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Irish Tax Monitor

The Roundtable April 2023

BEPS & Insurance

The OECD included specific guidance for the application of GloBE rules for insurance companies in its recent, major update. What are the key insurance specific points and the implications for insurance companies in scope of the rules?

Yvonne Diamond, Senior Tax Manager, BDO: The guidance provides a number of clarifications regarding the application of the GloBE Model Rules for insurance groups.

The guidance clarifies that the "Taxable Distribution Method" election (Article 7.6 of the GloBE Model Rules) applies to Insurance Investment Entities where certain conditions are met. This means that the income and taxes related to such distributions or deemed distributions should be treated as income and taxes of the Constituent Entity that owns the Insurance Investment Entity, and the entity itself is excluded from top-up tax calculations.

In order to preserve the tax neutrality of the Investment Entity regarding any minority-interest holders, Insurance Investment Entities are specifically excluded in the definitions of Intermediate Parent Entity and Partially-Owned Parent Entity in the guidance.

Yvonne Diamond

Article 3.2.10 of the GloBE Model Rules provides a set of rules that essentially treats Additional Tier One Capital in the same manner as a debt instrument. Therefore, movements in equity due to distributions on Restricted Tier One Capital instruments should be treated as being within GloBE Income or Loss.

The insurance company is obligated to pay all earnings from the investment to the policyholders less an investment management fee where it holds investments in equities on behalf of the policyholders. The new rules aim to eliminate what is described as a potential mismatch under the GloBE rules.

Under the rules for Excluded Dividends, there is an exception for dividends from Short-term Portfolio Shareholdings (i.e. held for less than one year at the time a dividend is distributed). These dividends are included in the GloBE Income or Loss.

Mutual insurance companies are regulated insurance companies which are owned exclusively by their policyholders. The guidance clarifies that the Investment Entity Transparency Election in Article 7.5 applies when an Investment Entity is owned by a mutual insurance company.

The clarifications set out above will be welcome by the insurance sector. In the absence of this latest guidance, there was a risk that certain elements of the rules would not operate as intended for the industry, and there was concern that the application of GloBE rules could lead to unintended results for insurance groups.

M&A - Debt vs Equity

What are key tax implications for companies choosing between equity or debt to finance an investment or acquisition and how could the introduction of DEBRA change this?

Cian O'Sullivan, Tax Director, BDO: From a tax perspective, the key determinant for deciding between debt and equity is generally whether the company can obtain a tax deduction for any interest expense. An Irish company would generally need to rely on obtaining relief for the interest expense as an "interest as a charge". This would require the company to meet certain criteria such as having a "material interest" (5%) in the investee company and having at least one director in common with the investee company.

Following the passing of Anti-Tax Avoidance Directives by the EU, Ireland introduced legislation in recent years which has had the effect of curtailing the level of interest deductibility, the most relevant of which are the Interest Limitation Rules (ILR), which may limit the net interest deduction to 30% of EBITDA (earnings before interest, taxes, depreciation and amortisation).

Cian O'Sullivan

Interest relief is generally available for companies to some degree. However, the costs of raising equity are currently not deductible for tax purposes in Ireland. This is also the case in most other jurisdictions. In order to address the disparity between the tax deductibility of expenses related to debt versus equity, the European Commission presented a proposal on 11 May 2022 for a debt-equity bias reduction allowance (DEBRA).

There are two elements to DEBRA. The first of which is a tax allowance on increases in equity, which is calculated by multiplying the year-on-year increase in equity by a notional interest rate. The allowance will be deductible for ten consecutive tax periods with the annual allowance being limited to 30% of EBITDA.

The second element is a limitation of interest deductions to 85% of excess borrowing costs, which will work in tandem with the ILR. Unlike the ILR, this limitation would be permanent so that the disallowed interest may not be carried forward.

The introduction of certain rules resulting in the possible denial or restriction of deductions for interest expenses, and the potential introduction of equity deduction, has the potential to make equity a more attractive form of raising finance for a company where previously debt would have been the preferred option. Of course, this is solely looking at matters through a tax lens, and there are many legal and commercial considerations that often lead the debt v equity decision making process.

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