

Notes on draft guidance:

1. The numbering relates to the new Corporate Finance Manual to be published in October, not to the current CFM.
2. Guidance on the provisions of Schedule 21 FA 2009 relating to 'forward points' on currency contracts will be included in a different chapter.

CFM63100 - Foreign exchange: matching: anti-avoidance: FA 2009: 'one way exchange effect'

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CFM63110 – Foreign exchange: matching: anti-avoidance: FA 2009: 'one way exchange effect': overview

FA 2009: the 'one-way exchange effect provision'

The Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) Regulations 2006 – SI 2006/843) which aimed to counter particular 'one-way bet' schemes ([CFM63010](#)) were revoked by FA09, and replaced by a more widely targeted anti-avoidance rule ('TAAR'), which prevents exchange gains from being matched where a 'one way exchange effect' is present. The details of this rule are explained at [CFM63120](#) onwards.

Commencement

The new anti-avoidance rule applies to accounting periods beginning on or after 22 April 2009. Accounting periods straddling 22 April 2009 are treated as if they were two periods, with exchange gains and losses being computed separately for each period. The restriction on matching exchange gains applies to the part-period beginning on 22 April 2009, but not to the earlier part of the accounting period.

The commencement rule at FA09/SCH21/PARA11 also applies to the old regulations so they apply to a part-period up to 22 April 2009, but not subsequently.

CFM63120 - Foreign exchange: matching: anti-avoidance: FA 2009: 'one way exchange effect': summary of the legislation

Arrangements with a one-way exchange effect

CTA09/S328(4A) provides that an exchange gain arising from an loan relationship asset or liability of a company is not disregarded because of the forex matching rules if two conditions are met.

- The loan relationship must be **part of arrangements** ([CFM63130](#)) having a **one-way exchange effect** in the accounting period.
- The arrangements cause the company to gain a **tax advantage** that is **more than negligible**.

There is similar provision for derivative contracts at CTA09/S606(4E). There is no restriction on the matching of exchange losses.

In deciding whether or not the anti-avoidance rule applies, it is necessary to start from the perspective of a company having an exchange gain that it wants to match. The tests apply anew in each accounting period. So if an arrangement does not, in the period in question, give rise to an exchange gain that might potentially be matched, it will not be within the scope of the anti-avoidance rule – even if it has been caught in a previous accounting period, or might be caught in a future period.

The anti-avoidance rule applies both where matching takes place under primary legislation ([CFM62220](#)) and where it takes place under the Disregard Regulations. Since CTA09/S328(4A) applies to loan relationship assets as well as liabilities, it is also capable of applying where

- exchange gains on a 'permanent as equity' loan are taken to reserves and potentially disregarded because of CTA09/S328(3)
- a company uses a creditor loan relationship as a hedge of foreign exchange risk on its own share capital

[CFM63130](#) to [CFM63190](#) explains the conditions for the rule to operate, and [CFM63200](#) gives some examples.

CFM63130 - Foreign exchange: matching: anti-avoidance: FA 2009: 'one way exchange effect': meaning of 'part of arrangements'

Meaning of 'part of arrangements'

'Arrangements' are defined widely at CTA09/S328H(3) (for loan relationships) or CTA09/606H(3) (for derivative contracts) to include any agreements, understandings, schemes, transactions or series of transactions, whether or not legally enforceable. In deciding whether or not a loan relationship or relevant contract is part of an arrangement, regard can be had in particular to the circumstances in it was entered into, the currency in which it is denominated, and its likely effect – but the statutory list is not exhaustive, and other factors may be taken into account.

There is no requirement that financial instruments or transactions forming part of an arrangement must be entered into at the same time, and it is possible for financial instruments that have been put in place for wholly commercial reasons to subsequently become part of an avoidance arrangement.

