

## SCHEDULES

### SCHEDULE 26

Section 83

#### DERIVATIVE CONTRACTS

##### PART 1

###### INTRODUCTION

###### *Profits arising from derivative contracts*

- 1 (1) For the purposes of corporation tax all profits arising to a company from its derivative contracts shall be chargeable to tax as income in accordance with this Schedule.
- (2) Except where otherwise indicated, the amounts to be brought into account in accordance with this Schedule in respect of any matter are the only amounts to be brought into account for the purposes of corporation tax in respect of that matter.

##### PART 2

#### DERIVATIVE CONTRACTS

###### *Derivative contracts and relevant contracts*

- 2 (1) For the purposes of the Corporation Tax Acts a company's derivative contracts are those of its relevant contracts which satisfy the following provisions of this Schedule.
- (2) For the purposes of this Schedule a "relevant contract" is—
  - (a) an option,
  - (b) a future, or
  - (c) a contract for differences.

###### *Contracts to satisfy accounting requirements etc*

- 3 (1) A relevant contract is not a derivative contract for the purposes of this Schedule for any accounting period unless—
  - (a) it is treated for accounting purposes as a derivative financial instrument,
  - (b) in the case of a relevant contract falling within paragraph 6 or 7 which is not treated as described in paragraph (a), it is treated for accounting purposes as a financial asset, or
  - (c) in the case of a relevant contract which is not treated as described in paragraph (a) or (b), it falls within sub-paragraph (2).
- (2) A relevant contract falls within this sub-paragraph if—
  - (a) its underlying subject matter is commodities, or

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- (b) it is a contract for differences whose underlying subject matter is—
  - (i) intangible fixed assets,
  - (ii) weather conditions, or
  - (iii) creditworthiness.
- (3) For the purposes of sub-paragraph (1)(a), a relevant contract of a company is treated for accounting purposes as a derivative financial instrument for an accounting period if, for that accounting period, it is so treated for the purposes of the relevant accounting standard used by the company for that accounting period (or would be so treated if the company were a company which used the relevant accounting standard in respect of the relevant contract).
- (4) For the purposes of sub-paragraph (1)(b), a relevant contract of a company is treated for accounting purposes as a financial asset for an accounting period if, for that accounting period, it is so treated for the purposes of the relevant accounting standard used by the company for that accounting period (or would be so treated if the company were a company which used the relevant accounting standard in respect of the relevant contract).
- (5) For the purposes of sub-paragraphs (3) and (4), the “relevant accounting standard” used by a company for an accounting period is—
  - (a) in relation to any accounting period for which it is required or permitted to be used by the company, Financial Reporting Standard 13 issued in September 1998 by the Accounting Standards Board, as it has effect for periods of account ending on 31st December 2002, or
  - (b) in relation to any accounting period for which it is required or permitted to be used by the company, any subsequent accounting standard dealing with transactions which are derivative financial instruments or financial assets under Financial Reporting Standard 13, as from time to time amended.

*Contracts excluded by virtue of their underlying subject matter*

- 4 (1) A relevant contract is not a derivative contract for the purposes of this Schedule if its underlying subject matter consists wholly of any one or more of the excluded types of property or is treated as consisting wholly of such property.
- (2) For the purposes of this paragraph as it relates to an option or future, the excluded types of property are—
  - (a) land, whether situated in the United Kingdom or elsewhere;
  - (b) tangible movable property, other than commodities which are tangible assets;
  - (c) intangible fixed assets;
  - (d) shares in a company;
  - (e) rights of a unit holder under a unit trust scheme; and
  - (f) any assets representing loan relationships to which either section 92 or 93 of the Finance Act 1996 (c. 8) applies.
- (3) For the purposes of this paragraph as it relates to a contract for differences, the excluded types of property are those falling within paragraphs (a),(b) and (d) to (f) of sub-paragraph (2).

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- (4) Paragraph 9 applies for the purpose of determining whether the underlying subject matter of a relevant contract is to be treated as consisting wholly of any one or more of the excluded types of property.
- (5) This paragraph has effect subject to paragraphs 5 to 8 (which qualify the exclusion of relevant contracts by this paragraph).

*Qualified exclusion: contract held by company for purposes of trade*

- 5
- (1) Paragraph 4 does not prevent a relevant contract to which this paragraph applies from being a derivative contract.
  - (2) This paragraph applies to a relevant contract of a company if—
    - (a) it is entered into or acquired by the company for the purposes of a trade carried on by it, and
    - (b) its underlying subject matter consists, or is treated as consisting, wholly of—
      - (i) shares in a company,
      - (ii) rights of a unit holder under a unit trust scheme, or
      - (iii) assets representing a loan relationship to which either section 92 or 93 of the Finance Act 1996 applies.
  - (3) Paragraph 9 applies for the purpose of determining whether the underlying subject matter of a relevant contract is to be treated as consisting wholly of the property referred to in sub-paragraph (2)(b).

*Qualified exclusion: contract producing guaranteed return*

- 6
- (1) Paragraph 4 does not prevent a relevant contract to which this paragraph applies from being a derivative contract.
  - (2) This paragraph applies to a relevant contract of a company if—
    - (a) its underlying subject matter consists, or is treated as consisting, wholly of—
      - (i) shares in a company,
      - (ii) rights of a unit holder under a unit trust scheme, or
      - (iii) assets representing a loan relationship to which either section 92 or 93 of the Finance Act 1996 (c. 8) applies, and
    - (b) it satisfies the condition in sub-paragraph (3).
  - (3) The condition referred to in sub-paragraph 2(b) is that—
    - (a) the relevant contract is designed to produce a guaranteed return, or
    - (b) the relevant contract and one or more of the following, namely—
      - (i) one or more other relevant contracts, whose underlying subject matter consists wholly or partly of shares in a company, rights of a unit holder under a unit trust scheme or assets representing loan relationships to which either section 92 or 93 of the Finance Act 1996 applies, and which would be derivative contracts if the condition in this sub-paragraph were satisfied in relation to them,
      - (ii) one or more assets representing loan relationships to which either section 92 or 93 of that Act applies, and
      - (iii) one or more assets representing loan relationships to which section 93A of that Act applies,

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are associated transactions designed to produce a guaranteed return.

- (4) For the purposes of this paragraph—
- (a) the return on a relevant contract of a company comprises any amounts accruing to the company as respects the contract for any accounting period, and
  - (b) the return on an asset representing a loan relationship of a company is the amount that must be paid to discharge the money debt arising in connection with that relationship.
- (5) For the purposes of this paragraph the relevant contract in question is, or that contract and the other associated transactions are, designed to produce a guaranteed return if, as regards that contract, or as regards that contract and the other associated transactions taken together, it would be reasonable to assume, from considering—
- (a) the likely effect of that contract or of that contract and the other associated transactions,
  - (b) the circumstances in which—
    - (i) that contract is entered into or acquired, or
    - (ii) the contract and the other associated transactions, or any of them, are entered into or acquired, or
  - (c) the matters in both of paragraphs (a) and (b),
- that the main purpose (or one of the main purposes) of that contract, or of that contract and the other associated transactions, is or was the production of a guaranteed return from that contract, or from that contract and any one or more of the other associated transactions.
- (6) For the purposes of this paragraph a guaranteed return is produced from the relevant contract in question, or from that contract and any one or more of the other associated transactions, wherever (as regards that contract or as regards that contract and those transactions, taken together) risks from fluctuations in the underlying matter of that contract, or of that contract or any one or more of the other associated transactions, are so eliminated or reduced as to produce a return from that contract, or from that contract and any one or more of the other associated transactions, which equates, in substance, to the return on an investment of money at interest.
- (7) For the purposes of sub-paragraph (6) the cases where risks from fluctuations in the underlying matter of the relevant contract in question, or of that contract or any one or more of the other associated transactions, are eliminated or reduced shall be deemed to include any case where the main reason, or one of the main reasons, for the choice of that underlying matter is—
- (a) that there appears to be no risk that it will fluctuate, or
  - (b) that the risk that it will fluctuate appears to be insignificant.
- (8) In this paragraph—
- (a) the references, in relation to an asset representing a loan relationship to which section 92 of the Finance Act 1996 (c. 8) applies, to the underlying matter are references to the value of shares in a company which may be acquired under that relationship;
  - (b) the references, in relation to an asset representing a loan relationship to which section 93 or 93A of the Finance Act 1996 applies, to the underlying matter are references to the value of chargeable assets of a particular description to which that relationship is linked;

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- (c) the references, in relation to a relevant contract, to fluctuations in the underlying matter are references to fluctuations determined by reference to its underlying subject matter.
- (9) For the purposes of this paragraph a company is a connected company in relation to another company if, in the accounting period in question, there is a connection between the company and that other company; and whether there is a connection between those companies shall be determined in accordance with sections 87(3) and (4) and 87A of the Finance Act 1996 (disregarding section 88 of that Act).
- (10) Paragraph 9 applies for the purpose of determining whether the underlying subject matter of a relevant contract is to be treated as consisting wholly of the property referred to in sub-paragraph (2)(a).

*Qualified exclusion: guaranteed amount payable on maturity*

- 7 (1) Paragraph 4 does not prevent a relevant contract to which this paragraph applies from being a derivative contract.
- (2) This paragraph applies to a relevant contract of a company if—
- (a) its underlying subject matter consists, or is treated as consisting, wholly of—
    - (i) shares in a company,
    - (ii) rights of a unit holder under a unit trust scheme, or
    - (iii) assets representing a loan relationship to which either section 92 or 93 of the Finance Act 1996 applies, and
  - (b) it satisfies the condition in sub-paragraph (3).
- (3) The condition referred to in sub-paragraph (2)(b) is that—
- (a) the relevant contract is designed to secure that the relevant amount payable in respect of the relevant contract does not fall below the guaranteed amount, or
  - (b) the relevant contract and one or more of the following, namely—
    - (i) one or more other relevant contracts, whose underlying subject matter consists wholly or partly of shares in a company, rights of a unit holder under a unit trust scheme or assets representing loan relationships to which either section 92 or 93 of the Finance Act 1996 (c. 8) applies, and which would be derivative contracts if the condition in this sub-paragraph were satisfied in relation to them,
    - (ii) one or more assets representing loan relationships to which either section 92 or 93 of that Act applies, and
    - (iii) one or more assets representing loan relationships to which section 93A of that Act applies,are associated transactions designed to secure that the relevant amount payable in respect of the associated transactions does not fall below the guaranteed amount.
- (4) For the purposes of this paragraph the relevant contract in question is, or that contract and the other associated transactions are, designed to secure that the relevant amount payable in respect of that contract, or that contract and any one or more of the other associated transactions, does not fall below the guaranteed amount if, as regards that contract, or as regards that contract and the transactions, taken together, it would be reasonable to assume, from considering—

