IAS 39 Working Group meeting: 1 October 2010

Discussion paper 3: draft regulations on amendments to the corporation tax rules on loan relationships and derivative contracts arising from the introduction of IFRS 9

1. This discussion paper invites comments on amendments to Parts 5 and 7 of the Corporation Tax Act 2009 (CTA), to be made under sections 465A and 701A CTA[1]. The proposals relate to changes in accounting standards on financial instruments arising from the introduction of International Financial Reporting Standard 9.

2. Previous discussion papers (Discussion paper 1 and Discussion paper 2) set out some of the implications of changes to accounting standards for the corporation tax rules on loan relationships and derivative contracts.

3. The proposed regulations address the impact of changes in the classification and measurement of financial instruments, and in particular make changes in the following areas:

    - the definition and application of a 'change of accounting policy';
    - the adjustments to be made on a change of accounting policy;
    - the rules on hybrid and compound instruments;
    - transitional adjustments under the Change of Accounting Practice Regulations;
    - other consequential changes.

4. Further draft regulations will be issued when the International Accounting Standards Board's proposals for new standards on impairment, hedge accounting, derecognition and other changes to IAS 39 have become clearer.

5. Comments on the draft regulations should be sent to: tony.sadler@hmrc.gsi.gov.uk, fiona.hay@hmrc.gsi.gov.uk , or adeline.chan@hmrc.gov.uk by **15 October 2010**.

Change of accounting policy

6. Tax adjustments arising on a 'change of accounting policy' are dealt with by sections 315 to 319 CTA (for loan relationships) and sections 613 to 615 CTA (for derivative contracts)[2]. These sections are likely to apply in future to more, and more varied, changes in accounting policy than is currently the case. Although sections 315 and 613 apply to changes in accounting policy generally, section 315(3) and 613(3) give prominence to the first-time adoption of IFRS, which is no longer the central issue for tax purposes.

7. Section 316 currently applies where a company does not restate its comparative figures on a change of accounting policy. Section 308(2) applies where the change gives rise to a prior period adjustment. This leads to some anomalies in the application of the rules which have not caused many difficulties to date (because hitherto most changes have been from the

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[1] Inserted by Schedule 19 to Finance Act 2010
[2] References in this paper to a change in the loan relationships rules should generally be taken to apply also to the equivalent rules for derivative contracts, unless otherwise specified.

amortised cost basis (ACB) to fair value), but which may give rise to problems where there is a change from available-for-sale (AFS) to ACB, or where a company applying ACB for tax purposes moves to ACB in its accounts.

8. For example, where a company brings in a prior year adjustment on reclassifying the loan relationship as an ACB asset, the difference between its fair value and its amortised cost is currently brought under section 308. This change of basis credit or debit takes no account of departures from the accounts that take place because of the application of the special tax rule that requires connected companies to apply the ACB for tax purposes.

9. Regulation 3 therefore inserts a new subsection 308(4) to disapply section 308(2) where the prior period adjustment arises from a change of accounting policy. Section 316 will then apply generally wherever there is a change of accounting policy, whether or not this involves a prior period adjustment and restatement of comparative figures. Regulation 13 makes the equivalent change for Part 7.

10. Regulation 4 aligns the tax definition of ‘accounting policies’ with the definition in IAS 8 to mean ‘the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements’. The adoption of IFRS 9 will therefore be a ‘change of accounting policy’ within section 316 CTA. Regulation 14 makes the equivalent change for Part 7.

Tax adjustments made on a change of accounting policy

11. Regulation 5 amends the term ‘carrying value’ in section 316 CTA to ‘tax-adjusted carrying value’ (TACV). The term is similarly amended throughout Part 5 CTA (with necessary adaptations in Regulations 7 and 8 for the intra-group transfer rules). Regulation 16 makes the equivalent change for Part 7.

12. The change makes it clear that the term refers not to the carrying value disclosed in the accounts but a figure that takes into account the effect of the tax rules listed in section 317(5). Regulation 17 inserts the term into the list of definitions that apply for the purposes of the whole of Part 5, in the same way that section 702 CTA applies the term in relation to Part 7.

