HMRC - CFM95640 - x-Interest: Loan Relationship Fair Value Accounting

TIOPA10/S456

A company with a creditor loan relationship (ie. a loan receivable) will have several potential accounting treatments available when it includes the asset on its balance sheet, depending on the relevant accounting standard. It could measure it at amortised cost, for example, but could also be required to account for it at fair value through profit or loss.

Accounting at fair value will introduce an element of volatility into the company’s accounts.

For example, if the company made a ten year bond of £100m with fixed coupons of 6%, the fair value of the loan would fluctuate due to changes in market expectations. If market rates increase the fair value of the asset would decrease to compensate (and vice versa).

These fair value movements will be included in tax-interest as relevant loan relationship amounts under either s383 or s386, and could impact on interest capacity from year to year. To prevent this uncertainty, the legislation allows an election to be made to apply the amortised cost basis to creditor loan relationships instead of applying fair value accounting. There is no prescribed form for the election. If the group has a Customer Compliance Manager (CCM), elections can be sent to them, otherwise see the CIR internet page for where to send elections.

Time limits

The election must be made within twelve months from the end of the later of the first accounting period in which the company has a fair value creditor relationship, or, if that accounting period ended before 1 April 2017, the first accounting period ending after that date.

The election has effect for that and all subsequent accounting periods, and once made the election is irrevocable.

Impairment losses

The {amortised cost} of a financial asset takes several factors into account such as any repayments of capital or impairments. Since impairment losses are excluded from the tax-interest amount (s383(3)(b)), there is no need to calculate any impairment losses when determining the amortised cost of the asset only to then strip out this component.

Example

A Ltd is party to a £60m creditor loan relationship which it accounts for at fair value but has elected to apply the amortised cost basis when calculating its tax-interest amount. It transfers the loan to B Ltd who already holds a £250m creditor loan relationship accounted for at fair value and has not elected to use the amortised cost basis.

Post transfer, B Ltd will need to apply the amortised cost basis to the £60m loan and account for the £250m loan at fair value when calculating its tax-interest amount.

Application for insurance companies

Where an insurance company makes a fair value accounting election the effect is modified slightly. This is to ensure the election provides these companies with a practical alternative to the calculation of tax-interest, reflecting the fact that they may hold a large number of loan receivables.

For these companies they should calculate the tax-interest amounts arising on these loan assets as being the amount of interest accrued in the period. In most cases, therefore, this will ignore amounts of premia, discounts and fees in respect of such instruments.

Where the insurer holds an interest in an OEIC, unit trust or offshore fund which is deemed to be a loan relationship under the {bond fund rules} (CTA09/S490) then it should calculate the tax-interest amounts arising from this deemed loan relationship on the basis of the amounts that can reasonably be regarded as equating to interest accrued for the period.

For OEICs and Authorised Unit Trusts, this will generally be determined by treating all interest distributions received from the fund in a period as falling within the definition of tax-interest while all non-interest distributions would not be tax-interest.

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