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## **HEDGING PROCEEDS FROM FUTURE SHARE ISSUES**

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### **Who is likely to be affected?**

1. Companies that use currency derivative contracts to hedge the value of the future proceeds from a rights issue of shares against the risk of currency fluctuations.

### **General description of the measure**

2. The Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) Regulations 2004 (Statutory Instrument 2004/3256) will be amended to bring in special rules that apply when a company announces a rights issue of shares denominated in a currency other than its functional currency and enters into a currency derivative contract that seeks to hedge the risk to the value of the future share issue proceeds from currency fluctuations. Where this is the case, any exchange gain or loss on the currency derivative contract will be excluded from being brought into account for tax purposes.
3. Any such exchange gain or loss will be permanently excluded from being brought into account unless, in the case of a gain, any part of that gain is subsequently distributed to shareholders. In that case, the gain will be brought back into charge for tax purposes in the accounting period in which the distribution takes place and to the extent that the gain has been distributed.

### **Operative date**

4. The new rules will apply to all currency derivative contracts (with one exception – see paragraph 5 below) entered into on or after 1 January 2009 with the intention of hedging the exchange risk to the future share proceeds.

5. Where the hedge was entered into before 10 March 2009, the new rules will only apply where it was still current on 10 March. In that case, any latent exchange loss on the contract between the date it was entered into and 9 March will be taken into account for tax purposes provided there is an exchange loss when the contract is closed out. Where the final exchange loss is smaller than the latent exchange loss at 9 March, the loss to be brought into account will be restricted to the final loss.

### **Current law and proposed revisions**

6. Statutory Instrument 2004/3256 already allows for the disregard of exchange profits and losses on derivative contracts that are hedging the cash flow risk from certain forecast transactions and firm commitments.
7. Consequently, hedges of future share issue proceeds could come within these provisions. However, exchange gains and losses left out of account are brought back into charge for tax purposes once the derivative contract performing the hedging function is closed or ceases to perform the hedging function.
8. As there would be no matching debit or credit brought into account for tax purposes on the share proceeds, the derivative contract would not form an effective hedge after tax.
9. The changes to Statutory Instrument 2004/3256 will ensure that any gains or losses on relevant currency derivative contracts will not be brought into account for tax purposes as they arise. Also, they will be permanently excluded from being brought into account for tax purposes unless overall there is an exchange gain made on the relevant derivative contract and that gain is subsequently distributed to shareholders. This will ensure that tax hedging treatment applies only where the gain on the derivative to compensate for the reduction in the value of the capital raised remains within the business to boost the capital of the business.

### **Further advice**

10. The changes introduced by this measure were announced by the Financial Secretary to the Treasury in a Written Ministerial Statement on 10 March 2008.
11. If you have any questions about this change, please contact Aidan Reilly on 020 7147 2575 (email: [aidan.reilly@hmrc.gsi.gov.uk](mailto:aidan.reilly@hmrc.gsi.gov.uk)) or Paul Gilham on 020 7147 2619 (email: [paul.gilham@hmrc.gsi.gov.uk](mailto:paul.gilham@hmrc.gsi.gov.uk)). Information about Budget measures is available on the HM Revenue & Customs website at [www.hmrc.gov.uk](http://www.hmrc.gov.uk)