

# Tax Representation



**TAXREP 54/07**

## **TAX LAW REWRITE: BILL 5: CORPORATION TAX**

### **DERIVATIVE CONTRACTS**

*Memorandum submitted in August 2007 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to Paper CC/SC(21)05 issued in June 2007 by HMRC Tax Law Rewrite Team*

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The Tax Faculty of the Institute of Chartered Accountants in England and Wales

**TAXREP 54/07**

Tax Law Rewrite: Bill 5: corporation tax  
Derivative contracts

# TAX LAW REWRITE: BILL 5: CORPORATION TAX

## DERIVATIVE CONTRACTS

### INTRODUCTION

1. We welcome the opportunity to comment on Paper CC/SC(07)21 (Bill 5: Derivative Contracts) published on 21 June 2007 by HMRC's Tax Law Rewrite team at [http://www.hmrc.gov.uk/rewrite/consult\\_draft\\_derivative.pdf](http://www.hmrc.gov.uk/rewrite/consult_draft_derivative.pdf).
2. Details about the Institute of Chartered Accountants in England and Wales and the Tax Faculty are in Annex 1. Our Ten Tenets for a Better Tax System which we use as a benchmark are summarised in Annex 2.

### GENERAL COMMENTS

3. Although of relatively recent origin, in Finance Act 2002, the Derivative Contracts legislation has since been materially amended in later Finance Acts and through Statutory Instruments, including in particular the recent SI 2006 No. 3269. It is clearly very helpful to now unpack and re-order the resulting source material in the new rewritten Part, comprised of 12 Chapters, in a way which improves accessibility to this particularly complex legislation. The complexity unavoidably remains, reflecting the nature of derivative contracts themselves and their continuing development; but it is to be expected that most users of the rewritten legislation will be expert in this field. It will, however, be clearly helpful for the Explanatory Notes to contain references to applicable secondary legislation.
4. We note that work remains to be done on consequentials and transitionals.

### ANSWERS TO QUESTIONS

5. **Q1** In rewriting the loan relationships provisions the source reference to "profits and gains" has been reduced to "gains" on the ground that only one term is necessary, "gains" being adopted as the usual accounting term for positive amounts. If "gains" can be employed to mean "profits" in the loan relationship clauses, it is difficult to see why "gains (and losses)" cannot also be employed for the purposes of the derivative contracts clauses. The justification for employing "profits and losses" in Explanatory Notes paragraph 14, in this context, is not convincing and such use of different terms might cause unintended and unnecessary confusion.
6. **Q2** We agree the drafting of clause 22(3), describing what a "relevant holding" is for the purposes of clause 22 (Contracts relating to holdings in unit trusts, OEICs or offshore funds), in terms of the underlying subject matter of the contract rather than referring to a relevant holding of a "person".
7. **Q3** On the understanding that the original policy intention was to adopt a narrower meaning of "offshore fund" in construing the meaning of a "relevant interest in an

offshore fund” we agree its adoption, in line with practice, in drafting clause 22(3)(a)(iii) (Contracts relating to holdings in unit trusts, OEICs or offshore funds).

8. **Q4** In drafting clause 26(2)(a) (Conditions A to E mentioned in section 24(3)) we agree the proposal to extend condition A to cases where a company acquires a plain vanilla contract as well as cases where it enters into such a contract.
9. **Q5** We support the proposal to drop the requirement that an election under clause 30 (Election for section 29 not to apply) should be made in writing to HMRC.
10. **Q6** We support the proposal to supply in clause 126(4) (Meaning of “carrying value”) a definition of “impairment loss” and, for consistency, to model this on the definition provided for loan relationships by section 103(1) FA 1996. The meaning of “impairment” itself is not, however, defined further than as in s 103(1) FA 1996, which weakens the definition, but this has presumably not given rise to any difficulty since FA 1996 and it is to be expected that it will be recognisable in context.

## **SPECIFIC COMMENTS ON DRAFT LEGISLATION**

### **cl 43 Index-linked gilt-edged securities with embedded contracts for differences**

11. **(6)** With reference to Explanatory Notes paragraph 195, does it need to be made clearer that clause 8 (Priority of rules under this Part for corporation tax) does apply, so that credits and debits not brought into account by clause 43 are still within clause 8(1)? The latter applies to ‘amounts that are brought into account in accordance with this Part’ whereas clause 43(6) provides that the credits and debits ‘may not be so brought into account’.

### **Chapter 10 Special kinds of company**

12. Is it intended to rewrite paragraph 39 Schedule 26 FA 2002 elsewhere, relating to the approval for s 842 ICTA purposes of investment trusts?
13. Paragraph 51 of Schedule 26 FA 2002 (provision of deduction of tax) was amended by paragraph 422(6) of Schedule 1 Income Tax Act 2007, as a signpost to s 980 Income Tax Act 2007 (derivative contracts: exception from duties to deduct). Why has this signpost not been rewritten in the Paper CC/SC(07)21 draft clauses?

