itm Irish Tax Monitor

In this month's roundtable our panel examine a number of BEPS issues related to aircraft leasing, specifically in relation to the substance based income exclusion (SBIE) and whether Irish aircraft leasing companies will be able to access the exclusion. For the domestic life insurance sector, the treatment of 'old basis business' under BEPS rules is also examined, with further guidance required. Other topics explored include the EU's Carbon Border Adjustment Mechanism (CBAM) and what importers need to do now to prepare for the regime; the opportunity to streamline Ireland's interest deductibility regime; key rulings from the Tax Appeals Commission and the important role that the corporate tax function can play in a company's ESG strategy.

Tangible aviation assets

Can you explain how the substance based income exclusion (SBIE) works? Aircraft Leasing Ireland has said if the Irish industry cannot access the tangible assets SBIE it will result in "a fundamental change to lessors' Irish corporation tax position." Please discuss.

The Deloitte Contributors in the August Roundtable Panel consisted of:
Kathy Lai, Assistant Manager, Financial Services Tax, Tax and Legal, Deloitte Ireland; Joanne Clarke, Director, Indirect Tax, Tax and Legal, Deloitte Ireland; John Fitzgibbon, Senior Manager, Corporate Tax, Tax and Legal, Deloitte Ireland; Fiona McLafferty, Managing Director, Tax Controversy, Tax and Legal, Deloitte Ireland; Ronan Connaughton, Director, Corporate Tax, Tax and Legal, Deloitte Ireland; Goker Yuruk, Manager, Global Trade Advisory, Tax and Legal, Deloitte Ireland; Mattia Piol, Manager, Indirect Tax, Tax and Legal, Deloitte Ireland.

Kathy Lai, Assistant Manager, Financial Services Tax, Tax and Legal, Deloitte Ireland: In July 2023, the OECD Inclusive Framework on Base Erosion and Profit Shifting (BEPS) issued further administrative guidance regarding Pillar 2 which contained comments on the substance-based income exclusion (SBIE).

The SBIE operates to reduce the income subject to the top-up tax arising as a result of Pillar 2. This exclusion aims at providing a measure of relief where real substance exists in a jurisdiction.

The carve-out consists of two components based on eligible employee expenses and eligible tangible assets. The SBIE for tangible assets is calculated based on 8% (reducing down to 5% over a number of years) of the average carrying value of eligible tangible assets for the Fiscal Year. The definition of eligible tangible assets includes (but is not limited to) property, plant and equipment, as well as a lessee's right of use assets, located in the jurisdiction.

This is of relevance for those in the aircraft leasing industry, who operate and own substantial tangible assets as part of their leasing trade. Given the nature of aircraft, specifically for aircraft flying on international routes, it would be of critical importance how the 'location' is to be determined.


Kathy Lai

The guidance has noted that for operating leases, a lessor will be allowed to take a portion of the carrying value of the aircraft into account for the SBIE if the aircraft is located in the same jurisdiction as the lessor. The amount allowed is equal to the excess, if any, of the lessor's average carrying value of the asset determined at the beginning and end of the tax year over the average amount of the lessee's right of use asset determined at the beginning and end of the tax year.

Further with respect to determining the "location" of the aircraft, if the asset is located in the same jurisdiction as the lessor more than 50% of the time during the relevant period, the lessor would be entitled to the full tangible asset carve-out with respect to that asset (less the right of use asset mentioned above). Where the asset is located in the same jurisdiction as the lessor 50% or less of the time, the lessor will only be entitled to the SBIE in proportion to the time the asset was located within the jurisdiction of the lessor.

Therefore, based on the latest available guidance, leased aircraft would not qualify for the SBIE unless physically located in Ireland (in the case of an Irish tax resident lessor entity). This will significantly impact in an adverse manner on the usefulness of the SBIE because subject to a few exceptions (e.g. a lease to an Irish airline), leased aircraft generally spend no time in Ireland.

VAT & EU Law

Can you comment on the recently published determination of the Tax Appeals Commission on a VAT case (31TACD2023) and its implications for Irish taxpayers?

Joanne Clarke, Director, Indirect Tax, Tax and Legal, Deloitte Ireland: While the Irish Revenue Commissioners has requested a referral of this case to the

Joanne Clarke

High Court, the current TAC decision has two important implications for Irish taxpayers.

