STATUTORY INSTRUMENTS

2004 No. 2201

INCOME TAX

The Finance Act 2002, Schedule 26, Parts 2 and 9 (Amendment) Order 2004

Made - - - - 27th August 2004

Laid before House of Commons - - - - - - 27th August 2004

Coming into force - - 17th September 2004

The Treasury, in exercise of the powers conferred upon them by paragraph 13 of Schedule 26 to the Finance Act 2002(**1**) make the following Order:

PART 1

Introduction

Citation, commencement and effect

1.—(1) This Order may be cited as the Finance Act 2002, Schedule 26, Parts 2 and 9 (Amendment) Order 2004 and shall come into force on 17th September 2004.

(2) This Order has effect in relation to periods of account beginning on or after 1st January 2005 subject to paragraph (3).

(3) The provisions listed in paragraph (4) have effect in relation to contracts entered into on or after 1st August 2004 in an accounting period ending on or after 17th September 2004.

(4) The provisions are—

(a) article 4(c),

(b) article 5(b)(i) and (c)(i),

(c) article 11(a), (b)(i), and (iii), (c) and (e),

(d) article 12,

(e) article 15 to the extent that it inserts paragraphs 45A(1)(a) and (d) and (2) to (5), 45B, 45C and 45G into Part 9 of Schedule 26 to the Finance Act 2002,

(**1**) 2002 c. 23, paragraph 13 is amended by paragraph 2 of Schedule 9 to the Finance Act 2004 (c. 12).

(f) article 16(a); and

(g) article 17.

PART 2

Amendment of Part 2 of Schedule 26 to the Finance Act 2002

2. Part 2 of Schedule 26 to the Finance Act 2002 is amended as follows.

3. In paragraph 2, for sub-paragraph (1) substitute—

"(1) For the purposes of the Corporation Tax Acts, a company's derivative contracts are those of its relevant contracts—

(a) which satisfy any of the conditions in paragraphs (a) to (c) of paragraph 3(1), and

(b) which are not prevented from being derivative contracts by paragraph 4 or any other provision of the Corporation Tax Acts.".

4. In paragraph 3—

(a) for sub-paragraph (1)(b) substitute—

"(b) in the case of a relevant contract which is not treated as mentioned in paragraph (a), it is a relevant contract to which paragraph 6, 7, or 8 applies, or";

(b) in sub-paragraph (1)(c) for "is not treated as described in" substitute "does not fall within";

(c) for sub-paragraph (2)(b) substitute—

"(b) it is a contract for differences whose underlying subject matter is—

(i) land (wherever situated),

(ii) tangible movable property, other than commodities which are tangible assets,

(iii) intangible fixed assets,

(iv) weather conditions, and

(v) creditworthiness.";

(d) omit sub-paragraph (4); and

(e) in sub-paragraph (5)—

(i) for "sub-paragraphs (3) and (4)" substitute "sub-paragraph (3)"; and

(ii) in paragraph (b) omit "or financial assets".

5. In paragraph 4—

(a) after sub-paragraph (1) insert—

"(1A) Nothing in this paragraph prevents a relevant contract to which paragraph 6, 7 or 8 applies from being a derivative contract.";

(b) in sub-paragraph (2)—

(i) omit paragraphs (a) and (b);

(ii) at the end of paragraph (d) add "and";

(iii) at the end of paragraph (e) omit "and"; and

(iv) omit paragraph (f);

(c) in sub-paragraph (3)—

(i) omit "(a), (b) and"; and

(ii) for "(d) to (f)" substitute "(d) and (e)"; and

(d) in sub-paragraph (5) for "paragraphs 5 to 8" substitute "paragraphs 5 and 5A".

6. In paragraph 5(2)(b)—

(a) at the end of sub-paragraph (i) add "or";

(b) at the end of sub-paragraph (ii) omit ", or"; and

(c) omit sub-paragraph (iii).

7. After paragraph 5 insert—

"Qualified exclusion: embedded derivatives whose underlying subject matter is shares

5A.—(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 a deemed relevant contract to which the company is treated as party under section 94A(2)(b) of the Finance Act 1996,

(b) its underlying subject matter consists, or is treated as consisting, wholly of shares in a company, and

(c) the company is party as a creditor to the host contract under section 94A(2)(a) of that Act.

