EXPLANATORY MEMORANDUM TO

THE EXCHANGE GAINS AND LOSSES (BRINGING INTO ACCOUNT GAINS OR LOSSES) (AMENDMENT) REGULATIONS 2015

2015 No. 1960

THE LOAN RELATIONSHIPS AND DERIVATIVE CONTRACTS (DISREGARD AND BRINGING INTO ACCOUNT OF PROFITS AND LOSSES) (AMENDMENT) REGULATIONS 2015

2015 No. 1961

THE LOAN RELATIONSHIPS AND DERIVATIVE CONTRACTS (CHANGE OF ACCOUNTING PRACTICE) (AMENDMENT NO. 2) REGULATIONS 2015

2015 No. 1962

AND

THE LOAN RELATIONSHIPS AND DERIVATIVE CONTRACTS (EXCHANGE GAINS AND LOSSES USING FAIR VALUE ACCOUNTING) (AMENDMENT) REGULATIONS 2015

2015 No. 1963

1. Introduction

1.1 This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs on behalf of Her Majesty's Treasury and is laid before the House of Commons by Command of Her Majesty.

2. Purpose of the instrument

2.1 These four sets of Regulations provide for consequential amendments as a result of legislation introduced by sections 31 and 33 of Finance (No.2) Act 2015 amending Parts 5 and 7 of the Corporation Tax Act 2009 ("CTA 2009").

2.2 In particular, they make amendments to-

- the Exchange Gains and Losses (Bringing into Account Gains and Losses) Regulations 2002 (S.I. 2002 /1970: the 'EGL(BAGL) Regulations');
- the Loan Relationships and Derivative Contracts (Disregard and Bringing into Account Profits and Losses) Regulations 2004 (S.I. 2004 / 3256: the 'Disregard Regulations');
- the Loan Relationships and Derivative Contracts (Change of Accounting Practice) Regulation 2004 (S.I. 2004 / 3271: the 'Change of Accounting Practice Regulations'); and
- the Loan Relationships and Derivative Contracts (Exchange Gains and Losses using Fair Value Accounting) Regulations 2005 (S.I. 2005 / 3422: the EGL(FV) Regulations).

3. Matters of special interest to Parliament

Matters of special interest to the Select Committee on Statutory Instruments

3.1 None.

Other matters of interest to the House of Commons

3.2 As this instrument is subject to the negative procedure and has not been prayed against, consideration as to whether there are other matters of interest to the House of Commons does not arise at this stage.

4. Legislative Context

4.1 Under Part 5 of the CTA 2009 a company is generally taxable on profits and losses from loan relationships based on the amounts recognised in determining the company's profit or loss for the period. Similar rules for derivative contracts are set out in Part 7 of the CTA 2009.

4.2 The provisions in Parts 5 and 7 CTA 2009 are supplemented, in particular, by the following sets of Regulations.

4.3 The EGL(BAGL) Regulations are concerned with exchange gains or losses on loans or derivatives ("the hedging instrument"), which hedge certain assets and which have previously been disregarded for tax. They ensure that such gains and losses are brought into account at a time and in a manner consistent with the tax treatment of the hedged asset. In broad terms, this means that previously disregarded exchange gains or losses arising on the hedging instrument are brought back into account when there is a disposal of the hedged asset (other than a no gain/no loss disposal).

4.4 The Disregard Regulations provide detailed rules that were introduced in 2004 following the introduction of International Accounting Standards. They provide specific treatment to alter the amounts brought into account in respect of particular instruments. In particular, they provide rules where loans and derivatives are taken out to hedge commercial risks.

4.5 The Change of Accounting Practice Regulations provide detailed rules that were introduced in 2004 following the introduction of International Accounting Standards. They provide specific treatment to alter the amounts brought into account in respect of a change of accounting policy. In particular, they can provide for certain amounts to be spread over ten years and for other specified amounts not to be brought into account at all.

4.6 The EGL(FV) Regulations provide specific rules for calculating amounts of exchange gains and losses where a loan relationship or derivative contract is measured at fair value or is part of a designated fair value hedge.

5. Extent and Territorial Application

5.1 The extent of this instrument is the United Kingdom.

5.2 The territorial application of this instrument is the United Kingdom.

6. European Convention on Human Rights

6.1 As the instruments are subject to negative resolution procedure and do not amend primary legislation, no statement is required.

7. Policy background

What is being done and why

7.1 At Budget 2013, the Government announced consultation on a package of proposals to modernise the corporation tax rules governing the taxation of corporate debt and derivative contracts, with a view to legislating in Finance Bill 2014 and Finance Bill 2015. This work supports the Government's aim of promoting a tax system which is efficient, competitive, predictable, simple and fair.

7.2 As a result of the changes being made to primary legislation, certain consequential amendments are needed to existing Regulations. These instruments give effect to those consequential amendments.