For example, in the dual currency loan scheme described at [CFM63010](#), the dual currency loan would be part of an arrangement that also includes the shareholding in the US dollar subsidiary and the external borrowing by Plc. The effect of these three components is to achieve an economic hedge of the group's US investment while potentially generating an allowable forex loss (but not a corresponding taxable gain), and all three components operate together in achieving this effect. It would not matter if the shareholding and external borrowing had been in place for some time, and the dual currency loan was added later.

CFM63140 - Foreign exchange: matching: anti-avoidance: FA 2009: 'one way exchange effect': meaning of 'one way exchange effect'

Identifying a one-way exchange effect

CTA09/S328A (or CTA09/S606A for derivative contracts) sets out what is meant by a one-way exchange effect. Two conditions must be satisfied before an arrangement can be said to have this effect.

First, the arrangements must include an **option**, or a **relevant contingent contract** that behaves like an option. Guidance on the meaning of the terms in bold is at [CFM63180](#). Thus the majority of net investment hedges – where, for example, a plain vanilla loan, a swap or a forward currency contract is used as the hedging instrument – will not need to be considered under the anti-avoidance rule because they do not involve options or option-like arrangements.

The second condition involves a comparison of two amounts, referred to as 'amount A' and 'amount B'. Broadly, this comparison is between the exchange losses that would be brought into account for CT if the currency concerned moved in one direction, and the exchange gain that would be taxed if the currency moved the other way by the same amount. The anti-avoidance rule will apply only if amount A is **not** equal to amount B.

Example

A UK company holds shares in an Australian subsidiary. In order to protect itself against losses if the Australian dollar weakened, while still having the ability to benefit if the Australian dollar strengthens, the company buys a put option over the Australian dollar from an unconnected bank. For tax purposes, the option is fully matched to the shares. If the Australian dollar weakens, it will exercise the option, and an exchange gain arises on the option (counterbalancing the loss in value of the shares). Because of forex matching, however, this is not brought into account. Were the Australian dollar to appreciate by the same amount, the company would not exercise the option and no taxable exchange differences would arise. Amount A and amount B are therefore equal – both are nil. Thus company's ability to match any forex gain on the option is not restricted by the anti-avoidance rule.

But even where amount A is not equal to amount B, the second condition has a further leg that must also be satisfied. The difference between amounts A and B must **not** be the same as if it would be if the matching rules were ignored. In other words, one-way exchange effect must depend, at least in part, on forex matching. Where option-based arrangements produce an asymmetric effect for tax, but this has nothing to do with matching, they are not caught. There is an example at [CFM63210](#).

The legislation goes on to refine these basic concepts. It sets out how amounts A and B are to be calculated ([CFM63150](#)) and the time at which the comparison is to be carried out.

CFM63150 - Foreign exchange: matching: anti-avoidance: FA 2009: 'one way exchange effect': meaning of 'amounts A and B'

Calculating amount A and amount B

Amount A

In broad terms, this is the aggregate exchange losses that arise to the company doing the forex matching ('company A'), and companies connected with it, as a result of the arrangement. It is defined as the sum of 'relevant exchange losses' arising to company A, and companies connected with it, less the sum of the 'relevant exchange gains' of those companies. It may be a negative number (i.e. exchange gains exceed exchange losses), or nil.

In order to be 'relevant', an exchange gain or loss must arise on a loan relationship or a relevant contract to which the company is a party, and which forms part of the arrangements. 'Relevant contract' takes its meaning from Part 7 of CTA09 – a future, option or contract for differences. There is, however, no requirement for this to be a derivative contract, so it includes any derivative embedded in some other type of contract (which is treated as a relevant contract by virtue of S584, S585 or S586), or an instrument that is not accounted for as a derivative.

Furthermore, the exchange gain or loss must be brought into account for CT purposes. But in assessing this, the effect of the anti-avoidance rule itself is disregarded, as is any effect of the 'unallowable purposes' rules (CTA09/S441 and S442, and CTA09/S690 to S692).

