protections afforded by the recently introduced outbound payment rules.

- ***Countries which do not have a domestic concept of tax residence***

  The exemptions provided under Section 246(3)(h)(I) and Section 246(3)(ccc) require the recipient of the interest to be resident for the purpose of tax in the relevant territory, under the laws of that country. We recommend that the scope of these exemptions be broadened, such that the exemptions would also apply where the recipient is treated as a resident of a relevant territory, under the terms of the relevant double tax treaty. Such an amendment would address scenarios where the relevant territory does not have a domestic concept of tax residence (e.g., the US).

- ***Tax imposed on interest receivable***

  The exemption in Section 246(3)(h) is subject to a condition that the recipient jurisdiction imposes a tax that generally applies to interest receivable. As the outbound payment defensive measures provide an equivalent safeguard against double non-taxation outcomes, we recommend that this condition be removed to avoid unnecessary duplication.

- ***Paid in the State***

  A requirement that interest be "paid in the State" is present in the following exemptions:

  - Section 246(3)(a) – interest paid to a bank in the ordinary course of a banking business
  - Section 246(3)(bb) – interest paid to a 75% group company where an election in writing is made pursuant to Section 246(5)
  - Section 246(3)(bbb) – interest paid to a certain investment undertakings
  - Section 246(3)(cc) – interest paid to a qualifying Section 110 company

  - Section 246(3)(fa) – interest paid to certain approved pension schemes

  We believe that this requirement adds unnecessary uncertainty and complexity. We recommend that a legislative amendment be made to remove the condition that such interest "be paid in the State".

- ***Payments to tax transparent entities***

  The withholding tax legislation does not specifically address how payments made to tax transparent entities (e.g. a partnership) should be dealt with.

  Revenue have confirmed in their published guidance that where all of the partners in a partnership qualify for one or more exemptions, Revenue are prepared to effectively look-through the partnership and allow the domestic withholding tax exemptions to be applied where certain additional conditions are met. This can give rise to a significant administrative burden for persons paying the interest. It would be much more straight forward if the law were amended to allow the person paying the interest to obtain and rely on a declaration from the transparent entity confirming that (i) it is treated as tax transparent for all of the partners in their countries of residence and (ii) the amounts of interest are due to partners who would be entitled to an exemption from Irish withholding tax were they to receive it directly.

Section 64 – Interest on quoted Eurobonds

Section 64 makes provision for an important withholding tax exemption which applies to interest paid under the terms of a quoted Eurobond, where certain conditions are met. It is one of the features that underpins Ireland's attractiveness as a hub for international finance and investment.

For the most part, the quoted Eurobond rules work well. However, the additional eligibility requirements that must be met where the paying agent is located in the State places Irish paying agents at a competitive disadvantage. We recommend that the additional requirements be removed for payments made through Irish paying agents to ensure parity of treatment.

Section 845C – Additional tier 1 instruments

Section 845C designates paid on additional tier 1 instruments to be interest and extends the application of Section 64 (which exempts interest paid on quoted Eurobonds from withholding tax, where certain conditions are met) to such instruments. Limb (b) of the definition of "Additional Tier 1 instrument" envisages that such an instrument may be issued by an entity that is not a financial institution within the meaning of the Capital Requirements Directive where various equivalent conditions are met. Further clarity is required regarding the circumstances in which instruments issued by non-financial institutions would be regarded as meeting those equivalence conditions. Further consultation and stakeholder engagement will be necessary to ensure the legislation operates as intended.

Key recommendations

- Section 246:
    - Broaden the list of jurisdictions to include ones with which Ireland has effective information exchange agreements in place within the meaning of Section 826(1C)
    - Broaden the concept of residence to include jurisdictions which do not have a concept of residence
    - Remove the requirement that the recipient jurisdiction imposes a tax that generally applies to interest receivable
    - Remove the requirement that interest must be paid in the State
    - Provide clarity regarding the application of these rules to tax transparent entities
- Section 64 - Retain the withholding tax exemption for interest paid on quoted Eurobond securities and remove the distinction between domestic and foreign paying agents
- Section 845C – Clarity is required as to the application of this provision to non-banking taxpayers

2.6.2 Deposit Interest Retention Tax – Chapter 4 of Part 8

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 do not propose any changes to these provisions at this time.

