SCHEDULES

SCHEDULE 26

DERIVATIVE CONTRACTS

Modifications etc. (not altering text)

C1 Sch. 26 modified by 1996 c. 8, **s. 86(3C)** (as inserted (24.7.2002 with effect as mentioned in s. 82(2) of the amending Act) by 2002 c. 23, s. 82, **Sch. 25 Pt. 1 para. 6(3)**)

C1 Sch. 26 extended (retrospective to 30.9.2002) by Finance Act 2003 (c. 14), **s. 177(4)(8)(11)**

PART 2

DERIVATIVE CONTRACTS

Derivative contracts and relevant contracts

2 (1) For the purposes of the Corporation Tax Acts a company's derivative contracts are those of its relevant contracts which satisfy the following provisions of this Schedule.

(2) For the purposes of this Schedule a "relevant contract" is—

(a) an option,

(b) a future, or

(c) a contract for differences.

Contracts to satisfy accounting requirements etc

3 (1) A relevant contract is not a derivative contract for the purposes of this Schedule for any accounting period unless—

(a) it is treated for accounting purposes as a derivative financial instrument,

(b) in the case of a relevant contract falling within paragraph 6 or 7 which is not treated as described in paragraph (a), it is treated for accounting purposes as a financial asset, or

(c) in the case of a relevant contract which is not treated as described in paragraph (a) or (b), it falls within sub-paragraph (2).

(2) A relevant contract falls within this sub-paragraph if—

(a) its underlying subject matter is commodities, or

(b) it is a contract for differences whose underlying subject matter is—

(i) intangible fixed assets,

(ii) weather conditions, or

(iii) creditworthiness.

(3) For the purposes of sub-paragraph (1)(a), a relevant contract of a company is treated for accounting purposes as a derivative financial instrument for an accounting period if, for that accounting period, it is so treated for the purposes of the relevant accounting standard used by the company for that accounting period (or would be so treated if the company were a company which used the relevant accounting standard in respect of the relevant contract).

(4) For the purposes of sub-paragraph (1)(b), a relevant contract of a company is treated for accounting purposes as a financial asset for an accounting period if, for that accounting period, it is so treated for the purposes of the relevant accounting standard used by the company for that accounting period (or would be so treated if the company were a company which used the relevant accounting standard in respect of the relevant contract).

(5) For the purposes of sub-paragraphs (3) and (4), the "relevant accounting standard" used by a company for an accounting period is—

(a) in relation to any accounting period for which it is required or permitted to be used by the company, Financial Reporting Standard 13 issued in September 1998 by the Accounting Standards Board, as it has effect for periods of account ending on 31st December 2002, or

(b) in relation to any accounting period for which it is required or permitted to be used by the company, any subsequent accounting standard dealing with transactions which are derivative financial instruments or financial assets under Financial Reporting Standard 13, as from time to time amended.

Contracts excluded by virtue of their underlying subject matter

4 (1) A relevant contract is not a derivative contract for the purposes of this Schedule if its underlying subject matter consists wholly of any one or more of the excluded types of property or is treated as consisting wholly of such property.

(2) For the purposes of this paragraph as it relates to an option or future, the excluded types of property are—

(a) land, whether situated in the United Kingdom or elsewhere;

(b) tangible movable property, other than commodities which are tangible assets;

(c) intangible fixed assets;

(d) shares in a company;

(e) rights of a unit holder under a unit trust scheme; and

(f) any assets representing loan relationships to which either section 92 or 93 of the Finance Act 1996 (c. 8) applies.

(3) For the purposes of this paragraph as it relates to a contract for differences, the excluded types of property are those falling within paragraphs (a),(b) and (d) to (f) of sub-paragraph (2).

(4) Paragraph 9 applies for the purpose of determining whether the underlying subject matter of a relevant contract is to be treated as consisting wholly of any one or more of the excluded types of property.

(5) This paragraph has effect subject to paragraphs 5 to 8 (which qualify the exclusion of relevant contracts by this paragraph).

Qualified exclusion: contract held by company for purposes of trade

5 (1) Paragraph 4 does not prevent a relevant contract to which this paragraph applies from being a derivative contract.

(2) This paragraph applies to a relevant contract of a company if—

(a) it is entered into or acquired by the company for the purposes of a trade carried on by it, and

(b) its underlying subject matter consists, or is treated as consisting, wholly of—

(i) shares in a company,

(ii) rights of a unit holder under a unit trust scheme, or

(iii) assets representing a loan relationship to which either section 92 or 93 of the Finance Act 1996 applies.