Two companies are connected if they are connected for loan relationships purposes. The exemptions from connection in CTA09/S466(3) (companies controlled by the Crown etc) and CTA09/S468 ([CFM35000](#)) apply.

Amount B

Amount B – again, in broad terms – is the aggregate exchange gain that would have arisen if the currency had moved the other way to the same extent. More precisely, it is the sums of the relevant exchange gains of company A and companies connected with it, less the sum of the relevant exchange losses of those companies, computed on the **counterfactual currency assumption** (see [CFM63060](#)). As with amount A, it can be negative or nil.

Test days

Since exchange gains or losses must arise over a particular period, a comparison of amount A and amount B must be carried out on a defined day, referred to in the legislation as a 'test day'. Unless the test day is the last day of an accounting period, the period between the start of a company's accounting period and the test day is treated as if it were a separate accounting period, with exchange gains or losses being computed for that period.

Example

An arrangement involves three connected companies, A, B and C. A and B prepare accounts to 31 December, while C prepares accounts to 31 March. 2 October 2010 is a test day with respect to that arrangement. In computing amounts A and B, the taxpayer company (company A) must take into account relevant exchange gains or relevant exchange losses arising to itself and to company B in the period 1 January to 2 October 2010, and to company C in the period 1 April to 2 October 2010. Amount A and amount B will always both be computed over the same period or periods.

CTA09/S328C (or CTA09/S606C for derivative contracts) defines 'test day'. It is any day on which – again, putting it broadly – financial outcomes for a company will, or might, diverge. Thus where an arrangement includes one or more options, it is the day on which the option is exercised or (if it is not exercised in the period) any day on which it might have been exercised; or the day on which there is a disposal (by company A, or a company connected with it) of an option, or a variation. Similarly, where arrangements include one or more

relevant contingent contracts ([CFM63080](#)), a day on which an operative condition of the contract is met will be a test day, as will a day on which a disposal or variation occurs.

As a long-stop, the last day of an accounting period will always be a test day, in order to bring in arrangements where, for example, an option is not exercisable at any time in the period but exchange gains or losses may nevertheless arise as a result of fair value movements.

In many, if not most, cases there will be more than one test day during an accounting period. In practice, however, it will usually only be necessary to look at one or two test days. It is only necessary for a one-way exchange effect to arise on one of these days for the anti-avoidance rule to apply. And, where an arrangement is not caught on the day or days selected, it will often be possible to infer that it would not be caught on any possible test day.

CFM63160 - Foreign exchange: matching: anti-avoidance: FA 2009: 'one way exchange effect': meaning of 'counterfactual assumption'

The counterfactual currency movement assumption

The computation of amount A ([CFM63150](#)) is based on what has actually happened in the accounting period of company A, and companies connected with it. Computation of amount B requires us to imagine what would have happened had the currency moved the other way. CTA09/S328D and CTA09/606D set out how this imaginative leap is to be made.

It is necessary to make two key assumptions. First, if the **relevant foreign currency** has appreciated with respect to the company's **operating currency** ([CFM63190](#)) over the test period, or any part of it, it must be assumed that the currency has depreciated by the same percentage. Conversely, if the foreign currency has depreciated over a period, it must be assumed to have appreciated by the same percentage over the same period.

The reference here to 'part of a period' is important. Suppose, for example, that – as in the example at [CFM63150](#) – a company is considering the test period 1 January to 2 October 2010. However, the company has a loan denominated in the relevant foreign currency (which was part of the arrangements) and which was repaid on 31 March 2010. If, in the period to 31 March, the relevant foreign currency appreciates by 10%, it must be assumed – in computing the contribution to amount B made by that loan – that it had actually depreciated by 10%. It does not matter, in considering the loan, how the currency moved over the entire period 1 January to 2 October.