2.6.3 Encashment Tax

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.

Encashment tax is a withholding tax which applies to specific types of income, payable through a payment agent in the State to persons resident in the State. Encashment tax withheld is creditable against corporation tax / income tax payable by the recipient. Revenue has the administrative power to exclude certain recipients from the scope of the tax so that they can receive such coupons without deduction of encashment tax.

The obligation on payment agents located in the State to deduct encashment taxes means that they operate at a commercial disadvantage. The administration cost which falls on Irish payment agents leaves them at an economic disadvantage as compared to their European competitors.

We believe that the encashment tax regime has outlived its purpose and should be abolished, as it was in the UK as part of a tax modernisation initiative. The regime was introduced at a time when it was difficult for a tax authority to obtain information about foreign dividends. Since its introduction, tax transparency and information exchange between taxing authorities has improved and expanded, not only within the European Union but also within the OECD and treaty jurisdictions. Furthermore, with the introduction of the self-assessment system, the risk of non-taxation has reduced, placing substantial penalties on taxpayers for non-compliance with their self-assessment obligations.

Key recommendations

- Abolish encashment tax

2.7 Reporting Obligations

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.

As noted by the OECD[4], the core task of a tax administration is to raise revenue to fund government services and to do so in a way which does not impose unnecessary burdens on taxpayers. Unfortunately, the latter objective has not been met in Ireland.

The tax reporting burden imposed on Irish business has grown exponentially over the last 20 years. In addition to the reporting obligations referenced in the consultation, taxpayers are required to provide substantial amounts of data across all tax heads ranging from tax returns which have ballooned in size (38 pages have been added to the corporation tax return form since 2012), to a vast array of information returns. The relentless layering on of complex tax reporting obligations on business has led to higher administrative costs and the diversion of valuable resources away from core business activities which generate value for the economy.

Reform and rationalisation of the information reporting by taxpayers is essential to ensure that Irish businesses remain competitive. This requirement has already been recognised by the European Commission, which has initiated the REFIT[5] programme. It is focused on ensuring that the intended benefits of EU law are achieved for individuals and businesses, while simplifying existing EU laws and cutting red tape, whenever possible. Ireland needs to adopt a similar approach in consultation with the business community. There is a need to critically examine the reporting obligations placed on businesses applying a similar lens.

Our observations on the reporting obligations in relation to the payment of interest are as follows:

- ***Section 36(3) – Government securities***

  In our review, the reporting requirement under Section 64 give rise to an unnecessary level of administration which should be removed. Given the effectiveness of the Irish self-assessment regime, the risk of under-declaration of government bond interest arising to Irish residents is very low.

- ***Section 64(3) – payment of interest on Eurobond***

  In our review, the reporting requirement under Section 64 gives rise to an unnecessary level of administration which should be removed. Given the effectiveness of the Irish self-assessment regime, the risk of under-declaration of Eurobond income arising to Irish residents is very low. Indeed, most Eurobonds are held by corporates and institutions.

- ***Section 891 and 891B – banks / financial institutions on payment of interest***

  Amending reporting requirements applicable to financial institutions is cumbersome to both the taxpayer and Revenue. Banking IT systems evolve over time, layering new systems onto archaic systems to meet new reporting standards. Where this reporting requirement is not removed from legislation based on information already obtained via other reporting requirements made by the same institution, then no further amendments should be made to

[4] Tax Administration 2024, OECD

[5] REFIT – making EU law simpler, less costly and future proof - European Commission - https://commission.europa.eu/

section 891 and 891B. Furthermore, any potential changes necessitate a high level of stakeholder engagement.