(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 shares in a company.".

8. In paragraph 6—

(a) omit sub-paragraph (1);

(b) at the end of sub-paragraph (2)(a)(i) add "or";

(c) at the end of sub-paragraph (2)(a)(ii) for "or" substitute "and";

(d) omit sub-paragraph (2)(a)(iii);

(e) in sub-paragraph (3)(b)(i)—

(i) for "company," substitute "company or";

(ii) omit from "or assets" to "applies"; and

(iii) at the end add "and";

(f) in sub-paragraph (3)(b) for sub-paragraphs (ii) and (iii) substitute—

"(ii) one or more assets representing loan relationships to which section 94A of the Finance Act 1996 applies, but only to the extent that each of those assets represents the rights and liabilities of a host contract within the meaning of that section,";

(g) omit sub-paragraph 8(a) and (b);

(h) omit sub-paragraph (9); and

(i) in the heading to the paragraph, for "*Qualified exclusion*:" substitute "*Derivative contracts*:".

9. In paragraph 7—

(a) omit sub-paragraph (1);

(b) at the end of sub-paragraph (2)(a)(i) add "or";

(c) at the end of sub-paragraph (2)(a)(ii) for "or" substitute "and";

(d) omit sub-paragraph (2)(a)(iii);

(e) in sub-paragraph (3)(b)(i)—

(i) for "company," substitute "company or";

(ii) omit from "or assets" to "applies"; and

(f) in sub-paragraph (3)(b) for sub-paragraphs (ii) and (iii) substitute—

"(ii) one or more assets representing loan relationships to which section 94A of the Finance Act 1996 applies, but only to the extent that each of those assets represents the rights and liabilities of a host contract within the meaning of that section,"; and

(g) in the heading to the paragraph, for "*Qualified exclusion*:" substitute "*Derivative contracts*:".

10. In paragraph 8—

(a) omit sub-paragraph (1);

(b) in sub-paragraph (2)(c)—

(i) at the end of sub-paragraph (i) add "or";

(ii) at the end of sub-paragraph (ii) omit ", or"; and

(iii) omit sub-paragraph (iii); and

(c) in the heading to the paragraph, for "*Qualified exclusion*:" substitute "*Derivative contracts:*".

11. In paragraph 9—

(a) in sub-paragraph (1) for "any of sub-paragraphs (2) to (4)" substitute "sub-paragraph (2) or (4)";

(b) in sub-paragraph (2)(a)—

(i) for "(a)", where first occurring, substitute "(c)";

(ii) for "(f)", where first occurring, substitute "(e)";

(iii) omit "(a), (b) and"; and

(iv) for "to (f)", in the second place where it occurs, substitute "and (e)";

(c) omit sub-paragraph (3);

(d) in sub-paragraph (4)(a) for "paragraphs (d) to (f)" substitute "paragraphs (d) and (e)"; and

(e) in sub-paragraph (5)—

(i) at the end of paragraph (a), insert "or"; and

(ii) omit paragraph (b).

12. At the end of paragraph 11 add—

"(7) Where the underlying subject matter of a relevant contract consists of or includes income from any of the following—

(a) land (wherever situated),

(b) shares in a company,

(c) rights of a unit holder under a unit trust scheme,

the underlying subject matter shall not be treated, by reason only of that income, as being land or such shares or rights (as the case may be).".

13.—(1) Paragraph 12 is amended as follows.

(2) For sub-paragraph (1) substitute—

"(1) This paragraph defines the following expressions for the purposes of this Schedule—

(a) a capital redemption policy (see sub-paragraph (2));

(b) a contract for differences (see sub-paragraphs (3) to (5));

(c) a future (see sub-paragraphs (6), (7) and (10));

(d) intangible fixed assets (see sub-paragraph (11));

(e) an option (see sub-paragraphs (8) and (10));

(f) shares in a company (see sub-paragraph (12));

(g) a warrant (see sub-paragraph (9))."

(3) For sub-paragraph (11) substitute—

"(11) "Intangible fixed assets" has the same meaning as in Schedule 29 to this Act; and paragraphs 73 to 76 of that Schedule (and paragraph 72 of that Schedule so far as it relates to those paragraphs) have effect for the purposes of this Part as they have effect for the purposes of that Schedule.".