The second key assumption is that – except for the treatment of options and contingent contracts – the company has acted in precisely the same way as it has acted in reality. Thus in the above example of the loan repaid on 31 March 2010, it cannot be argued – either by the company or HMRC – that if the foreign currency really had depreciated by 10% up to 31 March, it would not have repaid the loan, or would have repaid it on a different date.

But where an option is exercised on the test day, or where the company could have exercised the option but did not do so, it is necessary to consider whether the company would have made the same choice if exchange rates had moved the other way. The test is whether, in all the circumstances, it is more likely than not that a different decision would have been made.

The economic effect of exercising, or not exercising, an option will normally be a key factor. For example, it will be normally be 'more likely than not' for a call option over a particular currency to be exercised if the spot price of the currency has risen above the strike price. But other circumstances may need to be considered. Thus if an avoidance arrangement hinges on an option not being exercised, even where this goes against the company's economic interest, the agreements or understandings between the parties would also be a relevant consideration.

CFM63170 - Foreign exchange: matching: anti-avoidance: FA 2009: 'one way exchange effect': meaning of tax advantage

Arrangements giving no, or a negligible, tax advantage

The main test for a one-way exchange effect – the effect potentially exists unless amount A is exactly equal to amount B – is an exacting one. It might be possible for the 'not equal' condition to be met purely because of some minor quirk of accounting, even though the arrangement in question was not intended to avoid tax.

It is also possible in theory (although improbable in practice) that arrangements operate asymmetrically so that a group ends up paying more tax on exchange differences than would otherwise be the case – for example, it actually brings an exchange gain into account, whereas on the counterfactual assumption no corresponding exchange loss would arise.

Thus as a further safeguard against non-abusive arrangements coming within the anti-avoidance rule, CTA09/S328(4A)(c) (and the derivative contracts equivalent) provide that the matching of exchange gains will only be ruled out if the arrangements give rise to a tax advantage that is more than negligible.

'Tax advantage' takes its meaning from ICTA88/S840ZA, a broad definition that includes both increasing allowable deductions or decreasing taxable profits. There is no requirement that the advantage should accrue in the accounting period being self-assessed.

The legislation does not spell out the comparator to be used in determining whether there is a tax advantage – this comes from case law, in particular the case of [Commissioners of Inland Revenue v Parker \(43TC396\)](#), where Lord Wilberforce said:

'The paragraph, as I understand it, presupposes a situation in which an assessment to tax, or increased tax, either is made or may possibly be made, that the taxpayer is in a position to resist the assessment by saying that the way in which he received what it is sought to tax prevents him from being taxed on it; and that the Revenue is in a position to reply that if he had received what it is sought to tax in another way he would have had to bear tax. In other words, there must be a contrast as regards the "receipts" between the actual case where these accrue in a non-taxable way with a possible accruer in a taxable way, and unless this contrast exists, the existence of the advantage is not established.'

In many 'one way bet' avoidance schemes, the avoidance is bolted on to a commercial hedge of net investment in a foreign operation. The appropriate comparator may often be 'plain vanilla' arrangements that achieve the same hedging purpose.

Negligible tax advantage

HMRC will generally accept that a tax advantage is negligible if the decrease in taxable profits, or increase in losses, is or is likely to be less than £50,000 in any 12-month accounting period (or pro rata for a short accounting period). However, the relative as well as the absolute size of the tax advantage needs to be considered. If the transactions concerned involve very large amounts of money, a decrease in profits or an increase of losses of more than £50,000 may be 'negligible' in the context.

CFM63180 - Foreign exchange: matching: anti-avoidance: FA 2009: 'one way exchange effect': options and relevant contingent contracts

Options and relevant contingent contracts

Options

CTA09/S328F (and S606F) define 'option'. The starting point is the definition of an option in CTA09/S580 – although this says only that an option includes a warrant. Otherwise the word takes its normal market meaning. However, CTA09/S580(2) and (3) are disapplied, so an option that can only be cash-settled – which would be a contract for differences under Part 7 CTA09 – is an option for the purposes of the one-way exchange effect rules.

