EXPLANATORY MEMORANDUM TO

THE EXCHANGE GAINS AND LOSSES (BRINGING INTO ACCOUNT GAINS OR LOSSES) (AMENDMENT) REGULATIONS 2013

2013 No. 1843

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

2. Purpose of the instrument

2.1 These Regulations amend the Exchange Gains and Losses (Bringing into Account Gains or Losses) Regulations 2002 (S.I. 2002/1970, "the principal Regulations"). The principal Regulations provide for exchange gains or losses on loans or derivatives which hedge foreign exchange risk from a company's investment in a foreign enterprise, and which have previously been disregarded for corporation tax purposes, to be brought back into account in specified circumstances.

2.2 These Regulations amend regulation 5 and regulation 8 of the principal Regulations to deal with the situation where there is a change in functional currency or designated currency. This more closely aligns the principal Regulations with the approach taken in section 9C of Corporation Tax Act 2010 (CTA 2010) in the context of the currency used for the tax calculation of chargeable gains and losses. Section 9C CTA 2010 was introduced by section 66 of Finance Act 2013 (FA 2013).

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

3.1 None.

4. Legislative Context

4.1 Section 9C CTA 2010 introduced by section [66] of FA 2013 makes provision in relation to the currency used for the tax calculation of chargeable gains and losses. These Regulations amend the principal Regulations to make equivalent provision in relation to loans and derivatives used as hedges.

4.2 The principal Regulations operate to ensure that exchange gains or losses on loans or derivatives, which hedge certain assets and which have previously been excluded from tax, are brought into account at a time and in a manner consistent with the tax treatment of the hedged asset. In broad terms, this means that exchange gains or losses arising on the hedging instrument that have been disregarded are brought back into account when there is a disposal of the hedged asset (other than a no gain/no loss disposal).

4.3 If the asset consists of shares, so that exchange rate movements will be reflected in the overall chargeable gain or allowable loss accruing on the share disposal, the ‘matched’ gains or losses on the hedging instruments will also be brought back into account as an adjustment in the calculation of the chargeable gain or allowable loss.

4.4 If the asset consists of a loan relationship, or a ship or aircraft, so that profits or losses on disposal are likely to be taxed as income, exchange gains or losses on the hedging instruments are also brought back into account as income.

4.5 If disposal of the matched asset does not give rise to a tax charge, for example because the Substantial Shareholding Exemption (Sch 7AC, TCGA 1992) applies to a disposal of shares, exchange gains or losses on matched loans or derivatives are never brought back into account.

4.6 Regulation 5 of the principal Regulations sets out the basis on which the net gain or net loss to be brought back into account is to be calculated.

4.7 Regulation 8 of the principal Regulations sets out specific rules where the matched asset is disposed of under a ‘no gain / no loss’ provision. In these circumstances the net gain or net loss is only brought into account on the occasion of the first subsequent disposal of the asset which is not a ‘no gain / no loss’ provision.

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 Section 66 of FA 2013 inserted a new provision, section 9C of CTA 2010 which simplifies the calculation of chargeable gains on disposals of ships, aircraft, shares and interests in shares for companies which have, or have had, a functional currency other than sterling and for investment companies which have made a designated currency election.

7.2 Separately, companies may have used liabilities or derivatives (“hedging instruments”) to mitigate the exchange risk arising on a foreign currency asset. The principal Regulations look to align the treatment of the hedging instrument with that of the underlying foreign currency asset.

7.3 Where a company has chosen to hedge their exposure to exchange gains and losses arising on any assets to which section 9C of CTA 2010 applies, and there is a change in the company's functional or designated currency, the statute prescribes a particular mechanism for translating the allowable expenditure on the asset into the new currency. The new provision can also affect the calculation of the base cost where the asset is acquired under a "no gain / no loss" provision. Under the principal Regulations as currently drafted, this could give rise to inappropriate amounts being brought into account for tax purposes in respect of the gains and losses held over on the hedging instrument.

7.4 Amendments are therefore being made to apply to the calculation of the net gain or net loss where section 9C CTA 2010 applies in relation to the matched asset.

7.5 The amendment to regulation 5 of the principal Regulations is to ensure that where there is a change in currency, the aggregate amount is to be retranslated from the previous currency into the new currency based on the spot rate of exchange for the day of the change in currency. This mirrors the approach in section 9C CTA 2010.

7.6 The amendment to regulation 8 of the principal Regulations is to deal with the situation where there is a change in relevant currency following a no gain / no loss transfer. For example where the acquiring company changes currency or the asset is transferred to a company which uses a different currency. In both these circumstances the net gain or net loss to be brought into account on the first relevant disposal is translated into the new currency at the spot rate of exchange for the day of the change in currency or the day of the transfer. Again, this is to ensure that the principal Regulations interact correctly with section 9C CTA 2010.

- ***Consolidation***

7.7 The Government has announced that it will consult on modernising the legislation governing the taxation of loan relationships and derivative contracts. Depending on the outcome of that consultation, consideration will be given to consolidating the principal Regulations.

8. Consultation outcome

8.1 On 3 June 2013 the Government published a technical note including draft Regulations. The Regulations have now been updated to reflect specific points raised by respondents to the technical note. Further drafts of the Regulations have been shared on an informal basis with stakeholders as they have been developed.

9. Guidance

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

10. Impact

10.1 This measure is expected to have a negligible impact on businesses. It applies to certain multinational companies which have, or have had, a functional currency other than sterling, of which, fewer than 500 are affected. There is no impact on charities or voluntary bodies.

10.2 There is no impact on the public sector.

10.3 A Tax Information and Impact Note covering this instrument was published at Budget 2013 on 20 March 2013 and is available on the HMRC website at: www.hmrc.gov.uk/thelibrary/tiins.htm. It remains an accurate summary of the impacts that apply to this instrument.

11. Regulating small business

11.1 The legislation is unlikely to apply to small business as it principally affects companies within multinational groups where there is a change in functional currency of the company.

12. Monitoring & review

12.1 This policy will be monitored through information obtained through clearance applications and enquiries into self-assessments.

13. Contact

Richard Daniel at HMRC Tel: 020 7147 0230 or email: richard.daniel@hmrc.gsi.gov.uk can answer any queries regarding the instrument.