HM Revenue
& Customs

Corporation tax: modernising the taxation of corporate debt and derivative contracts

Who is likely to be affected?

This measure affects companies subject to corporation tax, which issue or hold debt or which are party to derivative contracts.

General description of the measure

This measure updates the rules governing the taxation of corporate debt (known as loan relationships) and derivative contracts. It makes a series of changes to update the computation of profits and losses on these instruments and the detailed rules by which they are taxed.

Policy objective

This measure updates the rules to take account of developments in accounting and in business practice since their original introduction in 2006. It supports the Government's policy of simplifying taxation by addressing difficulties which have arisen in the application of the regime. It makes the rules more certain and easier to comply with by clarifying the structure and detailed rules, and makes the regime fairer by providing more robust protection against tax avoidance.

Background to the measure

At Budget 2013, the Government announced consultation on a package of proposals to modernise the corporation tax rules governing the taxation of corporate debt and derivative contracts, with a view to including the bulk of the resulting legislation in Finance Bill 2015.

A consultation document *Modernising the taxation of corporate debt and derivative contracts* was published on 6 June 2013, and the Government's response was published on 10 December 2013.

A Technical Note, setting out the framework of the changes and the Government's priorities in the light of consultation, was published on 8 April 2014.

Detailed proposal

Operative date

The changes made by this measure will have effect in respect of companies' accounting periods commencing on or after 1 January 2016, with two exceptions:

- A new provision which relieves credits which arise when debts of companies in financial distress are released, or the terms modified, will apply to releases and modifications on or after 1 January 2015.
- The new regime anti-avoidance rules will apply, where the conditions are met, in respect of arrangements entered into on or after 1 April 2015.

Current law

The current legislation is in Parts 5 and 7 of the Corporation Tax Act (CTA) 2009, dealing with loan relationships and derivative contracts respectively. Part 6 deals with matters which, while not within the definition of loan relationships, are brought within the Part 5 rules.

The Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) Regulations 2004 (SI 2004/3256) (known as the 'Disregard Regulations') provide detailed rules concerning the tax treatment of hedging relationships. The Loan Relationships and Derivative Contracts (Change of Accounting Practice) Regulations 2004 (SI 2004 / 3271) provide rules concerning changes in accounting practice.

Proposed revisions

Legislation will be introduced in Finance Bill 2015. The main changes are:

The relationship between accountancy and tax will be clarified and strengthened. In particular, sections 307 and 595 CTA 2009 will be amended to remove the requirement that amounts brought into account for tax must 'fairly represent' the profits, gains and losses arising.

Sections 308 and 597 will be amended to bring the calculation of taxable amounts in line with the usual approach to the computation of profits, for both commercial and tax purposes. Taxation will be based only on amounts recognised as items of accounting profit or loss, rather than on amounts recognised anywhere in accounts – in reserves or equity, for example. A transitional rule will ensure that this change is broadly tax neutral.

Section 322 will be amended and a new section 323A introduced to exclude taxable amounts which would otherwise arise where arrangements are made to restructure the debts of a company in financial distress with a view to ensuring its continued solvency. This will cover situations where debt is released, or where the terms are modified, supplementing and extending the existing rule which exempts credits arising in debtor companies when creditors exchange debt investment for an equity stake.

A new regime-wide anti-avoidance rule will be introduced into each of Parts 5 and 7, which will counter arrangements entered into with a main purpose of obtaining a tax advantage by way of the loan relationships or derivative contracts rules. As a consequence, a number of existing specific anti-avoidance rules will be repealed.

Further changes to Parts 5 and 7 will be made by way of secondary legislation in 2015, in particular to update the rules on forex hedging, convertible instruments and property-based derivatives.

Amendments will be made to secondary legislation by the end of 2014 to facilitate the transition to new accounting standards which many companies will make in 2015. This will permit companies to elect into, rather than out of, the Disregard Regulations; exclude certain transitional adjustments in respect of distressed debt; and preserve the foreign exchange treatment for 'permanent as equity' debt. More information on these accounting changes can be found at *www.hmrc.gov.uk/accounting-standards*.

Summary of impacts

Exchequer impact (£m)	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
	-	-	negligible	negligible	negligible	negligible
	This measure is expected to have a negligible impact on the Exchequer.					
Economic impact	The measure is not expected to have any significant economic impacts.					
Impact on individuals, households and families	No impact on individuals or households has been identified. The measure is concerned with corporate taxpayers only. The measure is not expected to impact on family formation, stability or breakdown.					
Equalities impacts	No impact on equalities has been identified.					
Impact on business including civil society organisations	This measure is expected to have a negligible one off familiarisation impact on businesses overall. It will affect mainly large companies and that impact is expected to be negligible. The measure is expected to reduce ongoing costs due to simplification of the legislation. No impact on civil society organisations is anticipated.					
Operational impact	Revised legislation should be easier for HM Revenue & Customs to operate and reduce resource needed to combat attempted avoidance.					
Other impacts	Small and micro business assessment: the interaction of small companies with the loan relationships and derivative contracts regimes is generally straightforward, and no material impact on them is anticipated. Other impacts have been considered and none have been identified.					

Monitoring and evaluation

The impact and operation of this measure will be continuously monitored by way of information collected from companies' tax returns and regular contacts with businesses and other stakeholders.

Further advice

If you have any questions about this change, please contact Andy Stewardson on 03000 586085 (email: andy.stewardson@hmrc.gsi.gov.uk).