Matters to be treated as distributions and Interest on Certain Loans

Part 06-02-03

This document should be read in conjunction with section 130 of the Taxes Consolidation Act 1997

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Interest on Certain Loans

The meaning of the term “distribution” for the purposes of the Corporation Tax Acts is set out in section 130 of the Taxes Consolidation Act 1997.

Broadly, a distribution is any dividend or other distribution out of the assets of a company in respect of shares in the company. The scope of the definition is widened to include a variety of other payments which are treated as distributions. A distribution is not deductible in calculating a company’s income. It is regarded as a distribution out of the company’s income rather than an expense in earning that income. One of the categories of payment which is treated as a distribution is interest paid by a company on a loan if the level of interest on the loan depends on the results of the company’s business. The distribution treatment is designed to prevent equity investments being disguised by companies as loans in order to obtain an interest deduction.

However, a type of loan - referred to as **a ratchet loan** - has been developed for commercial reasons and it also links the level of interest on the loan and the borrowing company’s profitability. The link for these loans is such that, a lower interest rate applies when the borrower’s results improve (because the lender’s risk thereby reduces) and a higher interest rate applies when the borrower’s results disimprove. As the level of interest on these loans is linked to the borrowing company’s profitability, the interest is technically “caught” by the distribution treatment of section 130 TCA 1997. However, as these loans are commercial in nature and are not a mechanism to disguise an equity investment as a loan, the interest on this type of loan **should not be** treated as a distribution.