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- (a) the likely effect of that contract or of that contract and the other associated transactions,
  - (b) the circumstances in which—
    - (i) that contract is entered into or acquired, or
    - (ii) that contract and the other associated transactions, or any of them, are entered into or acquired, or
  - (c) the matters in both of paragraphs (a) and (b),
- that the main purpose (or one of the main purposes) of that contract, or of that contract and the other associated transactions, is or was to secure that the relevant amount so payable does not fall below the guaranteed amount.
- (5) For the purposes of this paragraph the guaranteed amount is—
- (a) in a case where the relevant contract in question is designed as described in sub-paragraph (3)(a), 80% of the consideration paid or payable by the company for entering into, or acquiring, that contract, or
  - (b) in a case where the relevant contract in question and the other associated transactions are designed as described in sub-paragraph (3)(b), 80% of the consideration paid or payable by the company or a company which is a connected company in relation to that company for entering into, or acquiring, any one or more of the associated transactions.
- (6) For the purposes of this paragraph the relevant amount payable is—
- (a) in a case where the relevant contract in question is designed as described in sub-paragraph (3)(a), the amount payable, in money or money's worth, to any person on the maturity of that contract, or
  - (b) in a case where the relevant contract in question and the other associated transactions are designed as described in sub-paragraph (3)(b), the amount payable, in money or money's worth, to any person on the maturity of any one or more of the associated transactions.
- (7) For the purposes of sub-paragraph (6) the amount payable on maturity is—
- (a) in the case of a relevant contract, the amount payable on performance of the relevant contract, or
  - (b) in the case of an asset representing a loan relationship, the amount that must be paid to discharge the money debt arising in connection with that relationship.
- (8) For the purposes of this paragraph a company is a connected company in relation to another company if, in the accounting period in question, there is a connection between the company and that other company; and whether there is a connection between those companies shall be determined in accordance with sections 87(3) and (4) and 87A of the Finance Act 1996 (c. 8) (disregarding section 88 of that Act).
- (9) Paragraph 9 applies for the purpose of determining whether the underlying subject matter of a relevant contract is to be treated as consisting wholly of the property referred to in sub-paragraph (2)(a).
- (10) This paragraph has effect subject to paragraph 48 (which provides for a company to elect to treat a relevant contract falling within this paragraph as two assets).

*Qualified exclusion: contract held by company to provide insurance benefits*

- 8 (1) Paragraph 4 does not prevent a relevant contract to which this paragraph applies from being a derivative contract.
- (2) This paragraph applies to a relevant contract of a company if—
- (a) the company is a company carrying on long-term insurance business,
  - (b) the relevant contract is or was entered into or acquired by the company in order to provide such benefits as are described in sub-paragraph (3), and
  - (c) the underlying subject matter of the relevant contract consists, or is treated as consisting, wholly of—
    - (i) shares in a company,
    - (ii) rights of a unit holder under a unit trust scheme, or
    - (iii) assets representing a loan relationship to which either section 92 or 93 of the Finance Act 1996 applies.
- (3) The benefits referred to in sub-paragraph (2)(b) are benefits under policies of life insurance or capital redemption policies where—
- (a) the terms of the policy or contract permit part of the rights conferred by the policy or contract to be surrendered by the holder of the policy or contract at intervals of one year or less, and
  - (b) the amount which may be paid on the surrender of such part of the rights conferred equates, in substance, to the return on an investment of money at interest.
- (4) Paragraph 9 applies for the purpose of determining whether the underlying subject matter of a relevant contract is to be treated as consisting wholly of the property referred to in sub-paragraph (2)(c).

*Underlying subject matter which is subordinate or of small value disregarded*

- 9 (1) This paragraph applies in relation to a relevant contract which falls within any of sub-paragraphs (2) to (4).
- (2) A relevant contract falls within this sub-paragraph if its underlying subject matter consists of—
- (a) any one or more of the excluded types of property falling within paragraphs (a) to (f) of sub-paragraph (2) of paragraph 4 (or, in the case of a contract for differences, within paragraphs (a), (b) and (d) to (f) of that sub-paragraph), and
  - (b) other underlying subject matter which is—
    - (i) subordinate in relation to any of the property referred to in paragraph (a), or
    - (ii) of small value in comparison with the value of the underlying subject matter as a whole.
- (3) A relevant contract falls within this sub-paragraph if its underlying subject matter consists of—
- (a) any one or more of the excluded types of property falling within paragraphs (a) to (c) of sub-paragraph (2) of paragraph 4 (or, in the case of a contract for differences, within paragraphs (a) and (b) of that sub-paragraph), and
  - (b) other underlying subject matter which is—

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- (i) subordinate in relation to any of the property referred to in paragraph (a), or
  - (ii) of small value in comparison with the value of the underlying subject matter as a whole.
- (4) A relevant contract falls within this sub-paragraph if its underlying subject matter consists of—
- (a) any one or more of the excluded types of property falling within paragraphs (d) to (f) of sub-paragraph (2) of paragraph 4, and
  - (b) other underlying subject matter which is—
    - (i) subordinate in relation to any of the property referred to in paragraph (a), or
    - (ii) of small value in comparison with the value of the underlying subject matter as a whole.
- (5) Where this paragraph applies in relation to a relevant contract, its underlying subject matter shall be treated for the purposes of this Schedule as if it consisted wholly of—
- (a) in the case of a relevant contract falling within sub-paragraph (2), the excluded types of property referred to in paragraph (a) of that sub-paragraph,
  - (b) in the case of a relevant contract falling within sub-paragraph (3), the excluded types of property referred to in paragraph (a) of that sub-paragraph, or
  - (c) in the case of a relevant contract falling within sub-paragraph (4), the excluded types of property referred to in paragraph (a) of that sub-paragraph.
- (6) For the purposes of this paragraph whether part of the underlying subject matter of a relevant contract of a company is subordinate or of small value is to be determined by reference to the time when the company enters into or acquires the relevant contract.

#### *Associated transactions*

- 10 (1) For the purposes of this Part of this Schedule two or more transactions are associated transactions if all of them are entered into or acquired in pursuance of the same scheme or arrangements.
- (2) Nothing in this Part shall be construed as preventing transactions with different parties, or transactions with parties different from the parties to the scheme or arrangements in pursuance of which they are entered into or acquired, from being associated transactions.
- (3) For the purposes of this paragraph the cases in which any two or more transactions are to be taken to be entered into or acquired in pursuance of the same scheme or arrangements shall include any case in which it would be reasonable to assume, from either or both of—
- (a) the likely effect of the transactions, and
  - (b) the circumstances in which the transactions, or any of them, are entered into or acquired,
- that neither of them or, as the case may be, none of them would have been entered into or acquired independently of the other or the others.
- (4) In this paragraph “scheme or arrangements” includes schemes, arrangements and understandings of any kind, whether or not legally enforceable.



*Meaning of “underlying subject matter”*

- 11 (1) In this Part of this Schedule references to the underlying subject matter of a relevant contract are to be construed in accordance with this paragraph.
- (2) The underlying subject matter of an option is—
- (a) the property which would fall to be delivered if the option were exercised, or
  - (b) where the property which would so fall to be delivered is a derivative contract, the underlying subject matter of that derivative contract.
- (3) The underlying subject matter of a future is—
- (a) the property which, if the future were to run to delivery, would fall to be delivered at the date and price agreed when the contract is made, or
  - (b) where the property which would so fall to be delivered is a derivative contract, the underlying subject matter of that derivative contract.
- (4) The underlying subject matter of a contract for differences is—
- (a) where the contract for differences relates to fluctuations in the value or price of property described in the contract, the property so described, or
  - (b) where an index or factor is designated in the contract for differences, the matter by reference to which the index or factor is determined.
- (5) In the case of a contract for differences, its underlying subject matter may include—
- (a) interest rates;
  - (b) weather conditions;
  - (c) creditworthiness.
- (6) Interest rates are not the underlying subject matter of a relevant contract in a case where, under the terms of that contract,—
- (a) the date on which a party to that contract becomes subject to a duty to make a payment is a variable date, and
  - (b) the amount of that payment varies according to the date of payment,
- and the terms of the relevant contract refer to an interest rate or rates for the purpose only of establishing that amount.

*Definition of terms relating to derivative contracts*

- 12 (1) This paragraph defines these expressions for the purposes of this Part of this Schedule
- (a) a capital redemption policy;
  - (b) a contract for differences;
  - (c) a future;
  - (d) intangible fixed assets;
  - (e) an option;
  - (f) shares in a company;
  - (g) a warrant.
- (2) A “capital redemption policy” is a contract effected in the course of capital redemption business (within the meaning of section 458 of the Taxes Act 1988).
- (3) A “contract for differences” is a contract the purpose or pretended purpose of which is to make a profit or avoid a loss by reference to fluctuations in—

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- (a) the value or price of property described in the contract, or
  - (b) an index or other factor designated in the contract.
- (4) For the purposes of sub-paragraph (3)(b) an index or factor may be determined by reference to any matter and, for those purposes, a numerical value may be attributed to any variation in a matter.
- (5) None of the following is a contract for differences—
- (a) a future;
  - (b) an option;
  - (c) a contract of insurance;
  - (d) a capital redemption policy;
  - (e) a contract of indemnity;
  - (f) a guarantee;
  - (g) a warranty;
  - (h) a loan relationship.
- (6) A “future” is a contract for the sale of property under which delivery is to be made—
- (a) at a future date agreed when the contract is made, and
  - (b) at a price so agreed.
- (7) For the purposes of sub-paragraph (6)(b) a price is to be taken to be agreed when the contract is made—
- (a) notwithstanding that it is left to be determined by reference to the price at which a contract is to be entered into on a market or exchange or could be entered into at a time and place specified in the contract; or
  - (b) in a case where the contract is expressed to be by reference to a standard lot and quality, notwithstanding that provision is made for a variation in the price to take account of any variation in quantity or quality on delivery.
- (8) An “option” includes a warrant.
- (9) A “warrant” is an instrument which entitles the holder to subscribe for shares in a company or assets representing a loan relationship of a company; and for these purposes it is immaterial whether the shares or assets to which the warrant relates exist or are identifiable.
- (10) References to a future or option do not include references to a contract whose terms provide—
- (a) that, after setting off their obligations to each other under the contract, a cash payment is to be made by one party to the other in respect of the excess, if any, or
  - (b) that each party is liable to make to the other party a cash payment in respect of all that party’s obligations to the other under the contract,
- and do not provide for the delivery of any property.
- Nothing in this sub-paragraph has effect to exclude, from references to a future or option, references to a future or option whose underlying subject matter is currency.
- (11) “Intangible fixed assets” has the same meaning as in Part 1 of Schedule 29 to this Act, but any asset excluded by Part 10 of that Schedule is not an intangible fixed asset for the purposes of this Part of this Schedule.

