EXPLANATORY MEMORANDUM TO

THE LOAN RELATIONSHIPS AND DERIVATIVE CONTRACTS (CHANGE OF ACCOUNTING PRACTICE) (AMENDMENT) (No. 2) REGULATIONS 2007

2007 No. 3432

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

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

2. Description

2.1 This instrument contains regulations relating to the taxation of banks and building societies. It amends certain provisions of The Loan Relationships and Derivative Contracts (Change of Accounting Practice) Regulations 2004 (S.I. 2004/3271) ("the Loan Relationship Regulations") on the taxation of accounting adjustments relating to bank and building society dormant deposit accounts.

2.2 The Regulations have effect for periods of account beginning on or after 1 January 2008.

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

None.

4. Legislative Background

The power to make the regulations is in section 85B(3) and (5) of, and paragraph 19B of Schedule 9 to, the Finance Act 1996. These provisions allow certain profits and losses from loan relationships to be left out of account, to be brought into account in a different way or to be brought into account at a later date..

5. Extent

This 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 The EU required all listed companies to prepare their consolidated financial statements in accordance with International Accounting Standards ("IAS") with effect from 1 January 2005.

7.2 The Department of Trade and Industry laid Regulations (S.I. 2004/2947) amending the 1985 Companies Act which gave groups the choice of preparing their individual company accounts under IAS from this date.

7.3 As the taxation of financial transactions normally follows the accounting and transition to IAS was expected to throw up a lot of accounting adjustments, the move to IAS had the potential to have significant adverse tax impacts for business and Government.

7.4 Therefore the Loan Relationship Regulations were introduced to defer the taxation of financial transaction accounting adjustments arising in 2005 on transition to IAS until 2006. This deferral of the tax effect of the adjustments until reliable figures were known gave the Government time to consider what, if anything, should be done about the transitional adjustments.

7.5 The Loan Relationship Regulations were amended in 2005 by the Loan Relationships and Derivative Contracts (Change of Accounting Practice) (Amendment) Regulations 2005 (S.I 2005/3383), so that most transitional adjustments were brought into account for tax on a spreading basis over 10 years beginning with the first period of account of the company on or after 1st January 2006. However the adjustments relating to dormant bank and building society accounts were deferred until the first period of account beginning on or after 1 January 2007 and subsequently deferred until the first period of account beginning on or after 1 January 2008 by the Loan Relationships and Derivative Contracts (Change of Accounting Practice) (Amendment) Regulations 2006 (S.I. 2006/3238).

7.6 The dormant account adjustments arise from the fact that old UKGAAP accounting standard FRS5 allowed banks and building societies to remove liabilities from their balance sheets where it was considered that there was no reasonable prospect of the customer reclaiming his money. Where the institutions did this the balances of these dormant accounts were credited to their income for the period. IAS required the institutions to bring these liabilities back on to the balance sheet resulting in adjustments to reverse the previous credits to income.

7.7 The reason for deferring the treatment of the dormant account adjustments was to allow HMRC time to undertake research to establish the quantum of these adjustments and how they had previously been taxed.

7.8 These regulations now amend the Loan Relationship Regulations as follows:

i) Subject to (ii), dormant account adjustments will be spread over the same 10 year period as the other transitional adjustments, save that where a company has moved over to IAS in a period of account period beginning on or before 1 January 2008, any adjustments that would otherwise have been made at that earlier date are brought into account in the first period of account beginning on or after 1 January 2008..

ii) The transitional adjustment that is to be brought into account on the spreading basis will be that proportion of the dormant account adjustments that represent amounts previously subject to tax.

8. Impact

A Regulatory Impact Assessment has not been prepared for this instrument as it has no impact on charities or voluntary bodies and no significant impact on businesses as there are no compliance costs and no administrative burden costs.

9. Contact

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