

**2005 No. 2082**

**CORPORATION TAX**

**The Finance Act 2002, Schedule 26, Parts 2 and 9 (Amendment  
No. 2) Order 2005**

*Made* - - - - - *27th July 2005*

*Laid before House of Commons* *27th July 2005*

*Coming into force in accordance with regulation 1*

The Treasury, in exercise of the powers conferred upon them by paragraph 13 of Schedule 26 to the Finance Act 2002(a) and paragraph 52 of Schedule 4 to the Finance Act 2005, make the following Order:

**Citation, commencement and effect**

1.—(1) This Order may be cited as the Finance Act 2002, Schedule 26, Parts 2 and 9 (Amendment No. 2) Order 2005.

(2) Subject to paragraph (5), this Order shall come into force on 17th August 2005.

(3) Subject to paragraphs (4) to (6), this Order has effect in relation to periods of account beginning on or after 1st January 2005 and ending on or after 17th August 2005.

(4) Articles 3, 5, 7, 8, 9, 12, 13, 14, 15, 16, 19, 21, 22 and 23 have effect in relation to periods of account beginning on or after 1st January 2005 and ending on or after 16th March 2005.

(5) Article 6—

(a) shall come into force on 28th July 2005, and

(b) has effect in relation to periods of account ending on or after that day.

(6) Articles 2 and 10 have effect accordingly.

**Amendment of Part 2 of Schedule 26 to the Finance Act 2002**

2. Part 2 of Schedule 26 to the Finance Act 2002 is amended as follows.

3. In paragraph 2(4) for “Schedule 26” substitute “this Schedule”.

4.—(1) Amend paragraph 3 as follows.

(2) In sub-paragraph (1)(a) omit “or”.

(3) After sub-paragraph (1)(a) insert—

“(b) it is a relevant contract which—

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(a) 2002 c. 23. Paragraph 13 is amended by paragraph 2 of Schedule 9 to the Finance Act 2004 (c. 12) and paragraph 52 of Schedule 4 to the Finance Act 2005 (c. 7).

- (i) does not fall within paragraph (a) solely because it does not meet the requirement in paragraph 9(b) of Financial Reporting Standard 26 issued in December 2004 by the Accounting Standards Board, but
  - (ii) is treated for accounting purposes as, or as forming part of, a financial asset or liability, or”.
- (4) In sub-paragraph (1)(c) after “paragraph (a)” insert “or (b)”.
- (5) In sub-paragraph (3) for “which used the relevant” substitute “which used a relevant”.
- (6) After sub-paragraph (3) insert—
- “(4) For the purposes of sub-paragraph (1)(b), a relevant contract of a company is treated for accounting purposes as, or as forming part of, a financial asset or liability for an accounting period if, for that accounting period, it is so treated for the purposes of the relevant accounting standard used by the company for that accounting period (or would be so treated if the company were a company which used a relevant accounting standard for that accounting period in respect of the relevant contract).”.
- (7) In sub-paragraph (5) for the words preceding paragraph (a) substitute “In this paragraph “relevant accounting standard” means—”.
- 5.—(1)** Amend paragraph 4 as follows.
- (2) In sub-paragraph (2)(b)—
- (a) for “(2A) or (2B)” substitute “(2A), (2B), (2C) or (2D)”.
  - (b) in sub-paragraph (i) after “company,” insert “other than shares in relation to which section 91A or 91B of the Finance Act 1996(a) has effect,”.
- (3) In sub-paragraph (2A)—
- (a) after paragraph (a) insert “and”; and
  - (b) omit paragraph (c) and the word “and” before it.
- (4) In sub-paragraph (2B)—
- (a) at the end of paragraph (a) omit “and”;
  - (b) at the end of paragraph (b) insert—
    - “, and
    - (c) the relevant contract is not a deemed relevant contract to which the company is treated as party under section 94A(2)(b) of the Finance Act 1996(b).”.
- (5) After sub-paragraph (2B) insert—
- “(2C) The conditions specified in this sub-paragraph are—
- (a) the relevant contract is entered into or acquired—
    - (i) by a company otherwise than for the purposes of a trade carried on by it or by a company which is a mutual trading company; or
    - (ii) by a company for the purposes of its life assurance business; and
  - (b) the relevant contract is an option, quoted on a recognised stock exchange, to subscribe for shares in a company.
- (2D) The conditions specified in this sub-paragraph are—
- (a) the company that holds the relevant contract has a hedging relationship between—
    - (i) the relevant contract, and
    - (ii) an asset representing a loan relationship which is treated as mentioned in section 94A(1) of the Finance Act 1996, and

