EVERSHEDS SUTHERLAND

Interest Limitation Rules

The Finance Bill 2021

On 21 October 2021, the Irish Finance Bill 2021 (the "**Bill**") was published. The Bill sets out the draft legislation that will implement the EU Anti-Tax Avoidance Directive ("**ATAD**") in Ireland. The rules applying the ATAD interest limitation rules ("**ILR**") will affect the tax deductibility of interest and financing expenses for a wide range of Irish companies.

EU Interest Limitation Rules

The ILR will apply to accounting periods commencing on or after 1 January 2022 and effectively seeks to limit the tax deductibility of net borrowing costs to 30% of a taxpayer's EBITDA subject to certain reliefs and exemptions. The ILR will only apply if the interest equivalent expense exceeds interest equivalent income. A crucial definition within these rules is interest equivalent, which has been broadly defined and includes:

- interest;
- the finance income and finance cost element of non-finance leases;
- the finance lease element of finance lease payments;
- discount, on securities issued at a discount;
- amounts under derivative instruments connected with the raising of finance; and
- following an amendment over the course of the legislative process, unrealised gains and losses on certain financial instruments economically equivalent to interest.

Interest group

The Bill provides for the application of ILR using a group approach i.e., calculating the interest restriction at the level of a local group of companies (an "**interest group**"). Membership is elective. The draft legislation provides that the interest group will encompass all companies within the charge to corporation tax in Ireland that are members of a financial consolidation group as well as any non-consolidated companies that are members of a tax loss group. This approach is to be welcomed and should ensure that the profits of all group members that are exposed to Irish tax are included.

The draft legislation provides for an equity-escape carve-out from the ILR. The legislation focuses on the ratio of equity to total assets. If the ratio of equity to total assets of the interest group is no lower than two percentage points below the worldwide group's ratio of equity to total assets then the equity ratio rule applies and no interest restriction arises.

An element of relief is also provided for under the group ratio rule. The group ratio rule calculates the group's exceeding borrowing costs as a percentage of its EBITDA (using the group's consolidated financial statements). If the group's percentage is higher than 30%, the taxpayer is permitted to use the higher figure when calculating any interest restriction amount.

ILR Exemptions and Reliefs

The draft legislation incorporates a number of important exemptions in line with ATAD as follows:

- **Carry forward -** Restricted interest should be available for carry forward to be deducted in future years where the taxpayer has sufficient capacity to claim the deduction (this would be the case where the company has not exceeded its 30% threshold in that year). This will be subject to certain limitations for companies in a tax loss position.
- **Unused capacity** - When exceeding borrowing costs are below the allowable amount (30% threshold). This unused amount may then be carried forward for up to 60 months and can be used in future periods where exceeding borrowing costs exceed 30% of EBITDA.
- **De minimis exemption** – This exemption will apply to interest expenses up to €3m i.e. where a taxpayer's group borrowing costs do not exceed €3m.
- **Legacy debt exemption –** This exemption will apply for debt put in place before 17 June 2016 that has not been altered since then.
- **Infrastructure projects -** The carve-out encompasses a broad variety of assets including energy infrastructure, transport infrastructure, environmental infrastructure and health infrastructure.

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