KPMG

cutting through complexity

M&A Tax Matters

Summer 2015

kpmg.co.uk

Welcome to the summer edition of M&A Tax Matters

Kicking things off in our summer edition of M&A Tax Matters, Christine Hood provides an update on the new Diverted Profits Tax ("DPT"), which was passed into law in the Finance Act 2015, highlighting the key changes from the draft legislation and how this might affect who falls within the scope of DPT, and who is required to notify.

Naz Klendjian and Margaret Stephens then discuss the OECD's BEPS Action Point 4 regarding interest deductions and other financial payments, providing us with an insight to their recent meeting with HMRC and other representatives from the infrastructure, transport and energy sectors.

Next up, Simon Ross-Skinner gives us an overview of the new disguised fee income legislation that is aimed at tackling potential causes of tax avoidance by managers of certain collective investment schemes, by ensuring they are taxed on their management fees as trading or employment income.

Then, Stephen Hunt, John Addison and Gary O'Neill explain and discuss the *Leekes v. Commissioners for HMRC (2015)* case on loss streaming, highlighting the areas which remain uncertain and the potential impacts for clients.

We then enter the world of stamp taxes where Sean Randall and Preema Patel are joined by Thomas Lewis for an overview of the abolition of bearer shares, and Fiona Cole for a brief discussion on the implications of the new SDRT penalties for late notification.

We travel across continents next and hear from our international colleagues Michael Rudnicki and Renatefecoe Mholo on South Africa's recent introduction of rules which limit the deductibility of interest. Their article summarises the new laws and discusses their application in an M&A context.

Finally, as we have seen an increase in a specialist form of contracts for differences in the M&A environment within the energy sector, Chris Murphy and Shantanu Sonde explain what they are and explore their tax and accounting treatment.

We hope you will enjoy our summer edition of M&A Tax Matters. If you would like further detail on the articles in this, or any previous issue, please call us, the authors, or your usual KPMG contact.

Editorial Team

Alistair Haley
Director
KPMG in the UK
T: +44 20 7694 4383
E: alistair.haley@kpmg.co.uk

Eleanor Houghton
Tax Assistant
KPMG in the UK
T: +44 20 7694 8827
E: eleanor.houghton@kpmg.co.uk

Contents

Diverted Profits Tax: Update post Budget 2015 publication of legislation 4

BEPS action point 4: Reflections on a public consultation meeting with the OECD and implications for M&A 6

Investment managers: Disguised fee income rules and impact from an M&A tax perspective 9

Leekes vs Commissioners for HMRC (2015): Loss streaming 11

Abolition of bearer shares: Stamp tax implications 13

Implications of the new SDRT penalties for late notification 16

Recent introduction of rules limiting the deductibility of interest: Summary of law and related application from a South African perspective 17

Contracts for differences: Tax and accounting treatment 20

Diverted Profits Tax: Update post Budget 2015 publication of legislation

The Diverted Profits Tax ("DPT") was amended in the 2015 Finance Bill and then passed into law in the Finance Act 2015, shortly before the UK general election. Her Majesty's Revenue and Customs ("HMRC") now have a substantial specialist DPT team in place and are training up Customer Relationship Managers. The legislation introduced some practical improvements from a taxpayer's perspective, but also broadened the scope of the regime in some circumstances. This article provides an update on the key changes, which are important from an M&A perspective.

To recap, the legislation imposes a 25% charge on perceived "diverted profits". Broadly, it applies to UK companies which are considered to have made an excessive payment to a low-tax low-substance group company, or in some circumstances to have charged an insufficient fee. It also applies to non-UK companies, which are considered to have avoided a UK taxable presence.

The most helpful change was the simplification of the circumstances in which a payment of interest out of a UK company falls outside the scope of DPT. Given the current level of anti-avoidance rules restricting the ability of a UK company to claim a deduction for financing costs it was agreed that there is no need for DPT to cover this.

Specifically, the final legislation considers whether the expense in a UK company is one which is deductible under the loan relationships legislation (which here includes "deemed" loan relationships, including interest-bearing balances which are not from a loan, and Islamic finance). If so, this expense is not within the scope of DPT. The exclusion also applies where the deduction is claimed for both interest and a derivative which hedges risk on the loan, such as an interest-rate or currency swap. The situation where the swap is not with the lender is not covered, although a vanilla swap which is correctly priced should fall outside the scope of DPT for other reasons.

There is also a helpful change in the form of a list of situations where, despite meeting the conditions which generally lead to an obligation to notify, a company may be able to conclude that notification is not required. The first situation is where the company can reasonably conclude that it has no liability to DPT. The legislation does not allow this route out of notification to be taken where the company's conclusion that it has no liability relies only on its transfer pricing being right, HMRC still wish to be notified so that they can scrutinise the transfer pricing. Before concluding that it has no liability, and therefore not notifying, a company would need to consider that if it is wrong, there is a tax-geared penalty for failing to notify, i.e. where there is a DPT liability contrary to the company's view, a penalty could also be charged. Thus, the company will be looking to fall out on the clearer tests, such as excepted loan relationships, the effective tax mismatch outcome, whether the non-UK company is trading, or the

threshold test for non-UK companies.

The more difficult tests about the design of the arrangements are less likely to enable a company to reach a solid conclusion.

There is also an exclusion from the obligation to notify where a HMRC Inspector has confirmed that the company does not have to notify for the current period because it has supplied all relevant information to HMRC and HMRC has examined it. This may seem not particularly helpful, (put another way, it could be interpreted as "you don't have to notify if you've already done something exactly equivalent to notifying"), but companies may be glad to be outside the DPT process. If a notification is made, there must always be a concern that a charging notice will be issued and that the company will have to pay the tax before it can appeal and demonstrate that its transfer pricing is correct.

There is also a further exclusion where the company can reasonably conclude that it has supplied all relevant information to HMRC and HMRC has examined it, even though it does not have specific confirmation. We understand that HMRC consider that a company which has supplied this information in the context of obtaining a pre-April 2015 Advanced Pricing Agreement could fall within this section, although it would need to be confident that the facts were still the same and that HMRC could not take a different view now as to the appropriate basis.

One consequence of these exceptions is that a company may be in a position before its accounting date to conclude that it does not have an obligation to notify, which should then be very helpful in demonstrating to its auditors that no DPT provision is required. Also, although there is no clearance procedure for DPT, HMRC have indicated that they will be prepared to discuss with taxpayers their potential liability to DPT before the notification date, on the basis of full information.

The less helpful change is the broadening of the scope of the charge on non-UK companies, by restricting the application of the de minimis rule. Previously, the legislation did not apply where a group had sales to UK customers below £10m per annum. The wording now considers sales from supplies of goods, services or other property which "relate to" activity carried on in the UK in connection to the overseas company's trade, made by any group company. It is likely to be much more difficult to quantify such sales than it was to identify the location of the customer. We understand that HMRC consider that the £10m limit includes sales of a non-UK company to a UK group company (e.g. the UK local distributor), even though the group's profit on those sales is going to be accounted for in the corporation tax computation of the UK distributor.

From our conversations with some clients, there is a very broad range of companies who are concerned that DPT may apply to them, or at least that they may have burdensome compliance obligations. Given the breadth of the legislation and the uncertainty which results from it, DPT is likely to become a contentious point in due diligence discussions. Many groups are already undertaking assessments and considering what their processes will be, and are preparing for transfer pricing discussions with HMRC with the aim of agreeing that notification is not required.

