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Our ref

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Dear Business and International Tax Division

Phase One of Reform of Ireland's Taxation Regime for Interest

Matheson welcomes the opportunity to respond to the paper "*Phase One of Reform of Ireland's Taxation Regime for Interest*" issued by the Department of Finance on 21 November 2025 (the "**Consultation Document**"). This submission is made on our own behalf.

Comment on policy direction

Preserving competitiveness In the current geopolitical environment, preserving the competitiveness of the Irish tax regime is a key priority. Ireland must now rely on levers other than rate to ensure the Irish tax system remains appealing and attractive for foreign investment. The reform of the taxation of interest is an opportunity for Ireland to enhance the competitiveness of the Irish regime and to ensure Ireland remains attractive for both existing and new foreign investment.

Certainty & simplicity A key element of the competitiveness of a tax regime is the ease of applying the rules. While the move to a single test for the deductibility of trading and non-trading interest expenses could be a welcome simplification, the proposed 'profit motive' test is not. It would bring

material uncertainty and complexity into the Irish regime. If the strawman proposed in the consultation document was implemented in its current form, it would be more damaging to Ireland's competitiveness than doing nothing.

Not adopt the strawman in its current form Rather than implementing the strawman in its current form, we urge policymakers to develop a system that better reflects the international norms for taxing interest. In that respect and reflective of the submission we made in January 2025, we recommend:

- The profit motive test should be abandoned. It is a concept that is not easily defined, would require much judicial interpretation and would cast uncertainty on normal commercial borrowing transactions that currently are subject to entirely certain rules. It would bring damaging complexity to Ireland's tax regime. We have set out more specific concerns below.

- A straight-forward 'commercial purpose' test should be adopted instead, for all trading and non-trading purposes. This test would simply ask: has the debt been incurred for the purposes of the company's business? If so, the interest on such debt should be deductible for Irish corporation tax purposes, unless expressly denied.

- A deduction should be expressly denied in two main cases. First, if the proposed 'targeted anti-avoidance rule' applies, namely where one of the main purposes of the borrowing is to obtain a tax advantage. Second, if the borrowing is used for an expressly disallowed purpose, such as borrowing to fund a philanthropic investment.

- The deductions for interest should in the first instance be ringfenced to their specific Cases, but with an entitlement to offset on a value-basis against income from other Cases.

- This approach would reflect the approach taken in the UK. This approach would equally reflect the approach under the Pillar Two rules. It is a system that would be easily understood by taxpayers and would be easy to administer.

- This straightforward approach is possible because Ireland already has robust internationally-benchmarked guardrails against inappropriate deductions for interest. In particular, the EU interest limitation rule, the EU anti-hybrid rules and the OECD transfer pricing rules provide the necessary protections against erosion of Exchequer tax receipts[1]. In addition, Ireland has a further nine broad categories of domestic anti-avoidance rules to protect against inappropriate deductions for interest.

- This approach would permit taxpayers to deduct interest on normal commercial borrowing in line with their accounts. It would be straightforward and well-understood by international investors. It would be a material improvement on Ireland's current idiosyncratic and outdated treatment of borrowing costs.

We appreciate that a change in approach at this stage may slow delivery of reform of the taxation of interest. However, we recommend taking all additional time that is required to get a best in class approach rather than pushing to meet a 2026 deadline.

[1] Ireland has over 26 pages of interest deduction-denial tax rules in the EU interest limitation rule, over 27 pages of deduction-denial tax rules that can apply to interest in the EU anti-hybrid rules and over 22 pages of deduction-denial tax rules that can apply to interest in the OECD transfer pricing rules

If this means a delay of a year (with an introduction at the end of 2027), that would be far more preferable than the currently proposed strawman.

Introducing the currently proposed strawman and then seeking to address the issues as they arise in an iterative approach over future years would damage Ireland's reputation as a stable and predictable jurisdiction to do business.

New interest deductibility rule for corporation tax

We submit that the 'profit motive' test is not fit-for-purpose. We also submit that a requirement to 'match' income to expenses would not be workable in practice, that the 'wholly and exclusively' test cannot exist in parallel with a 'profit motive' test and that investments that go bad should not be punished.