- (12) “Share”, in relation to a company, means any share in the company under which an entitlement to receive distributions may arise.

*Power to amend paragraphs 2 to 12*

- 13 (1) The Treasury may by order amend any of paragraphs 2 to 12.
- (2) The provision that may be made by an order under this paragraph includes provision—
- (a) adding to, or varying, the descriptions of contract which are derivative contracts within paragraph 2 or removing any such description of contract, or
  - (b) adding to, or varying, the descriptions of contracts which are excluded under paragraph 4 or removing any such description of contract.
- (3) The provision that may be made under sub-paragraph (2)(b), in relation to contracts which are excluded under paragraph 4, includes provision adding to, or varying, the provisions which qualify the exclusion of contracts under that paragraph or removing any such qualifying provision.
- (4) To the extent that an order under this paragraph includes provision—
- (a) varying the requirements under paragraph (a) or (b) of sub-paragraph (1) of paragraph 3 as to the treatment of a contract for accounting purposes, or
  - (b) adding to, or varying, the descriptions of contracts which fall within sub-paragraph (2) of that paragraph,
- it may provide for such variations to have effect in relation to accounting periods which end on or after the day on which the order comes into force (whenever beginning).
- (5) The power to make an order under this paragraph includes power—
- (a) to make different provision for different cases, and
  - (b) to make such consequential, supplementary, incidental or transitional provisions, or savings, as appear to the Treasury to be necessary or expedient (including provision amending any enactment or any instrument made under an enactment).

### **PART 3**

#### **METHOD OF TAXATION**

*Method of bringing amounts into account*

- 14 (1) For the purposes of corporation tax the profits and losses arising from the derivative contracts of a company shall be computed in accordance with this paragraph using the credits and debits given for the accounting period in question by the following provisions of this Schedule.
- (2) To the extent that, in any accounting period, a derivative contract of a company is one to which the company is party for the purposes of a trade carried on by it, the credits and debits given in respect of that contract for that period shall be treated (according to whether they are credits or debits) either—

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- (a) as receipts of that trade falling to be brought into account in computing the profits of that trade for that period; or
  - (b) as expenses of that trade which are deductible in computing those profits.
- (3) Where for any accounting period there are, in respect of the derivative contracts of a company, credits and debits that are not brought into account under sub-paragraph (2), they shall be brought into account for that accounting period as if they were non-trading credits or non-trading debits falling to be brought into account for the purposes of Chapter 2 of Part 4 of the Finance Act 1996 (c. 8) in respect of loan relationships of the company.
- (4) Sub-paragraph (2), so far as it provides for any amount to be deductible as mentioned in paragraph (b) of that sub-paragraph, shall have effect notwithstanding anything in section 74 of the Taxes Act 1988 (allowable deductions).

*Credits and debits brought into account*

- 15 (1) The credits and debits to be brought into account in the case of any company in respect of its derivative contracts shall be the sums which, in accordance with an authorised accounting method and when taken together, fairly represent, for the accounting period in question—
- (a) all profits and losses of the company which (disregarding any charges or expenses) arise to the company from its derivative contracts and related transactions; and
  - (b) all charges and expenses incurred by the company under or for the purposes of its derivative contracts and related transactions.
- (2) The reference in sub-paragraph (1)(a) to the profits and losses arising to a company does not include a reference to any amounts required to be transferred to the company's share premium account.
- (3) The reference in sub-paragraph (1)(a) to the profits and losses arising to a company includes—
- (a) a reference to any profits or losses which, in accordance with generally accepted accounting practice, are carried to or sustained by any reserve maintained by the company, and
  - (b) a reference to any forward premiums or discounts which arise from a derivative contract whose underlying subject matter consists wholly or partly of currency and which, in accordance with generally accepted accounting practice, are brought into account as profits or losses.
- (4) The reference in sub-paragraph (1)(b) to charges and expenses incurred for the purposes of a company's derivative contracts and related transactions does not include a reference to any charges or expenses other than those incurred directly—
- (a) in bringing any of those contracts into existence;
  - (b) in entering into or giving effect to any of those transactions;
  - (c) in making payments under any of those contracts or in pursuance of any of those transactions; or
  - (d) in taking steps for ensuring the receipt of payments under any of those contracts or in accordance with any of those transactions.
- (5) Where—

- (a) any charges or expenses are incurred by a company for purposes connected —
  - (i) with entering into a derivative contract or related transaction, or
  - (ii) with giving effect to any obligation that might arise under a derivative contract or related transaction,
- (b) at the time when the charges or expenses are incurred, the contract or transaction is one into which the company may enter but has not entered, and
- (c) if that contract or transaction had been entered into by that company, the charges or expenses would be charges or expenses incurred as mentioned in sub-paragraph (4),

those charges or expenses shall be treated for the purposes of this Schedule as charges or expenses in relation to which debits may be brought into account in accordance with sub-paragraph (1)(b) to the same extent as if the contract or transaction had been entered into.

- (6) Where—
  - (a) different authorised accounting methods are used for the purposes of this Schedule as respects the same derivative contract for different parts of the same accounting period or for successive accounting periods, and
  - (b) an amount is brought into account for the purposes of the company's statutory accounts in respect of the change of method,that amount shall be taken for the purposes of this Schedule to be included among the sums in respect of which credits and debits fall to be brought into account for the purposes of this Schedule in accordance with sub-paragraph (1)(a).
- (7) In this Schedule “related transaction”, in relation to a derivative contract, means any disposal or acquisition (in whole or in part) of rights or liabilities under the derivative contract.
- (8) The cases where there shall be taken for the purposes of sub-paragraph (7) to be a disposal or acquisition of rights or liabilities under a derivative contract shall include —
  - (a) those where such rights or liabilities are transferred or extinguished by any sale, gift, surrender or release, and
  - (b) those where the contract is discharged by performance in accordance with its terms.

- (9) This paragraph has effect subject to paragraph 16.

*Exchange gains and losses arising from derivative contracts*

- 16 (1) The reference in paragraph 15(1)(a) to the profits and losses arising to a company from its derivative contracts and related transactions includes a reference to exchange gains and losses arising to the company from its derivative contracts.
- (2) Sub-paragraph (1) is subject to the following provisions of this paragraph.
- (3) Sub-paragraph (1) does not have effect in relation to—
  - (a) so much of an exchange gain or loss arising to a company, in relation to a derivative contract whose underlying subject matter consists wholly or partly of currency, as falls within sub-paragraph (4),

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- (b) so much of any exchange gain or loss arising to a company as results from any translation from one currency to another pursuant to section 93A(4) of the Finance Act 1993 (c. 34) of the profit or loss of part of the company's business and falls within sub-paragraph (6), or
  - (c) so much of an exchange gain or loss arising to a company, in relation to a derivative contract whose underlying subject matter consists wholly or partly of currency, as falls within a description prescribed for the purpose in regulations made by the Treasury.
- (4) For the purposes of sub-paragraph (3)(a), an exchange gain or loss falls within this sub-paragraph to the extent that in accordance with generally accepted accounting practice an amount representing the whole or part of it—
- (a) is carried to or sustained by a reserve maintained by the company; and
  - (b) is set off by or against an amount falling within sub-paragraph (5).
- (5) An amount falls within this sub-paragraph if—
- (a) it represents the whole or part of an exchange gain or loss arising to the company in relation to any asset of the company; and
  - (b) in accordance with generally accepted accounting practice it is carried to or sustained by the reserve mentioned in sub-paragraph (4).
- (6) For the purposes of sub-paragraph (3)(b), an exchange gain or loss falls within this sub-paragraph to the extent that, in accordance with generally accepted accounting practice, an amount representing the whole or part of it is carried to or sustained by a reserve maintained by the company.
- (7) Where, by virtue of sub-paragraph (3), sub-paragraph (1) does not have effect in relation to an amount representing the whole or part of an exchange gain or loss, paragraph 15(3) shall not have effect in relation to that amount (but this sub-paragraph is subject to regulations under sub-paragraph (8)).
- (8) The Treasury may by regulations make provision for or in connection with bringing into account in prescribed circumstances amounts in relation to which sub-paragraph (1) does not, by virtue of sub-paragraph (3), have effect.
- (9) The reference in sub-paragraph (8) to bringing amounts into account is a reference to bringing amounts into account—
- (a) for the purposes of this Schedule, as credits or debits arising to a company from its derivative contracts and related transactions; or
  - (b) for the purposes of the Taxation of Chargeable Gains Act 1992 (c. 12).
- (10) Any power to make regulations under this paragraph includes power to make different provision for different cases.

#### PART 4

##### ACCOUNTING METHODS

###### *Authorised accounting methods*

- 17 (1) Subject to the following provisions of this Schedule, the alternative accounting methods that are authorised for the purposes of this Schedule are—
- (a) an accruals basis of accounting; and

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- (b) a mark to market basis of accounting under which any derivative contract to which that basis is applied is brought into account in each accounting period at a fair value.
- (2) An accounting method applied in any case shall be treated as authorised for the purposes of this Schedule only if—
- (a) subject to paragraphs (b) to (d), it is in conformity with generally accepted accounting practice to use that method in that case;
  - (b) it contains proper provision for allocating payments under a derivative contract, or arising as a result of a related transaction, to accounting periods;
  - (c) it contains proper provision for determining exchange gains and losses from a derivative contract for accounting periods; and
  - (d) where it is an accruals basis of accounting, it does not contain any provision (other than provision in respect of exchange losses or provision comprised in authorised arrangements for bad debt) that gives debits by reference to the valuation at different times of any derivative contract.
- (3) In the case of an accruals basis of accounting, proper provision for allocating payments under a derivative contract to accounting periods is provision which—
- (a) allocates payments to the period to which they relate, without regard to the periods in which they are made or received or in which they become due and payable;
  - (b) includes provision which, where payments relate to two or more periods, apportions them on a just and reasonable basis between the different periods;
  - (c) assumes, subject to authorised arrangements for bad debt, that every amount payable to the company under the derivative contract will be paid in full as it becomes due;
  - (d) secures the making of the adjustments required in the case of the derivative contract by authorised arrangements for bad debt; and
  - (e) provides, subject to authorised arrangements for bad debt, that, where there is a release of any liability owed by the company under the derivative contract, the appropriate amount in respect of the release is credited to the company in the accounting period in which the release takes place.
- (4) In the case of a mark to market basis of accounting, proper provision for allocating payments under a derivative contract to accounting periods is provision which allocates payments to the periods in which they become due and payable.
- (5) In this paragraph the references to authorised arrangements for bad debt are references to accounting arrangements under which debits and credits are brought into account in conformity with the provisions of paragraph 22.
- (6) In this paragraph “fair value”, in relation to a derivative contract of a company, means the amount which, at the time as at which the value falls to be determined, is the amount that the company would obtain from or, as the case may be, would have to pay to an independent person for—
- (a) the transfer of all the company’s rights under the contract in respect of amounts which at that time are not yet due and payable; and
  - (b) the release of all the company’s liabilities under the contract in respect of amounts which at that time are not yet due and payable.

