
STATUTORY INSTRUMENTS

2006 No. 3269

**The Finance Act 2002, Schedule 26,
(Parts 2 and 9) (Amendment) Order 2006**

Amendment of Part 2 of Schedule 26

Amendment of paragraph 2 of Schedule 26

3. In paragraph 2 (derivative contracts and relevant contracts) for sub-paragraphs (3) to (5) substitute—

“(2A) For provisions which treat a company as being party to a relevant contract see—

- (a) section 94A of the Finance Act 1996 (loan contracts with embedded derivatives);
- (b) paragraph 2A below (non-financial contracts with embedded derivatives);
- (c) paragraph 2B below (hybrid derivatives).

(2B) In this Schedule “plain vanilla contract” means a relevant contract other than one to which a company is treated as being party by virtue of a provision mentioned in sub-paragraph (2A).”.

Insertion of paragraphs 2A and 2B of Schedule 26

4. After paragraph 2 insert—

“Non-financial contracts with embedded derivatives

2A.—(1) This paragraph applies where—

- (a) a company is party to a contract (a “non-financial contract”) which is not a loan relationship and to which paragraph 2B does not apply, and
- (b) in accordance with generally accepted accounting practice, the company treats 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 (the “non-financial host contract”).

(2) The company is to be treated for the purposes of this Schedule as—

- (a) party to a relevant contract (a “non-financial embedded derivative”) whose rights and liabilities consist only of the embedded derivative, or
- (b) if there is more than one embedded derivative, party to relevant contracts each of whose rights and liabilities consist only of one of the non-financial embedded derivatives.

(3) Each relevant contract to which the company is treated as party under sub-paragraph (2) is to be treated as an option, a future, or a contract for differences according to whether the rights and liabilities of the embedded derivative would be of that character if contained in a separate contract.

Hybrid derivatives

2B.—(1) This paragraph applies where—

- (a) a company is party to a relevant contract which satisfies the conditions in paragraph (b) or (c) of paragraph 3(1) (a “hybrid derivative”),
- (b) in accordance with generally accepted accounting practice, the company treats 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 (the “host contract”), and
- (c) a contract consisting of only those remaining rights and liabilities would be a relevant contract.

(2) The company is to be treated for the purposes of this Schedule as—

- (a) party to a relevant contract whose rights and liabilities consist only of the embedded derivative, or (if there is more than one derivative), party to relevant contracts each of whose rights and liabilities consist only of one of the embedded derivatives, and
- (b) party to a relevant contract whose rights and liabilities are those of the host contract.

(3) Each relevant contract to which the company is treated as party under sub-paragraph (2)(a) (a “nested derivative”) or (2)(b) (a “quasi-derivative host contract”) is to be treated as an option, a future, or a contract for differences according to whether the rights and liabilities of the embedded derivative or host contract would be of that character if contained in a separate contract.”.

Amendment of paragraph 3 of Schedule 26

5.—(1) Amend paragraph 3(1) (contracts to satisfy accounting requirements etc.) as follows.

- (2) In sub-paragraph (1)(a) omit “financial instrument”.
- (3) In sub-paragraph (2)(b)(iv) for “and” substitute “or”.
- (4) In sub-paragraph (3) omit “financial instrument”.
- (5) In sub-paragraph (5)—
 - (a) omit paragraph (a),
 - (b) in paragraph (aa) omit “by the company”, and
 - (c) in paragraph (b)—
 - (i) omit “by the company”, and
 - (ii) for “derivative financial instruments” substitute “derivatives”.

Amendment of paragraph 4 of Schedule 26

6.—(1) Amend paragraph 4(2) (contracts excluded by virtue of their underlying subject matter) as follows.

- (2) In sub-paragraph (2)(b) after “(2C)” insert “, (2CA)”.
- (3) For sub-paragraph (2A) substitute—

(1) Paragraph 3 was amended by article 3 of [S.I. 2004/2201](#), article 3 of [S.I. 2005/646](#) and article 4 of [S.I. 2005/2082](#).
 (2) Paragraph 4 was amended by article 4 of [S.I. 2004/2201](#), article 4 of [S.I. 2005/646](#), article 5 of [S.I. 2005/2082](#) and article 5 of [S.I. 2005/3440](#).

- “(2A) The conditions specified in this sub-paragraph are that the relevant contract—
- (a) is a plain vanilla contract entered into by a company carrying on life assurance business;
 - (b) is an approved derivative for the purposes of Rule 4.3.5 of the Integrated Prudential Sourcebook; and
 - (c) does not fall within paragraph 3(1)(b).”.
- (4) In sub-paragraph (2B)—
- (a) in paragraph (b)(ii) after “of the company” insert “or any liability related to share capital of the company”, and
 - (b) in paragraph (c) for the words from “a deemed relevant contract” to the end substitute “a loan-contract embedded derivative.”
- (5) After sub-paragraph (2C) insert—
- “(2CA) The conditions specified in this sub-paragraph are—
- (a) the relevant contract is entered into or acquired—
 - (i) by a company otherwise than in the course of activities forming an integral part of a trade carried on by it, or
 - (ii) by a company which is a mutual trading company;
 - (b) the relevant contract is—
 - (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 a loan-contract embedded derivative; and
 - (d) the shares to be acquired or delivered constitute, or would (if acquired or delivered) constitute a substantial shareholding within the meaning of paragraph 8 of Schedule 7AC to TCGA 1992.”.