Christine Hood
Director
KPMG in the UK
T: +44 121 232 3381
E: christine.hood@kpmg.co.uk

Rob Norris
Director
KPMG in the UK
T: +44 121 232 3367
E: rob.norris@kpmg.co.uk

BEPS Action 4: Interest deductions and other financial payments

In our spring edition of M&A Tax Matters, we discussed the key features of the Organisation for Economic Co-operation and Development's ("OECD") discussion draft on interest deductions (Action 4) under the BEPS Action Plan and the situations likely to be affected in the M&A market from new structural rules that limit interest deductibility. The OECD has since received 1,000+ pages of submissions (please click here) and held consultations with industry, advisers, governments and NGOs (please click here). Following the end of the public consultation period in February 2015, OECD and governments have continued to work together behind closed doors to shape the final guidance by September 2015 for delivery to G20 leaders and Finance Ministers.

This article is intended to share information but it is important to understand that there can be no certainty as to what final OECD guidance will actually say and there remains much to be agreed on. There can also be no certainty about when and how tax authorities will take account of the guidance. The UK Government has stated publicly that it is committed to following best practice.

On 22 April 2015, KPMG chaired a meeting between HMRC/HM Treasury ("HMT") and representatives from investors/developers in the infrastructure, transport, energy and utility sectors.

The purpose of the meeting was for HMRC/HMT to share the progress made on interest deductibility in light of earlier submissions from KPMG/The Infrastructure Forum and seek further reactions from these sectors to inform HMRC/HMT's discussions at a meeting with the OECD in May 2015 to further progress the guidance:

- The current direction of OECD thinking is the 'combined approach' in the draft guidance:
  a. By applying the group interest allocation rule with a carve-out for entities meeting a low fixed-ratio test (to exclude low risk entities); or
  b. By applying a fixed-ratio rule with a carve-out permitting entities to apply the group interest allocation rule where this results in additional deductible interest.
- The final guidance will likely recommend a primary rule, being the fixed ratio rule i.e. a restriction of interest relief to a fixed percentage of earnings before interest, taxes, depreciation and amortisation ("EBITDA") at the entity level. We expect that fixed percentage to be low (perhaps around 10%-20%) in comparison to current EBITDA ratio limits in some other countries' tax laws, as these are still perceived to be too generous by the OECD.
- The OECD recognise that certain industries attract higher gearing ratios, and are likely to recommend a secondary group allocation rule for groups prepared to substantiate their higher group-wide ratio (based on an accounting concept of groups, i.e. control/

more than 50%). The OECD acknowledges from the submissions the complexities a group allocation rule presents, hence their positioning of this as a 'back up' qualification for interest relief.

- Third party debt remains in scope and there is a sense that the wider multinational corporation ("MNC") community did not make a convincing case for the use of internal on-lending to fund overseas investments. There seems to be real enthusiasm for restricting interest deductions which allow BEPS notwithstanding potential damage to the flow of capital for investment.
- This 'direction of travel' reflects a substantively unchanged position from the draft guidance. Coupled with the fact that there is no appetite within the OECD for 'blanket' carve outs for capital-intensive/highly geared sectors this means that previously identified risks/inappropriateness of the low fixed ratio approach and group allocation remain a clear and present potential danger to these sectors.

HMRC/HMT conveyed the OECD's current thinking that the group allocation 'back up' qualification should in theory serve as the 'silver bullet' in that sectors such as infrastructure should be able to apply it to access interest deductions based on their group-wide ratio position, however high.

We explained how, in practice, this approach does not work given how third party infrastructure financing operates on prospective assumptions about entity level cashflows and given the long-term nature of financing arrangements spanning changes of ownership (leaving third party interest deductions of the business subject to the vagaries of M&A activity). We explained how an EBITDA ratio is also not a usual measure of economics in infrastructure financing, which is based more on cash cover ratios.

We further briefed HMRC/HMT on how the impact of the approach would extend well beyond a slight increase in future cost of capital for companies, but would include the potential for mass loan defaults on previously financed infrastructure which will be destructive to investors and governments.

The OECD and country representatives do remain sympathetic to protecting higher geared sectors if it is clear that there can be no BEPS (i.e. cross-border profit shifting opportunities) arising from the relaxations that would be needed to be introduced into the guidance to do so.

How can continuing investment into UK infrastructure be supported?

The remaining focus of the meeting and our subsequent engagement with HMRC/HMT was therefore to set out the order of priorities or 'must-haves' (framed in terms of financing or ownership characteristics which result in limited or no BEPS risk) to support continuing investment into UK infrastructure as a stable, low risk destination for international, long term capital, which were set out as follows.

1. Grandfathering of existing infrastructure loan arrangements

- A significant proportion of approximately 800 existing Public-Provate Partnership ("PPP") projects would be unable to provide future returns to their investors, including UK pension funds and other investors likely to undertake M&A in future UK projects.
- Without these protections, a significant proportion of projects would become insolvent because the pricing agreed with the public sector assumed full interest tax relief for 95% or above gearing and change of law risk lies with the private sector.
- OECD guidance should ideally be sufficiently flexible to enable UK domestic rules to be designed to allow grandfathering of up to 20 years duration, subject to there being no scope for 'mischief' i.e. provisos about no subsequent change to historic financing structures.

2. Exclusion of third party infrastructure debt

- As noted, third party debt remains within the scope of the OECD's approach. The exclusion of third party infrastructure debt would be justified on the basis that infrastructure financing by definition precludes opportunities for BEPS on commercial grounds. Debt which is specifically raised to finance infrastructure is cheaper than corporate debt which can be lent cross-border and applied for wider group purposes.
- Lenders will generally insist on lending to an entity which holds the infrastructure asset directly, or to an entity, resident in the same jurisdiction, which has the sole purpose of on-lending to that entity. The lenders will take security over shares in the entity which holds the asset or over its 100% holding company. In this way the borrowings cannot be applied to any other purpose and income from the asset must be applied to servicing and repaying the lender, in priority to being available to investors. In other words the wider objective of BEPS being to allocate interest deductions to the entities with the economic activity is already met.

3. Exclusion of wholly domestic financing arrangements on the grounds there cannot be BEPS

- This exclusion would be of considerable benefit to future infrastructure investment/M&A in UK and other countries. This is because mature and relatively widely held businesses holding infrastructure assets such as airports and water companies are often wholly domestic. They are low risk businesses with domestic users and customers, often subject to domestic regulation or party to domestic arrangements with public sector bodies.

Where to next?

At the time of writing, we have received some early indications on the progress of the OECD discussions in May:

- The fixed EBITDA ratio may be positioned as a range (e.g. 10%-20%) given that certain jurisdictions currently have a very low interest rate environment (e.g. US, UK, Germany etc.) while others (e.g. Brazil, India) have high interest rates, the expectation being that low interest rate jurisdictions would be expected to be at the lower end of the range.
- The proposals suggested to protect infrastructure, such as grandfathering and a 'wholly domestic' exemption, may in practice be difficult to achieve and have little OECD precedent, however, the OECD remains open to considering sectoral protections for infrastructure, oil & gas, and financial services. These are yet to be discussed in detail and it is anticipated that these discussions will be progressed in more detail between OECD and governments in June 2015 meetings.

