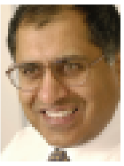
A quiet report



MOHAMMED AMIN LOOKS AT WHAT ALISTAIR DARLING'S FIRST PRE-BUDGET REPORT MEANS FOR TREASURERS.

The new Chancellor of the Exchequer gave his first Pre-Budget Report (PBR) on 9 October. By now, many hectares of newsprint have been devoted to analysing its implications for entrepreneurs, private investors, families and politicians. But what did it do for corporate treasurers? In truth, this was a very quiet PBR for treasurers, although there are some changes to consider.

Alistair Darling: no shocks in first PBR

CHANGES TO MATCHING RULES Many companies hedge balance sheet translation risk by taking out foreign currency loans or currency derivatives. At present, a loan or derivative may only be matched for tax purposes with a share investment up to the book value of the shares in the investor company's accounts. The value of the underlying foreign currency assets held by the investee company may be far in excess of the book value at which the shares are carried by the investor. The investor company may wish to hedge the foreign exchange (FX) risk on the underlying assets, but may not currently be able to match the entire hedging instrument (loan or derivative) for tax purposes.

The PBR made amendments to the disregard regulations to allow a company to elect to match a hedging loan or derivative with the value of the net foreign currency assets underlying the share investment, rather than restricting the amount matched to the book value of the shares. Amending regulations will be laid later this year and will be effective for accounting periods beginning on or after 1 January 2008.

The current rules treat a loan or derivative as matched with a share investment for tax purposes if:

- the loan or derivative is formally designated as a hedge of the shares for accounting purposes; or
- the loan or derivative is intended to act as a hedge of the FX risk on the shares.

HM Revenue & Customs intends to publish draft regulations in early 2008 to replace the intention-based test with "a more objective and straightforward approach". The regulations will also refine the rules for matching based on the value of underlying assets, and include an anti-avoidance rule to prevent companies disregarding exchange gains for tax purposes in circumstances where a deductible exchange loss would be claimed. These changes will apply to accounting periods beginning on or after 1 January 2009.

DISTRIBUTIONS FROM SHARES TREATED AS LOAN RELATIONSHIPS Anti-avoidance rules were introduced in 2005 to tax the fair value movements of shares as income items, under the loan relationship rules, where the fair value movement of the shares mirrors an interest-like return. The rules are contained in section 91A onwards of the Finance Act 1996.

The most common types of distribution (including dividends) paid in respect of such shares by a UK company are deemed to be outside the exemption in ICTA 1988 section 208, and are therefore taxable. Such distributions typically reduce the fair value of the shares, hence also generating a tax deduction under the Finance Act 1996 rules. HMRC has been notified of a scheme where distributions on such shares have been structured so that they still benefit from the exemption in section 208. The effect of the non-taxable distribution is to reduce the fair value of the shares, with that reduction having effect for tax purposes, even though the distribution was not taxable. Anti-avoidance legislation has therefore been introduced to treat as taxable any type of distribution paid on or after 9 October 2007 in respect of a share treated as a loan relationship.

LEASING There were some more changes to the leasing rules, taking effect from the day of the PBR, to counter perceived tax avoidance. In particular, under a long funding lease a lessor is not entitled to capital allowances on the cost of the asset, but is only taxed on the finance element of the lease rentals. This effectively puts the lessor in the same tax position as a bank making a loan to a purchaser of the asset, where the bank is taxable only on the loan interest.

Legislation is also to be introduced so that where leasing arrangements give the lessor a tax deduction for the cost of the leased asset, then the lessor will be taxed on the full lease rentals. Additional legislation will be introduced to counter other situations where the long funding lease rules are used to create a tax loss where there is little or no commercial loss.

IN TRUTH, THIS WAS A VERY QUIET PRE-BUDGET REPORT FOR TREASURERS, ALTHOUGH THERE ARE SOME CHANGES TO CONSIDER

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