Sections 584 to 586 allow an embedded derivative, which would have the characteristics of an option if it stood alone, to be an option for Part 7 purposes. CTA09/S328F(2) further widens the scope of the term by treating as an option any provision within a contract that it is possible to regard as an option. It is not necessary for the company to account separately for the embedded option, or even to be permitted by GAAP to do so.

For a contractual provision to have the characteristics of an option, it must have two key characteristics. It must permit a party to the contract to exercise a choice, and the likelihood of the party making that choice must be linked in a predictable manner to the price or value of an underlying subject matter. Since the legislation is concerned with the computation of exchange differences, an option-like clause is unlikely to require consideration unless the underlying subject matter is, or includes, a foreign currency.

For example:

- A foreign currency bank loan, used to hedge shares in an overseas subsidiary, is callable by the lender in the event of default. There is no predictable link between currency movements and the occurrence of a default, or the lender's decision about whether or not to call in the loan if a default does occur. The arrangement would not be seen as containing an option just because of a provision of this sort.
- In the dual currency loan example at [CFM63010](#), HoldCo has a choice under the terms of the dual currency loan to make repayment in either dollars or sterling. If the dollar depreciates, compared to its value when the loan is taken out, it is in HoldCo's interest to repay in dollars because it will then have an exchange gain. There is a clear relationship between the value of the dollar and HoldCo's likely decision. The dual currency feature of the contract is an 'option' within the meaning of the legislation.

Relevant contingent contracts

A relevant contingent contract is a contract to which the company doing the forex matching, or a company connected with it, is a party, and which contains an 'operative condition' (CTA09/S328G and CTA09/S606G). An operative condition is one that, if a particular contingency is met, changes a right or liability under the contract, and which operates directly or indirectly by reference to exchange rates.

Thus, in the dual currency loan that is being used as an example, the terms of the loan might provide that HoldCo **must** repay the loan in US dollars if, at the repayment date, the value of the dollar is less than it was at the start of the loan. Although this might sometimes be referred to as an automatically exercised option, it is not an option in legal terms, because HoldCo has no choice. But it would nevertheless come within the legislation as a relevant contingent contract.

CFM63190 - Foreign exchange: matching: anti-avoidance: FA 2009: 'one way exchange effect': relevant and operating currency

Relevant currency, operating currency and related terms

Operating currency

The definition of a company's 'operating currency' is tied to the functional currency rules at FA93/S92 to S92C – it is the currency in which it is required to prepare its tax computations.

If the arrangements involve a partnership, in which company A or a connected company is a partner, the company partner will bring into account debits or credits from a loan relationship or derivative held by the partnership. For the purposes of computing exchange gains and losses on such deemed loan relationships or relevant contracts, it is assumed that the company partner's operating currency is the functional currency of the partnership. For example, if the partnership operates in sterling and has sterling borrowings, no exchange gains or losses will arise to a company partner from those partnership borrowings, even if the company has a non-sterling functional currency.

Relevant currency

This is the currency in which the loan relationships or relevant contracts, which give rise to exchange gains or losses includes in amounts A and B, are denominated.

An arrangement may involve more than one relevant currency. Suppose for example an arrangement involves company A, whose functional currency is sterling, and company B, which has US dollar functional currency. The arrangements include dollar-denominated financial instruments, but also a sterling loan between A and B. The dollar-denominated instruments will give rise to exchange gains or losses in A (but not in B, if B is a party), while the sterling loan will give rise to exchange differences in B (but not in A). Both US dollars and sterling are relevant currencies in relation to this arrangement.