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(a) Sections 91A and 91B were inserted by paragraph 10(1) and (2) of Schedule 7 to the Finance (No. 2) Act 2005 (c. 22).  
 (b) 1996 c. 8. Section 94A was inserted by section 52 of and paragraph 13 of Schedule 10 to the Finance Act 2004 (c. 12).

- (b) each relevant contract to which the company is treated as party under section 94A(2)(b) in the case of that loan relationship is a derivative contract to which paragraph 45D, 45F, 45FA, 45J or 45K applies.”.

**6.** After paragraph 4A insert—

**“4B.—**(1) This paragraph applies to a company if the conditions in sub-paragraph (2) are satisfied in relation to a relevant contract.

(2) The conditions are—

- (a) the company is a party to the relevant contract both immediately before and on 28th July 2005,
- (b) the relevant contract—
  - (i) was not a derivative contract immediately before that date, but
  - (ii) would (apart from this paragraph) be a derivative contract on that date, if an accounting period of the company began on that date, and
- (c) the relevant contract was a chargeable asset immediately before that date.

(3) The company shall, when it ceases to be a party to the relevant contract, bring into account, for the accounting period in which it ceased to be a party to the contract, the amount of any chargeable gain or allowable loss which would have been treated as accruing to the company on the assumption—

- (a) that it had made a disposal of the relevant contract immediately before 28th July 2005, and
- (b) that the disposal had been for a consideration equal to the fair value of the relevant contract on that date.

(4) The relevant contract shall be treated for the purposes of this Schedule as a derivative contract entered into by the company on 28th July 2005 for a consideration equal to the fair value of the contract on that date.

(5) Sub-paragraph (4) of paragraph 4A (meaning of chargeable asset) also applies for the purposes of this paragraph.

**4C.—**(1) This paragraph applies to a company if the conditions in sub-paragraph (2) are satisfied in relation to a relevant contract to which it becomes a party on or after 28th July 2005.

(2) The conditions are that (apart from this paragraph) the relevant contract—

- (a) is not a derivative contract on the date on which the company becomes a party to it, but
- (b) would be a derivative contract on that date, if an accounting period of the company began on that date, and
- (c) is a chargeable asset when the company becomes a party to it.

(3) The relevant contract shall be treated for the purposes of this Schedule as a derivative contract on and after that date.

(4) Sub-paragraph (4) of paragraph 4A (meaning of chargeable asset) also applies for the purposes of this paragraph.”.

**7.** In paragraph 11(1) for “In this Part of this Schedule” substitute “In this Schedule”.

**8.—**(1) Amend paragraph 12 as follows.

(2) In sub-paragraph (1) after paragraph (b) insert—

“(ba) a depositary receipt, in relation to shares (see sub-paragraph (17));”.

(3) For sub-paragraph (12) substitute—

“(12) “Share”, in relation to a company, means any share in the company under which an entitlement to receive distributions may arise; and any reference to a share includes a reference to each of the following—

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

(4) After sub-paragraph (16) insert—

“(17) “Depositary receipt”, in relation to shares (within the meaning of this Schedule) has the same meaning as it has in Part 4 of the Finance Act 1986(a) in relation to shares (within the meaning of that Part).”.

#### **Amendment of Part 4 of Schedule 26 to the Finance Act 2002**

9. In Part 4 of Schedule 26 to the Finance Act 2002 omit paragraph 21.

#### **Amendment of Part 9 of Schedule 26 to the Finance Act 2002**

10. Part 9 of Schedule 26 to the Finance Act 2002 is amended as follows.

11.—(1) Amend paragraph 44 as follows.

(2) For sub-paragraph (1) substitute—

“(1) This paragraph applies where—

- (a) a company is party to a relevant contract which is a derivative contract whose underlying subject matter consists, or is treated as consisting, wholly of shares or rights of a unit holder under a unit trust scheme,
- (b) the company entered into or acquired the relevant contract for the purposes of a trade carried on by it,
- (c) at any time (“the relevant time”) the relevant contract ceases to be held for those purposes,
- (d) the company continues to be party to the relevant contract after the relevant time, and
- (e) if the company had entered into or acquired the contract immediately after the relevant time, the relevant contract would not have been a derivative contract.”.

