EXPLANATORY MEMORANDUM TO THE

LOAN RELATIONSHIPS AND DERIVATIVE CONTRACTS (DISREGARD AND BRINGING INTO ACCOUNT OF PROFITS AND LOSSES) (AMENDMENT) REGULATIONS 2005

2005 No. 2012

1.   This explanatory memorandum has been prepared by Her Majesty's Commissioners of Revenue and Customs and is laid before the House of Commons by Command of Her Majesty.

This memorandum contains information for the Select Committee on Statutory Instruments.

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.

2.2   They extend a time limit for electing that regulations 7 to 9 of the Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) Regulations 2004 (SI 2004/3256) do not apply. 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**

Regulation 7(2)(c) of the regulations extends a time limit for making an election from 31st March 2005 to 1st October 2005. Thus there may be companies which have already elected under the provisions of SI 2004/3256. Such companies are not disadvantaged by the extension of the time limit.

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   These regulations are related to the Exchange Gains and Losses (Bringing Into Account Gains or Losses) (Amendment) Regulations 2005 which are being made at the same time.

5. **Extent**

This instrument applies to all of the United Kingdom.

6. **European Convention on Human Rights**

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement 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). For 2005 onwards 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 on these regulations.

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

9. **Contact**

Richard Thomas at Her Majesty's Revenue & Customs Tel 020 7147 2558 or e-mail richard.thomas@hmrc.gsi.gov.uk can answer any queries regarding the instrument.
.