13. Transitional adjustments will be arrived at, as now, by comparing the TACV before and after the change. Some changes are then made to the operation of the rules in section 316 CTA determining the amounts to be brought into account on a change of accounting policy.

14. New subsection 316(4A) ensures that any restatement of comparative figures is ignored in determining whether there has been an increase or decrease in the TACV, so that the same values are used whether or not there has been any restatement of comparatives. Regulation 15 makes the equivalent change for Part 7.

15. Section 316(3) and (4) currently give the right result in terms of the credit or debit brought in on the change of accounting policy, but do not displace the accounts carrying value for tax purposes as the starting point for computing further credits and debits. This means that later computations do not take account of adjustments required under the connected party rules.

16. New subsection 349(5) (inserted by Regulation 9) is intended to address the problem. It ensures that where at the beginning of later period there is a difference between the TACV of the loan relationship and the amortised cost used for the purposes of section 349, loan relationship credits and debits in subsequent periods will be computed using the TACV rather than the accounts value.

Example: change from AFS to ACB

17. A company holds a loan note issued by a connected party with a face value of £1000 and a fair value at the end of the earlier period of £860. The note is accounted for as AFS and reclassified as ACB. The company regards the note as impaired and its carrying value at the start of the later period is £920.

18. For tax purposes, credits and debits have been computed on ACB, and will continue to be so after the accounting change from AFS to ACB. If the company restates its comparatives it will bring in a prior period adjustment of £60 (£920 minus £860). Section 308 currently operates to tax this, which is not the correct answer where the companies are connected and where loan relationships credits and debits have been taxed on an amortised cost basis throughout without recognition of impairment.

19. Under new subsection 316(4A), the change of accounting policy will be within section 316, and by comparing the TACV before (1000) and after (1000) the change, the accounts profit of 60 will not be taxed.

20. If the company does not restate comparative figures, section 316 currently operates to impose a carrying value for tax purposes of £1000 and there is (correctly) no transitional credit. However, this currently only applies for the purposes of section 316 and if the note is subsequently written back up to £1000 the accounts credit of £80 (1000 less 920) would be taxable.

21. Under new subsection 349(5), loan relationship credits and debits are computed on the basis that the accounts carrying value in later periods is the TACV £1000, and the accounts profit of £80 is not taxable.

22. The position would be slightly different if the company had gone from being unconnected to being connected, and subsequently went through a change of accounting policy. In this case, section 349 would require the application of the amortised cost basis. ACB for these purposes recognises cumulative amortisation and the tax ACB under section 349 would be £920. On a change of accounting policy, the TACV before and after the change would be 920, and the accounts profit of £60 (on the change from AFS 860 to ACB per the accounts 920) would be ignored for tax purposes.

23. If the asset was then written back up to £1000, subsection 349(5) would have no effect since there is no difference between the accounts carrying value and the TACV at the start of the later period. The 80 accounts profit would be a taxable loan relationships credit under the normal operation of section 349(2)).

Example: change from ACB to fair value

24. A loan relationship stated at ACB (100) before the change is measured at fair value (150) after the change. Any restatement of comparative figures, and the

prior period adjustment of 50 (currently taxable under section 308), are ignored under new section 316(4A). Section 316 applies to tax 50, arrived at by comparing the TACV before and after the change.

Hybrid and compound instruments

25. The current tax rules in sections 415 and 585 CTA are based on the separation in the accounts between the host contract and the embedded derivative or equity instrument. IFRS 9 removes the requirement to bifurcate a financial asset into a host contract and an embedded derivative. Under IFRS 9, most hybrid instruments will be accounted for at 'fair value through profit and loss' (FVTPL) in their entirety.

26. For financial liabilities, the IASB's current proposals envisage minor changes to the current position. Separation of a compound instrument into host contract and an equity instrument will continue. Companies can opt to fair value their liabilities as a single instrument.

27. The regulations are based on the following approach.

Securities to which sections 92-93 FA 1996 applied

28. Securities held before 2005, and which were taxed under the former sections 92-93 FA 1996, that were required after 2005 to be bifurcated in their accounts, had continuity of treatment under regulations 11 and 12 of the Disregard Regulations (SI 2004/3256) (the 'Disregards'). As a result no transitional amounts were brought in under the Change of Accounting Practise Regulations (SI 2004/3271) (the 'COAP Regulations').

