



# Corporation Tax Act 2009

## 2009 CHAPTER 4

### PART 7

#### DERIVATIVE CONTRACTS

#### CHAPTER 1

#### INTRODUCTION

##### *Introduction*

#### **570 Overview of Part**

- (1) This Part is about how profits and losses arising to a company from its derivative contracts are brought into account for corporation tax purposes.
- (2) For the meaning of “derivative contract”, see section 576 and the remainder of Chapter 2.
- (3) For how such profits and losses are calculated and brought into account, see—
  - (a) section 572 (profits and losses to be calculated using credits and debits given by this Part),
  - (b) section 573 (trading credits and debits to be brought into account under Part 3),
  - (c) section 574 (non-trading credits and debits to be brought into account under Part 5), and
  - (d) Chapter 7 (chargeable gains arising in relation to derivative contracts).
- (4) For the priority of this Part for corporation tax purposes, see Chapter 12.
- (5) This Part also contains the following Chapters (which mainly relate to the amounts to be brought into account in respect of derivative contracts)—
  - (a) Chapter 3 (credits and debits to be brought into account: general),

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- (b) Chapter 4 (further provision about credits and debits to be brought into account),
  - (c) Chapter 5 (continuity of treatment on transfers within groups),
  - (d) Chapter 6 (special kinds of company),
  - (e) Chapter 8 (further provision about chargeable gains and derivative contracts),
  - (f) Chapter 9 (European cross-border transfers of business),
  - (g) Chapter 10 (European cross-border mergers),
  - (h) Chapter 11 (tax avoidance), and
  - (i) Chapter 13 (general and supplementary provisions).
- (6) See also section 980 of ITA 2007 (payments under derivative contracts excepted from duty to deduct income tax).

*How profits and losses from derivative contracts are dealt with*

**571 General rule: profits chargeable as income**

- (1) The general rule for corporation tax purposes is that all profits arising to a company from its derivative contracts are chargeable to corporation tax as income in accordance with this Part.
- (2) But see Chapter 7, which makes provision for cases in which profits arising to a company from its derivative contracts are chargeable to corporation tax as chargeable gains.

**572 Profits and losses to be calculated using credits and debits given by this Part**

- (1) Profits and losses arising to a company from its derivative contracts are to be calculated using the credits and debits given by this Part.
- (2) For exceptions to this section, see sections 652 to 658 (issuers of securities with embedded derivatives: deemed options and contracts for differences).

**573 Trading credits and debits to be brought into account under Part 3**

- (1) This section applies so far as in an accounting period a company is a party to a derivative contract for the purposes of a trade it carries on.
- (2) The credits in respect of the contract for the period are treated as receipts of the trade which are to be brought into account in calculating the profits of the trade for that period.
- (3) The debits in respect of the contract for the period are treated as expenses of the trade which are deductible in calculating those profits.
- (4) So far as subsection (3) provides for any amount to be deductible, it applies despite anything in—
  - (a) section 53 (capital expenditure),
  - (b) section 54 (expenses not wholly and exclusively for trade and unconnected losses), or
  - (c) section 59 (patent royalties).

- (5) For cases in which this section does not apply, see—
- (a) section 616 (disapplication of fair value accounting for certain embedded derivatives), and
  - (b) Chapter 7 (chargeable gains arising in relation to derivative contracts).

#### **574 Non-trading credits and debits to be brought into account under Part 5**

- (1) This section applies if, for an accounting period, there are credits or debits in respect of the derivative contracts of a company which are not brought into account in accordance with section 573.
- (2) Those credits or debits—
- (a) are to be treated as non-trading credits or non-trading debits (within the meaning of Part 5 (loan relationships)) for the period, and
  - (b) are accordingly to be brought into account in determining whether the company has non-trading profits or a non-trading deficit from its loan relationships for the period.
- (3) For cases in which this section does not apply, see—
- (a) section 616 (disapplication of fair value accounting for certain embedded derivatives), and
  - (b) Chapter 7 (chargeable gains arising in relation to derivative contracts).

## **CHAPTER 2**

### **CONTRACTS TO WHICH THIS PART APPLIES**

#### *Introduction*

#### **575 Overview of Chapter**

- (1) This Chapter makes provision about the contracts to which this Part applies.
- (2) In particular, it—
- (a) contains a definition of “derivative contract” (see section 576),
  - (b) contains other definitions (such as “relevant contract”, “option”, “future” and “contract for differences”) which are used in determining whether a contract is a derivative contract (see sections 577 to 583),
  - (c) makes provision about cases in which companies are treated as parties to relevant contracts (see sections 584 to 586),
  - (d) provides for certain contracts and transactions to be treated as derivative contracts (see sections 587 and 588), and
  - (e) provides for certain contracts to be treated as not being derivative contracts because of their underlying subject matter (see sections 589 to 593).

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*Meaning of “derivative contract” and other basic definitions*

**576 “Derivative contract”**

- (1) For the purposes of this Part, a contract of a company is a derivative contract of the company for an accounting period if it—
  - (a) is a relevant contract (see sections 577 and 578),
  - (b) meets any of the accounting conditions for the accounting period (see section 579), and
  - (c) is not prevented from being a derivative contract by section 589 (contracts excluded because of underlying subject matter: general) or any other provision of the Corporation Tax Acts.
- (2) See also sections 587 and 588 (other contracts etc treated as derivative contracts).
- (3) But note section 701 which includes power to amend the provisions of this Chapter relating to the meaning of “derivative contract”.

**577 “Relevant contract”**

- (1) In this Part “relevant contract” means—
  - (a) an option,
  - (b) a future, or
  - (c) a contract for differences.
- (2) For the meaning of “option”, “future” and “contract for differences”, see sections 580, 581 and 582 respectively.

**578 Relevant contracts of a company and being party to such contracts**

- (1) For the purposes of this Part, references to a relevant contract of a company are references to a relevant contract entered into or acquired by the company (but see subsection (3)).
- (2) For the purposes of this Part, a relevant contract is acquired by a company if the company becomes—
  - (a) entitled to the rights under the relevant contract, and
  - (b) subject to the liabilities under it.
- (3) For particular cases where companies are treated as parties to relevant contracts, see—
  - (a) section 584 (hybrid derivatives with embedded derivatives),
  - (b) section 585 (loan relationships with embedded derivatives), and
  - (c) section 586 (other contracts with embedded derivatives).
- (4) References in this Part to a company being a party to a relevant contract are to be read in accordance with this section.

**579 The accounting conditions**

- (1) The accounting conditions for any accounting period are that—
  - (a) the relevant contract is treated for accounting purposes as a derivative,
  - (b) the relevant contract—

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- (i) is not so treated just because of not meeting the requirement in paragraph 9(b) of Financial Reporting Standard 26 issued in December 2004 by the Accounting Standards Board (requirement for no initial net investment or smaller initial net investment than comparable types of contract), but
    - (ii) is or forms part of a financial asset or liability for accounting purposes, or
  - (c) the relevant contract is not within paragraph (a) or (b), but is within subsection (2).
- (2) A relevant contract is within this subsection if—
  - (a) its underlying subject matter is commodities, or
  - (b) it is a contract for differences whose underlying subject matter is—
    - (i) land,
    - (ii) tangible movable property, other than commodities which are tangible assets,
    - (iii) intangible fixed assets,
    - (iv) weather conditions, or
    - (v) creditworthiness.
- (3) For the purposes of subsection (1)(a), a relevant contract of a company is treated for accounting purposes as a derivative for an accounting period if for that period—
  - (a) it is so treated for the purposes of the relevant accounting standard used by the company for that period, or
  - (b) it would be so treated if the company used the relevant accounting standard for that period in respect of the contract.
- (4) For the purposes of subsection (1)(b), a relevant contract of a company is or forms part of a financial asset or liability for accounting purposes for an accounting period if for that period—
  - (a) it is or does so for the purposes of the relevant accounting standard used by the company for that period, or
  - (b) it would be or would do so if the company used the relevant accounting standard for that period in respect of the contract.
- (5) In this section “relevant accounting standard” means—
  - (a) for any accounting period in relation to which it is required or permitted to be used, Financial Reporting Standard 25 issued in December 2004 by the Accounting Standards Board, as from time to time modified, amended or revised, or
  - (b) for any accounting period in relation to which it is required or permitted to be used, any subsequent accounting standard dealing with transactions which are derivatives, as from time to time modified, amended or revised.
- (6) For the meaning of “underlying subject matter”, see section 583.

## **580 “Option”**

- (1) In this Part “option” includes a warrant.
- (2) References in this Part to an option do not include a contract whose terms—
  - (a) provide—

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- (i) that, after setting off their obligations to each other under the contract, a cash payment is to be made by one party to the other in respect of the excess, if any, or
  - (ii) that each party is liable to make to the other party a cash payment in respect of all that party's obligations to the other under the contract, and
  - (b) do not provide for the delivery of any property.
- (3) Subsection (2) does not prevent an option whose underlying subject matter is currency from being an option.
- (4) But see—
- (a) section 652 (introduction to sections 653 to 655),
  - (b) section 665 (issuers of securities with embedded derivatives: equity instruments), and
  - (c) section 695 (transfers of value to connected companies),
- in which “option” is to be construed as if subsections (2) and (3) were omitted.

## **581 “Future”**

- (1) In this Part “future” means a contract for the sale of property under which delivery is to be made—
- (a) at a future date agreed when the contract is made, and
  - (b) at a price so agreed,
- but this is subject to subsection (3).
- (2) For the purposes of subsection (1)(b), a price is agreed when the contract is made even if—
- (a) the price is left to be determined by reference to the price at which a contract is to be entered into on a market or exchange or could be entered into at a time and place specified in the contract, or
  - (b) in a case where the contract is expressed to be by reference to a standard lot and quality, provision is made for a variation in the price to take account of any variation in quantity or quality on delivery.
- (3) References in this Part to a future do not include a contract whose terms—
- (a) provide—
    - (i) that, after setting off their obligations to each other under the contract, a cash payment is to be made by one party to the other in respect of the excess, if any, or
    - (ii) that each party is liable to make to the other party a cash payment in respect of all that party's obligations to the other under the contract, and
  - (b) do not provide for the delivery of any property.
- (4) Subsection (3) does not prevent a future whose underlying subject matter is currency from being a future.

## **582 “Contract for differences”**

- (1) In this Part “contract for differences” means a contract the purpose or pretended purpose of which is to make a profit or avoid a loss by reference to fluctuations in—
  - (a) the value or price of property described in the contract, or
  - (b) an index or other factor designated in the contract.
- (2) But none of the following is a contract for differences—
  - (a) an option,
  - (b) a future,
  - (c) a contract of insurance,
  - (d) a capital redemption policy,
  - (e) a contract of indemnity,
  - (f) a guarantee,
  - (g) a warranty, or
  - (h) a loan relationship.
- (3) For the purposes of subsection (1)(b), an index or factor may be determined by reference to any matter.

## **583 “Underlying subject matter”**

- (1) In this Part references to the underlying subject matter of a relevant contract are to be read as follows.
- (2) The underlying subject matter of an option is—
  - (a) the property which would fall to be delivered if the option were exercised, or
  - (b) if the property which would so fall is a derivative contract, the underlying subject matter of that contract.
- (3) The underlying subject matter of a future is—
  - (a) the property which, if the future were to run to delivery, would fall to be delivered at the date and price agreed when the contract is made, or
  - (b) if the property which would so fall is a derivative contract, the underlying subject matter of that contract.
- (4) The underlying subject matter of a contract for differences is—
  - (a) if the contract for differences relates to fluctuations in the value or price of property described in the contract, the property so described, or
  - (b) if an index or factor is designated in the contract for differences, the matter by reference to which the index or factor is determined.
- (5) The things which may be the subject matter of a contract for differences include—
  - (a) interest rates,
  - (b) weather conditions, and
  - (c) creditworthiness.
- (6) Interest rates are not the underlying subject matter of a relevant contract if—
  - (a) under the terms of that contract—
    - (i) the date on which a party to that contract becomes subject to a duty to make a payment is a variable date, and

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- (ii) the amount of that payment varies according to the date of payment, and
  - (b) those terms refer to an interest rate only for the purpose of establishing that amount.
- (7) The underlying subject matter of a relevant contract is not treated as being—
- (a) land,
  - (b) shares in a company, or
  - (c) rights of a unit holder under a unit trust scheme,
- just because its underlying subject matter includes income from that kind of property.

*Cases where companies treated as parties to relevant contracts*

#### **584 Hybrid derivatives with embedded derivatives**

- (1) This section applies if—
- (a) a company is a party to a relevant contract which meets the condition in section 579(1)(b) or (c) (contracts not treated for accounting purposes as derivatives),
  - (b) in accordance with generally accepted accounting practice, the company treats the rights and liabilities under the contract as divided between—
    - (i) rights and liabilities under one or more derivatives (“embedded derivatives”), and
    - (ii) the remaining rights and liabilities, and
  - (c) a contract consisting of only those remaining rights and liabilities would be a relevant contract.
- (2) The company is treated for the purposes of this Part—
- (a) as a party to a relevant contract whose rights and liabilities consist only of those of the embedded derivative, or (if there is more than one embedded derivative) as a party to relevant contracts each of whose rights and liabilities consist only of those of one of the embedded derivatives, and
  - (b) as a party to a relevant contract whose rights and liabilities are those within subsection (1)(b)(ii).
- (3) Each relevant contract to which a company is treated as a party under subsection (2) is treated for the purposes of this Part as an option, a future or a contract for differences depending on what the character of a separate contract containing the rights and liabilities of the deemed relevant contract would be.
- (4) In this Part “hybrid derivative” means a relevant contract within subsection (1)(a).
- (5) See also—
- (a) section 592 (embedded derivatives treated as meeting condition in section 591 etc), and
  - (b) section 616 (disapplication of fair value accounting for certain embedded derivatives).



### **585 Loan relationships with embedded derivatives**

- (1) This section applies if in accordance with generally accepted accounting practice a company treats the rights and liabilities under a loan relationship to which it is 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 or equity instruments (“embedded derivatives”).
- (2) The company is treated for the purposes of this Part—
  - (a) as a party to a relevant contract whose rights and liabilities consist only of those of the embedded derivative, or
  - (b) if there is more than one embedded derivative, as a party to relevant contracts each of whose rights and liabilities consist only of those of one of the embedded derivatives.
- (3) Each relevant contract to which a company is treated as a party under subsection (2) is treated for the purposes of this Part as an option, a future or a contract for differences depending on what the character of a separate contract containing the rights and liabilities of the embedded derivative would be.
- (4) For the corresponding treatment of the rights and liabilities within subsection (1)(a), see section 415 (loan relationships with embedded derivatives).
- (5) See also—
  - (a) section 416 (election for section 415 and this section to apply), and
  - (b) section 635 (some creditor relationships treated as ones in relation to which section 415 and this section have effect).

### **586 Other contracts with embedded derivatives**

- (1) This section applies if a company—
  - (a) is a party to a contract which is neither a hybrid derivative nor a loan relationship, and
  - (b) in accordance with generally accepted accounting practice, treats the rights and liabilities under the contract as divided between—
    - (i) rights and liabilities under one or more derivatives (“embedded derivatives”), and
    - (ii) the remaining rights and liabilities.
- (2) The company is treated for the purposes of this Part—
  - (a) as a party to a relevant contract whose rights and liabilities consist only of those of the embedded derivative, or
  - (b) if there is more than one embedded derivative, as a party to relevant contracts each of whose rights and liabilities consist only of those of one of the embedded derivatives.
- (3) Each relevant contract to which a company is treated as a party under subsection (2) is treated for the purposes of this Part as an option, a future or a contract for differences depending on what the character of a separate contract containing the rights and liabilities of the embedded derivative would be.

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- (4) See also section 616 (disapplication of fair value accounting for certain embedded derivatives).

*Other contracts etc treated as derivative contracts*

**587 Contract relating to holding in OEIC, unit trust or offshore fund**

- (1) This section applies in relation to a relevant contract to which a company is a party in an accounting period if—
- (a) it is not a derivative contract for the purposes of this Part but for this section, and
  - (b) its underlying subject matter consists wholly or partly of a relevant holding in that period.
- (2) This Part has effect—
- (a) for that accounting period, and
  - (b) for any succeeding accounting period in which the relevant contract is a relevant contract of the company,
- as if the relevant contract were a derivative contract.
- (3) For the purposes of this section, the underlying subject matter of a contract consists wholly or partly of a relevant holding in an accounting period if—
- (a) at any time in that period it consists wholly or partly of—
    - (i) any shares in an open-ended investment company,
    - (ii) any rights under a unit trust scheme, or
    - (iii) a material interest in an offshore fund within the meaning of Chapter 3 of Part 6 (see section 489), and
  - (b) there is a time in the period when that company, scheme or fund fails to meet the qualifying investments test.
- (4) In subsection (3) “meeting the qualifying investments test” has the same meaning as in section 493 (the qualifying investments test).
- (5) See section 18(2)(c)(ii) of F(No.2)A 2005 (section 17(3): specific powers) for the power to modify the meaning of “relevant holding” for the purposes of this section by regulations under section 17(3) of that Act (regulations about authorised unit trusts and OEICs).
- (6) For the way in which credits and debits are to be brought into account where this section applies, see section 601 (application of fair value accounting).
- (7) See also—
- (a) section 602 (contract becoming one relating to holding in OEIC, unit trust or offshore fund), and
  - (b) section 660 (company ceasing to be party to contract relating to holding in OEIC, unit trust or offshore fund).

