HM Revenue
& Customs

Taxation impacts arising from the withdrawal of LIBOR

Consultation Document

Publication date: 19 March 2020
Closing date for comments: 28 May 2020

Subject of this consultation:	This consultation looks at the tax impacts that may arise from the expected withdrawal of LIBOR.
Scope of this consultation:	HMRC has identified a number of statutory references to LIBOR that need amending as a result of the withdrawal of LIBOR, and is seeking views on how this should be done. In addition, the consultation aims to ensure HMRC fully understands the significant tax impacts that could arise from the reform of LIBOR and other benchmark rates. This will inform HMRC about any further response required, in addition to the legislative changes needed to address explicit references to LIBOR.
Who should read this:	Companies with loans, derivatives or other instruments which refer to LIBOR, representative bodies, tax professionals, accountants, relevant regulatory bodies and accounting bodies.
Duration:	19 March 2020 to 28 May 2020.
Lead official:	The lead official is Oli Jones (HMRC).
How to respond or enquire about this consultation:	Any enquiries about the consultation should be addressed to Oli Jones by email (oli.jones@hmrc.gov.uk). Please include a phone number if it might be helpful to discuss your enquiry. Responses should be sent by email oli.jones@hmrc.gov.uk . They can also be sent by post to: Oli Jones HM Revenue & Customs Room 3C/04 100 Parliament Street London SW1A 2BQ
Additional ways to be involved:	HMRC welcomes discussions with interested parties and is considering establishing a working group with stakeholders. Interested parties should contact Oli Jones.
After the consultation:	The Government expects to publish its response to the consultation in Summer 2020. Depending on the responses received, any legislative changes necessary are expected to be published in draft for inclusion in Finance Bill 2020-21.
Getting to this stage:	Draft guidance has been published alongside this document, setting out HMRC's view of the main tax impacts for affected businesses.
Previous engagement:	There has already been informal discussion with various representatives and regulatory bodies

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1. Introduction

Background

1.1 London Interbank Offered Rate (LIBOR) is a set of benchmark interest rates based on the rates at which banks are willing to borrow wholesale unsecured funds. It is widely used as a reference rate for loans, derivatives and other financial instruments.

1.2 Publication of LIBOR is expected to cease after the end of 2021. Consistent with a report by the Financial Stability Board in July 2014, attempts have been made to try to anchor LIBOR submissions and rates to actual transactions to ensure the sustainability of the rate. While significant improvements have been made to the benchmark since then, the underlying market that LIBOR seeks to measure – the market for unsecured wholesale term lending to banks – is no longer sufficiently active. Therefore, in a speech in 2017 the FCA indicated publicly that they do not intend to use their powers to compel panel banks to contribute to LIBOR after end-2021. Panel banks have voluntarily agreed to continue providing submissions to LIBOR until then, but its publication cannot be guaranteed beyond this date. Market participants should therefore plan on the basis that LIBOR will no longer be published after end-2021. This means any financial instrument which refers to LIBOR will either need to be amended or replaced so that it no longer uses LIBOR as a reference rate. This move towards a non-LIBOR reference rate is referred to as a 'transition' throughout this paper.

1.3 Although this document refers specifically to LIBOR, similar benchmark rates exist worldwide such as EURIBOR for the Euro and TIBOR for Japanese yen. Businesses may also be looking to restructure instruments which contain references to these other benchmark rates. References to 'LIBOR' in this document should therefore be read to include other benchmark rates where relevant.

Position under the current law

1.4 HMRC has published draft guidance alongside this consultation document which sets out HMRC's general view on the key tax issues arising for businesses from the transition on the basis of the law as it currently stands. The guidance was published in response to initial comments from a small number of tax advisers highlighting potential issues arising from the withdrawal of LIBOR, and requesting the additional guidance. The guidance sets out HMRC's view of these potential issues and provides clarity to companies that are in the process of amending financial instruments which refer to LIBOR.