There is clearly still a lot left to discuss at the OECD. Whilst HMRC/HMT thinking seems quite advanced, they did emphasise that their focus to date has been on the OECD-level output albeit this will be guidance on what is considered best practice as opposed to rules that are 'set in stone'.

Now that the recent UK general election is behind us, we should be able to engage more meaningfully with HMRC/HMT at a UK policy level on how they intend to import the anticipated guidance into UK tax law e.g. interactions with existing tax rules such as transfer pricing and other more technical considerations (such as whether rules like unallowable purpose would be relaxed where groups find themselves needing to refinance to gear up to their group allocated amounts, or how any new 'mechanical' rules would overlay with other rules such as oil & gas tax-specific regime etc.).

We would strongly hope that these considerations will involve a further period of industry consultation by HMRC/HMT in the UK as UK tax policy will be a key area to understand when making tax assumptions in near-term M&A/deal work. Whilst to date potential significance of the issue has not filtered through 'en masse' to M&A deal teams and deal lenders, the rubber seems close to hitting the road.

This is evidenced recently by the office of gas and electricity markets ("Ofgem") expressing their concerns over the uncertainty surrounding the deductibility of interest in the context of the ongoing competitive M&A tenders for the offshore transmission links connecting offshore windfarms to the grid ("OFTOs"). To avoid distortions arising from investors factoring in interest deductibility uncertainty thus substantially increasing the price offered to maintain the OFTOs which in turn would push up our home electricity bills, it has seen necessary to instruct investors in the meantime not to make assumptions in its bids about changes in interest rules.

This is a live example of the issue identified in our earlier submission to the OECD regarding the potentially harmful impact of the rules to this sector in that either the investor or the consumer risk paying a higher price as a result of uncertainty. UK tax policy will therefore need to carefully balance the need for investment with alignment to OECD best practice in the coming months.

Naz Klendjian
Partner
KPMG in the UK
T: +44 20 7311 6509
E: naz.klendjian@kpmg.co.uk

Margaret Stephens
Partner
KPMG in the UK
T: +44 20 7311 6693
E: margaret.stephens@kpmg.co.uk

Investment managers: Disguised fee income rules and impact from an M&A tax perspective

Following the announcement in the Autumn Statement, the Finance Act 2015 now includes legislation to tackle what the government perceives as tax avoidance; by ensuring that managers of certain collective investment schemes are taxed on their management fees as trading or employment income.

The rules were drafted to tax all amounts arising from a collective investment scheme, which involves a partnership, as trading income unless otherwise exempt from the rules. Exemptions were then provided for certain carried interest and co-invest arrangements as defined. The rules affect amounts arising on or after 6 April 2015. Amounts are broadly considered to arise at the point when an individual can access them.

Since the publication of the draft rules, KPMG as well as other interested parties have made representations to HMRC regarding the rules. The updated rules provide clarity on a number of areas which had previously caused concern, although certain fund returns still fall within the scope of the rules, despite hopes that these would be excluded.

The final legislation

The legislation follows the same approach as the draft rules – to tax amounts arising to individuals (directly or indirectly) from investment schemes, if the individual performs investment management services in relation to that scheme, unless the amounts are excluded by falling within the co-invest or carried interest definition.

We have highlighted below the main impacts of the new rules

Amounts arising from fixed profit shares

The objective of the rules is to bring into tax (as trading income) amounts which arise to an individual from an allocation of a fixed (or guaranteed) profit share from an investment scheme. Therefore any amount received by way of a fixed profit share from a fund is expected to be taxed as trading income under these rules.

Carried interest exemption

The new rules provide for an exemption for amounts which an individual receives if they fall within the definition of carried interest.

This definition has been extended from that in the draft legislation – the rules still exempt amounts arising from a 'standard' carried interest model as a safe harbour, but also gives a much broader definition of carried interest. This acknowledges that the modern investment market utilises a variety of different mechanisms to align executives' interests to those of their investors.

The broader definition seeks to define what may arise by way of a profit-related return. Broadly, where amounts arise by way of a profit related return, such that the return is variable by reference to a fund's profits similarly to an external investor's return, then this should fall within the new carried interest definition. This is subject to the returns being at a 'significant risk'

Territorial scope

The new rules provide that a deemed 'management fee' should be treated as profits from a trade, and that the trade shall be treated as carried on in the UK to the extent that the individual performs the relevant services in the UK. This is a welcome revision, as the old rules potentially taxed a foreign individual who had very limited nexus to the UK. If non-residents receive a 'disguised fee' and have undertaken management functions in the UK, then they will need to consider the relevant double taxation agreement to determine the extent to which any deemed income from UK activity will be taxable under these rules. If a non-domiciled (but UK resident) receives a 'disguised fee' by virtue of activity partly undertaken in the UK, then we would generally expect that the whole of the 'disguised fee' will be subject to tax in the UK.

Co-invest arrangements

The rules no longer require a return on an investment to be comparable to a commercial rate of interest for it to be excluded from the rules. This is a welcome correction.

The rules do however require a return to be of the same type, and comparable to external investors' return to fall within this definition. Therefore funds with leveraged co-investment arrangements, or which use alternative structures through which to structure their co-invest will need to consider the rules carefully.

The legislation has not provided for a clear deferment of tax in circumstances where an amount arises to an individual, but they are mandated to use the amounts to fund co-investment into the scheme as part of the wider arrangements. However, as an individual will be taxable on amounts that arise to him or her, it should only be taxable when he or she is able to access the funds. These rules should therefore be considered carefully on a case by case basis. Also, any funds which have a management fee waiver provision, or a funded co-invest arrangement would potentially be affected. Such funds would also need to consider the rules carefully.

Sources of indirect income

The rules potentially tax any amounts which arise directly or indirectly from an investment scheme. Therefore it appears that a dividend from some companies (such as investment managers) may fall within this definition regardless of whether the funds have already been subject to corporation tax (and regardless of whether the returns are comparable to any external investors in the company). However, HMRC take the view that a dividend from a genuinely commercial trading company should not be caught providing the investment managers receive an arm's length return for their service. They do believe more contrived structures should be caught.

Other impacts

The rules extend the scope of the rules to potentially affect investment managers in investment schemes structures as an investment trust, as well as collective investment scheme.

Simon Ross-Skinner
Senior Manager
KPMG in the UK
T: +44 20 7311 5078
E: simon.ross-skinner@kpmg.co.uk

Leekes vs Commissioners for HMRC (2015): Loss streaming

The recent First-tier Tax Tribunal ruling in the Leekes case, which considers the loss streaming rules before the 2010 rewrite, suggests that where a loss making trade is transferred without a change in ownership, and the successor carries on the whole of the transferred trade as part of its activities, the successor may no longer be required to stream the losses. This article gives an overview of the case and the decision, the areas which remain uncertain and the potential implications for clients.

Case overview

In *Leekes Limited v HMRC [2015] UK FTT 93*, Leekes Limited ("Leekes") purchased the entire share capital of Coles of Bilston Limited for £1. Coles' trade at that date comprised three furniture stores plus warehousing facilities in the west midlands. The Coles trade at the point of sale had trading losses carried forward. Following the acquisition, the Coles trade was transferred to Leekes at fair value. Coles became dormant following the transfer of its business and retained no liabilities. One of the Coles stores was renovated and re-opened selling Leekes' products. All three Coles stores were re branded as Leekes Ltd stores and continued to trade selling the same types of products. Leekes made a claim to offset the Coles losses against the total profits of the merged trade now carried on in Leekes. HMRC argued that these losses could only be offset against profits relating to the Coles trade. The tribunal held in favour of the tax payer.

