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A similar version of this article first appeared in *Tax Journal*, 14 February

# TOTAL RETURN SWAPS = BASE ERODING EVIL?

## By Sandy Bhogal

*Sandy Bhogal, head of UK tax at Mayer Brown, discusses issues arising from the latest draft anti-avoidance legislation on total return swaps*

Following the publication of wide-ranging draft legislation in December 2013, on 23 January 2014, HMRC published revised draft legislation with a revised technical note to tackle tax avoidance schemes making use of intra-group total return swaps and other financial derivatives. The revised legislation and technical note were published following a considerable amount of objection from taxpayers and tax advisers alike about the potentially wide effect of the measure on normal commercial transactions.

The new legislation will take the form of section 695A of the Corporation Tax Act 2009 and have effect from 5 December 2013 (subject to transitional rules). Broadly, it will catch derivative arrangements involving two companies in the same group, the result of which is, in substance, a payment (directly or indirectly) from the paying company to the other comprising "all or a significant part" of the profits of the paying company (or a company in the same group). There is an exception for arrangements that are of a kind which companies carrying on the same kind of business as the paying company would enter into "in the ordinary course of that business". Where arrangements are caught, resulting debits (and certain credits) will be disallowed for UK corporation tax purposes.

The draft legislation and accompanying guidance are by no means perfect; notably, neither explains what "significant part" means, even though this is evidently a fundamental part of the draft provision. In practice, it is expected that there will be two main 'get-outs' for 'ordinary' derivative transactions: firstly, where there is no payment of profits (as in the case of standard hedging transactions which move the return on the underlying rather than a company's profits); and, secondly, under the 'ordinary course of business' test (which is summarised in the technical note). However, there may well be derivative transactions which do not fall neatly into either of these categories.

The revised technical note does contain examples of acceptable and unacceptable arrangements, including a statement that securitisation arrangements will not be caught "in the vast majority of cases". Nevertheless, one is still left with the impression that this is something of a knee-jerk response, rather overlooking the fact that intra-group total return swaps and other derivative transactions are not always motivated by base erosion/tax avoidance, as in the case of non-tax driven balance sheet management for example. All intra-group derivative transactions will now need to be analysed through the lens of the new rules, including where derivatives are used to centralise group risk or where derivative positions are entered into by group entities for operational or cost-sharing reasons.

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