

**EXPLANATORY MEMORANDUM TO**  
**THE LOAN RELATIONSHIPS AND DERIVATIVE CONTRACTS (DISREGARD AND**  
**BRINGING INTO ACCOUNT OF PROFITS AND LOSSES) (AMENDMENT)**  
**REGULATIONS 2013**

**2013 No. 2781**

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

**2. Purpose of the instrument**

2.1 The Loan Relationships and Derivative Contracts (Disregard and Bringing into Account) Regulations 2004 (S.I. 2004/3256, 'the Disregard Regulations') were introduced to ensure that certain hedging transactions can be undertaken in a tax neutral manner.

2.2 The purpose of these amending Regulations is to ensure hedging in relation to banks' and investment firms' equity accounted Additional Tier One regulatory capital instruments and building societies' deferred shares are treated in the same way as other companies' issued share capital. This will allow banks, building societies and investment firms to reflect the economic reality of their hedging arrangements.

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

3.1 None

**4. Legislative Context**

4.1 A company must bring into account for tax purposes debits and credits in respect of loan relationships and derivative contracts by reference to amounts recognised for accounting purposes (section 307 and 595 of the Corporation Tax Act 2009 ('CTA 2009')). References to a company's profits and losses includes any foreign exchange gains and losses arising on those loan relationships and derivative contracts (section 328 and 606 CTA 2009).

4.2 The Disregard Regulations were introduced to address problems that arose when companies adopted International Accounting Standards that would have rendered previously tax neutral hedging transactions ineffective for tax purposes. The Disregard Regulations ensure previously tax neutral exchange gains and losses arising from a company's loan relationships and derivative contracts which act as economic hedges for the company's assets and liabilities remain effective for tax purposes.

4.3 The Disregard Regulations only apply to specific types of transaction,

4.4 The Basel III requirements, which are adopted in Europe via the Capital Resources Directive IV and the Capital Resources Regulations requires banks, building societies and investment firms to issue new forms of regulatory capital which includes Additional Tier One (AT1) instruments.

4.5 Where AT1 instruments or deferred shares are issued in currencies other than that which the issuing company uses for accounting purposes, exchange gains and losses may arise on the AT1 instruments or deferred shares. The issuing company may use foreign currency loan or derivative contract assets to reduce their exposure to foreign exchange movements but as these hedges are not currently within the scope of the Disregard Regulations there may be a permanent mismatch for tax between the exchange gains and losses arising on the loan relationship and derivative contract assets and the AT1 or deferred shares liabilities. This amendment removes this mismatch by extending the Disregard Regulations to hedges in relation to AT1 and deferred shares.

## **5. Territorial Extent and Application**

5.1 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 The Disregard Regulations remove the mismatch where a company uses foreign currency loans or derivative contracts to reduce foreign exchange in relation to its own share capital.

7.2 This instrument provides the same treatment for equity accounted AT1 instruments and deferred shares issued by building societies as that provided for a company's own share capital.

- Consolidation

7.3 This instrument will not be consolidated.

## **8. Consultation outcome**

8.1 This instrument was consulted on an informal basis over the period of a week with interested parties, however, the changes form part of a wider consultation on regulations to prescribe the tax treatment of new AT1 and Tier Two instruments that may be issued by banks, building societies and investment firms. Those regulations have been consulted on for 12 weeks and the responses to that consultation highlighted the need for an amendment to the Disregard Regulations. The short consultation period on this instrument was necessary to ensure that the instrument is in force before the issue on new AT1 instruments proposed for the end of 2013. All parties consulted supported the changes.

## **9. Guidance**

9.1 Guidance on this instrument will be provided in the form of a technical note and by amendment to existing HMRC guidance.

## **10. Impact**

10.1 The impact on business, charities or voluntary bodies is negligible.

10.2 The impact on the public sector is negligible.

10.3 A Tax Information and Impact Note covering this instrument will be published on the HMRC website at <http://www.hmrc.gov.uk/thelibrary/tiins.htm>.

## **11. Regulating small business**

11.1 The legislation does not apply to small business.

## **12. Monitoring & review**

12.1 HMRC will monitor the affect of this instrument to ensure that it operates as intended and this will form part of a review of the wider Regulations on new AT1 and Tier Two instruments in 2017.

## **13. Contact**

**Fiona Hay** at Her Majesty's Revenue and Customs and Tel: 03000 585 882 or email: [fiona.hay@hmrc.gsi.gov.uk](mailto:fiona.hay@hmrc.gsi.gov.uk) can answer any queries regarding the instrument.