(3) After sub-paragraph (2) insert—

“(3) Paragraph 9 applies for the purpose of determining whether the underlying subject matter of a relevant contract is to be treated as consisting wholly of the property referred to in sub-paragraph (1)(a).”.

12. In paragraph 45C(1)(d)(b) for “does” substitute—

“and paragraph 45K (issuers of securities with embedded derivatives: deemed contracts for differences) do”.

13.—(1) Amend paragraph 45D(c) as follows.

(2) In sub-paragraph (2)—

- (a) omit paragraph (b); and
- (b) after paragraph (e) insert—

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(a) 1986 c. 41.

(b) Paragraph 45C was inserted by article 15 of S.I. 2004/2201.

(c) Paragraph 45D was inserted by article 15 of S.I. 2004/2201 and amended by articles 5 and 6 of S.I. 2004/3270.

“(f) the asset representing the creditor relationship is not an existing asset”.

(3) After sub-paragraph (3) insert—

“(3A) Where in any accounting period—

- (a) a company is party to a creditor relationship for the purposes of its life assurance business, and
- (b) that creditor relationship is one in relation to which section 94A of the Finance Act 1996 would have effect but for the fact that the company accounts for the creditor relationship at fair value through profit and loss,

this paragraph shall have effect for that accounting period as it would if the creditor relationship were one in relation to which that section has effect.”.

(4) In sub-paragraph (4) insert the following definition at the appropriate place—

““existing asset” means an asset in relation to which paragraph 9(2) of Schedule 10 to the Finance Act 2004 has effect;”.

(5) For sub-paragraph (8) substitute—

“(8) The creditor relationship shall not be treated as a qualifying corporate bond by virtue of section 117(A1) of the Taxation of Chargeable Gains Act 1992.”.

(6) After sub-paragraph (8) insert—

“(9) See also paragraph 45H (treatment of gains and losses on terminal exercise of option).”.

14. In paragraph 45E(a) omit sub-paragraph (5).

15.—(1) Amend paragraph 45F as follows.

(2) After sub-paragraph (2)(e) insert—

“(f) the asset representing the creditor relationship is not an existing asset.”.

(3) In sub-paragraph (7) after “this paragraph” insert—

“—

“existing asset” means an asset in relation to which paragraph 11(2) of Schedule 10 to the Finance Act 2004 has effect;”.

(4) For sub-paragraph (8) substitute—

“(8) The creditor relationship shall not be treated as a qualifying corporate bond by virtue of section 117(A1) of the Taxation of Chargeable Gains Act 1992.”.

16. After paragraph 45F(b) insert—

**“Creditor relationships: existing assets**

**45FA.**—(1) Where paragraph 45D or 45F would apply to a derivative contract for an accounting period but for sub-paragraph (2)(f) of that paragraph—

- (a) paragraph 14(3) (non-trading credits and debits) shall not apply to the relevant credits and debits, and
- (b) the creditor relationship by virtue of which paragraph 45D or 45F would so apply to that derivative contract shall not be treated as a qualifying corporate bond by virtue of section 117(A1) of the Taxation of Chargeable Gains Act 1992.

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(a) Paragraph 45E was inserted by article 15 of S.I. 2004/2201.

(b) Paragraph 45F was inserted by article 15 of S.I. 2004/2201 and amended by articles 5 and 7 of S.I. 2004/3270.

(2) For the purposes of this paragraph the relevant credits and debits are the credits and debits given in relation to the contract for the accounting period by paragraph 15.”.

17. After paragraph 45G(a) insert—

**“Treatment of net gains and losses on terminal exercise of option**

**45H.**—(1) This paragraph applies where—

- (a) a derivative contract is one to which paragraph 45D applies for an accounting period,
- (b) rights that fall to be treated as comprised in the derivative contract are exercised to any extent in the accounting period, and
- (c) those rights are rights to acquire shares.

