HMRC - CFM57371 - Hedging: Anti-Avoidance

This guidance applies to periods of account starting on or after 1 January 2015.

Anti-avoidance arrangements

Regulation 6(1)(d)

There is a special rule in regulation 6(1)(d) to counter potential avoidance that could otherwise exploit the tax or accounting rules on hedging instruments. The rule is widely drawn and applies where there is an arrangement with a main purpose of obtaining a tax advantage that would not have arisen had regulation 7, 8 or 9 applied in respect of the contract. The effect of the rule is to apply regulation 7, 8 or 9 (as case may be).

Application

The changes to the elections under regulation 6A are to enable businesses to make an informed choice as to the most appropriate computational basis for them in respect of derivative financial instruments. Companies with derivative contracts that fulfil a hedging function essentially have three main strategies regarding how they treat them for tax:

Adopting an approach of designating hedging relationships in the accounts;

Electing into regulation 7, 8 or 9 of the Disregard Regulations;

Do neither of these meaning they will be subject to taxed on the full amount of fair value volatility on the instruments.

In most cases, it is expected that companies will either adopt a policy of designating hedging relationships in their accounts or electing into regulations 7, 8 and 9 of the Disregard Regulations. Exceptionally, companies may decide to neither designate hedging relationship in their accounts nor elect into the Disregards Regulations. This may be the case where a company has a large number of derivative financial instruments. In this case, the company will be taxed on fair value profits, and obtain relief for fair value losses.

As long as companies adopt one of these three strategies and applies it consistently to all its derivatives (or to a particular type of derivative) then this would not typically invoke the anti-avoidance rule. However, if they seek to mix and match different strategies to gain tax benefits with the benefit of hindsight then the anti-avoidance rule should be considered.

In particular, the anti-avoidance rule is intended to be invoked where a company seeks tax relief for a fair value loss and takes any steps to avoid being taxed on fair value profits. For example, where it applies different strategies based on whether derivatives give rise to a profit or a loss, or claiming a fair value loss and undertaking planning to ensure fair value profits do not arise in the future.

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