

2005 No. 3374

CORPORATION TAX

The Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) (Amendment No. 2) Regulations 2005

Made - - - - *7th December 2005*
Laid before the House of Commons *8th December 2005*
Coming into force - - *29th December 2005*

The Treasury, in exercise of the powers conferred upon them by sections 84A(3A), 85B(3)(a) and (5)(b) of and paragraph 19B(1) and (2)(a) of Schedule 9 to the Finance Act 1996(a), paragraphs 16(3A) and 17C(1), (3)(b) and (4) of Schedule 26 to the Finance Act 2002(b) and paragraph 52 of Schedule 4 to the Finance Act 2005(c), make the following Regulations:

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) (Amendment No. 2) Regulations 2005 and shall come into force on 29th December 2005.

(2) These Regulations have effect in relation to periods of account beginning on or after 1st January 2005 and ending after these Regulations come into force.

Amendment to the Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) Regulations 2004

2. Amend the Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) Regulations 2004(d) as follows.

3. In regulation 3(7) (exchange gains or losses arising from liabilities or assets hedging shares etc) and regulation 4(5) (exchange gains or losses arising from derivative contracts hedging shares etc) in the definition of “unmatched carrying value” for “value as shown in the company’s accounts” substitute “relevant value”.

4. In regulation 3(6) for “if” substitute “in particular where”.

5. In regulation 4 after paragraph (4) insert—

(a) 1996 c. 8. Section 84A was inserted by paragraph 3 of Part 1 of Schedule 23 to the Finance Act 2002 (c. 23) and sub-section (3A) was substituted by paragraph 2(2) of Schedule 10 to the Finance Act 2004 (c. 12). Section 85B was substituted and inserted by paragraph 3 of Schedule 10 to the Finance Act 2004. Paragraph 19B of Schedule 9 was inserted by paragraph 36 of Schedule 10 to the Finance Act 2004.

(b) 2002 c. 23. Paragraph 16(3A) was substituted by paragraph 48(2), and paragraphs 17C(1) and 17C(3)(b) were substituted by paragraph 50, of Part 2 of Schedule 10 to the Finance Act 2004.

(c) 2005 c.7.

(d) S.I. 2004/3256, amended by S.I. 2005/2012.

“(4A) For the purposes of paragraph 16(3A) of Schedule 26 to the Finance Act 2002 there is prescribed an exchange gain or loss arising to a company in an accounting period in relation to a derivative contract of the company which is matched with the whole or part of any share capital of the company.

(4B) A derivative contract is matched with share capital in particular where for the accounting period of the company immediately preceding the first accounting period beginning on or after 1st January 2005—

- (a) exchange gains and losses on the derivative contract were taken to a reserve; and
- (b) set off there against exchange gains and losses on the share capital.”.

6. After regulation 4 insert—

“Relevant value

4A.—(1) For the purposes of regulations 3(7) and 4(5), “relevant value” means—

- (a) the value determined on the basis of accounting used in the prior accounting period in the case specified in paragraph (2), and
- (b) the value shown in the accounts of the company in any other case.

(2) The case specified is where—

- (a) an asset is matched in accordance with regulation 3(3)(b) or 4(3)(b);
- (b) in the prior accounting period the exchange gains or losses in relation to that asset were taken to a reserve and set off there against exchange gains or losses in relation to the liability or derivative contract with which the asset is matched; and
- (c) the value of the asset shown in the company’s accounts was, in accordance with generally accepted accounting practice, determined—
 - (i) on an historic cost basis of accounting in the first accounting period beginning on or after 1st January 2005, and
 - (ii) on a different basis of accounting in the prior accounting period.

(3) In this regulation the “prior accounting period” means the accounting period of the company immediately preceding its first accounting period beginning on or after 1st January 2005.”.

7.—(1) Amend regulation 6 (rules about fair value profits and losses) as follows.

(2) In paragraph (3)(a) and (4)(a) for “7(2)” substitute “7(1)”.

(3) In paragraph (5)—

- (a) at the beginning insert “Subject to paragraph (5A)”; and
- (b) after “that regulation” insert “but that regulation 9A shall apply,”.

(4) After paragraph (5) insert—

“(5A) An election under paragraph (5) has no effect in relation to interest rate contracts—

- (a) where—
 - (i) the contract or a portion of the contract (“the hedging instrument”) is designated as a hedge in respect of any risks arising in respect of an asset, liability, receipt or expense (“the hedged item”);
 - (ii) fair value profits or losses arising on the hedged item or in relation to any of the risks arising in respect of the hedged item, or any portion of the hedged item, are not brought into account for the purposes of corporation tax for that period; and
 - (iii) fair value profits or losses arising on the hedging instrument are not recognised in the company’s statement of recognised gains and losses or statement of changes in equity;

or

(b) where the hedged item is a loan relationship to which section 87(1) of the Finance Act 1996 applies.”.