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*Application of accounting methods*

- 18 (1) This paragraph has effect, subject to the following provisions of this Schedule, for the determination of which of the alternative authorised accounting methods that are available by virtue of paragraph 17 is to be used as respects the derivative contracts of a company.
- (2) Different methods may be used as respects different derivative contracts or, as respects the same derivative contract, for different accounting periods or different parts of the same accounting period.
- (3) If a basis of accounting which is or equates with an authorised accounting method is used as respects any derivative contract of a company in a company's statutory accounts, then the method which is to be used for the purposes of this Schedule as respects that contract for the accounting period, or part of a period, for which that basis is used in those accounts shall be—
- (a) where the basis used in those accounts is an authorised accounting method, that method; and
  - (b) where it is not, the authorised accounting method to which it equates;
- but this sub-paragraph is subject to paragraphs 19 to 21.
- (4) For any period or part of a period for which the authorised accounting method to be used as respects a derivative contract of a company is not—
- (a) the method determined under sub-paragraph (3),
  - (b) an authorised mark to market basis of accounting in accordance with an election under paragraph 19, or
  - (c) an authorised mark to market basis of accounting in accordance with paragraph 20 or 21,
- an authorised accruals basis of accounting shall be used for the purposes of this Schedule as respects that derivative contract.
- (5) For the purposes of this paragraph (but subject to sub-paragraph (6))—
- (a) a basis of accounting equates with an authorised accruals basis of accounting if it purports to allocate payments under a derivative contract to accounting periods according to when they are taken to accrue; and
  - (b) a basis of accounting equates with an authorised mark to market basis of accounting if it purports in respect of a derivative contract—
    - (i) to produce credits or debits computed by reference to the determination, as at different times in an accounting period, of a fair value; and
    - (ii) to produce credits or debits relating to payments under that derivative contract according to when they become due and payable.
- (6) An accounting method which purports to make any such allocation of payments under a derivative contract as is mentioned in sub-paragraph (5)(a) shall be taken for the purposes of this paragraph to equate with an authorised mark to market basis of accounting (rather than with an authorised accruals basis of accounting) if—
- (a) it purports to bring that derivative contract into account in each accounting period at a value which would be fair value if the valuation were made on the basis that any periodic payments falling to be made under the contract were to be disregarded to the extent that they have already accrued; and
  - (b) the credits and debits produced in the case of that contract by that method (when it is properly applied) correspond, for all practical purposes, to the



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credits and debits produced in the case of that contract, and for the same accounting period, by an authorised mark to market basis of accounting.

*Application of accounting methods: election to follow generally accepted accounting practice*

- 19 (1) Sub-paragraph (2) has effect if, in the case of a company falling within paragraph 52(1)(c) or (d) (companies whose statutory accounts are accounts to which Part 1 of Schedule 21C or 21D to the Companies Act 1985 (c. 6) applies or accounts falling to be drawn up in accordance with the requirements imposed under the law of the home State),—
- (a) an authorised mark to market basis of accounting would be used as respects some or all of the company's derivative contracts, were the company a UK company following generally accepted accounting practice, but
  - (b) that is not the basis of accounting used as respects those derivative contracts in the company's statutory accounts.
- (2) Where this sub-paragraph has effect in relation to a company, the company may elect to use an authorised mark to market basis of accounting as its authorised accounting method for the purposes of this Schedule in relation to every derivative contract as respects which that basis would be used were it a UK company following generally accepted accounting practice.
- (3) Any election under sub-paragraph (2)—
- (a) must be made before the expiration of the period of two years following the end of the company's first accounting period beginning on or after 1st October 2002 in which it is party to a derivative contract in relation to which an election under sub-paragraph (2) may be made;
  - (b) has effect for that accounting period and all subsequent accounting periods of the company; and
  - (c) is irrevocable.
- (4) A company which makes an election under sub-paragraph (2) as respects its derivative contracts shall be taken for the purposes of Chapter 2 of Part 4 of the Finance Act 1996 (c. 8) to have at the same time made an election under section 86(3A) of that Act having effect—
- (a) for the accounting periods mentioned in sub-paragraph (3)(b), and
  - (b) as respects any loan relationships to which the company is or may become a party in any of those accounting periods,
- and that election shall so have effect notwithstanding anything in paragraph (a) or (b) of subsection (3B) of that section.

*Application of accounting methods: requirement to follow generally accepted accounting practice*

- 20 (1) Sub-paragraph (2) has effect if, in the case of a company falling within paragraph 52(1)(c) or (d),—
- (a) the company has not made an election under paragraph 19,
  - (b) an authorised mark to market basis of accounting would be used for an accounting period—
    - (i) as respects some or all of the company's derivative contracts, and
    - (ii) as respects some or all of its loan relationships,

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were the company a UK company following generally accepted accounting practice, and

- (c) that basis of accounting—
  - (i) is used in the company’s statutory accounts as respects those loan relationships for that accounting period, but
  - (ii) is not the basis of accounting used in the company’s statutory accounts as respects those derivative contracts for that accounting period.

(2) Where this sub-paragraph has effect in relation to any accounting period, the company must for that accounting period use an authorised mark to market basis of accounting as its authorised accounting method for the purposes of this Schedule in relation to every derivative contract as respects which that basis would be used were it a UK company following generally accepted accounting practice.

(3) Sub-paragraph (4) has effect where, in the case of a derivative contract of a company,

- (a) the company uses, as respects the contract, a basis of accounting other than an authorised mark to market basis of accounting for an accounting period (the “preceding period”), but
- (b) by virtue of sub-paragraph (2), the company must for the succeeding accounting period (the “first mark to market period”) use, as respects the contract, an authorised mark to market basis of accounting as its authorised accounting method for the purposes of this Schedule.

(4) Where this sub-paragraph has effect in relation to a derivative contract of a company, the company shall be deemed—

- (a) to have disposed of the contract immediately before the end of the preceding period for a consideration of an amount equal to the fair value of the contract at that time, and
- (b) to have reacquired it for the same consideration immediately after the beginning of the first mark to market period.

*Basis of accounting for contracts falling within paragraph 6, 7 or 8*

21 (1) This paragraph applies in relation to a contract which is a derivative contract for the purposes of this Schedule by virtue of—

- (a) paragraph 6 (contracts producing a guaranteed return),
- (b) paragraph 7 (contracts where guaranteed amount payable on maturity), or
- (c) paragraph 8 (contracts to provide insurance benefits).

(2) Where this paragraph applies in relation to a derivative contract, the accounting method to be used as respects the derivative contract for an accounting period shall be an authorised mark to market basis of accounting.

## PART 5

### SPECIAL PROVISION FOR BAD DEBT ETC

#### *Bad debt etc*

- 22 (1) In determining the credits and debits to be brought into account in accordance with an accruals basis of accounting, a departure from the assumption in the case of the derivative contracts of a company that every amount payable under those contracts to the company will be paid in full as it becomes due shall be allowed to the extent only that—
- (a) a debt is a bad debt;
  - (b) a doubtful debt is estimated to be bad; or
  - (c) a liability to pay any amount is released.
- (2) Such a departure shall be made only where the accounting arrangements of the company satisfy sub-paragraphs (3) and (4).
- (3) This sub-paragraph is satisfied if the accounting arrangements allowing the departure also require appropriate adjustments, in the form of credits, to be made if the whole or any part of an amount taken or estimated to represent an amount of bad debt is paid or otherwise ceases to be an amount in respect of which such a departure is allowed.
- (4) This sub-paragraph is satisfied if, in determining any credits and debits to be brought into account in respect of exchange gains and losses arising from the company's derivative contracts, the accounting arrangements allowing the departure require an amount payable under a derivative contract—
- (a) to be left out of account, to the extent that such a departure is allowed; and
  - (b) to be taken into account again, to the extent that it is represented by credits brought into account under sub-paragraph (3).
- (5) Where—
- (a) in the case of a derivative contract of a company, a liability owed by the company to pay an amount under the contract is released, and
  - (b) the release takes place in an accounting period for which an authorised accruals basis of accounting is used as respects the contract,
- no credit in respect of the release shall be required to be brought into account in the case of the company if the release is part of a relevant arrangement or compromise (within the meaning given by section 74(2) of the Taxes Act 1988).

## PART 6

### SPECIAL COMPUTATIONAL PROVISIONS

#### *Derivative contracts for unallowable purposes*

- 23 (1) Where in any accounting period a derivative contract of a company has an unallowable purpose, this paragraph shall apply for the purpose of determining the credits and debits which fall, in the case of the company, to be brought into account for the purposes of this Schedule.

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- (2) Subject to sub-paragraph (4), the credits to be brought into account in the case of the derivative contract for the accounting period shall not include so much of the exchange credits given by the authorised accounting method used as respects the contract as, on a just and reasonable apportionment, is referable to the unallowable purpose.
- (3) Subject to sub-paragraph (4), the debits to be brought into account in the case of the derivative contract for the accounting period shall not include so much of the debits given by the authorised accounting method used as respects the contract as, on a just and reasonable apportionment, is referable to the unallowable purpose.
- (4) If, in the case of the derivative contract,—
  - (a) the amount of the debits referable to the unallowable purpose, in accordance with sub-paragraph (3), for that accounting period, exceeds
  - (b) the amount of the exchange credits referable to that purpose, in accordance with sub-paragraph (2), for that accounting period,the difference between the amounts (the “net loss”) may be brought into account as a debit to the extent permitted by sub-paragraph (5).
- (5) An amount of accumulated net losses may be brought into account for an accounting period if, and to the extent that, there is for that period an amount of accumulated credits (other than exchange credits).
- (6) For the purposes of sub-paragraph (5) the amount of accumulated net losses is, in relation to an accounting period,—
  - (a) the amount of any net loss arising, in the case of the derivative contract, for that accounting period or any earlier accounting period, in accordance with sub-paragraph (4), less
  - (b) the amount of any such net loss as was brought into account in accordance with sub-paragraph (5) in any earlier accounting period.
- (7) For the purposes of sub-paragraph (5) the amount of accumulated credits (other than exchange credits) is, in relation to an accounting period,—
  - (a) the amount of any credits (other than exchange credits) arising, in the case of the derivative contract, for that accounting period or any earlier accounting period, less
  - (b) an amount equal to the amount of any net loss, arising in the case of the derivative contract, which was brought into account in accordance with sub-paragraph (5) in any earlier accounting period.
- (8) Amounts which, by virtue of this paragraph, are not brought into account for the purposes of this Schedule as respects any matter are in consequence also amounts which, in accordance with paragraph 1(2), are not to be brought into account for the purposes of corporation tax as respects that matter apart from this Schedule.
- (9) For the purposes of this paragraph, a credit is an exchange credit, in the case of a company, to the extent that it is attributable to any exchange gains arising to the company which, by virtue of paragraph 16, are included in the reference to the profits arising to the company in paragraph 15(1)(a).
- (10) This paragraph is supplemented by paragraph 24.

