

EXPLANATORY MEMORANDUM TO
THE LOAN RELATIONSHIPS AND DERIVATIVE CONTRACTS (DISREGARD
AND BRINGING INTO ACCOUNT OF PROFITS AND LOSSES) (AMENDMENT)
REGULATIONS 2009

[2009] No. [XXXX]

1. This explanatory memorandum has been prepared by HM Revenue & Customs, on behalf of HM Treasury, and is laid before the House of Commons by Command of Her Majesty.

2. Purpose of the instrument

2.1 The purpose of this instrument is to ensure that the profits and losses on derivative contracts entered into for the purposes of hedging against currency exchange fluctuations on the proceeds from a proposed rights issue of shares are not brought into account for tax purposes.

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

3.1 These Regulations have effect in relation to certain derivative contracts either entered into on or after 10 March 2009 or entered into on or after 1 January 2009 providing that the derivative contract performs a hedging function up to and including 10 March 2009 (the day of the announcement of these changes by the Financial Secretary to the Treasury in a Written Ministerial Statement). Authority for the limited retrospective effect of these Regulations can be found in paragraph 52(2) of Schedule 4 to the Finance Act 2005.

4. Legislative Context

4.1 The Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) Regulations 2004 Statutory Instrument 2004 No.3256 (“the principal Regulations”) sets out how certain debits or credits in respect of derivative contracts are to be brought into account for corporation tax.

4.2 This instrument amends the principal Regulations to remove an inconsistency in the treatment of certain derivative contracts.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

6.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

7.1 This instrument amends the principal Regulations to ensure that the risk from currency fluctuations to the future capital raised from a proposed rights issue of shares denominated in a different currency from the issuing company's functional currency can be hedged using derivative contracts on a tax neutral basis.

7.2 The current principal Regulations do not provide for tax neutrality in respect of such hedging transactions.

7.3 As a result there is a tax mismatch between the treatment of the derivative contract and the hedged item with the exchange movements on the derivative contract being taxed on a fair value basis whereas the opposite movement wrapped up in the share issue proceeds is not subject to tax. This would prevent the hedging contract from performing an effective economic hedge after tax is taken into account.

7.4 For derivative contracts entered into with unconnected parties (or otherwise where the counterparty risk ultimately rests with an unconnected party) on or after 10 March 2009, these Regulations ensure that where currency derivative contracts are entered into with the purpose of hedging against currency fluctuations on the future proceeds from a rights issue of shares then the debits and credits on the derivative contract are, with one exception, permanently disregarded for tax purposes.

7.5 For such derivative contracts entered into on or after 1 January 2009, that still perform the required hedging function on 10 March 2009, there is a transitional provision that means that where the contract was standing at an exchange loss on 9 March 2009, it is possible that that loss will be brought into account. This would be where a loss is made on the derivative contract on termination and there would also have been a loss had the derivative contract been terminated on 9 March 2009. The loss that is brought into account would be the lower of those two amounts. All gains on such contracts will, with one exception, be permanently disregarded for tax purposes.

7.6 The exception referred to in paragraphs 7.4 and 7.5 is where the derivative contract makes a gain and any of that gain is distributed to shareholders. Where that is the case, and to the extent that that gain is distributed to shareholders, the gain will be brought back into account for tax purposes for the accounting period in which it is distributed.

8. Consultation outcome

8.1

9. Guidance

9.1 Guidance is being published to accompany this Instrument.

10. Impact

10.1 An Impact Assessment has not been produced for this instrument as it has a negligible impact on business, charities or voluntary bodies.

11. Regulating small business

11.1 The legislation does not apply to small business.

12. Monitoring & review

12.1 Operational staff will keep this matter under review to ensure that the changes made by this instrument achieve their aims.

13. Contact

Aidan Reilly or Paul Gilham at Her Majesty's Revenue & Customs Tel: 020 7147 2575 or 020 7147 2619 respectively or email: aidan.reilly@hmrc.gsi.gov.uk or paul.gilham@hmrc.gsi.gov.uk can answer any queries regarding the instrument.