



Corporation Tax Act 2009

2009 CHAPTER 4

PART 7

DERIVATIVE CONTRACTS

CHAPTER 2

CONTRACTS TO WHICH THIS PART APPLIES

Introduction

575 Overview of Chapter

- (1) This Chapter makes provision about the contracts to which this Part applies.
- (2) In particular, it—
 - (a) contains a definition of “derivative contract” (see section 576),
 - (b) contains other definitions (such as “relevant contract”, “option”, “future” and “contract for differences”) which are used in determining whether a contract is a derivative contract (see sections 577 to 583),
 - (c) makes provision about cases in which companies are treated as parties to relevant contracts (see sections 584 to 586),
 - (d) provides for certain contracts and transactions to be treated as derivative contracts (see sections 587 and 588), and
 - (e) provides for certain contracts to be treated as not being derivative contracts because of their underlying subject matter (see sections 589 to 593).

Status: Point in time view as at 17/07/2012.

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Meaning of “derivative contract” and other basic definitions

576 “Derivative contract”

- (1) For the purposes of this Part, a contract of a company is a derivative contract of the company for an accounting period if it—
 - (a) is a relevant contract (see sections 577 and 578),
 - (b) meets any of the accounting conditions for the accounting period (see section 579), and
 - (c) is not prevented from being a derivative contract by section 589 (contracts excluded because of underlying subject matter: general) or any other provision of the Corporation Tax Acts.
- (2) See also sections 587 and 588 (other contracts etc treated as derivative contracts).
- (3) But note section 701 which includes power to amend the provisions of this Chapter relating to the meaning of “derivative contract”.

577 “Relevant contract”

- (1) In this Part “relevant contract” means—
 - (a) an option,
 - (b) a future, or
 - (c) a contract for differences.
- (2) For the meaning of “option”, “future” and “contract for differences”, see sections 580, 581 and 582 respectively.

578 Relevant contracts of a company and being party to such contracts

- (1) For the purposes of this Part, references to a relevant contract of a company are references to a relevant contract entered into or acquired by the company (but see subsection (3)).
- (2) For the purposes of this Part, a relevant contract is acquired by a company if the company becomes—
 - (a) entitled to the rights under the relevant contract, and
 - (b) subject to the liabilities under it.
- (3) For particular cases where companies are treated as parties to relevant contracts, see—
 - (a) section 584 (hybrid derivatives with embedded derivatives),
 - (b) section 585 (loan relationships with embedded derivatives), and
 - (c) section 586 (other contracts with embedded derivatives).
- (4) References in this Part to a company being a party to a relevant contract are to be read in accordance with this section.

579 The accounting conditions

- (1) The accounting conditions for any accounting period are that—
 - (a) the relevant contract is treated for accounting purposes as a derivative,
 - (b) the relevant contract—

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- (i) is not so treated just because of not meeting the requirement in paragraph 9(b) of Financial Reporting Standard 26 issued in December 2004 by the Accounting Standards Board (requirement for no initial net investment or smaller initial net investment than comparable types of contract), but
 - (ii) is or forms part of a financial asset or liability for accounting purposes, or
 - (c) the relevant contract is not within paragraph (a) or (b), but is within subsection (2).
- (2) A relevant contract is within this subsection if—
 - (a) its underlying subject matter is commodities, or
 - (b) it is a contract for differences whose underlying subject matter is—
 - (i) land,
 - (ii) tangible movable property, other than commodities which are tangible assets,
 - (iii) intangible fixed assets,
 - (iv) weather conditions, or
 - (v) creditworthiness.
- (3) For the purposes of subsection (1)(a), a relevant contract of a company is treated for accounting purposes as a derivative for an accounting period if for that period—
 - (a) it is so treated for the purposes of the relevant accounting standard used by the company for that period, or
 - (b) it would be so treated if the company used the relevant accounting standard for that period in respect of the contract.
- (4) For the purposes of subsection (1)(b), a relevant contract of a company is or forms part of a financial asset or liability for accounting purposes for an accounting period if for that period—
 - (a) it is or does so for the purposes of the relevant accounting standard used by the company for that period, or
 - (b) it would be or would do so if the company used the relevant accounting standard for that period in respect of the contract.
- (5) In this section “relevant accounting standard” means—
 - (a) for any accounting period in relation to which it is required or permitted to be used, Financial Reporting Standard 25 issued in December 2004 by the Accounting Standards Board, as from time to time modified, amended or revised, or
 - (b) for any accounting period in relation to which it is required or permitted to be used, any subsequent accounting standard dealing with transactions which are derivatives, as from time to time modified, amended or revised.
- (6) For the meaning of “underlying subject matter”, see section 583.