Appreciation or depreciation of currency

The legislation sets out explicitly what is meant by one company appreciating or depreciating against another by a given percentage. Currency A appreciates relative to currency B over a given period if the value of one unit of currency A, expressed in terms of currency B, is greater at the end of the period than the beginning. Thus if \$1 is worth £0.60 at the beginning of a period and £0.72 at the end, the dollar has appreciated relative to sterling by 20% ($0.72 - 0.60 / 0.60 \times 100\%$) over the period. Depreciation of a currency is similarly defined.

Exceptionally, one currency may appreciate against the other by more than 100% in a period. It would then be mathematically impossible to apply the counterfactual currency movement assumption, because a currency cannot lose more than 100% of its value. In such a case, it is assumed that the currency appreciation is actually 100%.

CFM63200 - Foreign exchange: matching: anti-avoidance: FA 2009: 'one way exchange effect': example of application of the TAAR

Example: application of legislation to dual currency loan scheme

A company (HoldCo) hedges a US denominated shareholding with a dual currency loan, in the structure shown at [CFM63010](#). HoldCo accounts in sterling, and prepares accounts to 31 December. HoldCo's parent company (Plc) has borrowed externally in dollars. For simplicity, it is assumed that the whole of the amount borrowed is on-lent to HoldCo.

In year ended 31 December 2010, Plc and HoldCo roll over the dual currency loan (DLC) three times, with the following results:

Period	Currency movement	Tax result
1 January – 31 March	Dollar weakens	HoldCo does not exercise option to repay DLC in sterling. HoldCo has matched exchange gain on loan, Plc's tax position is flat.
1 April – 30 June	Dollar strengthens	HoldCo exercises option and loan repaid in sterling. Plc has exchange loss on external borrowing, HoldCo has neither gain nor loss.
1 July – 30 September	Dollar strengthens	HoldCo exercises option and loan repaid in sterling. Plc has exchange loss on external borrowing, HoldCo has neither gain nor loss.
1 October – 31 December	Dollar weakens	HoldCo does not exercise option to repay DLC in sterling. HoldCo has matched exchange gain on loan, Plc's tax position is flat.

The parties to the arrangement are Plc and HoldCo, and the elements of the arrangement in year ended 31 December 2010 are the external loan; each instance of the dual currency loan; and the shares in the subsidiary (on which, however, no taxable exchange gains or losses will apply). These arrangements include an option within the dual currency loan (see [CFM63180](#), second bullet point), or alternatively, if the repayment currency is determined automatically by reference to exchange rates, the loan will be a relevant contingent contract.

Suppose that, for each dual currency loan, the option is exercisable (only) on the maturity date. 31 March, 30 June, 30 September and 31 December are all possible test days.

Consider the situation at 31 March. Between 1 January and 31 March, the dollar weakens by (say) 10%. For tax purposes, neither HoldCo nor Plc bring any exchange gains or exchange losses into account, so amount A is nil. What would happen if the dollar had depreciated by 10%? The loan would have been repaid in sterling, so that HoldCo would have neither exchange gain nor exchange loss, but Plc would have a loss on its external borrowing. So amount B would not be nil – it would be a negative quantity (an overall loss).

The matching rules are integral to this effect. If there were no matching, HoldCo would – in the actual scenario – have a taxable exchange gain on the dual currency loan. Looking at HoldCo and Plc together, there would be an overall ‘relevant exchange gain’ equal to the ‘relevant exchange loss’ in the counterfactual scenario. Both legs of the condition at CTA09/S328A(3) are therefore satisfied.

The arrangements also cause Plc to gain a tax advantage in the accounting period. If it had on-lent the funds to HoldCo through a ‘plain vanilla’ US dollar loan, it would have neither exchange gains nor losses in the period; as matters stand, it has losses in the periods to 30 June and 30 September that are unmatched by any exchange gains. All of the conditions in CTA09/S328(4A) are therefore satisfied. As a result, the exchange gains arising to HoldCo in the accounting period, which would otherwise be matched, are brought into account.

