EXPLANATORY MEMORANDUM TO

THE LOAN RELATIONSHIPS AND DERIVATIVE CONTRACTS (DISREGARD AND BRINGING INTO ACCOUNT OF PROFITS AND LOSSES) (AMENDMENT) REGULATIONS 2011

2011 No. 698

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

2. Purpose of the instrument

2.1 The Loan Relationships and Derivative Contracts (Disregard and Bringing into Account) Regulations 2004 ('the Disregard Regulations') were introduced to address accounting changes arising from the introduction of International Accounting Standards ('IAS') that would have rendered previously tax neutral hedging transactions ineffective for tax purposes. The Disregard Regulations ensure that certain transactions can be undertaken in a tax neutral manner.

2.2 The purpose of these amending Regulations is to address a situation which is not covered by the current regulations.

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

3.1 None

4. Legislative Context

4.1 Section 307 of the Corporation Tax Act 2009 ('CTA 2009') provides that a company brings into account for tax purposes loan relationship debits and credits by reference to amounts recognised for accounting purposes. Section 595 CTA 2009 provides that a company brings into account for tax purposes derivative contract credits and debits by reference to amounts recognised in the company's accounts.

4.2 Section 328 CTA 2009 provides that references to a company's profits and losses on its loan relationships includes a reference to the foreign exchange gains and losses arising on those loan relationships. Section 606 CTA 2009 provides that references to a company's profits or losses on its derivative contracts includes a reference to the foreign exchange gains and losses arising on those derivative contracts.

4.3 The Disregard Regulations were introduced to address problems that arose when companies adopted IAS. Without the Disregard Regulations previously tax neutral exchange gains and losses arising from a company's loan relationships and derivative contracts which act as economic hedges for the company's assets and liabilities would have been brought into account for tax purposes.

4.4 The Disregard Regulations only apply to specific types of transaction, sections 328(4) and (5), 598(1) and 606(4) and (5) of CTA 2009 enable regulations to be made to alter the way in which exchange gains and losses are brought into account for tax purposes.

5. Territorial Extent and Application

5.1 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

- **What is being done and why**

7.1 The policy underlying the Disregard Regulations is to allow companies to be taxed in a way that reflects the economic position of companies which use loan relationships and derivative contracts to hedge their foreign exchange exposure in relation to their foreign currency assets and liabilities rather than by reference to their accounts. The Disregard Regulations do this by disregarding for tax purposes foreign exchange gains and losses which arise in certain circumstances.

7.2 These Regulations alter the way in which companies bring into account their exchange gains and losses in the following case. Where a company has elected to match the underlying net asset value of an asset the company is only able to determine the value for matching purposes at the start of a review period. The amendments provide that where there is a 10% increase or decrease in the net asset value a new review period will start. This allows the company to make immediate adjustments to the value of the asset which is matched to reflect the economic reality.

8. Consultation outcome

8.1 A working group consisting of representatives from corporate groups and their advisors has been consulted by HMRC on the Disregard Regulations.

8.2 The Regulations were well received.

9. Guidance

9.1 HMRC will publish guidance on the operation of the Regulations.

10. Impact

10.1 An Impact Assessment has not been prepared for this instrument as it has negligible impact on business, charities or voluntary bodies.

11. Regulating small business

11.1 The legislation does not apply to small business.

12. Monitoring & review

12.1 HMRC intends to monitor the legislation for instances of mismatch between the accounting treatment and the economic purpose of hedging transactions and make further regulations if necessary. HMRC will review these Regulations in 2013 to determine whether they operate as intended.

13. Contact

Fiona Hay at HMRC Tel: 020 7147 2543 or email: fiona.hay@hmrc.gsi.gov.uk can answer any queries regarding the instrument.