*Derivative contracts for unallowable purposes: supplementary*

- 24 (1) For the purposes of paragraph 23 a derivative contract to which a company is party shall be taken to have an unallowable purpose in an accounting period where the purposes for which, at times during that period, the company—
- (a) is party to the contract, or
  - (b) enters into transactions which are related transactions by reference to that contract,
- include a purpose (“the unallowable purpose”) which is not amongst the business or other commercial purposes of the company.
- (2) For the purposes of this paragraph the business and other commercial purposes of a company do not include the purposes of any part of its activities in respect of which it is not within the charge to corporation tax.
- (3) For the purposes of this paragraph, where one of the purposes for which a company—
- (a) is party to a derivative contract at any time, or
  - (b) enters into a transaction which is a related transaction by reference to any derivative contract of the company,
- is a tax avoidance purpose, that purpose shall be taken to be a business or other commercial purpose of the company only where it is not the main purpose, or one of the main purposes, for which the company is party to the contract at that time or, as the case may be, for which the company enters into that transaction.
- (4) The reference in sub-paragraph (3) to a tax avoidance purpose is a reference to any purpose that consists in securing a tax advantage (whether for the company or any other person).
- (5) In this paragraph “tax advantage” has the same meaning as in Chapter 1 of Part 17 of the Taxes Act 1988 (tax avoidance).

*Debits and credits treated as relating to capital expenditure*

- 25 (1) This paragraph applies where any debit or credit given by an authorised accounting method for any accounting period in respect of a company’s derivative contract is allowed by generally accepted accounting practice to be treated, in the accounts of the company, as an amount brought into account in determining the value of a fixed capital asset or project.
- (2) Notwithstanding the application to it of the treatment allowed by generally accepted accounting practice, the debit or credit shall be brought into account for the purposes of corporation tax, for the accounting period for which it is given, in the same way as a debit or credit which, in accordance with generally accepted accounting practice, is brought into account in determining the company’s profit or loss for that period.
- (3) No debit may be brought into account by virtue of this paragraph if it is taken into account in arriving at the amount of expenditure in relation to which a debit may be given by Schedule 29 to this Act.

*Transfers of value to connected companies*

- 26 (1) This paragraph applies where—
- (a) as a result of the expiry of an option of a company which, until its expiry, was a derivative contract of the company, there is a transfer of value by the

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- company (“the transferor”) to a company which is a connected company in relation to it (“the transferee”), and
- (b) the transferee is not chargeable to corporation tax, in respect of the derivative contract, under or by virtue of this Schedule.
- (2) In order to determine, for the purposes of sub-paragraph (1)(a), whether there is a transfer of value, it shall be assumed that—
- (a) if there had not been a connection between the transferor and the transferee, the option would not have expired, and
- (b) if there had not been such a connection, it would have been exercised on the date on which it expired.
- (3) Where this paragraph applies in relation to the expiry of the option of the transferor, the transferor shall bring the appropriate amount into account in accordance with paragraph 15 for the appropriate accounting period as a credit in respect of the derivative contract.
- (4) In sub-paragraph (3)—
- (a) the appropriate accounting period is the accounting period of the transferor in which the option expired, and
- (b) the appropriate amount is the amount (if any) paid by the transferor to the transferee for the grant of the option by the transferee.
- (5) In this paragraph “option” has the same meaning as in paragraph 12, apart from sub-paragraph (10).
- (6) For the purposes of this paragraph, a company is a connected company in relation to another company if, in the accounting period in question, there is a connection between the company and that other company; and whether there is a connection between those companies shall be determined in accordance with sections 87(3) and (4) and 87A of the Finance Act 1996 (c. 8) (disregarding section 88 of that Act).

*Exchange gains and losses where derivative contracts not on arm’s length terms*

- 27 (1) Sub-paragraph (2) applies where—
- (a) a company is party to a derivative contract in an accounting period,
- (b) as regards the derivative contract, an exchange gain or exchange loss arises to the company for the accounting period in question, and
- (c) the profits and losses of the company fall by virtue of Schedule 28AA to the Taxes Act 1988 (provision not at arm’s length) to be computed for tax purposes as if the company were not party to the derivative contract.
- (2) Where this sub-paragraph applies, any exchange gains and losses which arise to the company from the derivative contract for the accounting period in question shall be left out of account in determining the credits and debits which are, in the case of the company, to be brought into account for the purposes of this Schedule.
- (3) Sub-paragraph (4) applies where—
- (a) a company is party to a derivative contract in an accounting period,
- (b) as regards the derivative contract, an exchange gain or exchange loss arises to the company for the accounting period in question, and
- (c) the profits and losses of the company fall by virtue of Schedule 28AA to the Taxes Act 1988 to be computed for tax purposes as if the terms of the

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derivative contract were those that would have been agreed by the company and the other party to the derivative contract had they been dealing at arm's length.

- (4) Where this sub-paragraph applies, the credits and debits which are, in the case of the company, to be brought into account for the purposes of this Schedule shall be determined on the assumption that, in the accounting period in question, the amount of any exchange gain or loss arising to the company from the derivative contract is the adjusted amount.
- (5) In sub-paragraph (4) the “adjusted amount” is the amount of an exchange gain or loss (including an exchange gain of nil) which would have arisen from the derivative contract if the terms of the contract were those that would have been agreed by the company and the other party to the derivative contract had they been dealing at arm's length.

#### *Transactions within groups*

- 28 (1) This paragraph applies where, as a result of any transaction or series of transactions falling within sub-paragraph (2), one of the companies there referred to (“the transferee company”) directly or indirectly replaces the other (“the transferor company”) as a party to a derivative contract.
- (2) The transactions or series of transactions referred to in sub-paragraph (1) are—
- (a) a related transaction between two companies that are—
    - (i) members of the same group, and
    - (ii) within the charge to corporation tax in respect of that transaction;
  - (b) a series of transactions having the same effect as a related transaction between two companies each of which—
    - (i) has been a member of the same group at any time in the course of that series of transactions, and
    - (ii) is within the charge to corporation tax in respect of the related transaction;
  - (c) a transfer between two companies of business consisting of the effecting or carrying out of contracts of long-term insurance which has effect under an insurance business transfer scheme; and
  - (d) any transfer between two companies which is a qualifying overseas transfer within the meaning of paragraph 4A of Schedule 19AC to the Taxes Act 1988 (transfer of business of overseas life insurance company).
- (3) The credits and debits to be brought into account for the purposes of this Schedule in the case of the two companies shall be determined as follows—
- (a) the transaction, or series of transactions, by virtue of which the replacement takes place shall be disregarded except for the purpose of identifying the company in whose case any credit or debit not relating to that transaction, or those transactions, is to be brought into account; and
  - (b) the transferor company and the transferee company shall be deemed (except for that purpose) to be the same company.
- (4) References in this paragraph to one company replacing another as a party to a derivative contract shall include references to a company becoming a party to any derivative contract which confers rights or imposes duties which are equivalent to

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any rights or duties of the other company under a derivative contract of which that other company has previously ceased to be a party.

- (5) In this paragraph “insurance business transfer scheme” means a scheme falling within section 105 of the Financial Services and Markets Act 2000 (c. 8), including an excluded scheme falling within Case 2, 3 or 4 of subsection (3) of that section.
- (6) In this paragraph references to companies being members of the same group of companies shall be construed in accordance with section 170 of the Taxation of Chargeable Gains Act 1992 (c. 12).
- (7) This paragraph has effect subject to paragraphs 29 and 30.

*Transactions within groups: exceptions relating to insurance*

- 29 (1) Paragraph 28 does not apply by virtue of sub-paragraph (2)(a) or (b) of that paragraph in relation to any transfer of an asset, or of any rights or duties under or interest in an asset, where the asset was within one of the categories set out in section 440(4)(a) to (e) of the Taxes Act 1988 (assets held for certain categories of long term business) either immediately before the transfer or immediately afterwards.
- (2) Paragraph 28 does not apply by virtue of sub-paragraph (2)(c) or (d) of that paragraph in relation to any transfer of an asset, or of any rights or duties under or interest in an asset, where the asset—
- (a) was an asset within one of the categories set out in section 440(4) of the Taxes Act 1988 immediately before the transfer, and
  - (b) is not an asset within that category immediately afterwards.
- (3) For the purposes of sub-paragraph (2) above, where one of the companies is an overseas life insurance company an asset shall be taken to be within the same category both immediately before the transfer and immediately afterwards if it—
- (a) was an asset within one category immediately before the transfer, and
  - (b) is an asset within the corresponding category immediately afterwards.
- (4) In this paragraph “overseas life insurance company” has the same meaning as in Chapter 1 of Part 12 of the Taxes Act 1988.

*Transactions within groups: authorised mark to market basis of accounting*

- 30 Paragraph 28 does not apply where the transferor company uses an authorised mark to market basis of accounting as respects the derivative contract in question, but in any such case the amount to be brought into account by the transferee company in respect of the transaction referred to in that paragraph, or in respect of the series of transactions there referred to, taken together, must be the fair value of the derivative contract as at the date of transfer to the transferee company.

*Derivative contracts with non-residents*

- 31 (1) This paragraph applies in relation to a company where, as a result of any transaction,
- (a) the company and a non-resident both become party to a derivative contract,
  - (b) the company becomes party to a derivative contract to which a non-resident is party, or



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- (c) a non-resident becomes party to a derivative contract to which the company is party.
- (2) For each accounting period for any part of which the company and the non-resident are both party to a derivative contract, the credits and debits which fall, in the case of the company, to be brought into account for the purposes of this Schedule as respects the derivative contract shall not include, in a case where that contract makes provision for notional interest payments, any relevant debit arising in relation to that contract.
- (3) For the purposes of sub-paragraph (2) the amount of a relevant debit shall be computed by determining, as regards that accounting period, the amount (if any) by which—
- (a) the aggregate of any notional interest payments made by the company to the non-resident while the company and the non-resident are both party to the derivative contract, exceeds
  - (b) the aggregate of any notional interest payments made by the non-resident to the company during that time.
- (4) For the purposes of sub-paragraphs (2) and (3) a notional interest payment is any payment the amount of which falls to be determined (wholly or mainly) by applying to a notional principal amount specified in a derivative contract, for a period so specified, a rate the value of which at all times is the same as that of a rate of interest so specified.
- (5) Sub-paragraph (2) shall not apply where the company is a bank, building society, financial trader or recognised clearing house and—
- (a) the company is party to the derivative contract solely for the purposes of a trade or part of a trade carried on by it in the United Kingdom, and
  - (b) it is party to the derivative contract otherwise than as agent or nominee of another person.
- (6) Sub-paragraph (2) shall not apply where—
- (a) the non-resident is party to the derivative contract solely for the purposes of a trade or part of a trade carried on by him in the United Kingdom through a branch or agency, and
  - (b) he is party to the derivative contract otherwise than as agent or nominee of another person.
- (7) Sub-paragraph (2) shall not apply where arrangements made in relation to the territory in which the non-resident is resident—
- (a) have effect by virtue of section 788 of the Taxes Act 1988, and
  - (b) make provision, whether for relief or otherwise, in relation to interest (as defined in the arrangements).
- (8) Where the non-resident is party to the contract as agent or nominee of another person, sub-paragraph (7) shall have effect as if the reference to the territory in which the non-resident is resident were a reference to the territory in which that other person is resident.
- (9) In this paragraph—
- “non-resident” means a person who is not resident in the United Kingdom;
  - “recognised clearing house” has the meaning given by section 285 of the Financial Services and Markets Act 2000 (c. 8).

