



ICAS comments on Draft Finance Bill Clause 21 and Schedule 7

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About ICAS

1. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants and we represent over 21,000 members working across the UK and internationally. Our members work in all fields, predominantly across the private and not for profit sectors.
2. ICAS has a public interest remit, a duty to act not solely for its members but for the wider good. From a public interest perspective, our role is to share insights from ICAS members into the many complex issues and decisions involved in tax and financial system design, and to point out operational practicalities.

Comments

3. ICAS welcomes the opportunity to comment on the draft legislation.
4. In view of the very short time allowed for comment and the publication of the legislation in two stages (making it difficult to consider the complete picture) we strongly suggest that the new interest deductibility provisions should be subject to a formal short term review by HMRC and the government, so that issues which arise post-implementation can be addressed quickly through amendments to the legislation.

Modified debt cap and carried forward amounts

5. We welcome the extension of the carry forward for excess capacity from 3 years to 5 years. However, the operation of the Modified Debt Cap rule (MDCR) is likely to mean that, unless the rules are amended, UK groups will be disadvantaged and may be unable to make use of carried forward interest.
6. A wholly UK group which is loss making should be able to use its carried forward interest amounts once it becomes profitable. However, the MDCR will cap the deduction at the amount of group level net third party interest - leaving it without any capacity to use brought forward amounts, in spite of the longer carry forward of unused capacity and the indefinite carry forward of unused interest.
7. By contrast a company or group which is part of a larger multinational group will be unlikely to suffer the same permanent restriction of its interest deduction. MDCR will cap its future deductions at net third party interest of the entire worldwide group – the UK interest is likely to be below this level, allowing the UK company or group to use brought forward interest amounts over time.
8. UK competitiveness is particularly important post-Brexit so we would appreciate clarification that this effect is unintended and will be addressed.

Transitional provision: change of accounting policy

9. Paragraph 83 of Schedule 7 makes transitional provision by excluding amounts brought into account under the change of accounting policy rules for loan relationships. However, it does not cover derivative contracts. This contrasts with the transitional provision in paragraph 84 which covers both loan relationships and derivative contracts.

10. We assume that this is an error in the draft legislation and that paragraph 83 will be amended to include derivative contracts as well as loan relationships.

Mark to market losses on bonds

11. There is a lack of clarity on the treatment of mark to market losses on bonds and the nature of the BEPS risk that this treatment is seeking to address. The response to the consultation deals with the treatment of derivatives in paragraph 2.10 and indicates that groups will be given the option of making an election to exclude the fair value movements arising on derivatives (to work in a similar manner to the Disregard Regulations). However, this does not address loan relationships. Paragraphs 2.14 and 2.15 of the response cover impairment losses – which will be excluded from the rules – but mark to market losses are not impairment losses, so again do not appear to be covered. The amendments issued on 26 January, to allow substitution by election of amortised cost movements for mark to market losses, do not address the issues. All these amendments do is introduce further complexity but with unclear benefits.
12. This is a significant issue for the life insurance sector which currently holds bonds to back policy holder liabilities. It would no longer be feasible to do this if companies could only obtain relief for 30% of losses on bonds; the risk would be unacceptable. This would have detrimental consequences for the gilt market.
13. Rapid clarification of the intended treatment and the BEPS risk it is seeking to address is vital.