

SCHEDULES

SCHEDULE 26

DERIVATIVE CONTRACTS

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.
- (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.

Status: This is the original version (as it was originally enacted).

- (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 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).

Status: This is the original version (as it was originally enacted).

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 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

Status: This is the original version (as it was originally enacted).

- (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 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.

Status: This is the original version (as it was originally enacted).

- (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
 - (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—

Status: This is the original version (as it was originally enacted).

- (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).