1.5 The draft guidance can be located at: https://www.gov.uk/government/publications/draft-guidance-on-the-taxation-impacts-arising-from-the-withdrawal-of-libor-and-other-benchmark-rate-reform

1.6 Question 1 – Are there any additional issues that should be included in the draft guidance, or points that could be expressed more clearly?

Scope of the consultation

1.7 HMRC has identified a small number of references to LIBOR in the current tax legislation dealing with the treatment of leases. These statutory references will need to be replaced with a suitable alternative. HMRC is seeking views on how this should be done. Chapter 2 considers this aspect.

1.8 In addition, HMRC is keen to ensure that it is aware of all of the significant tax issues that arise from the withdrawal of LIBOR. This is so that HMRC can ensure that the tax system continues to operate effectively and so we can consider whether it is necessary to take any further action. HMRC has not to date seen evidence that any further legislative changes are necessary, and wishes to test this.

1.9 The potential implications arising from the withdrawal of LIBOR are considered in Chapter 3. You might also want to refer to the draft guidance at paragraph 1.5 above for further analysis.

2. Statutory references to LIBOR

2.1 There are a small number of references to LIBOR in tax legislation dealing with leases. These use LIBOR as a fallback rate when an interest rate is required for the purpose of the rules but the actual interest rate implicit in the lease cannot be determined. The sections affected are as follows:

Section 70O, Capital Allowances Act (CAA) 2001
Section 228MB, CAA 2001
Section 437C, Corporation Tax Act (CTA) 2010

2.2 The lease payments test at section 70O, CAA 2001 is one of the three tests used to define funding leases (see the definition of a funding lease at section 70J, CAA2001). The lease payment test requires a present value to be calculated using the interest rate implicit in the lease. If this rate cannot be determined, then section 70O stipulates that 12-month LIBOR plus 1% is to be used instead, meaning the necessary calculations can still be performed. The legislation states that the LIBOR rate is to be taken at the 'relevant time', which is defined as the inception of the lease. Without a fallback rate, there would be no interest rate to use as the basis for the calculation.

2.3 Section 228MB, CAA 2001 and section 437C, CTA 2010 set out how to calculate the present value of payments due under a lease. Section 228MB, CAA 2001 applies for the purposes of restricting the lessor's qualifying expenditure on the leased asset to the sum of the present value of the lessor's income under the lease and residual value of the asset. Section 437C, CTA 2010 applies for the purposes of determining the value under a lease that is ascribed to plant or machinery in the context of the sale of lessor rules (Part 9 of CTA 2010). In both cases they provide a fallback rate for the purposes of calculating the present value of a lease where the rate implicit in the lease cannot be determined. They also use 12-month LIBOR plus 1% as the fallback rate and the legislation defines which date the rate is to be taken on.

2.4 With the withdrawal of LIBOR, an alternative fallback rate will need to be chosen and statutory references updated accordingly. This new fallback rate will need to have similar characteristics to 12-month LIBOR to ensure there are no unintended consequences.

2.5 Question 2 – How common is it for companies to rely on each of the LIBOR fallback provisions in tax legislation?

2.6 Question 3 – Are there any additional places where tax legislation depends on LIBOR that need updating in light of its expected withdrawal at the end of 2021?

New reference rates

2.7 The preferred alternative to LIBOR in the sterling markets is SONIA (Sterling Overnight Index Average) which is a near risk-free rate[1]. This means the rate does not factor in the risk of financial loss, unlike LIBOR which takes into account the credit worthiness of the borrowing bank.

2.8 There are similar rates for the other LIBOR currencies:

- Secured Overnight Financing Rate (SOFR) for US dollar (USD)
- Swiss Average Rate Overnight (SARON) for the Swiss franc (CHF)
- Tokyo Overnight Average Rate (TONAR) for the Japanese yen (JPY)
- Euro Short-Term Rate (€STR) for the Euro (EUR)

2.9 Such rates are backwards looking, based on actual overnight borrowing transactions, unlike 12-month LIBOR which is forwards looking, based on hypothetical borrowing for a 12-month period. These rates do not, therefore, offer an exactly equivalent alternative to 12-month LIBOR.