It should also be noted that the Leekes case looked at the old loss streaming rules under section 343 Income And Corporation Taxes Act ('ICTA') 1988 which were rewritten in 2010. As a result, all references in the article unless otherwise stated relate to ICTA 1988.

Transfers of trade

When assessing whether the Leekes case may be relevant to a proposed or prior group reconstruction it is first necessary to understand which of the two succession provisions your transfer falls into:

- If the successor begins to carry on the predecessor's trade, then there would be a succession under section 343(1) (now 940B(2) Corporation Tax Act ('CTA') 2010); or
- If the successor carries on the activities of the predecessor's trade as part of its trade, t hen section 343(8) (now section 951(1) CTA 2010) deems these activities to be a separate trade.

The following two leading cases provide examples of the application of each provision. In *Briton Ferry Steel Co Ltd v Barry (HM Inspector of Taxes)(1939) 23 TC 414*, Briton Ferry Steel Co Limited ("BFS") whose principal activity was the production of steel bars which were supplied to six operating subsidiaries for conversion into black plate and tin plate, restructured its operations; liquidating the subsidiaries and transferring all the subsidiary company's assets to BFS.

After the restructuring, the original activities of BFS underwent a change, because it had lost six customers, namely, the six subsidiary companies, and the steel bars which previously they would have disposed of by sale to those companies, are now no longer sold at all. The activities carried on by the subsidiaries after the transfer carried on as before, albeit, no purchase of the steel bars was necessary as they were now produced by the same entity i.e. all the profit generating activities of the subsidiaries remained intact. It was found that this was a succession under FA 1926 s 32(2) (an ancestor of section 343(1)), regardless of the fact that the successor had only a single trade (and hence had not begun to carry on each trade separately).

In contrast in *Falmer Jeans Ltd v Rodin (HM Inspector of Taxes) (1990) 63 TC 55*, the Falmer Jeans Group restructured their operations transferring the trade of a manufacturing subsidiary to Falmer Jeans Limited ("FJ"), whose principal activity was the sale of clothing. In this case it was found that section 343(8) applied as although the core activities of the old trade (i.e. manufacturing) were carried on by FJ, the fact that the whole-sale distribution activities of the manufacturing entity were discontinued meant section 343(1) could not apply.

When is loss streaming required?

Under section 343(3) ICTA 1988 "the successor shall be entitled to relief under section 393(1), as for a loss sustained by the successor in carrying on the trade, for any amount for which the predecessor would have been entitled to relief if it had continued to carry on the trade". HMRC's position in relation to this provision has always been that transferred losses are only allowed against the profits from the trade or part-trade acquired from the predecessor regardless of the nature of the succession i.e. whether the transfer fell within section 343(1) or section 343(8).

The Leekes case related to a succession which fell within section 343(1) as all the activities of the Cole trade were carried on in the same form following the succession. Broadly speaking, the tribunal found that as section 343(1) and section 343(3) ICTA 1988 make no specific reference to a deemed separate trade, in contrast to section 343(8) ICTA 1988, that the losses should be available against the combined Leekes trade i.e. no streaming was required.

As a result, the Leekes decision is only be relevant to a specific transaction fact pattern i.e. where section 343(1) is deemed to apply. Loss streaming will still be required where the succession falls within section 343(8) ICTA 1998 i.e. situations where only part of the predecessor's trade has been transferred and merged with the successor's existing trade, or when certain profit making functions are discontinued following the restructuring.

Practical impact of Leekes in a M&A context?

Following the Leekes decision groups may now wish to give additional consideration as to whether it is possible to deviate from normal practice and transfer a loss-making trade into a profit-making trade. Such actions will usually be triggered where groups are either undertaking pre-acquisition restructuring to spin off a particular trade or business unit within the group, or looking to integrate a target into the wider group post-acquisition. In addition, groups may want to consider amending prior open tax returns where they feel Leekes should apply.

A number of our clients have already engaged us to establish whether a proposed restructuring could fall with section 940B(2) (formerly section 343(1)), opening the possibility of offsetting transferred losses against the combined successors trade, and our recommended approach to engaging with HMRC. However, it should be noted that an area of potential uncertainty around the Leekes case is whether the rewrite of section 343 to CTA 2010 Part 22 will impact the analysis. One particular point here is whether under the rewrite it is possible for a succession to be deemed to fall within both section 940B(2) and section 951 CTA 2010. Under the old rules, where a transfer was deemed to fall within section 343(8) it could not also fall within section 343(1) as section 343(8) deemed the separate trade to exist only "if the effect of so treating" would be if it allowed section 343(1) to apply. No such language is included in the rewrite.

Due to the uncertainty over whether this decision will be appealed by HMRC, the preference may still be to merge the profit-making trade into the loss-making trade, meaning the loss streaming provisions will not be in point. However, we have found that in many cases there are strong commercial drivers for why a group would prefer to merge a loss-making trade into a profit-making trade than the other way around. For example, the loss-making trade may be small in comparison to the profit-making trade. As a result, the legal and commercial costs to the business of having to redraft or renegotiate contracts with a limited number of counter parties should be less. The tribunal's decision in the Leekes case made it clear that that they were keen not to ignore the commercial realities of the situation, highlighting the need to place commercial considerations at the heart of any proposed restructuring.

We also recommend that groups carefully assess whether any restructuring could lead to a major change in the nature or conduct of a trade thereby restricting the availability of carried forward trading losses where a change of control has or may take place in the future.

Gary O'Neill
Director
KPMG in the UK
T: +44 20 7311 2592
E: garry.oneill@kpmg.co.uk

Stephen Hunt
Manager
KPMG in the UK
T: +44 20 7694 2772
E: stephen.hunt@kpmg.co.uk

John Addison
Manager
KPMG in the UK
T: +44 20 7694 4458
E: john.addison@kpmg.co.uk

Abolition of bearer shares: Stamp tax implications

The Small Business, Enterprise and Employment Act 2015 ("SBEEA") received Royal Assent on 26 March 2015 and will come into force on 26 May 2015. One of its aims is to achieve an enhanced degree of transparency in respect of the ownership of companies. As a non-revenue statute, one could be forgiven for not knowing of its existence. It does, though, have stamp tax implications. This is because it abolishes 'share warrants to bearer' (also known as 'bearer shares'). For the acquisition of entities that may have issued bearer shares, consideration should be given to these new rules during the due diligence process to ensure the target entity has complied with the required changes in the given timeline.

Any company who has issued bearer shares will soon need to take action prescribed by the SBEEA. Non-compliance will result in serious consequences, including the potential loss for holders of the right to income and capital attaching to their bearer shares.

What is a bearer share?

A bearer share is an unregistered share owned by whoever physically holds the share warrant.

Why abolish them?

As bearer shares are unregistered and may be transferred without the involvement of the company, they may be held anonymously. This can enable a person exercising control of a company to conceal their identity and, the Government considers, assists illicit activity (such as tax evasion or money laundering).

