EXPLANATORY MEMORANDUM TO

THE LOAN RELATIONSHIPS AND DERIVATIVE CONTRACTS (CHANGE OF ACCOUNTING PRACTICE) REGULATIONS 2016

2016 No. 1234

1. Introduction

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

1.2 This memorandum contains information for the Select Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 These Regulations amend the Loan Relationships and Derivative Contracts (Change of Accounting Practice) Regulations 2004 (S.I. 2004/ 3271 - 'the COAP Regulations') the purpose of which is to provide specific tax treatment for loan relationships and derivative contracts on a change of accounting policy.

2.2 In particular, these 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').

3. Matters of special interest to Parliament

Matters of special interest to the Select Committee on Statutory Instruments

3.1 These Regulations have effect in relation to periods of account beginning on or after 1 January 2016. This will, as far as possible, ensure the rules introduced by Finance (No. 2) Act 2015 will operate as intended from the start.

3.2 Authority for this limited retrospective effect of these Regulations can be found at section 319(5) and section 598(6) of the CTA 2009 for loan relationships and derivative contracts respectively.

Other matters of interest to the House of Commons

3.3 As this instrument is subject to negative resolution 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 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 CTA 2009.

4.2 The provisions in Parts 5 and 7 CTA 2009 are supplemented, in particular, by the COAP Regulations. These provide detailed rules that were introduced in 2004 following the introduction of International Accounting Standards. They provide

specific treatments of 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 for tax at all.

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 instrument is subject to negative resolution procedure and does 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 a consultation on a package of proposals to modernise the corporate tax rules governing the taxation of corporate debt and derivative contracts. This work supports the Government's aim of promoting a tax system with is efficient, competitive, predictable, simple and fair.

7.2 As a result of the changes made to Part 5 and Part 7 of CTA 2009, certain consequential amendments are needed to the COAP Regulations to avoid double taxation or double relief. Amounts may otherwise be brought into account under both the new Part 5 or Part 7 rules and under the COAP Regulations. The principal case in point is where is a company has recognised amounts in Other Comprehensive Income in respect of an 'available-for-sale' asset under International Accounting Standard 39 (IAS 39). This instrument gives effect to the consequential amendments required.

7.3 The amendments will prevent further amounts bring brought into account under the 10 year spreading rules where those amounts are amounts within Other Comprehensive Income at the commencement of the new Part 5 and Part 7 rules.

7.4 This amendment will ensure that the rules operate as intended, and will ensure that amounts are taxed or relieved once and only once.

Consolidation

7.5 The Government is continuing with its project to modernise the taxation of corporate debt and derivative contracts. Following the outcome of that work consideration will be given to consolidating the COAP Regulations.

8. Consultation outcome

8.1 The consultation ran for four weeks ended 1 November 2016 with draft Regulations and a draft Explanatory Note published on GOV.UK. Responses were generally supportive and have not required significant changes to the drafting.

9. Guidance

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

10. Impact

10.1 There is no impact on charities or voluntary bodies. The impact on business is that the amendment ensures the interaction of the COAP Regulations with the 2015 changes operate as intended.

10.2 There is negligible impact on the public sector.

10.3 A Tax Information and Impact Note (TIIN) covering both the changes made in Finance (No. 2) Act 2015 and in these Regulations was published on 8 July 2015 and is available at www.gov.uk/government/collections/tax-information-and-impact-notes-tiins. It remains an accurate summary of the impacts that apply to this amendment.

11. Regulating small business

11.1 The legislation is unlikely to apply to activities undertaken by small business.

11.2 The accounting changes where the legislation could be relevant principally affect large groups with listed debt or equity. We do not expect any impact on small companies, whose current interaction with the loan relationships and derivative contracts regimes is generally straightforward.

12. Monitoring & review

12.1 The 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.