**588 Associated transaction treated as derivative contract**

- (1) This section is to be read as if it were in Chapter 7 (shares with guaranteed returns etc) of Part 6 (relationships treated as loan relationships etc).

- (2) See, in particular—
  - section 526(2) (meaning of “non-qualifying share”), and
  - section 532 (meaning of “associated transaction” and “the associated transactions condition”).
- (3) Subsection (4) applies in a case which falls within section 523(1)(b)(ii) (loan relationships: non-qualifying shares) because the share mentioned in section 523(1)(a) is a non-qualifying share as a result of the associated transactions condition being met.
- (4) An associated transaction is treated for the purposes of this Part as a derivative contract or a transaction in respect of a derivative contract if it is not in fact such a contract or transaction.
- (5) For the way in which credits and debits are to be brought into account where subsection (4) applies, see section 603 (application of fair value accounting).

#### *Exclusions from derivative contracts*

### **589 Contracts excluded because of underlying subject matter: general**

- (1) A relevant contract is not a derivative contract for the purposes of this Part if its underlying subject matter—
  - (a) consists wholly of excluded property (see subsections (2) to (5)), or
  - (b) is treated as consisting wholly of such property.
- (2) “Excluded property” means—
  - (a) intangible fixed assets,
  - (b) shares in a company other than shares within subsection (3), or
  - (c) rights of a unit holder under a unit trust scheme other than a scheme in relation to which section 490 (holdings in OEICs, unit trusts and offshore funds treated as creditor relationship rights) has effect.
- (3) The shares within this subsection are—
  - (a) shares to which section 524 or 526 (shares subject to outstanding third party obligations and shares which are non-qualifying shares) applies, and
  - (b) shares in an open-ended investment company in relation to which section 490 has effect.
- (4) Subsection (2)(a) applies only in relation to a relevant contract which is an option or future.
- (5) Subsection (2)(b) and (c) apply only in relation to a relevant contract which—
  - (a) meets any of conditions A to E in section 591, and
  - (b) is not designed to produce a return which equates in substance to the return on an investment of money at a commercial rate of interest.
- (6) Section 590 applies for determining whether the underlying subject matter of a relevant contract is to be treated as consisting wholly of excluded property.

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### **590 Disregard of subordinate or small value underlying subject matter**

- (1) This section applies in relation to a relevant contract if its underlying subject matter consists only of—
  - (a) excluded property, and
  - (b) other underlying subject matter which is—
    - (i) subordinate in relation to any of the excluded property, or
    - (ii) of small value in comparison with the value of the underlying subject matter as a whole.
- (2) The underlying subject matter of the contract is treated for the purposes of this Part as if it consisted wholly of excluded property.
- (3) For the purposes of this section, whether part of the underlying subject matter of a relevant contract of a company is subordinate or of small value is to be determined by reference to the time when the company enters into or acquires the contract.
- (4) In this section “excluded property” has the same meaning as in section 589.

### **591 Conditions A to E mentioned in section 589(5)**

- (1) The following are the conditions mentioned in section 589(5).
- (2) Condition A is that the relevant contract—
  - (a) is a plain vanilla contract entered into or acquired by a company carrying on life assurance business,
  - (b) is an approved derivative for the purposes of Rule 3.2.5 of the Insurance Prudential Sourcebook, and
  - (c) does not meet the condition in section 579(1)(b) (contract which is or forms part of a financial asset or liability for accounting purposes).
- (3) Condition B is that—
  - (a) the relevant contract is entered into or acquired by a company otherwise than for the purposes of a trade carried on by it,
  - (b) there is a hedging relationship between the contract and—
    - (i) an asset of the company which consists of shares or rights of a unit holder under a unit trust scheme, or
    - (ii) any share capital of the company or any liability related to share capital of the company, and
  - (c) the relevant contract is not one to which the company is treated as a party under section 585(2) (loan relationships with embedded derivatives).
- (4) Condition C is that—
  - (a) the relevant contract is entered into or acquired by a company otherwise than for the purposes of a trade carried on by it, and
  - (b) the relevant contract is an option which is listed on a recognised stock exchange to subscribe for shares in a company.
- (5) Condition D is that—
  - (a) the relevant contract is entered into or acquired by a company otherwise than in the course of activities forming an integral part of a trade carried on by it,
  - (b) the relevant contract is—

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- (i) an option to acquire shares in a company, or
    - (ii) a future requiring delivery of shares in a company,
  - (c) the relevant contract is not one to which the company is treated as a party under section 585(2), and
  - (d) the shares to be acquired or delivered—
    - (i) constitute a substantial shareholding within the meaning of paragraph 8 of Schedule 7AC to TCGA 1992 (meaning of “substantial shareholding”), or
    - (ii) would do so if acquired or delivered.
- (6) Condition E is that—
  - (a) the company which is a party to the relevant contract has a hedging relationship between—
    - (i) the relevant contract, and
    - (ii) an asset or liability representing a loan relationship which is treated as mentioned in section 585(1) (loan relationships with embedded derivatives), and
  - (b) each relevant contract to which the company is treated as a party under section 585(2) in the case of that loan relationship is a derivative contract to which any of the provisions in subsection (7) applies.
- (7) The provisions mentioned in subsection (6)(b) are—
  - (a) section 645 (creditor relationships: embedded derivatives which are options),
  - (b) section 648 (creditor relationships: embedded derivatives which are exactly tracking contracts for differences),
  - (c) sections 653 to 655 (issuers of securities with embedded derivatives: deemed options), and
  - (d) section 658 (issuers of securities with embedded derivatives: deemed contracts for differences).
- (8) For the cases in which sections 653 to 655 and section 658 apply, see sections 652 and 656 respectively.

## **592 Embedded derivatives treated as meeting condition in section 591 etc**

- (1) This section applies if for an accounting period—
  - (a) a company is a party to a hybrid derivative which meets the condition in section 579(1)(b) (contract which is or forms part of a financial asset or liability for accounting purposes),
  - (b) the embedded derivative is a relevant contract which meets the condition in section 579(1)(a) (contract treated for accounting purposes as derivative),
  - (c) the underlying subject matter of that contract consists, or is treated as consisting, wholly of—
    - (i) shares in a company, or
    - (ii) rights of a unit holder under a unit trust scheme, and
  - (d) the host contract is or forms part of a financial asset or liability for accounting purposes.
- (2) The embedded derivative is treated—

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- (a) for the purposes of section 589 (contracts excluded because of underlying subject matter: general) as meeting one of the conditions in section 591, and
  - (b) as a chargeable asset.
- (3) The host contract is treated for the purposes of the Corporation Tax Acts as if it were a creditor relationship of the company (see Part 5 (loan relationships)).
- (4) Section 590 (disregard of subordinate or small value underlying subject matter) applies for the purpose of determining whether the underlying subject matter is to be treated as consisting wholly of property mentioned in subsection (1)(c) as that section so applies in relation to excluded property.
- (5) In this section—
- “the embedded derivative” means the relevant contract to which the company is treated as a party under section 584(2)(a) because of the hybrid derivative mentioned in subsection (1)(a), and
  - “the host contract” means the relevant contract to which the company is treated as a party under section 584(2)(b) because of that hybrid derivative.

### **593 Contracts where part of underlying subject matter is excluded property**

- (1) This section applies to a relevant contract of a company—
- (a) which is an option or future,
  - (b) which meets any of the accounting conditions in section 579(1), and
  - (c) whose underlying subject matter consists of—
    - (i) excluded property, and
    - (ii) other underlying subject matter.
- (2) A relevant contract to which this section applies is treated for the purposes of the Corporation Tax Acts as if it were the following two contracts—
- (a) a relevant contract whose underlying subject matter consists of the excluded property, and
  - (b) a relevant contract whose underlying subject matter consists of the other underlying subject matter.
- (3) For the purposes of giving effect to subsection (2), all such apportionments as are just and reasonable are to be made.
- (4) This section does not apply to a relevant contract if it is determined in accordance with section 590 (disregard of subordinate or small value underlying subject matter) that the underlying subject matter of the relevant contract is to be treated as consisting wholly of excluded property.
- (5) In this section “excluded property” has the same meaning as in section 589 (contracts excluded because of underlying subject matter: general).

## CHAPTER 3

### CREDITS AND DEBITS TO BE BROUGHT INTO ACCOUNT: GENERAL

#### *Introduction*

#### **594 Overview of Chapter**

- (1) This Chapter contains rules of general application about the credits and debits to be brought into account for the purposes of this Part.
- (2) In particular, it—
  - (a) sets out the general principles which are to apply in relation to the bringing into account of credits and debits, including the use of generally accepted accounting practice and the taking into account of related transactions (see sections 595 and 596),
  - (b) makes provision about the interpretation of the expression “amounts recognised in determining a company’s profit or loss” (see sections 597 to 599),
  - (c) makes provision in relation to the application of fair value accounting (see sections 600 to 603),
  - (d) sets out some general rules which differ from generally accepted accounting practice (see sections 604 and 605),
  - (e) makes provision about exchange gains and losses (see section 606),
  - (f) makes provision about pre-contract or abortive expenses (see section 607),
  - (g) makes provision about companies ceasing to be parties to derivative contracts and companies moving abroad (see sections 608 to 610), and
  - (h) makes provision in relation to statutory insolvency arrangements (see section 611).

#### *General principles*

#### **595 General principles about the bringing into account of credits and debits**

- (1) This Part operates by reference to the accounts of companies and amounts recognised for accounting purposes in those accounts.
- (2) The general rule is that the amounts to be brought into account by a company as credits or debits for any period for the purposes of this Part are those which are recognised in determining the company’s profit or loss for the period in accordance with generally accepted accounting practice (but this is subject to subsections (3) and (4)).
- (3) The credits and debits to be brought into account in respect of a company’s derivative contracts are the amounts which, when taken together, fairly represent for the accounting period in question—
  - (a) all profits and losses of the company which arise to it from its derivative contracts and related transactions (excluding expenses), and
  - (b) all expenses incurred by the company under or for the purposes of those contracts and transactions.

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- (4) Expenses are only treated as incurred as mentioned in subsection (3)(b) if they are incurred directly—
  - (a) in bringing any of the derivative contracts into existence,
  - (b) in entering into or giving effect to any of the related transactions,
  - (c) in making payments under any of those contracts or as a result of any of those transactions, or
  - (d) in taking steps to ensure the receipt of payments under any of those contracts or in accordance with any of those transactions.
- (5) For the treatment of pre-contract or abortive expenses, see section 607.
- (6) In subsection (3) “profits and losses” includes profits and losses of a capital nature.
- (7) This section is subject to the following provisions of this Part.
- (8) For the meaning of “related transaction” see section 596.

#### **596 Meaning of “related transaction”**

- (1) In this Part “related transaction”, in relation to a derivative contract, means any disposal or acquisition (in whole or in part) of rights or liabilities under the contract.
- (2) For this purpose the cases where there is taken to be such a disposal or acquisition include—
  - (a) those where rights or liabilities under the derivative contract are transferred or extinguished by any sale, gift, surrender or release, and
  - (b) those where the contract is discharged by performance in accordance with its terms.

*Amounts recognised in determining a company’s profit or loss*

#### **597 Amounts recognised in determining a company’s profit or loss**

- (1) References in this Part to an amount recognised in determining a company’s profit or loss for a period are to an amount recognised in—
  - (a) the company’s profit and loss account, income statement or statement of comprehensive income for that period,
  - (b) the company’s statement of total recognised gains and losses, statement of recognised income and expense, statement of changes in equity or statement of income and retained earnings for that period, or
  - (c) any other statement of items recognised in calculating the company’s profits and losses for that period.
- (2) If, in accordance with generally accepted accounting practice, an amount is shown as a prior period adjustment in any statement within subsection (1), it must be brought into account for the purposes of this Part in calculating the company’s profits and losses for the period to which the statement relates.
- (3) Subsection (2) does not apply to an amount recognised for accounting purposes by way of correction of a fundamental error.



## **598 Regulations about recognised amounts**

- (1) The Treasury may by regulations make provision—
  - (a) excluding amounts of a specified description from section 597(1) (amounts recognised in determining a company’s profit or loss),
  - (b) requiring amounts of a specified description which are not within section 597(1) to be brought into account in determining a company’s profit or loss for a period in specified circumstances, and
  - (c) as to the way in which any such amounts are to be brought into account.
- (2) For the purposes of subsection (1)(b), it does not matter whether the amounts are not within section 597(1) because of regulations under subsection (1)(a) or otherwise.
- (3) The regulations may (in particular) make provision by reference to the fact that amounts derive from or otherwise relate to amounts brought into account in a specified way in a previous period of account.
- (4) The regulations may—
  - (a) make different provision for different cases, and
  - (b) make provision subject to an election or to other specified conditions.
- (5) The regulations may apply, exclude or modify any of the provisions of this Part in relation to cases for which provision is made by the regulations.
- (6) The regulations may apply to periods of account beginning before they are made, but not earlier than the beginning of the calendar year in which they are made.

## **599 Meaning of “amounts recognised for accounting purposes”**

- (1) If a company—
  - (a) draws up accounts which are not GAAP-compliant accounts, or
  - (b) does not draw up accounts at all,this Part applies as if GAAP-compliant accounts had been drawn up.
- (2) Accordingly, references in this Part to amounts recognised for accounting purposes include references to the amounts which would have been recognised if GAAP-compliant accounts had been drawn up for the period of account in question and any relevant earlier period.
- (3) For this purpose a period of account is relevant to a later period if the accounts for the later period rely to any extent on amounts derived from the earlier period.
- (4) In this section “GAAP-compliant accounts” means accounts drawn up in accordance with generally accepted accounting practice.

### *Application of fair value accounting*

## **600 Contract which is or forms part of financial asset or liability**

- (1) This section applies to a derivative contract which meets the condition in section 579(1)(b) (contract which is or forms part of a financial asset or liability for accounting purposes).

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- (2) The amounts to be brought into account in accordance with this Part in respect of the contract are to be determined on the basis of fair value accounting.

**601 Contract relating to holding in OEIC, unit trust or offshore fund**

- (1) This section applies if a company is a party in an accounting period to a relevant contract which is treated as a derivative contract under section 587 (contract relating to holding in OEIC, unit trust or offshore fund).
- (2) The credits and debits which are to be brought into account in accordance with this Part in respect of the relevant contract are to be determined on the basis of fair value accounting.

**602 Contract becoming one relating to holding in OEIC, unit trust or offshore fund**

- (1) This section applies if—
- (a) a company is a party to a relevant contract in two successive accounting periods,
  - (b) section 587 (contract relating to holding in OEIC, unit trust or offshore fund) applies in relation to the relevant contract for the second accounting period but not the first accounting period, and
  - (c) immediately before the beginning of the second accounting period the relevant contract was a chargeable asset.
- (2) For the purposes of section 601(2), the opening valuation of the contract as at the beginning of the second accounting period is taken to be equal to the market value of the contract.
- (3) In subsection (2) “the market value of the contract” means the amount which would have been the market value of the contract for the purposes of corporation tax on chargeable gains if it had been disposed of immediately before the end of the first accounting period.
- (4) For the rules which apply where the company ceases to be a party to the contract, see section 660 (company ceasing to be party to contract relating to holding in OEIC, unit trust or offshore fund).

**603 Associated transaction treated as derivative contract**

- (1) This section is to be read as if it were in Chapter 7 (shares with guaranteed returns etc) of Part 6 (relationships treated as loan relationships etc).
- (2) See, in particular, section 532(3) (meaning of “associated transaction”).
- (3) Subsection (4) applies if credits and debits are required to be brought into account in accordance with this Part in respect of any associated transaction because of section 588 (which treats such a transaction which is not a derivative contract as if it were).
- (4) Those credits and debits are to be determined on the basis of fair value accounting.

*Rules differing from generally accepted accounting practice*

**604 Credits and debits treated as relating to capital expenditure**

- (1) This section applies if generally accepted accounting practice allows a credit or debit for an accounting period in respect of a company's derivative contract to be treated in the company's accounts as an amount recognised in determining the value of a fixed capital asset or project.
- (2) Despite that treatment, the credit or debit must be brought into account in accordance with this Part, in the accounting period for which it is given, in the same way as a credit or debit which is recognised in determining the company's profit or loss for that period in accordance with generally accepted accounting practice.
- (3) But subsection (2) does not apply to a debit which is recognised in arriving at the amount of expenditure in relation to which a debit may be given by Part 8 (intangible fixed assets).
- (4) Subsection (5) applies if a debit is recognised as mentioned in subsection (1).
- (5) No debit may be brought into account in accordance with this Part in respect of—
  - (a) the writing down of so much of the value of the asset or project, or
  - (b) so much of any amortisation or depreciation as represents a writing off of that value,as is attributable to that debit.

