HMRC - CFM57041 - Hedging: Change In Election Approach

Change in election approach

The election approach was changed in December 2014. There were previously four separate elections that could be made, each with slightly different effects. The amendments made in 2014 changed to make ‘following profit or loss the default treatment and streamlines the existing permutation into a single election into regulations 7, 8 and 9. The new rules apply for periods of account commencing on or after 1 January 2015.

Previous approach (elect-out) - periods of account commencing before 1 January 2015

The previous default position was that the Disregard Regulations would apply automatically to derivatives which were part of a hedging relationship. The type of contract would determine whether regulation 7, 8 or 9 applied, for example a currency contract would be dealt with by regulation 7.

If the company did not want the Regulations to apply, they could make an irrevocable election to opt-out of regulation 7, 8 or 9 and, in certain cases, apply regulation 9A instead. Regulation 9A would essentially follow the amounts shown in the accounts instead, meaning detailed computations were not necessary. The effect of the election was also disapplied in particular cases (which depended on the particular election made).

Current approach (elect-in) - periods of account commencing on or after 1 January 2015

The default position going forwards is that the ‘follow the accounts’ approach will apply. This broadly means companies will be able to follow the amounts recognised in profit or loss. Regulation 9A should ensure that amounts recognised in OCI as a result of a designated cash flow hedge are not brought into account for tax purposes.

If companies want to disregard fair value movements, they can make an election to opt-in to regulation 7, 8 and 9 of the Disregard Regulations. This means regulation 7, 8 and 9 will have effect (where the relevant conditions are satisfied) and computational adjustments will be necessary. The election can specify which of regulations 7, 8 or 9 are to be applied.

The company will be locked into a particular approach for an initial period (normally three years). Thereafter the company will have the option of revising its election position, which will apply prospectively for new derivatives moving forwards.

Companies previously applying fair value accounting

If a company already holds derivatives which are accounted for at fair value and which would fall under regulations 7, 8 or 9 of the Disregard Regulations, the existing treatment is grandfathered without them having to do anything. The company will now also have the option of revising its election position, which will apply prospectively for new derivatives moving forwards.

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