



MOORE

Ireland's Interest Limitation Rules – Practical Considerations for SMEs

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INTRODUCTION

Interest Limitation Rules ("ILR") have recently been introduced to the Irish tax system by Finance Act 2021. The introduction was required to ensure Ireland complies with the EU Anti-Tax Avoidance Directive ("ATAD") which was adopted by the EU Council on 20 June 2016. The ILR are designed to discourage artificial debt arrangements used by EU based companies to minimise taxes through base erosion and profit shifting.

An example of such base erosion and profit shifting are excessive interest deductions on intragroup (or 3rd party) debt arrangements which reduce profits of companies in high-tax jurisdictions. Interest income arising from intragroup debt arrangements is typically subject to tax in jurisdictions with lower rates of corporate tax which ultimately reduces the overall effective tax rate of corporate groups. The purpose of the ILR is to limit the maximum tax deduction for net borrowing costs to 30% of EBITDA (Earnings before Interest, Tax, Depreciation and Amortization) as measured under tax principles. This article focuses on the practical issues of the ILR for Small and Medium sized companies ("SMEs")

What taxpayers are in scope?

Any company incurring tax deductible debt costs and which is within the charge to Irish corporation tax may be affected by the ILR rules. However, exemptions are available for the following:

1. **De minimis threshold:** where net borrowing costs do not exceed €3M in respect of an accounting period of 12 months (pro-rated threshold if a shorter period).
2. **Standalone entities:** an Irish resident company that has no associated enterprises or permanent establishments ('associated enterprise' includes any individual who owns at least 25% of the entity).
3. **Legacy debt exclusion:** costs in respect of 'legacy debt' being debt the terms of which were agreed prior to 17 June 2016.
4. **Long-term public infrastructure projects:** qualifying long-term infrastructure project to provide, upgrade, operate or maintain a large-scale asset in an EU Member State.

How are restricted amounts calculated?

Broadly, where the exclusions do not apply, the ILR restricted amount is calculated by:

1. Comparing the interest income and equivalent amounts earned by the taxpayer (taxable interest equivalent or "TIE") against certain deductible debt costs (deductible interest equivalent or "DIE") to arrive at the net borrowing costs.
2. Determining the EBITDA of the relevant entity, as computed under tax principles, to calculate the allowable amount (30%).
3. Evaluating the borrowing costs (step 1) in excess of the allowable amount (step 2) and increasing the taxable profits of the entity for that period accordingly (if an excess arises).

Carry forward provisions

Restricted borrowing costs may be carried forward indefinitely for offset in future periods where there is sufficient 'spare capacity' under the ILR assessment.

A taxpayer may also carry forward 'total spare capacity' for a period not exceeding 60 months (5 years). Total spare capacity is the aggregate of amounts below zero from Step 1 (**interest spare capacity**) and any unutilised balance arising from Step 3 (**limitation spare capacity**).

SME group considerations

Companies within the charge to Irish corporation tax may elect to be treated as an 'interest group' for the purposes of the ILR. In order to elect to be treated as an interest group, the companies must be:

1. Members of the same consolidated group for accounting purposes, or
2. Qualify as members of the same corporation tax group as defined under s. 411 TCA 1997 (75% common beneficial ownership test).

The election provides alternative assessment options under the ILR which can provide for deductions greater than 30% of EBITDA. For example, the 'Group Ratio Rule' may permit a higher deduction for a single entity within a group based on the following ratio:

$$\frac{\text{Group Net Borrowing Cost}}{\text{Group EBITDA}}$$

Alternatively, the 'Equity Ratio Rule' may be applied to provide full relief for borrowing costs where a single entity's ratio of equity to assets exceeds 98% of the worldwide group ratio:

$$\frac{\text{Equity}}{\text{Total Assets}}$$

In addition, any excess borrowing costs which arise within a group may be transferred to specific group entities. The ability to transfer the taxable amounts provides an opportunity for tax planning with regard to the offset of losses and other considerations.

Single company worldwide group

It should be noted the alternative group ratios may be applied to a single company worldwide group ("SCWG") subject to certain modification. For example, a single entity may compare its position under the ILR to that of the company if it was a member of a worldwide group (taking into account related party transactions).

A SCWG is defined as a company that is not .

- a member of a worldwide group (based on consolidation for accounting purposes)
- a member of an interest group (discussed above) or
- a standalone entity (see exclusions).

This provides alternatives to owner-managed businesses and SMEs which are assessed as SCWGs under the ILR provisions.

Preliminary tax

A top-up of preliminary tax may be made by both 'small' and 'large' taxpayers to accommodate ILR amendments to taxable profits for accounting periods up to 31 December 2027.

The preliminary tax paid before the top up must have amounted to at least 90% of the current year tax liability but for the ILR amendment. Top-up payments of preliminary tax must be made within 6 months after the end of the accounting period in order to avoid penalties on late payment.

When do the rules come into effect?

The rules are effective for accounting periods commencing on or after the 1 January 2022. A reporting obligation will arise with regard to the ILR on the Corporation Tax Return (Form CT1) for the relevant period. However, it is recommended affected taxpayers consider the impact of the ILR in advance.

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If you have any queries or concerns regarding the impact of the ILR, please do not hesitate to contact us.

For further information, please see contact information below.

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