**605 Credits and debits recognised in equity**

- (1) This section applies if in accordance with generally accepted accounting practice a credit or debit for a period in respect of a company's derivative contract—
  - (a) is recognised in equity or shareholders' funds, and
  - (b) is not recognised in any of the statements mentioned in section 597(1) (amounts recognised in determining a company's profit or loss).
- (2) The credit or debit must be brought into account for the period in accordance with this Part in the same way as a credit or debit which is recognised in determining the company's profit or loss for the period in accordance with generally accepted accounting practice.

*Miscellaneous*

**606 Exchange gains and losses**

- (1) The reference in section 595(3) to the profits and losses arising to a company from its derivative contracts includes a reference to exchange gains and losses so arising.
- (2) Subsection (1) is subject to subsections (3) and (4).
- (3) Subsection (1) does not apply to an exchange gain or loss of a company so far as—
  - (a) it arises—
    - (i) in relation to a derivative contract whose underlying subject matter consists wholly or partly of currency, or

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- (ii) as a result of the translation from one currency to another of the profit or loss of part of the company's business, and
  - (b) it is recognised in the company's statement of total recognised gains and losses, statement of recognised income and expense, statement of changes in equity or statement of income and retained earnings.
- (4) Subsection (1) does not apply to so much of an exchange gain or loss arising to a company in relation to a derivative contract whose underlying subject matter consists wholly or partly of currency as is within a description specified for the purpose in regulations made by the Treasury.
- (5) The Treasury may by regulations make provision for or in connection with bringing into account in specified circumstances amounts to which subsection (1) does not apply because of subsection (3) or (4).
- (6) The reference in subsection (5) to bringing amounts into account is a reference to bringing amounts into account—
- (a) for the purposes of this Part as credits or debits arising to a company from its derivative contracts, or
  - (b) for the purposes of corporation tax on chargeable gains.
- (7) The regulations may—
- (a) make different provision for different cases, and
  - (b) make provision subject to an election or to other specified conditions.
- (8) For the meaning of references to exchange gains or losses from derivative contracts, see section 705.

### **607 Pre-contract or abortive expenses**

- (1) This section applies if—
- (a) a company may enter into a derivative contract or related transaction but has not yet done so,
  - (b) it incurs any expenses for purposes connected—
    - (i) with entering into it, or
    - (ii) with giving effect to any obligation which might arise under it, and
  - (c) had the company entered into the contract or transaction, the expenses would be expenses within section 595(3)(b).
- (2) The expenses are treated as expenses in relation to which debits may be brought into account in accordance with section 595(3) to the same extent as if the company had entered into the contract or transaction.

### **608 Company ceasing to be party to derivative contract**

- (1) This section applies if—
- (a) a company ceases to be a party to a derivative contract in an accounting period (the "cessation period"),
  - (b) profits or losses arise to the company from the derivative contract or a related transaction in that period, and

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- (c) the credits or debits brought into account in accordance with this Part for that period do not include credits or debits representing the whole of those profits or losses.
- (2) Credits or debits in respect of so much of those profits or losses as are not represented by credits or debits brought into account for the cessation period must continue to be brought into account in accordance with this Part over one or more subsequent accounting periods (“post-cessation periods”) as in the case of a derivative contract to which the company is a party in those periods.
- (3) Subsection (4) applies if any question arises how far in a post-cessation period—
  - (a) the company is a party to the derivative contract for the purposes of a trade it carries on, or
  - (b) the derivative contract is referable to a particular business the company carries on or a particular description of such business.
- (4) The question is to be determined by reference to the circumstances immediately before the company ceased to be a party to the derivative contract, instead of the circumstances in the post-cessation period.
- (5) Subsection (6) applies if any question arises—
  - (a) how far the derivative contract has a particular purpose in a post-cessation period, or
  - (b) whether there is a connection between the company and any other person for a post-cessation period.
- (6) The question is to be determined by reference to the circumstances in the cessation period, instead of the circumstances in the post-cessation period.
- (7) For the purposes of the Corporation Tax Acts, references to a person’s derivative contracts and to a person being a party to a derivative contract are to be read in accordance with this section.

## **609 Company ceasing to be UK resident**

- (1) If a company ceases to be UK resident, this Part applies as if—
  - (a) immediately before so ceasing the company had assigned the rights and liabilities under its derivative contracts for consideration of an amount equal to their fair value at that time, and
  - (b) it had immediately reacquired them for consideration of the same amount.
- (2) Subsection (1) does not apply in relation to a derivative contract so far as immediately after the company ceases to be UK resident its rights and liabilities under the contract are held or owed for the purposes of a permanent establishment of the company in the United Kingdom.
- (3) Subsection (1) does not apply if—
  - (a) the conditions in section 630(1)(a) and (b) are met in relation to the company (transferee leaving group after replacing transferor as party to derivative contract), and
  - (b) it ceases to be UK resident at the same time as it ceases to be a member of the relevant group.
- (4) In subsection (3) “the relevant group” has the meaning given by section 630(4).

**610 Non-UK resident company ceasing to hold derivative contract for UK permanent establishment**

- (1) This section applies if the rights and liabilities under a derivative contract of a company which is not UK resident cease to any extent to be held or owed for the purposes of a permanent establishment of the company in the United Kingdom in circumstances not involving a related transaction.
- (2) This Part applies as if—
  - (a) immediately before the rights and liabilities so cease the company had assigned them, so far as so ceasing, for consideration of an amount equal to their fair value at that time, and
  - (b) the company had immediately reacquired them for consideration of the same amount.
- (3) This section does not apply if—
  - (a) the conditions in section 630(1)(a) and (b) are met in relation to the company (transferee leaving group after replacing transferor as party to derivative contract), and
  - (b) the rights and liabilities mentioned in subsection (1) cease to be held or owed for the purposes of the permanent establishment at the same time as the company ceases to be a member of the relevant group.
- (4) In subsection (3) “the relevant group” has the meaning given by section 630(4).

**611 Release under statutory insolvency arrangement of liability under derivative contract**

No credit is required to be brought into account by a company in respect of the release of the company’s liability to pay an amount under a derivative contract of the company if the release is part of a statutory insolvency arrangement.

**CHAPTER 4****FURTHER PROVISION ABOUT CREDITS AND DEBITS TO BE BROUGHT INTO ACCOUNT***Introduction***612 Overview of Chapter**

- (1) This Chapter makes further provision about the credits and debits to be brought into account for the purposes of this Part.
- (2) In particular, it—
  - (a) provides for adjustments on a change of accounting policy (see sections 613 to 615),
  - (b) makes provision in relation to certain embedded derivatives (see sections 616 to 618),
  - (c) makes provision about partnerships involving companies (see sections 619 to 621),

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- (d) makes provision about contracts ceasing to be derivative contracts (see section 622), and
- (e) makes provision in relation to some gilt-edged securities (see section 623).

*Adjustments on change of accounting policy*

**613 Introduction to sections 614 and 615**

- (1) Sections 614 and 615 (adjustments on change of accounting policy) apply if—
  - (a) there is a change of accounting policy in drawing up a company’s accounts from one period of account to the next, and
  - (b) the accounting policy in each of those periods accords with the law and practice applicable in relation to that period.
- (2) In this section and those sections—
  - (a) the first of those periods of account is referred to as “the earlier period”, and
  - (b) the next is referred to as “the later period”.
- (3) Sections 614 and 615 apply, in particular, if—
  - (a) the company prepares accounts for the earlier period in accordance with UK generally accepted accounting practice and for the later period in accordance with international accounting standards, or
  - (b) the company prepares accounts for the earlier period in accordance with international accounting standards and for the later period in accordance with UK generally accepted accounting practice.
- (4) If an election is made under section 416, this section and sections 614 and 615 apply as if there were a change of accounting policy consisting of the company treating the assets referred to in section 416(1)(c) as mentioned in section 585(1) as from the date the election has effect.

**614 Change of accounting policy involving change of value**

- (1) If there is an increase in the carrying value of a derivative contract of the company between—
  - (a) the end of the earlier period, and
  - (b) the beginning of the later period,a credit of an amount equal to the increase must be brought into account in accordance with this Part for the later period.
- (2) If there is a decrease in the carrying value of such a derivative contract between—
  - (a) the end of the earlier period, and
  - (b) the beginning of the later period,a debit of an amount equal to the decrease must be brought into account in accordance with this Part for the later period.
- (3) This section does not apply so far as such a credit or debit as is mentioned in this section falls to be brought into account apart from this section.

**615 Change of accounting policy after ceasing to be party to derivative contract**

- (1) This section applies if—
- (a) the company has ceased to be a party to a derivative contract in an accounting period (“the cessation period”),
  - (b) section 608 (credits and debits to be brought into account in respect of profits and losses arising in the cessation period) applied to the cessation, and
  - (c) there is a difference between the amount outstanding in respect of the derivative contract (see subsection (5))—
    - (i) at the end of the earlier period, and
    - (ii) at the beginning of the later period.
- (2) If that amount has increased, a credit of an amount equal to the increase must be brought into account in accordance with this Part for the later period.
- (3) If that amount has decreased, a debit of an amount equal to the decrease must be brought into account in accordance with this Part for the later period.
- (4) Subsections (2) and (3) do not apply so far as the credit or debit falls to be brought into account apart from this section.
- (5) In subsection (1) “the amount outstanding in respect of the derivative contract” means so much of the recognised deferred income or recognised deferred loss from the derivative contract as has not been represented by credits or debits brought into account in accordance with this Part in respect of the contract.
- (6) In subsection (5)—
- “recognised deferred income”, in relation to a derivative contract, means the amount recognised in the company’s balance sheet in accordance with generally accepted accounting practice as deferred income in respect of the profits which arose from the contract or a related transaction in the cessation period, and
- “recognised deferred loss”, in relation to a derivative contract, means the amount so recognised as deferred loss in respect of the losses which so arose.

*Certain embedded derivatives***616 Disapplication of fair value accounting**

- (1) This section applies if—
- (a) a company is treated as a party to a relevant contract under section 584(2)(a) or 586(2) (“the embedded derivative”),
  - (b) the embedded derivative is a derivative contract which meets the condition in section 579(1)(a) (contract treated for accounting purposes as derivative),
  - (c) section 592 (embedded derivatives treated as meeting condition in section 591 etc) does not apply in relation to the embedded derivative, and
  - (d) regulation 9 of the Disregard Regulations (interest rate contracts) does not apply to the embedded derivative.
- (2) If this section applies—



- (a) sections 573 and 574 (trading credits and debits to be brought into account under Part 3 and non-trading credits and debits to be brought into account under Part 5) do not apply in relation to the embedded derivative, and
  - (b) subsection (3) or subsections (4) to (6) apply in relation to the original contract, depending on whether that contract is a hybrid derivative or a contract within section 586(1).
- (3) If the original contract is a hybrid derivative, profits and losses are to be calculated for the purposes of this Part as if that contract—
  - (a) were not one where the rights and liabilities are treated for accounting purposes as divided as mentioned in section 584(1) (hybrid derivatives with embedded derivatives), and
  - (b) were not one in relation to which a fair value basis of accounting is used.
- (4) If the original contract is a contract within section 586(1), profits and losses are to be brought into account for the purposes of the Corporation Tax Acts in relation to that contract as if that contract—
  - (a) were not one where the rights and liabilities are treated for accounting purposes as divided as mentioned in section 586(1) (other contracts with embedded derivatives), and
  - (b) were not one in relation to which a fair value basis of accounting is used.
- (5) Accordingly, this Part does not apply to the original contract (except for the purposes of this section), but section 46 applies to that contract as if fair value accounting were not generally accepted accounting practice in relation to the company.
- (6) Subsections (4) and (5) apply despite section 699(1) (priority of this Part for corporation tax purposes).
- (7) In this section—
  - “the Disregard Regulations” means the Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) Regulations 2004 (S.I. 2004/3256), and
  - “the original contract” means—
    - (a) the hybrid derivative as a result of which the company falls to be treated under section 584(2) (hybrid derivatives with embedded derivatives) as a party to the embedded derivative, or
    - (b) the contract within section 586(1) (other contracts with embedded derivatives) as a result of which the company falls to be treated under section 586(2) as a party to the embedded derivative.

### **617 Election for section 616 not to apply**

- (1) A company may elect that section 616 is not to apply in relation to its contracts.
- (2) But such an election does not apply to a contract if—
  - (a) the contract is a contract of long-term insurance, or
  - (b) the underlying subject matter of the embedded derivative is, or includes, commodities.
- (3) An election under this section—
  - (a) must be made before the end of the first applicable accounting period of the company, and

(b) is irrevocable.

(4) In subsection (3) “the first applicable accounting period” means the first accounting period in which the conditions in section 616(1) are met.

(5) Section 618 makes further provision about elections under this section.

## **618 Elections under section 617: groups of companies**

(1) If—

- (a) a company makes an election under section 617 in relation to its contracts, and
- (b) another company, which is a member of the same group as the company making the election, is a party to a contract to which the election applies,

the other company is treated, in relation to that contract, as if it had also made such an election.

(2) If—

- (a) a company (“the electing company”) makes an election under section 617 in relation to its contracts,
- (b) another company (“the transferee”) becomes a party to a contract to which section 584 (hybrid derivatives with embedded derivatives) or section 586 (other contracts with embedded derivatives) applies, in place of the electing company (whether before or after the election is made), and
- (c) the transferee is a member of the same group of companies as the electing company at the time of the transfer,

the transferee is treated, in relation to the contract mentioned in paragraph (b), as if it had also made such an election.

(3) If—

- (a) a company (“A”) is treated under section 584 or 586 as a party to a relevant contract in relation to which section 616(1) applies,
- (b) another company (“B”) becomes a party to that contract in place of A,
- (c) A and B are members of the same group of companies when B becomes a party to the contract, and
- (d) section 616(1) does not apply in relation to B’s other relevant contracts because of an election under section 617 (whenever made),

subsection (4) applies, unless A, subsequent to B’s becoming a party to the contract, makes such an election.

(4) B is treated, in relation to the contract mentioned in subsection (3)(b), as if section 616(1) applied in relation to it.

(5) In this section, references to a company being a member of the same group of companies are to be read in accordance with section 170 of TCGA 1992 (interpretation of sections 171 to 181 of that Act: groups).

### *Partnerships involving companies*

## **619 Partnerships involving companies**

(1) This section applies if—

- (a) a trade or business is carried on by a firm,
  - (b) any of the partners in the firm is a company (a “company partner”), and
  - (c) the firm is a party to a contract which is a derivative contract or would be a derivative contract if the firm were a company.
- (2) No credits or debits may be brought into account in accordance with this Part in respect of the contract in calculating the profits and losses of the trade or business for corporation tax purposes under section 1259 (calculation of firm’s profits and losses).
- (3) Instead, each company partner must bring into account in accordance with this Part credits and debits in respect of the contract for each of its accounting periods in which the conditions in subsection (1) are met.
- (4) Sections 620 (determination of credits and debits by company partners) and 621 (company partners using fair value accounting) contain special rules about the credits and debits to be brought into account under subsection (3).
- (5) In sections 620 and 621 “company partner” has the same meaning as in this section.

## **620 Determination of credits and debits by company partners**

- (1) The credits and debits to be brought into account under section 619(3) are to be determined separately for each company partner as follows.
- (2) The contract entered into or acquired by the firm is treated as if it were instead entered into or acquired by the company partner for the purposes of the trade or business which the company partner carries on.
- (3) Anything done by or in relation to the firm in connection with the contract is treated as done by or in relation to the company partner.
- (4) So far as exchange gains or losses arising from the contract are recognised in the firm's—
  - (a) statement of total recognised gains and losses,
  - (b) statement of recognised income and expense,
  - (c) statement of changes in equity, or
  - (d) statement of income and retained earnings,they are treated as if they had been recognised in the corresponding statement of the company partner.
- (5) The credits and debits in the case of each company partner are the partner’s appropriate share of the total credits and debits determined in accordance with subsections (2) to (4).
- (6) A company partner’s “appropriate share” is the share which would be apportioned to it on the assumption in subsection (7).
- (7) The assumption is that the total credits and debits determined in accordance with subsections (2) to (4) are apportioned between the partners in the shares in which any profit or loss would be apportioned between them in accordance with the firm’s profit-sharing arrangements.

**621 Company partners using fair value accounting**

- (1) This section applies if a company partner uses fair value accounting in relation to its interest in the firm.
- (2) The credits and debits to be brought into account by the company partner under section 619(3) are to be determined on the basis of fair value accounting.

*Miscellaneous***622 Contracts ceasing to be derivative contracts**

- (1) This section applies if a company is a party to a relevant contract which ceases to be a derivative contract.
- (2) The company is treated for the purposes of this Part as if it had disposed of the contract in a related transaction at the relevant time for consideration of an amount equal to the notional carrying value of the contract at that time.
- (3) In this section “the relevant time” means the time when the contract ceases to be a derivative contract.
- (4) For the purposes of this section, the “notional carrying value” of the contract at the relevant time is the amount which would have been the carrying value of the contract in the accounts of the company if a period of account had ended immediately before that time.
- (5) See also section 662 (chargeable gains provision for contracts ceasing to be derivative contracts).