Bearer shares and stamp taxes

A higher rate of stamp duty is chargeable on the issue of bearer shares. The duty chargeable is 1.5% of the market value of the shares. The stamp duty applies to the issue of a bearer instrument on behalf of a UK company that is denominated in Sterling.

On the transfer of the bearer share, as this is effected by way of delivery, the purchaser does not execute a stock transfer form. Therefore, the bearer instrument does not incur a charge to stamp duty (or stamp duty reserve tax). The logic of the 1.5% charge on issue is to compensate for the lost revenue on transfers.

Following the introduction of the SBEEA, as seen below, the higher rate charge on issue and the exemption from stamp duty on the transfer of these shares now have a very limited life (albeit HMRC have not collected the higher rate charge since 2012, acknowledging that the charge is incompatible with EU Law).

The effect of the SBEEA

From and including 26 May 2015:

- Companies will no longer be permitted to issue new bearer shares regardless of any permission contained in the company's articles of association.

- All existing bearer shares will need to be:
  - Converted to registered shares;
  - Surrendered; or
  - Cancelled.
- Companies will have to adhere to a strict timetable to comply with the new legislation (see timeline later).
- Notices may be issued:
  - In the local Gazette;
  - To the holder of the bearer share in the same way the company would normally communicate with them; and
  - On the company's website.

Surrender period timeline

- 26 May 2015 - Commencement date of the surrender period
- 25 June 2015 - First notice of right to surrender. Before the 26 June 2015 companies must issue a notice to each holder of bearer shares stating the following:
  - The holder's right to surrender;
  - The consequence of not exercising that right before 26 December 2015 (seven months after the commencement date);
  - The right to surrender will expire at the end of the surrender period (see below); and
  - The consequences of not surrendering the share.
- 25 January 2016 - Second notice of right to surrender. Before 26 January 2016 (eight months after the commencement date), a company must issue a second notice to each holder of bearer shares re-stating the contents of the first notice.
- 25 February 2016 - End of the surrender period. A holder will lose his or her right to surrender bearer shares after the end of the surrender period.
- 26 February 2016 onwards - Post surrender period
  - A company must, on or before 26 May 2016 (three months after the expiry of surrender period) apply to court for a cancellation order for the bearer shares.
  - If the cancellation order is granted, an amount equal to the aggregate of the nominal value of the bearer shares and any premium paid on them and any accrued but unpaid dividends and distributions that the holder would otherwise have been entitled to receive from 26 December 2015 (when the rights conferred by bearer shares will be suspended) to the date of the cancellation order must be paid to court within 14 days of the order.
  - The court may make a suspended cancellation order for a period of two months (a grace period) in the event the court is not satisfied the requirements for a cancellation order is fulfilled.

Consequences for non-compliance

If a company fails to comply with the notice obligations, each officer of the company shall be taken to have committed an offence.

To encourage holders to surrender their bearer shares, all rights attached to the bearer shares will be suspended automatically from the end of month seven of the nine-month surrender period. This will include voting rights, as well as rights to receive dividends and other distributions. Any transfer or agreement to transfer the share warrants made after the end of this seven month period will be void (so making the bearer shares non-transferable). Any accrued but unpaid dividends or other distributions that which the shareholder would, but for the suspension, have been entitled to receive must be paid into a separate bank account established by the company in accordance with the SBEEA. If the bearer shares are surrendered subsequently, the suspension of rights will cease to have effect from the date of

surrender and such sums must paid to the shareholder by the company.

A company which has bearer shares in issue may not make an application for striking off.

Cancellation orders

If the court is satisfied that a company has complied with the notice requirements with respect to its bearer shareholders during the surrender period, it must make a cancellation order.

When bearer shares are cancelled by a cancellation order, the company must provide a number of documents (including a copy of the order and a statement of capital) to the Registrar within 15 days. Failure to do so will amount to an offence by the company and every officer in default.

Within 14 days of the cancellation of the bearer shares, the company must pay into court the nominal value of the cancelled shares and any premium paid on them, together with the value of any accrued but unpaid dividends or other distributions which the holder would, but for the suspension of rights from 26 December 2015 to the date of the cancellation order, have been entitled to receive. A holder of cancelled bearer shares may apply to the court within three years to claim any sum paid into court in respect of such shares, but the court will only allow such applications if there were exceptional circumstances preventing the holder from making a surrender during the surrender period. After three years, any sums remaining in court will be paid into a new fund to be established by HM Treasury.

What should you do now?

1. Look back in your records to see if your company or any member of its group has issued bearer shares and compile a list of the current holders and their addresses for service of notices.
2. Update all officers of each relevant company on the changes in the legislation and consequences of non-compliance.
3. Prepare your notices in advance to allow you to circulate on time.
4. Potentially look to establish a separate bank account for any shares which are not surrendered before 26 December 2015.

From a transactional perspective, for the acquisition of entities which may have issued bearer shares in the past, the due diligence process should consider whether the bearer shares have been correctly dealt with in accordance to the new rules.

Sean Randall
Associate Partner
KPMG in the UK
T: +44 20 7694 4318
E: sean.randall@kpmg.co.uk

Thomas Lewis
Manager
KPMG in the UK
T: +44 20 7311 6276
E: thomas.lewis@kpmg.co.uk

Preema Patel
Tax Assistant
KPMG in the UK
T: +44 20 7311 3583
E: preema.patel@kpmg.co.uk

Implications of the new SDRT penalties for late notification

Until the start of the year, purchasers of UK shares had the benefit of a relatively relaxed late filing penalty system in respect of stamp duty reserve tax ("SDRT"). On 1 January 2015, however, the late filing and payment penalty regimes in Schedules 55 and 56 to the Finance Act 2009 that apply to most other taxes were switched on for SDRT by regulations (SI 2014/3269).

One question that so far is unresolved is how the new regime for late filing interacts with the provision that cancels SDRT where stamp duty is paid within six years of the share sale agreement: FA 1986 s 92. The cancellation of the SDRT liability does not cancel the late filing penalty for SDRT. Suppose, e.g. UK shares are transferred intra-group, but the stock transfer form is not stamped by the 'accountable date' for SDRT (which for 'off-market' transfers is the 7th day of the following month from when the unconditional share sale agreement was entered into), would HMRC apply the late filing penalty and what grace period (if any) would they give?

Before the regimes in Schedules 55 and 56 were switched on, HMRC informally gave a grace period of 60 days to stamp documents before interest was charged and late notification penalties were imposed in respect of SDRT. It remains to be seen whether this approach continues. Updated guidance has been promised by HMRC. We will inform you of it in a future issue. In the meantime, readers should consider notifying HMRC of SDRT liabilities where stock transfer forms will not be stamped within 30 days of the accountable date.

Sean Randall
Associate Partner
KPMG in the UK
T: +44 20 7694 4318
E: sean.randall@kpmg.co.uk

Fiona Cole
Senior Manager
KPMG in the UK
T: +44 121 232 3073
E: fiona.cole@kpmg.co.uk

Preema Patel
Tax Assistant
KPMG in the UK
T: +44 20 7311 3583
E: preema.patel@kpmg.co.uk

Recent introduction of rules limiting the deductibility of interest: Summary of law and application from a South African transactional perspective

The South African tax environment for transactions has changed over the last year as the South African legislator has begun to monitor and target funding structures which have the effect of reallocating "profits" from one company to another company by way of an interest charge, through the intervention of tax legislation. New provisions have been introduced which are consistent with a number of foreign jurisdictions which have enacted interest-deduction limitation rules. These rules are important from an M&A perspective particularly intra-group funding arrangements.

