EXPLANATORY MEMORANDUM TO
THE LOAN RELATIONSHIPS AND DERIVATIVE CONTRACTS (CHANGE OF ACCOUNTING PRACTICE) (AMENDMENT) REGULATIONS 2007

2007 No. 950

1. This explanatory memorandum has been prepared by the Her Majesty's Commissioners of Revenue and Customs and is laid before the House of Commons by Command of Her Majesty.

2. Description

2.1 The regulations provide for amounts which were erroneously allowed as deductible for tax purposes by the Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) (Amendment) Regulations 2006 (SI 2006/3236) to be brought into account at a later date. They do this by stopping the bringing into account over ten years of an adjustment amount arising on a change of accounting basis in accordance with the Loan Relationships and Derivative Contracts (Change of Accounting Practice) Regulations SI 2004/3271 once the bringing into account has recovered the erroneously given deduction.

2.2 The regulations also insert into SI 2004/3271 a further example of derivative contracts where amounts arising as a result of a change in accounting practice are to be wholly disregarded. The change in practice concerned must be one arising as result of a company's transition from following existing UK Generally Accepted Accounting Practice (GAAP) to following International Accounting Standards (IAS) or revised UK GAAP.

2.3 They also make further amendments to SI 2004/3271 to correct minor errors.

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

None

4. Legislative Background

4.1 These regulations are being made to clarify and amend the treatment of transitional amounts in Chapter 2 Part 9 Finance Act 1996 (loan relationships) and Schedule 26 FA 2002 (derivative contracts) in the light of their practical application and of issues raised by a Consultative working group.

4.2 This instrument relates in part to the Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) (Amendment) Regulations 2007.

.**5. Extent**

The instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

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

7. Policy background

7.1 Profits and losses on debts and derivative contracts are generally brought into account as they are recognised in accounts drawn up using UK Generally Accepted Accounting Practice (GAAP). From 2005 all companies are permitted to use International Accounting Standards (IAS) to draw up their accounts, and such accounts will be an acceptable basis for tax purposes – section 50 of the Finance Act 2004.

7.2 Where a company changes its accounting basis, any difference between the carrying value of the asset or liability between the period of change and the previous period are brought into account for tax purposes in the period of change.

7.3 In some cases IAS requires certain "hybrid contracts" to be divided between a debt element and a derivative element. The treatment of such cases which were not so "bifurcated" under previous accounting standards is extremely complex, and it has come to light that in certain cases amendments made by SI 2006/3236 caused an excessive amount of debits to be given.

7.4 These regulations modify and amend the loan relationships and derivative contracts tax law in the light of practical experience of, in particular, the application of IAS. It is not appropriate to amend tax law otherwise than through legislative change, so no alternative avenues of achieving the objective have been explored.

7.5 There has been extensive consultation on the workings of SI 2004/3271 as amended with relevant bodies, especially a Consultative Working Group, and this Order carries on the process of clarifying and amending those Parts in the light of their practical application.

7.5 Guidance on the regulations generally is provided in HMRC's Corporate Finance Manual and on its website under the heading "Accounting Standards - the UK tax implications".

8. Impact

8.1 A Regulatory Impact Assessment has not been prepared for this instrument as it has no impact on business, charities or voluntary bodies.

8.2 The impact on the public sector is nil.

9. Contact

Richard Thomas at Her Majesty's Revenue & Customs, telephone 020 7147 2558 or e-mail richard.thomas@hmrc.gsi.gov.uk can answer any queries regarding the instrument.