29. This treatment will continue where a company adopts IFRS 9 and no longer bifurcates in its accounts. Regulations 11(4) and 12(3) of the Disregards will operate as they do currently to prevent transitional credits and debits, other than those relating to interest or exchange gains and losses, being brought into account on adoption of IFRS 9. No changes to regulations 11 and 12 are needed to achieve this.

Other existing bifurcated securities

30. There are three categories of existing securities to be considered here:

- securities originating pre-2005 to which sections 92-93 FA 1996 did not apply and which after 2005 were required to be bifurcated in the accounts and taxed accordingly;
- securities in respect of which a company elected under paragraph 7 Schedule 6 F(No.2)A 2005 (now section 416 CTA) to treat old UK GAAP assets as bifurcated in the accounts and taxed accordingly;
- securities originating after the adoption of IAS 39, bifurcated in the accounts and taxed accordingly.

31. In each case section 415 CTA requires these securities to be taxed on the basis of the accounts, the host contract under Part 5 and the embedded derivative under Part 7 CTA. In the case of securities held before the adoption of IAS 39, transitional adjustments will have been brought into account for tax under the COAP Regulations, subject to 10-year spreading.

32. Regulation 18 provides for the current tax treatment of such securities to be grandfathered following the adoption of IFRS 9. Credits and debits will continue to be computed in accordance with sections 415 and 585 CTA, and 10-year spreading of existing transitional adjustments will continue.

33. This is subject to an irrevocable election (Regulation 19) to follow the unbifurcated accounts following the adoption of IFRS 9. Transitional adjustments will arise where such an election is made. Paragraph 44 below has more on future transitional adjustments.

34. On transfer of an asset intra-group, under the normal operation of Chapter 4 Part 5 (for loan relationships) and Chapter 5 Part 7 (for derivative contracts) the transferee company will apply the notional carrying value ascribed by section 340 to the unbifurcated instrument (where the transferor has elected out of continuity treatment) and sections 340 and 625 (where bifurcation is applied for tax purposes).

Securities acquired after adoption of IFRS 9

35. A convertible, asset-linked or similar instrument that would have been accounted for as a hybrid instrument under IAS 39 will, following the adoption of IFRS 9, be subject to fair value accounting as a single instrument.

36. A number of respondents have argued that the chargeable gains treatment applicable to certain embedded derivatives under the current rules in Chapter 7 Part 7 CTA should continue. HMRC's view is that there is no strong case for replicating the current treatment accorded to instruments which will not be bifurcated in their accounts, for a number of reasons.

    - Many such instruments will be held on trading account by companies in the financial sector with all amounts arising on the instrument being brought in under Part 5 CTA.

    - Providing an election to apply bifurcation for tax purposes where the security is accounted for as a single instrument introduces further complexity into this area of already complex legislation. In practical terms such an election would have to be irrevocable and applicable to all the company's loan relationships (as with the election now at section 416). Experience with section 416 suggests that such an election is likely to be little used.

    - An alternative to replicating the treatment currently provided in Chapter 7 of Part 7 CTA would be to reintroduce the treatment formerly provided by sections 92 to 93 FA 1996. These sections taxed only the interest (and, after 2002, forex) arising on convertible and asset-linked securities, with other profits and losses taxed under chargeable gains rules. Replication of these rules would add a significant additional volume of legislation.

    - Most free-standing equity derivatives are now within the derivative contracts rules. It is not clear why instruments that include rights that would previously have been accounted for as an embedded derivative necessarily require different treatment.

37. HMRC does, however, acknowledge the case for a continuation of the exemption for gains to which the substantial shareholding exemption would apply and which is currently achieved by section 642 CTA. Regulation 11 therefore provides that a company can elect to replicate the effect of section 642 where the conditions in section 645 CTA would have been met if the company had been treated as party to a loan relationship to which section 415 would have applied in respect of a host contract and section 585 in respect of an embedded derivative under generally accepted accounting practice before the adoption of IFRS 9.