(3) Paragraph 9 applies for the purpose of determining whether the underlying subject matter of a relevant contract is to be treated as consisting wholly of the property referred to in sub-paragraph (2)(b).

Qualified exclusion: contract producing guaranteed return

6 (1) Paragraph 4 does not prevent a relevant contract to which this paragraph applies from being a derivative contract.

(2) This paragraph applies to a relevant contract of a company if—

(a) its underlying subject matter consists, or is treated as consisting, wholly of—

(i) shares in a company,

(ii) rights of a unit holder under a unit trust scheme, or

(iii) assets representing a loan relationship to which either section 92 or 93 of the Finance Act 1996 (c. 8) applies, and

(b) it satisfies the condition in sub-paragraph (3).

(3) The condition referred to in sub-paragraph 2(b) is that—

(a) the relevant contract is designed to produce a guaranteed return, or

(b) the relevant contract and one or more of the following, namely—

(i) one or more other relevant contracts, whose underlying subject matter consists wholly or partly of shares in a company, rights of a unit holder under a unit trust scheme or assets representing loan relationships to which either section 92 or 93 of the Finance Act 1996 applies, and which would be derivative contracts if the condition in this sub-paragraph were satisfied in relation to them,

(ii) one or more assets representing loan relationships to which either section 92 or 93 of that Act applies, and

(iii) one or more assets representing loan relationships to which section 93A of that Act applies,

are associated transactions designed to produce a guaranteed return.

(4) For the purposes of this paragraph—

(a) the return on a relevant contract of a company comprises any amounts accruing to the company as respects the contract for any accounting period, and

(b) the return on an asset representing a loan relationship of a company is the amount that must be paid to discharge the money debt arising in connection with that relationship.

(5) For the purposes of this paragraph the relevant contract in question is, or that contract and the other associated transactions are, designed to produce a guaranteed return if, as regards that contract, or as regards that contract and the other associated transactions taken together, it would be reasonable to assume, from considering—

(a) the likely effect of that contract or of that contract and the other associated transactions,

(b) the circumstances in which—

(i) that contract is entered into or acquired, or

(ii) the contract and the other associated transactions, or any of them, are entered into or acquired, or

(c) the matters in both of paragraphs (a) and (b),

that the main purpose (or one of the main purposes) of that contract, or of that contract and the other associated transactions, is or was the production of a guaranteed return from that contract, or from that contract and any one or more of the other associated transactions.

(6) For the purposes of this paragraph a guaranteed return is produced from the relevant contract in question, or from that contract and any one or more of the other associated transactions, wherever (as regards that contract or as regards that contract and those transactions, taken together) risks from fluctuations in the underlying matter of that contract, or of that contract or any one or more of the other associated transactions, are so eliminated or reduced as to produce a return from that contract, or from that contract and any one or more of the other associated transactions, which equates, in substance, to the return on an investment of money at interest.

(7) For the purposes of sub-paragraph (6) the cases where risks from fluctuations in the underlying matter of the relevant contract in question, or of that contract or any one or more of the other associated transactions, are eliminated or reduced shall be deemed to include any case where the main reason, or one of the main reasons, for the choice of that underlying matter is—

(a) that there appears to be no risk that it will fluctuate, or

(b) that the risk that it will fluctuate appears to be insignificant.

(8) In this paragraph—

(a) the references, in relation to an asset representing a loan relationship to which section 92 of the Finance Act 1996 (c. 8) applies, to the underlying matter are references to the value of shares in a company which may be acquired under that relationship;

(b) the references, in relation to an asset representing a loan relationship to which section 93 or 93A of the Finance Act 1996 applies, to the underlying matter are references to the value of chargeable assets of a particular description to which that relationship is linked;

(c) the references, in relation to a relevant contract, to fluctuations in the underlying matter are references to fluctuations determined by reference to its underlying subject matter.

(9) For the purposes of this paragraph a company is a connected company in relation to another company if, in the accounting period in question, there is a connection

between the company and that other company; and whether there is a connection between those companies shall be determined in accordance with sections 87(3) and (4) and 87A of the Finance Act 1996 (disregarding section 88 of that Act).

(10) Paragraph 9 applies for the purpose of determining whether the underlying subject matter of a relevant contract is to be treated as consisting wholly of the property referred to in sub-paragraph 2(a).

Qualified exclusion: guaranteed amount payable on maturity

7 (1) Paragraph 4 does not prevent a relevant contract to which this paragraph applies from being a derivative contract.