(5) In paragraph (6) for the words from “before” to the end substitute—

“before—

(a) 1st October 2005 in the case of an election under paragraph (3), or

(b) 31st March 2006 in the case of an election under paragraph (5),

and has effect for that accounting period and all subsequent accounting periods unless, in the case of an election under paragraph (3), revoked.”.

(6) In paragraph (6A) at the end add “This paragraph does not apply to cases within paragraph (7).”.

(7) In paragraph (7) at the end insert “or, if later, 31st March 2006”.

(8) In paragraphs (8) and (9) delete “or (5)”.

(9) In paragraph (9) for “Inland Revenue” substitute “Her Majesty’s Revenue and Customs”.

(10) After paragraph (9) insert—

“(9A) An election under paragraph (5) shall be made in writing to Her Majesty’s Revenue and Customs and is irrevocable.”.

(11) In paragraph (12)(a) after the words in parenthesis insert “and paragraph 50A(3A) of that Schedule shall be modified in accordance with paragraph (12A)”.

(12) After paragraph 12 insert—

“(12A) The modification to paragraph 50A(3B) of Schedule 26 to the Finance Act is as follows—

(a) in paragraph (a) delete “and”;

(b) after paragraph (b) insert—

“, and

(c) regulations 7, 8 and 9 of the Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) Regulations 2004.”.

8. In regulation 7(1)(a)(ii) (fair value profits and losses arising from derivative contracts which are currency contracts) and regulation 8(1)(a)(ii) (profits and losses arising from derivative contracts which are commodity contracts or debt contracts) for “to which fair value accounting applies for that accounting period” substitute “for which fair value profits or losses are brought into account for the purposes of corporation tax”.

9. In regulation 9 (profits or losses arising from derivative contracts which are interest rate contracts) after paragraph (2) insert—

“(2A) Where an interest rate contract—

(a) becomes a contract to which paragraph (1) applies, or

(b) ceases to be a contract to which paragraph (1) applies,

the amount to be brought into account for the purposes of paragraph 17C(1)(b) of Schedule 26 to the Finance Act 2002 is such amount as is just and reasonable in the circumstances and with regard to whether as a result of the change any amounts cease to be brought into account or are brought into account more than once.”.

10. After regulation 9 insert—

“**9A.**—(1) For the purposes of paragraph 17C(1)(a) of Schedule 26 to the Finance Act 2002 there is prescribed all credits and debits representing the whole or part of the fair value profit or loss arising to a company in relation to an interest rate contract in an accounting period if—

- (a) the contract or a portion of the contract (“the hedging instrument”) is designated as a hedge in respect of any risks arising in respect of an asset, liability, receipt or expense (“the hedged item”);
- (b) fair value profits or losses arising on the hedging instrument are recognised in accordance with generally accepted accounting practice in the company’s statement of recognised gains and losses or statement of changes in equity (“equity statements”); and
- (c) the company has made an election under regulation 6(5).

This is subject to paragraph (2).

(2) Credits and debits which—

- (a) are brought into account in the profit and loss account or income statement (including debits and credits previously brought into account in an equity statement and transferred to the profit and loss account or income statement), or
- (b) are taken to the carrying value of an asset or liability,

are not prescribed for the purposes of paragraph 17C(1)(a) of Schedule 26 to the Finance Act 2002.

This is subject to paragraph (3).

(3) In relation to credits or debits within paragraph (2)(a), there is prescribed for the purposes of paragraph 17C(1)(a) of Schedule 26 to the Finance Act 2002 any debits or credits corresponding to the paragraph (2)(a) debits or credits which are reflected in an equity statement.

(4) In this regulation “an interest rate contract” has the same meaning as in regulation 9.”.

11.—(1) Amend regulation 10 (bringing fair value profits and losses into account on currency and commodity contracts) as follows.

(2) In paragraph (3A) at the beginning insert “Subject to paragraph (3B),”.

(3) After paragraph (3A) insert—

“(3B) Where the disposal mentioned in paragraph (3A)(b) is to a company (“the transferee”) which is a member of the same group of companies, in applying paragraph (3A)(a) to the transferee FVP shall be treated as meaning the fair value profits and losses of the transferor.

(3C) In paragraph (3B), “group of companies” has the meaning given in paragraph 28(6) of Schedule 26 to the Finance Act 2002.”.

(4) In paragraph (10)(a) for “or” in the second place it occurs substitute “and”.

12. In regulation 11 (profits and losses arising from loan relationships with embedded derivatives) after paragraph (3) insert—

“(4) Where there is a change of accounting policy in drawing up a company’s accounts from one period of account to the next affecting the amounts to be brought into account for accounting purposes in respect of the company’s loan relationships, the amounts prescribed in paragraphs (1) to (3) that would otherwise be brought into account for the purposes of Chapter 2 of the Finance Act 1996 shall not be brought into account.”.