38. Regulation 18 continues to apply section 642 to existing instruments by virtue of the continued application of section 585.

'Old UK GAAP' securities following adoption of IFRS 9

39. Where a company has not adopted IAS 39/FRS 26, and did not make an election under section 416 CTA, it will usually account for the security on the ACB and will be taxed on its profits and losses from the instrument under Part 5 CTA. Following the transition to IFRS 9, such securities will be accounted for on fair value basis. Transitional adjustments will arise on the change of accounting policy and subject to the spreading under the COAP regulations.

40. Where a company is subject to the connected company rules and is required to use the amortised cost basis, as described above, the tax-adjusted carrying value will apply before and after the change to ensure continuity of tax treatment.

Financial liabilities

41. Subject to finalisation of the IASB's decision on the classification and measurement of financial liabilities under IFRS 9, on the basis that bifurcation between the host contract and the equity instrument or embedded derivative will continue, no change is proposed to the rules in Part 7 CTA that apply to issuers of securities with embedded derivatives or equity instruments (sections 652-659 and sections 665-666 CTA) and which provide for a 'TCGA' chargeable gain or allowable loss.

Sections 415 and 585 CTA

42. Credits and debits in respect of the loan relationship and the derivative contract will therefore continue to be computed in accordance with sections 415 and 585 where there is a change of accounting policy, and in the earlier accounting period the company accounts for the loan relationship in the manner described in section 415(1) but does not do so in the later period. Credits and debits that would otherwise be brought into account under sections 316 or 614 will not be brought into account.

43. In effect this will apply to:
    - companies that hold financial assets that were bifurcated prior to the adoption of IFRS 9 (subject to the election to follow the unbifurcated treatment in the accounts);
    - companies that have made an election under section 416;
    - issuers of compound instruments and any other cases in which the accounting treatment continues to require bifurcation.

Amendment to the Change of Accounting Practice (COAP) Regulations (SI 2004/3271)

44. Transitional adjustments will arise on a change of accounting policy under section 316 CTA, including prior-year adjustments and cases where an election is made not to grandfather the current treatment of bifurcated instruments.

45. Currently, transitional adjustments under the COAP Regulations are spread over 10 years. It is proposed that for a change of accounting policy under sections 316 or 614 CTA on or after a date to be decided, transitional adjustments will be spread over four years. The four-year period aligns with assessing time limits. HMRC understands that the change would also bring the spreading rule more in line with the average maturity of AFS assets held by major financial institutions. The change to the COAP Regulations would be made under existing powers in sections 319 and 598 CTA 2009.

46. This change will apply to all transitional adjustments, not just those relating to IFRS 9 adoption, but will not affect transitional amounts that have already arisen and are being spread over 10 years, nor will it affect COAP Regulation 3B (dormant accounts).

Other changes

Securities held between connected companies

47. It is envisaged that section 418 CTA, which imposes additional credits on the holder of a convertible instrument issued by a connected company, will be repealed as part of the proposed legislation on Group Mismatch Schemes.

Repeal of section 416 CTA

48. Regulation 10 repeals section 416 CTA. This section can only apply to companies that did not hold any hybrid securities in its first post-2005 period of account and subsequently acquired such an asset, and made an election within 90 days of doing so. Since 12 March 2008 such an election cannot be made in respect of intra-group assets. It is extremely unlikely that an election under section 416 CTA could now be made.

Qualifying corporate bonds

49. Regulation 18(2)(c) addresses the capital gains consequences of a change of accounting. A security that is currently bifurcated into a host contract and an embedded derivative (typically a convertible or asset-linked security) will be prevented from being a QCB by sections 645(7) and 648(7) CTA. The current treatment will be grandfathered so that it continues to be a non-QCB after the accounting change, in line with the continuity treatment set out in paragraph 32 above.

50. Where a company elects for the instrument to be taxed on the basis of the unbifurcated treatment in the accounts, the instrument will become a QCB and in principle any difference in the fair value of loan relationships and embedded derivative before the change and the fair value of the whole

instrument after the change would be brought in under the change of accounting policy rule.

51. This presents difficulties in identifying whether such amounts are loan relationship credits and debits, chargeable gains/allowable losses, or a mixture of both.