A. The unsuitability of the 'profit motive' test We submit that the profit motive test would result in uncertainty, complexity and undermine the competitiveness of the Irish regime. We have identified four broad problems:

- **A profit motive test would be ill-defined.** The proposed 'profit motive' test would be a wholly new legal concept in Irish tax law. There is no available case law to assist in its interpretation and application to particular facts. Given its novelty, disputes between taxpayers and the Revenue Commissioners ("**Revenue**") on its interpretation would be unavoidable and these would inevitably require litigation to resolve, in the same way as the term 'wholly and exclusively' has resulted in a very significant body of litigation. The difference is that the term 'wholly and exclusively' has now been well defined by the courts, so disputes as to its scope are now rare. In contrast, it would take decades of case law and taxpayer disputes before a similar well-established understanding meaning of the 'profit motive' test would emerge. Until then, taxpayers would be faced with increased uncertainty and increased costs, in seeking advice and potentially in disputing interpretations with Revenue.

- **A profit motive test would give rise to arbitrary distinctions**. We submit that the profit motive test would result in arbitrary results. There should be no place in a regime intended to improve the Irish tax code for arbitrary results. We submit that two examples in the Consultation Document strikingly illustrate this arbitrary aspect of the proposed profit motive test.

  1. Borrowings to fund capital contributions versus share subscriptions First, if a company borrows to make a capital contribution to a wholly-owned subsidiary, the Consultation Document states that the borrowing would not satisfy the profit motive test. In contrast, if the same company borrows to subscribe for share capital of its wholly-owned subsidiary, the Consultation Document states that such borrowing would satisfy the profit motive test (page 24). We see no substantive distinction between these two transactions. In both cases, the borrowing company is borrowing funds to equity capitalise the wholly-owned subsidiary. In both cases, the subsidiary company (having received the capital from the borrowing company) can deploy the capital in exactly the same way, giving rise to precisely the same outcome (generation of dividends for the borrowing company). The difference in the treatment of the borrowing company, denying the borrowing company a tax deduction for its borrowing costs in one case but not the other, does not withstand scrutiny.

  2. Borrowings to fund dividends versus working capital Second, if a company borrows money to pay a dividend, the Consultation Document states that the interest payable by the company on such borrowing would not be deductible. In contrast, the Consultation Document confirms that interest payable on amounts borrowed to fund the working capital of a trade which would

be deductible under the same test. We submit that this is a false distinction. In many cases, the working capital of a company also constitutes the profit 'reserves' of the company that are available for distribution. A company pays a dividend (thus reducing its working capital) and then borrows funds to replace that working capital, the interest expense on that borrowing would be deductible, according to the Consultation Document. However, it seems that if the timing is reversed and the company first borrows money and then uses that cash to pay a dividend (because the rest of its reserves is tied-up in stock and other non-cash assets), the company cannot claim a deduction for the interest costs of such borrowings. This distinction is arbitrary. More importantly, this distinction would undermine Ireland's offering. It is an entirely normal and common event for a company to borrow to pay a cash dividend. The interest expense incurred on such borrowings is a real cost to the business. We see no policy reason why Ireland should deny a deduction for such *bona fide* commercial borrowings.

Based on the commentary included in the Consultation Document, it is clear that the profit motive test would persistently give rise to arbitrary distinctions, complexity and uncertainty. It will not improve the competitiveness of the Irish offering to attract investment.

- **The burden of proof on taxpayers would be too demanding.** We submit that the burden of proof which taxpayers would have to satisfy for every borrowing would be too high, and much higher than currently is the case under the Case I 'wholly and exclusively' test. It appears to us that taxpayers would first be required to evidence the purpose of all borrowings and then, second, evidence how the purpose was intended to generate profits or gains. The Consultation Document does not state what evidence would be required to demonstrate the purpose of a borrowing. Would all loan document be required to include a clause setting out the purpose of the loan? This is not required at present. Would something further be required? Would there be an effective tax law requirement for board minutes of a directors' meeting approving the borrowing and would these board minutes be required to demonstrate how the purpose of the loan was intended to generate a profit or a gain? This brings more complexity into the Irish tax rules than currently is the case.

- **Borrowings for more than one purpose do not seem to be contemplated** including loans that are recirculated in the business. The same is true of loans that are used with business revenue to cover on-going expenses – there generally will be no clear delineation between how the borrowed funds are used and how the business revenue is used. For example a business might borrow on an overdraft to cover various classes of expenses when there is a temporary requirement for cashflow. Given the fungible nature of cash, it is difficult to distinguish between the use of revenue earned during the term of the loan and the proceeds of the loan as both could be used to cover similar business expenses.