CFM63210 - Foreign exchange: matching: anti-avoidance: FA 2009: ‘one way exchange effect’: examples where the TAAR would not apply

Examples of arrangements that do not create a ‘one-way exchange effect’

Example 1

Company A, which is resident in the UK, acquires shares in a Eurozone subsidiary of €50 million. In order to hedge the investment, the parent company of A (‘ParentCo’) borrows €50 million from an external bank, which it on-lends to A on identical terms. However, ParentCo wishes to limit its potential exchange loss on the borrowing if the euro strengthens, so it enters into a collar arrangement with a bank (see [CFM13350](#) if you need an explanation of a collar) under which ParentCo will not have to bear further forex losses if the euro appreciates against sterling by more than 10%, but equally it will not profit if the euro depreciates by more than 15%.

The shares in the subsidiary held by company A, the €50 million external borrowing, the intercompany loan and the collar contract between ParentCo and the bank are all part of the same arrangement.

In year ended 31 December 2011, the euro actually appreciates against sterling by 12%. Considering the last day of the accounting period as a test day, ParentCo’s exchange loss on the external borrowing is – because of the existence of the collar – limited to 10%. The counterfactual assumption would be that the euro depreciated by 12%. In that case, ParentCo would benefit from, and bring into account for tax purposes, the full 12% exchange gain. Clearly, in this situation, amount A is not equal to amount B.

An arrangement will not, however, produce a ‘one-way exchange effect’ if precisely the same asymmetry would occur in the absence of any forex matching rules ([CFM63140](#)). This is the case here.

The intra-group borrowing by company A is fully matched with the shares in the euro subsidiary, so company A does not bring into account any exchange differences on the loan. What would happen if there were no forex matching rules? A 12% appreciation of the euro would result in company A bringing into account a forex gain, but a 12% depreciation would

result in a precisely equal forex loss being allowed. (Similarly, there is no one-way effect at ParentCo's end of the intra-group loan.)

Thus the asymmetry introduced by the collar arrangement has nothing to do with forex matching, and would exist to precisely the same extent if the matching rules were disregarded. The arrangement therefore does not produce a one-way exchange effect within CTA09/S328A.

Example 2

The facts are as in the example at [CFM63140](#) – a company holding shares in an Australian subsidiary enters into a put option over the Australian dollar as a hedge. In this case, however, the option is not fully matched with the shares. If the Australian dollar weakens, the company will exercise the option and an exchange gain will arise. If the Australian dollar strengthens, the company will not exercise the option, and neither a gain nor a loss will ensue.

In year ended 31 December 2011, the company exercises the option and there is an exchange gain. Because the derivative is only partially matched with the shares, part of the gain is disregarded, but part is brought into account for tax purposes. If the Australian dollar had strengthened by the same percentage, nothing would have been brought into account for tax purposes. So amount A will not be equal to amount B. Moreover, in this case we can **not** say that exactly the same asymmetry would have occurred if the forex matching rules were disregarded. Without forex matching, the whole of the exchange gain would be taxable: so amount A would be different. Amounts A and B would still be unequal, but by a different amount.

The situation does not, however, create any tax advantage for the company. If the company had not entered into this arrangement, it is likely that it would have hedged the shares in a way that did not involve options (for example, by means of a loan or a cross-currency swap). Even if such a loan or derivative was not fully matched, the unmatched portion would give rise to exchange gains if the Australian dollar weakened, or losses if it strengthened. Over a period of time, such a course of action might be expected to give a tax-neutral result. If the company did not hedge at all, it would of course have neither gain nor loss.

The actual arrangement, on the other hand, means that the company may realise a taxable gain from the option, but can never have a countervailing exchange loss. It therefore does not give rise to a tax advantage – rather, it represents a tax disadvantage. There is no restriction of the matched gain under CTA09/S 606(4E).

HMRC would not take the view, in this scenario, that the payment of (tax-deductible) premium for the option in itself gives rise to a tax advantage.