(2) In any such case—

- (a) sub-paragraph (3) has effect in relation to a disposal of the asset representing the creditor relationship mentioned in paragraph 45D(1)(b) (“the associated creditor relationship”), and
- (b) sub-paragraph (4) has effect in relation to a disposal of all or any of the shares (“the relevant shares”) acquired—
  - (i) as a result of the exercise of rights mentioned in sub-paragraph (1)(b), but
  - (ii) otherwise than as a result of a disposal of the associated creditor relationship.

(3) For the purpose of computing any chargeable gain accruing to the company on a disposal of the asset representing the associated creditor relationship, the sums allowable as a deduction under section 38(1)(a) of the Taxation of Chargeable Gains Act 1992 (acquisition costs) shall—

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

(4) For the purpose of computing 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 the Taxation of Chargeable Gains Act 1992 (acquisition costs) shall—

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

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

(5) If the amount of the excess in sub-paragraph (3)(b) or (4)(b) is greater than the amount of expenditure allowable under section 38(1)(a) of the Taxation of Chargeable Gains Act 1992, the amount of the excess that cannot be deducted from the expenditure so allowable shall, for the purpose mentioned in sub-paragraph (3) or (4) (as the case may be), be added to the amount of the consideration for the disposal of the shares.

(6) In this paragraph—

G is the sum of—

- (a) the initial carrying value of the derivative contract, and
- (b) the amounts of any chargeable gains treated as accruing to the company under paragraph 45A(4)(a) 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 sub-paragraph (1)(b);

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(a) Paragraph 45G was inserted by article 15 of S.I. 2004/2201 and amended by articles 5 and 8 of S.I. 2004/3270.

L is the sum of the amounts of any allowable losses treated as accruing to the company under paragraph 45A(4)(b) in respect of the derivative contract in each relevant accounting period, so far as so referable.

(7) For the purposes of sub-paragraph (6)—

- (a) the “initial carrying value” of the derivative contract is the amount treated in accordance with section 94A(2) of the Finance Act 1996 as the carrying value of the derivative contract at the time the company became party to the loan relationship;
- (b) a “relevant accounting period” is—
  - (i) the accounting period in which the disposal in question is made, or
  - (ii) any previous accounting period.

### **Treatment of credits and debits on terminal exercise of option**

**45HA.**—(1) This paragraph applies where—

- (a) a company is a party to a derivative contract in an accounting period otherwise than by virtue of section 94A(2)(b) of the Finance Act 1996,
- (b) the derivative contract is an option,
- (c) rights comprised in the derivative contract are exercised to any extent in that accounting period, and
- (d) those rights are rights to acquire shares.

(2) In any such case, for the purpose of computing 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 the Taxation of Chargeable Gains Act 1992<sup>(a)</sup> (acquisition costs) shall—

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

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

(3) If the amount of the excess in sub-paragraph (2)(b) is greater than the amount of expenditure allowable under section 38(1)(a) of the Taxation of Chargeable Gains Act 1992, the amount of the excess that cannot be deducted from the expenditure so allowable shall, for the purpose mentioned in sub-paragraph (2), be added to the amount of the consideration for the disposal of the shares.

(4) In this paragraph—

G is the sum of the credits brought into account under paragraph 14(2) 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 the rights mentioned in sub-paragraph (1)(b);

L is the sum of the debits brought into account under paragraph 14(2) in respect of the derivative contract in each relevant accounting period, so far as so referable.

(5) For the purposes of sub-paragraph (4), a “relevant accounting period” is—

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

**18.**—(1) Amend paragraph 45J<sup>(b)</sup> as follows.

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<sup>(a)</sup> 1992 c. 12.

<sup>(b)</sup> Paragraph 45J was inserted by articles 5 and 10 of S.I. 2004/3270 and amended by articles 13 and 16 of S.I. 2005/646.

(2) In sub-paragraph (3)(a) for “14(3) (non-trading)” substitute “14(2) and (3) (trading and non-trading)”.

(3) For sub-paragraph (4) substitute—

“(4) If the company was a party to the debtor relationship immediately before its first accounting period to begin on or after 1st January 2005—

- (a) sub-paragraphs (5) and (9) do not apply, but
- (b) where sub-paragraph (7) applies, E shall be taken to be nil and an allowable loss of an amount equal to F shall accordingly be treated as accruing to the company in the accounting period there mentioned.”.