- **Features of the existing interest regime seem to be retained.** While it is proposed that using amounts borrowed to fund the working capital of a trade would be deductible under the profit motive test, it is not clear whether a similar approach would be adopted where a business borrows to fund its working capital in a non-trading context. Retaining that distinction under a new regime for taxing interest would fundamentally undermine the purpose of the reform and would simply retain the existing regime in a different guise. If the policy intention is to retain a distinction between borrowing for the purpose of a trade and borrowing for other purposes, we believe that runs entirely contrary to the overall objective of this reform.

We strongly recommend that the profit motive test be removed.

B. Matching or allocation of interest expense is not required or suitable The proposal that a new regime may require matching borrowings with the profits or gains arising from the funded activity or investment makes the proposal unworkable. Requiring matching would detach the rules from commercial reality. In commercial life, businesses have multiple funding sources and multiple expenses which are not concomitant, reflecting the fungible nature of cash. Requiring matching would be to impose an entirely artificial construct on normal business activity.

Matching is a core element of section 76E of the Taxes Consolidation Act 1997 ("TCA") and is one of the reasons the provision has not been adopted in practice. We would strongly recommend against introducing matching.

C. There should be no need to also retain the 'wholly and exclusively' test There is a suggestion in the paragraph at the end of page 29 that a version of the wholly and exclusively test may apply in addition to the 'profit motive' test and the requirement to allocate interest expense to particular activities or investments that generate profits or gains. We cannot see the circumstances when a wholly and exclusively test (or a comparable 'to the extent' test) would be relevant in addition to a profit motive test and a requirement to match. That is increasing complexity, rather than improving Ireland's regime for taxing interest.

More broadly, the paragraph evinces a reluctance to move away from the existing principles that apply to taxing interest. If the reform of the taxation of interest is to be meaningful it will require a new approach.

D. Investments that go wrong should not be penalised The proposal on page 29 is that no deduction would be available for interest during an accounting period if there are no activities or there is no investment held by the company supported by the borrowings. That approach would go against the objectives of the reform and would unjustly penalise taxpayers who borrow to make investments that subsequently go wrong. For example, if a company borrowed €1,000 to acquire equipment that it expected to lease, but the equipment became obsolete shortly afterwards and the taxpayer sold the equipment for €300, the taxpayer would be denied a deduction for interest it continues to pay on the loan that remains owing in those circumstances. Such interest remains a real business expense and is incurred for a *bona fide* business purpose. The taxpayer should be entitled to recognise this actual expense when computing its liability to tax.

International guardrails

A. Transfer Pricing

Recommend no general extension of transfer pricing to medium enterprises It is unclear from the Consultation Document whether the transfer pricing provisions in Part 35A TCA would be commenced with respect to all transactions for medium enterprises or just with respect to loan transactions. Commencing the provisions with respect to all transactions for medium enterprises would be a very significant step by the Government, as it would impose material compliance costs on medium enterprises.

The UK government consulted last year on the possibility of removing their exemption from transfer pricing rules for medium enterprises. They decided to retain their existing exemption. Some of the concerns raised by stakeholders who argued against removing the exemption included the disproportionate compliance costs that would arise for medium enterprises; the limited transfer pricing risk that medium enterprises pose; and that existing anti-avoidance rules already provide sufficient safeguards against profit diversion. Similar to the position in the UK, we would recommend that rather

than commencing the transfer pricing provisions for medium enterprises, the Department of Finance and Revenue instead monitor the tax at risk and only commence the provisions if there is evidence that the Irish tax base is at risk.

B. Interest limitation rule

Support extension of deadline for group election Extension of the deadline for making an interest group election We welcome the proposal to extend the timeline for making an interest group election. This is a pragmatic proposal and enables taxpayers who have inadvertently made errors in their returns (e.g., failing to check the box to expressly claim the election) to rectify the position. Related amendments should also be made to the timelines for making the group and equity ratio elections.

Correcting errors On a related but separate broader point, we strongly recommend that section 959V TCA be amended to allow such errors to be corrected up to four years after the end of the chargeable period to which the return relates in all cases. Provisions like section 959V TCA that facilitate correction of taxpayer errors foster a pro-compliance environment. The ability to access those provisions should be broader rather than narrower.