- ***Section 891A – reporting under Section 246(3)(h)***

  In our review the reporting requirement under Section 891A gives rise to an unnecessary level of administration for businesses which should be removed. The risk of non-compliance with the requirements of Section 246(3)(h) is low given its scope and the fact that it only applies to interest paid by a company to a company.

- ***CRS, FATCA, and DAC 2***

  The ability for Ireland to unilaterally determine the level of information to be exchanged under these regimes is limited. We recommend that the Department/Revenue continues to engage with stakeholders regularly regarding the requirements of these regimes. When it engages with the European Commission regarding its review of DACs[6], Ireland should advocate for the elimination of duplicate reporting and a focus on ensuring that only relevant data is collected and shared.

Key recommendations

- Consult with the financial services industry if any reporting changes are been implemented
- Engage with the European Commission in the evaluation of DACs
- Remove the reporting requirements under:
  - Section 36
  - Section 64
  - Section 891 | 891B
  - Section 891A

[6] Evaluation of administrative cooperation in the field of direct taxation: open public consultation and call for evidence - European Commission - https://taxation-customs.ec.europa.eu/

3. Broader Policy Considerations

3.1 Reforming Existing Interest Regime

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.

Ireland's tax regime for businesses must be best-in-class if it is to compete for inward investment in the new global tax environment. In addition, Ireland's tax regime must work for indigenous Irish businesses that are seeking to raise finance to support growth and scale up their operations. As noted throughout our response, removing redundancy and cutting complexity in our interest deduction regime must be the objective of all parties involved in the design and administration of our tax system, if this is to be achieved.

However, we must recognise that the relative stability of Ireland's tax regime over many decades has been of major benefit for businesses operating here. Equally, this stability has been a positive point of differentiation for businesses evaluating whether they should set up operations here. Therefore, wholescale or radical change to Ireland's tax environment for businesses must be approached with the greatest level of caution and transparency.

All businesses, but particularly large multinational businesses, have been subject to unprecedented levels of change in the area of tax in recent years. This change has almost exclusively had the effect of adding complexity, constraining business practices, increasing administrative burden and increasing the cost of doing business. Cumulatively, this trend has the potential to stifle growth and reduce the competitiveness of our economy. A reimagination of Ireland's tax deduction regime must not be allowed to further aggravate the position.

It is crucial that all future changes to Ireland's tax regime are framed by a growth mindset and designed in collaboration with businesses and practitioners. Positive changes to Ireland's regime must be married with certainty for businesses so that we compete effectively for foreign investment and promote indigenous business.

Timing

Before rushing to undertake a fundamental redesign of the system, which would take a lot of time to design and implement, we believe that current efforts should be focused on resolving issues in the existing regime. While it may be possible to envisage an "ideal" tax regime for interest, it is our view that the first step should be focused on the removal of redundancies and inefficiencies in the rules.

Undertaking a full and frank review of our current system aimed at identifying inefficiencies and redundancies should be the first step in the process of designing any new interest deduction regime in Ireland. Reaching agreement as to what aspects of the existing regime are essential and those which may be removed or simplified will signpost what is feasible with respect to any deeper redesign of the regime. In addition, the process of optimising Ireland's current tax deduction regime is likely to require several years to complete and will challenge policymakers, legislators, administrators, businesses and practitioners. This effort would be undermined greatly if a fundamental redesign of the system was to be undertaken concurrently.

In this regard, the current review of the existing regime should take place in full, with any resulting changes to the tax system allowed to become embedded and their effects understood, before a more fundamental change is contemplated. In this way, all parties will have greater insight into what can be achieved by a redesigned tax deduction regime and how best to go about this.

Avoiding uncertainty for businesses

In addition, beyond our above concerns regarding timing, we believe there are inherent challenges for policymakers, administrators, and businesses that must be recognised upfront before any move is made to fundamentally re-design our tax deduction regime.