**623 Index-linked gilt-edged securities with embedded contracts for differences**

- (1) This section applies to a derivative contract of a company for an accounting period if each of conditions A to D is met.
- (2) Condition A is that the derivative contract is a relevant contract to which the company is treated as a party under section 585(2) (loan relationships with embedded derivatives) because of a creditor relationship of the company.
- (3) Condition B is that the derivative contract is treated as a contract for differences by section 585(3) (contract treated as option, future or contract for differences).
- (4) Condition C is that the creditor relationship is an index-linked gilt-edged security.
- (5) Condition D is that the credits and debits which fall to be brought into account for the accounting period for the purposes of Part 5 (loan relationships) in respect of the host contract are non-trading credits and non-trading debits.
- (6) The credits and debits which would fall to be brought into account in accordance with this Part in respect of the derivative contract for the accounting period apart from this section may not be so brought into account.
- (7) In this section—  
“the host contract” means the loan relationship to which the company is treated as a party under section 415(2) (loan relationships with embedded

derivatives) because of the creditor relationship mentioned in subsection (2), and

“index-linked gilt-edged security” has the same meaning as in Part 5 (see section 399(4)).

## CHAPTER 5

### CONTINUITY OF TREATMENT ON TRANSFERS WITHIN GROUPS

#### *Introductory*

#### **624 Introduction to Chapter**

- (1) This Chapter makes provision—
  - (a) about continuity of treatment in some cases in which a company replaces a member of the same group of companies as a party to a derivative contract, and
  - (b) about cases in which the company ceases to be a member of the group.
- (2) For the meaning of references in this Chapter to a company replacing another as a party to a derivative contract, see section 627.
- (3) In this Chapter, references to a company being a member of a group of companies are to be read in accordance with section 170 of TCGA 1992 (interpretation of sections 171 to 181 of that Act: groups).
- (4) For modifications of this Chapter for insurance companies, see section 636.

#### *Group member replacing another as party to derivative contract*

#### **625 Group member replacing another as party to derivative contract**

- (1) This section applies if—
  - (a) there is a transaction within section 626(2) or a series of transactions within section 626(3),
  - (b) as a result one of the companies involved (“the transferee”) directly or indirectly replaces the other (“the transferor”) as a party to a derivative contract.
- (2) The credits and debits to be brought into account in accordance with this Part in respect of the derivative contract are determined in accordance with subsections (3) to (5).
- (3) For the accounting period in which the transaction or, as the case may be, the first of the transactions takes place, the transferor is treated as having entered into that transaction for consideration of an amount equal to the notional carrying value of the contract (see subsection (6)).
- (4) For any accounting period in which the transferee is a party to the contract, it is treated as if it had acquired the contract for consideration of an amount equal to its notional carrying value.

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- (5) If a discount arises in respect of the transaction or series of transactions, the consideration is increased for the purposes of subsection (3) (but not subsection (4)) by the amount of the discount.
- (6) For the purposes of this section—
  - (a) “discount” has same meaning as in section 480 (relevant non-lending relationships involving discounts), and
  - (b) the notional carrying value of a contract is the amount which would have been its carrying value in the accounts of the transferor if a period of account had ended immediately before the date when the transferor ceased to be a party to the contract.
- (7) Schedule 28AA to ICTA (provision not at arm’s length) does not apply in relation to the amounts in respect of which credits or debits are to be brought into account under this section.
- (8) This section is subject to sections 628 (transferor using fair value accounting) and 629 (tax avoidance).

#### **626 Transactions to which section 625 applies**

- (1) This section applies for the purposes of section 625(1)(a).
- (2) A transaction is within this subsection if it is a related transaction between two companies which are—
  - (a) members of the same group, and
  - (b) within the charge to corporation tax in respect of that transaction.
- (3) A series of transactions is within this subsection if it is a series of transactions having the same effect as a related transaction between two companies each of which—
  - (a) has been a member of the same group at any time in the course of that series of transactions, and
  - (b) would be within the charge to corporation tax in respect of such a related transaction.

#### **627 Meaning of company replacing another as party to derivative contract**

- (1) References in this Chapter to one company (“A”) replacing another company (“B”) as a party to a derivative contract include references to A becoming a party to a derivative contract which—
  - (a) confers rights within subsection (2),
  - (b) imposes liabilities within subsection (2), or
  - (c) both confers such rights and imposes such liabilities.
- (2) Rights or liabilities are within this subsection if they are equivalent to those of B under a derivative contract to which B has previously ceased to be a party.

### *Exceptions to section 625*

#### **628 Transferor using fair value accounting**

- (1) This section applies instead of section 625 if, in a case where that section would otherwise apply, the transferor uses fair value accounting as respects the derivative contract.
- (2) The amount which is to be brought into account by the transferor in respect of—
  - (a) the transaction mentioned in that section, or
  - (b) the series of transactions mentioned in that section taken together,is the fair value of the derivative contract as at the date of transfer to the transferee.
- (3) For any accounting period in which the transferee is a party to the contract, for the purpose of determining the credits and debits to be brought into account in respect of the contract in accordance with this Part, the transferee is treated as if it had acquired the contract for consideration of an amount equal to the fair value of the contract as at the date of transfer to it.
- (4) If a discount arises in respect of the transaction or series of transactions, the amount to be brought into account under subsection (2) is increased by the amount of the discount.
- (5) In this section—

“discount” has the same meaning as in section 480 (relevant non-lending relationships involving discounts), and

“the transferor” and “the transferee” have the same meaning as in section 625.

#### **629 Tax avoidance**

- (1) Section 625 does not apply if conditions A and B are met.
- (2) Condition A is that the transferor is a party to arrangements in accordance with which there is likely to be a transfer of rights or liabilities under the derivative contract by the transferee to another person in circumstances in which section 625 would not apply.
- (3) Condition B is that the purpose or one of the main purposes of the arrangements is to secure a tax advantage for the transferor or a person connected with it.
- (4) Section 625 does not apply in relation to a disposal if section 698 (disposals for consideration not fully recognised by accounting practice) applies in relation to the disposal.
- (5) In this section—

“arrangements” includes any scheme, agreement, understanding, transaction or series of transactions,

“tax advantage” has the meaning given by section 840ZA of ICTA,

“transfer” includes any arrangement which equates in substance to a transfer (including any acquisition or disposal of, or increase or decrease in, a share of the profits or assets of a firm), and

“the transferor” and “the transferee” have the same meaning as in section 625.

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*Transferee leaving group after replacing transferor as party to derivative contract*

**630 Introduction to sections 631 and 632**

- (1) Sections 631 and 632 apply if—
- (a) section 625 (group member replacing another as party to derivative contract) applies because of a transaction or series of transactions within section 626(2) or (3), and
  - (b) before the end of the relevant 6 year period and while still a party to the relevant derivative contract, the transferee ceases to be a member of the relevant group.
- (2) But the transferee is not to be treated for the purposes of this section and sections 631 and 632 as having left the relevant group if—
- (a) rights and liabilities under a derivative contract are transferred in the course of a transfer or merger in relation to which Chapter 9 (European cross-border transfers of business) or Chapter 10 (European cross-border mergers) applies, and
  - (b) the transferee ceases to be a member of the relevant group in consequence of the transfer or merger.
- (3) In a case where subsection (2) applies, if the transferee becomes a member of another group in consequence of the transfer or merger, it is to be treated for the purposes of this section and sections 631 and 632 as if the relevant group and the other group were the same.
- (4) In this section and sections 631 and 632—
- “the relevant 6 year period” means the period of 6 years following—
- (a) in a case where section 625 applies because of a transaction within section 626(2) (“case A”), that transaction, or
  - (b) in a case where section 625 applies because of a series of transactions within section 626(3) (“case B”), the last transaction of that series,
- “the relevant derivative contract” means the derivative contract mentioned in section 625(1),
- “the relevant group” means—
- (a) in case A, the group mentioned in section 626(2),
  - (b) in case B, the group mentioned in section 626(3), and
- “the transferee” has the same meaning as in section 625.

**631 Transferee leaving group otherwise than because of exempt distribution**

- (1) This section applies if—
- (a) the transferee ceases to be a member of the relevant group, and
  - (b) it does not so cease just because of a distribution which is exempt as a result of—
    - (i) section 213(2) of ICTA (exempt distributions), or
    - (ii) section 213A of ICTA (exempt distributions: division of business).
- (2) If condition A or B is met, this Part applies as if—
- (a) the transferee had assigned its rights and liabilities under the relevant derivative contract immediately before so ceasing,



- (b) the assignment had been for consideration of an amount equal to their fair value at that time, and
  - (c) the transferee had immediately reacquired them for consideration of the same amount.
- (3) Condition A is that if subsection (2) applied a credit would be brought into account in accordance with this Part by the transferee because of subsection (2)(a) and (b).
- (4) Condition B is that—
  - (a) the transferee has a hedging relationship between the relevant derivative contract and a creditor relationship, and
  - (b) because of section 345(2)(a) and (b) (transferee leaving group otherwise than because of exempt distribution) a credit is to be brought into account by the transferee for the purposes of Part 5 (loan relationships) in respect of the creditor relationship.

### **632 Transferee leaving group because of exempt distribution**

- (1) This section applies if—
  - (a) the transferee ceases to be a member of the relevant group just because of a distribution which is exempt as a result of—
    - (i) section 213(2) of ICTA (exempt distributions), or
    - (ii) section 213A of ICTA (exempt distributions: division of business),and
  - (b) there is a chargeable payment within the meaning of section 214(2) of that Act (chargeable payments connected with exempt distributions) within 5 years after the making of the distribution.
- (2) If condition A or B is met, this Part applies as if—
  - (a) the transferee had assigned its rights and liabilities under the relevant derivative contract immediately before that chargeable payment was made,
  - (b) the assignment had been for consideration of an amount equal to their fair value immediately before the transferee ceased to be a member of the relevant group, and
  - (c) the transferee had immediately reacquired them for consideration of the same amount.
- (3) Condition A is that if subsection (2) applied a credit would be brought into account in accordance with this Part by the transferee because of subsection (2)(a) and (b).
- (4) Condition B is that—
  - (a) the transferee has a hedging relationship between the relevant derivative contract and a creditor relationship, and
  - (b) because of section 346(2)(a) and (b) (transferee leaving group because of exempt distribution) a credit is to be brought into account by the transferee for the purposes of Part 5 (loan relationships) in respect of the creditor relationship.

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## CHAPTER 6

### SPECIAL KINDS OF COMPANY

#### *Mutual trading companies*

#### **633 Mutual trading companies**

For the purposes of this Part, activities carried on by a company in the course of any mutual trading are treated as not constituting the whole or any part of a trade.

#### *Insurance companies*

#### **634 Insurance companies**

For the purposes of this Part, activities carried on by a company in the course of—

- (a) any mutual insurance or other mutual business which is not life assurance business, or
  - (b) any basic life assurance and general annuity business,
- are treated as not constituting the whole or any part of a trade.

#### **635 Creditor relationships: embedded derivatives which are options**

- (1) This section applies if in any accounting period—
  - (a) a company is a party to a creditor relationship for the purposes of its life assurance business, and
  - (b) that creditor relationship is one in relation to which sections 415 and 585 (which both apply to loan relationships with embedded derivatives) would have effect but for the fact that the company accounts for the creditor relationship at fair value through profit and loss.
- (2) This Part and Part 5 (loan relationships) have effect for that accounting period as they would if the creditor relationship were one in relation to which those sections have effect.

#### **636 Modifications of Chapter 5**

- (1) Chapter 5 (continuity of treatment on transfers within groups) has effect in relation to insurance companies with the following modifications.
- (2) Section 625(1)(a) (which sets out one of the conditions for that section to apply) has effect as if for “section 626(2)” there were substituted “section 626(2), (2A) or (2B)”.
- (3) Section 626 (transactions to which section 625 applies) has effect as if after subsection (2) there were inserted—
  - “(2A) A transaction is within this subsection if it is a transfer between two companies of business consisting of the effecting or carrying out of contracts of long-term insurance which has effect under an insurance business transfer scheme.
  - (2B) A transaction is within this subsection if it is a transfer between two companies which is a qualifying overseas transfer.”

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- (4) Section 625 (group member replacing another as party to derivative contract) does not apply as a result of a transaction or series of transactions within section 626(2) or (3) in relation to a transfer of an asset, or of rights or duties under or an interest in an asset, if the asset was within one of the categories set out in section 440(4)(a), (d) and (e) of ICTA (assets held for certain categories of long-term business)—
  - (a) immediately before the transfer, or
  - (b) immediately after it.
- (5) Section 625 does not apply as a result of a transaction within section 626(2A) or (2B) in relation to a transfer of an asset, or of rights or duties under or an interest in an asset, if the asset—
  - (a) was within one of the categories set out in section 440(4) of ICTA (transfer of assets etc) immediately before the transfer, and
  - (b) is not within that category immediately after it.
- (6) Subsection (7) applies for the purposes of subsection (5) if one of the companies is an overseas life insurance company.
- (7) An asset is taken to be within the same category both immediately before the transfer and immediately after it if the asset—
  - (a) was within one category immediately before the transfer, and
  - (b) is within the corresponding category immediately after it.

#### *Investment and venture capital trusts*

### **637 Investment trusts: profits or losses of a capital nature**

- (1) Profits or losses of a capital nature arising to an investment trust from a derivative contract may not be brought into account as credits or debits in accordance with this Part.
- (2) For the purposes of this section, “profits or losses of a capital nature” means profits or losses which—
  - (a) are accounted for through the capital column of the income statement in accordance with the Statement of Recommended Practice, or
  - (b) would have been so accounted for if that Statement had been applied correctly.
- (3) “The Statement of Recommended Practice”, in relation to an accounting period for which it is required or permitted to be used, means—
  - (a) the Statement of Recommended Practice relating to Investment Trust Companies, issued by the Association of Investment Trust Companies in January 2003, as from time to time modified, amended or revised, or
  - (b) any subsequent Statement of Recommended Practice relating to investment trusts, as from time to time modified, amended or revised.
- (4) The Treasury may by order amend the definition of “profits or losses of a capital nature” in subsection (2), so far as it applies in relation to an investment trust which prepares accounts in accordance with international accounting standards.

**638 Venture capital trusts: profits or losses of a capital nature**

- (1) Profits or losses of a capital nature arising to a venture capital trust from a derivative contract may not be brought into account as credits or debits in accordance with this Part.
- (2) For the purposes of this section, “profits or losses of a capital nature” means profits or losses which—
  - (a) are accounted for through the capital column of the income statement in accordance with the Statement of Recommended Practice, or
  - (b) would have been so accounted for if the venture capital trust had been an investment trust and that Statement had been applied correctly.
- (3) In this section “the Statement of Recommended Practice” has the meaning given by section 637(3) (investment trusts: profits or losses of a capital nature).
- (4) The Treasury may by order amend the definition of “profits or losses of a capital nature” in subsection (2), so far as it applies in relation to a venture capital trust which prepares accounts in accordance with international accounting standards.

**CHAPTER 7**

## CHARGEABLE GAINS ARISING IN RELATION TO DERIVATIVE CONTRACTS

*Introduction***639 Overview of Chapter**

- (1) This Chapter makes provision about cases in which—
  - (a) credits and debits are not to be brought into account in accordance with section 574 (non-trading credits and debits to be brought into account under Part 5: loan relationships) (see sections 640 and 643 to 650), but
  - (b) instead profits arising to a company from its derivative contracts are chargeable to corporation tax as chargeable gains (see sections 641 to 650).
- (2) This Chapter also makes provision about cases in which—
  - (a) credits and debits are not to be brought into account in accordance with section 573 (trading credits and debits to be brought into account under Part 3: trading income) or section 574 (non-trading credits and debits to be brought into account under Part 5: loan relationships) (see section 651), but
  - (b) instead provisions relating to corporation tax on chargeable gains apply in relation to derivative contracts (see sections 652 to 658).

*Some credits and debits not to be brought into account under Part 5***640 Credits and debits not to be brought into account under Part 5**

- (1) If any of the provisions in subsection (2) applies to a derivative contract of a company for an accounting period, section 574 (non-trading credits and debits to be brought into account under Part 5: loan relationships) does not apply to the relevant credits and debits.

- (2) The provisions are—
  - (a) section 643 (contracts relating to land or certain tangible movable property),
  - (b) section 645 (creditor relationships: embedded derivatives which are options),
  - (c) section 648 (creditor relationships: embedded derivatives which are exactly tracking contracts for differences), and
  - (d) section 650 (property based total return swaps).
- (3) For the meaning of “relevant credits” and “relevant debits”, see section 659.
- (4) For the treatment of the relevant credits and debits in the case of a derivative contract to which section 643, 645, 648 or 650 applies, see section 641 (derivative contracts to be taxed on a chargeable gains basis).