Substitution of paragraph 4C of Schedule 26

7. For paragraph 4C(3) substitute—

“Treatment of credits and debits on former chargeable asset

- 4D.**—(1) This paragraph applies if—
- (a) a company is party to a plain vanilla contract which (not having been a derivative contract) became a derivative contract before 30th December 2006,
 - (b) the company disposes of the derivative contract by ceasing to be a party to it, and
 - (c) paragraphs 4A and 4B do not apply in relation to the contract.
- (2) For the purposes of computing any chargeable gain accruing to the company on the disposal—
- (a) paragraph 1(2) does not apply; and
 - (b) the sums allowable as a deduction under section 38(1)(a) of TCGA 1992 (acquisition costs) shall—
 - (i) if G exceeds L, be increased by the amount of that excess, and
 - (ii) if L exceeds G, be reduced by the amount of that excess.

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

(4) In this paragraph—

G is the sum of the credits brought into account under paragraph 14(3) in respect of the derivative contract in each relevant accounting period, and

L is the sum of the debits brought into account under paragraph 14(3) in respect of the derivative contract in each relevant accounting period.

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

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

Amendment of paragraph 9 of Schedule 26

8.—(1) Amend paragraph 9(4) (underlying subject matter which is subordinate or of small value disregarded) as follows.

- (2) In sub-paragraph (1) omit “or (4)”.
- (3) Omit sub-paragraph (4).
- (4) In sub-paragraph (5)—
 - (a) in paragraph (a) omit “or”, and
 - (b) omit paragraph (c).

Amendment of paragraph 12 of Schedule 26

9.—(1) Amend paragraph 12(5) (definition of terms relating to derivative contracts) as follows.

(2) For sub-paragraph (1) substitute—

“(1) This paragraph defines the following expressions for the purposes of this Schedule—

- a capital redemption policy (see sub-paragraph (2));
- a contract for differences (see sub-paragraphs (3) to (5));
- a depositary receipt (in relation to shares) (see sub-paragraph (17));
- designated (see sub-paragraph (13));
- a future (see sub-paragraphs (6), (7) and (10));
- a hedging relationship between a relevant contract and an asset or liability, in the case of any company (see sub-paragraph (14));
- intangible fixed assets (see sub-paragraph (11));
- Integrated Prudential Sourcebook (see sub-paragraph (15));
- loan-contract embedded derivative (see sub-paragraph (11A));
- loan-contract host contract (see sub-paragraph (11B));
- long-term insurance fund (see sub-paragraph (16));

(4) Paragraph 9 was amended by article 11 of [S.I. 2004/2201](#) and article 7 of [S.I. 2005/646](#).

(5) Paragraph 12 was amended by article 13 of [S.I. 2004/2201](#), article 9 of [S.I. 2005/646](#), article 8 of [S.I. 2005/2082](#) and article 6 of [S.I. 2005/3440](#).

an option (see sub-paragraphs (8) and (10));
original asset (see sub-paragraph (11C));
original creditor relationship (see sub-paragraph (11D));
shares in a company (see sub-paragraph (12));
a warrant (see sub-paragraph (9)).”.

(3) After sub-paragraph (11) insert—

“(11A) ”Loan-contract embedded derivative” means a contract to which a company is treated as party by virtue of section 94A(2)(b) of the Finance Act 1996.

(11B) ”Loan-contract host contract” means a loan relationship to which a company is treated as party by virtue of section 94A(2)(a) of the Finance Act 1996.

(11C) ”Original asset” means an asset representing an original creditor relationship.

(11D) ”Original creditor relationship” means a loan relationship to which—

(a) a company is creditor, and

(b) section 94A of the Finance Act 1996 applies.”.

(4) In sub-paragraph (13) before “has the same meaning” insert “, except in paragraph 45G,”.

(5) In sub-paragraph (14) for paragraph (b) substitute—

“(b) in any other case—

(i) the hedging instrument is intended to act as a hedge of the exposure to changes in fair value of the hedged item that is attributable to a particular risk and could affect the profit or loss of the company, and

(ii) the hedged item is an asset or liability recognised for accountancy purposes or is an identified portion of such an asset or liability.”.

(6) In sub-paragraph (16) for “and “contract of long-term insurance” have” substitute “has”.