Understandably, policymakers and legislators will be highly attuned to the impact of any redesign of the interest regime on the Irish Exchequer. However, it will be crucial not to lose sight of the impact of a fundamental re-design on businesses. Many of them will have significant concerns about the potential impact of any changes on existing structures and the inevitable level of uncertainty caused by a transition to a new regime. They will require certainty from the outset that existing arrangements will be grandfathered and that a transition to the new regime will offer tangible benefits, and not a greater level of uncertainty or complexity. Businesses have invested significant resources in developing an understanding of the existing rules, and have made significant business decisions on the basis of the existing regime.

As reflected in our responses to this consultation, we believe the current regime features redundancies and areas for optimisation which require action. Left unresolved, these inefficiencies will depress economic activity in Ireland and stifle growth. However, many businesses are largely able to navigate the current Irish interest deduction regime despite the constraints and challenges that the regime presents. In addition, while the rules are overly complex and administratively burdensome, they are well-established and understood by tax professionals working in Ireland. Gaining a full understanding of the new rules and their impact on existing and future commercial operations in Ireland will present a material challenge for all parties and should not be understated.

Fundamental features

Despite our above concerns, there are essential characteristics and features identifiable now which we believe should be taken into account in relation to any future fundamental re-design of the interest deduction regime:

- ***Substantive positive change***

  What must be avoided at all costs is a fundamental re-writing of the rules to arrive at broadly the same position. Such an outcome would be enormously disruptive for businesses who understand the boundaries of the existing regime, which is supported by an extensive body of practice and case law. It would also negatively impact Ireland's reputation as a good place to do business.

  Even where the stated objective of a fundamental re-write is simplification, it will inevitability give rise to a period of transitional uncertainty and undermine our reputation for transparency and stability in our tax regime.

- ***Broaden the criteria for deduction***

  Given the other protections in place against base erosion (e.g., ILR, Pillar Two, anti-hybrid rules, etc.) that already exist in Ireland, we believe it would be essential that all parties agree that a fundamental re-design should have the effect of substantively broadening the basis for claiming interest deductions against business profits. Absent a commitment to such a policy from the outset, it is debatable as to whether efforts to fundamentally re-design the regime should be brought forward.

- ***Greater parity across forms of income***

  Given the complexity it introduces into Ireland's tax regime, it should be the objective of the redesign to remove or reduce the disparities that exist between the treatment of interest incurred in earning various forms of income (e.g., trading income, rental income, investment income, etc.).

- ***Extensive coordination with businesses and practitioners***

  We welcome the opportunity to provide our insight and views in response to this and other tax consultations undertaken by the Department. Perhaps to a greater extent than any consultation to date, it will be crucial that this process of open discussion is maintained throughout the process of re-designing the Irish tax deduction regime. As noted above, changes to the regime must be driven by a desire to produce substantive positive changes for Irish business. This can only realistically be achieved if insights from businesses are actively incorporated into the determination of the principles on which the rules are based and the specific legislation proposed.

- ***Stability once introduced***

  As noted above, one of the strengths of Ireland's tax regime is its stability. Once re-designed, every effort must be made to ensure that the new regime is allowed to become embedded and assimilated into the Irish tax environment. Incremental changes that reduce the utility and efficiency of the new regime must be avoided, particularly in the initial years after its introduction.

- ***Certainty of interpretation***

  Taxpayers should have the opportunity to engage with Revenue regarding the interpretation of the new rules prior to their enactment. Ideally, draft Revenue guidance would be issued in conjunction with the release of draft legislation throughout the design process.

In our view, each of the above matters are essential ingredients in making any re-design of the tax deduction regime in Ireland a success. We believe that in the absence of agreement across all parties on these matters, any reimagination of the regime risks creating huge turmoil while providing little satisfaction to any party involved.

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