580 “Option”

- (1) In this Part “option” includes a warrant.
- (2) References in this Part to an option do not include a contract whose terms—
 - (a) provide—

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- (i) 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
- (ii) 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
- (b) do not provide for the delivery of any property.
- (3) Subsection (2) does not prevent an option whose underlying subject matter is currency from being an option.
- (4) But see—
 - (a) section 652 (introduction to sections 653 to 655),
 - (b) section 665 (issuers of securities with embedded derivatives: equity instruments), and
 - (c) section 695 (transfers of value to connected companies),
 in which “option” is to be construed as if subsections (2) and (3) were omitted.

581 “Future”

- (1) In this Part “future” means 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,
 but this is subject to subsection (3).
- (2) For the purposes of subsection (1)(b), a price is agreed when the contract is made even if—
 - (a) the price 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, provision is made for a variation in the price to take account of any variation in quantity or quality on delivery.
- (3) References in this Part to a future do not include a contract whose terms—
 - (a) provide—
 - (i) 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
 - (ii) 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
 - (b) do not provide for the delivery of any property.
- (4) Subsection (3) does not prevent a future whose underlying subject matter is currency from being a future.

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582 “Contract for differences”

- (1) In this Part “contract for differences” means 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.
- (2) But none of the following is a contract for differences—
 - (a) an option,
 - (b) a future,
 - (c) a contract of insurance,
 - (d) a capital redemption policy,
 - (e) a contract of indemnity,
 - (f) a guarantee,
 - (g) a warranty, or
 - (h) a loan relationship.
- (3) For the purposes of subsection (1)(b), an index or factor may be determined by reference to any matter.

583 “Underlying subject matter”

- (1) In this Part references to the underlying subject matter of a relevant contract are to be read as follows.
- (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) if the property which would so fall is a derivative contract, the underlying subject matter of that 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) if the property which would so fall is a derivative contract, the underlying subject matter of that contract.
- (4) The underlying subject matter of a contract for differences is—
 - (a) if the contract for differences relates to fluctuations in the value or price of property described in the contract, the property so described, or
 - (b) if an index or factor is designated in the contract for differences, the matter by reference to which the index or factor is determined.
- (5) The things which may be the subject matter of a contract for differences include—
 - (a) interest rates,
 - (b) weather conditions, and
 - (c) creditworthiness.
- (6) Interest rates are not the underlying subject matter of a relevant contract if—
 - (a) under the terms of that contract—
 - (i) the date on which a party to that contract becomes subject to a duty to make a payment is a variable date, and

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- (ii) the amount of that payment varies according to the date of payment, and
 - (b) those terms refer to an interest rate only for the purpose of establishing that amount.
- (7) The underlying subject matter of a relevant contract is not treated as being—
- (a) land,
 - (b) shares in a company, or
 - (c) rights of a unit holder under a unit trust scheme,
- just because its underlying subject matter includes income from that kind of property.

Cases where companies treated as parties to relevant contracts

584 Hybrid derivatives with embedded derivatives

- (1) This section applies if—
- (a) a company is a party to a relevant contract which meets the condition in section 579(1)(b) or (c) (contracts not treated for accounting purposes as derivatives),
 - (b) in accordance with generally accepted accounting practice, the company treats the rights and liabilities under the contract as divided between—
 - (i) rights and liabilities under one or more derivatives (“embedded derivatives”), and
 - (ii) the remaining rights and liabilities, and
 - (c) a contract consisting of only those remaining rights and liabilities would be a relevant contract.
- (2) The company is treated for the purposes of this Part—
- (a) as a party to a relevant contract whose rights and liabilities consist only of those of the embedded derivative, or (if there is more than one embedded derivative) as a party to relevant contracts each of whose rights and liabilities consist only of those of one of the embedded derivatives, and
 - (b) as a party to a relevant contract whose rights and liabilities are those within subsection (1)(b)(ii).
- (3) Each relevant contract to which a company is treated as a party under subsection (2) is treated for the purposes of this Part as an option, a future or a contract for differences depending on what the character of a separate contract containing the rights and liabilities of the deemed relevant contract would be.
- (4) In this Part “hybrid derivative” means a relevant contract within subsection (1)(a).
- (5) See also—
- (a) section 592 (embedded derivatives treated as meeting condition in section 591 etc), and
 - (b) section 616 (disapplication of fair value accounting for certain embedded derivatives).