52. Instead, sections 316 and 614 will be disapplied entirely to ensure that they do not bring into account of credits or debits, and the effect of the election will be to treat the change of accounting policy as a disposal of the bifurcated security at the end of the earlier period, and a reacquisition (as a QCB) at the start of the later period. The deemed disposal value and reacquisition cost will be equal to the base cost computed under section 670(3) CTA. Any adjustment arising on the transition will be taxed as an unindexed capital gain of the earlier period.

53. Where section 645 or 648 does not apply the security will be a QCB and the effect of the deemed disposal will be to bring into charge the fair value difference as a loan relationship credit or debit for the earlier period. This will apply in only a handful of cases since the normal reason for section 645/648 not applying is that the instrument is accounted for at FVTPL and not bifurcated.

The Corporation Tax Act (Changes in Accounting Standards) Regulations 2010

PART 1

Introduction

Citation, commencement and effect

1.—(1) These Regulations may be cited as the Corporation Tax Act (Changes in Accounting Standards) Regulations 2010 and shall come into force on *** 2010.

(2) These Regulations shall have effect in relation to accounting periods beginning on or after that day.

This is subject to paragraphs (3) and (4) and regulations 18 and 19 (transitional provisions).

(3) If in consequence of a change in accounting standards a company adopts a relevant accounting change for a period of account, or part of a period of account, which coincides with a pre-commencement period, these Regulations shall have effect in relation to that pre-commencement period.

(4) Regulation 10 (omission of section 416 (election for application of section 415 and 585) and 417 (further provisions about elections under section 416)) shall have effect in relation to accounting periods beginning on or after 1st January 2011.

PART 2

Amendments to the Corporation Tax Act 2009

Amendments to the Corporation Tax Act 2009

2. The Corporation Tax Act 2009 is amended as follows.

CHAPTER 1

Loan Relationships

Amendment of section 308 (amounts recognised in determining a company's profit or loss)

3. In section 308 (amounts recognised in determining a company's profit or loss) after subsection (3) insert—

> "(4) Subsection (2) does not apply to an amount shown as a prior period adjustment recognised as a result of a change of accounting policy in drawing up the company's accounts from one period of account to the next.
>
> (5) In subsection (4) "change of accounting policy" has the same meaning as in section 315.".

Amendment of section 315 (introduction to sections 316 to 319)

4. In section 315 (introduction to sections 316 to 319) for subsection (3) substitute—

> "(3) For the purposes of this section a "change of accounting policy" means a change in the specific principles, bases, conventions, rules and practices that a company applies in preparing and presenting its financial statements in consequence of the issue, revocation, amendment or recognition of, or withdrawal of recognition from, an accounting standard by an accounting body."

Amendment of section 316 (change of accounting policy involving change of value)

5.—(1) Amend section 316 (change of accounting policy involving change of value) as follows.

(2) In subsections (1) to (4) for "carrying value" substitute "tax-adjusted carrying value" in each place.

(3) After subsection (4) insert—

> "(4A) In determining whether there has been any increase or decrease in the tax-adjusted carrying value of an asset or liability for the purposes of this section, any restatement in the later period of comparative figures for the earlier period shall be ignored.".

Amendment of section 317 (carrying value)

6. In section 317 (carrying value) for "carrying value" substitute "tax-adjusted carrying value" in the following places—

(a) the heading;

(b) subsection (1) in the first place it occurs;

(c) subsection (2);

(d) subsection (4).

Amendment of section 340 (group transfers and transfers of insurance business: transfer at notional carrying value)

7.—(1) Amend section 340 (group transfers and transfers of insurance business: transfer at notional carrying value) as follows.

(2) In subsection (6)(c) for "carrying value" substitute "tax-adjusted carrying value" in the second place it occurs.

(3) In subsection (6) omit paragraph (a).

Amendment of section 342 (issues of new securities or reorganisations: disposal at notional carrying value)

8.—(1) Amend section 342 (issues of new securities or reorganisations: disposal at notional carrying value) as follows.

(2) In subsection (3) for "carrying value" substitute "tax-adjusted carrying value" in the second place it occurs.

(3) In subsection (4) omit the definition of "carrying value".

