EXPLANATORY MEMORANDUM TO

THE LOAN RELATIONSHIPS AND DERIVATIVE CONTRACTS (CHANGE OF ACCOUNTING PRACTICE) (AMENDMENT) REGULATIONS 2015

[Year] No. [XXXX]

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.

This memorandum contains information for the Select Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 These Regulations amend the Loan Relationships and Derivative Contracts (Change of Accounting Practice) Regulations 2004 (S.I 2004 / 3271) – the 'COAP Regulations' – the purpose of which is to provide specific tax treatment for loan relationship and derivative contracts on a change of accounting policy.

2.2 These Regulations amend the COAP Regulations relating to accountancy changes that become mandatory for many companies for periods from 1 January 2018. In particular, they make provision relating to transitional adjustments specifically arising on first adoption of International Financial Reporting Standard 9 (IFRS 9) in respect of credit losses.

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

3.1 These Regulations have effect in relation to periods of account beginning on or after 1 January 2015 (following the announcement of these changes at Autumn Statement 2014). This is because in certain cases early adoption of IFRS 9 is permissible.

3.2 Authority for the limited retrospective effect of these Regulations can be found at section 319(5) and Section 598(6) of the Corporation Tax Act 2009 for loan relationships and derivative contracts respectively.

4. Legislative Context

4.1 The Regulations are made by the Treasury under powers conferred by section 319 of the Corporation Tax Act 2009 in relation to loan relationships, and section 598 of the same Act in relation to derivative contracts.

4.2 The COAP Regulations provide detailed rules that were introduced in 2004 following the introduction of International Accounting Standards. They provide specific treatment to alter the amounts brought into account in respect of a change of accounting policy. In particular, they can provide for certain amounts to be spread over ten years and for other specified amounts not to be brought into account at all.

5. Territorial Extent and Application

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 A new accounting standard (IFRS 9) for financial instruments was published by the International Accounting Standards Board in July 2014 and will be mandatory for certain companies from 2018. Early adoption is permitted, although the standard needs to be approved by the EU before it can be applied under EU-endorsed IFRS or Financial Reporting Standard 101.

7.2 IFRS 9 will change the way in which a company recognises ‘credit losses’ (also referred to as bad debts or impairment provisions). The new standard will require companies which apply International Accounting Standards or Financial Reporting Standard 101 to make credit loss allowances on a more forward looking basis from 2018. This is referred to as the ‘expected loss’ model, whereas its predecessor (IAS 39) used an ‘incurred loss’ model.

7.3 IFRS 9 will result in an increase of credit loss allowances in the companies affected. These higher allowances will effectively bring forward tax relief, therefore reducing corporation tax receipts following the adoption of the new accounting standard.

7.4 The COAP Regulations generally prescribe that amounts arising from loans and derivatives on transition to a new accounting policy are not brought into account immediately but rather spread over a 10 year period. However this requirement to spread any transitional adjustment over a period of 10 years does not apply where the debt falls to be repaid in the current accounting period (normally 12 months).

7.5 At Autumn Statement 2014 the Government announced a measure to spread the transitional adjustment arising on adoption of IFRS 9 relating to credit losses over a 10 year period regardless of when the debt falls to be repaid. This is to protect the Exchequer from a sudden reduction in corporation tax receipts as a result of the change. The COAP Regulations are therefore being amended to give effect to this.

7.6 The amendment will have effect in any case where the company adopts the recognition and measurement requirements of IFRS 9, whether this is for accounts prepared under International Accounting Standards, under Financial Reporting Standard 101 or under Financial Reporting Standard 102 (as permitted under Sections 11 and 12 of that standard).

7.7 The measure will have effect for periods of account commencing on or after 1 January 2015.

- Consolidation

7.8 The Government is continuing to consult on modernising the legislation governing the taxation of loan relationships and derivative contracts. Following the outcome of that consultation, consideration will be given to consolidating the principal Regulations.

8. Consultation outcome

Consultation ends on the 22 May 2015.

9. Guidance

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

10. Impact

10.1 This measure looks to ease the impact of accountancy changes that become mandatory for certain companies from 1 January 2018. As this measure only applies to entities within the scope of corporation tax it will not have any impact on charities or voluntary bodies.

10.2 There is negligible impact on the public sector.

10.3 A Tax Information and Impact Note (TIIN) covering this instrument will be published on the GOV.UK website at:
www.gov.uk/government/collections/tax-information-and-impact-notes-tiins

11. Regulating small business

The legislation is unlikely to apply to small business as the accountancy changes principally affects groups with listed debt or equity. There will be further consideration of the impact on small business after the consultation period.

12. Monitoring & review

This policy will be monitored through information obtained through collaborative engagement with customers and enquiries into self-assessments.

13. Contact

Richard Daniel at HMRC Tel: 03000 569 408 or email: richard.daniel@hmrc.gsi.gov.uk can answer any queries regarding the instrument.