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585 Loan relationships with embedded derivatives

- (1) This section applies if in accordance with generally accepted accounting practice a company treats the rights and liabilities under a loan relationship to which it is a party as divided between—
 - (a) rights and liabilities under a loan relationship, and
 - (b) rights and liabilities under one or more derivative financial instruments or equity instruments (“embedded derivatives”).
- (2) The company is treated for the purposes of this Part—
 - (a) as a party to a relevant contract whose rights and liabilities consist only of those of the embedded derivative, or
 - (b) if there is more than one embedded derivative, as a party to relevant contracts each of whose rights and liabilities consist only of those of one of the embedded derivatives.
- (3) Each relevant contract to which a company is treated as a party under subsection (2) is treated for the purposes of this Part as an option, a future or a contract for differences depending on what the character of a separate contract containing the rights and liabilities of the embedded derivative would be.
- (4) For the corresponding treatment of the rights and liabilities within subsection (1)(a), see section 415 (loan relationships with embedded derivatives).
- (5) See also—
 - (a) section 416 (election for section 415 and this section to apply), and
 - (b) section 635 (some creditor relationships treated as ones in relation to which section 415 and this section have effect).

586 Other contracts with embedded derivatives

- (1) This section applies if a company—
 - (a) is a party to a contract which is neither a hybrid derivative nor a loan relationship, and
 - (b) in accordance with generally accepted accounting practice, treats the rights and liabilities under the contract as divided between—
 - (i) rights and liabilities under one or more derivatives (“embedded derivatives”), and
 - (ii) the remaining rights and liabilities.
- (2) The company is treated for the purposes of this Part—
 - (a) as a party to a relevant contract whose rights and liabilities consist only of those of the embedded derivative, or
 - (b) if there is more than one embedded derivative, as a party to relevant contracts each of whose rights and liabilities consist only of those of one of the embedded derivatives.
- (3) Each relevant contract to which a company is treated as a party under subsection (2) is treated for the purposes of this Part as an option, a future or a contract for differences depending on what the character of a separate contract containing the rights and liabilities of the embedded derivative would be.

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- (4) See also section 616 (disapplication of fair value accounting for certain embedded derivatives).

Other contracts etc treated as derivative contracts

587 Contract relating to holding in OEIC, unit trust or offshore fund

- (1) This section applies in relation to a relevant contract to which a company is a party in an accounting period if—
- (a) it is not a derivative contract for the purposes of this Part but for this section, and
 - (b) its underlying subject matter consists wholly or partly of a relevant holding in that period.
- (2) This Part has effect—
- (a) for that accounting period, and
 - (b) for any succeeding accounting period in which the relevant contract is a relevant contract of the company,
- as if the relevant contract were a derivative contract.
- (3) For the purposes of this section, the underlying subject matter of a contract consists wholly or partly of a relevant holding in an accounting period if—
- (a) at any time in that period it consists wholly or partly of—
 - (i) any shares in an open-ended investment company,
 - (ii) any rights under a unit trust scheme, or
 - (iii) a material interest in an offshore fund within the meaning of Chapter 3 of Part 6 (see section 489), and
 - (b) there is a time in the period when that company, scheme or fund fails to meet the qualifying investments test.
- (4) In subsection (3) “meeting the qualifying investments test” has the same meaning as in section 493 (the qualifying investments test).
- (5) See section 18(2)(c)(ii) of F(No.2)A 2005 (section 17(3): specific powers) for the power to modify the meaning of “relevant holding” for the purposes of this section by regulations under section 17(3) of that Act (regulations about authorised unit trusts and OEICs).
- (6) For the way in which credits and debits are to be brought into account where this section applies, see section 601 (application of fair value accounting).
- (7) See also—
- (a) section 602 (contract becoming one relating to holding in OEIC, unit trust or offshore fund), and
 - (b) section 660 (company ceasing to be party to contract relating to holding in OEIC, unit trust or offshore fund).

