

**EXPLANATORY MEMORANDUM TO**  
**THE LOAN RELATIONSHIPS AND DERIVATIVE CONTRACTS (DISREGARD**  
**AND BRINGING INTO ACCOUNT OF PROFITS AND LOSSES) (AMENDMENT)**  
**REGULATIONS 2006**

**2006 No. 3236**

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.

**2. Description**

2.1 The regulations provide for a new election to be made to apply regulation 9A of the Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) Regulations 2004 (SI 2004/3256) in cases where it was not previously available. They also amend regulation 9A to allow it to be applied to a wider range of contracts.

2.2. The regulations provide for an election to be made to hedge a net investment in an overseas subsidiary at a value higher than cost where the net asset value of the investment exceeds cost.

2.3 In addition, they amend regulations 11 and 12 of SI 2004/3256 to clarify the workings of those regulations, and in particular to ensure that exchange gains and losses on certain types of security are not taken into account where they have been disregarded in periods before those starting on or after 1 January 2005.

2.4 The regulations have effect for periods of account beginning on or after 1<sup>st</sup> January 2006 and ending on or after the date the regulations come into force.

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

None.

**4. Legislative Background**

4.1 These regulations are being made to clarify and amend the treatment of hedging contracts and of hybrid contracts in Chapter 2 Part 9 Finance Act 1996 (loan relationships) and Schedule 26 FA 2002 (derivative contracts) in the light of their practical application and of issues raised by a Consultative working group.

4.2 This instrument relates in part to the Loan Relationships and Derivative Contracts (Change of Accounting Practice) (Amendment) Regulations 2006

## **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 are 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 These regulations modify the loan relationships and derivative contracts tax law in the light of practical experience of, in particular, the application of IAS. It is not appropriate to amend tax law otherwise than through legislative change, so no alternative avenues of achieving the objective have been explored.
- 7.5 There has been extensive consultation on the workings of SI 2004/3256 as amended with relevant bodies, especially a Consultative Working Group, and this Order clarifies and amends those Parts in the light of their practical application.
- 7.6 Guidance on the regulations generally is provided in HMRC's Corporate Finance Manual and on its website under the heading "Accounting Standards - the UK tax implications".

## **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**

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