

10th February 2004

Inland Revenue
Business Tax
Room 4W1
22 Kingsway
London WC2B 6NR

Dear Sirs

Corporation tax: Derivatives based on property and share values

The Association

1. The Association of Corporate Treasurers was formed in 1979 to encourage and promote the study and practice of corporate 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. A professional body and not a trade association, it has over 3,000 Fellows, Members and Associate Members. 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. The majority of Fellows work in large UK public companies, responsible for the treasury and corporate finance functions.
2. The ACT usually comments from the corporate and not the financial services sector standpoint

Summary

3. Overall, we welcome the introduction of a standardised tax regime for property derivatives. This should assist companies to better manage their property interests. However, several features of the proposed regime will need alteration to work satisfactorily.
4. The proposed regime on equity derivatives is unwelcome, and unnecessary.

Desirable features for a property derivatives regime

5. Generally, there will be a need to ensure, as far as possible, that there are no mismatches between the treatment of a derivative and the treatment of the

underlying subject matter. In particular, we see the need to permit the hedging of capital gains and losses as being of considerable importance.

6. If unrealised gains on derivatives are to be taxed over the life of the contract, then in our view there will be a need to allow carry-back of capital losses for a period of six years, if only to permit the set off of losses against unrealised gains. This is of particular importance if the adoption of International Accounting Standards means that revaluation gains and losses are more often recorded through the accounts.
7. Any new rules will also need to deal with the situation where a derivative is held in one group company, but the underlying asset is held in another group company.
8. It will also need to be made clear that the underlying subject matter of a rent swap will be the rents as such and not the property itself.

Extension to equity derivatives

9. We believe that the extension of the proposed changes to equity derivatives is inappropriate.
 - Companies have only just got to grips with the changes to the taxation of derivatives introduced by the Finance Act 2002 and now is not the time to introduce fundamental changes.
 - The changes would lead to the loss of indexation relief for equity derivatives held as capital assets.
 - In many cases a company would be entitled to substantial shareholding relief in respect of gains realised on an equity derivative where the derivative relates to shares which the company holds and which themselves qualify for substantial shareholding relief. It is not clear to us how this relief would be preserved under the new regime.
10. We are concerned that the proposed regime would not allow hedging treatment to be achieved as any gain or loss on an equity derivative would be taxed over its life on the basis on which profits and losses are recognised in the company's accounts, whereas any gain or loss on the underlying shares would only be recognised on a realisations basis. A mismatch would arise as it would not be possible to carry back a loss realised on the disposal of shares against a profit which had arisen on a derivative contract in an earlier accounting period.
11. There will need to be a provision to ensure that there is an interaction with substantial shareholding relief where an option or future would be treated as an asset relating to shares for the purposes of paragraph 30 of Schedule 7AC TCGA 1992.
12. We note that you may wish to make all responses to formal consultations available for public inspection unless the respondent requests otherwise. These comments are on the record and may be freely quoted and made available for public inspection.

13. We hope these responses are helpful for your deliberations and if you need any further information or clarifications please contact any of the people listed below.

Yours faithfully,

Richard Raeburn
Chief Executive

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<p><i>The Association of Corporate Treasurers is a company limited by guarantee in England under No. 1445322 at the above address</i></p>	