

Payment and receipt of interest without deduction of income tax

Part 08-03-06

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1. As a general rule **Section 246 TCA 1997** requires the deduction of income tax at the standard rate from annual interest paid by:
 - companies
 - any person to another person whose usual place of abode is outside the State.

The European Investment Bank (EIB) is exempt from all direct taxes in Ireland by virtue of **Article 21 of Protocol (No 7) on the Privileges and Immunities of the European Union** and the European Bank for Reconstruction and Development [EBRD] is exempt from all direct taxes in Ireland by virtue of **S.I. No. 65/1991 - European Bank For Reconstruction and Development (Designation and Immunities) Order, 1991** . Therefore, while these payments are not covered by a specific exemption in **section 246**, companies may pay interest gross to both the EIB and EBRD . There is no requirement that companies seek confirmation from Revenue under **section 246(3)(d)** (see below for further details).

2. The section contains an extensive range of exemptions from the general rule to withhold tax. These exemptions are allowed automatically and do not require prior approval from Revenue. Practices in relation to a number of these exemptions are set out below.

a. Meaning of bona fide bank

Section 246(3)(a) and **246(3)(b)** provides that interest paid in the State on an advance from a bank carrying on a bona fide banking business in the state may be paid without deduction of tax and also that interest paid by such a bank in the ordinary course of its business may be paid without deduction of tax.

The term bona fide bank is not defined in the legislation. However, Revenue interpret it to mean:

- any credit institution who is the holder of a banking licence granted under **Section 9 of the Central Bank Act 1971**.
- a bank licenced pursuant to **Section 9 of the Central Bank Act 1971**, and registered as a designated credit institution under **section 14 of the Asset Covered Securities Act 2001**.
- an Irish branch of a foreign bank operating here under the terms of the **EU Directive 2006/48/EC**.
- an EU branch of an Irish credit institution who is a holder of a banking licence granted under **Section 9 of the Central Bank Act 1971**.
- a building society within the meaning of the **Building Societies Act 1889**, or a society established in accordance with the law of any other Member State of the European Communities which corresponds to that Act.

b. Syndicated Debt

The exemption under **section 246(3)(a)** will apply to interest paid by an Irish corporate borrower to a bank carrying on a bona fide banking business in the State,

where the bank did not provide the original advance but took an assignment of the original loan or part of the loan from a foreign institutional lender. Refer to relevant extracts from Tax Briefing 55, annexed to this manual, where this confirmation was first given.

c. Section 246 (3)(b) - Capital Borrowing

Certain circumstances may arise where the payment of interest by a bank or building society on funding raised abroad may not be regarded as arising in the ordinary course of business but the interest is treated as an allowable deduction in the computation of trading profits. Revenue are prepared, in these circumstances, to treat the interest as payable on ordinary course borrowing for the purposes of **section 246 (3)(b)**, thereby allowing such interest to be paid gross.

d. Section 246 (3)(ccc) and 246(3)(h) Interest Paid to US Companies and US Limited Liability Companies)

Subsections (3)(ccc) and (3)(h) section 246 TCA 1997 provide that withholding tax is not to be deducted from certain interest payments where the recipient of the interest is, by virtue of the law of a relevant territory, resident for the purposes of tax in a relevant territory. A relevant territory means a Member State of the European Communities other than the Republic of Ireland or a territory with which Ireland has a Double Taxation Treaty.

U.S. Companies

The requirement to be resident for the purposes of tax in a relevant territory may give rise to difficulties for US companies as the concept of residence for tax purposes is not recognised under US tax law and it is not possible for the payer of the interest to get such a confirmation. It is not the intention of the legislation to exclude US companies from the exemption from withholding tax provided for in either **section 246(3)(ccc) or 246(3)(h) TCA 1997**. To clarify the position for US companies Revenue are prepared to accept that a company which is incorporated in the US and taxed in the US on its worldwide income will qualify for the exemption from withholding tax provided for in **section 246(3)(ccc) and 246(3)(h) TCA 1997**.

U.S. LLCs

An additional difficulty arises for US Limited Liability Companies (LLC's). An LLC has corporate form and personality but is categorised as a partnership under the Internal Revenue Code of the USA. As such, the LLC is not separately taxed but is treated as a transparent or 'look through' entity for US tax purposes and its income is taken to flow through to its members who are taxed according to US principles as though they received the money directly. Therefore on a strict interpretation of the legislation an exemption from withholding tax cannot be granted where the interest is paid to US residents through a US LLC.

In recognition of the difficulties arising from the use of US LLCs Revenue are prepared to 'look through' the US LLC to the ultimate recipients of the interest subject to the following conditions:

1. Where the ultimate recipients of the interest themselves would qualify for exemption from withholding tax under **section 246(3)(ccc) or 246(3)(h) TCA 1997**.
2. Where business is conducted through an LLC for market reasons and not for tax avoidance purposes.

e. Section 246(3)(d) TCA 1997

Revenue has discretionary power under the provisions of **section 246(3)(d) TCA 1997** to grant permission to a company to pay interest without deduction of withholding tax. However, due to the wide range of exemptions generally available under the legislation authorisation under this section would only be granted in very exceptional circumstances.