2.10 In addition, it is expected that in most cases loans, derivatives and other instruments will in the future use these rates ‘compounded in arrears’, based on the overnight rates over a period of time (typically three months). Again, these will be backwards looking, with the final rate known only at the end of the interest period, and therefore could be unsuitable for being used to discount future cashflows under the lease to calculate its present value.

Forward-looking rates

2.11 Work is ongoing to produce Term SONIA Reference Rates (TSRR) that replicate the forward-looking nature of the existing LIBOR rates. Alternative term reference rates are also being considered in the US and Europe. It is not currently expected that term rates will be able to be reliably obtained for other currencies.

2.12 The use of these rates will likely be limited and the compounded in arrears rates are expected to be the primary vehicle for LIBOR transition. However, there are situations where it is appropriate to use a forward-looking rate due to the specific nature of the product or customer. The forward-looking term rates could be more suitable replacement for 12-month LIBOR in the context of its use in the tax leasing legislation.

2.13 There are a number of benchmark administrators that are looking to produce these term reference rates, and it is not at this stage clear which, if any, reference rate the market will adopt. It is therefore not currently clear that it would be appropriate to specify particular reference rates in the legislation, although this could change in the future.

[1] As recommended by the Working Group on Sterling Risk-Free Reference Rates https://www.bankofengland.co.uk/news/2017/april/sonia-recommended-as-the-sterling-near-risk-free-interest-rate-benchmark.

2.14 Typically the term reference rates are based on the observed rates from the overnight index swap (OIS) markets. These markets set out the interest rate to be used on the floating leg of an interest rate swap. It may therefore be possible to simply refer to an appropriate rate based on the OIS market.

The sovereign rate

2.15 Most governments issue bonds to raise finance. The UK, for example, issues gilts while the US issues a variety of Treasury bills. Countries in the Eurozone also issue bonds, such as the Bunds issued by Germany.

2.16 Bonds are typically available in a range of tenors with each attracting a different coupon rate. The coupon rate payable on such bonds is known as the 'sovereign rate' and depend in part on the credit worthiness of the country issuing them rather than that of the banks polled for LIBOR. The rates are easily accessible and updated daily.

Options for replacement rate

2.17 Until the work to produce a rate replicating the forward looking nature of LIBOR is finalised, three options to replace references to LIBOR have been identified.

1. We could use the overnight reference rate that is relevant for the currency of the lease – i.e. SONIA for GBP, SOFR for USD, SARON for CHF, TONAR for JPY and €STR for EUR. Potentially this could be 'compounded in arrears' to produce a rate that is more stable.

2. We could use an appropriate term reference rate for the currency of the lease.

3. We could use the relevant sovereign rate, depending on the underlying instrument. This could be difficult where the instrument is denominated in EUR because we would need to be able to tie the instrument to a specific country.

2.18 Question 4 – What do you see are the advantages and disadvantages of each option for replacing references to LIBOR in tax legislation?

2.19 Question 5 – Comparing the three options, what is your preferred option and why?

2.20 Question 6 – Are there any other options that should be considered?

2.21 Question 7 – Do you think changing statutory references will have any impact on your administrative burdens and costs? If so, please provide details including any one-off and on-going costs.

2.22 Question 8 – Do you think changing statutory references will have any additional impact on small and micro businesses, not already covered? If so, please provide details, including any one-off and on-going costs.

3. Issues arising from the withdrawal of LIBOR

Pre-transition: Hedge accounting

3.1 The withdrawal of LIBOR could theoretically have a tax impact even before the instrument which references LIBOR is amended or replaced. This is especially the case where a company has entered into an instrument in order to hedge itself against either fair value movements or cash flow variability.

3.2 For example, a company paying floating rate interest based on LIBOR might enter into an interest rate swap to effectively convert the floating rate interest into fixed interest. If the hedging instrument (the interest rate swap) is accounted for as a cash flow hedge, then fair value movements on the swap will be taken to reserves, where they are not taxable. The withdrawal of LIBOR could mean that the derivative can no longer be accounted for as a cash flow hedge because the withdrawal of LIBOR means that future cash flows are uncertain. This might mean that fair value movements on the derivative would be taken to profit or loss and typically be taxable.

