

**EXPLANATORY MEMORANDUM TO**  
**THE LOAN RELATIONSHIPS AND DERIVATIVE CONTRACTS (DISREGARD**  
**AND BRINGING INTO ACCOUNT OF PROFITS AND LOSSES) (AMENDMENT**  
**NO. 2) REGULATIONS 2005**

**2005 No. 3374**

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 regulation 9A of the Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) Regulations 2004 (SI 2004/3256) (inserted by these regulations) applies in place of regulation 9.
- 2.3 They also amend other parts of SI 2004/3256 in response to representations about the workings of those regulations.

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

- 3.1 Regulation 6(5)(c) of the regulations extends a time limit for making an election from 1<sup>st</sup> October 2005 to 31<sup>st</sup> March 2006. 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. In addition paragraph 52 of Schedule 4 to the Finance Act 2005 (also cited) permits the regulations to have effect for the accounting periods in which they are made

## **5. Extent**

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 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 of the 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 of Schedule 10 to the Finance Act 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, telephone 020 7147 2558 or e-mail [richard.thomas@hmrc.gsi.gov.uk](mailto:richard.thomas@hmrc.gsi.gov.uk) can answer any queries regarding the instrument.