Firstly, it evidences and supports the right of Irish taxpayers during the administrative tax compliance process with the Irish Revenue to obtain sufficient detail of any file the Revenue has prepared with regard to a possible assessment on the taxpayer and to be given sufficient time to review and respond, prior to Revenue making any conclusive decision. In this regard, the raising of an assessment in itself is identified as a conclusive decision on the basis that, if not challenged by the taxpayer, it results in a liability to tax. Therefore, notice and a period of reflection are required in advance of this. This right of the taxpayer to a fair opportunity to defend its position is supported within the TAC decision by various Court of Justice of the European Union (CJEU) jurisprudence, which Irish taxpayers can rely on, regardless of the outcome of this case at the High Court.

Secondly, the decision aids taxpayers in understanding further their obligations relating to possible involvement in or awareness of VAT fraudulent and evasive supply chains. It builds on previous CJEU rulings with regard to assessing whether a taxpayer "knew" or "should have known" that there was VAT fraud in a supply chain and emphasised the need for sufficient due diligence by businesses on their counterparties; more than just at a "tick the box" exercise. In looking at the material facts and evidence available to the taxpayer, the Commissioner identified matters which were irregular and should have raised concerns, however he also ensured not to over compartmentalise the facts but to consider the totality of the evidence. The Commissioner concluded that the taxpayer could not have been expected to know what the Irish Revenue knew about the counterparties and so there was insufficient evidence that the taxpayer should have known about the VAT fraud in the supply chain.

Tax Administration

The Irish Tax Institute says that Ireland has 'one of the most complicated interest deductibility regimes within the EU.' How can Ireland's interest deductibility rules be simplified and brought more in line with other EU jurisdictions?

John Fitzgibbon, Senior Manager, Corporate Tax, Tax and Legal, Deloitte Ireland: Finance Act 2021 introduced interest limitation rules ("ILR") which broadly restrict interest deductibility of corporate entities to 30% of EBITDA. These rules were required to be introduced under the EU's Anti-Tax Avoidance Directive.

Ireland already had overly complex legislation in place relating to interest deductibility, specifically the provisions

John Fitzgibbon

set out in section 247 and 249, Taxes Consolidation Act 1997 ("TCA 1997"). S.247 provides relief for interest as a charge on qualifying borrowings which are used to acquire shareholdings in trading companies while S.249 sets out anti-avoidance recovery of capital rules to prevent the abuse of S.247. However, these rules are subject to a number of conditions which mean they are overly complex from a practical perspective, particularly when compared with similar provisions in other EU Member States.

Given the introduction of the ILR, which have been consistently implemented across all EU Member States as required under the Directive, there should be sufficient provisions in place to protect against base erosion, profit shifting or avoidance activities. As such, consideration should now be given to modifying/removing the overly burdensome provisions of S.247 and S.249.

With regard to S.247, this section could be removed in place of a general test for permitting a deduction for interest expense that is incurred for a bona fide business or commercial purposes. At a minimum ~~however, the section should be simplified~~ by way of removing the requirement for a common director or removing the denial of a deduction for interest on intra group loans used to purchase certain assets from group companies. Likewise, the deemed recovery of capital rules in S.249 are very broad and can inadvertently trigger a deemed recovery of capital (and consequently, a denial of a deduction for an interest expense) even in the case of wholly commercial financing transactions and as such, should be simplified.

These amendments would help to simplify Ireland's interest deductibility rules and ensure that businesses operating in Ireland are not unfairly disadvantaged when compared with other EU Member States.

Tax Appeals Commissions

Can you comment on the Tax Appeals Commission's most noteworthy determinations in the first half of 2023?

Fiona McLafferty, Managing Director, Tax Controversy, Tax and Legal, Deloitte Ireland: In Determination 101TACD2023, it was determined that the

Fiona McLafferty

taxpayer was a recognised body involved in the provision of vocational training and entitled to the exemption from VAT. The Revenue Commissioners had maintained that a legal agreement entered into by the taxpayer should be construed as meaning that the taxpayer was providing personnel to a third-party who was delivering the training services to the taxpayer. This was rejected by the Tax Appeals Commission. The outcome was a repayment of tax of €4,365,302.

In Determination 85TACD2023, it was determined that the taxpayer was entitled to business property relief on a gift of shares where the company had cash balances in the business. The Revenue Commissioners had maintained that 75% of the cash balance should not qualify as being for business purposes and should be treated as an excepted asset for CAT. This was rejected by the Tax Appeals Commission. The outcome was a revision to the assessment from tax due of €236,770 to a repayment of tax of €3,099.

In Determination 60TACD2023, it was determined that the taxpayer had delivered a complete and accurate tax return meaning the Revenue Commissioners were precluded from making an amended assessment outside the 4 year time-limit. Consequently, the Tax Appeals Commission was not required to determine the substantive issue, namely whether a Single Payment Scheme payment by the Department of Agriculture was taxable in the hands of the taxpayer or a company incorporated by the taxpayer to undertake the farming trade. The outcome was a revision to the assessment from tax due of €72,728.35 to nil.