(2) This paragraph applies to a relevant contract of a company if—
- (a) its underlying subject matter consists, or is treated as consisting, wholly of—
  - (i) shares in a company,
  - (ii) rights of a unit holder under a unit trust scheme, or
  - (iii) assets representing a loan relationship to which either section 92 or 93 of the Finance Act 1996 applies, and
- (b) it satisfies the condition in sub-paragraph (3).

(3) The condition referred to in sub-paragraph 2(b) is that—
- (a) the relevant contract is designed to secure that the relevant amount payable in respect of the relevant contract does not fall below the guaranteed amount, or
- (b) the relevant contract and one or more of the following, namely—
  - (i) one or more other relevant contracts, whose underlying subject matter consists wholly or partly of shares in a company, rights of a unit holder under a unit trust scheme or assets representing loan relationships to which either section 92 or 93 of the Finance Act 1996 (c. 8) applies, and which would be derivative contracts if the condition in this sub-paragraph were satisfied in relation to them,
  - (ii) one or more assets representing loan relationships to which either section 92 or 93 of that Act applies, and
  - (iii) one or more assets representing loan relationships to which section 93A of that Act applies,

  are associated transactions designed to secure that the relevant amount payable in respect of the associated transactions does not fall below the guaranteed amount.

(4) For the purposes of this paragraph the relevant contract in question is, or that contract and the other associated transactions are, designed to secure that the relevant amount payable in respect of that contract, or that contract and any one or more of the other associated transactions, does not fall below the guaranteed amount if, as regards that contract, or as regards that contract and the transactions, taken together, it would be reasonable to assume, from considering—
- (a) the likely effect of that contract or of that contract and the other associated transactions,
- (b) the circumstances in which—
  - (i) that contract is entered into or acquired, or
  - (ii) that contract and the other associated transactions, or any of them, are entered into or acquired, or

(c) the matters in both of paragraphs (a) and (b),

that the main purpose (or one of the main purposes) of that contract, or of that contract and the other associated transactions, is or was to secure that the relevant amount so payable does not fall below the guaranteed amount.

(5) For the purposes of this paragraph the guaranteed amount is—

(a) in a case where the relevant contract in question is designed as described in sub-paragraph (3)(a), 80% of the consideration paid or payable by the company for entering into, or acquiring, that contract, or

(b) in a case where the relevant contract in question and the other associated transactions are designed as described in sub-paragraph (3)(b), 80% of the consideration paid or payable by the company or a company which is a connected company in relation to that company for entering into, or acquiring, any one or more of the associated transactions.

(6) For the purposes of this paragraph the relevant amount payable is—

(a) in a case where the relevant contract in question is designed as described in sub-paragraph (3)(a), the amount payable, in money or money's worth, to any person on the maturity of that contract, or

(b) in a case where the relevant contract in question and the other associated transactions are designed as described in sub-paragraph (3)(b), the amount payable, in money or money's worth, to any person on the maturity of any one or more of the associated transactions.

(7) For the purposes of sub-paragraph (6) the amount payable on maturity is—

(a) in the case of a relevant contract, the amount payable on performance of the relevant contract, or

(b) in the case of an asset representing a loan relationship, the amount that must be paid to discharge the money debt arising in connection with that relationship.

(8) For the purposes of this paragraph a company is a connected company in relation to another company if, in the accounting period in question, there is a connection between the company and that other company; and whether there is a connection between those companies shall be determined in accordance with sections 87(3) and (4) and 87A of the Finance Act 1996 (c. 8) (disregarding section 88 of that Act).

(9) Paragraph 9 applies for the purpose of determining whether the underlying subject matter of a relevant contract is to be treated as consisting wholly of the property referred to in sub-paragraph (2)(a).

(10) This paragraph has effect subject to paragraph (which provides for a company to elect to treat a relevant contract falling within this paragraph as two assets).

Qualified exclusion: contract held by company to provide insurance benefits

8 (1) Paragraph 4 does not prevent a relevant contract to which this paragraph applies from being a derivative contract.

(2) This paragraph applies to a relevant contract of a company if—

(a) the company is a company carrying on long-term insurance business,

(b) the relevant contract is or was entered into or acquired by the company in order to provide such benefits as are described in sub-paragraph (3), and

(c) the underlying subject matter of the relevant contract consists, or is treated as consisting, wholly of—
(i) shares in a company,
(ii) rights of a unit holder under a unit trust scheme, or
(iii) assets representing a loan relationship to which either section 92 or 93 of the Finance Act 1996 applies.

