Explanatory Note

Clause 24: Loan relationships and derivative contracts: transfer-pricing rules

Summary

1. This measure ensures that companies are not taxed under the corporate debt or derivative contract rules on credits arising where debits, previously denied for tax under the transfer pricing rules, later reverse. The measure has effect from 1 April 2016.

Details of the clause

2. Subsection 1 amends section 446 of Corporation Tax Act (CTA) 2009, which governs how amounts under a loan relationship are to be brought into account as a result of adjustments made under Part 4 of Taxation (International and Other Provisions) Act 2010. It inserts a new subsection (8) which excludes amounts from being taxed to the extent that they represent a reversal of, or otherwise correspond with, an amount for which a corporation tax deduction was previously restricted under this section as a result of the application of the transfer pricing provisions.
3. Subsection 2 makes an equivalent amendment to section 693 CTA 2009, which governs how amounts under a derivative contract are to be brought into account as a result of adjustments made under Part 4 of Taxation (International and Other Provisions) Act 2010.
4. Subsection 3 explains that these changes have effect for accounting periods beginning on or after 1 April 2016.
5. Subsection 4 provides that where an accounting period straddles 1 April 2016, it is treated as two separate accounting periods for this purpose only. In this case the changes have effect for the accounting period that is treated as beginning on 1 April 2016.

Background note

6. At Budget 2013, the government announced consultation on a package of proposals to modernise the CT rules governing the taxation of corporate debt and derivative contracts. The main changes made as a result of the consultation are contained in Schedule 7 to Finance (No.2) Act 2015.
7. Typically amounts of profits and losses arising from loan relationships and derivative contracts are brought into account for corporation tax in line with the company's accounts. However, the transfer pricing rules apply where the loan or derivative is not on arm's length terms and there is a potential tax advantage. In such a case, the profits and losses are to be

calculated as if the loan or derivative had been on arm's length terms.

8. As a result of recent changes to UK accounting standards, there are now more occasions where companies can be required to recognise amounts in their financial statements which subsequently reverse. Where the transfer pricing rules apply, this can result in a restriction of corporation tax deductions for the amounts of debits, while the corresponding credits on reversal in subsequent periods could remain taxable.

9. This measure prevents that unintended outcome by ensuring that credits are not taxed to the extent that debits have been restricted under sections 446 or 693 as a result of the application of the transfer pricing provisions.

10. If you have any questions about this change, or comments on the legislation, please contact Richard Daniel on 03000 569 408 (email: richard.daniel@hmrc.gsi.gov.uk).