PART 3

Amendment of Part 9

14. Part 9 of Schedule 26 to the Finance Act 2002 is amended as follows.

15. After paragraph 45 insert—

"**Derivative contracts which are to be taxed on a chargeable gains basis**

45A.—(1) This paragraph applies to a derivative contract of a company for an accounting period if any of the following provisions applies to the derivative contract for the period—

(a) paragraph 45C (derivative contracts relating to land or certain tangible movable property);

(b) paragraph 45D (creditor relationship with embedded derivative which is an option relating to qualifying ordinary shares or mandatorily convertible preference shares);

(c) paragraph 45F (creditor relationship with embedded derivative which is an exactly tracking contract for differences whose subject matter is land or qualifying ordinary shares);

(d) paragraph 45G (property based total return swaps).

(2) Where this paragraph applies to a derivative contract for an accounting period—

(a) paragraph 14(3) (non-trading credits and debits) shall not apply to the relevant credits and debits, but

(b) sub-paragraph (4) shall apply to them instead.

(3) For the purposes of this paragraph the relevant credits and debits—

(a) in the case of a derivative contract falling within any of paragraphs (a) to (c) of sub-paragraph (1), are the credits and debits given in relation to the contract for the accounting period by paragraph 15;

(b) in the case of a derivative contract falling within paragraph (d) of that sub-paragraph, are the credits and debits described in sub-paragraph (2) of paragraph 45G.

(4) For the purposes of corporation tax on chargeable gains—

(a) if C exceeds D, a chargeable gain equal in amount to the amount of the excess shall be treated as accruing to the company in the accounting period,

(b) if D exceeds C, a loss equal in amount to the amount of the excess shall be treated as accruing to the company in the accounting period,

but this is subject to sub-paragraph (6).

(5) In sub-paragraph (4)—

C means the sum of the relevant credits for the accounting period in respect of the derivative contract;

D means the sum of the relevant debits for the accounting period in respect of the derivative contract.

(6) Sub-paragraph (4) does not apply in the case of a derivative contract falling within sub-paragraph (1)(b) (embedded option) if, on the assumption that—

(a) the rights and liabilities that fall to be treated as comprised in the derivative contract by virtue of section 94A of the Finance Act 1996 (loan relationships with embedded derivatives) had been contained in a separate contract,

(b) that separate contract were an actual option,

(c) that option were disposed of at the end of the accounting period, and

(d) a gain accrued for the purposes of corporation tax on chargeable gains to the company on the disposal,

paragraph 2 of Schedule 7AC to the Taxation of Chargeable Gains Act 1992(**2**) (substantial shareholding exemptions: disposal of asset related to shares) would apply to that gain.

Carry back of net losses on derivative contracts to which paragraph 45A applies

45B.—(1) This paragraph applies in the case of a company if the following conditions are satisfied—

(a) there is a net amount of paragraph 45A losses (see sub-paragraph (5)(a)) for an accounting period (the "loss period"),

(b) there is a net amount of paragraph 45A gains (see sub-paragraph (5)(b)) for a previous accounting period (the "gains period"),

(c) the gains period falls wholly or partly within the period of 24 months immediately preceding the start of the loss period,

(d) within 2 years after the end of the loss period the company makes a claim for the purpose in respect of the whole or a part of the net amount of paragraph 45A losses for the loss period.

(2) In any such case—

(a) the net amount of paragraph 45A gains for the gains period, and

(b) the net amount of paragraph 45A losses for the loss period,

shall each be reduced (but not below nil) by the amount in respect of which the claim is made.

(**2**) 1992 c. 12, Schedule 7AC was inserted by paragraph 1 of Part 1 of Schedule 8 to the Finance Act 2002 (c. 23).

(3) For the purposes of sub-paragraph (2)—

(a) the net amount of paragraph 45A gains for a later period must be reduced so far as possible before the net amount of paragraph 45A gains for an earlier period, and

(b) where a gains period falls partly before the start of the 24 month period referred to in sub-paragraph (1), only the appropriate fraction of the net amount of paragraph 45A gains for the gains period may be reduced.

(4) For the purposes of sub-paragraph (3), the "appropriate fraction" is—

$$\frac{A}{B}$$

where—

A is the number of days in the gains period that fall within the 24 month period, and

B is the number of days in the gains period.