*Some derivative contracts to be taxed on a chargeable gains basis*

#### **641 Derivative contracts to be taxed on a chargeable gains basis**

- (1) This section applies to a derivative contract of a company for an accounting period if any of the provisions in subsection (2) applies to the derivative contract for the period.
- (2) The provisions are—
  - (a) section 643 (contracts relating to land or certain tangible movable property),
  - (b) section 645 (creditor relationships: embedded derivatives which are options),
  - (c) section 648 (creditor relationships: embedded derivatives which are exactly tracking contracts for differences), and
  - (d) section 650 (property based total return swaps).
- (3) For the purposes of corporation tax on chargeable gains—
  - (a) if C exceeds D, a chargeable gain equal to the amount of the excess is treated as accruing to the company in the accounting period,
  - (b) if D exceeds C, an allowable loss equal to the amount of the excess is treated as accruing to the company in the accounting period.
- (4) “C” means the sum of the relevant credits for the accounting period in respect of the derivative contract.
- (5) “D” means the sum of the relevant debits for the accounting period in respect of the derivative contract.
- (6) For a case in which this section does not apply, see section 642.
- (7) See also section 663 (carry back of net losses on derivative contracts to which this section applies).

#### **642 Exception from section 641**

- (1) Section 641 does not apply to a derivative contract to which section 645 applies if, on the assumptions in subsection (2), 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 (2)(d).
- (2) Those assumptions are that—

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- (a) the rights and liabilities treated as comprised in the derivative contract 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.

*Derivative contracts to which sections 640 and 641 apply*

### **643 Contracts relating to land or certain tangible movable property**

- (1) This section applies to a derivative contract of a company for an accounting period if conditions A, B and C are met.
- (2) Condition A is that the underlying subject matter of the derivative contract consists of either or both of the following—
  - (a) land,
  - (b) tangible movable property, other than commodities which are tangible assets.
- (3) Condition B is that the company is not a party to the derivative contract at any time in the accounting period for the purposes of a trade carried on by it.
- (4) Condition C is that the company is not an excluded body.
- (5) For the case where the underlying subject matter of a derivative contract also includes income from property within subsection (2)(a) or (b), see section 644.

### **644 Income to be left out of account in determining whether section 643 applies**

- (1) This section applies if the underlying subject matter of a derivative contract includes income from property within section 643(2)(a) or (b).
- (2) If that income is subordinate income, it is left out of account in determining for the purposes of section 643 whether condition A is met.
- (3) Income is “subordinate income” if it is—
  - (a) subordinate in relation to so much of the underlying subject matter of the derivative contract as consists of property within section 643(2)(a) or (b), or
  - (b) of small value in comparison with the value of the underlying subject matter as a whole.
- (4) For the purposes of this section, whether part of the underlying subject matter of a derivative contract of a company is subordinate or of small value is to be determined by reference to the time when the company enters into or acquires the contract.

### **645 Creditor relationships: embedded derivatives which are options**

- (1) This section applies to a derivative contract of a company for an accounting period if each of conditions A to E is met.
- (2) Condition A is that the derivative contract is a relevant contract to which the company is treated as a party under section 585(2) (loan relationships with embedded derivatives) because of a creditor relationship of the company.

- (3) Condition B is that the derivative contract is treated as an option by section 585(3) (contract treated as option, future or contract for differences).
- (4) Condition C is that the underlying subject matter of the derivative contract—
  - (a) is qualifying ordinary shares, or
  - (b) is mandatorily convertible preference shares.
- (5) Condition D is that the company is not a party to the creditor relationship at any time in the accounting period for the purposes of a trade carried on by it.
- (6) Condition E is that the company is not an excluded body.
- (7) Where this section applies to a derivative contract, the asset representing the creditor relationship is treated for corporation tax purposes as not being a qualifying corporate bond.
- (8) See also—
  - (a) section 647 (meaning of certain expressions in this section), and
  - (b) section 670 (treatment of net gains and losses on exercise of option).

#### **646 Exclusions from section 645**

- (1) Section 645 does not apply to a derivative contract of a company for an accounting period if condition A or B is met in the period.
- (2) Condition A is that the rights and liabilities which fall to be treated as comprised in the derivative contract are such that the extent to which shares may be acquired in accordance with them is to be determined using a cash value—
  - (a) which is specified in the contract for the asset representing the creditor relationship mentioned in section 645(2), or
  - (b) which is or will be ascertainable by reference to that contract.
- (3) Condition B is that the rights and liabilities which fall to be treated as comprised in the derivative contract are such that—
  - (a) the company is entitled or obliged to receive a payment instead of the shares which are the underlying subject matter of the derivative contract, and
  - (b) the amount of that payment differs by more than an insignificant amount from the value of the shares which the company would be entitled to acquire in accordance with those rights and liabilities at the time it became entitled or obliged to receive the payment.

#### **647 Meaning of certain expressions in section 645**

- (1) This section applies for the purposes of section 645.
- (2) “Mandatorily convertible preference shares” means shares which—
  - (a) represent the creditor relationship mentioned in section 645(2),
  - (b) are not qualifying ordinary shares, and
  - (c) are issued upon terms which stipulate that they must be converted into, or exchanged for, qualifying ordinary shares by a relevant time.

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- (3) In subsection (2) “relevant time” means a time no more than 24 hours after the acquisition of the shares by a person who, immediately before that acquisition, had the creditor relationship.
- (4) “Qualifying ordinary shares” means shares in a company which satisfy conditions A and B.
- (5) Condition A is that the shares are all or part of the issued share capital (however described) of the company, other than—
  - (a) capital the holders of which have a right to a dividend at a fixed rate but have no other right to share in the profits of the company, or
  - (b) capital the holders of which have no right to a dividend of any description nor any other right to share in the profits of the company.
- (6) Condition B is that the shares—
  - (a) are listed on a recognised stock exchange, or
  - (b) are shares in a holding company or a trading company.
- (7) In subsection (6) “holding company” and “trading company” have the same meaning as in section 165 of TCGA 1992 (see section 165A of that Act).

**648 Creditor relationships: embedded derivatives which are exactly tracking contracts for differences**

- (1) This section applies to a derivative contract of a company for an accounting period if each of conditions A to F is met.
- (2) Condition A is that the derivative contract is a relevant contract to which the company is treated as a party under section 585(2) (loan relationships with embedded derivatives) because of a creditor relationship of the company.
- (3) Condition B is that the derivative contract is treated as a contract for differences by section 585(3) (contract treated as option, future or contract for differences).
- (4) Condition C is that the derivative contract is an exactly tracking contract.
- (5) Condition D is that the underlying subject matter of the derivative contract is qualifying ordinary shares listed on a recognised stock exchange.
- (6) Condition E is that the company is not a party to the creditor relationship at any time in the accounting period for the purposes of a trade carried on by it.
- (7) Condition F is that the company is not an excluded body.
- (8) Where this section applies to a derivative contract, the asset representing the creditor relationship is treated for corporation tax purposes as not being a qualifying corporate bond.
- (9) See also section 672 (treatment of net gains and losses on disposal of certain embedded derivatives).

**649 Meaning of certain expressions in section 648**

- (1) This section applies for the purposes of section 648.



- (2) “Exactly tracking contract” means a contract where the amount which is to be paid to discharge the rights and liabilities which fall to be treated as comprised in the contract is equal to the amount found by applying R% to C, where—
- R% is the percentage change (if any) over the relevant period in—
- (a) the value of the assets which are the underlying subject matter of the contract, or
  - (b) any index of the value of those assets, and
- C is the amount falling to be regarded in accordance with generally accepted accounting practice as the cost of the asset representing the creditor relationship mentioned in section 648(2) on the date when that asset came into existence.
- (3) In subsection (2) “the relevant period” means—
- (a) the period between—
    - (i) the date when the asset representing that creditor relationship came into existence, and
    - (ii) the date when the debtor relationship corresponding to that creditor relationship comes to an end, or
  - (b) any other period in which almost all of that period falls, and which differs from that period only for purposes connected with giving effect to a valuation in relation to rights or liabilities under that asset.
- (4) “Qualifying ordinary shares” means shares in a company which are all or part of the issued share capital (however described) of the company, other than—
- (a) capital the holders of which have a right to a dividend at a fixed rate but have no other right to share in the profits of the company, or
  - (b) capital the holders of which have no right to a dividend of any description nor any other right to share in the profits of the company.

## **650 Property based total return swaps**

- (1) This section applies to a derivative contract of a company for an accounting period if each of conditions A to F is met.
- (2) Condition A is that the derivative contract is a contract for differences.
- (3) Condition B is that one or more indices are specified in the contract.
- (4) Condition C is that at least one index so specified (“the capital value index”) is an index of changes in the value of land.
- (5) Condition D is that the underlying subject matter of the derivative contract also includes interest rates.
- (6) Condition E is that the company is not a party to the derivative contract at any time in the accounting period for the purposes of a trade carried on by it.
- (7) Condition F is that the company is not an excluded body.

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*Some credits and debits not to be brought into account under Part 3 or 5*

### **651 Credits and debits not to be brought into account under Part 3 or Part 5**

- (1) If the provisions in subsection (2)(a) or (b) apply to a derivative contract for an accounting period, sections 573 (trading credits and debits to be brought into account under Part 3: trading income) and 574 (non-trading credits and debits to be brought into account under Part 5: loan relationships) do not apply to the relevant credits and debits.
- (2) The provisions are—
  - (a) sections 653 to 655 (issuers of securities with embedded derivatives: deemed options), and
  - (b) section 658 (issuers of securities with embedded derivatives: deemed contracts for differences).
- (3) For the cases in which sections 653 to 655 and section 658 apply, see sections 652 and 656 respectively.
- (4) For the provision which applies where sections 653 to 655 or 658 apply, see those sections.

*Issuers of securities with embedded derivatives: deemed options*

### **652 Introduction to sections 653 to 655**

- (1) Sections 653 to 655 apply to a derivative contract of a company for an accounting period if each of conditions A to E is met.
- (2) Condition A is that the derivative contract is a relevant contract to which the company is treated as a party under section 585(2) (loan relationships with embedded derivatives) because of a debtor relationship of the company.
- (3) Condition B is that the derivative contract is treated as an option by section 585(3) (contract treated as option, future or contract for differences).
- (4) Condition C is that the underlying subject matter of the derivative contract is shares.
- (5) Condition D is that at the time when the company became a party to the debtor relationship—
  - (a) it was not carrying on a banking business or a business as a securities house, or
  - (b) if it was carrying on such a business, it did not become a party to the debtor relationship in the ordinary course of that business.
- (6) Condition E is that the company is not an excluded body.
- (7) In this section “option” is to be construed as if section 580(2) and (3) (meaning of “option”) were omitted.

### **653 Shares issued or transferred as a result of exercise of deemed option**

- (1) Subsections (2) and (3) apply if—
  - (a) the option mentioned in section 652(3) is exercised at any time in the accounting period, and

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- (b) shares are issued or transferred in fulfilment of the obligations under the option (“the relevant disposal”).
- (2) Section 144(2) of TCGA 1992 (exercise of options) applies to the relevant disposal as if the carrying value of the option at the time the company became a party to the debtor relationship mentioned in section 652(2) were the consideration for the grant of the option.
- (3) So far as it would otherwise apply, section 17(1) of TCGA 1992 (deemed market value consideration) does not apply to the relevant disposal.

#### **654 Payment instead of disposal on exercise of deemed option**

- (1) Subsection (2) applies if—
- (a) the option mentioned in section 652(3) is exercised at any time in the accounting period,
  - (b) no shares are issued or transferred in fulfilment of the obligations under the option, and
  - (c) an amount is paid in fulfilment of those obligations.
- (2) If —
- (a) CV exceeds X, a chargeable gain equal to the amount of the excess is treated as accruing to the company in the accounting period,
  - (b) X exceeds CV, an allowable loss equal to the amount of the excess is treated as accruing to the company in the accounting period.
- (3) In this section—
- “CV” means—
- (a) if the company was a party to the debtor relationship mentioned in section 652(2) at the time it was created, the carrying value of the option at that time, or
  - (b) if the company became a party to that relationship at a later time, the carrying value of the option at that time,
- “X” means the amount paid by the debtor in fulfilment of the obligations under the debtor relationship reduced (but not below nil) by the fair value of the host contract at the date on which the option is exercised, and
- “the host contract” means the loan relationship to which the company is treated as a party under section 415(2) (loan relationships with embedded derivatives) because of the debtor relationship.

#### **655 Ceasing to be party to debtor relationship when deemed option not exercised**

- (1) Subsection (2) applies if the company ceases to be a party to the debtor relationship mentioned in section 652(2) at a time when the option mentioned in section 652(3) has not been exercised.
- (2) The company is treated for the purposes of corporation tax on chargeable gains—
- (a) as having acquired an asset for consideration of an amount equal to Y, and
  - (b) as having disposed of that asset for consideration of an amount equal to CV.
- (3) In this section—
- “CV” has the same meaning as in section 654,

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“Y” means—

- (a) if the company ceases to be a party to the debtor relationship as a result of the redemption or repayment of the liability representing that relationship, the amount paid by the company, or
- (b) otherwise, the consideration given by the company on its ceasing to be a party to that relationship,

in either case reduced (but not below nil) by the fair value of the host contract at the date on which it so ceases, and

“the host contract” has the same meaning as in section 654.

*Issuers of securities with embedded derivatives: deemed contracts for differences*

### **656 Introduction to section 658**

- (1) Section 658 (chargeable gain or allowable loss treated as accruing) applies to a derivative contract of a company for an accounting period if each of conditions A to F is met.
- (2) Condition A is that the derivative contract is a relevant contract to which the company is treated as a party under section 585(2) (loan relationships with embedded derivatives) because of a debtor relationship of the company.
- (3) Condition B is that the derivative contract—
  - (a) is treated as a contract for differences by section 585(3) (contract treated as option, future or contract for differences), and
  - (b) is not within section 652.
- (4) Condition C is that the derivative contract is an exactly tracking contract.
- (5) Condition D is that the underlying subject matter of the derivative contract is shares.
- (6) Condition E is that at the time when the company became a party to the debtor relationship—
  - (a) it was not carrying on a banking business or a business as a securities house, or
  - (b) if it was carrying on such a business, it did not become a party to the debtor relationship in the ordinary course of that business.
- (7) Condition F is that the company is not an excluded body.
- (8) For the meaning of “exactly tracking contract”, see section 657.

### **657 Meaning of “exactly tracking contract” in section 656**

- (1) This section applies for the purposes of section 656.
- (2) “Exactly tracking contract” means a contract where the amount which is to be paid to discharge the rights and liabilities which fall to be treated as comprised in the contract is equal to the amount found by applying R% to C, where—
  - R% is the percentage change (if any) over the relevant period in—
    - (a) the value of the assets which are the underlying subject matter of the contract, or
    - (b) any index of the value of those assets, and

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C is the amount falling to be regarded in accordance with generally accepted accounting practice as the proceeds of issue of the liability which represents the debtor relationship mentioned in section 656(2).

- (3) In subsection (2) “the relevant period” means—
- (a) the period between—
    - (i) the date when the liability representing that debtor relationship came into existence, and
    - (ii) the date when the creditor relationship corresponding to that debtor relationship comes to an end, or
  - (b) any other period in which almost all of that period falls, and which differs from that period only for purposes connected with giving effect to a valuation in relation to rights or liabilities under the liability representing that debtor relationship.

### **658 Chargeable gain or allowable loss treated as accruing**

- (1) Subsection (2) applies if—
- (a) the debtor relationship mentioned in section 656(2) comes to an end, and
  - (b) an amount (“the discharge amount”) is paid to discharge all the company’s obligations under that relationship.
- (2) For the purposes of corporation tax on chargeable gains, a chargeable gain or allowable loss equal to the amount mentioned in subsection (3) is treated as accruing to the company.
- (3) That amount is the amount of the gain or loss (as the case may be) which would accrue on the assumptions in subsection (4).
- (4) Those assumptions are that—
- (a) the derivative contract is an asset of the company,
  - (b) there is a disposal of that asset at the time when the debtor relationship comes to an end,
  - (c) the consideration for the disposal of that asset is equal to the relevant amount, and
  - (d) the cost of the asset is equal to the discharge amount.
- (5) In subsection (4) “the relevant amount” means—
- (a) if the company was a party to the debtor relationship at the time it was created, the amount of the proceeds of issue of the security representing that relationship, or
  - (b) if the company became a party to the debtor relationship after that time, the amount of the carrying value of the host contract at that time.
- (6) In this section “the host contract” means the loan relationship to which the company is treated as a party under section 415(2) (loan relationships with embedded derivatives) because of the debtor relationship.

*Interpretation***659 Meaning of “relevant credits” and “relevant debits”**

- (1) This section applies for the purposes of this Chapter.
- (2) In the case of a derivative contract which is not one to which section 650 (property based total return swaps) applies for an accounting period, the relevant credits and debits are the credits and debits which are given in relation to the derivative contract for the accounting period by section 595.
- (3) In the case of a derivative contract to which section 650 applies for an accounting period, the relevant credits and debits are the credits and debits which—
  - (a) are given in relation to the derivative contract for the accounting period by section 595, and
  - (b) are within subsection (4).
- (4) The credits and debits are those found for the period by applying R% to N, where—
 

N is the amount which is the notional principal amount in the case of the derivative contract, and

R% is the percentage change (if any) in the capital value index over the relevant period.
- (5) In subsection (4) “the relevant period” means—
  - (a) the accounting period, if the company is a party to the derivative contract throughout that period,
  - (b) in any other case, any part of the accounting period throughout which the company is a party to the derivative contract.
- (6) For the meaning of “the capital value index”, see section 650(4).