In Determination 35TACD2023, it was determined that the taxpayer had a genuine doubt in relation to the method by which the depreciation adjustment in the corporation tax computations should be calculated. The Revenue Commissioners had maintained that the expression of doubt was not genuine. This was rejected by the Tax Appeals Commission.

Life Insurance - Old Basis Business

What is the taxation of 'Old Basis Business' of life insurance companies in Ireland? Has any guidance been provided on the application of BEPS Pillar II rules for life insurers with 'Old Basis Business' in Ireland?

Ronan Connaughton, Director, Corporate Tax, Tax and Legal, Deloitte Ireland: The taxation of domestic life assurance companies and their policyholders depends on when the life assurance business was written. In its broadest sense life assurance business written on or before 31 December 2000 is referred to as 'Old Basis Business' and as such is a declining part of most domestic life companies' business. It is subject to a regime knows as the 'I-E' (or income less expenses) regime which has its origins in historical UK case law. Life assurance business written on or after 1 January 2001 is referred to as 'New Basis Business' and is subject to what is referred to as a 'gross roll up' regime whereby broadly profits roll up within a life policy until a 'chargeable event' occurs at which point an exit tax may arise.

The 'I-E' tax computation in respect of Old Basis Business is based on investment return (e.g., broadly investment income plus chargeable gains less management expenses) as opposed to trading profits. The investment return is apportioned between policyholders and shareholders; the policyholders' share being taxed

Ronan Connaughton

at a corporation tax rate equal to the standard rate of Income Tax (20%) and the shareholders' share being taxed at the standard rate of corporation tax (12.5%).

The Old Basis Business or I-E regime is essentially a tax regime which is unique to Irish life assurance companies. As such no guidance has yet been provided in respect of the interaction of this taxation regime and the BEPS Pillar II rules. Indeed, Insurance Ireland stressed in their response to the Pillar II Feedback Statement issued by the Department of Finance in March 2023 that given the unique nature of the taxation of 'Old Basis Business' of life insurance companies in Ireland that further detail and guidance would be required to clarify the application of the Pillar II rules, including references to policyholder taxes. To date no such guidance has been forthcoming and as such the practical implications of the proposed legislation on Old Basis Business and the I-E regime have yet to be addressed.

Carbon Tax

The EU's Carbon Border Adjustment Mechanism (CBAM) will apply from 1st October 2023. What are the implications for taxpayers and how can corporates prepare for the new rules?

Goker Yuruk, Manager, Global Trade Advisory, Tax and Legal, Deloitte Ireland and **Mattia Piol, Manager, Indirect Tax, Tax and Legal, Deloitte Ireland**: The European Union (EU) has introduced a Carbon Border Adjustment Mechanism (CBAM) which will put a price on certain high-polluting goods entering the EU based on their carbon content. This is a climate measure taken by the EU Commission with a view to address

Goker Yuruk

carbon leakage in line with EU's Fit for 55 agenda. The aim of this mechanism is to prevent EU importers of CBAM products from out-sourcing production to countries that do not levy carbon emissions. CBAM will be based on a system of certificates to cover the direct emissions as well as the indirect emissions embedded into the imported products. The certificate price will be based on the EU Emissions Trading System (ETS) allowance price.

The CBAM will initially apply to imports of cement, iron and steel, aluminium, fertilisers, and electricity, as these sectors are considered carbon intensive.

A transitional period will apply from 1 October 2023 to December 2025. During this period, EU importers are required to submit quarterly CBAM-reports, disclosing data on CBAM products imported and the related embedded emissions of certain greenhouse gases. The first CBAM report will be due by 31 January 2024. At the end of the transitional period, the EU Commission will decide whether to extend this mechanism to other products.

From January 2026, the CBAM is expected to become fully operational and, therefore, EU importers (declarants) will be required to purchase the CBAM certificates and submit an annual CBAM declaration. Only the importers that have received a special authorisation will be entitled to import CBAM goods into the EU.

The draft regulation published on 13 June 2023, among other measures, specifies the penalties for non-compliance with the quarterly CBAM report requirements, which shall be between €10 and €50 for each tonne of unreported embedded emissions.

Considering the imminent starting date of the transitional period, it is important that businesses are aware of CBAM

Mattia Piol

rules. An initial impact assessment to verify whether the products are in scope is essential and could be the base to set up an efficient data collection and reporting process to comply with CBAM requirements. In long term, the relevant supply chains and the strategic investment decisions can be reconsidered based on the CBAM legislation to mitigate the tax burdens.