Proposed €6m group-wide de minimis threshold should not be introduced We submit that Ireland should not introduce a €6m group-wide de minimis threshold. For Irish corporate groups, the €3m per entity safe-harbour is a really important saver of compliance costs, allowing subsidiaries with low interest expenses to be excluded from costly analyses of the interest limitation rule each year. Furthermore, a €6m figure is entirely arbitrary, with no reflection of whether a group is medium-sized or a very large multinational.

For the Irish investment fund industry, real asset funds (including infrastructure, energy, and aviation) rely upon the Anti-Tax Avoidance Directive's ("**ATAD**") €3 million per-entity safe harbour in offering fund managers a straightforward and ringfenced approach to financing. These investments are typically funded, in part, using borrowings and asset portfolios are segregated by lender requirements. The ATAD explicitly permits a €3 million per-entity safe harbour. We submit that any change should be made through the ATAD itself, rather than through domestic restrictions that effectively displace the €3 million threshold per-entity rule.

If there are concerns about intentional fragmentation, we would support targeted anti-fragmentation guidance and proportionate guardrails that do not undermine the €3 million per-entity safe harbour.

Removal of the cliff edge effect. We support the proposal to "taint" all costs and consider that this approach should reduce arbitrage while removing punitive outcomes where thresholds are narrowly exceeded.

Wait until EU completes its review As the ATAD upon which the interest limitation rule is based is currently being considered at EU level, it would be premature to make material changes to the Irish provisions before changes are agreed at EU level. We recommend pausing material changes to the interest limitation rule until the revision of the ATAD is complete at EU level. This will avoid the risk of making short term changes and enable the revision of the rule to be considered holistically.

Section 247

While we believe that a carefully constructed general rule on interest deductibility, as described above, could entirely remove the need for section 247. In that context we would also welcome the proposal to retain section 247 and 249 TCA on an elective basis only as a pragmatic approach, reflecting various stakeholder comments.

We also welcome the proposals to simplify section 247 TCA by removing the anachronistic requirements including the requirement to have a common director and the requirement for the money to flow from the bank account of the investing company to the investee company and on to the connected company.

In addition and as noted in our January 2025 submission, we recommend:

- removing the requirement to have a 5% common shareholding;
- removing the broader requirement to 'defray money applied' which is interpreted to deny a deduction if the proceeds are used for a short-term purpose. We see no reason why a delay in applying the borrowed funds (or an interim use of the funds for a short-term purpose) should impact on the deductibility of the interest expense;
- removing the requirement that interest be 'yearly interest'. Again, we see no reason why short term funding of a holding company should deny the ability to claim a deduction for a genuine business expense;
- removing the treatment of the deduction as a 'charge' on income, rather than a normal deductible expense. While this 'charge' treatment does confer some advantages, it results in more complex tax compliance administration costs. We believe a straightforward deduction, combined with flexible 'group surrender' rules, would be much more preferable for Ireland's perceived 'ease of use' for multinational corporate groups and international investors;
- revising the language of section 247(4A)(h) TCA so that it is more precise in its application – currently taxpayers tend to seek confirmation from Revenue that the provision will not apply to their transaction;
- removing section 247(2B) TCA as it is notoriously difficult to apply given it is drafted in such broad terms;
- revisiting the treatment of intermediate holding companies under the regime as the application of the rules to such entities is overly complex and does not reflect commercial life; and
- revising the language of section 249 TCA so that it is more precise in its application and that it doesn't trigger double recoveries of capital or recoveries of capital when a group transfers shares as part of a group reorganisation effected for bona fide commercial purposes.

Miscellaneous items

Simplification of section 130 TCA Section 130(2)(d)(iv) TCA cannot be justified on a policy basis in an open trading country which as Ireland. Once all of the other anti-avoidance provisions that would apply to the same payment are taken into account (transfer pricing, interest limitation rule, anti-hybrid rules and outbound payment rules), there is no remaining policy reason to recharacterise payments of interest to group companies resident in non-treaty countries as dividends. These interest payments are real business costs of the Irish company paying them. Section 130(2)(d)(iv) imposes Irish corporation tax on phantom profits of the Irish company. That is not what a fair and modern tax system should do, and undermines Ireland's position as an attractive and competitive jurisdiction. Such interest expenses are not income that Ireland has a fair claim to tax. Therefore, we submit that although the proposal to reduce the scope of the provision is welcome, the proposal does not go far enough.