**CHAPTER 8**

## FURTHER PROVISION ABOUT CHARGEABLE GAINS AND DERIVATIVE CONTRACTS

*Company ceasing to be party to certain contracts***660 Contract relating to holding in OEIC, unit trust or offshore fund**

- (1) This section applies if—
  - (a) a company is a party to a relevant contract in two successive accounting periods,
  - (b) section 587 (contract relating to holding in OEIC, unit trust or offshore fund) applies in relation to the relevant contract for the second of those periods but not the first, and
  - (c) immediately before the beginning of the second period the relevant contract was a chargeable asset.
- (2) The company must bring into account for the accounting period in which it ceases to be a party to the contract the amount of any chargeable gain or allowable loss which would have been treated as accruing to it on the assumptions in subsection (3).

- (3) Those assumptions are that—
  - (a) the company disposed of the relevant contract immediately before the beginning of the second period mentioned in subsection (1), and
  - (b) the disposal was for consideration of an amount equal to the value (if any) given to the relevant contract in the accounts of the company at the end of the first such period.

## **661 Contract which becomes derivative contract**

- (1) This section applies if—
  - (a) a company is a party to a relevant contract which (not having been a derivative contract) becomes a derivative contract, and
  - (b) immediately before the relevant contract becomes a derivative contract it is a chargeable asset.
- (2) The company must bring into account for the accounting period in which it ceases to be a party to the relevant contract the amount of any chargeable gain or allowable loss which would have been treated as accruing to it on the assumptions in subsection (3).
- (3) Those assumptions are that—
  - (a) the company disposed of the relevant contract immediately before the relevant time, and
  - (b) the disposal was for consideration of an amount equal to the notional carrying value of the relevant contract at that time.
- (4) In this section “the relevant time” means the time when the relevant contract becomes a derivative contract.
- (5) Section 622(4) (meaning of “notional carrying value”) applies for the purposes of this section.

### *Contracts ceasing to be derivative contracts*

## **662 Contracts ceasing to be derivative contracts**

- (1) This section applies if a company is a party to a relevant contract which ceases to be a derivative contract.
- (2) The company is treated for the purposes of corporation tax on chargeable gains as if it had acquired the contract immediately after the relevant time for consideration of an amount equal to the notional carrying value of the contract at that time.
- (3) In this section “the relevant time” means the time when the contract ceases to be a derivative contract.
- (4) Section 622(4) (meaning of “notional carrying value”) applies for the purposes of this section.

*Carry back of net losses on certain derivative contracts***663 Contracts to which section 641 applies**

- (1) This section applies in the case of a company if—
  - (a) there are net section 641 losses for an accounting period (“the loss period”),
  - (b) there are net section 641 gains for a previous accounting period (“the gains period”),
  - (c) the gains period falls wholly or partly within the period of 24 months immediately preceding the start of the loss period, and
  - (d) within two years after the end of the loss period the company makes a claim in respect of the whole or a part of the net section 641 losses for the loss period.
- (2) The net section 641 gains for the gains period are reduced (but not below nil) by the amount in respect of which the claim is made.
- (3) And the net section 641 losses for the loss period are reduced by the amount in respect of which the claim is made.
- (4) For the purposes of this section—
  - (a) the net section 641 gains for a later period are reduced so far as possible before the net section 641 gains for an earlier period, and
  - (b) where a gains period falls partly before the start of the 24 month period mentioned in subsection (1), only the appropriate fraction of the net section 641 gains for that period may be reduced.
- (5) For the meaning of “net section 641 gains”, “net section 641 losses” and “the appropriate fraction”, see section 664.

**664 Meaning of certain expressions in section 663**

- (1) This section applies for the purposes of section 663.
- (2) If for an accounting period L exceeds G, there are net section 641 losses for the period of an amount equal to the excess.
- (3) If for an accounting period G exceeds the sum of L and N, there are net section 641 gains for the period of an amount equal to the excess.
- (4) In this section—
 

G is the sum of the amounts of any chargeable gains treated as accruing to the company in the period under section 641(3)(a) in respect of derivative contracts of the company (“section 641 gains”),

L is the sum of the amounts of any allowable losses treated as accruing to the company in the period under section 641(3)(b) in respect of derivative contracts of the company (“section 641 losses”), and

N is the sum of the amounts of any non-section 641 losses which would fall to be deducted in the period from section 641 gains, on the assumption in subsection (5).
- (5) That assumption is that, as respects the accounting period, non-section 641 losses are treated as being deducted from non-section 641 gains, so far as possible, before any remainder is deducted from section 641 gains.



(6) The “appropriate fraction” is—

$$\frac{A}{B}$$

where—

A is the number of days in the gains period which fall within the 24 month period mentioned in section 663(1)(c), and

B is the number of days in the gains period.

(7) In this section—

“deducted” means deducted in accordance with section 8(1) of TCGA 1992 (company’s total profits to include chargeable gains),

“the gains period” has the same meaning as in section 663,

“non-section 641 gains” means any chargeable gains accruing to the company in the accounting period, other than section 641 gains, and

“non-section 641 losses” means any allowable losses of the company which may be deducted in the accounting period, other than section 641 losses.

*Issuers of securities with embedded derivatives: equity instruments*

**665 Introduction to section 666**

- (1) Section 666 (allowable loss treated as accruing) applies to a company for an accounting period if each of conditions A to F is met.
- (2) Condition A is that the company is treated as a party to a relevant contract under section 585(2) (loan relationships with embedded derivatives) because of a debtor relationship of the company.
- (3) Condition B is that the division mentioned in section 585(1) (loan relationships with embedded derivatives) in the case of the debtor relationship is between—
  - (a) rights and liabilities under a loan relationship, and
  - (b) rights and liabilities under an equity instrument of the company.
- (4) Condition C is that the relevant contract is treated as an option by section 585(3) (contract treated as option, future or contract for differences).
- (5) Condition D is that the company pays an amount in the accounting period to the person who is a party to the debtor relationship as creditor in discharge of any obligations under that relationship.
- (6) Condition E is that at the time when the company became a party to the debtor relationship—
  - (a) it was not carrying on a banking business or a business as a securities house, or
  - (b) if it was carrying on such a business, it did not become a party to that relationship in the ordinary course of that business.
- (7) Condition F is that the company is not an excluded body.
- (8) In this section “option” is to be construed as if section 580(2) and (3) (meaning of “option”) were omitted.

**666 Allowable loss treated as accruing**

(1) If A exceeds B, an allowable loss equal to the amount of the excess is treated as accruing to the company in the accounting period for the purposes of corporation tax on chargeable gains.

(2) In this section—

A is the amount paid as mentioned in section 665(5) reduced (but not below nil) by an amount equal to the fair value of the host contract at the time that amount is paid,

B is the amount treated as the carrying value of the relevant contract mentioned in section 665(4) at the time the company became a party to the debtor relationship mentioned in section 665(2), and

“the host contract” means the loan relationship to which the company is treated as a party under section 415(2) (loan relationships with embedded derivatives) because of the debtor relationship.

*Treatment of shares acquired in certain circumstances***667 Shares acquired on exercise of non-embedded option**

(1) This section applies if—

- (a) a company is a party to a derivative contract in an accounting period,
- (b) the derivative contract is a plain vanilla contract,
- (c) the contract is an option,
- (d) rights to acquire shares are comprised in the contract, and
- (e) shares are acquired as a result of the exercise of any of those rights in the accounting period.

(2) For the purpose of calculating any chargeable gain accruing to the company on a disposal by it of all the shares so acquired, the sums allowable as a deduction under section 38(1)(a) of TCGA 1992 (acquisition costs) are—

- (a) if G exceeds L, increased by the amount of that excess,
- (b) if L exceeds G, reduced by the amount of that excess,

and, in the case of a part disposal of those shares, section 42(2) of that Act (part disposals) has effect accordingly.

(3) If the amount of the excess in subsection (2)(b) is greater than the amount of expenditure allowable under section 38(1)(a) of TCGA 1992, the amount of the excess which cannot be deducted from the expenditure so allowable is, for the purpose mentioned in subsection (2), added to the amount of the consideration for the disposal of the shares.

(4) For the meaning of G and L, see section 669.

**668 Shares acquired on running of future to delivery**

(1) This section applies if—

- (a) a company is a party to a derivative contract in an accounting period,
- (b) the derivative contract is a plain vanilla contract,
- (c) the contract is a future, and

- (d) delivery is taken of shares in accordance with the terms of the future.
- (2) For the purpose of calculating any chargeable gain accruing to the company on a disposal by it of all the shares so delivered, the sums allowable as a deduction under section 38(1)(a) of TCGA 1992 (acquisition costs) are—
  - (a) if G exceeds L, increased by the amount of that excess,
  - (b) if L exceeds G, reduced by the amount of that excess,and, in the case of a part disposal of those shares, section 42(2) of that Act (part disposals) has effect accordingly.
- (3) If the amount of the excess in subsection (2)(b) is greater than the amount of expenditure allowable under section 38(1)(a) of TCGA 1992, the amount of the excess which cannot be deducted from the expenditure so allowable is, for the purpose mentioned in subsection (2), added to the amount of the consideration for the disposal of the shares.
- (4) For the meaning of G and L, see section 669.

#### **669 Meaning of G and L in sections 667 and 668**

- (1) This section applies for the purposes of sections 667 and 668.
- (2) G is the sum of the credits brought into account under section 574 (non-trading credits and debits to be brought into account under Part 5) in respect of the derivative contract in each relevant accounting period so far as referable, on a just and reasonable apportionment, to the shares acquired as a result of the exercise of rights mentioned in section 667(1)(e) or the delivery mentioned in section 668(1)(d).
- (3) L is the sum of the debits brought into account under section 574 in respect of the derivative contract in each relevant accounting period, so far as so referable.
- (4) In this section “relevant accounting period” means—
  - (a) the accounting period in which the disposal in question is made, or
  - (b) any previous accounting period.

#### *Treatment of net gains and losses on exercise of option*

#### **670 Treatment of net gains and losses on exercise of option**

- (1) This section applies if—
  - (a) a derivative contract is one to which section 645 (creditor relationships: embedded derivatives which are options) applies for an accounting period,
  - (b) rights to acquire shares fall to be treated as comprised in the derivative contract because of section 585(2), and
  - (c) any of those rights are exercised or otherwise disposed of in the accounting period.
- (2) Subsection (3) applies if there is a disposal of the asset representing the creditor relationship mentioned in section 645(2).
- (3) For the purpose of calculating any chargeable gain accruing to the company on the disposal, the sums allowable as a deduction under section 38(1)(a) of TCGA 1992 (acquisition costs) are—

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- (a) if the sum of G and CV exceeds L, increased by the amount of that excess,
  - (b) if L exceeds the sum of G and CV, reduced by the amount of that excess.
- (4) Subsection (5) applies if there is a disposal of all or any of the shares (“the relevant shares”) acquired—
- (a) as a result of the exercise of rights mentioned in subsection (1)(c), and
  - (b) in circumstances where a disposal is deemed not to occur because of section 127 of TCGA 1992 (equation of original shares and new holding).
- (5) For the purpose of calculating any chargeable gain accruing to the company on a disposal of all the relevant shares, the sums allowable as a deduction under section 38(1)(a) of TCGA 1992 (acquisition costs) are—
- (a) if the sum of G and CV exceeds L, increased by the amount of that excess,
  - (b) if L exceeds the sum of G and CV, reduced by the amount of that excess,
- and, in the case of a part disposal of those shares, section 42(2) of that Act (part disposals) has effect accordingly.
- (6) If the amount of the excess in subsection (3)(b) or (5)(b) is greater than the amount of expenditure allowable under section 38(1)(a) of TCGA 1992, the amount of the excess which cannot be deducted from the expenditure so allowable is, for the purpose mentioned in subsection (3) or (5) (as the case may be), added to the amount of the consideration for the disposal so mentioned.
- (7) Sections 37 and 39 of TCGA 1992 (consideration chargeable to tax on income and exclusion of expenditure by reference to tax on income) do not apply in relation to a disposal mentioned in subsection (2) or (4) above.
- (8) For the meaning of G, L and CV, see section 671.

### **671 Meaning of G, L and CV in section 670**

- (1) This section applies for the purposes of section 670.
- (2) G is the sum of the amounts of any chargeable gains treated as accruing to the company under section 641(3)(a) (derivative contracts to be taxed on a chargeable gains basis) in respect of the derivative contract in each relevant accounting period, so far as referable, on a just and reasonable apportionment, to the shares acquired as a result of the exercise of rights mentioned in section 670(1)(c).
- (3) L is the sum of the amounts of any allowable losses treated as accruing to the company under section 641(3)(b) in respect of the derivative contract in each relevant accounting period, so far as so referable.
- (4) CV is the amount by which the carrying value of the host contract at the date on which the option is exercised exceeds the carrying value of that contract at—
- (a) the date on which the company became a party to the creditor relationship mentioned in section 645(2), or
  - (b) (if later) the date on which the derivative contract became one to which section 645 applies.
- (5) In this section—
- “the host contract” means the loan relationship to which the company is treated as a party under section 415(2) (loan relationships with embedded

derivatives) because of the creditor relationship mentioned in section 645(2), and

“relevant accounting period” means—

- (a) the accounting period in which the disposal in question is made, or
- (b) any previous accounting period.

*Treatment of net gains and losses on disposal of certain embedded derivatives*

**672 Treatment of net gains and losses on disposal of certain embedded derivatives**

- (1) This section applies if—
  - (a) a derivative contract is one to which section 648 (creditor relationships: embedded derivatives which are exactly tracking contracts for differences) applies for an accounting period, and
  - (b) the asset representing the creditor relationship mentioned in section 648(2) is disposed of in the accounting period.
- (2) For the purpose of calculating any chargeable gain accruing to the company on the disposal, the sums allowable as a deduction under section 38(1)(a) of TCGA 1992 (acquisition costs) are—
  - (a) if the sum of G and CV exceeds L, increased by the amount of that excess,
  - (b) if L exceeds the sum of G and CV, reduced by the amount of that excess.
- (3) If the amount of the excess in subsection (2)(b) is greater than the amount of expenditure allowable under section 38(1)(a) of TCGA 1992, the amount of the excess which cannot be deducted from the expenditure so allowable is, for the purpose mentioned in subsection (2), added to the amount of the consideration for the disposal.
- (4) Sections 37 and 39 of TCGA 1992 (consideration chargeable to tax on income and exclusion of expenditure by reference to tax on income) do not apply in relation to the disposal.
- (5) For the meaning of G, L and CV, see section 673.

**673 Meaning of G, L and CV in section 672**

- (1) This section applies for the purposes of section 672.
- (2) G is the sum of the amounts of any chargeable gains treated as accruing to the company under section 641(3)(a) (derivative contracts to be taxed on a chargeable gains basis) in respect of the derivative contract in each relevant accounting period.
- (3) L is the sum of the amounts of any allowable losses treated as accruing to the company under section 641(3)(b) in respect of the derivative contract in each relevant accounting period.
- (4) CV is the amount by which the carrying value of the host contract at the date of the disposal exceeds the carrying value of that contract at the date on which the company became a party to the creditor relationship mentioned in section 648(2).
- (5) In this section—

“the host contract” means the loan relationship to which the company is treated as a party under section 415(2) (loan relationships with embedded

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derivatives) because of the creditor relationship mentioned in section 648(2), and

“relevant accounting period” means—

- (a) the accounting period in which the disposal is made, or
- (b) any previous accounting period.

## CHAPTER 9

### EUROPEAN CROSS-BORDER TRANSFERS OF BUSINESS

#### *Introduction*

#### **674 Introduction to Chapter**

(1) This Chapter applies if—

- (a) condition A or B is met, and
- (b) each of the companies mentioned in subsection (2)(a) or (3)(a) makes a claim under this section,

but see section 677 (tax avoidance etc) and section 680 (disapplication of Chapter where transparent entities involved).

(2) Condition A is that—

- (a) a company resident in one member State transfers to a company resident in another member State the whole or part of a business carried on in the United Kingdom,
- (b) the transfer is wholly in exchange for shares or debentures issued by the transferee to the transferor, and
- (c) immediately after the transfer the transferee is within the charge to corporation tax.

(3) Condition B is that—

- (a) a company transfers part of its business to one or more companies,
- (b) the transferor is resident in one member State,
- (c) the part of the transferor’s business which is transferred is carried on by the transferor in the United Kingdom,
- (d) at least one transferee is resident in a member State other than that in which the transferor is resident (and each transferee is resident in a member State, but not necessarily the same one),
- (e) the transferor continues to carry on a business after the transfer,
- (f) immediately after the transfer each transferee is within the charge to corporation tax, and
- (g) the transfer—
  - (i) is made in exchange for the issue of shares in or debentures of each transferee to each person holding shares in or debentures of the transferor, or
  - (ii) is not so made only because, and only so far as, a transferee is prevented from so issuing such shares or debentures by section 658 of the Companies Act 2006 (c. 46) (general rule against limited company

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acquiring own shares) or by a corresponding provision of the law of another member State preventing such an issue.