(5) For the purposes of this paragraph—

(a) where for any accounting period L exceeds G, there is a net amount of paragraph 45A losses for that period of an amount equal to that excess,

(b) where for any accounting period G exceeds the sum of L and N, there is a net amount of paragraph 45A gains for that period of an amount equal to that excess.

(6) In the application of sub-paragraph (5) in relation to any accounting period of a company—

G is the sum of the amounts of any chargeable gains treated as accruing to the company in the period under paragraph 45A(4)(a) in respect of derivative contracts of the company ("paragraph 45A gains"),

L is the sum of the amounts of any allowable losses treated as accruing to the company in the period under paragraph 45A(4)(b) in respect of derivative contracts of the company,

N is the sum of the amounts of any non-paragraph 45A losses that would fall to be deducted in the period from paragraph 45A gains, on the assumption in sub-paragraph (7).

(7) The assumption is that, as respects the accounting period, non-paragraph 45A losses are treated as being deducted from non-paragraph 45A gains, so far as possible, before any remainder is deducted from paragraph 45A gains.

(8) In this paragraph—

"deducted" means deducted in accordance with section 8(1) of the Taxation of Chargeable Gains Act 1992(**3**);

"non-paragraph 45A gains" means any chargeable gains accruing to the company in the accounting period, other than paragraph 45A gains;

"non-paragraph 45A losses" means any allowable losses of the company that may be deducted in the accounting period, other than losses accruing in the period under paragraph 45A(4)(b).

Derivative contracts relating to land or certain tangible movable property

45C.—(1) This paragraph applies to a derivative contract of a company for an accounting period if the following conditions are satisfied—

(**3**) 1992 c. 12.

(a) the derivative contract is not one to which the company is party at any time in the accounting period for the purposes of a trade carried on by the company (but see sub-paragraph (2)),

(b) the company is not a body falling within sub-paragraph (3);

(c) the underlying subject matter of the derivative contract falls within sub-paragraph (4);

(d) paragraph 45F (embedded derivative which is an exactly tracking contract for differences whose subject matter is land) does not apply to the derivative contract.

(2) The condition in sub-paragraph (1)(a) does not apply if the company—

(a) is party to the derivative contract for the purposes of life assurance business, or

(b) is a mutual trading company.

(3) The bodies that fall within this sub-paragraph are—

an authorised unit trust;

an investment trust;

an open-ended investment company;

a venture capital trust.

(4) The underlying subject matter of a derivative contract falls within this sub-paragraph if it consists of either or both of the following—

(a) land (wherever situated);

(b) tangible movable property, other than commodities which are tangible assets.

This sub-paragraph is subject to the following qualification.

(5) Where the underlying subject matter of a derivative contract includes income from property of either or both of the types described in sub-paragraph (4) and that income is—

(a) subordinate in relation to so much of the underlying subject matter of the derivative contract as consists of property of either or both of those types, or

(b) of small value in comparison with the value of the underlying subject matter as a whole,

that income shall be left out of account in determining for the purposes of sub-paragraph (1)(c) whether the underlying subject matter of the derivative contract falls within sub-paragraph (4).

(6) For the purposes of sub-paragraph (5) whether part of the underlying subject matter of a derivative 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 contract.

Creditor relationships: embedded derivatives which are options

45D.—(1) This paragraph applies to a derivative contract of a company for an accounting period if the following conditions are satisfied—

(a) section 94A of the Finance Act 1996(**4**) (loan relationships with embedded derivatives) has effect in relation to a creditor relationship of the company,

(b) the derivative contract is the relevant contract, or one of the relevant contracts, to which the company is treated under subsection (2)(b) of that section as party in the case of that creditor relationship,

(**4**) 1996 c. 8, section 94A of the Finance Act 1996 was inserted by paragraph 13 of Part 1 of Schedule 10 to the Finance Act 2004.

(c) that relevant contract is treated by virtue of subsection (3) of that section as an option,

(d) the additional conditions in sub-paragraph (2) are satisfied.