The South African provisions have recently been introduced into the Income Tax Act No. 58 of 1962 ("the Act") which aim to limit the interest deduction that can be claimed by a company specifically in circumstances where funding is acquired by a company from a creditor who is not subject to tax under the provisions of the Act. These provisions (contained in section 23M of the Act) came into operation on 1 January 2015 and have the effect of limiting interest deductions available to South African residents (the debtor), on funding obtained, from a 'creditor' that is in a 'controlling relationship' with that debtor or that is not in a controlling relationship with that debtor, if that creditor obtained the funding for the debt advanced to the debtor from persons in a controlling relationship with that debtor. For the provisions of section 23M to apply, the amount of interest incurred by the debtor during a given year of assessment should not be 'subject to tax' in the hands of the person to which the interest accrues. This article highlights some of the key features of the new provision and is further broken down into some of the key words and phrases utilised in the section.

Creditor

The term 'creditor' is not defined in the Act, as such we refer to its ordinary dictionary meaning which defines a creditor is "a person or commercial enterprise (i.e. a company) to whom money is owed". Creditor in the context of section 23M would refer to any persons (including include an insolvent estate, the estate of a deceased person, any trust and any portfolio of a collective investment scheme) who advance interest-bearing funding to a debtor.

What is a controlling relationship?

A controlling relationship means a relationship where a person directly or indirectly holds at least 50 per cent of the equity shares in a company or at least 50 per cent of the voting rights in a company is exercisable by a person. A typical holding company/subsidiary relationship will qualify as a 'controlling relationship'. The creditor, being persons as described above, is restricted to holding shares in a company as defined.

Debtor

The term debtor is defined in section 23M as any person who is a resident or any person who is not a resident that has permanent establishment in the Republic if the debt concerned is effectively connected with that permanent establishment. However, as the creditor (or person from whom the funding is sourced) must be in a controlling relationship with the debtor, the debtor in the context of section 23M would need to be a "company" as defined.

Not subject to tax

The term "subject to tax" has not been defined for purposes of section 23M of the Act. However, based on the content of the Explanatory Memorandum on the Taxation Laws Amendment Bill, 2014 it would appear that a creditor would be regarded as not being subject to tax where a creditor completely escapes both the Income Tax and the Interest Withholding Tax ("IWT") net, whether by virtue of an exemption in the Act or through the operation of a Double Taxation Agreement ("DTA").

From an income tax perspective, interest could be exempt if it accrues to a resident exempt entity such as a pension fund or if the interest accrues to a person who is not a resident (who would otherwise be subject to tax on South African sourced income in terms of the gross income definition in section 1 of the Act) and is exempt under the provisions of section 10(1)(h). The "not subject to tax" requirement therefore poses little problem in relation to income tax and it is clear that the scope of section 23M is not only limited to cross border funding arrangements. However, for section 23M to apply to interest payable to a non-resident, no IWT must be payable in the year in which the interest accrues to the creditor.

Interest payable to non-residents could escape the IWT net where the amount is exempt from IWT (for example interest paid by banks and interest paid on listed debt are exempt from IWT) or where the amount would arguably be subject to IWT, but by virtue of the operation of a DTA between South Africa and another contracting state the recipient entity is relieved from the liability to pay tax in South Africa. For purposes of this article, we have not discussed the distinction between being "subject to tax" and being "liable for tax" although we note that in instances where the interest escapes the IWT net as result of the application of a DTA rather than an exemption there is an argument that the interest is subject to IWT but that no liability for tax arises as result of the DTA. It is submitted that the DTA would need to relieve the recipient of the IWT liability in its entirety for the provisions of section 23M to be applicable. Examples of DTA's where South Africa has no taxing rights are France and Ireland. Where the provisions of the DTA, for example those with Switzerland and Germany, merely reduce the percentage at which IWT may be levied, the interest would remain subject to tax in the Republic.

A further nuance to the 'subject to tax' requirement which is important to highlight in the context of cross border loans is the requirement that the amount of interest must be subject to tax in the year of assessment in which the interest accrues. From an IWT perspective, IWT is triggered when an amount of interest is "paid". Interest is deemed to be paid on the earlier of the date on which the interest is "paid or becomes due and payable". Where an amount of interest is unconditionally incurred during a particular tax year but the debtor is only required to make payment in a later year – for example where the loan is a bullet loan where interest is only payable at the end of the term of the loan – the interest would be due and payable in a later year of assessment later than the year in which the interest accrues. IWT will therefore only become payable in a later year of assessment. When tested for the year of assessment in which the interest accrues, the interest would not be subject to tax in that year of assessment and the provisions of section 23M would be triggered in that year of assessment. As discussed below, the provisions for determining the quantum of the interest which can be claimed on affected loans allow for any interest disallowed as a deduction in a

given year of assessment to be carried forward to subsequent years of assessment. The application of section 23M to loans where the interest is subject to IWT in a later year than the year in which the interest accrues will therefore merely defer a portion of the interest which can be claimed to the year of assessment in which the IWT is paid.

On the basis that section 23M would find application to a particular transaction, the interest deduction in the hands of the debtor in respect of all debts to which section 23M applies will be limited to the amount determined in accordance with the following formula;

- The amount of interest received by or accrued to that debtor, plus
- A formula driven percentage of the adjusted taxable income of the debtor, less
- Any amount of interest incurred by the debtor in respect of debts not subject to section 23M.

Adjusted taxable income

The term adjusted taxable income as defined in section 23M of the Act is based on taxable income arrived at in terms of the general provisions of the Act, adjusted for interest and capital allowances.

Percentage of adjusted taxable income

In terms of section 23M, the percentage of adjusted taxable income to be included in the limitation formula must be determined in accordance with the following formula:

$$A=B \times C/D$$

Where:

"A" represents the percentage to be applied;

"B" represents 40;

"C" represents the average repo rate plus 400 basis points; and

"D" represents 10.

but not exceeding 60 per cent of the adjusted taxable income of that debtor

This formula links the percentage of adjusted taxable which can be used to determine the interest deduction to the repo rate whilst providing for an overall ceiling of 60% of adjusted taxable income.

Once the interest amount is determined with reference to the above formulae, only the amount equal to the interest so determined can be claimed as a tax deduction during that year of assessment, regardless of the actual quantum of the "interest expense". The disallowed portion of the interest may be carried forward to the succeeding year of assessment and will be deemed to be interest incurred in that year (and could be subject to the section 23M limitation in the subsequent year of assessment).