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## PART 7

### COLLECTIVE INVESTMENT SCHEMES

#### *Authorised unit trusts: capital profits and losses*

- 32 (1) Where any profits or losses arising to an authorised unit trust from a derivative contract in an accounting period are capital profits or losses, they must not be brought into account as credits or debits for the purposes of this Schedule, notwithstanding paragraph 15.
- (2) For the purposes of this paragraph, capital profits and losses arising from a derivative contract in an accounting period are such profits and losses arising from a derivative contract as fall to be dealt with under—
- (a) the heading “net gains/losses on investments during the period”, or
  - (b) the heading “other gains/losses”,
- in the statement of total return for the accounting period.
- (3) For the purposes of sub-paragraph (2), the statement of total return for an accounting period is the statement of total return which, in accordance with the Statement of Recommended Practice used for the accounting period, must be included in the accounts contained in the annual report of the authorised unit trust which deals with the accounting period.
- (4) For the purposes of sub-paragraph (3), the “Statement of Recommended Practice” used for an accounting period is—
- (a) in relation to any accounting period for which it is required or permitted to be used, the Statement of Recommended Practice relating to Authorised Unit Trust Schemes issued by the Investment Management Regulatory Organisation Limited in January 1997, as from time to time modified, amended or revised, or
  - (b) in relation to any accounting period for which it is required or permitted to be used, any subsequent statement of recommended practice dealing with accounting requirements relating to authorised unit trust schemes, as from time to time modified, amended or revised.

#### *Open-ended investment companies: capital profits and losses*

- 33 (1) Where any profits or losses arising to an open-ended investment company from a derivative contract in an accounting period are capital profits or losses, they must not be brought into account as credits or debits for the purposes of this Schedule, notwithstanding paragraph 15.
- (2) For the purposes of this paragraph, capital profits and losses arising from a derivative contract in an accounting period are such profits and losses arising from a derivative contract as fall to be dealt with under—
- (a) the heading “net gains/losses on investments during the period”, or
  - (b) the heading “other gains/losses”,
- in the statement of total return for the accounting period.
- (3) For the purposes of sub-paragraph (2), the statement of total return for an accounting period is the statement of total return which, in accordance with the Statement of Recommended Practice used for the accounting period, must be included in the

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accounts contained in the annual report of the open-ended investment company which deals with the accounting period.

- (4) For the purposes of sub-paragraph (3), the “Statement of Recommended Practice” used for an accounting period is—
- (a) in relation to any accounting period for which it is required or permitted to be used, the Statement of Recommended Practice relating to Open-Ended Investment Companies issued by the Financial Services Authority in November 2000, as from time to time modified, amended or revised, or
  - (b) in relation to any accounting period for which it is required or permitted to be used, any subsequent statement of recommended practice dealing with accounting requirements relating to open-ended investment companies issued by the Financial Services Authority, as from time to time modified, amended or revised.

#### *Power to amend paragraphs 32 and 33*

- 34 (1) The Treasury may by order amend paragraph 32 or 33 so as to alter the definition of capital profits or losses in consequence of the modification, amendment, revision or replacement of a Statement of Recommended Practice.
- (2) The power to make an order under this paragraph includes power—
- (a) to make different provision for different cases, and
  - (b) to make such consequential, supplementary, incidental or transitional provisions, or savings, as appear to the Treasury to be necessary or expedient (including provision amending any enactment or any instrument made under an enactment).

#### *Distributing offshore funds*

- 35 (1) For the purposes of paragraph 5(1) of Schedule 27 to the Taxes Act 1988 (computation of UK equivalent profit), the assumptions to be made in determining what, for any period, would be the total profits of an offshore fund are to include the assumptions in sub-paragraphs (2) and (3).
- (2) The first assumption is that this Schedule does not apply for the purposes of corporation tax in computing the profits or loss of an offshore fund.
- (3) The second assumption is that for the purposes of corporation tax the profits and losses that are to be taken to arise from the derivative contracts of an offshore fund are to be computed—
- (a) in accordance with the provisions applicable, in the case of unauthorised unit trusts, for the purposes of income tax; and
  - (b) as if the provisions so applicable had effect in relation to an accounting period of an offshore fund as they have effect, in the case of unauthorised unit trusts, in relation to a year of assessment.
- (4) In this paragraph “unauthorised unit trust” means the trustees of any unit trust scheme which is not an authorised unit trust but is a unit trust scheme for the purposes of section 469 of the Taxes Act 1988.

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*Contracts relating to holdings in unit trust schemes, open-ended investment companies and offshore funds*

- 36 (1) This paragraph applies in relation to a relevant contract to which a company is party in an accounting period if—
- (a) it is not a derivative contract for the purposes of this Schedule, and
  - (b) its underlying subject matter consists wholly or partly of a holding which is, in that period, a relevant holding.
- (2) Where this paragraph applies in relation to a relevant contract of a company in an accounting period—
- (a) the Corporation Tax Acts shall have effect for that period (and any succeeding accounting period in which the relevant contract is a relevant contract of the company) as if the relevant contract were a derivative contract, and
  - (b) the accounting method to be used as regards the relevant contract for that period (and any such succeeding period) shall be an authorised mark to market basis of accounting.
- (3) For the purposes of this paragraph a person holds a relevant holding in an accounting period if, at any time in that period, he holds—
- (a) any rights under a unit trust scheme,
  - (b) any shares in an open-ended investment company, or
  - (c) any relevant interests in an offshore fund,
- and there is a time in that period when that scheme, company or fund fails to satisfy the non-qualifying investments test.
- (4) For the purposes of this paragraph—
- (a) “a relevant interest in an offshore fund” has the same meaning as in paragraph 7 of Schedule 10 to the Finance Act 1996 (c. 8), and
  - (b) a unit trust scheme, open-ended investment company or offshore fund fails to satisfy the non-qualifying investments test if it fails to satisfy the test in paragraph 8 of that Schedule.

*Contract which becomes contract to which paragraph 36 applies*

- 37 (1) This paragraph applies if the conditions in sub-paragraphs (2) and (3) are satisfied in relation to any relevant contract of a company.
- (2) The first condition is that—
- (a) the company is party to the relevant contract in two successive accounting periods (“the first and second accounting periods”), and
  - (b) paragraph 36 applies in relation to that relevant contract for the second accounting period but not the first.
- (3) The second condition is that the relevant contract was, immediately before the beginning of the second accounting period, a chargeable asset.
- (4) Where an opening valuation of the relevant contract falls to be made at the beginning of the second accounting period (for the purposes of bringing an amount into account for that period on a mark to market basis of accounting), the value of that contract at that time shall be taken for the purpose of the opening valuation to be equal to whatever, in relation to a disposal immediately before the end of the first accounting

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period, would have been taken to be the market value of that contract for the purposes of the Taxation of Chargeable Gains Act 1992 (c. 12).

- (5) When the company ceases to be a party to the relevant contract it shall bring into account, for the accounting period in which it ceased to be a party to that contract, the amount of any chargeable gain or allowable loss which would have been treated as accruing to the company on the assumption—
- (a) that it had made a disposal of the asset immediately before the beginning of the second accounting period, and
  - (b) that the disposal had been for a consideration equal to the value (if any) given to the relevant contract in the accounts of the company at the end of the first accounting period.
- (6) For the purposes of this paragraph an asset is a chargeable asset if any gain accruing on the disposal of the asset by the company would be a chargeable gain for the purposes of the Taxation of Chargeable Gains Act 1992 (and includes any obligations under futures contracts which, by virtue of section 143 of that Act, are regarded as assets to the disposal of which that Act applies).

*Investment trusts and venture capital trusts: capital reserves*

- 38 (1) Where any profits or losses arising to an investment trust from a derivative contract for an accounting period are carried to or sustained by a capital reserve in accordance with the Statement of Recommended Practice used for the accounting period, those profits and losses must not be brought into account as credits or debits for the purposes of this Schedule, notwithstanding paragraph 15.
- (2) Where any profits or losses arising to a venture capital trust from a derivative contract for an accounting period—
- (a) are carried to or sustained by a capital reserve in accordance with the Statement of Recommended Practice used for the accounting period as if the venture capital trust were an investment trust, or
  - (b) would be carried to or sustained by a capital reserve if the venture capital trust were an investment trust and were using that Statement of Recommended Practice,
- those profits and losses must not be brought into account as credits or debits for the purposes of this Schedule, notwithstanding paragraph 15.
- (3) For the purposes of this paragraph, the “Statement of Recommended Practice” used for an accounting period is—
- (a) in relation to any accounting period for which it is permitted to be used, the Statement of Recommended Practice relating to Investment Trust Companies issued by the Association of Investment Trust Companies in December 1995, as from time to time modified, amended or revised, or
  - (b) in relation to any accounting period for which it is permitted to be used, any subsequent statement of recommended practice relating to investment trusts, as from time to time modified, amended or revised.

*Investment trusts: approval for purposes of section 842 of the Taxes Act 1988*

- 39 (1) For the purpose of determining whether a company may be approved for the purposes of section 842 of the Taxes Act 1988 (investment trusts) for any accounting period, the excess of any relevant credits arising in that period over any relevant debits so

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arising shall be treated for the purposes of that section as income derived from shares or securities.

- (2) For the purposes of this paragraph “relevant credits” and “relevant debits”, in relation to an accounting period, are credits and debits which are brought into account in respect of that period by virtue of paragraph 14(3) as if they were non-trading credits and non-trading debits falling to be brought into account for the purposes of Chapter 2 of Part 4 of the Finance Act 1996 (c. 8) in respect of loan relationships of the company.