(2) The additional conditions are—

(a) the company is not party to the creditor relationship at any time in the accounting period for the purposes of a trade carried on by it (but see sub-paragraph (3)),

(b) the derivative contract is not one to which any of paragraphs 6 to 8 applies,

(c) the underlying subject matter of the derivative contract—

(i) is qualifying ordinary shares (see sub-paragraph (4)), or

(ii) is mandatorily convertible preference shares (see sub-paragraph (4)),

(d) the company is not a body falling within paragraph 45C(3) (authorised unit trusts etc),

(e) this paragraph is not prevented from applying to the derivative contract for the accounting period by paragraph 45E.

(3) The condition in sub-paragraph (2)(a) does not apply if the company—

(a) is party to the creditor relationship for the purposes of life assurance business, or

(b) is a mutual trading company.

(4) In this paragraph—

"mandatorily convertible preference shares" means shares—

(a) which represent the creditor relationship,

(b) which are not qualifying ordinary shares, and

(c) which are issued upon terms that stipulate that they must be converted into, or exchanged for, qualifying ordinary shares by a relevant time,

and for this purpose "relevant time" means a time no more than 24 hours after the acquisition of the shares by a person who, immediately before that acquisition, had the creditor relationship;

"qualifying ordinary shares" means shares in a company (the "relevant company") which satisfy the Conditions in sub-paragraphs (5) and (6).

(5) Condition 1 is that the shares are shares representing some or all of the issued share capital (by whatever name called) of the relevant company, other than—

(a) capital the holders of which have a right to a dividend at a fixed rate but have no other right to share in the profits of that company, or

(b) capital the holders of which have no right to a dividend of any description nor any other right to share in the profits of that company.

(6) Condition 2 is that the shares—

(a) are listed on a recognised stock exchange, or

(b) are shares in a holding company or a trading company.

(7) In sub-paragraph (6)—

"holding company" has the meaning given in paragraph 22(1) of Schedule A1 to the Taxation of Chargeable Gains Act 1992(**5**);

"trading company" has the meaning given by paragraph 22A of that Schedule.

(**5**) Schedule A1 to the Taxation of Chargeable Gains Act 1992 was inserted by Schedule 20 to the Finance Act 1988 (c. 36) and the definition of "holding company" was substituted by paragraph 4(1) of Schedule 10 to the Finance Act 2002.

(8) See also paragraph 45H (treatment of gains and losses on terminal exercise of option).

Exclusions from paragraph 45D

45E.—(1) Paragraph 45D does not apply to a derivative contract of a company for an accounting period if any of the following Conditions is satisfied in the case of the derivative contract in the period.

(2) In this paragraph "the original asset" means the asset that represents the creditor relationship mentioned in paragraph 45D(1).

(3) Condition 1 is that the rights and liabilities that fall to be treated as comprised in the derivative contract are such that the extent to which shares may be acquired in accordance with them is to be determined using a cash value—

(a) which is specified in the contract for the original asset, or

(b) which is or will be ascertainable by reference to that contract.

(4) Condition 2 is that the rights and liabilities that fall to be treated as comprised in the derivative contract are such that—

(a) the company is entitled or obliged to receive a payment instead of the shares which are the underlying subject matter of the derivative contract, and

(b) the amount of that payment differs by more than an insignificant amount from the value of the shares which the company would be entitled to acquire in accordance with those rights and liabilities at the time it became entitled or obliged to receive the payment.

(5) Condition 3 is that there is for the accounting period a connection (within the meaning of section 87(3) of the Finance Act 1996)(**6**) between—

(a) the company, and

(b) the company that issued the original asset,

and the original asset is not one in relation to which, by virtue only of subsection (5)(b) of section 73, the amendments made by that section do not have effect.

Creditor relationships: embedded derivatives which are exactly tracking contracts for differences

45F.—(1) This paragraph applies to a derivative contract of a company for an accounting period if the following conditions are satisfied—

(a) section 94A of the Finance Act 1996 (loan relationships with embedded derivatives) has effect in relation to a creditor relationship of the company,

(b) the derivative contract is the relevant contract, or one of the relevant contracts, to which the company is treated under subsection (2)(b) of that section as party in the case of that creditor relationship,

(c) that relevant contract is treated by virtue of subsection (3) of that section as a contract for differences,

(d) the additional conditions in sub-paragraph (2) are satisfied.

(2) The additional conditions are—

(**6**) Sub-section (3) was amended by paragraph 7 of Part 1, and by Part 3(12), of Schedule 25 and Schedule 40 respectively, to the Finance Act 2002.

