STATUTORY INSTRUMENTS

2006 No. 843

CORPORATION TAX

The Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) Regulations 2006

Made - - - -	*21st March 2006*
Laid before the House of Commons - - - -	*21st March 2006*
Coming into force - -	*22nd March 2006*

The Treasury make the following Regulations in exercise of the powers conferred by sections 84A(3A) of the Finance Act 1996(**1**) and paragraphs 16(3A) and 17C(1) of Schedule 26 to the Finance Act 2002(**2**).

Citation, commencement and effect

1.—(1) These Regulations may be cited as the Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) Regulations 2006, and shall come into force on 22nd March 2006.

(2) These Regulations have effect in relation to accounting periods ending on or after 22nd March 2006.

(3) But these Regulations do not have effect where a company ceased to be party to a loan relationship or derivative contract before 22nd March 2006.

Interpretation

2.—(1) In these Regulations—

"for accounting purposes" means for the purposes of accounts drawn up in accordance with generally accepted accounting practice, and "generally accepted accounting practice" has the meaning given by section 50 of the Finance Act 2004(**3**);

"derivative contract" has the same meaning as in Schedule 26 to the Finance Act 2002;

(**1**) 1996 c. 8. Section 84A was inserted by paragraph 3 of Schedule 23 to the Finance Act 2002 (c. 23), and subsection (3A) was inserted by paragraph 2(2) of Schedule 10 to the Finance Act 2004 (c. 12).

(**2**) 2002 c. 23. In Schedule 26, paragraph 16(3A) was inserted by paragraph 48(2) of Schedule 10 to the Finance Act 2004, and paragraph 17C was inserted by paragraph 50 of Schedule 10 to the Finance Act 2004.

(**3**) 2004 c. 12. Section 50 was amended by paragraphs 49 and 50 of Schedule 4 to the Finance Act 2005 (c. 7).

"hedged item" is to be construed in accordance with regulation 3;

"hedging instrument" is to be construed in accordance with regulation 3;

"hedging relationship" is to be construed in accordance with regulation 3;

"underlying subject matter" has the same meaning as in Schedule 26 to the Finance Act 2002.

(2) In these Regulations "designated", "effective hedge", "firm commitment", "forecast transaction", "foreign operation" and "net investment in a foreign operation" have the same meaning as for accounting purposes.

(3) For the purposes of these Regulations two companies are treated as being in the same group if there is a connection between the two companies within the meaning given by section 87 of the Finance Act 1996(**4**) (accounting method where parties have a connection).

Interpretation of "hedging relationship" and related expressions

3.—(1) For the purposes of these Regulations, a company has a hedging relationship between a derivative contract or a liability representing a loan relationship on the one hand ("the hedging instrument") and an asset, liability, receipt or expense on the other ("the hedged item") if and to the extent that—

(a) the hedging instrument and the hedged item are designated by the company as a hedge; or

(b) in any other case the hedging instrument is intended to act as a hedge of—

(i) the exposure to changes in fair value of a hedged item which is a recognised asset or liability or an unrecognised firm commitment or an identified portion of such an asset, liability or commitment that is attributable to a particular risk and could affect profit or loss of the company;

(ii) the exposure to variability in cash flows that is attributable to a particular risk associated with a hedged item that is a recognised asset or liability or a forecast transaction and could affect profit or loss of a company; or

(iii) a net investment in a foreign operation of the company.

(2) In these Regulations—

(a) any reference to a hedging instrument includes a reference to part of an instrument; and

(b) any reference to a hedged item includes a reference to part of a hedged item.

Disallowance of certain exchange losses where obligations may be settled in more than one currency

4.—(1) This regulation applies to an exchange loss arising to a company if—

(a) the exchange loss arises—

(i) in relation to an asset or liability representing a loan relationship of the company, or

(ii) in relation to a derivative contract whose underlying subject matter consists wholly or partly of currency, and

(b) conditions A to D are met.

(2) Condition A is that the company is party to one or more loan relationships or derivative contracts ("the specified instruments").

(3) Condition B is that another company in the same group ("company Y") has a net investment in a foreign operation.

(**4**) Section 87 was amended by paragraph 7 of Schedule 25 to the Finance Act 2002 and paragraph 4 of Schedule 10 to the Finance Act 2004.

(4) Condition C is that if the assets constituting the net investment were held instead by the company, it is likely that there would be a hedging relationship (with the specified instruments constituting the hedging instrument and the net investment constituting the hedged item).

(5) Condition D is that there are arrangements in place such that—

(a) the arrangements are represented by any combination of loan relationships and derivative contracts ("the arrangement instruments");

(b) company Y is a party to at least one of the arrangement instruments; and

(c) company Y, or another company that is party to the arrangements, can, by exercising an option included in the terms of any arrangement instrument or otherwise, determine that an exchange gain or loss that would arise, but for the company's ability to determine otherwise, does not arise.

(6) For the purposes of section 84A(3A) of the Finance Act 1996 there is prescribed any exchange loss arising to the company in relation to any of the specified instruments representing a loan relationship of the company to the extent that existing unallowable purposes rules do not apply.

(7) For the purposes of paragraph 16(3A) to Schedule 26 to the Finance Act 2002 there is prescribed any exchange loss arising to the company in relation to any derivative contract which is one of the specified instruments to the extent that existing unallowable purposes rules do not apply.

(8) In this regulation "existing unallowable purposes rules" means the rules specified in—

(a) paragraph 13 of Schedule 9 to the Finance Act 1996(**5**) (loan relationships for unallowable purposes), and

(b) paragraph 23 of Schedule 26 to the Finance Act 2002(**6**) (derivative contracts for unallowable purposes).

Disallowance of certain losses arising on derivative contracts

5.—(1) This regulation applies if conditions A to D are met.

(2) Condition A is that a company is party to two or more derivative contracts.

(3) Condition B is that those derivative contracts are hedging instruments intended to act as a hedge of currency risk.

(4) Condition C is that at least one of those derivative contracts ("the non-excluded contract") is a contract where any profit or loss arising on it is an amount that does not fall within paragraph 16(3) of Schedule 26 to the Finance Act 2002(**7**).

(5) Condition D is that a loss arises on the non-excluded contract.

(6) The amount of the loss arising on the non-excluded contract is not to be recognised in determining a company's profit or loss for any period.

(**5**) Paragraph 13 of Schedule 9 was amended by paragraph 13 of Schedule 23, paragraph 30 of Schedule 25 and Part 3(10) of Schedule 40 to the Finance Act 2004 and paragraph 32 of Schedule 10 to the Finance Act 2004.
(**6**) Paragraph 23 of Schedule 26 was amended by paragraph 4 of Schedule 9 and paragraph 55 of Schedule 10 to the Finance Act 2004.
(**7**) Paragraph 16(3) of Schedule 26 was substituted by paragraph 48(2) of Schedule 10 to the Finance Act 2004.

Vernon Coaker
Tom Watson
Two of the Lords Commissioners of Her Majesty's Treasury

21st March 2006

EXPLANATORY NOTE

(This note is not part of the Regulations)

These Regulations provide that certain exchange losses and certain losses arising on derivative contracts are not to be brought into account in determining a company's profit or loss.

Regulation 1 provides for citation, commencement and effect.

Regulation 2 provides for interpretation, and regulation 3 is concerned with the interpretation of the expression "hedging relationship" and other related expressions.

Regulation 4 provides that certain exchange losses are not to be brought into account where the obligations may be settled in more than one currency.

Regulation 5 provides that the amount of a loss arising on certain derivative contracts is not to be recognised in determining a company's profit or loss for any period.

These Regulations impose no new costs on business.