Loan relationships and derivative contracts – targeted anti-avoidance rules applying from Royal Assent to the Finance Act

As a result of the review and consultation on modernising the rules on loans and derivative contracts which started in June 2013, targeted anti-avoidance rules (TAARs) are being introduced into both the loan relationship and derivative contracts regimes. The TAARs are intended to counteract the effect of arrangements if their main purpose, or one of their main purposes, is to enable a company to obtain a tax advantage under either the loan relationship or derivative contracts rules. The TAARs will apply to arrangements entered into on or after Royal Assent to F(No. 2)A 2015.

In some ways, the approach taken is similar to the General Anti-Abuse Rule introduced in 2013 but the drafting is a great deal simpler and it is more straightforward to assess the potential application.

Going forward from Royal Assent to the Finance Act, whilst most arrangements involving loan relationships and derivatives will be unaffected, it will be necessary to test arrangements against the requirements of the TAARs.

Nature of tax advantage and counteraction

The TAARs apply to arrangements which affect the quantum and timing of the recognition of debits and credits from loan relationships and derivative contracts. For example, a TAAR could be relevant if the amount of any credit brought into account is reduced.

If a TAAR applies, adjustments are to be made to debits and credits to counteract the tax advantage on a just and reasonable basis.

Exclusion of arrangements if they are consistent with principles and policy objectives of the legislation

Arrangements are excluded from a TAAR if the obtaining of the tax advantage can reasonably be regarded as consistent with any principles on which the loan relationship and derivative contracts rules are based (whether expressly or implied) and the policy objectives of those provisions.

Draft HMRC guidance says that indicators of Parliament's intention may be found in ministerial statements made when a provision was announced or introduced, Hansard reports of Finance Bill debates or explanatory notes published with Finance Bill clauses. However, HMRC manuals are not relevant.

Examples of outcomes which are not consistent with the principles and policy of the legislation

The legislation includes examples of tax outcomes that may indicate that this exclusion should not apply if it is reasonable to assume that such a result was not anticipated when the relevant provisions were enacted. For example, this could be relevant if:

- taxable profits are lower than the economic profit, or tax losses are higher than the economic loss; or

- the recognition of a profit or loss in the accounts is prevented or delayed.

Repeal of existing anti-avoidance provisions

As a result of the introduction of the TAARs, certain anti-avoidance provisions will be repealed for arrangements entered into or disposals occurring on or after Royal Assent to F(No. 2)A 2015.

It had been intended that the provision to counter arrangements to circumvent the rules applying to debt purchased at a discount to face value and for unconnected debts which become connected would be repealed (section 363A CTA 2009). Since its introduction in February 2012, it has been necessary to consider this anti-avoidance provision in the context of acquisitions/disposals of debt and financial restructurings where surplus debt is being eliminated. It has now been decided that the provision will be retained, though this may be reconsidered at some time in the future.

Potential application of the TAARs

In relation to arrangements which have the effect of utilising tax losses brought forward, it is not thought that the loan relationship TAAR will, generally, apply where interest income on a new loan is sheltered by tax losses brought forward. As noted above, the loan relationship TAAR applies to arrangements which affect the quantum and timing of the recognition of debits and credits from loan relationships and an arrangement which consists of a loan, with matching taxable interest income and expense, should not be caught, notwithstanding that the taxable credit may be sheltered by losses. However, it will still be necessary to determine the main purpose or purposes of the borrowing to assess the possible application of the unallowable purposes rule to the borrower. In addition, new rules to counter loss refreshing were introduced with effect from 18 March 2015 which will need to be considered.

It will also be important to keep in mind that the TAARs could be relevant if loans or derivatives are transferred, perhaps to a non UK entity, in circumstances where not all credits are brought into account.

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Produced by Create Graphics | Document CRT033310

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