## **DETAILED COMMENTS ON DRAFTING**

### **cl 5 Non-trading credits and debits brought into account under Part [6]**

14. **(3)(a)** Within the brackets, ‘relationships’ should be ‘relationship’.

### **cl 22 Contracts relating to holdings in unit trusts, OEICs or offshore funds**

15. In Explanatory Notes paragraph 82, in the third line, insert ‘and’ before ‘that’ (scheme).

### **cl 36 Generally accepted accounting practice and recognised amounts**

16. In Explanatory Notes paragraph 169, the reference to clause 32(5) should be to clause 32(6).

**cl 44 Company ceasing to be party to derivative contract**

17. In Explanatory Notes paragraph 197, in the second sentence, should 'are' be inserted immediately after 'debts'?
18. (4) In clause 44(4) we note in passing that 'particular class, category or description' of business in paragraph 53(4)(b) Schedule 26 FA 2002 has been abbreviated to 'particular description'. This appears to rest on the tenable assumption that a class or category of business is a 'description' of business, but it does leave open the query as to why the words 'class' and 'category' were employed in the source legislation.

**cl 46 Non-UK resident companies treated as assigning derivative contracts no longer held for permanent establishment in UK**

19. (1) Is the inclusion of the word 'any' before 'circumstances' necessary, as it does not appear in paragraph 22A(1)(b) Schedule 26 FA 2002?

**cl 55 Change of accounting policy: company ceasing to be party to derivative contract**

20. (1) The cross-reference in clause 55(1)(c) should be to subsection (5).

**cl 59 Bringing into account adjustments under Schedule 28AA to ICTA**

21. In Explanatory Notes paragraph 255, in the final sentence, the reference should be to clause 32(3).

**Chpt 6 Chargeable gains arising in relation to derivative contracts**

22. **Overview** In Explanatory Notes, paragraph 276, in the third bullet point, 'relationships' should be 'relationship'.

**cl 91 Company ceasing to be party to contract which became derivative contract**

23. In Explanatory Notes, paragraph 376, in the first sentence, the first reference to 'company' should be to 'clause'.

**cl 93 Carry back of net losses on derivative contracts to which section 66 applies**

24. In Explanatory Notes paragraph 383, in the first sentence, insert 'clause 66' after 'under'.

**cl 114 Formation of SE by merger: disregard of incidental transfers of derivative contracts**

25. If 'Societas Europaea' in paragraph 30B(a) of Schedule 26 FA 2002 is not to be rewritten, the term 'SE' requires definition.
26. In Explanatory Notes paragraph 489 the reference to 'Subsection (6)' should be to 'Subsection (4)'.

**cl 132 Meaning of "relevant credits" and "relevant debits"**

27. In clause 132(3) 'relevant credit' should read 'relevant credits'.

**cl 133 Meaning of "section 21 embedded derivative" and "[section j] 061084 A a a] best contract"**

28. In Explanatory Notes paragraph 548, in the second line, delete 'under'.

**cl 134 Other definitions**

29. We note the inclusion now in clause 134 (Other definitions) of various terms defined as having ‘the meaning it has for accounting purposes’. This adds clarification to the source legislation [and appears sufficient in the case of the definitions of “income statement”, “statement of changes in equity” and “statement of total recognised gains and losses”; but is this sufficient in the case of the definitions of “equity instrument” and “financial instrument”?]

TJH/PCB  
10.8.07

**WHO WE ARE**

1. The Institute of Chartered Accountants in England & Wales is a professional body representing some 128,000 members. The Institute operates under a Royal Charter with an obligation to act in the public interest. It is regulated by the Department of Trade and Industry through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy (which includes taxation).
2. The Tax Faculty is the centre for excellence and an authoritative voice for the Institute on taxation matters. It is responsible for tax representations on behalf of the Institute as a whole and it also provides services to more than 11,000 Faculty members who pay an additional subscription.
3. Further information is available on the ICAEW Tax Faculty website at [www.icaew.com/taxfac](http://www.icaew.com/taxfac) or telephone 020 7920 8646.

## THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. **Statutory:** tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. **Certain:** in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. **Simple:** the tax rules should aim to be simple, understandable and clear in their objectives.
4. **Easy to collect and to calculate:** a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. **Properly targeted:** when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. **Constant:** Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. **Subject to proper consultation:** other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. **Regularly reviewed:** the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. **Fair and reasonable:** the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. **Competitive:** tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as **TAXGUIDE 4/99**; see <http://www.icaew.co.uk/index.cfm?route=128518>.