MAPLES GROUP

UPDATE

# Irish Finance Bill 2021 – Implications for International and Irish Business

On 21 October 2021, the Irish Finance Bill 2021 (the "Bill") was published. It contains over 220 pages of draft tax legislation and this summary highlights a number of the most significant proposed changes for Irish and international companies, investment funds and financial institutions. The Bill will now progress through Dáil Éireann, the Irish Parliament, where it may be further amended, to be enacted into law before the end of the year.

The Bill contains the following important provisions:

- The rules applying the EU Anti-Tax Avoidance Directive's ("ATAD") interest limitation rules ("ILR") will affect the tax deductibility of interest and financing expenses for a wide range of Irish companies. There are a number of important exclusions and provisions relevant to the Irish funds and structured finance industries.

- The Bill also includes provisions to implement the EU ATAD rules on anti-reverse hybrid mismatches. These will be relevant for investment funds structured as partnerships and common contractual funds.

- The Bill seeks to encourage investment in the Irish economy by reforming the Employment Investment Incentive Scheme ("EIIS") and would allow a wider range of funds to be offered to investors.

- In relation to corporation tax, a new digital gaming tax credit is introduced, as well as some reforms to Irish transfer pricing and controlled foreign company provisions.

- In relation to real estate, the provisions bring non-residents holding Irish land within the charge to Irish corporation tax, increasing the rate of tax to 25% and applying Irish transfer pricing rules. In addition, the legislation proposes the introduction of a 3% vacant site levy to encourage housebuilding

## EU Interest Limitation

The Bill sets out the draft legislation that will implement the EU ATAD ILR in Ireland. The ILR is one of the most significant changes to Irish taxation in 20 years. The ILR will apply to accounting periods commencing on or after 1 January 2022.

The ILR rules potentially apply if a taxpayer's interest expense exceeds its interest equivalent income. The ability to claim a tax deduction for the excess interest is restricted to 30% of EBITDA (earnings before tax and before deductions for net interest expense, depreciation and amortisation).

The draft legislation incorporates a number of important exemptions and exclusions in line with ATAD. There is an exemption for 'standalone entities' and for entities where the net borrowing costs are less than the €3m de minimis amount. There are also exclusions for legacy debt, which is debt put in place prior to 17 June 2016, and long-term infrastructure projects. There is no exception for financial undertakings such as regulated investment

funds, banks and insurance companies, although in an Irish context Irish regulated funds should not generally rely upon the deductibility of interest expenses to preserve their tax position as they are either tax exempt or tax transparent.

*Interest Income and Interest Expense*

The definition of interest equivalent income is broad 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; and
- amounts under derivative instruments connected with the raising of finance.

The definition of interest also includes elements of the profit and loss movements on financial assets and liabilities to the extent those amounts would reasonably be considered to be economically equivalent to interest.

*Grouping Rules*

Companies can elect to operate the interest restriction on a single entity or local Irish group basis (an "interest group").

Where the Irish taxpayer is part of a consolidated worldwide group for accounting purposes ("worldwide group"), the indebtedness of the overall group at worldwide level may be considered for the purposes of providing additional relief under one of two grouping rules. For many corporate and investment fund structures, the application of these grouping rules will be of significant importance.

The concept of a single company worldwide group ("SCWG") may be of relevance to certain securitisation and structured finance vehicles. A SCWG is a company that is neither a standalone entity nor a member of a worldwide group or an interest group. Where a taxpayer meets this definition, it can apply the grouping rules by comparing its position as a single entity to its position as if it was a member of a worldwide group, with the latter taking into account related party transactions for the purposes of the comparison. From a policy perspective, the SCWG ensures that Ireland avoids the anomalous situation of treating groups of companies more favourably than individual companies without justification on BEPS grounds.

Finally, where the deductible borrowing costs of a relevant entity are restricted in an accounting period, the restricted amount can be carried forward to succeeding accounting periods. The company can then claim relief for those amounts where, having applied the ILR in that future period, it could have deducted more interest (referred to as spare capacity). Any additional spare capacity can be carried forward for a period of up to five years.

## EU Anti-Hybrid Rules

The Bill introduces provisions arising from the ATAD rules on anti-reverse hybrid structures. The changes are potentially significant to Irish entities such as investment funds established as partnerships, trusts or common contractual funds. Broadly, the provisions will bring tax transparent entities within scope of Irish corporation tax where the entity is 50% or more owned / controlled by entities resident in a jurisdiction that regard it as tax opaque and, as a result of this hybridity, double non-taxation occurs, subject to certain exceptions.

The rule provides an exemption for 'collective investment schemes' that are subject to investor-protection regulation, are widely held and hold a diversified portfolio of assets. In this context the draft legislation provides welcome clarity. Irish investment limited partnerships and common contractual funds are within the definition of collective investment schemes. The legislation provides that a partnership, including a 1907 limited partnership which is managed by an Irish AIFM

shall also be within the term. The concept of widely held is defined by reference to whether there is a 'Beneficial Owner' within the meaning of the EU Anti-Money Laundering Directive. A series of factors are relevant in determining whether a diversified portfolio of assets exists. There is also a safe harbour that applies where no more than 10% of the securities held by the entity are issued by a single issuer. Specific provision is made for the periods when a new fund commences or is winding down, where investments may be more concentrated.

