

Modernising the taxation of corporate debt and derivative contracts
Minutes of Working Group 3 meeting on 29 July 2014
100 Parliament Street at 10am

Attendees:

Andrei Belinski (Centrica)
Anne Murphy (L&G / ABI)
Chris Kell (HSBC)
David Boneham (Deloitte / CIOT)
David Hill (Grant Thornton)
David Lindsay (KPMG)
Fiona Thomson (E&Y)
Graham Williams (PwC)
John Lindsay (Linklaters)
Kieran Sweeney (Lloyds Banking Group)
Matthew Hodkin (Norton Rose)
Paul Freeman (KPMG)

Richard Daniel (HMRC)
Roger Muray (HMRC)
Andy Stewardson (HMRC)
Robert Harvey (HMRC)

Apologies:

Charles Yorke (Allen & Overy)
Jackie Latham (Rolls Royce)

1 Introduction

Draft legislation

- 1.1 Updated draft primary and secondary legislation had been circulated ahead of the meeting. The main purpose of the meeting was to discuss this draft legislation.

2 Primary legislation

Overview

- 2.1 The draft primary legislation amended sections 306, 307 and 308 CTA 2009 and introduced new sections 306A and 320A CTA 2009. These changes fell partly within the remit of WG1 and partly within that of WG3; in practice both working groups would be likely to discuss all the changes, albeit with a particular focus on those most relevant to the subject matter of that particular working group.
- 2.2 Section 307 (3) – which set out what specific matters were dealt with under the loan relationship regime – was to be effectively rewritten into the new section 306A;

the general rule in section 307 (2) would be explicitly linked to section 306A. As a consequence of this rewrite the “fairly represents” rule would be dropped. The general rule would therefore be more clearly to follow the accounting treatment, although this would be subject to, in particular, the regime TAAR.

- 2.3 The “taken together” language in section 307 (3) would also be omitted as a result of the rewrite, but current thinking was that this should not have any substantive impact.
- 2.4 Section 307 (3) also contained an explicit reference to “the accounting period in question” which did not feature in the proposed new wording; WG1 had already raised a question as to whether this risked creating uncertainty in the context of long periods of account. HMRC’s initial view was that the reference to “any period” in section 307 (2) CTA 2009, together with the general rule in section 1172 CTA 2010 and Marshall Hus tax case meant that there should be no difficulty here. There was an ongoing discussion as to whether a specific detailed rule within the loan relationship regime would nonetheless be beneficial as adding clarity to the position.
- 2.5 It was noted that the draft legislation showed section 307 (1) as being omitted but that HMRC had not yet concluded on this point.
- 2.6 Not currently impacted by the draft legislation but under consideration by HMRC was section 313 (1) CTA 2009. This set out the general rule that any GAAP-compliant accounting treatment was acceptable for tax purposes, subject to specific statutory override. It was unclear to HMRC whether this provision performed any substantive function or just acted as useful sign posting, and if the latter whether it was in fact useful. It was noted by the non-HMRC participants that the provision could be relevant in the context of deemed loan relationships not appearing in the actual GAAP-compliant accounts, as giving a rule for how these deemed relationships should be taken as being accounted for.
- 2.7 Section 308 CTA 2009 was to be amended to refer only to items recognised in profit or loss, in line with the previously discussed policy decision to move to an approach of simply following profit and loss in most cases. A new subsection 1A was intended to ensure that amounts recycled from OCI would be caught. A concern was raised that amounts only taxed when recycled might lose their original nature; HMRC did not think that this would necessarily be the case but would give further consideration to the point.
- 2.8 A new section 320A CTA 2009 would be introduced to deal with amounts which would never be recycled and so would otherwise escape the charge to tax. In drafting the legislation HMRC had been particularly thinking of cases such as own credit risk where amounts taken to OCI would not be recycled if the debt was redeemed/derecognised early, but section 320A was not limited to a particular list of cases. This was primarily to simplify the drafting and to reduce the likelihood of future amendments to react to further changes in accounting practice.
- 2.9 The changes to section 308 would require a change to the definition of “carrying value” in section 317. Consequential changes would also be needed to the group continuity and exit charge rules to ensure that these operated as intended. The non-HMRC participants were anxious that the position of the transferee under the amended group continuity rules be made clear, as there was some uncertainty in how the transferee should be taxed under the existing proposals.

3 **Non-interest bearing loans**

- 3.1 Potential issues arose in relation to non-interest bearing loans which are not repayable on demand. Following transition the accounting treatment would typically be to discount the loan on initial recognition to its fair value and then amortise the discount over the term of the loan. This would therefore be expected to give rise to a transitional adjustment and an ongoing stream of debits/credits.
- 3.2 HMRC's perception was that this type of instrument was most commonly used in connected party situations. This being so it was HMRC's view that in the majority of cases the change in accounting treatment would be effectively ignored for tax purposes. This was because in a connected party situation the use of amortised cost accounting was mandated for tax purposes and "amortised cost" had a statutory definition rather than simply taking its meaning for accounting purposes. HMRC's view was that the "cost" of a non-interest bearing loan was (broadly) the actual consideration for entering into the loan, rather than the value at which it was initially recognised at for accounting purposes (if different). The transaction price would normally be the fair value of the instrument, but could be different. Where this resulted in a change in the loan's initial carrying value for accounting purposes, the effect of the connected company rules (where they apply) should therefore mean that this is irrelevant for tax purposes.
- 3.3 Several of the non-HMRC participants questioned whether the technical analysis outlined by HMRC accurately reflected the usual treatment adopted by companies with such instruments. It was also noted that this approach appeared to conflict with the treatment generally accepted by HMRC in relation to convertible instruments. HMRC expressed the view that the technical analysis in relation to convertible instruments was different because of the specific statutory provision [s415 CTA 2009] that was designed to respect the accounting bifurcation of such instruments for tax purposes. This meant that a single legal instrument was, for the purposes of the loan relationship rules, treated as two separate instruments. Some doubt was expressed by the non-HMRC participants as to whether this statutory provision was drafted in such a way as to allow this distinction to be drawn.
- 3.4 If HMRC's analysis was accepted, then the transition from 'old' UK GAAP should have no direct tax impact. However, it was noted that this would not be the case with the subsequent move to align the tax and accounting definitions of "amortised cost". HMRC was considering both transitional arrangements for existing loans and whether any special rules were required to deal with such loans after the alignment of the definitions. There was a particular concern in relation to situations where the new accounting treatment would result in a stream of potentially deductible debits in the borrower without a corresponding stream of taxable credits in the lender – for example, where the lender was an individual.

4 **Secondary legislation**

Overview

- 4.1 Updated drafts of the secondary legislation discussed in the previous meeting had been circulated and it was proposed to release these for public consultation in the near future. If participants wished to provide any further detailed points ahead of the consultation these should be sent across as soon as possible, otherwise comments could of course be provided as part of the consultation process.

4.2 A brief query was raised as to whether the fact that Regulation 9 was capable of applying to part of a contract meant that the new Regulation 6 should similarly be construed as capable of applying to part of a contract. The initial view was that the position would be governed by the interpretation provisions in Regulation 2, but this would be considered further.

5 **AOB**

5.1 It was noted that HMRC was still working on the issues previously discussed in relation to (a) foreign exchange, and (b) the future treatment of equity instruments other than regulatory capital securities.