Example of specific circumstances when this power may be exercised:

Assignment¹ / Novation² of a loan by a bank:

A company which is an SME who borrowed from a bank may not be aware that the reason no withholding tax is operated is the application of section 246(3)(a). If that loan is sold, reassigned or novated from the bank to an SPV then the SME has a withholding tax obligation.

Where the loan is assigned to a “section 110 company” then section 246(3)(cc) operates to remove the withholding obligation. However, an SPV which is taxed in accordance with section 110 cannot offer any proof of their section 110 status to an SME meaning that in the majority of cases an SME cannot know whether or not a withholding tax obligation has arisen following an assignment of their original loan.

Therefore, where the loan agreement contains a gross-up clause which would in effect increase the SME’s interest charge by the amount of the withholding tax, the SME can apply for authorisation under **section 246(3)(d)**.

Example of gross-up:

SME had borrowed from its bank. Its loan was reassigned to an entity which is not a bank. It is about to pay €100 in interest and its loan agreement includes a gross up clause. It would therefore have to pay €125 in interest, with €25 paid to Revenue in withholding tax and €100 paid to the new lender. The new lender will then file its tax return and claim a credit for the tax withheld, thus receiving €125 in total.

In order for the SME to avail of this exemption an application must be made to Revenue under **section 246(3)(d) TCA 1997**. Full facts regarding the loan must be disclosed in writing. Please note that copies of all agreements between each of the parties to the loan and relevant documentation which sets out details of arrangements in place between each of the parties regarding interest payments on the advance/loan may be requested.

¹ An SME company may only become aware that the loan has been assigned when they receive new payment instructions or details of a new intermediary who is handling the loan.

² An SME company should be involved in the novation of a loan from their old bank to the new lender.

The Revenue address to send the applications under **section 246(3)(d) TCA 1997** is as follows

Office of the Revenue Commissioners
Business Taxes Policy and Legislation Division
Financial Services Unit
2nd Floor
Stamping Building
Dublin Castle
Dublin 2

Upon receipt of all information, subject to the conditions outlined above, Revenue will consider applications under section 246(3)(d) whereby interest may be paid gross.

A more recent version of this manual is available.

Excerpt from Tax Briefing 55
INTEREST PAYMENTS - Exemption from Withholding Tax

Interest Paid to US companies and US Limited Liability Companies Exemption from Withholding Tax

Subsections (3)(ccc) and (3)(h) of Section 246 TCA 1997 provide that withholding tax is not to be deducted from certain interest payments where the recipient of the interest is, by virtue of the law of a relevant territory, resident for the purposes of tax in a relevant territory. A relevant territory means a Member State of the European Communities other than the Republic of Ireland or a territory with which Ireland has a Double Taxation Treaty.

US Companies

It has come to Revenue's attention that the requirement to be resident for the purposes of tax in a relevant territory may give rise to difficulties for US companies as the concept of residence for tax purposes is not recognised under US tax law and it is not possible for the payer of the interest to get such a confirmation. It is not the intention of the legislation to exclude US companies from the exemption from withholding tax provided for in either Section 246(3)(ccc) or 246(3)(h) TCA 1997. To clarify the position for US companies Revenue are prepared to accept that a company which is incorporated in the US and taxed in the US on its worldwide income will qualify for the exemption from withholding tax provided for in Section 246(3)(ccc) and 246(3)(h) TCA 1997.

US LLC's

An additional difficulty arises for US Limited Liability Companies (LLCs). An LLC has corporate form and personality but is categorised as a partnership under the Internal Revenue Code of the USA. As such, the LLC is not separately taxed but is treated as a transparent or 'look through' entity for US tax purposes and its income is taken to flow through to its members who are taxed according to US principles as though they received the money directly. Therefore on a strict interpretation of the legislation an exemption from withholding tax cannot be granted where the interest is paid to US residents through a US LLC. In recognition of the difficulties arising from the use of US LLCs Revenue are prepared to 'look through' the US LLC to the ultimate recipients of the interest subject to the following conditions:

1. Where the ultimate recipients of the interest themselves would qualify for exemption from withholding tax under Section 246(3)(ccc) or 246(3)(h) TCA 1997.
2. Where business is conducted through an LLC for market reasons and not for tax avoidance purposes.

Syndicated Debt Held by Irish Banks and the application of Section 246(3)(a) TCA 1997

Section 246(3)(a) TCA 1997 excludes from withholding tax interest paid in the State on an advance from a bank carrying on a bona fide banking business in the State. Exemption under this Section will apply to interest paid by an Irish corporate borrower to a bank carrying on a bona fide banking business in the State, where the bank did not provide the original advance but took an assignment of the original loan or part of the loan from a foreign institutional lender.