(3) The benefits referred to in sub-paragraph (2)(b) are benefits under policies of life insurance or capital redemption policies where—
(a) the terms of the policy or contract permit part of the rights conferred by the policy or contract to be surrendered by the holder of the policy or contract at intervals of one year or less, and
(b) the amount which may be paid on the surrender of such part of the rights conferred equates, in substance, to the return on an investment of money at interest.

(4) Paragraph 9 applies for the purpose of determining whether the underlying subject matter of a relevant contract is to be treated as consisting wholly of the property referred to in sub-paragraph (2)(c).

Underlying subject matter which is subordinate or of small value disregarded

9 (1) This paragraph applies in relation to a relevant contract which falls within any of sub-paragraphs (2) to (4).

(2) A relevant contract falls within this sub-paragraph if its underlying subject matter consists of—
(a) any one or more of the excluded types of property falling within paragraphs (a) to (f) of sub-paragraph (2) of paragraph (4) (or, in the case of a contract for differences, within paragraphs (a), (b) and (d) to (f) of that sub-paragraph), and
(b) other underlying subject matter which is—
(i) subordinate in relation to any of the property referred to in paragraph (a), or
(ii) of small value in comparison with the value of the underlying subject matter as a whole.

(3) A relevant contract falls within this sub-paragraph if its underlying subject matter consists of—
(a) any one or more of the excluded types of property falling within paragraphs (a) to (c) of sub-paragraph (2) of paragraph 4 (or, in the case of a contract for differences, within paragraphs (a) and (b) of that sub-paragraph), and
(b) other underlying subject matter which is—
(i) subordinate in relation to any of the property referred to in paragraph (a), or
(ii) of small value in comparison with the value of the underlying subject matter as a whole.

(4) A relevant contract falls within this sub-paragraph if its underlying subject matter consists of—
(a) any one or more of the excluded types of property falling within paragraphs (d) to (f) of sub-paragraph (2) of paragraph 4, and

(b) other underlying subject matter which is—
(i) subordinate in relation to any of the property referred to in paragraph (a), or
(ii) of small value in comparison with the value of the underlying subject matter as a whole.

(5) Where this paragraph applies in relation to a relevant contract, its underlying subject matter shall be treated for the purposes of this Schedule as if it consisted wholly of—
(a) in the case of a relevant contract falling within sub-paragraph (2), the excluded types of property referred to in paragraph (a) of that sub-paragraph,
(b) in the case of a relevant contract falling within sub-paragraph (3), the excluded types of property referred to in paragraph (a) of that sub-paragraph, or
(c) in the case of a relevant contract falling within sub-paragraph (4), the excluded types of property referred to in paragraph (a) of that sub-paragraph.

(6) For the purposes of this paragraph whether part of the underlying subject matter of a relevant contract of a company is subordinate or of small value is to be determined by reference to the time when the company enters into or acquires the relevant contract.

Associated transactions

10 (1) For the purposes of this Part of this Schedule two or more transactions are associated transactions if all of them are entered into or acquired in pursuance of the same scheme or arrangements.

(2) Nothing in this Part shall be construed as preventing transactions with different parties, or transactions with parties different from the parties to the scheme or arrangements in pursuance of which they are entered into or acquired, from being associated transactions.

(3) For the purposes of this paragraph the cases in which any two or more transactions are to be taken to be entered into or acquired in pursuance of the same scheme or arrangements shall include any case in which it would be reasonable to assume, from either or both of—
(a) the likely effect of the transactions, and
(b) the circumstances in which the transactions, or any of them, are entered into or acquired,

that neither of them or, as the case may be, none of them would have been entered into or acquired independently of the other or the others.

(4) In this paragraph "scheme or arrangements" includes schemes, arrangements and understandings of any kind, whether or not legally enforceable.

Meaning of "underlying subject matter"

11 (1) In this Part of this Schedule references to the underlying subject matter of a relevant contract are to be construed in accordance with this paragraph.

(2) The underlying subject matter of an option is—
(a) the property which would fall to be delivered if the option were exercised, or
(b) where the property which would so fall to be delivered is a derivative contract, the underlying subject matter of that derivative contract.

(3) The underlying subject matter of a future is—
(a) the property which, if the future were to run to delivery, would fall to be delivered at the date and price agreed when the contract is made, or
(b) where the property which would so fall to be delivered is a derivative contract, the underlying subject matter of that derivative contract.

(4) The underlying subject matter of a contract for differences is—
(a) where the contract for differences relates to fluctuations in the value or price of property described in the contract, the property so described, or
(b) where an index or factor is designated in the contract for differences, the matter by reference to which the index or factor is determined.