588 Associated transaction treated as derivative contract

- (1) This section is to be read as if it were in Chapter 7 (shares with guaranteed returns etc) of Part 6 (relationships treated as loan relationships etc).

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- (2) See, in particular—
 - section 526(2) (meaning of “non-qualifying share”), and
 - section 532 (meaning of “associated transaction” and “the associated transactions condition”).
- (3) Subsection (4) applies in a case which falls within section 523(1)(b)(ii) (loan relationships: non-qualifying shares) because the share mentioned in section 523(1)(a) is a non-qualifying share as a result of the associated transactions condition being met.
- (4) An associated transaction is treated for the purposes of this Part as a derivative contract or a transaction in respect of a derivative contract if it is not in fact such a contract or transaction.
- (5) For the way in which credits and debits are to be brought into account where subsection (4) applies, see section 603 (application of fair value accounting).

Exclusions from derivative contracts

589 Contracts excluded because of underlying subject matter: general

- (1) A relevant contract is not a derivative contract for the purposes of this Part if its underlying subject matter—
 - (a) consists wholly of excluded property (see subsections (2) to (5)), or
 - (b) is treated as consisting wholly of such property.
- (2) “Excluded property” means—
 - (a) intangible fixed assets,
 - (b) shares in a company other than shares within subsection (3), or
 - (c) rights of a unit holder under a unit trust scheme other than a scheme in relation to which section 490 (holdings in OEICs, unit trusts and offshore funds treated as creditor relationship rights) has effect.
- (3) The shares within this subsection are—
 - (a) shares to which section 524 or 526 (shares subject to outstanding third party obligations and shares which are non-qualifying shares) applies, and
 - (b) shares in an open-ended investment company in relation to which section 490 has effect.
- (4) Subsection (2)(a) applies only in relation to a relevant contract which is an option or future.
- (5) Subsection (2)(b) and (c) apply only in relation to a relevant contract which—
 - (a) meets any of conditions A to E in section 591, and
 - (b) is not designed to produce a return which equates in substance to the return on an investment of money at a commercial rate of interest.
- (6) Section 590 applies for determining whether the underlying subject matter of a relevant contract is to be treated as consisting wholly of excluded property.

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590 Disregard of subordinate or small value underlying subject matter

- (1) This section applies in relation to a relevant contract if its underlying subject matter consists only of—
 - (a) excluded property, and
 - (b) other underlying subject matter which is—
 - (i) subordinate in relation to any of the excluded property, or
 - (ii) of small value in comparison with the value of the underlying subject matter as a whole.
- (2) The underlying subject matter of the contract is treated for the purposes of this Part as if it consisted wholly of excluded property.
- (3) For the purposes of this section, 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 contract.
- (4) In this section “excluded property” has the same meaning as in section 589.

591 Conditions A to E mentioned in section 589(5)

- (1) The following are the conditions mentioned in section 589(5).
- (2) Condition A is that the relevant contract—
 - (a) is a plain vanilla contract entered into or acquired by a company carrying on [F¹long-term business],
 - (b) is an approved derivative for the purposes of Rule 3.2.5 of the Insurance Prudential Sourcebook [F²(within the meaning given by section 139(4) of FA 2012)], and
 - (c) does not meet the condition in section 579(1)(b) (contract which is or forms part of a financial asset or liability for accounting purposes).
- (3) Condition B is that—
 - (a) the relevant contract is entered into or acquired by a company otherwise than for the purposes of a trade carried on by it,
 - (b) there is a hedging relationship between the contract and—
 - (i) an asset of the company which consists of shares or rights of a unit holder under a unit trust scheme, or
 - (ii) any share capital of the company or any liability related to share capital of the company, and
 - (c) the relevant contract is not one to which the company is treated as a party under section 585(2) (loan relationships with embedded derivatives).
- (4) Condition C is that—
 - (a) the relevant contract is entered into or acquired by a company otherwise than for the purposes of a trade carried on by it, and
 - (b) the relevant contract is an option which is listed on a recognised stock exchange to subscribe for shares in a company.
- (5) Condition D is that—
 - (a) the relevant contract is entered into or acquired by a company otherwise than in the course of activities forming an integral part of a trade carried on by it,
 - (b) the relevant contract is—