(4) For sub-paragraph (5) substitute—

“(4A) Sub-paragraph (5) applies if—

- (a) the option mentioned in sub-paragraph (1)(c) is exercised at any time in an accounting period, and
- (b) shares are issued or transferred in fulfilment of the obligations under the option (the “relevant disposal”).

(5) Where this sub-paragraph applies—

- (a) section 144(2) of the Taxation of Chargeable Gains Act 1992 (exercise of options) applies to the relevant disposal as if the amount treated in accordance with section 94A(2) of the Finance Act 1996 as the carrying value of the option at the time the company became party to the loan relationship (the “initial carrying value”) was the consideration for the grant of the option;
- (b) to the extent that it would otherwise apply, section 17(1) of the Taxation of Chargeable Gains Act 1992 (deemed market value consideration) does not apply to the relevant disposal.”.

(5) In sub-paragraph (8)—

- (a) in the definition of E, for “carrying amount” substitute “carrying value”; and
- (b) for the definition of F substitute—

“F is—

- (a) the amount paid in fulfilment of the obligations under the option, unless paragraph (b) applies, or
- (b) where a single amount is paid in fulfilment of the obligations under the debtor relationship, the part of the amount which falls to be treated for accounting purposes as the amount relating to the option.”.

(6) For sub-paragraph (9) substitute—

“(9) This sub-paragraph applies if the company ceases to be a party to the debtor relationship at a time when the option mentioned in sub-paragraph (1)(c) has not been exercised, and where it applies the company is treated for the purposes of corporation tax on chargeable gains—

- (a) as having acquired the option for a consideration equal to so much of any amount paid by the company in consideration for it ceasing to be a party to the debtor relationship as falls to be treated for accounting purposes as the amount relating to the option, and
- (b) as having disposed of the option for a consideration equal to the initial carrying value.”.

19. After paragraph 45J insert—



**“Issuers of securities with embedded derivatives: equity instruments**

**45JA.**—(1) This paragraph applies to a company for an accounting period if the following conditions are satisfied—

- (a) section 94A of the Finance Act 1996 (loan relationships with embedded derivatives) has effect in relation to a debtor relationship of the company,
- (b) the division mentioned in subsection (1) of that section in the case of that debtor relationship is between—
  - (i) rights and liabilities under a loan relationship, and
  - (ii) rights and liabilities under an equity instrument,
- (c) in the case of that debtor relationship, the company is treated under subsection (2)(b)(i) of that section as party to a relevant contract,
- (d) the relevant contract is treated by virtue of subsection (3) of that section as an option,
- (e) the relevant contract is not a derivative contract,
- (f) the company pays an amount in the accounting period to the person who is party to the loan relationship as creditor in discharge of any obligations under that relationship,
- (g) the additional conditions in sub-paragraph (2) are satisfied.

(2) The additional conditions are—

- (a) at the time when the company became party to the debtor relationship—
  - (i) it was not carrying on a banking business or a business as a securities house, or
  - (ii) if it was carrying on such a business, it did not become party to the debtor relationship in the ordinary course of that business;
- (b) the liability representing the debtor relationship was not owed by the company immediately before its first accounting period to begin on or after 1st January 2005; and
- (c) the company is not a body falling within paragraph 45C(3) (authorised unit trusts etc.).

(3) If RA exceeds E, an allowable loss equal to the amount of the excess shall be treated as accruing to the company for the purposes of corporation tax on chargeable gains in the accounting period.

(4) In sub-paragraph (3)—

RA is—

- (a) the amount paid as mentioned in sub-paragraph (1)(f), less
- (b) so much of that amount as is treated for accounting purposes as paid in discharge of the liabilities mentioned in sub-paragraph (1)(b)(i);

E is the amount treated in accordance with section 94A(2) of the Finance Act 1996 as the carrying value of the relevant contract at the time the company became party to the debtor relationship.

(5) In this paragraph “option” and “securities house” have the same meaning as in paragraph 45J(10).”.

**20.**—(1) Amend paragraph 45K(a) as follows.

(2) For sub-paragraph (1)(d) substitute—

“(d) the derivative contract—

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(a) Paragraph 45K was inserted by articles 5 and 10 of S.I. 2004/3270 and amended by articles 13 and 17 of S.I. 2005/646.

