

EXPLANATORY MEMORANDUM TO
THE LOAN RELATIONSHIPS AND DERIVATIVE CONTRACTS (DISREGARD
AND BRINGING INTO ACCOUNT OF PROFITS AND LOSSES)
(AMENDMENT) REGULATIONS 2007

2007 No. 948

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 correction to be made to the Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) Regulations 2004 (SI 2004/3256). Amendments made to regulation 12 by the Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) Regulations 2006 (SI 2006/3236) gave an excessive amount of debits in certain cases. These regulations restore the wording of regulation 12 to the wording it had before SI 2006/3236
- 2.2 The regulations also widen the circumstances in which an election may 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 They also make minor corrections and clarifications to SI 2004/3256.
- 2.4 The regulations have effect for periods of account ending on or after the date the regulations come into force, but the changes to regulation 12 do not affect cases where the company ceases to be a party to the security concerned before 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 correct an error in the treatment of hybrid contracts in Chapter 2 Part 9 Finance Act 1996 (loan relationships) and Schedule 26 FA 2002 (derivative contracts) and to extend the scope of an election in relation to derivative contracts used for hedging 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 2007.

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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