Modernising the taxation of corporate debt and derivative contracts
Minutes of Working Group 3 meeting on 16 September 2014
100 Parliament Street at 2pm

Attendees:

Andrei Belinski (Centrica)
Anne Murphy (L&G / ABI)
Chris Kell (HSBC)
Charles Yorke (Allen & Overy)
David Hill (Grant Thornton)
Paul Freeman (KPMG)
David Boneham (Deloitte / CIOT)
Richard Daniel (HMRC)
Andrew Gribble (HMRC)
Roger Muray (HMRC)
Steve Arnold (HMRC)
Andy Stewardson (HMRC)
Robert Harvey (HMRC)

1 Introduction

1.1 There were two substantive items on the agenda which had been circulated ahead of the meeting: draft legislation for inclusion in Finance Bill 2015 and an update on HMRC's current thinking on forex matters. Prior to discussing these, however, HMRC wanted to provide a brief update on the position in relation to IFRS 9.

2 IFRS 9

Working groups and taxpayer representations

2.1 HMRC noted that the final standard on IFRS 9 had now been published by the IASB. Although a dedicated working group had previously existed to look at IAS 39, HMRC had taken view that it was not appropriate to have additional meetings of this group at the current time given the current role of WG3 in considering the impact of GAAP changes more widely. HMRC was therefore happy for WG3 to be used as a forum for discussion of issues relating to IFRS 9, in addition to receiving representations either directly or via CRMs.

Impact of IFRS 9

2.2 HMRC's initial view was that most aspects of IFRS 9 should not require any consequent changes to the tax rules. For example, the hedging model did not involve any fundamental change in mechanics. HMRC was keen to hear if there were any differing views on this.

2.3 The aspect of IFRS 9 that was seen as a potential issue by HMRC – particularly in relation to the financial sector – was the adoption of the new impairment model, generally expected to give rise to significant transitional adjustments for accounting

purposes. HMRC was going through an exercise to quantify the likely scale of these transitional amounts and the results of this exercise would be a key driver in determining the policy advice to be given to ministers.

Possible approaches to taxing transitional adjustments

2.4 The fact that the quantification exercise was ongoing meant that HMRC was not in a position to give a formal view on what the eventual policy approach was likely to be. This would necessarily involve balancing various considerations, including the cost to the Exchequer, legislative complexity and the competitiveness of the UK tax regime. Conceptually, however, HMRC saw there as being broadly three possible approaches:

- To continue with the treatment under the existing legislation governing transitional adjustments (SI 2004/3271) – i.e. to broadly spread the transitional debit over ten years for tax purposes, other than to the extent this related to loans due to be discharged in the accounting period the transitional debit arose.
- To adopt a simplified form of the existing treatment whereby the whole of the transitional debit would automatically be spread over ten years.
- To move away from automatically following the accounting rules as a measure of credit losses for tax purposes (i.e. to move back to an approach closer to that existing pre-2005).

2.5 The non-HMRC participants in the working group expressed some reservations about the third of these options. It was felt that this would be a retrograde step in the context of the stated policy objectives of closer alignment with the accounts and reducing computational complexity. Moreover the recognition of the credit losses for accounting purposes gave a *prima facie* argument that the companies concerned had incurred these losses; any deferral or disallowance of these losses therefore required clear justification. Against this HMRC noted that it was its understanding that IFRS 9 effectively required the anticipation of losses and that this cast doubt on the appropriateness of simply bringing such losses into account for tax purposes in line with the accounting treatment.

2.6 HMRC reiterated that it would only be when the exercise to quantify the likely transitional debits had been completed that it would be in a position to properly develop its thinking around these three options. This quantification exercise had been delayed because affected institutions had themselves delayed their detailed impact assessments pending the release of the final version of IFRS 9, but this was now moving forward.

3 Draft primary legislation

3.1 The draft legislation had been circulated in advance of the meeting. Members of the working group were welcome to send any detailed comments/drafting points directly to HMRC (some comments had already been received). Accordingly it was not proposed to go through the draft legislation line-by-line in the meeting, but rather to focus on any particular questions which members of the working group had at this stage.

3.2 Questions raised included:

a) Would the draft legislation definitely be included in the FB 2015?

   HMRC was working on the basis that it would be, although it was not possible to be certain (including as to which Finance Bill in 2015 the draft legislation would be included in).

b) Did the proposed statutory definition of “fair value accounting” (which broadly equated to fair value through profit and loss) have the potential to cause confusion, as this was more restrictive than the usual meaning of that term?

   HMRC accepted the basic point, but did not regard it as a significant issue, noting that the term “fair value accounting” was used comparatively infrequently in the legislation.

c) Was it correct that in the proposed changes to s. 313 CTA 2009 the definition of “fair value accounting” was to apply for the purposes of the Part but that of “amortised cost” only for the section?

   Although this appeared slightly strange it was HMRC’s understanding that it was technically correct as the phrase “amortised cost” was in fact only used in s. 313 CTA 2009. ‘Fair value’ is used more widely – for example, in sections 333 and 345.

d) If the change of basis was because of the application of s. 349 CTA 2009 (application of amortised cost basis to connected companies relationships) did this result in ten-year spreading of the transitional adjustment?

   A change of basis in this situation should fall within the scope of s. 316 CTA 2009, but HMRC had not yet determined whether it should then also automatically fall into the COAP spreading rules. The current approach under sections 350 / 351 is that the amount is brought into account in full in the ‘later’ period.

e) What was the treatment of any change of basis resulting from the alignment of the statutory definition of amortised cost with the accounting definition?

   HMRC had in a previous meeting explained its view that the alignment of the definitions of amortised costs should result in a change of basis; the intention was for this to be explicitly excluded from s. 316 CTA 2009 and the treatment on transition instead be specified in the amending legislation.

f) Was there a risk of double taxation on recycling being dealt with where on transition items moved from being fair value through profit and loss to being fair value through OCI?

   HMRC confirmed that this was a known issue and was being addressed. Amounts would only be relieved / taxed once.

g) Had HMRC given any thought as to whether s. 128 CTA 2009 was consistent with the policy change with the regard to loan relationships of (in most cases) only taxing amounts recognised in profit and loss?

HMRC was thinking about this as it made sense to take a consistent approach, although it was noted that the amounts at stake under s. 128 were comparatively small.

4 **Forex**

4.1 HMRC had circulated a paper ahead of the meeting. This summarised a potential approach (broadly to replace the forex elements of the EGLBAGL and Disregard regulations) and identified some perceived problem areas (for example, reverse matching in partnerships) which HMRC would like to address as part of that approach.

4.2 HMRC was not proposing to discuss this in detail, but was hoping to get initial views on whether change in these areas and the suggested approach would be welcome. The general view of the non-HMRC participants was that *prima facie* the approach seemed sensible, that clarification of the difficult areas highlighted would be welcome, and that it would therefore be worthwhile exploring the proposals further.