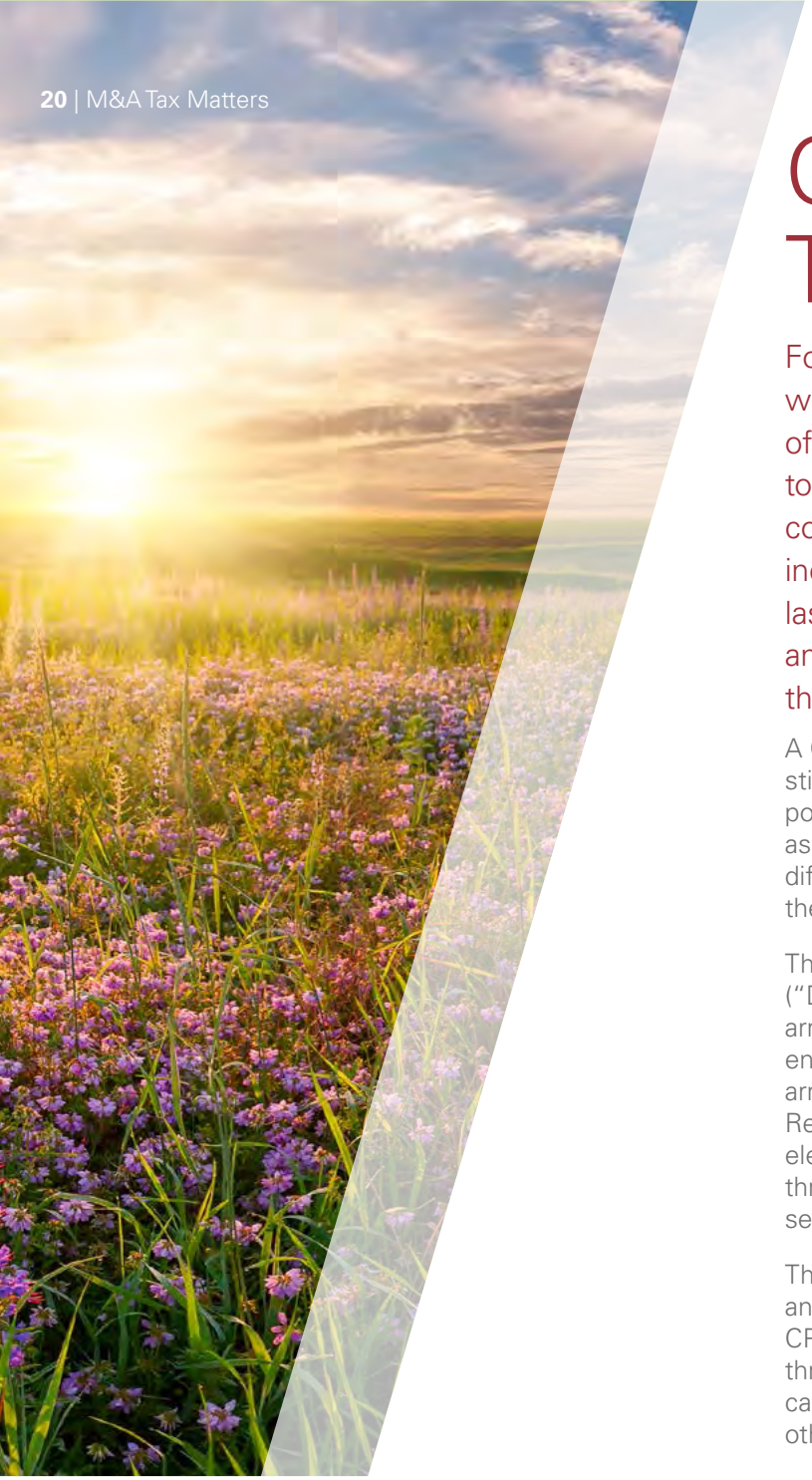
In other words, the interest not allowed as a deduction as a consequence of section 23M may be carried forward into perpetuity or until such point when the interest in question is fully utilised against taxable income or where IWT is only payable in a subsequent year of assessment, the year of assessment in which the IWT is paid (section 23M would not be applicable in this year of assessment as the interest would be subject to tax).

Whilst section 23M largely has the impact of deferring the deduction of a portion of a company's interest expense rather than permanently disallowing a portion thereof, the provisions of section 23M can impact the timing of a significant portion of any interest deduction even where interest withholding tax will ultimately be paid on the interest. As such, it goes without saying that all taxpayers who have entered into cross-border interest-bearing loans with persons in controlling relationships should be cautious not to overlook the requirements of section 23M. The provisions of section 23M should, however, not be considered in isolation as the provisions of the Act, such as the transfer pricing and thin capitalisation provisions as well as section 23N of the Act (restructure limitations) must be applied before considering section 23M.

Careful consideration of these new provisions should be given by multinational groups with South African subsidiaries that are currently the recipient of intra-group debt. Additionally, any funding of target structures containing South African entities should consider these rules to ensure any interest deduction is not limited.

Michael Rudnicki
Director
KPMG South Africa
T: +27 833776492
E: michael.rudnicki@kpmg.co.za

Renatefecoe Mholo
Senior Tax Consultant
KPMG South Africa
T: +27 827195012
E: renatefecoe.mholo@kpmg.co.za



Contracts for differences: Tax and accounting treatment

For our first article in a specialist series of recent topical issues impacting specialist M&A sectors, we explore the use of contracts for differences ("CfD") within the energy sector. This special type of CfD is a contract between two parties, which gives greater certainty and stability of revenues to electricity generators by reducing their exposure to volatile wholesale prices, whilst protecting consumers from paying for higher support costs when electricity prices are high. We have seen an increase of tax implications arising from these specialist CfDs in the M&A energy sector over the last few months and therefore it is important to understand the, sometimes unclear, accounting and tax treatment of these contracts. This article outlines the possible accounting and tax issues of these specialist CfDs.

A CfD is a contract between a "buyer" and a "seller", stipulating that the seller will pay to the buyer any positive difference between the current value of an asset and a strike price specified within the CfD. If the difference is negative, then the buyer instead would pay the seller.

The Department of Energy and Climate Change ("DECC") is seeking to implement a specialist CFD arrangement (referred to in this article as an 'eCfD') to be entered into with renewable electricity generators. The arrangement is a key proposal within the Energy Market Reform ("EMR") to deliver an increase in low-carbon electricity generation. This policy is to be implemented through the creation of a CfD delivered through a separate entity: the Counterparty Body (the "CPB").

The eCfD contract will be entered into between the CPB and renewable electricity generators and will involve the CPB essentially subsidising the electricity generators through the eCfD mechanism in order to make low-carbon power generation more competitive than it otherwise would be. In other words, the eCfD acts to some degree as a mechanism for providing a financial incentive to build and operate the generator.

The CPB will collect a statutory levy from retail suppliers of electricity which will fund obligations under the eCfD contract. The CPB will be designed to be cash-flow neutral, with levy income designed to match payments made under the eCfD.

Under the eCfD regime, the electricity generator will be party to a eCfD with the CPB, and the differential payments from the eCfD Counterparty will be received by the electricity generator. The electricity generator bears the risk inherent in being able to sell power at the current market price but is assured of payments for differences between the strike price in the contract and the market price where the market price is lower. If the market price of power is higher, then the electricity generator will pay the differential to the CPB.

Accounting from the perspective of an electricity generator

The basis of accounting for eCfDs is presenting some difficulties as different interpretations are possible under IFRS. It appears likely that the eCfD is a financial instrument. A financial instrument is any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity. This is a broad definition, which would likely encompass the eCfD.

Even as a financial instrument, however, it is not clear that the eCfD would be within the scope of IAS 39 Financial Instruments: Recognition and Measurement.