*Venture capital trusts: approval for purposes of section 842AA of the Taxes Act 1988*

- 40 (1) For the purpose of determining whether a company may be approved for the purposes of section 842AA of the Taxes Act 1988 (venture capital trusts) for any accounting period, the excess of any relevant credits arising in that period over any relevant debits so arising shall be treated for the purposes of that section as income derived from shares or securities.
- (2) For the purposes of this paragraph “relevant credits” and “relevant debits”, in relation to an accounting period, are credits and debits which are brought into account in respect of that period by virtue of paragraph 14(3) as if they were non-trading credits and non-trading debits falling to be brought into account for the purposes of Chapter 2 of Part 4 of the Finance Act 1996 in respect of loan relationships of the company.

## PART 8

### INSURANCE AND MUTUAL TRADING COMPANIES

*Application of Schedule to insurance and mutual trading companies*

- 41 (1) This Schedule shall apply in relation to insurance and mutual trading companies as it applies in relation to other companies.
- (2) Sub-paragraph (1) is subject to paragraphs 42 and 43.

*Application of Part 1 of Schedule 11 to the Finance Act 1996*

- 42 (1) Part 1 of Schedule 11 to the Finance Act 1996 (c. 8) (special provision with respect to loan relationships for insurance companies) shall have effect (subject to sub-paragraphs (2) to (4)) in relation to derivative contracts as it has effect in relation to loan relationships.
- (2) Any provision of that Part of that Schedule which applies only to debtor relationships (within the meaning of Chapter 2 of Part 4 of that Act) shall not have effect in relation to derivative contracts for the purposes of sub-paragraph (1).
- (3) That Part of that Schedule shall have effect in its application in relation to derivative contracts as if—
- (a) references to Chapter 2 of Part 4 of the Finance Act 1996 were references to this Schedule,
  - (b) references to section 80(5) of that Act were references to paragraph 1(2) of this Schedule,

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- (c) references to section 82(2) of that Act were references to paragraph 14(2) of this Schedule, and
  - (d) references to credits and debits given in respect of a loan relationship by Chapter 2 of Part 4 of that Act were references, respectively, to the credits and debits given in respect of a derivative contract by this Schedule.
- (4) In the application of that Part of that Schedule in the case of any contract of an insurance company—
- (a) which is a derivative contract by virtue of paragraph 5, and
  - (b) to which the insurance company is party for the purposes of any life assurance business, or any category of life assurance business, carried on by it or partly for those purposes,
- any credits or debits given in respect of the contract shall not, to the extent that they are referable to that business or any category of that business, be brought into account in accordance with that Schedule as it has effect by virtue of this paragraph (and accordingly the provisions applicable apart from this Schedule shall, to that extent, apply for the purposes of computing the profits of an insurance company for the purposes of corporation tax).

#### *Non-life mutual business*

- 43 (1) This paragraph applies in relation to any contract of a mutual trading company—
- (a) which is a derivative contract by virtue of paragraph 5, and
  - (b) to which the mutual trading company is party, at any time in an accounting period, for the purposes of any non-life mutual business carried on by it or partly for those purposes.
- (2) Where this paragraph applies in relation to a contract, this Schedule shall have effect in relation to the contract subject to sub-paragraph (3).
- (3) To the extent that the credits or debits which, but for this sub-paragraph, fall to be brought into account in respect of the contract for that period are referable to any non-life mutual business they shall not be brought into account under this Schedule.
- (4) The extent to which any credits or debits are referable to the purposes of any non-life mutual business or to other purposes shall be determined by apportioning those credits and debits on a just and reasonable basis.

## **PART 9**

### MISCELLANEOUS

#### *Derivative contracts ceasing to be held for purposes of trade*

- 44 (1) This paragraph applies where—
- (a) a company is party to a relevant contract which is a derivative contract by virtue of paragraph 5 (contracts entered into or acquired by a company for the purposes of a trade carried on by it), and
  - (b) the purposes for which the company entered into or acquired the relevant contract cease at any time (“the relevant time”) to be the company’s purposes in relation to that relevant contract, but

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- (c) the company continues to be party to the relevant contract after the relevant time.
- (2) Where this paragraph applies, the company shall be deemed—
- (a) to have disposed of the relevant contract immediately before the relevant time for a consideration of an amount equal to the fair value of the contract at the relevant time, and
  - (b) to have reacquired it immediately after that time for the same consideration.

*Contracts becoming held for purposes of trade*

- 45 (1) This paragraph applies where a relevant contract of a company—
- (a) whose underlying subject matter consists, or is treated as consisting, wholly of—
    - (i) shares in a company,
    - (ii) rights of a unit holder under a unit trust scheme, or
    - (iii) assets representing a loan relationship to which either section 92 or 93 of the Finance Act 1996 (c. 8) applies,
  - (b) which is a chargeable asset, and
  - (c) which was entered into or acquired by the company otherwise than for the purposes of a trade carried on by it,
- is at any time appropriated by the company for the purposes of a trade carried on by it.
- (2) Where this paragraph applies—
- (a) section 161 of the Taxation of Chargeable Gains Act 1992 (c. 12) (appropriations to and from stock) shall have effect in relation to the appropriation of that contract, but
  - (b) the company may not make an election under subsection (3) of that section in relation to that appropriation.
- (3) For the purposes of this paragraph an asset is a chargeable asset if any gain accruing on the disposal of the asset by the company would be a chargeable gain for the purposes of the Taxation of Chargeable Gains Act 1992 (and includes any obligations under futures contracts which, by virtue of section 143 of that Act, are regarded as assets to the disposal of which that Act applies).
- (4) Paragraph 9 applies for the purpose of determining whether the underlying subject matter of a relevant contract is to be treated as consisting wholly of the property referred to in sub-paragraph (1)(a).

*Contracts where part of underlying subject matter of excluded type*

- 46 (1) This paragraph applies to a relevant contract of a company—
- (a) which is an option or future,
  - (b) which satisfies the requirements of paragraph 3 (accounting requirements etc), and
  - (c) whose underlying subject matter falls within sub-paragraph (2).
- (2) The underlying subject matter of a relevant contract falls within this sub-paragraph if it consists of—
- (a) any one or more of the excluded types of property falling within paragraphs (a) to (f) of sub-paragraph (2) of paragraph 4, and



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- (b) underlying subject matter other than that referred to in paragraph (a).
- (3) Where this paragraph applies to a relevant contract of a company, it shall be treated for the purposes of the Corporation Tax Acts as if it were two separate contracts, namely—
  - (a) a relevant contract of the company whose underlying subject matter consists of the excluded types of property referred to in sub-paragraph (2)(a), and
  - (b) a relevant contract of the company whose underlying subject matter consists of the underlying subject matter referred to in sub-paragraph (2)(b).
- (4) For the purposes of giving effect to sub-paragraph (3) all such apportionments as are just and reasonable shall be made.
- (5) This paragraph does not apply to a relevant contract if it is determined in accordance with paragraph 9 that the underlying subject matter of the relevant contract in question is to be treated as consisting wholly of any one or more of the excluded types of property referred to in sub-paragraph (2)(a).

*Contracts where underlying subject matter of different excluded types*

- 47
- (1) This paragraph applies to a relevant contract of a company—
    - (a) which is an option or future,
    - (b) which satisfies the requirements of paragraph 3 (accounting requirements etc), and
    - (c) whose underlying subject matter falls within sub-paragraph (2).
  - (2) The underlying subject matter of the relevant contract falls within this sub-paragraph if it consists, or is treated as consisting, wholly of—
    - (a) any one or more of the excluded types of property falling within paragraphs (a) to (c) of sub-paragraph (2) of paragraph 4, and
    - (b) any one or more of the excluded types of property falling within paragraphs (d) to (f) of that sub-paragraph.
  - (3) Where this paragraph applies to a relevant contract of a company, it shall be treated for the purposes of the Corporation Tax Acts as if it were two separate contracts, namely—
    - (a) a relevant contract of the company whose underlying subject matter consists of the excluded types of property referred to in sub-paragraph (2)(a), and
    - (b) a relevant contract of the company whose underlying subject matter consists of the excluded types of property referred to in sub-paragraph (2)(b).
  - (4) For the purposes of giving effect to sub-paragraph (3) all such apportionments as are just and reasonable shall be made.
  - (5) Paragraph 9 applies for the purpose of determining whether the underlying subject matter of a relevant contract is to be treated as consisting wholly of the excluded types of property referred to in paragraphs (a) and (b) of sub-paragraph (2).
  - (6) If a relevant contract of a company is one to which this paragraph applies in consequence of the application of paragraph 9 (as described in sub-paragraph (5)), any underlying subject matter of the contract which is subordinate or of small value and which is disregarded in accordance with that paragraph shall be apportioned in accordance with sub-paragraph (4).

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But if and so far as the underlying subject matter of a relevant contract is disregarded in accordance with paragraph 9 by reason of being subordinate in relation to such property as is referred to in paragraph (a) or, as the case may be, paragraph (b) of sub-paragraph (3), it shall be apportioned accordingly.

- (7) This paragraph does not apply to a relevant contract if it is determined in accordance with paragraph 9 that the underlying subject matter of the relevant contract in question is to be treated as consisting wholly of—
- (a) any one or more of the excluded types of property falling within paragraphs (a) to (c) of sub-paragraph (2) of paragraph 4, or
  - (b) any one or more of the excluded types of property falling within paragraphs (d) to (f) of that sub-paragraph.

*Election to treat contract as two assets*

- 48 (1) This paragraph applies to a relevant contract of a company if it would, but for an election under this paragraph, be a derivative contract to which paragraph 7 applies.
- (2) Where this paragraph applies to a relevant contract of a company, the company may elect that its relevant contract shall be treated for the purposes of the Corporation Tax Acts as if it were—
- (a) a creditor relationship of the company which is a relevant zero coupon bond, and
  - (b) an option of the company whose underlying subject matter is the same as the underlying subject matter of the relevant contract to which this paragraph applies.
- (3) For the purposes of sub-paragraph (2) a relevant zero coupon bond is a zero coupon bond—
- (a) issued at the time when the consideration for entering into, or acquiring, the relevant contract to which this paragraph applies was payable by the company,
  - (b) falling to be redeemed—
    - (i) on the date on which that relevant contract falls to be performed, or
    - (ii) in a case where that relevant contract may fall to be performed on more than one date, on the date which is the last of those dates, and
  - (c) issued at a price equal to the amount that would have been the market value of a zero coupon bond—
    - (i) issued at that time,
    - (ii) falling to be redeemed on that date or, as the case may be, on that last date, and
    - (iii) producing, by the time of its redemption, an amount equal to the amount which is the guaranteed amount in relation to that relevant contract.
- (4) The only accounting method authorised for the purposes of Chapter 2 of Part 4 of the Finance Act 1996 (c. 8) for use by a company as respects a creditor relationship arising under sub-paragraph (2)(a) shall be an authorised mark to market basis of accounting.
- (5) None of paragraphs 6 to 8 shall apply to an option arising under paragraph (2)(b).

