INTEREST LIMITATION RULES

Finance Act 2021 introduced new Interest Limitation Rules (ILR) in accordance with the EU's Anti-Tax Avoidance Directive (ATAD).

The new rules will impact any company with debt funding that is liable to Corporation Tax in Ireland and are effective for accounting periods commencing 1 January 2022.

The purpose of the ILR is to limit base erosion by utilising excessive interest deductions. The ILR does this by limiting the maximum tax deduction for net borrowing costs to 30% of Tax EBITDA*.

Net borrowing costs is the net amount arrived at by netting taxable interest income against deductible interest expense.

Corporate taxpayers may operate the interest restriction on a single entity or local group basis.

EXCEPTIONS

There are a number of exceptions provided for under the legislation. The exceptions are designed to address circumstances where there is a limited risk of base erosion or profit shifting.

These exceptions are:

- Where the Irish taxpayer's net borrowing costs are less than €3 million
- Where a company is a standalone company, being a company that has no associated enterprises or permanent establishments
- Long-Term Public Infrastructure Projects, being a project to provide, upgrade, operate or maintain a large-scale asset in the general public interest, and
- Interest on legacy debt, being debt the terms of which were agreed prior to 17 June 2016.

GROUP AND EQUITY RATIOS

An interest deduction greater than 30% of Tax EBITDA could be available for the Irish corporate taxpayer where the following circumstances apply to its ratios as set out below.

GROUP RATIO

$$\frac{\text{Group NET borrowing cost}}{\text{Group EBITDA}}$$

Where the Irish taxpayer is part of a consolidated worldwide group for accounting purposes and the worldwide group's net borrowing costs as a proportion of EBITDA are greater than 30%, Irish corporate taxpayer can use this higher proportion in its own calculations.

EQUITY RATIO

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

If the Irish corporate taxpayer's ratio of equity to assets exceeds 98% of the worldwide group's ratio, the ILR does not apply and the entity can get a full deduction for interest if this test is satisfied.

* Finance Act 2021 sets out a specific formula for the calculation of Tax Adjusted EBIDTA.

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CARRY FORWARD PROVISIONS

Where the deductible borrowing costs of a company 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 has not met the 30% of Tax EBITDA limit and could therefore deduct more interest in that period.

In scenarios where a company's net borrowing costs has not met the 30% of Tax EBITDA limit, amounts up to the 30% limit can be carried forward for a period of up to five years.

HOW BDO CAN HELP

We can help assess your group's financing structure and financing costs in order to mitigate the impact of significant restrictions.

FOR HELP AND ADVICE ON THE ILR, TALK TO OUR EXPERTS:

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Q&As

Why is ILR so topical at the moment?

ILR has been a subject for discussion in recent years under both the OECD BEPS and the EU ATAD projects. As a result, Finance Act 2021 has now introduced Interest Limitation Rules into Irish tax law, with effect from 1 January 2022.

Why is ILR being introduced?

In some circumstances, companies were able to reduce the amount of tax they had to pay by using excessive interest deductions. The ILR aims to address this.

What should I do?

You should contact your tax advisor to carry out a review of whether your company could be affected by these new rules and to understand the impact of the rules on your business.

Do I need to act now? My company's tax return for 2022 won't be due for filing until 2023.

Yes, it is important to consider these rules as soon as possible in order to provide sufficient time to consider these complex rules fully, to assess the impact on your business, and to identify any opportunities to minimise the impact of the restrictions. In addition, the rules may be relevant for your company's preliminary tax liability due in 2022.