

2005 No. 2012

INCOME TAX

The Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) (Amendment) Regulations 2005

<i>Made</i> - - - -	<i>21st July 2005</i>
<i>Laid before the House of Commons</i>	<i>21st July 2005</i>
<i>Coming into force</i> - -	<i>11th August 2005</i>

The Treasury, in exercise of the powers conferred upon them by sections 84A(3A), 85B(3)(a) and (5)(b) of the Finance Act 1996(a), paragraphs 16(3A) and 17C(1) and (3)(b) of Schedule 26 to the Finance Act 2002(b), make the following Regulations:

Citation, commencement and effect

1.—(1) These Regulations may be cited as the Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) (Amendment) Regulations 2005 and shall come into force on 11th August 2005.

(2) These Regulations have effect in relation to periods of account beginning on or after 1st January 2005 and ending after these Regulations come into force.

Amendment to the Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) Regulations 2004

2. Amend the Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) Regulations 2004(c) as follows.

3. In regulation 2(1) (interpretation)—

(a) for the definition of “exchange gain or loss” substitute—

““exchange gain or loss” has the same meaning as in paragraph 54 of Schedule 26 to the Finance Act 2002;”;

(b) insert the following definitions in the appropriate places—

““loan relationship” has the same meaning as in section 81 of the Finance Act 1996(d);”,

(a) 1996 c. 8. Section 84A was inserted by paragraph 3 of Part 1 of Schedule 23 to the Finance Act 2002 (c. 23) and sub-section (3A) was substituted by paragraph 2(2) of Schedule 10 to the Finance Act 2004 (c. 12). Section 85B was substituted and inserted by paragraph 3 of Schedule 10 to the Finance Act 2004.

(b) 2002 c. 23. Paragraph 16(3A) was substituted by paragraph 48(2), and paragraphs 17C(1) and 17C(3)(b) were substituted by paragraph 50, of Part 2 of Schedule 10 to the Finance Act 2004.

(c) S.I. 2004/3256.

(d) Section 81 was amended by section 82 of, and paragraphs 1 and 2 of Schedule 25 to, the Finance Act 2002.

““a paragraph 50A credit or debit” means the credit or debit to be brought into account in accordance with paragraph 50A of Schedule 26 to the Finance Act 2002(a);”, and

““a prior period adjustment credit or debit” means so much of any credit or debit as represents a prior period adjustment taken into account by virtue of paragraph 17B(1)(b) of Schedule 26 to the Finance Act 2002(b) as a result of a change of accounting basis;”.

4.—(1) Amend regulation 3 (exchange gains or losses arising from liabilities or assets hedging shares etc.) as follows.

(2) After paragraph (1) insert—

“(1A) For the purposes of paragraph (1) a liability representing a loan relationship does not include any liability representing a relationship within section 100(1) of the Finance Act 1996(c).”.

(3) In paragraph (2) after “value” insert “, or profits or losses arising on the disposal,”.

(4) In paragraph (3)—

(a) for the first sentence substitute—

“Shares, ships or aircraft are matched to the greatest possible extent with—

- (a) the liability representing the loan relationship designated as a hedge if condition 1 is satisfied;
- (b) subject to paragraph (a), the liability representing the loan relationship referred to in condition 2 if that condition is satisfied;”;

(b) omit condition 1;

(c) in condition 3—

- (i) for “could” substitute “intends”;
- (ii) after “into” insert “and continuing to be subject to”;
- (iii) omit “reasonably expect”;

(d) renumber—

- (i) condition 2 as condition 1, and
- (ii) condition 3 as condition 2.

(5) In paragraph (4)—

(a) for “condition 3” substitute “condition 2”; and

(b) after “into” insert “or, if later, when the asset is acquired”.

5.—(1) Amend regulation 4 (exchange gains or losses arising from derivative contracts hedging shares etc.) as follows.

(2) In paragraph (2) after “value” insert “, or profits or losses arising on the disposal,”.

(3) In paragraph (3)—

(a) for the first sentence substitute—

“Shares, ships or aircraft are matched to the greatest possible extent with—

- (a) the derivative contract designated as a hedge if condition 1 is satisfied;
- (b) subject to paragraph (a), the derivative contract referred to in condition 2 if that condition is satisfied.”;

(a) 2002 c.23. Paragraph 50A was inserted by paragraph 67 of Part 2 of Schedule 10 to the Finance Act 2004.

(b) Paragraph 17B was substituted by paragraph 50 of Part 2 of Schedule 10 to the Finance Act 2004.