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- (6) For the purposes of giving effect to sub-paragraph (2) all such apportionments as are just and reasonable shall be made.
- (7) An election under sub-paragraph (2) in relation to a relevant contract—
  - (a) may only be made within the period of two years following the end of the company's first accounting period in which it is party to the relevant contract;
  - (b) has effect for that accounting period and all subsequent accounting periods of the company; and
  - (c) is irrevocable.
- (8) For the purposes of this paragraph a “zero coupon bond” is a security—
  - (a) whose issue price is less than the amount payable on redemption, and
  - (b) which does not provide for any amount to be payable by way of interest.
- (9) For the purposes of this paragraph “market value” has the same meaning as in the Taxation of Chargeable Gains Act 1992 (c. 12).

#### *Partnerships involving companies*

- 49 (1) This paragraph applies where—
- (a) a trade, profession or business is carried on by persons in partnership (“the firm”);
  - (b) any of those persons is a company (a “company partner”); and
  - (c) the firm is party to a contract which is a derivative contract or would be a derivative contract if the firm were a company.
- (2) In any such case—
- (a) in computing the profits and losses of the trade, profession or business for the purposes of corporation tax in accordance with section 114(1) of the Taxes Act 1988 (computation as if the partnership were a company) no credits or debits shall be brought into account under this Schedule in respect of the contract; but
  - (b) credits and debits shall be brought into account under this Schedule in respect of the contract in accordance with the following provisions of this paragraph by each company partner for each of its accounting periods in which the conditions in sub-paragraph (1) are satisfied.
- (3) The credits and debits to be brought into account as mentioned in sub-paragraph (2) (b) shall be determined separately in the case of each company partner.
- (4) For the purpose of determining those credits and debits in the case of any particular company partner—
- (a) the contract entered into or acquired by the firm shall be treated as if it were instead entered into or acquired by that company partner, for the purposes of the trade, profession or business which that company partner carries on,
  - (b) anything done by or in relation to the firm in connection with the contract shall be treated as done by or in relation to the company partner, and
  - (c) to the extent that any exchange gains or losses arising from the contract are carried to or sustained by a reserve maintained by the firm and are set off by or against another amount as described in paragraph 16(4), the exchange gains or losses shall to that extent be treated as carried to or sustained by

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such a reserve maintained by the company partner and set off by or against another amount,  
and credits and debits (the “gross credits and debits”) shall be determined accordingly.

- (5) The credits and debits to be brought into account under this Schedule pursuant to sub-paragraph (2)(b) in the case of any particular company partner shall be that company partner’s appropriate share of the gross credits and debits determined in accordance with sub-paragraph (4) in the case of that company partner.
- (6) For the purposes of sub-paragraph (5), the “appropriate share”, in the case of a company partner, is the share that would be apportioned to that company partner if—
- (a) the gross credits and debits determined in accordance with sub-paragraph (4) in the case of that company partner fell to be apportioned between the partners; and
  - (b) the apportionment fell to be made in the shares in which any profit or loss computed in accordance with subsection (1) of section 114 of the Taxes Act 1988 would be apportioned between them under subsection (2) of that section.

*Partnerships involving companies: application of accounting methods*

- 50 (1) This paragraph has effect where, in accordance with paragraph 49, credits and debits in respect of a contract of a firm are to be brought into account under this Schedule by a company partner for any accounting period of that company partner.
- (2) Where this paragraph has effect, paragraph 18 shall apply in relation to the contract, subject to sub-paragraph (3).
- (3) Where as respects any accounting period or any part of an accounting period—
- (a) the credits and debits in respect of the contract, which fall to be brought into account under this Schedule by the company partner in accordance with paragraph 49, are not brought into account by the company partner for the purposes of its statutory accounts, but
  - (b) the company partner brings its share in the profits or loss of the firm into account on a mark to market basis of accounting for the purposes of its statutory accounts,
- the company partner must use in relation to that period or, as the case may be, that part of a period, an authorised mark to market basis of accounting in relation to the contract for the purposes of this Schedule.
- (4) For the purposes of this paragraph “company partner” and “firm” have the same meaning as in paragraph 49.

*Prevention of deduction of tax*

- 51 Notwithstanding anything in section 349 of the Taxes Act 1988 or any other provision of the Tax Acts, where the profits and losses arising from a derivative contract of a company are computed in accordance with this Schedule, the company shall not be required, on making a payment under the contract, to deduct out of it any sum representing an amount of income tax on it.

## PART 10

### INTERPRETATION

#### *Statutory accounts*

- 52 (1) In this Schedule “statutory accounts”, in relation to a company, means—
- (a) any accounts relating to that company that are drawn up in accordance with any requirements of the Companies Act 1985 (c. 6) or the Companies (Northern Ireland) Order 1986 (S.I. 1986/1032 (N.I. 6)) that apply in relation to that company;
  - (b) any accounts relating to that company that are drawn up in accordance with any requirements of regulations under section 70 of the Friendly Societies Act 1992 (c. 40) that apply in relation to that company;
  - (c) any accounts relating to that company which are accounts to which Part 1 of Schedule 21C to the Companies Act 1985 or Part 1 of Schedule 21D to that Act applies;
  - (d) in the case of a company which—
    - (i) is not subject to such requirements as are mentioned in paragraphs (a) or (b), and
    - (ii) is a company in whose case there are no accounts for the period in question that fall within paragraph (c),any accounts relating to the company drawn up in accordance with requirements imposed in relation to that company under the law of its home State; and
  - (e) in the case of a company which—
    - (i) is not subject to any such requirements as are mentioned in paragraph (a), (b) or (d), and
    - (ii) is a company in whose case there are no accounts for the period in question that fall within paragraph (c),the accounts relating to the company that most closely correspond to the accounts which, in the case of a company formed and registered under the Companies Act 1985 (c. 6), are required under that Act.
- (2) For the purposes of sub-paragraph (1), the home State of a company is the country or territory under whose law the company is incorporated.

#### *Derivative and relevant contracts of person*

- 53 (1) For the purposes of this Schedule references to a relevant contract of a person are references to a relevant contract entered into or acquired by a person; and references to a person’s being party to a relevant contract shall be construed accordingly.
- (2) For the purposes of sub-paragraph (1), a relevant contract is acquired by a person if that person becomes entitled to the rights, and subject to the liabilities, under the relevant contract whether by assignment or otherwise.
- (3) Where—
- (a) a company ceases to be party to a derivative contract in an accounting period (the “cessation period”),

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- (b) profits or losses arise to the company from the derivative contract or a related transaction in the cessation period, and
- (c) the credits or debits brought into account for the purposes of this Schedule for the cessation period do not include credits or debits which represent the whole of those profits or losses,

credits or debits in respect of so much of those profits or losses as are not represented by credits or debits brought into account for the cessation period shall continue to be brought into account under this Schedule over one or more subsequent accounting periods (“post-cessation periods”) as in the case of a derivative contract to which the company is party in those periods and sub-paragraphs (4) and (5) shall apply.

- (4) In any case falling within sub-paragraph (3), any question—
  - (a) whether, in a post-cessation period, the company is, or is to any extent, party to the contract for the purposes of a trade carried on by it, or
  - (b) whether, in a post-cessation period, the contract is to any extent referable to a particular business, or a particular class, category or description of business, carried on by the company,

shall be determined by reference to the circumstances immediately before the company ceased to be party to the contract instead of the circumstances in the post-cessation period.

- (5) In any case falling within sub-paragraph (3), any question—
  - (a) whether the contract has to any extent a particular purpose in a post-cessation period, or
  - (b) whether there is a connection between the company and any other person for a post-cessation period,

shall be determined by reference to the circumstances in the cessation period instead of the circumstances in the post-cessation period.

- (6) For the purposes of the Corporation Tax Acts references to a person’s derivative contracts and to a person’s being party to a derivative contract shall be construed accordingly.

### *General interpretation*

- 54 (1) In this Schedule—

“authorised accounting method”, “authorised accruals basis of accounting” and “authorised mark to market basis of accounting” shall be construed in accordance with paragraph 17;

“bank” means any of the following—

- (a) the Bank of England;
- (b) any person falling within section 840A(1)(b) of the Taxes Act 1988; and
- (c) any firm falling within section 840A(1)(c) of that Act;

“contract for differences” shall be construed in accordance with paragraph 12;

“contract of insurance” has the meaning given by Article 3(1) of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (S.I. 2001/544);

“derivative contract” shall be construed in accordance with paragraph 2;

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“exchange gain” and “exchange loss” shall be construed in accordance with sub-paragraphs (2) and (3);

“fair value” has the meaning given by paragraph 17;

“future” has the meaning given by paragraph 12;

“insurance company” means a company which effects or carries out contracts of insurance;

“intangible fixed assets” has the meaning given by paragraph 12;

“investment trust” is a company approved for the purposes of section 842 of the Taxes Act 1988 (investment trusts) for an accounting period;

“life assurance business” has the same meaning as in section 431 of the Taxes Act 1988;

“long-term insurance business” means business which consists of the effecting and carrying out of contracts which fall within Part II of Schedule 1 to the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 and “contract of long-term insurance” means any contract which falls within that Part of that Schedule;

“non-life mutual business” means any mutual trading, or any mutual insurance or other mutual business, which (in either case) is not life assurance business;

“option” has the meaning given by paragraph 12;

“related transaction” has the meaning given by paragraph 15;

“relevant contract” has the meaning given by paragraph 2;

“shares”, in relation to a company, has (except in paragraphs 39 and 40) the meaning given by paragraph 12;

“statutory accounts” has the meaning given by paragraph 52;

“UK company” means a company incorporated or formed under the law of a part of the United Kingdom;

“underlying subject matter” has the meaning given by paragraph 11;

“warrant” has the meaning given by paragraph 12.

- (2) References in this Schedule to exchange gains or exchange losses, in the case of any company, are references respectively to—

- (a) profits or gains, or
- (b) losses,

which arise as a result of comparing at different times the expression in one currency of the whole or some part of the valuation put by the company in another currency on an asset or liability of the company.

If the result of such a comparison is that neither an exchange gain nor an exchange loss arises, then for the purposes of this Schedule an exchange gain of nil shall be taken to arise in the case of that comparison.

- (3) A reference to an exchange gain or loss from a company’s derivative contract is a reference to an exchange gain or loss arising to a company in relation to a derivative contract of the company.

- (4) In this Schedule “financial trader” means—

- (a) any person who—
  - (i) falls within section 31(1)(a), (b) or (c) of the Financial Services and Markets Act 2000 (c. 8), and

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- (ii) has permission under that Act to carry on one or more of the activities specified in Article 14 and, in so far as it applies to that Article, Article 64 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 ([S.I. 2001/544](#)); or
- (b) any person not falling within paragraph (a) who is approved by the Board for the purposes of this paragraph.