Comments on behalf of
The Association of Corporate Treasurers

in response to
Corporation Tax Reform, A consultation document
(Inland Revenue and HM Treasury, August 2003)

Introduction

The Association of Corporate Treasurers is not directly involved with the full range of CT Reform but we would like to comment on two specific aspects of reform covered in the consultation document published in August 2003.

Information about the ACT is attached in the Appendix and contact details are on page

I. Accounting Standards

In general we are supportive of moves towards taxation being based more closely on financial accounts given the potential for simplification and reduction in the compliance burden which such a move might offer. However, in view of the current developments in accounting, specifically the introduction of International Financial Reporting Standards (under the IASB) and the general move towards fair value accounting with effect from 1 January 2005, we do not believe it would be appropriate for taxation to become more closely aligned with financial accounts at this time.

We have been heavily involved in discussions with the IASB and others concerning the new standards and in particular the proposed hedge accounting aspects in IAS 39. We are very concerned that because of the very restricted definition of hedge accounting in IAS 39 non-financial sector corporates will be required to reflect changes in the fair value of their derivative contracts held for hedging purposes directly in their profit & loss accounts, leading to considerable volatility in their financial results. These companies will then be faced with the choice of trying to explain the resultant volatility to the financial media and analysts or changing, or even eliminating, sensible commercial hedging activities. There is already evidence from the US of changes in the hedging behaviour of companies in response to FAS 133, and we believe this to be very regrettable. If the guidance notes to IAS39, when finalised, do not allow hedge accounting on internal contracts arising from hedging on a net basis, then hedge accounting will be more restricted under IAS compliant accounts (than US GAAP compliant accounts). Consequently, volatility arising in IAS compliant accounts would exceed volatility in US GAAP compliant accounts.

We are concerned that if taxation were also to be based on the fair value results of derivatives this would present an even more tangible and effective deterrent to sensible corporate hedging activities. We believe that every effort should be made to ensure that non-financial sector corporates are not taxed by reference to short term movements in the values of financial derivatives which are commercially held for the long term as part of a genuine commercial hedging policy.

Reference has been made to the fact that such derivatives are readily realisable and that therefore any argument based on inability to pay is flawed. However it is important to recognise that even though these derivatives are often readily realisable, they are being held for long term commercial purposes and therefore if taxation forces their premature sale this would amount to taxation having an undue influence on commercial behaviour.

The vast majority of financial derivatives held by non-financial sector corporates are held for hedging purposes even though they may not qualify for hedging treatment under the restrictive definition in IAS 39. We believe it is vital that profits and losses on such derivative contracts continue to be taxed on an accruals basis.

II. Leasing

We believe that the changes to the tax treatment of leasing which are proposed in the consultation document are likely to result in the total demise of this market. We understand that the effective transferability of capital allowances has always been a sensitive issue and that on some occasions in the past leasing structures have been used inappropriately.

However in our view the aim of capital allowances is to incentivise investment activity or at least to ensure that tax relief is obtained by those who invest in productive assets, and leasing is in many cases merely an alternative form of borrowing to invest.

For many corporates, primarily those with taxable profits against which to offset capital allowances, leasing is an unnecessarily expensive alternative to borrowing, and consequently they have only limited use for leasing. However for the smaller enterprises, particularly those in a start-up phase, and not yet making taxable profits, leasing is a vital source of finance and the only way in which they can obtain effective tax relief for their investment, by way of reduced leasing payments.

When it introduced R&D tax credits for SME's in a repayable form the Government effectively acknowledged that it was justifiable and sensible to put a company in a start-up situation, with no taxable profits, in the same position as regards tax relief as a more established company with existing profits from other sources. The use of leasing effectively to monetise the tax relief produced by capital allowances by way of reducing leasing/financing charges does precisely this.

We would therefore urge the Government, whilst trying to implement its other policy objectives with regard to leasing, to bear in mind the vital part which leasing currently plays in the financing of smaller start-up enterprises. We believe that a way should be found of effectively giving the benefit of capital allowances to these companies, in spite of the absence of profits, either by allowing an effective leasing regime to continue or perhaps by introducing a mechanism involving an election to transfer the benefit of capital allowances to a financing institution where the borrower cannot itself obtain effective relief.

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The Association

The Association of Corporate Treasurers was formed in 1979 to encourage and promote the study and practice of finance and treasury management and to educate those involved in the field.

Today, it is an organisation of professionals in corporate finance, risk and cash management operating internationally. It has over 3,000 fellows, members and associate members, mainly UK based. With more than 1,200 students in more than 40 countries, its education and examination syllabuses are recognised as the global standard setters for treasury education.

Members of the Association work in many fields and in companies of all sizes. A number of members are on the boards of major companies in both executive and non-executive capacities. Others are involved in entrepreneurial stage, business start-ups.

The majority of fellows, however, are professionals working as senior executives below the board level in large public companies, responsible for the treasury and corporate finance functions.