EXPLANATORY MEMORANDUM TO

THE LOAN RELATIONSHIPS AND DERIVATIVE CONTRACTS (DISREGARD AND BRINGING INTO ACCOUNT OF PROFITS AND LOSSES) (AMENDMENT NO. 2) REGULATIONS 2011

2011 No. 2912

1. This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs ("HMRC") on behalf of Her Majesty's Treasury and is laid before the House of Commons by Command of Her Majesty.

2. Purpose of the instrument

2.1 The Loan Relationships and Derivative Contracts (Disregard and Bringing into Account) Regulations 2004 ('the Disregard Regulations') were introduced to address accounting changes arising from the introduction of International Accounting Standards ('IAS') that would have rendered previously tax neutral hedging transactions ineffective for tax purposes. The Disregard Regulations ensure that certain transactions can be undertaken in a tax neutral manner.

2.2 The purpose of these amending Regulations is to put beyond doubt that the Disregard Regulations only apply at the point that a company has a foreign currency loan relationship liability which is a hedge of foreign currency shares, ships or aircrafts.

3. Matters of special interest to the Select Committee on Statutory Instruments

3.1 The Regulations come into force less than 21 days after the date on which they were made. The Department regrets that compliance with the 21-day rule is not possible in this case. The Regulations block a disclosed avoidance scheme. Unless the Regulations come into force immediately there is a significant risk that transactions would be entered into to pre-empt the operation of the regulations.

4. Legislative Context

4.1 Section 307 of the Corporation Tax Act 2009 ('CTA 2009') provides that a company brings into account for tax purposes loan relationship debits and credits by reference to amounts recognised for accounting purposes. Section 595 CTA 2009 provides that a company brings into account for tax purposes derivative contract credits and debits by reference to amounts recognised in the company's accounts.

4.2 Section 328 CTA 2009 provides that references to a company's profits and losses on its loan relationships includes a reference to the foreign exchange gains and losses arising on those loan relationships. Section

606 CTA 2009 provides that references to a company's profits or losses on its derivative contracts includes a reference to the foreign exchange gains and losses arising on those derivative contracts.

4.3 The Disregard Regulations were introduced to address problems that arose when companies adopted IAS. Without the Disregard Regulations previously tax neutral exchange gains and losses arising from a company's loan relationships and derivative contracts which act as economic hedges for the company's assets and liabilities would have been brought into account for tax purposes.

4.4 The Disregard Regulations only apply to specific types of transaction, sections 328(4) and (5), 598(1) and 606(4) and (5) of CTA 2009 enable regulations to be made to alter the way in which exchange gains and losses are brought into account for tax purposes.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

6.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

7.1 The policy underlying the Disregard Regulations is to allow companies to be taxed in a way that reflects the economic position of companies which use loan relationships and derivative contracts to hedge their foreign exchange exposure in relation to their foreign currency assets and liabilities rather than by reference to their accounts. The Disregard Regulations do this by disregarding for tax purposes foreign exchange gains and losses which arise in certain circumstances one of these circumstances is where a company uses a foreign currency loan relationship or derivative contract to reduce its exposure in relation to foreign currency movements on foreign currency shares, ships or aircraft assets. This is known as 'matching' or 'hedging'.

7.2 These Regulations put beyond doubt that a company which has an existing foreign currency loan relationship or derivative contract and matches same currency shares, ships or aircraft at a later date only comes within the provisions of the Disregard Regulations at the date the shares, ships or aircrafts are 'matched' or 'hedged'.

8. Consultation

8.1 There was no consultation as this is an anti–avoidance measure.

9. Guidance

9.1 HMRC will publish guidance on the operation of the Regulations.

10. Impact

10.1 A Tax Information and Impact Note covering this instrument will be published on the HMRC website at http://www.hmrc.gov.uk/thelibrary/tiins.htm.

11. Regulating small business

11.1 The legislation does not apply to small business.

12. Monitoring & review

12.1 HMRC intends to monitor the legislation for further instances of these type of transactions and will make further regulations if necessary. HMRC will review these Regulations in 2014 to determine whether they operate as intended.

13. Contact

Fiona Hay at HMRC Tel: 020 7147 2543 or email: fiona.hay@hmrc.gsi.gov.uk can answer any queries regarding the instrument.