(c) 1996 c. 8, section 100 was substituted by section 79 of, and paragraphs 1 and 6 of Schedule 23 to, the Finance Act 2002 and relevantly amended by section 80 of, and paragraph 9 of Schedule 4 to, the Finance Act 2005 (c. 7).

- (b) omit condition 1;
 - (c) in condition 3—
 - (i) for “could” substitute “intends”;
 - (ii) after “into” insert “and continuing to be party to”; and
 - (iii) omit “reasonably expect”;
 - (d) renumber—
 - (i) condition 2 as condition 1, and
 - (ii) condition 3 as condition 2.
- (4) In paragraph (4)—
- (a) for “condition 3” substitute “condition 2”;
 - (b) for “carrying value of” where it first appears substitute “value of the obligation under”; and
 - (c) after “into” insert “or, if later, when the asset is acquired”.
- (5) In paragraph (5)—
- (a) omit the definition of “carrying value”; and
 - (b) insert—
 - ““the value of the obligation under the derivative contract” means the value of the obligation of the company to pay in exchange for one currency an amount of a second currency and includes any notional obligation to pay an amount of currency in respect of a contract for differences.”.

6.—(1) Amend regulation 5(1) (regulations 3 and 4: supplementary) as follows.

- (2) In sub-paragraph (b)—
- (a) in paragraph (i) after “liability” insert “mentioned in regulation 3(1)”;
 - (b) in paragraph (ii) after “contract” insert “mentioned in regulation 4(1)”;
 - (c) omit the words from “the extent” to the end.
- (3) At the end of the paragraph add—

“the extent to which an asset is matched is determined in accordance with the following rules”.

(4) For Rule 1 substitute—

Rule 1

Liabilities and contracts are regarded as matched to the greatest possible extent with assets which are ships or aircraft.”.

(5) In Rule 2 at the end insert “if the disposal were made on a date falling more than 12 months after the date of acquisition of the asset”.

- (6) In Rule 3—
- (a) after “liabilities” insert “and contracts”;
 - (b) delete “if the disposal were made on a date falling more than 12 months after the date of acquisition of the asset”.

7.—(1) Amend regulation 6 (rules about fair value profits and losses) as follows.

- (2) In paragraph (6)—
- (a) after “paragraph” insert “(6A) and”;
 - (b) for “these Regulations apply” substitute “regulations 7 and 8, or regulation 9 applies to that company”; and

(c) for “31st March 2005” substitute “1st October 2005”.

(3) After paragraph (6) insert—

“(6A) In any case where a company—

- (a) does not use fair value accounting in relation to its derivative contracts for an accounting period beginning on or after 1st January 2005, and
- (b) begins to use fair value accounting in a subsequent accounting period (“the subsequent period”) in relation to contracts to which regulations 7 or 8, or regulation 9 apply and to which it is a party at the start of that period,

an election under paragraph (3) or (5) shall be made before the start of the subsequent period.”.

(4) In paragraph (7) for “within” substitute “under”.

8.—(1) Amend regulation 7 (fair value profits or losses arising from derivative contracts which are currency contracts) as follows.

(2) For paragraph (1) substitute—

“(1) For the purposes of paragraph 17C(1)(a) of Schedule 26 to the Finance Act 2002 there is prescribed in relation to a derivative contract whose underlying subject matter consists wholly of currency —

- (a) all credits and debits representing the whole or part of a company’s fair value profit or loss in an accounting period if—
 - (i) there is a hedging relationship between the contract or part of the contract and a forecast transaction or a firm commitment (“the hedged item”) of the company; and
 - (ii) the hedged item is not one to which fair value accounting applies for that accounting period;
- (b) a company’s paragraph 50A credit or debit in relation to such a contract, if for the accounting period in which the paragraph 50A credit or debit falls to be brought into account sub-paragraph (a) applies to the contract; and
- (c) a company’s prior period adjustment credit or debit in relation to such a contract, if for the accounting period in which the prior period adjustment credit or debit falls to be brought into account sub-paragraph (a) applies to the contract,

and the credits and debits mentioned in sub-paragraphs (a) to (c) together make up the regulation 7 fair value profits or losses.”.

(3) Omit paragraph (2).

(4) In paragraph (3) after “the part of the” insert “regulation 7”.

(5) After paragraph (3) insert—

“(4) Paragraph 16(3) of Schedule 26 to the Finance Act 2002 does not apply to any regulation 7 fair value profit or loss.”.