- (4) In this Chapter—
- “the transfer of business” means the transfer of business mentioned in subsection (2)(a) or (3)(a),
  - “transferee” has the same meaning as in subsection (2) or (3), and
  - “the transferor” has the same meaning as in subsection (2) or (3).
- (5) For the meaning of “company” and “resident in a member State”, see section 681.

#### *Transfers of derivative contracts at notional carrying value*

### **675 Transfer of derivative contract at notional carrying value**

- (1) This section applies if in the course of the transfer of business the transferor transfers the rights and liabilities under a derivative contract to a transferee.
- (2) For the purpose of determining the credits and debits to be brought into account in respect of the derivative contract in accordance with this Part, the transferor and the transferee are treated as having entered into the transfer of those rights and liabilities for consideration of an amount equal to the notional carrying value of the contract.
- (3) For the purposes of this section, the notional carrying value of a contract is the amount which would have been its carrying value in the accounts of the transferor if a period of account had ended immediately before the date when the transferor ceased to be a party to the contract.
- (4) This section is subject to section 676 (transferor using fair value accounting).

### **676 Transferor using fair value accounting**

- (1) This section applies instead of section 675 if, in a case where that section would otherwise apply, the transferor uses fair value accounting as respects the derivative contract.
- (2) The amount which is to be brought into account by the transferor in respect of the transfer of the rights and liabilities mentioned in section 675(1) is the fair value of the derivative contract as at the date of transfer to the transferee.
- (3) For any accounting period in which the transferee is a party to the derivative contract, for the purpose of determining the credits and debits to be brought into account in respect of the contract in accordance with this Part, the transferee is treated as if it had acquired the contract for consideration of an amount equal to the fair value of the contract as at the date of transfer to it.

#### *Exception for tax avoidance cases and clearances*

### **677 Tax avoidance etc**

- (1) This Chapter does not apply in relation to the transfer of business if—
  - (a) the transfer of business is not effected for genuine commercial reasons, or

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- (b) the transfer of business forms part of a scheme or arrangements of which the main purpose, or one of the main purposes, is avoiding liability to corporation tax, capital gains tax or income tax.
- (2) But subsection (1) does not prevent this Chapter from applying if before the transfer of business—
  - (a) the companies mentioned in section 674(2)(a) or (3)(a) have applied to the Commissioners for Her Majesty’s Revenue and Customs, and
  - (b) the Commissioners have notified them that they are satisfied that subsection will not have that effect.

### **678 Procedure on application for clearance**

- (1) This section applies in relation to an application under section 677(2).
- (2) The application must be in writing and must contain particulars of the operations which are to be effected.
- (3) The Commissioners for Her Majesty’s Revenue and Customs may by notice require the applicant to provide further particulars for the purpose of enabling them to make their decision.
- (4) Such a notice may only be given within 30 days of the receipt of the application or of any further particulars previously required under subsection (3).
- (5) If such a notice is not complied with within 30 days or such longer period as the Commissioners for Her Majesty’s Revenue and Customs may allow, they need not proceed further on the application.

### **679 Decision on application for clearance**

- (1) The Commissioners for Her Majesty’s Revenue and Customs must notify their decision on an application under section 677(2) to the applicant—
  - (a) within 30 days of receiving the application, or
  - (b) if they give a notice under section 678(3), within 30 days of the notice being complied with.
- (2) If the Commissioners for Her Majesty’s Revenue and Customs—
  - (a) notify the applicant that they are not satisfied as mentioned in section 677(2)(b), or
  - (b) do not notify their decision to the applicant within the time required by subsection (1),

the applicant may within 30 days of the notification or of that time require them to transmit the application to the tribunal, together with any notice given and further particulars provided under section 678(3).
- (3) In that case any notification by the tribunal has effect for the purposes of section 677(2)(b) as if it were a notification by the Commissioners for Her Majesty’s Revenue and Customs.
- (4) If any particulars provided under section 678 do not fully and accurately disclose all facts and considerations material for the decision—
  - (a) of the Commissioners for Her Majesty’s Revenue and Customs, or



(b) of the tribunal,  
any resulting notification by the Commissioners for Her Majesty's Revenue and Customs or the tribunal is void.

#### *Transparent entities*

### **680 Disapplication of Chapter where transparent entities involved**

- (1) This Chapter does not apply in relation to the transfer of business if the transferor is a transparent entity.
- (2) In this section “transparent entity” means a company which is resident in a member State other than the United Kingdom and which does not have an ordinary share capital.

#### *Interpretation*

### **681 Interpretation**

- (1) In this Chapter “company” means any entity listed as a company in the Annex to the Mergers Directive.
- (2) For the purposes of this Chapter, a company is resident in a member State if—
  - (a) it is within a charge to tax under the law of the State as being resident for that purpose, and
  - (b) it is not regarded, for the purpose of any double taxation relief arrangements to which the State is a party, as resident in a territory not within a member State.

## **CHAPTER 10**

### **EUROPEAN CROSS-BORDER MERGERS**

#### *Introduction*

### **682 Introduction to Chapter**

- (1) This Chapter applies if the following conditions are met—
  - (a) conditions A to D,
  - (b) in the case of a merger within subsection (2)(a), (b) or (c), condition E, and
  - (c) in the case of a merger within subsection (2)(c) or (d), condition F,but see section 686 (tax avoidance etc) and section 687 (disapplication of Chapter where transparent entities involved).
- (2) Condition A is that—
  - (a) an SE is formed by the merger of two or more companies in accordance with Articles 2(1) and 17(2)(a) or (b) of Council Regulation [\(EC\) No. 2157/2001](#) on the Statute for a European company (Societas Europaea),
  - (b) an SCE is formed by the merger of two or more co-operative societies, at least one of which is a society registered under the Industrial and Provident

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Societies Act 1965 (c. 12), in accordance with Articles 2(1) and 19 of Council Regulation (EC) No. 1435/2003 on the Statute for a European Co-operative Society (SCE),

- (c) a merger is effected by the transfer by one or more companies of all their assets and liabilities to a single existing company, or
  - (d) a merger is effected by the transfer by two or more companies of all their assets and liabilities to a single new company (other than an SE or an SCE) in exchange for the issue by the transferee, to each person holding shares in or debentures of a transferor, of shares or debentures.
- (3) Condition B is that each merging company is resident in a member State.
- (4) Condition C is that the merging companies are not all resident in the same State.
- (5) Condition D is that immediately after the merger the transferee is within the charge to corporation tax.
- (6) Condition E is that—
- (a) the transfer of assets and liabilities to the transferee in the course of the merger is made in exchange for the issue of shares or debentures by the transferee to each person holding shares in or debentures of a transferor, or
  - (b) that transfer is not so made only because, and only so far as, the transferee is prevented from so issuing such shares or debentures by section 658 of the Companies Act 2006 (c. 46) (general rule against limited company acquiring own shares) or by a corresponding provision of the law of another member State preventing such an issue.
- (7) Condition F is that in the course of the merger each transferor ceases to exist without being in liquidation (within the meaning given by section 247 of the Insolvency Act 1986 (c. 45)).
- (8) In this Chapter, “the merger” and “the merging companies” have the same meaning as in this section.
- (9) See—
- (a) section 683 for the meaning of “the transferee” and “transferor”, and
  - (b) section 688 for the meaning of “company”, “co-operative society” and “resident in a member State”.

### **683 Meaning of “the transferee” and “transferor”**

- (1) In this Chapter, “the transferee” means—
- (a) in relation to a merger within section 682(2)(a), the SE,
  - (b) in relation to a merger within section 682(2)(b), the SCE, and
  - (c) in relation to a merger within section 682(2)(c) or (d), the company to which assets and liabilities are transferred.
- (2) In this Chapter “transferor” means—
- (a) in relation to a merger within section 682(2)(a), a company merging to form the SE,
  - (b) in relation to a merger within section 682(2)(b), a co-operative society merging to form the SCE, and

- (c) in relation to a merger within section 682(2)(c) or (d), a company transferring all of its assets and liabilities.

*Transfers of derivative contracts at notional carrying value*

**684 Transfer of derivative contract at notional carrying value**

- (1) This section applies if in the course of the merger a transferor transfers the rights and liabilities under a derivative contract to the transferee.
- (2) For the purpose of determining the credits and debits to be brought into account in respect of the derivative contract in accordance with this Part, the transferor and the transferee are treated as having entered into the transfer of those rights and liabilities for consideration of an amount equal to the notional carrying value of the contract.
- (3) For the purposes of this section, the notional carrying value of a contract is the amount which would have been its carrying value in the accounts of the transferor if a period of account had ended immediately before the date when the transferor ceased to be a party to the contract.
- (4) This section is subject to section 685 (transferor using fair value accounting).

**685 Transferor using fair value accounting**

- (1) This section applies instead of section 684 if, in a case where that section would otherwise apply, the transferor uses fair value accounting as respects the derivative contract.
- (2) The amount which is to be brought into account by the transferor in respect of the transfer of the rights and liabilities mentioned in section 684(1) is the fair value of the derivative contract as at the date of transfer to the transferee.
- (3) For any accounting period in which the transferee is a party to the derivative contract, for the purpose of determining the credits and debits to be brought into account in respect of the contract in accordance with this Part, the transferee is treated as if it had acquired the contract for consideration of an amount equal to the fair value of the contract as at the date of transfer to it.

*Exception for tax avoidance cases and clearances*

**686 Tax avoidance etc**

- (1) This Chapter does not apply in relation to the merger if—
  - (a) the merger is not effected for genuine commercial reasons, or
  - (b) the merger forms part of a scheme or arrangements of which the main purpose, or one of the main purposes, is avoiding liability to corporation tax, capital gains tax or income tax.
- (2) But subsection (1) does not prevent this Chapter from applying if before the merger—
  - (a) any of the merging companies has applied to the Commissioners for Her Majesty's Revenue and Customs, and

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- (b) the Commissioners have notified the merging companies that they are satisfied that subsection will not have that effect.
- (3) Sections 678 and 679 have effect in relation to subsection (2) as in relation to section 677(2), taking the references in section 679 to section 677(2)(b) as references to subsection (2)(b) of this section.

### *Transparent entities*

#### **687 Disapplication of Chapter where transparent entities involved**

- (1) This section applies if one or more of the merging companies is a transparent entity.
- (2) If as a result of the merger the assets and liabilities of a transparent entity are transferred to another company, this Chapter does not apply in relation to the transfer.
- (3) In this section “transparent entity” means a company which is resident in a member State other than the United Kingdom and which does not have an ordinary share capital.

### *Interpretation*

#### **688 Interpretation**

- (1) In this Chapter—
  - “company” means any entity listed as a company in the Annex to the Mergers Directive, and
  - “co-operative society” means a society registered under the Industrial and Provident Societies Act 1965 (c. 12) or a similar society governed by the law of a member State other than the United Kingdom.
- (2) For the purposes of this Chapter, a company is resident in a member State if—
  - (a) it is within a charge to tax under the law of the State as being resident for that purpose, and
  - (b) it is not regarded, for the purpose of any double taxation relief arrangements to which the State is a party, as resident in a territory not within a member State.

## **CHAPTER 11**

### TAX AVOIDANCE

#### *Introduction*

#### **689 Overview of Chapter**

- (1) This Chapter contains rules connected with tax avoidance.
- (2) In particular—
  - (a) for rules about unallowable purposes, see sections 690 to 692,

- (b) for rules relating to credits and debits where transactions are not at arm's length, see sections 693 to 695,
- (c) for rules relating to credits and debits in the case of transactions with non-UK residents, see sections 696 and 697, and
- (d) for rules relating to disposals for consideration not fully recognised by accounting practice, see section 698.

### *Unallowable purposes*

#### **690 Derivative contracts for unallowable purposes**

- (1) This section applies if in any accounting period a derivative contract of a company has an unallowable purpose.
- (2) The company may not bring into account for that period for the purposes of this Part so much of any exchange credit in respect of that contract as is referable to the unallowable purpose on a just and reasonable apportionment.
- (3) The company may not bring into account for that period for the purposes of this Part so much of any debit in respect of that contract as is referable to the unallowable purpose on a just and reasonable apportionment.
- (4) Subsections (2) and (3) are subject to section 692 (allowance of accumulated net losses).
- (5) An amount which would be brought into account in accordance with this Part as respects any matter apart from this section and section 692—
  - (a) is treated for the purposes of section 699(1) (priority of this Part for corporation tax purposes) as if it were so brought into account, and
  - (b) accordingly may not be brought into account for any other corporation tax purposes as respects that matter.
- (6) For the purposes of this section and section 692, a credit is an exchange credit, in the case of any company, so far as it is attributable to any exchange gains arising to the company which are included in the reference to profits of the company in section 595(3) (see section 606 (exchange gains and losses from derivative contracts)).
- (7) For the meaning of “has an unallowable purpose” and “the unallowable purpose” in this section and section 692, see section 691.

#### **691 Meaning of “unallowable purpose”**

- (1) For the purposes of sections 690 and 692, a derivative contract of a company has an unallowable purpose in an accounting period if the purposes for which, at times during that period, the company—
  - (a) is a party to the contract, or
  - (b) enters into transactions which are related transactions by reference to it, include a purpose (“the unallowable purpose”) which is not amongst the business or other commercial purposes of the company.
- (2) If a company is not within the charge to corporation tax in respect of a part of its activities, for the purposes of this section the business and other commercial purposes of the company do not include the purposes of that part.

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- (3) Subsection (4) applies if a tax avoidance purpose is one of the purposes for which a company—
- (a) is a party to a derivative contract at any time, or
  - (b) enters into a transaction which is a related transaction by reference to a derivative contract of the company.
- (4) For the purpose of subsection (1), the tax avoidance purpose is only regarded as a business or other commercial purpose of the company if it is not—
- (a) the main purpose for which the company is a party to the derivative contract or, as the case may be, enters into the related transaction, or
  - (b) one of the main purposes for which it is or does so.
- (5) The references in subsections (3) and (4) to a tax avoidance purpose are references to any purpose which consists of securing a tax advantage for the company or any other person.
- (6) In this section “tax advantage” has the meaning given by section 840ZA of ICTA (meaning of “tax advantage”).

## **692 Allowance of accumulated net losses**

- (1) This section applies if—
- (a) in any accounting period a derivative contract of a company has an unallowable purpose, and
  - (b) there is a net loss in respect of that contract for that period.
- (2) For the purposes of this section, there is such a net loss if—
- (a) the sum of the debits in respect of that contract which are excluded from being brought into account for that period by section 690(3), exceeds
  - (b) the sum of the exchange credits in respect of that contract which are so excluded by section 690(2).
- (3) The amount of that excess is the amount of the net loss in respect of the contract for the period.
- (4) The amount of the excess accumulated net losses in respect of the contract for an accounting period is to be brought into account as a debit for that period.
- (5) The amount of the excess accumulated net losses in respect of a contract for an accounting period is found as follows.
- Step 1*  
 Add together the amount of any net loss arising in respect of the contract for that accounting period and earlier accounting periods.
- Step 2*  
 Deduct from the result of Step 1 any amount which was brought into account in accordance with this section in any earlier accounting period.
- Step 3*  
 Add together the amount of any credits (other than exchange credits) arising in respect of the contract for that accounting period or any earlier accounting period.
- Step 4*  
 Deduct from the result of Step 3 (but not so as to reduce it below nil)—

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- (a) so much of any debits arising in respect of the contract for that accounting period or any earlier accounting period as is not excluded from being brought into account by section 690(3), and
- (b) any amount which was brought into account in accordance with this section in any earlier accounting period.

*Step 5*

Compare the result of Step 2 and the result of Step 4.

The amount of the excess accumulated net losses for the period is the lower of those results.

*Transactions not at arm's length*

**693 Bringing into account adjustments under Schedule 28AA to ICTA**

- (1) This section deals with the credits and debits which are to be brought into account in accordance with this Part as a result of Schedule 28AA to ICTA (provision not at arm's length) applying in relation to a company's derivative contracts or related transactions.
- (2) Subsection (3) applies if under Schedule 28AA to ICTA an amount ("the imputed amount") is treated as an amount of profits or losses arising to a company from any of its derivative contracts or related transactions.
- (3) Credits or debits relating to the imputed amount are to be brought into account in accordance with this Part to the same extent as they would be in the case of an actual amount of such profits or losses.
- (4) Subsection (5) applies if under Schedule 28AA to ICTA an amount is treated as expenses incurred by a company under or for the purposes of any of its derivative contracts or related transactions.
- (5) Debits relating to the amount are to be brought into account in accordance with this Part to the same extent as they would be in the case of an actual amount of such expenses.

**694 Exchange gains and losses**

- (1) Subsections (2) to (7) apply if—
  - (a) a company is a party to a derivative contract in an accounting period, and
  - (b) an exchange gain or exchange loss arises to the company for the accounting period from the contract.
- (2) Subsection (3) applies if as a result of Schedule 28AA to ICTA (provision not at arm's length) the company's profits and losses are calculated for tax purposes as if it were not a party to the contract.
- (3) Any exchange gains or losses which arise to the company from the contract for the accounting period are left out of account in determining the credits and debits to be brought into account in accordance with this Part.
- (4) Subsection (5) applies if as a result of Schedule 28AA to ICTA the company's profits and losses are calculated for tax purposes as if the terms of the contract were those which would have been agreed by the company and the other party to the contract had they been dealing at arm's length ("the arm's length terms").