(a) the creditor relationship is not one to which the company is party at any time in the accounting period for the purposes of a trade carried on by the company (but see sub-paragraph (3)),

(b) the derivative contract is not one to which any of paragraphs 6 to 8 applies,

(c) the underlying subject matter of the derivative contract—

(i) is land (wherever situated), or

(ii) is qualifying ordinary shares listed on a recognised stock exchange,

(d) the company is not a body falling within paragraph 45C(3) (authorised unit trusts etc),

(e) the derivative contract is an exactly tracking contract (see sub-paragraphs (4) to (6)).

(3) The condition in sub-paragraph (2)(a) does not apply if the company—

(a) is party to the creditor relationship for the purposes of life assurance business, or

(b) is a mutual trading company.

(4) For the purposes of this paragraph "an exactly tracking contract" is a contract for differences where D is equal to the amount determined by applying R% to C, where—

D is the amount that must be paid to discharge the rights and liabilities that fall to be treated as comprised in the contract;

R% is a relevant percentage change in the value of the underlying subject matter of the contract (see sub-paragraph (5));

C is the amount falling for the purposes of Chapter 2 of Part 4 of the Finance Act 1996 to be regarded in accordance with generally accepted accounting practice as the initial cost of the asset which represents the creditor relationship.

(5) In sub-paragraph (4), the reference to a relevant percentage change in the value of the underlying subject matter of the contract is a reference to the percentage change (if any) over the relevant period in—

(a) the value of the assets which are the underlying subject matter of the contract,

(b) or any index of the value of those assets.

(6) In sub-paragraph (5) "the relevant period" means—

(a) the period between—

(i) the date when the asset representing the creditor relationship came into existence, and

(ii) the date when the corresponding debtor relationship comes to an end; or

(b) any other period in which almost all of that period is comprised, and which differs from that period exclusively for purposes connected with giving effect to a valuation in relation to rights or liabilities under the asset representing the creditor relationship.

(7) In this paragraph "qualifying ordinary shares" means shares which satisfy Condition 1 in paragraph 45D(5).

Property based total return swaps

45G.—(1) This paragraph applies to a derivative contract of a company for an accounting period if the following conditions are satisfied—

(a) the derivative contract is a contract for differences,

(b) one or more indices are designated in the contract,

(c) at least one index so designated (the "capital value index") is an index of changes in the value of land (wherever situated),

(d) the underlying subject matter of the derivative contract also includes interest rates.

(2) In any such case, the relevant credits and debits for the purposes of paragraph 45A(3)(b) are those which—

(a) are given in relation to the derivative contract for the accounting period by paragraph 15, and

(b) fall within sub-paragraph (3).

(3) The credits and debits are those found for the period by applying R% to N, where—

N is the amount which is the notional principal amount in the case of the derivative contract;

R% is the percentage change (if any) in the capital value index over the relevant period.

(4) In sub-paragraph (3) "the relevant period" means—

(a) the accounting period, if the company is party to the derivative contract throughout that period;

(b) in any other case, any part of the accounting period throughout which the company is party to the derivative contract.

Paragraph 45D: treatment of net gains and losses on terminal exercise of option

45H.—(1) This paragraph applies to a derivative contract of a company if the following conditions are satisfied—

(a) the derivative contract is one to which paragraph 45D applies for an accounting period,

(b) rights that fall to be treated as comprised in the derivative contract are exercised to any extent in that accounting period,

(c) those rights are rights to acquire shares which are the underlying subject matter of the derivative contract.

(2) In any such case, for the purpose of computing any chargeable gain accruing to the company on a disposal by it of all the shares so acquired, the sums allowable as a deduction under section 38(1)(a) of the Taxation of Chargeable Gains Act 1992 (acquisition costs) shall—

(a) if G exceeds L, be increased by the amount of that excess,

(b) if L exceeds G, be reduced by the amount of that excess,

and, in the case of a part disposal of those shares, section 42(2) of that Act shall have effect accordingly.

(3) If the amount of the excess in sub-paragraph (2)(b) is greater than the amount of expenditure allowable under section 38(1)(a) of the Taxation of Chargeable Gains Act 1992, the amount of the excess that cannot be deducted from the expenditure so allowable shall, for the purpose mentioned in sub-paragraph (2), be added to the amount of the consideration received for the disposal of the shares.