3.3 Both the International Accounting Standards Board (IASB) and Financial Reporting Council (FRC) have amended the respective hedge accounting rules for International Accounting Standards (IAS) and UK Generally Accepted Accounting Practice (UK GAAP) to address the issue outlined above. These amendments apply for accounting periods from 1 January 2020, with earlier adoption permitted. These amendments state that, for the period when the replacement for LIBOR is unknown, when drawing up accounts you should assume that the interest rate benchmark used by an instrument will not be altered as a result of the withdrawal. This means that where these amendments apply, the company should still be able to apply hedge accounting and there will be no impact on the tax treatment.

3.4 Where hedge accounting has not been adopted, companies have the option of making an election into the Disregard Regulations (S.I. 2004/3256). Where an election is made, and conditions met, the fair value movements in profit or loss are disregarded for tax and instead brought into account in line with the hedged risk. There are certain time limits for making an election. More information on these regulations can be found in HMRC’s Corporate Finance Manual at CFM57000.

3.5 Question 9 – In the context of this issue:

a) Are the amendments to the hedge accounting requirements in UK GAAP and IAS sufficient to ensure that hedge accounting can continue for instruments referencing LIBOR in the pre-transition period?

b) If the amendments are not sufficient, do the Disregard Regulations provide a viable solution to avoiding tax volatility?

3.6 Question 10 – Do any additional significant tax issues arise pre-transition?

The transition from LIBOR

3.7 There are different ways in which a company could transition from a financial instrument which uses LIBOR as a reference rate.

- Both parties could, for example, discharge their duties and obligations under the instrument and replace it with a new instrument which does not use LIBOR as a reference rate.
- Alternatively, they could amend the terms of the existing instrument so that references to LIBOR are replaced with a non-LIBOR rate. It may be necessary to amend the spread that is applied to the reference rate, or for additional payments to be made from one party to the other to compensate them for the changes in the terms of the contract.
- It might also be possible to amend the fallback provisions in the instrument so that they reference a specific non-LIBOR rate. This fallback provision would then engage before or at the point LIBOR was withdrawn.

3.8 A financial instrument held by a company is likely to fall within either the loan relationships regime (Part 5 of the Corporation Tax Act 2009) or the derivative contracts regime (Part 7 of the Corporation Tax Act 2009). The general rule is that the amounts to be brought into account for tax are those amounts that, in accordance with generally accepted accounting practice (GAAP), are recognised in determining a company's profit or loss. The accounting treatment is therefore highly determinative of the tax treatment.

3.9 The accounting treatment will be determined by the specific facts of the transition, for example whether an instrument has, for accounting purposes, been amended or replaced. The examples below are based on the current requirements of IFRS 9 Financial Instruments.

- If the transition represents a substantial modification, the company may be required to derecognise the old instrument and recognise the revised instrument based on its fair value at the time of the transaction. A gain or loss might therefore be recognised in profit or loss.
- If the transition does not represent a substantial modification, the accounting treatment could still recognise the difference in expected future cash flows as a modification gain or loss in profit or loss.
- Where, as a result of the restructuring, the conditions for hedge accounting are no longer met, this could introduce additional volatility in the amounts recognised in profit or loss.

3.10 There are ongoing projects looking at whether amendments to IAS and UK GAAP are required to address accounting issues that arise due to the restructuring of contracts because of the withdrawal of LIBOR. Therefore the accounting for such transitions may be subject to change.

3.11 Question 11 – In the context of transactions undertaken to restructure financial instruments for the withdrawal of LIBOR:

a) Are there situations where you expect significant gains or losses to be recognised in profit and loss accounts as a result of restructuring financial instruments for the withdrawal of LIBOR?

b) If so, do you expect these amounts to be brought into account for tax? If not, please explain the reason for this.

c) If you do expect amounts to be recognised in the accounts and brought into account for tax, do you expect this to cause any significant issues?