9.—(1) Amend regulation 8 (profits or losses from derivative contracts which are commodity contracts or debt contracts) as follows.

(2) For paragraph (1) substitute—

“(1) For the purposes of paragraph 17C(1)(a) of Schedule 26 to the Finance Act 2002 there is prescribed in relation to a commodity contract or debt contract—

- (a) all credits and debits representing the whole or part of a company’s fair value profit or loss arising in an accounting period if—
 - (i) there is a hedging relationship between the contract or part of the contract and a forecast transaction or a firm commitment (“the hedged item”) of the company; and

- (ii) the hedged item is not one to which fair value accounting applies for that accounting period;
- (b) a company's paragraph 50A credit or debit, if for the accounting period in which the paragraph 50A credit or debit falls to be brought into account, sub-paragraph (a) applies to the contract; and
- (c) a company's prior period adjustment credit or debit, if for the accounting period in which the prior period adjustment credit or debit falls to be brought into account, sub-paragraph (a) applies to the contract,

and the credits and debits mentioned in sub-paragraphs (a) to (c) together make up the regulation 8 fair value profits or losses.”.

(3) In paragraph (3) after “the part of the” insert “regulation 8”.

10.—(1) Amend regulation 10 (bringing fair value profits or losses into account on currency and commodity contracts) as follows.

(2) In paragraph (1)(a)—

- (a) after “any” insert “regulation 7 or 8”; and
- (b) omit the words “by virtue of regulation 7(1) or regulation 8(1)”.

(3) In paragraph (3) after “contract is” insert “, subject to paragraph (3A),”.

(4) After paragraph (3) insert—

“(3A) If paragraph (3)(b) applies—

- (a) the amount to be brought into account in an accounting period is the product of
DA/E x FVP,

where—

DA is the amount of depreciation recognised in the profit and loss account or income statement in relation to the hedged item in the accounting period,

E is the total expenditure on the hedged item, and

FVP is the aggregate amount of regulation 7 or 8 fair value profit;

- (b) where the hedged item is disposed of, the balance of the aggregate amount mentioned in paragraph (1)(a) which has not been brought into account under sub-paragraph (a) of this paragraph shall be brought into account in the accounting period in which the disposal takes place.”.

(5) In paragraph (5) after “paragraph (1)(b)” insert “or paragraph (3)”.

(6) In paragraph (6)—

- (a) in sub-paragraph (a) for “amount to” substitute “proportion”; and
- (b) in sub-paragraph (b) for “on which exchange gains and losses begin” substitute “which begins”.

(7) In paragraph (8)(a) for “applies” substitute “would apply but for paragraph 30 of that Schedule”.

(8) In paragraph (10)(b) after “represent” insert “regulation 7 or 8”.

11. After regulation 10 insert—

“Profits and losses arising from loan relationships with embedded derivatives

11.—(1) For the purposes of section 85B(3) of the Finance Act 1996 (amounts recognised in determining company's profits and loss)—

- (a) the amounts described in paragraph (2) are prescribed in relation to a company which is a party to a creditor relationship to which—

- (i) section 92 (convertible securities etc: creditor relationships) or 93 (relationships linked to the value of chargeable assets) of the Finance Act 1996(a) applies immediately before the start of the first accounting period of the company to begin on or after 1st January 2005, and
 - (ii) section 94A of the Finance Act 1996(b) (loan relationships with embedded derivatives) applies in the first accounting period of the company to begin on or after 1st January 2005; and
- (b) the amounts described in paragraph (3) are prescribed in relation to a company which is a party to a creditor relationship to which section 92 or 93 of the Finance Act 1996 applies immediately before the start of the first accounting period of the company to begin on or after 1st January 2005.
- (2) The prescribed amounts are all credits and debits in respect of the host contract save for—
- (a) credits in relation to interest accruing in respect of the creditor relationship without regard to the amounts given by the effective interest method; and
 - (b) credits and debits in respect of exchange gains and losses.
- (3) The prescribed amounts are all credits and debits save for—
- (a) credits in relation to interest, and
 - (b) credits and debits in respect of exchange gains and losses.

