Tax Treatment of Debt Issuance Costs

Part 04-06-21

This document should be read in conjunction with section 81, section 110, section 247 and section 845C of the Taxes Consolidation Act 1997

Document last reviewed August 2022

Revenue
Cáin agus Custaim na hÉireann
Irish Tax and Customs

The information in this document is provided as a guide only and is not professional advice, including legal advice. It should not be assumed that the guidance is comprehensive or that it provides a definitive answer in every case.

Table of Contents

Introduction 3

1 Conditions for deduction in computing trade income 3

2 Purposes of the Trade 3

2.1 Deductible Expenses – Swaps 3

2.2 Section 247 borrowings...4

2.2.1 Non-deductible expenses...4

2.2.2 Swaps entered into to hedge section 247 borrowings 5

3 Capital/Revenue 5

3.1 Financial Institutions 5

3.2 Tier 1 Debt in banks or other financial institutions 6

3.3 Additional Tier 1 instruments...6

Introduction

The purpose of this manual is to provide clarification of the tax treatment of costs associated with the issue of debt instruments. The type of costs concerned are legal and professional fees, brokerage fees, commissions, rating agency fees, swap costs and payments, arrangement fees, debt advisory fees, negotiation fees and other similar payments associated with fund-raising by financial institutions and by section 110 and other companies.

1 Conditions for deduction in computing trade income

To obtain a tax deduction for expenses under section 81 of the Taxes Consolidation Act 1997 (TCA), a company must be able to show that,

- the expenditure has been incurred wholly and exclusively for the purposes of the trade, and;
- it is not capital in nature or otherwise statutorily prohibited.

2 Purposes of the Trade

The nature of the debt and the associated expenditure will determine whether or not the expense is deductible. In this regard, an expense must first be incurred for the purposes of the trade. Expenditure on the borrowing company’s wages or salaries or the purchase of trading stock is clearly incurred for the purposes of the trade and would be deductible in computing the income of that trade. Expenses associated with any sums borrowed to fund such expenditure, incurred for the purposes of the trade, would also be deductible.

2.1 Deductible Expenses – Swaps

This paragraph covers both

- payments under an interest rate swap agreement (i.e. where only flows relating to interest are exchanged), and
- payments calculated by reference to the counterparty's interest commitments under a currency swap agreement (i.e. where, in addition to the exchange of flows relating to interest there is provision for the re-exchange of currencies at the termination of the swap).

Equalisation payments are calculated by reference to notional and not actual loans or debts between the parties and hence the payments are not interest. They have some of the characteristics of annual payments; however, other features are missing. As these payments are not annual payments, it follows that tax need not be deducted on making such payments under swap agreements.

Regular receipts under a swap agreement are income and the corresponding payments are revenue expenses. Where such amounts, received by a trader under a swap agreement, are directly related to interest which is an allowable deduction in computing the profits of the trade for tax purposes, these amounts are income of the trade and the corresponding payments under the swap agreement expenses of the trade.

Where swap arrangements involving a regular exchange of payments are entered into for bona fide commercial purposes in respect of an interest flow which is allowable as a deduction in arriving at the profits or gains assessable under Case V of Schedule D, the receipts and payments may be treated respectively as income or expenses proper to the computation of Case V profits or gains or losses providing this approach is consistently applied.

In other circumstances such receipts and payments are within the charge to tax under Case IV of Schedule D.

In summary, the tax treatment applicable to equalisation payments made under interest rate or currency swap agreements entered into to hedge Case I or Case V expenditure depends on the facts of each case. However:

- where the swap agreement is directly related to interest payments which are an allowable expense in computing the profits of the trade, equalisation payments made or received under the agreement are treated as trading expenses or income, and;
- where the swap agreement is directly related to interest payments which are an allowable expense in arriving at the profits or gains assessable under Case V of Schedule D, equalisation payments made or received under the agreement, may be treated as income or expenses proper to the computation of Case V profits or losses.

2.2 Section 247 borrowings

2.2.1 Non-deductible expenses

Where interest is incurred in connection with section 247 TCA 1997 borrowings used to acquire shares in or to loan money to certain other companies, it will not be allowable as an expense incurred wholly and exclusively for the purposes of a trade. Instead, section 243 TCA 1997 provides that interest incurred on a section 247 loan may be deducted on a paid basis as a charge on the company's income provided the conditions set out in section 247 TCA 1997 are met.

In addition, costs associated with a loan the interest on which is claimed as a charge on income are also not deductible in computing the company's trading income.

2.2.2 Swaps entered into to hedge section 247 borrowings

Where an interest rate or currency swap agreement is entered into in relation to a section 247 loan, the interest on which qualifies for relief as a charge on income under the provisions of section 243 and section 247 TCA 1997, equalisation payments made or received under the agreement are linked directly to the interest on the loan.

To the extent that the payments relate to interest on the section 247 loan, companies may treat such equalisation payments as an increase or reduction in the interest charge, as the case may be, provided such treatment is applied on a consistent basis.

The treatments outlined in relation to swaps will apply where the swap has been entered into for bona fide commercial purposes and the approach outlined is consistently applied.

3 Capital/Revenue

Expenditure which has been incurred wholly and exclusively for the purposes of a trade may still be disallowed if it is capital expenditure. In this regard Revenue will look to the nature of the borrowings to determine whether or not the expenses will be deductible. Where the borrowing is applied for capital purposes (e.g. to re-purchase share capital of the company), costs associated with that borrowing will not be deductible.

3.1 Financial Institutions

For the purpose of this manual the term "financial institution" includes a leasing company as well as a company which advances money in the ordinary course of a trade carried on in the State which includes the lending of money and for which any interest payable in respect of money so advanced is taken into account in computing the income of that trade of the company.

In relation to the issuance of debt (other than Tier 1 debt, which is always capital in nature see 3.2 below) by a financial institution, Revenue considers that the borrowings may be regarded as revenue in nature where the life of the debt is expected to be 12 years or less. In this regard, Revenue will treat the expected life of the debt, as set out in the prospectus or other document governing the debt issue, as determining the life of the debt.

Accordingly, a financial institution may deduct the costs associated with the issue in computing the income of its trade. Where the debt is not redeemed within this 12 year period, the deduction granted will not be withdrawn, unless at the time the debt was issued, the financial institution was in possession, or aware, of information, including information about any arrangement or understanding, which could reasonably be taken to indicate that the debt would not be redeemed within the 12 year period. Any costs connected with the extended term will not be deductible.

3.2 Tier 1 Debt in banks or other financial institutions

Debt issued to meet the Tier 1 solvency requirements for banks is always regarded as capital in nature. Accordingly, interest associated with the issue of this debt is not deductible for tax purposes. For the avoidance of doubt, it must also be noted that costs associated with Tier 1 debt are not deductible.

3.3 Additional Tier 1 instruments

Additional Tier 1 instruments are instruments issued by financial institutions to meet the regulatory capital requirements imposed by the Capital Requirements Directive IV and the Capital Requirements Regulations, which implemented Basel III in the EU.

Additional Tier 1 instruments share features of both debt and equity which makes the tax treatment of such instruments uncertain.

Section 845C TCA 1997 provides that Additional Tier 1 instruments are to be treated as debt instruments. Coupon payments in respect of the instruments are to be regarded as interest thereby enabling tax deductibility in respect of the coupon payments.

Section 845C TCA 1997 also provides for an exemption from the obligation to deduct withholding tax in respect of coupon payments made under the instruments by deeming the instruments to be quoted Eurobonds for the purpose of section 64 TCA 1997.