3.12 Question 12 – Are there any other significant tax issues that could arise as a result of the restructuring of financial instruments for the withdrawal of LIBOR?

Post-transition issues

3.13 HMRC has not identified any further significant issues that may arise for new instruments, or existing instruments, once they have been amended for the withdrawal of LIBOR.

3.14 Question 13 – Are there any additional significant tax issues which could arise as a result of the withdrawal of LIBOR?

4. Assessment of Impacts

Summary of Impacts

<table>
<tr><td>Exchequer impact (£m)</td><td>
<table>
<tr><td>2019/20</td><td>2020/21</td><td>2021/22</td><td>2022/23</td><td>2023/24</td><td>2024/25</td></tr>
<tr><td>-</td><td>-</td><td>nil</td><td>nil</td><td>nil</td><td>nil</td></tr>
</table>
These proposals are not expected to have an Exchequer impact.</td></tr>
<tr><td>Economic impact</td><td>These proposals are not expected to have any significant economic impacts.</td></tr>
<tr><td>Impact on individuals, households and families</td><td>No impact on individuals is anticipated as these changes only affect businesses. There is expected to be no impact on family formation, stability or breakdown.</td></tr>
<tr><td>Equalities impact</td><td>It is not anticipated that there will be impacts on groups sharing protected characteristics.</td></tr>
<tr><td>Impact on businesses and civil society organisations</td><td>There is no significant impact on businesses at present, however the recommended consultation will explore any potential impacts on businesses in greater detail. There is no impact on civil society organisations.</td></tr>
<tr><td>Impact on HMRC</td><td>No significant impact on HMRC is anticipated at present. This will be reassessed following consultation.</td></tr>
<tr><td>Other impacts, including on other public sector organisations</td><td>This consultation will assist the Financial Conduct Authority (FCA) and the Bank of England with the work they are doing on the withdrawal of LIBOR.

No other impacts on public sector organisations have been identified.</td></tr>
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5. Summary of Consultation Questions

Statutory references to LIBOR

Question 1 – Are there any additional issues that should be included in the draft guidance, or points that could be expressed more clearly?

Question 2 – How common is it for companies to rely on each of the LIBOR fallback provisions in tax legislation?

Question 3 – Are there any additional places where tax legislation depends on LIBOR that need updating in light of its expected withdrawal at the end of 2021?

Question 4 – What do you see are the advantages and disadvantages of each option for replacing references to LIBOR in tax legislation?

Question 5 – Comparing the three options, what is your preferred option and why?

Question 6 – Are there any other options that should be considered?

Question 7 – Do you think changing statutory references will have any impact on your administrative burdens and costs? If so, please provide details including any one-off and on-going costs.

Question 8 – Do you think changing statutory references will have any additional impact on small and micro businesses, not already covered? If so, please provide details, including any one-off and on-going costs.

Issues arising from the withdrawal of LIBOR

Question 9 – In the context of this issue:

a) Are the amendments to the hedge accounting requirements in UK GAAP and IAS sufficient to ensure that hedge accounting can continue for instruments referencing LIBOR in the pre-transition period?

b) If the amendments are not sufficient, do the Disregard Regulations provide a viable solution to avoiding tax volatility?

Question 10 – Do any additional significant tax issues arise pre-transition?

Question 11 – In the context of transactions undertaken to restructure financial instruments for the withdrawal of LIBOR:

a) Are there situations where you expect significant gains or losses to be recognised in profit and loss accounts as a result of restructuring financial instruments for the withdrawal of LIBOR?

b) If so, do you expect these amounts to be brought into account for tax? If not, please explain the reason for this.

c) If you do expect amounts to be recognised in the accounts, and brought into account for tax, do you expect this to cause any significant issues?

Question 12 – Are there any other significant tax issues that could arise as a result of the restructuring of financial instruments for the withdrawal of LIBOR?