12.—(1) For the purposes of section 85B(3) of the Finance Act 1996 the amounts described in paragraph (2) are prescribed in relation to a company which is a party to a debtor relationship to which—

- (a) section 92A (convertible securities etc: debtor relationships)(c) or 93 of the Finance Act 1996 applies immediately before the start of the first accounting period of the company to begin on or after 1st January 2005, and
 - (b) section 94A of the Finance Act 1996 applies in the first accounting period of the company to begin on or after 1st January 2005.
- (2) The prescribed amounts are all credits and debits in respect of the host contract save for—
- (a) debits in relation to interest accruing in respect of the debtor relationship without regard to the amounts given by the effective interest method; and
 - (b) credits and debits in respect of exchange gains and losses.”.

*Gillian Merron
Vernon Coaker*

21st July 2005

Two of the Lords Commissioners of Her Majesty’s Treasury

(a) Section 92 was amended by section 65(7) and (8) of the Finance Act 1999 (c. 16), sections 72, 73(1), 79, 82 and 141 to, and Part 3(8) and (10) of Schedule 40 to the Finance Act 2002 (c. 23) and section 882(1) of, and paragraphs 485 and 486 of the Income Tax (Trading and Other Income) Act 2005 (c. 5). Section 93 was amended by sections 75 and 141 of, and Part 3(8) of Schedule 40 to the Finance Act 2002. Both sections were repealed by sections 52 and 326 of, and paragraph 9 of Schedule 10 and Part 2(6) of Schedule 42 to, the Finance Act 2004 (c. 12).

(b) Section 94A was inserted by section 52 of, and paragraph 13 of Schedule 10 to, the Finance Act 2004 and amended by section 80 of, and paragraph 28(1) and (2) of Schedule 4 to, the Finance Act 2005 (c. 7).

(c) Section 92A was inserted by section 74 of the Finance Act 2002 and repealed by sections 52 and 326 of, and paragraph 10 of Schedule 10 and Part 2(6) of Schedule 42 to, the Finance Act 2004.

EXPLANATORY NOTE

(This note is not part of the Regulations)

These Regulations amend the Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) Regulations 2004 (S.I. 2004/3256; “the Principal Regulations”) which allow certain profits and losses from loan relationships and derivative contracts to be left out of account, to be brought into account in a different way or to be brought into account at a later date.

Regulation 1 provides for citation, commencement and effect.

Regulation 2 introduces the amendments to the Principal Regulations.

Regulation 3 amends regulation 2(1) (interpretation) of the Principal Regulations to insert definitions of new terms used in the amendments.

Regulations 4 and 5 amend regulations 3 (exchange gains or losses arising from liabilities or assets hedging shares etc.) and 4 (exchange gains or losses arising from derivative contracts hedging shares etc.) of the Principal Regulations respectively. The amendments clarify the order of priority for matching the loan relationship or derivative contract with shares, ships or aircraft; exclude certain relationships deemed to be loan relationships from regulation 3; insert a new provision in regulation 4 to explain how the value of an obligation under a derivative contract is calculated to enable the limit of matching to be determined.

Regulation 6 amends regulation 5 (regulations 3 and 4: supplementary) of the Principal Regulations to clarify the extent to which an asset is matched.

Regulation 7 amends regulation 6 (rules about fair value profits and losses) of the Principal Regulations to extend the time limit for making an election that regulations 7 to 9 of the Principal Regulations (which contain specific rules about excluding fair value profits and losses for the purposes of Schedule 26 to the Finance Act 2002 (c. 23)) shall not apply.

Regulations 8 and 9 amend regulations 7 (fair value profits or losses arising from derivative contracts which are currency contracts) and 8 (profits or losses arising from derivative contracts which are commodity contracts or debt contracts) of the Principal Regulations respectively so that fair value movements as a result of a change of accounting basis are disregarded in determining a company’s profit or loss.

Regulation 10 amends regulation 10 (bringing fair value profits or losses into account on currency and commodity contracts) of the Principal Regulations to provide how fair value profits and losses are to be brought into account in relation to expenditure which is depreciated over a period.

Regulation 11 inserts new regulations 11 and 12 into the Principal Regulations to exclude certain amounts in relation to convertible securities and loan relationships with embedded derivatives from amounts recognised in determining a company’s profit or loss.

These Regulations impose no new costs on business.

2005 No. 2012

INCOME TAX

**The Loan Relationships and Derivative Contracts (Disregard
and Bringing into Account of Profits and Losses) (Amendment)
Regulations 2005**

£3.00

© Crown copyright 2005

Printed and published in the UK by The Stationery Office Limited
under the authority and superintendence of Carol Tullo, Controller of Her Majesty's
Stationery Office and Queen's Printer of Acts of Parliament.

E1128 7/2005 151128T 19585

ISBN 0-11-073138-7



9 780110 731384