Minutes of WG1 meeting on 15 April 2014

HMRC noted that, following a paper produced last year, that there were a number of areas where there was general agreement on retaining existing regimes, including:

- Hedge accounting;
- Capitalised interest rules; and
- Distributions in specie.

However, further consideration was needed regarding the non-recognition / de-recognition of debits and credits in respect of loan relationships.

Non-recognition / De-recognition

Two scenarios were discussed by the group in relation to de-recognition / non-recognition – those involving avoidance and those which do not.

Avoidance Scenarios

To deal with this scenario, HMRC anticipates that it will either retain the de-recognition regime or rely on the (proposed) new regime TAAR. Which one will be relied upon will be decided at a later date.

Non-avoidance Scenarios

The group discussed two categories – a "one company, two items" category and a "two companies" category.

The "one company, two items" category broadly involves a company being party to a loan relationship as well as to another arrangement such that the overall tax treatment of the arrangements are altered. This category was not discussed at length.

The "two companies" category involves anomalous outcomes arising as a result of differences between determining which company is a party to a loan relationship (a legal-based test) and the recognition of debits and credits in respect of that loan relationship (an accounting-based test). That is, a company who is not legally party to a loan relationship may still recognise debits and credits in respect of the loan. Correspondingly, the company who is legally party to a loan relationship may not recognise any debits and credits in respect of the loan.

The group discussed the example of sub-participation arrangements. These may involve a company who is legally a party to a loan relationship transferring the risks and rewards of that loan relationship to another company without transferring the loan itself.

HMRC's initial view was that in these scenarios it would be preferable to deem the company recognising debits and credits in respect of the loan relationship to be a party to that loan relationship and taxed accordingly. That is, give priority to the accounting test over than the legal test.

The group agreed that this was generally an acceptable outcome for most cases. However, it was noted that uncertainty could arise under this approach, as the company recognising the debits and credits may be required to know that the company legally party to the loan relationship is not recognising any debits and credits.

HMRC was of the view that, typically, this scenario would arise in the context of a group transaction and therefore would not ordinarily present an issue. Moreover, the rule could require the company to assume that the company legally party to the loan relationship applies UK GAAP / IFRS and, if under those accounting standards it would not be required to bring any debits or credits into account, then that would satisfy the test. The group discussed an alternative that would simply deem a company to be a party to a loan relationship where it recognises debits and credits in respect of it, regardless of how any other company treats the loan relationship. The group noted the possibility of double taxation in that scenario, though questioned whether it was a real risk. .

More complex cases were discussed. For example, an SPV which has a loan relationship and no other assets. The parent company may recognise debits and credits in respect of the loan relationship as a result of its equity interest in the SPV even the shares are ordinary shares. This scenario may arise where the parent company transfers the loan to a subsidiary in return for shares without satisfying the derecognition criteria for the loan in IAS39 . In this case, however, it appeared more straightforward to tax the SPV in relation to the loan relationship (i.e. taxing the entity that is the 'closest' to the loan relationship). Deeming the parent to be a party to the loan relationship may instead give rise to taxable gains/losses in the parent company.

HMRC accepted that taxing gains and losses in this way is not the intention of the proposed rule, and therefore suggested that a separate rule/carve-out may be needed for specific scenarios such as these.

Transparent entities that are not partnerships

The group briefly discussed a proposal to treat all transparent entities as partnerships under the partnership deeming rules.

This requires a different rule to the non-recognition / de-recognition scenarios above, as there may be no mismatch between the accounting and legal recognition of a loan relationship rule for a transparent entity. Instead, there is simply an anomalous treatment of the transparent entity for tax purposes.

The group discussed the potential difficulty in precisely defining a transparent entity, but agreed that this proposal was generally an acceptable starting point.