(4) In this paragraph—

G is the sum of the amounts of any chargeable gains treated as accruing to the company under paragraph 45A(4)(a) in respect of the derivative contract in that or any previous accounting period so far as referable, on a just and reasonable apportionment to the shares acquired as a result of the exercise of the rights mentioned in sub-paragraph (1)(b);

L is the sum of the amounts of any allowable losses treated as accruing to the company under paragraph 45A(4)(b) in respect of the derivative contract in that or any previous accounting period so far as referable, on a just and reasonable apportionment to the shares acquired as a result of the exercise of the rights mentioned in sub-paragraph (1)(b).

Index-linked gilt-edged securities with embedded contracts for differences

45I.—(1) This paragraph applies to a derivative contract of a company for an accounting period if the following conditions are satisfied—

(a) section 94A of the Finance Act 1996 (loan relationships with embedded derivatives) has effect in relation to a creditor relationship of the company,

(b) that creditor relationship is an index-linked gilt-edged security,

(c) the credits and debits which fall to be brought into account for the accounting period for the purposes of Chapter 2 of Part 4 of the Finance Act 1996 in respect of the equivalent deemed loan relationship are non-trading credits and non-trading debits,

(d) the derivative contract is the relevant contract to which the company is treated under subsection (2)(b) of section 94A of the Finance Act 1996 as party in the case of the creditor relationship,

(e) that relevant contract is treated by virtue of subsection (3) of that section as a contract for differences.

(2) The credits and debits that would, apart from this paragraph, fall to be brought into account under this Schedule in respect of the derivative contract for the accounting period shall not be so brought into account.

(3) In this paragraph—

"the equivalent deemed loan relationship" is the loan relationship to which, in the case of the creditor relationship, the company is treated as party under section 94A(2)(a) of the Finance Act 1996;

"gilt-edged security" has the meaning given by section 103(1) of the Finance Act 1996;

"index-linked gilt-edged security" means any gilt-edged security the amount of the payments under which is determined wholly or partly by reference to the retail prices index;

"the retail prices index" has the same meaning as in the Income Tax Acts (see section 833(2) of the Taxes Act 1988)(**7**).".

16. In paragraph 46(2)(a)—

(a) for "(a)" substitute "(c)";

(b) for "(f)" substitute "(e)".

17. Omit paragraph 47.

(**7**) 1988 c. 1, as substituted by paragraph 22 of Schedule 2 to S.I.1996/273.

PART 4

Consequential amendments

18. In Part 8 of Schedule 26 to the Finance Act 2002, in paragraph 42(2), omit "(within the meaning of Chapter 2 of Part 4 of that Act)".

19.—(1) In Part 10 of Schedule 26 to the Finance Act 2002, paragraph 54 is amended as follows.

(2) In sub-paragraph (1), insert each of the following definitions at the appropriate place—

"creditor relationship" has the meaning given by section 103(1) of the Finance Act 1996;";

"debtor relationship" has the meaning given by section 103(1) of the Finance Act 1996;".

Jim Murphy
John Heppell
Two of the Lords Commissioners of Her Majesty's Treasury

27th August 2004

EXPLANATORY NOTE

(This note is not part of the Order)

This Order amends Parts 2, 8, 9 and 10 of Schedule 26 (derivative contracts) to the Finance Act 2002 (c. 23).

Article 1 provides for the citation, commencement and effect of the Order.

Article 2 introduces the amendments to Part 2 which are made by articles 3 to 13.

Article 14 introduces the amendments to Part 9 which are made by articles 15 to 17.

Articles 18 and 19 contain consequential amendments to Parts 8 and 10 respectively.

The effect of the amendments to Part 9 of Schedule 26 is to clarify the tax treatment of certain types of derivative contracts by excluding certain profits and losses from the charge to corporation tax as income and providing for them to be charged to corporation tax as chargeable gains. The changes apply to derivative contracts whose underlying subject matter is or includes land and to derivative contracts which are deemed to exist as a result of section 94A of the Finance Act 1996 (c. 8) (as inserted by paragraph 13 of Schedule 10 to the Finance Act 2004 (c. 12)), which provides for the accounting treatment applicable to loan relationships to be followed for tax purposes by separating the instrument into a debt component and a derivatives component.

This Order does not impose any new costs on business.