Tax Representation

TAXREP 43/05

TIME LIMITS FOR ELECTION UNDER THE DISREGARD REGULATIONS

Letter dated 26 September 2005 from Ian Hayes, the Chairman of the Technical Committee of the Tax Faculty of the Institute of Chartered Accountants in England & Wales, to the Paymaster General expressing concern about the proposed time limits for elections under the disregard regulations.

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INTRODUCTION

1 This representation sets out the text of a letter dated 26 September 2005 from Ian Hayes, the Chairman of the Technical Committee of the Tax Faculty of the Institute of Chartered Accountants in England & Wales, to the Paymaster General. It expresses concern about the proposed time limit of 30 September 2005 for elections under the disregard regulations, and follows on from a consultation paper posted to the HMRC website on 23 September 2005

WHO WE ARE

2 The Institute of Chartered Accountants in England and Wales (ICAEW) is the largest accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.

3 The Institute operates under a Royal Charter, working 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).

4 The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter *TAXline* to more than 11,000 members who pay an additional subscription.

TEXT OF THE LETTER DATED 26 SEPTEMBER 2005

5 We are extremely concerned by the contents of the Consultation Paper posted to HMRC website last Friday, 23 September 2005.

6 This Paper deals with corporation tax issues arising from the adoption of International Financial Reporting Standards and in particular the impact of *IAS 39, Financial Instruments: Measurement and Recognition* and the corresponding new UK standard, FRS 26. In particular our concern is in relation to the so-called Disregard Regulations (SI 2004/3256 as amended during 2005) and the different treatment of elections under Regulations 7 and 8 by comparison with the equivalent election under Regulation 9.

7 In the Consultation Paper there was an announcement that there would be an extension from 1 October to 31 December 2005 to the deadline for election under Regulation 9, which applies primarily to currency and interest rate swaps.

8 However the corresponding deadline for elections under Regulations 7 and 8, dealing primarily with currency and commodity forward contracts, has not been similarly extended and the proposed deadline is this coming Friday, 30 September 2005.

9 We consider that this is unreasonable and will force companies affected by the Regulations to make a difficult decision at extraordinarily short notice with no clarity as to what the effects of their actions will be, given that there was until the end of last week an expectation that there would be a deferral.

10 We are writing strongly to urge you to extend the election deadline to 31 December 2005 to cover Regulations 7 and 8 as well as Regulation 9.

11 There are three main reasons we consider that the deadline should be extended:

1. Companies simply do not know what the effect of an election will be. This is because the transitional rules on moving from 2004 UK GAAP to IFRS or FRS 26 are still not clear. The latest proposal is that most adjustments arising from fair value accounting will be deferred from 2005 to 2006 and then spread over the 10 years from 2006 to 2016. Thus, electing out could complicate tax compliance rather than simplify it.

2. The latest proposals for amending Regulation 9 could result in a considerable improvement. The effect of electing out would be not that all fair value movements on derivatives would be taxable, but rather that where a swap was designated as a cash-flow hedge of interest rate risk at single entity level and was effective as defined in IAS 39 and FRS 26, the company could follow its income statement (profit and loss account). In other cases tax fair value movements would be taxable. For those companies that had designated hedges at single entity level, this would be a massive simplification as tax would be based on numbers flowing straight from the accounts, yet cash tax volatility on effective hedges would be eliminated. There is no obvious reason that elections relating to currency and commodity forwards could not have the same effect. So forcing companies to chose now whether or not to make an election that might make things worse is clearly unreasonable.

3. Most companies and their advisors had seen the Disregard Regulations as a package and had not expected different deadlines for different elections. As it was obvious that there were still many problems to iron out in relation to swaps, it had been widely taken for granted that all of the deadlines would be extended. This view had been expressed strongly in the consultation process.

12 We would be more than happy to meet with your officials to expand on the above issues in more detail, please contact Ian Young at the Tax Faculty on 0207 920 8652. We have copied this letter to Richard Thomas who has chaired the IAS 39 working group and has been dealing with the detailed issues covered in this letter. We will be publishing this as a tax representation and it will be available on our website.

FH/IKY
26.9.05