If the eCfD is viewed as being within the scope of IAS 39, a possible classification could be that of a derivative contract measured at fair value through profit or loss. Under IFRS, a derivative is an instrument that changes value in response to an underlying variable, which has little or no initial investment and is settled at a future date. The eCfD could potentially meet these criteria. If the eCfD is considered to be a derivative, then the fair value of the eCfD will have to be determined at each reporting date, and changes in the value may need to be recognised in the income statement. Consideration will also need to be given to determining whether the eCfD has a "Day One" value and the manner of accounting for any gain arising on the eCfD at inception. The electricity generator may also determine whether the derivative qualifies as a cash flow hedge against the cash flows and revenues arising from the power purchase agreement thereby protecting the income statement from volatility.

The eCfD contract could also potentially be viewed as a government grant based on an interpretation that the CPB is a government body and the intent of the arrangement is to subsidise low carbon power generation. A government grant, under IAS 20 Government grants, is a transfer of resources to an entity by the government in return for compliance with certain conditions. If the eCfD arrangement is viewed as a government grant, the determination of whether the accounting should fall under IAS 20 or IAS 39 becomes important. If the arrangement is considered to be within the scope of IAS 20, then the recognition of the grant could potentially be linked to a provision of service (i.e. electricity generation) or an asset creation (i.e. construction of the plant). IAS 20 requires government grants to be recognised when the entity has reasonable assurance that it will meet the conditions of the grant.

However, another interpretation could be that a significant part of the value of the eCfD is linked to a non-financial variable. For example, if an electricity generator enters into a eCfD and uses wind energy to generate power, the payments which accrue under the eCfD are linked to the power produced which in turn is linked to whether the wind blows or not. In such instances, one might argue that a contract which is linked to a significant non-financial variable is not a derivative and therefore should not be accounted for as such.

Similarly, there are other instances within IAS 39 where arrangements that prima facie may meet the definition of financial instruments are not accounted for as financial instruments but rather as executory contracts. Typical examples include own-use derivatives and operating leases.

An executory contract is one in which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent. Own-use contracts are those that are entered into and continue to be held for receipt or delivery in accordance with an entity's expected usage requirements. A typical example of such contracts would be a forward contract to purchase a specific quantity of goods at a fixed price for use in the entity's own production process. Contracts that meet the requirements for exemption as 'own-use' contracts are not accounted for as derivatives even if they meet all of the other criteria for classification as derivatives. A potential argument could therefore be that the eCfD between the electricity generator and the CPB is akin to an own-use contract from the perspective of the electricity generator, since the contract is settled concurrently with the supply of power under the power purchase agreement and the intention of the eCfD arrangement is to ensure that the electricity generator is able to sell power generated only at a fixed price.

In summary, accounting for eCfDs is complex and judgmental and will therefore need considered analysis based on specific facts and circumstances, which could vary depending on the renewable technology used and the legal nature of the contract with the CPB. Accounting for eCfDs as derivative instruments could cause significant volatility in the income statement. In such cases, entities will have to consider carefully the accounting for any Day One gain arising as a result of this as well as possibilities to minimise volatility by adopting a hedge accounting strategy.

Tax issues from the perspective of an electricity generator

If the eCfD contract is treated as a derivative for accounting purposes then it should be treated as a "derivative contract" for tax purposes. In particular, it should qualify as a "contract for differences"; any doubt on this point was resolved by a change in law which applies to periods ending on or after 31 December 2013 (section 582(1) CTA 2009 as amended by SI 2013/3218).

Consequently, the debits and credits recognised in the profit and loss or other comprehensive income (if cash flow hedge accounting is applied) should, from the beginning, be brought into account for tax purposes. However, there is a set of rules (the "Disregard Regulations") which have the effect, in broad terms, of disregarding fair value gains and losses for tax purposes for certain types of derivative contracts.

In particular, these rules can apply to "commodity contracts" where there is a "hedging relationship". A hedging relationship includes the following scenarios: (a) there is a designated hedge for accounting purposes and (b) there is an intention to hedge the variability of future cash flows. If this rule applies, the disregarded gains and losses are brought into account at a future date or dates. This will typically be the earlier of (a) when the contract terminates and (b) when the hedged item begins to affect profit and loss.

In practice, careful consideration needs to be given to determining if the eCfD qualifies as a commodity contract and, if so, at what time gains and losses should be brought into account for tax purposes.

Conversely, if the eCfD contract is treated as an executory contract for accounting purposes then, typically, it will not be taxed as a derivative contract. Instead, gains and losses will, broadly, be brought into account when such amounts are recognised in the profit and loss.

Chris Murphy
Senior Manager
KPMG in the UK
T: +44 20 7311 1804
E: chris.murphy@kpmg.co.uk

Shantanu Sonde
Senior Manager
KPMG in the UK
T: +44 20 7311 5376
E: shantanu.sonde@kpmg.co.uk

For more information, speak to one of the KPMG Advisers listed below, or your usual KPMG contact.

Philip Brook
Partner
KPMG in the UK
T: +44 20 7311 4865
E: philip.brook@kpmg.co.uk

Tony Cheadle
Partner
KPMG in the UK
T: +44 20 7311 4583
E: tony.cheadle@kpmg.co.uk

John Cox
Partner
KPMG in the UK
T: +44 20 7311 4783
E: john.cox@kpmg.co.uk

Naz Klendjian
Partner
KPMG in the UK
T: +44 20 7311 6509
E: naz.klendjian@kpmg.co.uk

Paul McCartney
Partner
KPMG in the UK
T: +44 20 7311 6495
E: paul.mccartney@kpmg.co.uk

Margaret Stephens
Partner
KPMG in the UK
T: +44 20 7311 6693
E: margaret.stephens@kpmg.co.uk

Martyn Till
Partner
KPMG in the UK
T: +44 20 7694 1077
E: martyn.till@kpmg.co.uk

Steve Heath
Associate Partner
KPMG in the UK
T: +44 161 246 4087
E: steven.heath@kpmg.co.uk

Mark Cowland
Director
KPMG in the UK
T: +44 129 365 2764
E: mark.cowland@kpmg.co.uk

David Gordon
Director
KPMG in the UK
T: +44 20 7311 8903
E: david.i.gordon@kpmg.co.uk

Alistair Haley
Director
KPMG in the UK
T: +44 20 7694 4383
E: alistair.haley@kpmg.co.uk

Iain Kerr
Director
KPMG in the UK
T: +44 20 7311 5621
E: iain.kerr@kpmg.co.uk

Gavin Little
Director
KPMG in the UK
T: +44 20 7311 6047
E: gavin.little@kpmg.co.uk

Garry O'Neill
Director
KPMG in the UK
T: +44 20 7311 2592
E: garry.oneill@kpmg.co.uk

Bhupinder Purewal
Director
KPMG in the UK
T: +44 118 964 2262
E: bhupinder.purewal@kpmg.co.uk

Mikko Saressalo
Director
KPMG in the UK
T: +44 20 7311 6492
E: mikko.saressalo@kpmg.co.uk

Additional KPMG publications you may find of interest are listed below

Weekly Tax Matters

KPMG's weekly newsletter which covers the latest issues in taxation and government announcements relating to tax matters.

Taxation of Cross-Border Mergers and Acquisitions

Taxation of Cross-Border Mergers and Acquisitions features information from 60 countries on their current laws and regulations and the possible implications for tax-efficient structuring and financing of a merger or acquisition.

High-growth Markets Magazine

KPMG's High Growth Markets magazine brings you insight and perspective on today's global economic hot spots.

Previous issues of M&A Tax Matters

Past editions of this publication.

Create Graphics I CRT039958 I June 2015