

**EXPLANATORY MEMORANDUM TO  
THE LOAN RELATIONSHIPS AND DERIVATIVE CONTRACTS (DISREGARD OF  
PROFITS AND LOSSES) REGULATIONS 2004**

**2004 No. 3256**

1. This explanatory memorandum has been prepared by the Commissioners of Inland Revenue and is laid before the House of Commons by Command of Her Majesty.
2. **Description**
  - 2.1 The regulations provide for changes in fair value of certain derivative contracts to be left out of account for tax purposes when they are recognised in accounts, and in some cases, to be brought back into account for those purposes when the contract matures or is otherwise disposed of. They also provide for certain exchange gains and losses on other assets and liabilities to be left out of account..
3. **Matters of special interest to the Select Committee on Statutory Instruments**
  - 3.1 None
4. **Legislative Background**
  - 4.1 The power to make the regulations is in sections 84A(3A), 85B(3)(a), 85B(5)(b) of the Finance Act 1996 and paragraphs 16(3A), 17C(1)(a) and 17C(3)(b) of Schedule 26 to the Finance Act 2002 (as amended or inserted by Schedule 10 Finance Act 2004). These provisions allow certain profits and losses from loan relationships and derivative contracts to be left out of account, to be brought into account in a different way or to be brought into account at a later date.
  - 4.2 This is the first use of the powers cited, but regulations have been made under predecessor provisions of section 84A(3A) Finance Act 1996 and paragraph 16(3A) of Schedule 26 to the Finance Act 2002.
5. **Extent**
  - 5.1 The instrument applies to all of the United Kingdom.
6. **European Convention on Human Rights**
  - 6.1 This instrument is subject to annulment and does not amend primary legislation, so no certificate under the ECHR is required.

## **7. Policy background**

- 7.1 Profits and losses on debts and derivative contracts are generally brought into account as they are recognised in accounts drawn up using UK Generally Accepted Accounting Practice (GAAP). From 2005 all companies will be permitted to use International Accounting Standards (IAS) to draw up their accounts, and such accounts will be an acceptable basis for tax purposes – section 50 Finance Act 2004.
- 7.2 The treatment of profits and losses on debts and derivative contracts under IAS differs from that under UK GAAP – in particular the treatment of derivative contracts which are used to hedge (i.e. to reduce or eliminate risk in assets or liabilities) differs markedly.
- 7.3 In Budget 2004 the Government announced that companies that use IAS may nevertheless retain for tax purposes the existing UK GAAP treatment of hedging contracts. This treatment is normally to disregard changes in fair value of the hedge until the hedged asset or liability is recognised in the accounts, or to disregard fair value changes entirely. Consequently Parts 1 and 2 Schedule 10 FA 2004 made a number of changes to the tax legislation in this area, inserting a number of new powers to enable the existing UK GAAP tax treatment of hedging to continue.
- 7.4 There has been consultation with relevant bodies this Order and drafts have been published on the Inland Revenue's website for comments.

## **8. Impact**

- 8.1 A Regulatory Impact Assessment has not been prepared for this instrument as it has no impact on business, charities or voluntary bodies.
- 8.2 The impact on the public sector is nil, because the regulations maintain the status quo.

## **9. Contact**

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