We strongly recommend that the provision be deleted in full given (i) Ireland's implementation of the anti-hybrid rules which deny a deduction for a payment of interest to a related company to the extent it

is treated as a distribution in the recipient jurisdiction; (ii) Ireland's implementation of the transfer pricing rules which permit debt to be recharacterised as equity to the extent the borrowing exceeds a level that would be agreed between parties acting at arm's length; and (iii) the outbound payment rules that would deny an exclusion from withholding tax if the amount paid was not taxed. Retaining any element of section 130(2)(d)(iv) TCA ignores developments in Irish and international tax law since the provision was first introduced and evinces a reticence to move away from the existing regime for taxing interest.

Repeal of section 76E We support the repeal of section 76E TCA. It has not achieved its desired purpose. As noted above and in our January 2025 submission, the conditions the provision imposed made it unworkable in practice.

Taxation of interest income

Taxing interest on an accruals basis We welcome the proposal to tax interest income on an accruals basis for corporation tax.

However, we expect that new complexities particularly for taxpayers in-scope of Pillar Two may arise by taxing interest income earned under Case III and Case IV income on an accruals basis while taxing the remainder of Case III and Case IV income on a receipts basis. More broadly, we recommend that the government commits to examining the reasons for the differentiation between various cases of income and whether those historical distinctions continue to make sense in a modern business environment.

We do not support the taxation of interest on an accruals basis for income tax, where income is taxed under Case III or Case IV. It is very common for individuals to lend money in a non-trading context. It would be unfair, and would result in much inadvertent non-compliance, if such individuals were taxed on interest that has been accrued but not yet received. It would also force individuals to incur material costs, in seeking accounting advice and support regarding the recognition of interest income on an accruals basis.

Double tax relief Taxpayers will need a more pragmatic approach to relieving double taxation than that proposed in the Consultation Document. Currently, taxpayers that receive interest income as part of their trade (e.g., financial institutions) are taxed on an accruals basis. As a matter of course, those taxpayers claim relief from double taxation in the year the interest accrues not in the year the interest is received as suggested in the Consultation Document. This approach also reflects what has been agreed in the Commentary to the OECD Model Tax Convention (paragraph 32.8 to the Commentary on Articles 23A and 23B).

The proposal in the Consultation Document that taxpayers would need to wait until the interest was received to claim relief from double taxation is inconsistent with international tax norms (in particular those documented in the Commentary to the OECD Model Tax Convention) and existing practice. If guardrails are needed to protect against future changes of law, we instead recommend that taxpayers who have claimed double tax relief in respect of withholding taxes that have not yet been imposed be required to repay the relief if it subsequently transpires that no withholding tax was imposed on the payment received.

Taxation and deduction of interest equivalents

The Consultation Document is silent on the application of withholding tax to interest equivalents. We expect that it is not proposed that withholding tax would apply to payments of interest equivalents on the basis that they would not fall within the confines of 'yearly interest' in section 246 TCA. An extension of the Irish withholding tax rules to interest equivalent income would be incredibly damaging to Ireland's

financial sector. Further, it would result in a mismatch between the positions agreed under Ireland's double tax treaties and domestic rules which would further complicate the rules.

We would welcome confirmation that interest equivalents will not be regarded as 'yearly interest' for the purposes of section 246 TCA.

Other comments

If a policy decision is taken to permit deductions for interest against Case III income, the tax treatment of other aspects of those businesses should be addressed at the same time. In particular:

- Other expenses incurred by those businesses should be deductible under a similar general commercial purpose test; and
- Foreign exchange movements should be dealt with outside of the capital gains tax regime – the current treatment for entities borrowing in a foreign currency and on-lending in the same foreign currency in a non-trading context exposes taxpayers to unexpected tax costs and benefits. It seems reasonable to permit those taxpayers to follow the accounting treatment of foreign exchange movements when the borrowing and lending. The Pillar Two treatment for foreign exchange that applies to trading transactions should also apply to non-trading transactions.

Concluding remarks

We note that it is intended to issue an outline of draft legislation for comment on 16 April. If it is the case that the responses to the Consultation Document indicate that a fundamental revision of the proposal is required, we strongly recommend taking the time to ensure the policy principles underlying the changes are fixed before producing draft legislation. If that requires an extended timeline for implementation, we firmly believe taking the extra time to develop a coherent regime for taxing interest is merited rather than rushing a proposal for Finance Bill 2026 with the intention of amending it in future years.

We would welcome the opportunity to engage further as the review of the taxation of interest progresses.

Yours faithfully

Sent by email, bears no signature

MATHESON LLP