- (i) is an exactly tracking contract, within the meaning of paragraph 45F, or
- (ii) would be such a contract but for any condition in it that D cannot be less than 90% of C (where D and C have the same meaning as in paragraph 45F(4)), and”.

(3) In sub-paragraph (2) after paragraph (d) insert—

“(e) the liability representing the debtor relationship was not owed by the company immediately before its first accounting period to begin on or after 1st January 2005.”.

(4) In sub-paragraph (3)—

(a) for “period, paragraph 14(3) (non-trading” substitute—

“period—

(a) paragraph 14(2) and (3) (trading and non-trading”;

(b) at the end insert—

“; but

(b) sub-paragraph (3A) shall have effect.”.

(5) After sub-paragraph (3) insert—

“(3A) Where—

(a) the debtor relationship comes to an end, and

(b) an amount (“the discharge amount”) is paid to discharge all the company’s obligations under that relationship,

then, for the purposes of corporation tax on chargeable gains, there shall be treated as accruing to the company a chargeable gain or allowable loss of an amount determined in accordance with sub-paragraph (3B).

(3B) That amount is the amount of the gain or loss (as the case may be) that would accrue on the assumption 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 amount of the proceeds of issue of the security representing the debtor relationship, and

(d) the cost of the asset is equal to the discharge amount.”.

**21.—**(1) Amend paragraph 45L(a) as follows.

(2) In sub-paragraph (1)—

(a) in paragraph (a) for “derivative” substitute “relevant”;

(b) at the end of paragraph (a), omit “and”;

(c) after paragraph (a) insert—

“(aa) the contract is a derivative contract falling within paragraph 3(1)(a),

(ab) paragraph 45M does not apply in relation to the contract,”;

(d) after paragraph (b) insert—

“; and

(c) no election having effect in relation to the derivative contract is or has been made under sub-paragraph (2A),”;

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(a) Paragraph 45L was inserted by articles 5 and 10 of S.I. 2004/3270.

- (e) for “14(3) (non-trading” substitute “14(2) and (3) (trading and non-trading”); and
- (f) after “value” insert “of the”.

(3) For sub-paragraph (2) substitute—

“(2) Where sub-paragraph (1) applies, then notwithstanding paragraph 1(2) of this Schedule, profits and losses are to be brought into account for the purposes of the Corporation Tax Acts in relation to the contract mentioned in sub-paragraph (3) of paragraph 2 as if that sub-paragraph did not apply to it.”.

(4) After sub-paragraph (2) insert—

“(2A) A company may elect that this paragraph is not to apply to any of its contracts.

(2B) Any such election—

- (a) must be made by giving notice in writing to Her Majesty’s Revenue and Customs,
- (b) must be made before the end of the first applicable accounting period of the company, and
- (c) is irrevocable.

(2C) For the purposes of sub-paragraph (2B), the “first applicable accounting period” is the first accounting period ending on or after 17th August 2005 in which the conditions in paragraphs (a) to (b) of sub-paragraph (1) are satisfied.”.

**22.—**(1) Amend paragraph 45M(a) as follows.

(2) In sub-paragraph (1)—

- (a) after “where” insert “for an accounting period”;
- (b) in paragraph (a) for “derivative” substitute “relevant”;
- (c) for paragraph (b) substitute—

“(b) the contract is a derivative contract falling within paragraph 3(1)(a) or (b),”; and

(d) at the end of paragraph (c) insert—

“, and

- (d) the host contract is treated for accounting purposes as, or as forming part of, a financial asset.”.

(3) In sub-paragraph (2)(a) omit “which is a zero coupon bond”.

(4) Omit sub-paragraph (3).

(5) After sub-paragraph (4) insert—

“(5) For the purposes of sub-paragraph (1)(d), the host contract is treated for accounting purposes as, or as forming part of, a financial asset for an accounting period if, for that accounting period,—

- (a) it is so treated for the purposes of the relevant accounting standard used by the company for that accounting period, or
- (b) it would be so treated if the company used a relevant accounting standard for that accounting period in respect of the host contract.

(6) Sub-paragraph (5) of paragraph 3 (meaning of “relevant accounting standard”) applies for the purposes of sub-paragraph (5) as it applies for the purposes of sub-paragraphs (3) and (4) of that paragraph.”.

