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Friday 19th October, 2007

Representations of the International Swaps and Derivatives Association (“ISDA”) on the re-write project with regards to draft derivative contracts legislation

Dear Ms Bartlett,

The International Swaps and Derivatives Association (ISDA) is pleased to offer comments with regards to the Tax Law Rewrite and draft clauses which bring into account for the purposes of corporation tax profits and losses arising to a company from its derivatives contracts.

ISDA was previously involved in discussions with the Inland Revenue in drafting amendments to the original legislation in 2002. This sought to scope into the legislation a wider variety of derivatives contracts, while aligning the tax treatment of derivatives more closely to the company’s accounting treatment. ISDA has also been an active participant in HMRC working groups set up to discuss a variety of market driven initiatives and the likely impact of the introduction of International Financial Reporting Standards (IFRS).

We recognise and support the broad objectives of the Tax Law Rewrite project, and appreciate the project’s remit to “restate the law, not to change it”. We also understand how it might be considered beneficial to make tax law clearer and easier to use. In general we agree that clarifying the existing law and providing a more robust legislative base on which to build the rewrite can facilitate simplification and this can lead to higher levels of compliance. However, we also note on the list of “critical success factors” which “must be fully achieved” for the rewrite project to succeed the need for acceptance of the proposed changes by all the main users “as clearer and easier to apply”. ISDA does

not believe that the changes to the derivatives contract provisions of Draft Bill 5 achieve this. In fact our members strongly prefer the format of the existing legislation.

The derivatives contracts legislation was introduced by the Finance Act 2002, and is therefore only very recent legislation. The drafting was carried out in consultation with industry experts and by reference to “best practice”, and completed after the first tax rewrite act was enacted (the Capital Allowances Act 2001). We do not see a need to re-write this legislation just five years on and we understand that this is a widely held view throughout the financial services industry.

We do not intend to provide detailed comments on the drafting in this letter, rather confine ourselves to key messages. We do not think sufficient publicity was given to the publication of the draft text, and therefore we have not had enough time to review the proposed changes in this very detailed piece of legislation.

ISDA Key Messages

- In order to understand a firm’s tax liability with regards to its derivatives portfolios it is necessary to understand the firm’s accounting treatment. Rewriting derivatives contracts legislation along lines of what is currently considered to be “best practice” will not necessarily make the provisions any easier to understand.
- The relationship between the basis on which a firm’s taxable profits are determined and a firm’s accounting treatment has meant the derivatives contracts legislation has undergone significant change in recent years to reflect the introduction of IFRS and in particular IAS 39 (and FRS 26 under UK GAAP). These have been complex technical changes requiring statutory instrument (20 statutory instruments have been laid in the past 3 years) to enable HMRC to consult with industry experts on the wording to ensure that it was “fit for purpose”.
- Furthermore the nature of the derivatives markets will ensure further significant changes to the accounting standards in the near future. IFRS are currently only mandatory for consolidated accounts of publicly listed firms with securities that are admitted to trading on a regulated market of an EU Member State. It is possible that FRS 26 in the UK will become mandatory for most companies from as early as accounting periods beginning on or after 1 January 2009. Once accounting changes take effect, it is almost certain further changes will be necessary to the derivatives contract legislation in order to deal with their affects. In view of this, we consider that it is not appropriate for the derivative contracts legislation to be rewritten in 2009.

- The attempt to progress the rewrite of the derivative contracts legislation in an accelerated fashion is running contrary to the Chancellor's stated policy of simplifying the tax structure. In our view the project is in danger of increasing complexity and uncertainty. If the rewrite of the derivative contracts legislation continues along the current timetable it is likely that major flaws will not have been identified before the legislation is included in a final bill. This is likely to mean that significant changes will be required at Committee Stage.
- ISDA believes all the rewrite of the derivative contracts legislation will achieve in its current form and within the existing timeframe is to require taxpayers and their advisers to incur time and expense in getting to grips with the rewritten legislation.
- We believe an essential part of any rewrite of the derivative contracts legislation would focus on the detailed guidance in HMRC manuals. However due to resource constraints, HMRC is only just beginning to produce guidance on the changes to the legislation which have been introduced over the past three years. Therefore the guidance which has been produced is not yet complete.
- ISDA also questions the rationale of rewriting the legislation without addressing the related statutory instruments, which are an intrinsic part of the legislation.
- Finally, we note that the industry has already devoted considerable time to assisting HMRC adapt the derivative contracts legislation for the introduction of IFRS (and FRS 26) and there is no appetite for repeating this process for legislation that is being rewritten merely because the practice has changed in the last 5 years.

If you have any questions on the content of this letter please contact either Ed Duncan at ISDA (0203 088 3574) or Rachel Short at Citi (0207 986 6213).

Yours sincerely,



Rachel Short, Chair of the European Tax Committee
Director, Tax Department
Citigroup

A handwritten signature in black ink, appearing to read 'Ed A. Duncan', is written over a horizontal line. Below the line, there are several additional horizontal strokes, some of which are longer and more sweeping, creating a stylized underline.

Ed A. Duncan
Director of Policy
ISDA