7.3 The amendments to the EGL(BAGL) Regulations address the interaction with new sections 320A and 604A CTA 2009 and prevent the potential risk of amounts being brought into account under both sets of rules.

7.4 The amendments to the Disregard Regulations:

- Simplify the tax rules on hedging as a result of changes included in the Finance (No.2) Act 2015. Companies use hedging to mitigate the financial effects from risks that could impact upon the company's core business, such as fluctuating interest rates. In future taxable loan relationship and derivative contract profits and losses will be derived from amounts recognised as profits or losses in commercial accounts. This avoids the need for special rules in respect of designated cash flow hedges, and allows regulation 9A to be repealed.
- Introduce a new regulation 5A to ensure that the rules continue to apply appropriately to exchange gains and losses on foreign branches of UK companies. In particular, it ensures that amounts of exchange gains and losses on a loan or derivative as part of a designated net investment hedge are not brought into account on disposal of the foreign operation. This is in line with the tax treatment of the retranslation amounts in respect of the foreign operation, which were previously recorded in Other Comprehensive Income (OCI) and are excluded from being brought into account under the loan relationship and derivative contract rules by virtue of sections 328(3) and 606(3) CTA 2009 respectively.
- Amend regulation 6B and introduce new regulations 6C and 6D to provide for 'group continuity' treatment to cases where both the derivative contract and the hedged item are both transferred to the same group company.
- Regulation 6B deals with elections made into regulation 7 and 8 and states that section 628 CTA 2009 will apply to transfers and not section 625. Regulation 10(9) would then apply in respect of amounts which would otherwise be recognised on the transfer.
- Regulation 6C deals with elections into regulation 9 and ensures that section 625 will apply to transfers (instead of section 628).
- Regulation 6D covers situations where no election has been made.

7.5 The amendments to the Change of Accounting Practice Regulations:

- Introduce specific provision that apply where there is a change of accounting practice to deal with adjustments arising from fluctuations in a company's

credit rating (known as 'own credit risk'). When a company's creditworthiness deteriorates, the fair value of its issued debt will decrease (and vice versa). This means that a gain (or loss) has to be recognised in the company's profit and loss account. Under new accounting rules these amounts will in future be recognised in the company's reserves and therefore not immediately subject to tax.

- The rules contained in Finance (No.2) Act 2015 ensure that 'own credit risk' adjustments arising from the transition to following amounts in profit or loss for tax purposes are taxed over a five-year period to ensure a flat Exchequer impact. The amendments to the Change of Accounting Practice Regulations will ensure that transitional amounts associated with 'own credit risk' arising from a later accounting change will be treated in the same way, and similarly spread over five years.
- Make minor adjustments as a result of the tax rules following the amount of profit or loss in commercial accounts and changes in terminology, and removes some statutory language which has become obsolete as a result of the passage of time.

7.6 The amendments to the EGL(FV) Regulations:

- Update the statutory references as a result of the tax law rewrite project.
- Make minor adjustments as a result of following the amount of profit or loss in commercial accounts and changes in terminology.

Consolidation

7.7 The Government is continuing with its project on the modernisation of the taxation of corporate debt and derivative contracts. Following the outcome of that work, consideration will be given to consolidating each set of amended Regulations.

8. Consultation outcome

8.1 The consultation ran for four weeks, ending 30 October 2015, with draft regulations and a draft Explanatory Note published on www.gov.uk. Responses were generally supportive and have not required significant adjustments.

9. Guidance

9.1 HMRC guidance in the Corporate Finance Manual will in due course be amended.

10. Impact

10.1 The measure is expected to have a negligible one off familiarisation impact on businesses overall. It will affect mainly large companies and that impact is expected to be negligible. The measure is expected to reduce ongoing costs due to simplification of the legislation. No impact on charities or voluntary bodies is anticipated.

10.2 The impact on the public sector is negligible.

10.3 A Tax Information and Impact Note for the modernisation of the taxation of corporate debt and derivative contracts which covers these instruments was published at Summer Budget 2015 on 8 July 2015 and is available on the HMRC website at: www.gov.uk/government/collections/tax-information-and-impact-notes-tiins. It remains an accurate summary of the impacts that apply to this instrument.

11. Regulating small business

11.1 The legislation applies to activities that are undertaken by small businesses.

11.2 No specific action is proposed to minimise regulatory burdens on small businesses because their interaction with the loan relationships and derivative contracts regimes is generally straight-forward and no material impact is anticipated.

12. Monitoring & review

12.1 This policy will be monitored through information obtained through collaborative engagement with customers and enquiries into self-assessments.

13. Contact

13.1 Richard Daniel at HMRC Telephone: 03000 569 408 or email: richard.daniel@hmrc.gsi.gov.uk can answer any queries regarding the instrument.