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- (i) an option to acquire shares in a company, or
 - (ii) a future requiring delivery of shares in a company,
 - (c) the relevant contract is not one to which the company is treated as a party under section 585(2), and
 - (d) the shares to be acquired or delivered—
 - (i) constitute a substantial shareholding within the meaning of paragraph 8 of Schedule 7AC to TCGA 1992 (meaning of “substantial shareholding”), or
 - (ii) would do so if acquired or delivered.
- (6) Condition E is that—
 - (a) the company which is a party to the relevant contract has a hedging relationship between—
 - (i) the relevant contract, and
 - (ii) an asset or liability representing a loan relationship which is treated as mentioned in section 585(1) (loan relationships with embedded derivatives), and
 - (b) each relevant contract to which the company is treated as a party under section 585(2) in the case of that loan relationship is a derivative contract to which any of the provisions in subsection (7) applies.
- (7) The provisions mentioned in subsection (6)(b) are—
 - (a) section 645 (creditor relationships: embedded derivatives which are options),
 - (b) section 648 (creditor relationships: embedded derivatives which are exactly tracking contracts for differences),
 - (c) sections 653 to 655 (issuers of securities with embedded derivatives: deemed options), and
 - (d) section 658 (issuers of securities with embedded derivatives: deemed contracts for differences).
- (8) For the cases in which sections 653 to 655 and section 658 apply, see sections 652 and 656 respectively.

Textual Amendments

F1 Words in s. 591(2)(a) substituted (17.7.2012) by Finance Act 2012 (c. 14), Sch. 16 para. 167(2)

F2 Words in s. 591(2)(b) inserted (17.7.2012) by Finance Act 2012 (c. 14), Sch. 16 para. 167(3)

592 Embedded derivatives treated as meeting condition in section 591 etc

- (1) This section applies if for an accounting period—
 - (a) a company is a party to a hybrid derivative which meets the condition in section 579(1)(b) (contract which is or forms part of a financial asset or liability for accounting purposes),
 - (b) the embedded derivative is a relevant contract which meets the condition in section 579(1)(a) (contract treated for accounting purposes as derivative),
 - (c) the underlying subject matter of that contract consists, or is treated as consisting, wholly of—
 - (i) shares in a company, or
 - (ii) rights of a unit holder under a unit trust scheme, and

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- (d) the host contract is or forms part of a financial asset or liability for accounting purposes.
- (2) The embedded derivative is treated—
 - (a) for the purposes of section 589 (contracts excluded because of underlying subject matter: general) as meeting one of the conditions in section 591, and
 - (b) as a chargeable asset.
- (3) The host contract is treated for the purposes of the Corporation Tax Acts as if it were a creditor relationship of the company (see Part 5 (loan relationships)).
- (4) Section 590 (disregard of subordinate or small value underlying subject matter) applies for the purpose of determining whether the underlying subject matter is to be treated as consisting wholly of property mentioned in subsection (1)(c) as that section so applies in relation to excluded property.
- (5) In this section—
 - “the embedded derivative” means the relevant contract to which the company is treated as a party under section 584(2)(a) because of the hybrid derivative mentioned in subsection (1)(a), and
 - “the host contract” means the relevant contract to which the company is treated as a party under section 584(2)(b) because of that hybrid derivative.

593 Contracts where part of underlying subject matter is excluded property

- (1) This section applies to a relevant contract of a company—
 - (a) which is an option or future,
 - (b) which meets any of the accounting conditions in section 579(1), and
 - (c) whose underlying subject matter consists of—
 - (i) excluded property, and
 - (ii) other underlying subject matter.
- (2) A relevant contract to which this section applies is treated for the purposes of the Corporation Tax Acts as if it were the following two contracts—
 - (a) a relevant contract whose underlying subject matter consists of the excluded property, and
 - (b) a relevant contract whose underlying subject matter consists of the other underlying subject matter.
- (3) For the purposes of giving effect to subsection (2), all such apportionments as are just and reasonable are to be made.
- (4) This section does not apply to a relevant contract if it is determined in accordance with section 590 (disregard of subordinate or small value underlying subject matter) that the underlying subject matter of the relevant contract is to be treated as consisting wholly of excluded property.
- (5) In this section “excluded property” has the same meaning as in section 589 (contracts excluded because of underlying subject matter: general).

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