**23. Omit paragraph 48A(b).**

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(a) Paragraph 45M was inserted by articles 13 and 18 of S.I. 2005/646.  
(b) Paragraph 48A was inserted by articles 5 and 11 of S.I. 2004/3270.

27th July 2005

*Vernon Coaker*  
*Tom Watson*  
Two of the Lords of Her Majesty's Treasury

## **EXPLANATORY NOTE**

*(This note is not part of the Order)*

This Order amends Schedule 26 (derivative contracts) to the Finance Act 2002 (c. 23).

Article 1 provides for the citation, commencement and effect of the Order.

Article 2 introduces the amendments to Part 2 of Schedule 26.

Article 3 amends paragraph 2(4) to correct the reference to the Schedule.

Article 4 amends paragraph 3 extending the types of relevant contracts which are treated as derivative contracts to contracts which are treated for accounting purposes as, or as forming part of, a financial asset or liability.

Article 5 amends paragraph 4 to extend the type of relevant contract which is excluded from being a derivative contract by virtue of its underlying subject matter.

Article 6 inserts two new paragraphs, 4B and 4C, which make transitional provisions in relation to relevant contracts which are chargeable assets but are not derivative contracts.

Article 7 amends paragraph 11 so that paragraph applies to the whole of Schedule 26 of the Finance Act 2002.

Article 8 amends paragraph 12 to include definitions of new terms.

Article 9 omits paragraph 21 of Schedule 26 which is redundant as a consequence of amendments made by Finance Act 2002, Schedule 26, Parts 2 and 9 (Amendment) Order 2005 (S.I. 2005/646).

Article 10 introduces the amendments to Part 9 which are made by articles 11 to 23. The effect of these amendments is to clarify the tax treatment in relation to host contracts and embedded derivatives primarily where the underlying subject matter is shares or rights of a unit holder under a unit trust scheme.

Article 11 makes consequential amendments to paragraph 44 (derivative contracts ceasing to be held for purposes of trade).

Article 12 amends paragraph 45C (derivative contracts relating to land or certain tangible movable property) to exclude derivative contracts which are within paragraph 45K (issuers of securities with embedded derivatives: deemed contracts for differences).

Article 13 amends paragraph 45D (embedded derivatives which are options) in relation to life assurance business and to exclude existing assets (i.e. an asset representing a creditor relationship of a company to which section 93 (convertible securities etc.: creditor relationships) of the Finance Act 1996 (c. 8) applied).

Article 14 amends paragraph 45E (exclusions from paragraph 45D) in consequence of the omission of paragraph 48A.

Article 15 amends paragraph 45F (creditor relationships: embedded derivative which are exactly tracking contracts for differences) to exclude existing assets (i.e. an asset representing a creditor relationship of a company to which section 93 (relationships linked to the value of chargeable assets) of the Finance Act 1996 (c. 8) applied).

Article 16 inserts a new paragraph 45FA to provide for the treatment of existing assets excluded from paragraphs 45D and 45F.

Article 17 inserts a new paragraph 45H to provide for the treatment of net gains and losses on the terminal exercise of an option comprised in a derivative contract and a new paragraph 45HA to provide for the treatment of credits and debits on the terminal exercise of an equity option.

Article 18 amends paragraph 45J (issuers of securities with embedded derivatives: deemed options) in relation to the treatment of deemed options.

Article 19 inserts a new paragraph 45JA to provide for the treatment of an issuer of convertible debt securities which are treated for accounting purposes as equity instruments.

Article 20 amends paragraph 45K (issuers of securities with embedded derivatives: deemed contracts for differences) to exclude existing liabilities owed by a company.

Article 21 amends paragraph 45L (derivatives not embedded in a loan relationship) to introduce an election for this paragraph not to apply.

Article 22 amends paragraph 45M (treatment of host contract as a loan relationship) to clarify the treatment of a host contract which is not itself a loan relationship.

Article 23 omits paragraph 48A (embedded derivatives in connected party loans) so embedded derivatives in connected party loans may be taxed on a chargeable gains basis.

This Order does not impose any new costs on business.



**2005 No. 2082**

**CORPORATION TAX**

The Finance Act 2002, Schedule 26, Parts 2 and 9 (Amendment  
No. 2) Order 2005

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