13.—(1) Amend regulation 12 as follows.

(2) In paragraph (1) at the end insert “This is subject to paragraph (4).”.

(3) In paragraph (2)(a) after “relationship” insert “and credits and debits in respect of discounts, premiums, fees and other incidental costs to the extent that these amounts are not within section 92A(3) of the Finance Act 1996,”.

(4) After paragraph (2) insert—

“(3) Where there is a change of accounting policy in drawing up a company’s accounts from one period of account to the next affecting the amounts to be brought into account for accounting purposes in respect of the company’s loan relationships, the amounts prescribed in paragraphs (1) and (2) that would otherwise be brought into account for the purposes of Chapter 2 of the Finance Act 1996 shall not be brought into account.

(4) This regulation does not apply to a company which is a party to a debtor relationship in a case where—

- (a) the company is carrying on a banking business or a business consisting wholly or partly in dealing in securities, and
- (b) it entered into the debtor relationship in the ordinary course of that business.”.

Dave Watts
Vernon Coaker

7th December 2005

Two of the Lords Commissioners of Her Majesty’s Treasury

EXPLANATORY NOTE

(This note is not part of the Regulations)

These Regulations amend the Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) Regulations 2004 (S.I. 2004/3256; “the Principal Regulations”, as amended by S.I. 2005/2012) which 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.

Regulation 1 provides for citation, commencement and effect. Authority for the limited retrospective effect of these Regulations is given by paragraph 52 of Schedule 4 to the Finance Act 2005 (c. 7).

Regulation 2 introduces the amendments to the Principal Regulations.

Regulation 3 amends regulation 3 (exchange gains or losses arising from liabilities or assets hedging shares etc) and regulation 4 (exchange gains or losses arising from derivative contracts hedging shares etc) of the Principal Regulations to amend the definition of “unmatched carrying value” by reference to a new term “relevant value” which is defined in a new regulation 4A.

Regulation 4 amends regulation 3(6) of the Principal Regulations.

Regulation 5 amends regulation 4 of the Principal Regulations to make provision for cases where a derivative contract is used as a hedging instrument in relation to shares issued by the company.

Regulation 6 inserts two new regulations into the Principal Regulations. New regulation 4A defines “relevant value” in order to permit a company to continue to use a fair value basis of accounting in certain cases in relation to certain assets which are matched with a liability or derivative contract. New regulation 4B makes provision for cases where a company has non-trading loan relationships denominated in the same currency as the liability or derivative to be matched and the exchange gains or losses on the loan relationship are set off in the company’s profit and loss account against exchange gains or losses on the liability or derivative contract.

Regulation 7 amends regulation 6 (rules about fair value profits and losses) of the Principal Regulations to make provision for an election in relation to new regulation 9A.

Regulation 8 amends regulation 7(1)(a)(ii) (fair value profits and losses arising from derivative contracts which are currency contracts) and regulation 8(1)(a)(ii) (profits and losses arising from derivative contracts which are commodity contracts or debt contracts) of the Principal Regulations so that the Principal Regulations apply where the hedged item is not one for which fair value profits or losses are brought into account for the purposes of corporation tax.

Regulation 9 amends regulation 9 (profits or losses arising from derivative contracts which are interest rate contracts) of the Principal Regulations to make provision where an interest rate contract becomes or ceases to be a contract to which regulation 9 applies.

Regulation 10 inserts a new regulation 9A into the Principal Regulations which make provision for an alternative basis of taxing derivative contracts which are interest rate contracts.

Regulation 11 amends regulation 10 (bringing fair value profits and losses into account on currency and commodity contracts) of the Principal Regulations to make provision in relation to intra-group transfers of hedged items.

Regulation 12 amends regulation 11 (profits and losses arising from loan relationships with embedded derivatives) of the Principal Regulations to extend this regulation to other debits and credits brought into account under Chapter 2 of the Finance Act 1996 (c. 8).

Regulation 13 amends regulation 12 of the Principal Regulations so this regulation does apply where a company carrying on a banking or securities business issues convertible securities in the ordinary course of that business and to extend this regulation to other debits and credits brought into account under Chapter 2 of the Finance Act 1996.

These Regulations impose no new costs on business.

2005 No. 3374

CORPORATION TAX

**The Loan Relationships and Derivative Contracts (Disregard
and Bringing into Account of Profits and Losses) (Amendment
No. 2) Regulations 2005**

£3.00

ISBN 0-11-073762-8

© Crown copyright 2005

Printed and published in the UK by The Stationery Office Limited
under the authority and superintendence of Carol Tullo, Controller of Her Majesty's
Stationery Office and Queen's Printer of Acts of Parliament.

E1746 12/2005 151746T 19585

9 780110 737621