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- (5) The credits and debits which are to be brought into account in accordance with this Part in the case of the company are to be determined on the assumption that the amount of any exchange gain or loss arising to the company from the contract in the accounting period is the adjusted amount.
- (6) In subsection (5), the “adjusted amount” means the amount of an exchange gain or loss which would have arisen from the contract if its terms were the arm’s length terms.
- (7) That amount may be nil.
- (8) Nothing in Schedule 28AA to ICTA requires the amounts brought into account in accordance with this Part in respect of exchange gains and losses from derivative contracts to be calculated on the assumption that the arm’s length provision had been made instead of the actual provision.
- (9) But subsection (8) does not affect the application of—
  - (a) subsection (3) under subsection (2), or
  - (b) subsection (5) under subsection (4).
- (10) In subsection (8) “the actual provision” and “the arm’s length provision” have the same meaning as in Schedule 28AA to ICTA (see paragraph 1 of that Schedule).

## **695 Transfers of value to connected companies**

- (1) This section applies if—
  - (a) a company (“A”) paid an amount (“amount X”) to a company (“B”) for the grant of an option,
  - (b) there is a failure to exercise in full all the rights under the option,
  - (c) until the failure the option was a derivative contract of A,
  - (d) as a result of the failure there is a transfer of value by A to B,
  - (e) B is a connected company in relation to A, and
  - (f) B is not chargeable to corporation tax in accordance with this Part in respect of the derivative contract.
- (2) A must bring into account a credit of the appropriate amount in respect of the derivative contract for the accounting period in which the option expired or would have expired if none of the rights under it had been exercised.
- (3) If the option expired, “the appropriate amount” means amount X.
- (4) If any rights under the option were exercised (in whole or in part), “the appropriate amount” means amount X less so much of it as is referable, on a just and reasonable basis, to the rights which have been so exercised.
- (5) In determining for the purposes of subsection (1)(d) whether there is a transfer of value, the assumption in subsection (6) is made.
- (6) That assumption is that if there had not been a connection between A and B—
  - (a) all the rights under the option would have been exercised in full, and
  - (b) all of those rights would have been exercised on the latest date on which they were exercisable.
- (7) In this section “option” is to be construed as if section 580(2) and (3) (meaning of “option”) were omitted.



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- (8) For the purposes of this section, B is a connected company in relation to A in an accounting period if there is a time in the period when—
- (a) A controls B,
  - (b) B controls A, or
  - (c) A and B are both controlled by the same person.
- (9) But A and B are not taken to be controlled by the same person just because they have been under the control of—
- (a) a Minister of the Crown,
  - (b) a government department,
  - (c) a Northern Ireland department,
  - (d) a foreign sovereign power, or
  - (e) an international organisation.
- (10) Section 472 (meaning of “control”) applies for the purposes of this section.

*Transactions with non-UK residents*

**696 Derivative contracts with non-UK residents**

- (1) This section applies in relation to a company (“A”) if, as a result of any transaction—
- (a) A becomes a party to a derivative contract to which a non-UK resident (“NR”) is a party,
  - (b) NR becomes a party to a derivative contract to which A is a party, or
  - (c) A and NR both become a party to a derivative contract.
- (2) For each accounting period for any part of which A and NR are both a party to a derivative contract which makes provision for notional interest payments, the credits and debits which fall to be brought into account in accordance with this Part in respect of the contract in the case of A do not include the amount of any excluded debit in relation to that contract.
- (3) The amount of an excluded debit is calculated by determining for the accounting period the amount (if any) by which—
- (a) the sum of any notional interest payments made by A to NR while A and NR are both a party to the contract,  
exceeds
  - (b) the sum of any notional interest payments made by NR to A during that time.
- (4) For the purposes of this section, a payment is a notional interest payment if—
- (a) a derivative contract specifies—
    - (i) a notional principal amount,
    - (ii) a period, and
    - (iii) a rate of interest,
  - (b) the amount of the payment is determined (wholly or mainly) by applying a rate to the specified notional principal amount for the specified period, and
  - (c) the value of the rate is the same at all times as that of the specified rate of interest.
- (5) This section is subject to section 697.

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## **697 Exceptions to section 696**

- (1) Section 696 does not apply if A—
  - (a) is a bank, building society, financial trader or recognised clearing house,
  - (b) is a party to the derivative contract solely for the purposes of a trade or part of a trade it carries on in the United Kingdom, and
  - (c) is a party to it otherwise than as agent or nominee of another person.
- (2) Section 696 does not apply if NR—
  - (a) is a party to the derivative contract solely for the purposes of a trade or part of a trade which NR carries on in the United Kingdom through a relevant entity, and
  - (b) is a party to it otherwise than as agent or nominee of another person.
- (3) Section 696 does not apply if arrangements made in relation to the territory in which NR is resident—
  - (a) have effect because of section 788 of ICTA (double taxation relief), and
  - (b) make provision in relation to interest (as defined in the arrangements).
- (4) It does not matter whether the provision mentioned in subsection (3)(b) is for relief or otherwise.
- (5) If NR is a party to the contract as agent or nominee of another person, subsection (3) applies as if the reference to the territory in which NR is resident were a reference to the territory in which that other person is resident.
- (6) In this section—
 

“recognised clearing house” has the meaning given by section 285 of FISMA 2000 (exemption for recognised investment exchanges and clearing houses), and

“relevant entity” means—

  - (a) if NR is a company, a permanent establishment, and
  - (b) if that is not the case, a branch or agency.

*Disposals for consideration not fully recognised by accounting practice*

## **698 Disposals for consideration not fully recognised by accounting practice**

- (1) This section applies if in any accounting period (“the relevant accounting period”) a company with the relevant avoidance intention disposes of rights or liabilities under a derivative contract wholly or partly for consideration which—
  - (a) is not wholly in the form of money or a debt which falls to be settled by the payment of money, and
  - (b) is not fully recognised.
- (2) The relevant avoidance intention is the intention of eliminating or reducing the credits to be brought into account in accordance with this Part.
- (3) Consideration is not fully recognised if, as a result of the application of generally accepted accounting practice, the full amount or value of the consideration is not recognised in determining the company’s profit or loss for the relevant accounting period or any other accounting period.

- (4) In determining the credits which the company is to bring into account for the relevant accounting period in accordance with this Part, it is to be assumed that the whole of the consideration is recognised in determining the company's profit or loss for that period.
- (5) But this section does not apply if paragraph 1(2) of Schedule 28AA to ICTA (provision not at arm's length) operates in relation to the disposal so as to increase the tax liability of the company.

## CHAPTER 12

### PRIORITY RULES

#### **699 Priority of this Part for corporation tax purposes**

- (1) The amounts which are brought into account in accordance with this Part in respect of any matter are the only amounts which may be brought into account for corporation tax purposes in respect of it.
- (2) Subsection (1) is subject to any provision to the contrary.
- (3) For such provisions, see in particular—
  - (a) section 616 (disapplication of fair value accounting for certain derivative contracts),
  - (b) paragraph 93 of Schedule 2 (plain vanilla contracts which became derivative contracts before 30 December 2006), and
  - (c) section 83(2ZA) of FA 1989 (life assurance: receipts to be taken into account).

#### **700 Relationship of this Part to Part 5: loan relationships**

- (1) This section applies if—
  - (a) a company is a party to a loan relationship because of a derivative contract, and
  - (b) in accordance with this Part, a profit or loss accrues to the company on the contract for an accounting period ("the derivative profit or loss").
- (2) The general rule is that this Part does not apply to the derivative profit or loss if—
  - (a) an amount representing the derivative profit or loss, or
  - (b) an amount representing the profit or loss accruing to that company on the contract,is brought into account for that period for the purposes of Part 5 otherwise than because of section 574.
- (3) But in a case where section 585 (loan relationships with embedded derivatives) applies, the general rule does not apply so far as—
  - (a) the derivative profit or loss accrues from the rights and liabilities mentioned in section 585(1)(b) (rights and liabilities under derivative financial instruments or equity instruments), and
  - (b) that profit or loss is dealt with in accordance with that section and this Part.

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## CHAPTER 13

### GENERAL AND SUPPLEMENTARY PROVISIONS

#### *Power to amend certain provisions*

#### **701 Power to amend some provisions**

- (1) The Treasury may by order amend—
  - (a) Chapter 2 (except sections 578(1), (2) and (4), 585, 587 and 588),
  - (b) Chapter 4 (except section 613(4)),
  - (c) section 635,
  - (d) Chapter 7,
  - (e) Chapter 8 (except section 660),
  - (f) section 702,
  - (g) section 706,
  - (h) section 707,
  - (i) section 708,
  - (j) section 709,
  - (k) the definitions in section 710 specified in subsection (2), and
  - (l) paragraphs 80 to 94 of Schedule 2.
- (2) The definitions mentioned in subsection (1)(k) are—
  - capital redemption policy,
  - depository receipt (in relation to shares),
  - designated,
  - intangible fixed asset,
  - shares, and
  - warrant.
- (3) The provision that may be made by an order under this section includes provision—
  - (a) adding to or varying the descriptions of contract which are derivative contracts within section 576 (meaning of “derivative contract”) or removing any such description of contract, or
  - (b) adding to or varying the descriptions of contract which are excluded under section 589 (contracts excluded because of underlying subject matter: general) or removing any such description of contract.
- (4) The provision that may be made under subsection (3)(b), in relation to contracts which are excluded under section 589, includes provision—
  - (a) adding to the provisions which qualify the exclusion of contracts under that section,
  - (b) varying any such provision, or
  - (c) removing any such provision.
- (5) An order under this section may provide for any of its provisions to have effect in relation to—
  - (a) accounting periods ending on or after the day on which the order comes into force (whenever they begin),

- (b) periods of account beginning before the order is made, but not earlier than the beginning of the calendar year in which it is made.
- (6) An order under this section may—
- (a) make different provision for different cases, and
  - (b) contain incidental, supplemental, consequential and transitional provision and savings (including provision amending any enactment or any instrument made under an enactment).

#### *Other general definitions*

### **702 “Carrying value”**

- (1) For the purposes of this Part, the “carrying value” of a contract includes amounts recognised for accounting purposes in relation to the contract in respect of—
- (a) accrued amounts,
  - (b) amounts paid or received in advance, or
  - (c) impairment losses (including provisions for bad or doubtful debts).
- (2) In determining the profits and losses to be recognised in determining the carrying value of the contract for the purposes of this Part, the provisions in subsection (3) apply as they apply for the purposes of determining the credits and debits to be brought into account in accordance with this Part.
- (3) Those provisions are—
- (a) section 584 (hybrid derivatives with embedded derivatives),
  - (b) section 585 (loan relationships with embedded derivatives),
  - (c) section 586 (other contracts with embedded derivatives),
  - (d) section 625(3) to (5) (transactions within groups),
  - (e) sections 675 and 676 (European cross-border transfers of business), and
  - (f) sections 684 and 685 (European cross-border mergers).
- (4) In this section “impairment loss” means a debit in respect of the impairment of a financial asset, and “impairment” includes uncollectability.

### **703 “Chargeable asset”**

- (1) For the purposes of this Part, an asset is a chargeable asset if any gain accruing on its disposal would be a chargeable gain for corporation tax purposes.
- (2) For the purposes of this section, “asset” includes any obligations under futures contracts which are regarded because of section 143 of TCGA 1992 as assets to the disposal of which that Act applies.

### **704 “Creditor relationship” and “debtor relationship”**

- (1) In this Part “creditor relationship” has the same meaning as in Part 5 (loan relationships) (see section 302(5) (meaning of “creditor relationship”)).
- (2) In this Part “debtor relationship” has the same meaning as in Part 5 (see section 302(6) (meaning of “debtor relationship”)).

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*Status: This is the original version (as it was originally enacted).*

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## **705 Expressions relating to exchange gains and losses**

- (1) References in this Part to exchange gains or exchange losses, in relation to a company, are references respectively to—
  - (a) profits or gains which arise as a result of comparing at different times the expression in one currency of the whole or some part of the valuation put by the company in another currency on an asset or liability of the company, or
  - (b) losses which so arise.
- (2) If the result of such a comparison is that neither an exchange gain nor an exchange loss arises, for the purposes of this Part an exchange gain of nil is taken to arise in the case of that comparison.
- (3) The Treasury may make provision by regulations as to the way in which exchange gains or losses are to be calculated for the purposes of this section in a case where fair value accounting is used by the company.
- (4) The regulations may be made so as to apply to periods of account beginning before the regulations are made, but not earlier than the beginning of the calendar year in which they are made.
- (5) Any reference in this Part to an exchange gain or loss from a derivative contract of a company is a reference to an exchange gain or loss arising to a company in relation to a derivative contract of the company.

## **706 “Excluded body”**

In this Part “excluded body” means—  
an authorised unit trust,  
an investment trust,  
an open-ended investment company, or  
a venture capital trust.

## **707 “Hedging relationship”**

- (1) This section applies for the purposes of this Part.
- (2) A company has a “hedging relationship” between a relevant contract (“the hedging instrument”) and an asset or liability (“the hedged item”) so far as condition A or B is met.
- (3) Condition A is that the hedging instrument and the hedged item are designated as a hedge by the company.
- (4) Condition B is that—
  - (a) the hedging instrument is intended to act as a hedge of the exposure to changes in fair value of the hedged item which is attributable to a particular risk and could affect the profit or loss of the company, and
  - (b) the hedged item is an asset or liability recognised for accountancy purposes or is an identified portion of such an asset or liability.
- (5) For the purposes of subsections (2) and (4), the liabilities of a company include its own share capital.

## 708 “Plain vanilla contract”

In this Part “plain vanilla contract” means a relevant contract other than one to which a company is treated as being a party under—

- (a) section 584 (hybrid derivatives with embedded derivatives),
- (b) section 585 (loan relationships with embedded derivatives), or
- (c) section 586 (other contracts with embedded derivatives).

## 709 “Securities house”

In this Part “securities house” means a person—

- (a) who is authorised for the purposes of FISMA 2000, and
- (b) whose business consists wholly or mainly of dealing as a principal in financial instruments within the meaning of section 984 of ITA 2007.

## 710 Other definitions

In this Part—

“bank” means—

- (a) the Bank of England,
- (b) a person within section 840A(1)(b) of ICTA, or
- (c) a firm within section 840A(1)(c) of that Act,

“capital redemption policy” means a contract made in the course of capital redemption business (as defined in section 431(2ZF) of ICTA),

“contract of insurance” has the meaning given by section 431(2) of ICTA,

“contract of long-term insurance” has the meaning given by section 431(2) of ICTA,

“depository receipt”, in relation to shares (as defined in this section), has the same meaning as it has in Part 4 of FA 1986 in relation to shares (within the meaning of that Part),

“designated” has the meaning it has for accounting purposes,

“equity instrument” has the meaning it has for accounting purposes,

“fair value”, in relation to a derivative contract of a company, means the amount which, at the time as at which the value is to be determined, is the amount which the company would obtain from or, as the case may be, would have to pay to an independent person dealing at arm’s length for—

- (a) the transfer of the company’s rights under the contract, and
- (b) the release of all the company’s liabilities under it,

“fair value accounting” means a basis of accounting under which assets and liabilities are shown in the company’s balance sheet at their fair value,

“financial trader” means—

- (a) a person who—
  - (i) is within section 31(1)(a), (b) or (c) of FISMA 2000, and
  - (ii) has permission under that Act to carry on one or more of the activities specified in Article 14 and, in so far as it applies to that Article, Article 64 of the Financial Services and Markets Act (Regulated Activities) Order 2001 ([S.I. 2001/544](#)), or
- (b) a person not within paragraph (a) who is approved by the Commissioners for Her Majesty’s Revenue and Customs for the purposes of this section,

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“income statement” has the meaning it has for accounting purposes,

“intangible fixed asset” has the same meaning as in Part 8 (intangible fixed assets), and sections 804 to 807 and 809 (assets wholly excluded from that Part) (and sections 800 to 802 so far as they relate to those sections) apply for the purposes of this Part as they apply for the purposes of that Part,

“open-ended investment company” has the meaning given by section 468A(2) of ICTA,

“profit-sharing arrangements”, in relation to a firm, has the meaning given by section 1262(4) (allocation of firm’s profits or losses between partners),

“shares”, in relation to a company, means any shares in the company under which an entitlement to receive distributions may arise, including—

- (a) a depositary receipt for shares under which such an entitlement may arise, and
- (b) in the case of a company which has no share capital, any interests in the company possessed by members of the company,

“statement of changes in equity” has the meaning it has for accounting purposes,

“statement of comprehensive income” has the meaning it has for accounting purposes,

“statement of income and retained earnings” has the meaning it has for accounting purposes,

“statement of recognised income and expense” has the meaning it has for accounting purposes,

“statement of total recognised gains and losses” has the meaning it has for accounting purposes, and

“warrant” means an instrument which entitles the holder to subscribe for—

- (a) shares in a company, or
- (b) assets representing a loan relationship of a company,

whether or not the shares or assets exist or are identifiable.