(5) In the case of a contract for differences, its underlying subject matter may include—
(a) interest rates;
(b) weather conditions;
(c) creditworthiness.

(6) Interest rates are not the underlying subject matter of a relevant contract in a case where, under the terms of that contract,—
(a) the date on which a party to that contract becomes subject to a duty to make a payment is a variable date, and
(b) the amount of that payment varies according to the date of payment,

and the terms of the relevant contract refer to an interest rate or rates for the purpose only of establishing that amount.

Definition of terms relating to derivative contracts

12 (1) This paragraph defines these expressions for the purposes of this Part of this Schedule—
(a) a capital redemption policy;
(b) a contract for differences;
(c) a future;
(d) intangible fixed assets;
(e) an option;
(f) shares in a company;
(g) a warrant.

(2) A "capital redemption policy" is a contract effected in the course of capital redemption business (within the meaning of section 458 of the Taxes Act 1988).

(3) A "contract for differences" is a contract the purpose or pretended purpose of which is to make a profit or avoid a loss by reference to fluctuations in—
(a) the value or price of property described in the contract, or
(b) an index or other factor designated in the contract.

(4) For the purposes of sub-paragraph (3)(b) an index or factor may be determined by reference to any matter and, for those purposes, a numerical value may be attributed to any variation in a matter.

(5) None of the following is a contract for differences—
(a) a future;

(b) an option;
(c) a contract of insurance;
(d) a capital redemption policy;
(e) a contract of indemnity;
(f) a guarantee;
(g) a warranty;
(h) a loan relationship.

(6) A "future" is a contract for the sale of property under which delivery is to be made—
(a) at a future date agreed when the contract is made, and
(b) at a price so agreed.

(7) For the purposes of sub-paragraph (6)(b) a price is to be taken to be agreed when the contract is made—
(a) notwithstanding that it is left to be determined by reference to the price at which a contract is to be entered into on a market or exchange or could be entered into at a time and place specified in the contract; or
(b) in a case where the contract is expressed to be by reference to a standard lot and quality, notwithstanding that provision is made for a variation in the price to take account of any variation in quantity or quality on delivery.

(8) An "option" includes a warrant.

(9) A "warrant" is an instrument which entitles the holder to subscribe for shares in a company or assets representing a loan relationship of a company; and for these purposes it is immaterial whether the shares or assets to which the warrant relates exist or are identifiable.

(10) References to a future or option do not include references to a contract whose terms provide—
(a) that, after setting off their obligations to each other under the contract, a cash payment is to be made by one party to the other in respect of the excess, if any, or
(b) that each party is liable to make to the other party a cash payment in respect of all that party's obligations to the other under the contract,

and do not provide for the delivery of any property.

Nothing in this sub-paragraph has effect to exclude, from references to a future or option, references to a future or option whose underlying subject matter is currency.

(11) "Intangible fixed assets" has the same meaning as in Part 1 of Schedule 29 to this Act, but any asset excluded by Part 10 of that Schedule is not an intangible fixed asset for the purposes of this Part of this Schedule.

(12) "Share", in relation to a company, means any share in the company under which an entitlement to receive distributions may arise.

Power to amend paragraphs 2 to 12

13 (1) The Treasury may by order amend any of paragraphs 2 to 12.

(2) The provision that may be made by an order under this paragraph includes provision—

(a) adding to, or varying, the descriptions of contract which are derivative contracts within paragraph 2 or removing any such description of contract, or

(b) adding to, or varying, the descriptions of contracts which are excluded under paragraph 4 or removing any such description of contract.

(3) The provision that may be made under sub-paragraph (2)(b), in relation to contracts which are excluded under paragraph 4, includes provision adding to, or varying, the provisions which qualify the exclusion of contracts under that paragraph or removing any such qualifying provision.

(4) To the extent that an order under this paragraph includes provision—

(a) varying the requirements under paragraph (a) or (b)of sub-paragraph (1) of paragraph 3 as to the treatment of a contract for accounting purposes, or

(b) adding to, or varying, the descriptions of contracts which fall within sub-paragraph (2) of that paragraph,

it may provide for such variations to have effect in relation to accounting periods which end on or after the day on which the order comes into force (whenever beginning).

(5) The power to make an order under this paragraph includes power—

(a) to make different provision for different cases, and

(b) to make such consequential, supplementary, incidental or transitional provisions, or savings, as appear to the Treasury to be necessary or expedient (including provision amending any enactment or any instrument made under an enactment).