Question 13 – Are there any additional significant tax issues which could arise as a result of the withdrawal of LIBOR?

6. The Consultation Process

This consultation is being conducted in line with the Tax Consultation Framework. There are five stages to tax policy development:

Stage 1 Setting out objectives and identifying options.

Stage 2 Determining the best option and developing a framework for implementation including detailed policy design.

Stage 3 Drafting legislation to effect the proposed change.

Stage 4 Implementing and monitoring the change.

Stage 5 Reviewing and evaluating the change.

This consultation is taking place during stage 1 of the process. The purpose of the consultation is to seek views on the policy design and any suitable possible alternatives, before consulting later on a specific proposal for reform.

How to respond

A summary of the questions in this consultation is included at chapter six.

Responses should be sent by 28 May 2020, by email to oli.jones@hmrc.gov.uk or by post to:

Oli Jones
HM Revenue & Customs
Room 3C/04
100 Parliament Street
London
SW1A 2BQ

Telephone enquiries 03000 541 970.

Please <u>do not send consultation responses to the Consultation Coordinator.</u>

Paper copies of this document or copies in Welsh and alternative formats (large print, audio and Braille) may be obtained free of charge from the above address. This document can also be accessed from HMRC's GOV.UK pages. All responses will be acknowledged, but it will not be possible to give substantive replies to individual representations.

When responding please say if you are a business, individual or representative body. In the case of representative bodies please provide information on the number and nature of people you represent.

Working group

HMRC is looking to set up a small working group to consider the issues covered by this consultation. If you would like to join the working group, please contact Oli Jones.

Confidentiality

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 2018, General Data Protection Regulation (GDPR) and the Environmental Information Regulations 2004.

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Revenue & Customs.

Consultation Privacy Notice

This notice sets out how we will use your personal data, and your rights. It is made under Articles 13 and/or 14 of the General Data Protection Regulation

Your Data

The data

We will process the following personal data:

Name
Email address
Postal address
Phone number
Job title

Purpose

The purpose(s) for which we are processing your personal data is: Taxation impacts arising from the withdrawal of LIBOR.

Legal basis of processing

The legal basis for processing your personal data is that the processing is necessary for the exercise of a function of a government department.

Recipients

Your personal data will be shared by us with HM Treasury.

Retention

Your personal data will be kept by us for six years and will then be deleted.

Your Rights

- You have the right to request information about how your personal data are processed, and to request a copy of that personal data.
- You have the right to request that any inaccuracies in your personal data are rectified without delay.
- You have the right to request that any incomplete personal data are completed, including by means of a supplementary statement.
- You have the right to request that your personal data are erased if there is no longer a justification for them to be processed.
- You have the right in certain circumstances (for example, where accuracy is contested) to request that the processing of your personal data is restricted.

Complaints

If you consider that your personal data has been misused or mishandled, you may make a complaint to the Information Commissioner, who is an independent regulator. The Information Commissioner can be contacted at:

Information Commissioner's Office
Wycliffe House
Water Lane
Wilmslow
Cheshire
SK9 5AF
0303 123 1113
casework@ico.org.uk

Any complaint to the Information Commissioner is without prejudice to your right to seek redress through the courts.

Contact details

The data controller for your personal data is HM Revenue & Customs. The contact details for the data controller are:

HMRC
100 Parliament Street
Westminster
London SW1A 2BQ

The contact details for HMRC's Data Protection Officer are:

The Data Protection Officer
HM Revenue & Customs

7th Floor, 10 South Colonnade
Canary Wharf, London E14 4PU
advice.dpa@hmrc.gsi.gov.uk

Consultation Principles

This call for evidence is being run in accordance with the government's Consultation Principles.

The Consultation Principles are available on the Cabinet Office website:
http://www.cabinetoffice.gov.uk/resource-library/consultation-principles-guidance

If you have any comments or complaints about the consultation process please contact:

John Pay
Consultation Coordinator
Budget Team
HM Revenue & Customs
100 Parliament Street
London
SW1A 2BQ.

Please do not send responses to the consultation to this address.