Where the anti-reverse hybrid rules apply, the hybrid entity shall be subject to Irish corporation tax on the element of profits or gains which would otherwise go untaxed due to the hybridity. The legislation provides that the hybrid entity shall be entitled to appropriate or cancel a portion of units to order to satisfy this tax.

A series of additional hybrid related changes are outlined in the Bill. Importantly, there is a welcome amendment to the rules that apply where there is a payment by an Irish entity to a hybrid entity. The new rules provide a measure of relief in relation to such structures as the rules restricting deductibility of payments by the Irish entity apply only where it is 'reasonable to consider' the hybrid mismatch arises. This will assist Irish entities making payments to widely held funds.

## Reform of Employment Investment Incentive Relief

EII relief is an income tax relief for qualifying investments in certain start-up companies. A series of reforms were proposed to increase the amount of capital employed in the scheme. These amendments enable investors to claim the EII tax relief through investing in Irish Investment Limited Partnerships and 1907 Limited Partnerships. This opens up the scheme to a wider range of investment funds.

Managers considering the formation of such funds should consider which of two forms of partnership may best suit their market and objectives. Although the 1907 Limited Partnership is flexible, it is now quite outdated when compared with the newer regulated Investment Limited Partnership alternative. Issues such as VAT and regulation are also relevant considerations.

Other EII related changes announced include allowing investors to redeem their capital without penalty and to allow companies greater flexibility in how and when they deploy the capital.

The current relief from corporation tax for start-up companies in their first three years of trading is extended for a period of five years until 31 December 2026.

## Corporation Tax

A new tax credit is introduced to encourage the digital gaming sector. This takes the form of a refundable corporation tax credit for qualifying expenditure incurred in the design and development of digital games. The tax credit will be available at a rate of 32% of qualifying expenditure with a maximum limit of €25 million per project. A per project minimum spend requirement of €100,000 will also apply. The intention of the new tax credit is to enhance Ireland's competitiveness as a jurisdiction for the expanding digital gaming sector.

The relief will only be available for projects in the digital gaming sector that have been issued with a cultural certificate from the Minister for Tourism, Culture, Arts, Gaeltacht, Sport and Media. The Minister will consider the contribution the digital game is expected to make to the promotion and expression of Irish and European culture. Interestingly, in considering this the Minister may have regard to whether the game raises awareness of environmental matters or climate change. The certificate may be applied for on an interim basis meaning that it will not be necessary to wait until the conclusion of a project in order to avail of the relief.

In relation to transfer pricing, new rules which provide for an exclusion from the application of transfer pricing between two Irish entities have been included in the Bill. The exclusion will apply in respect of a transaction between certain associated persons who are both chargeable to tax in Ireland.

## Real Estate

There is a significant change to the tax treatment of non-Irish resident companies in receipt of Irish sourced rental income. Historically, such entities were subject to Irish income tax at 20%. Those companies will now be within the scope of corporation tax and subject to a tax rate of 25%. This change also means that such companies will now be within the scope of the Irish rules on transfer pricing and the interest limitation rules. There is provision for deductions relating to capital allowances and other rental deductions to be carried forward and set off against the corporation tax liability. The new rate of tax will apply from 1 January 2022. There will also be no preliminary tax filing deadlines for such companies.

A number of aspects of the new provisions require clarification. Currently, under Irish tax law rental payments to non-residents are subject to a 20% withholding tax. The use of an Irish rent collection agent will eliminate this, however, the agent is then liable to account for the tax on the rental profits. These arrangements may need to be reviewed.

The Bill proposes a new zoned land tax to encourage residential construction. The tax will apply to land that is zoned residential or that is zoned for a mix of uses, including residential use which is serviced, but has not yet been developed for housing. The tax will be based on the market value of the land and at a rate of 3% at the outset. The introduction of the tax will be gradual and there will be a two-year lead-in-time for land zoned before January 2022, and a three-year lead-in-time for land zoned after January 2022. The new zoned land tax sits alongside similar initiatives such as the stamp duty refund scheme introduced in prior years and both are intended to encourage construction.

## Climate Change and Sustainability

Action on climate change is a key part of the Budget 2022 agenda.
To encourage households to generate electricity a tax disregard of €200 is being introduced in respect of personal income received by households who sell residual electricity that they generate back to the grid. This will be available from 1 January 2022 to 31 December 2024.

The Accelerated Capital Allowance scheme for Energy Efficient Equipment, which allows an accelerated deduction when businesses invest in highly energy efficient equipment has been amended to prohibit equipment directly operated by fossil fuels from qualifying for the scheme. Measures are also introduced to include hydrogen powered vehicles and refueling equipment.

## Further Information

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