

Explanatory Note

Clause 25: Loan relationships and derivative contracts: exchange gains and losses

Summary

1. This measure amends provisions dealing with companies' exchange gains and losses from loan relationships or derivative contracts that are not at arm's length. It limits the amounts excluded from taxation by those provisions in cases where a loan or derivative is part of a hedging relationship intended to mitigate foreign currency risk. The measure has effect from 1 April 2016.

Details of the clause

2. Subsection 2 inserts new subsection 447(4A) into the Corporation Tax Act (CTA) 2009, concerned with debtor relationships not at arm's length. This limits the application of section 447 where the loan is matched. As a result, the amount of exchange gain or loss excluded by the section cannot exceed the exchange gain or loss arising on the unmatched element of the loan. This ensures that section 447 does not exclude any exchange gain or loss arising on the matched element of the loan.
3. Subsection 3 makes a corresponding amendment to section 448, concerned with debtor relationships that are 'equity notes' under section 1015(6) CTA 2010.
4. Subsection 4 and 5 make corresponding amendments to each of sections 449 and 451, concerned with creditor relationships not at arm's length.
5. Subsection 6 introduces new section 475B which sets out the circumstances in which a loan relationship is considered to be matched. A loan is matched to the extent to which either (i) the loan is in a matching relationship with another loan or derivative, or (ii) the exchange gains and losses on the loan are disregarded under regulations made under section 328(4) CTA 2009.
6. Subsection 7 and 8 make corresponding amendments to section 694 CTA 2009 in respect of derivative contracts not at arm's length.
7. Subsection 9 explains that the changes have effect for accounting periods beginning, on or after 1 April 2016.
8. Subsection 10 provides that where an accounting period straddles 1 April 2016, it is treated, for this purpose only, as two separate accounting periods. In this case section 446A has effect for the accounting period that is treated as beginning on 1 April 2016.

Background note

9. 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. The main changes made as a result of the consultation are contained in Schedule 7 to Finance (No.2) Act 2015.
10. Sections 447, 449, 451 and 694 CTA 2009 operate to restrict amounts of exchange gains and losses brought into account for corporation tax on loans and derivatives in cases where the loan or derivative are not at arm's length. Section 448 operates in a similar way where the loan is as 'equity note' under section 1015(6) Corporation Tax Act 2010.
11. A particular concern has been identified with those provisions, as a result of which they can introduce a foreign currency exposure for corporation tax purposes even though none exists commercially or in the accounts.
12. This measure ensures that those provisions do not apply to the extent to which the loan or derivative in question is matched. Loans and derivatives are in a matching relationship when one is intended by the company to hedge foreign currency risk on the other.
13. In addition, the measure ensures that those provisions do not apply to the extent to which exchange gains and losses are disregarded under 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').
14. 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).