Amendment of section 349 (application of amortised cost basis to connected companies relationships)

9.—(1) Amend section 349 (application of amortised cost basis to connected companies relationships) as follows.

(2) In subsection (2) at the end insert—

"This is subject to subsection (5).".

(3) Omit subsection (4).

(4) At the end insert—

"(5) If—

(a) section 316 (change of accounting policy involving change of value) has applied in relation to a loan relationship to which a company is a party, and

(b) at that time the loan relationship was a connected companies relationship,

the credits and debits which are to be brought into account in accordance with subsection (2) for any period after the later period shall be determined as if the cost of the asset or liability representing the loan relationship at the beginning of the later period was equal to the tax-adjusted carrying value at that time.

(6) In subsection (5) "later period" has the same meaning as in section 315.".

Omission of section 416 (election for application of section 415 and 585) and 417 (further provisions about elections under section 416)

10. Omit section 416 (election for application of section 415 and 585) and 417 (further provisions about elections under section 416).

Insertion of section 417A (embedded derivatives: credits and debits not brought into account)

11. After section 417 insert—

“417A Embedded derivatives: election for credits and debits not brought into account

(1) This section applies to a loan relationship to which a company is party if conditions A to C are met.

(2) Condition A is that in accordance with generally accepted accounting standards immediately before the introduction of International Financial Reporting Standard 9 issued in November 2009 by the International Accounting Standards Board the company would have treated the rights and liabilities under a loan relationship to which it was a party as divided between—

(a) rights and liabilities under a loan relationship, and

(b) rights and liabilities under one or more derivative financial instruments (“embedded derivative”).

(3) Condition B is that section 645 would have applied to the embedded derivative.

(4) Condition C is that, on the assumptions in subsection (4), paragraph 2 of Schedule 7AC to TCGA 1992 (substantial shareholding exemptions: gain on disposal of asset related to shares not a chargeable gain) would apply to the gain mentioned in subsection (4)(d).

(5) The assumptions are that—

(a) the rights and liabilities treated as comprised in the embedded derivative were contained in a separate contract,

(b) that separate contract was an option,

(c) that option was disposed of at the end of the accounting period, and

(d) a gain accrued to the company on the disposal for the purposes of corporation tax on chargeable gains.

(6) The company may elect that the credits and debits in respect of the rights and liabilities under the loan relationship in so far as they relate to the embedded derivative that would otherwise be brought into account under this Part shall not be brought into account.

(7) The election has effect in relation to all loan relationships to which the company is a party and to which this section applies.

(8) The election must be made not later than 90 days after becoming party to a loan relationship to which this section applies, or, if more than one loan relationship, the first of them.

(9) The election is irrevocable.

(10) The election has effect from the beginning of the period of account in which the company first becomes party to a loan relationship to which this section applies.”.

Amendment of section 476 (other definitions)

12. In section 476 (other definitions) after the definition of “tax advantage” insert—

““tax-adjusted carrying value” has the meaning given in section 317(1),”.

CHAPTER 2

Derivative Contracts

Amendment of section 597 (amounts recognised in determining a company's profit or loss)

13. In section 597 (amounts recognised in determining a company's profit or loss) after subsection (3) insert—

"(4) Subsection (2) does not apply to an amount shown as a prior period adjustment recognised as a result of a change of accounting policy.

(5) In subsection (4) "change of accounting policy" has the same meaning as in section 613.".

Amendment of section 613 (introduction to sections 614 and 615)

14. In section 613 (introduction to sections 614 and 615) for subsection (3) substitute—

"(3) For the purposes of [this section] a "change of accounting policy" means a change in the specific principles, bases, conventions, rules and practices that a company applies in preparing and presenting its financial statements in consequence of the issue, revocation, amendment or recognition of, or withdrawal of recognition from, an accounting standard by an accounting body."

Amendment of section 614 (change of accounting policy involving change of value)

15.—(1) Amend section 614 (change of accounting policy involving change of value) as follows.

(2) In subsections (1) and (2) for "carrying value" substitute "tax-adjusted carrying value" in each place.

(3) After subsection (2) insert—

"(2A) In determining whether there has been any increase or decrease in the tax-adjusted carrying value of a derivative contract for the purposes of this section, any restatement in the later period of comparative figures for the end of the earlier period shall be ignored.".

Tax-adjusted carrying value

16. In the following places for "carrying value" substitute "tax-adjusted carrying value"—

(a) section 622(4) in the second place it occurs;

(b) section 625(6)(b) in the second place it occurs;

(c) section 653(2);

(d) section 654(3)(a) and (b);

(e) section 658(5)(b);

(f) section 666(2);

(g) section 671(4) in both places;

(h) section 673(4) in both places;

(i) section 675(3) in the second place it occurs;

(j) section 684(3) in the second place it occurs;

(k) section 702 in—

(i) the heading,

(ii) subsection (1), and

(iii) subsection (2).

CHAPTER 3

Amendment of Schedule 4 (Index of Defined Expressions)

17.—(1) Amend Schedule 4 (Index of Defined Expressions) as follows.

(2) After the entry relating to "caravan" insert—

"tax-adjusted carrying value (in Part 5)	section 317(1)".

(3) In the entry relating to "carrying value (in Part 7)" for "carrying value" substitute "tax-adjusted carrying value".

PART 3

Transitional provisions

Transitional provisions

18.—(1) This regulation applies where, in relation to a loan relationship to which a company is a party,—

(a) in one period of account ("the first period")—

(i) sections 415 and 585 of the Corporation Tax Act 2009 (loan relationships with embedded derivatives) apply, or

(ii) section 416 of that Act (election for application of sections 415 and 585) applies and the company has made an election under that section, and

(b) in the next period of account ("the later period") none of those sections apply in consequence of a relevant accounting change occurring as a result of a change in accounting standards.

(2) Where this regulation applies—

(a) section 415(2) of the Corporation Tax Act 2009 shall apply in relation to the host contract,

(b) section 585(2) and (3) of the Corporation Tax Act 2009 shall apply in relation to the embedded derivative,

(c) if section 645 (creditor relationships: embedded derivatives which are options) or 648 (creditor relationships: embedded derivatives which are exactly tracking contracts) of the Corporation Tax Act 2009 applied to the embedded derivative in the first period, the loan relationship shall be treated for corporation tax purposes as not being a qualifying corporate bond, and

(d) debits and credits brought into account in accordance with the application of sections 415(2) and 585(2) and (3) of the Corporation Tax Act 2009 that would otherwise be brought into account in accordance with section 316 (change of accounting policy involving change of value) or 614 (change of accounting policy involving change of value) of the Corporation Tax Act 2009 shall not be brought into account.

(3) If in any period of account after the first period section 422 of the Corporation Tax Act 2009 (transfer of loan relationship at notional carrying value) applies in relation to the host contract and section 625 of that Act (group member replacing

another as party to a derivative contract) applies in relation to the embedded derivative, paragraph (2) shall apply in relation to the transferee.

(4) In this regulation—

“embedded derivative” has the same meaning as in section 585(1) of the Corporation Tax Act 2009;

“host contract” has the same meaning as in section 415(1)(a) of the Corporation Tax Act 2009.

Transitional provision: election

19.—(1) A company party to a loan relationship to which regulation 18 applies may elect that regulation 18(2)(a) to (c) shall not apply.

(2) If an election is made under this regulation the company is treated as disposing of the asset representing the loan relationship at the end of the first period and reacquiring the asset at the beginning of the later period for a consideration equal to the tax-adjusted carrying value of the asset at the beginning of the later period.

(3) An election under this regulation must be made within 12 months of the end of the later period.

(4) The election has effect in relation to all loan relationships to which paragraph (1) of regulation 18 applies.

(5) The election has effect from the beginning of the later period.

(6) The election is irrevocable.

(7) In this regulation—

“the first period” and “the later period” have the same meanings as in regulation 18;

“tax-adjusted carrying value” has the same meaning as in —

(a) section 317 of the Corporation Tax Act 2009 (carrying value), as amended by regulation 6, in relation to an asset representing a loan relationship, and

(b) section 702 of the Corporation Tax Act 2009 (carrying value), as amended by regulation 16, in relation to derivative contracts.