

## Analysis

## Consultation on intangibles: finally...

## Speed read

The government is consulting until 11 May 2018 on the scope for changes to the corporate intangible fixed assets (IFAs) regime, which was first introduced in 2002. The consultation is wide ranging: the government appears interested in making the regime fairer, ensuring there is more consistent alignment between the tax and accounting treatment of IFAs and goodwill, and making the regime more competitive internationally. Specific aspects of the regime on which views are sought include: the impact of the commencement rule (pre-FA 2002 rule), which excludes assets in existence at 1 April 2002; the impact of the restriction on goodwill and customer related intangibles on the complexity and competitiveness of the regime; the use and competitiveness of the election for a 4% per annum fixed rate of relief; and the impact of the regime's degrouping rules on mergers and acquisitions.



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As announced in the Autumn Budget, on 19 February the government published a new consultation to review the corporate intangible fixed assets regime (the IFA regime).

### Development of the IFA regime

The IFA regime was introduced from 1 April 2002 to improve how intangible fixed assets (such as copyrights, patents and trademarks) and goodwill are treated for UK corporation tax purposes. In broad terms, its aims were to align the tax treatment of intangible fixed assets and goodwill more closely with the accounting treatment; to tax the proceeds of exploitation and realisation of IP; and to give relief for the costs of acquiring and maintaining IP on an income basis.

The regime is now almost 16 years old. Most of the changes that have been made to the rules since their introduction have focused on tackling avoidance as opposed to simplification, with the inevitable result that the regime has lost some of its coherence and has become increasingly complex. When combined with its fatal flaw, namely the inconsistency in treatment between pre- and post-April 2002 intangibles, the regime now appears unattractive compared with equivalent regimes on offer in other jurisdictions.

### What's in the consultation?

The government is seeking views on certain specific aspects of the regime (set out below). However, the consultation is wide ranging and the government appears interested more generally in how the regime might be improved to achieve a fairer and more consistent alignment between the tax and accounting treatment of IFAs and goodwill, and to make it

more competitive internationally.

This consultation therefore presents an important, and long-awaited, opportunity for businesses and other stakeholders to make HMRC aware of their frustrations with the current system, and to put forward suggestions for reform.

The consultation canvasses five core areas for possible reform.

#### 1. Pre-FA 2002 intangibles

The IFA regime does not apply to assets which existed prior to 1 April 2002 (pre-FA02 intangibles), unless they have been acquired from an unrelated party since that date. Gains arising on the realisation of pre-FA02 intangibles remain subject to tax on capital gains.

This limitation of the IFA regime to intangible assets that were created, or acquired by an unrelated party, from 1 April 2002 onwards (post-FA02 intangibles) results in unfairness and complexity and can make the UK a less attractive location for holding IP. More specifically:

- The separate rules governing the taxation of pre-FA02 intangibles and post-FA02 intangibles give rise to complexity and increase compliance costs.
- The marked differences in treatment between pre-FA02 intangibles and post-FA02 intangibles result in similar assets being treated very differently without any apparent commercial justification and produce some seemingly arbitrary results. The example given in the consultation is that disposals of IP within the IFA regime are eligible for roll-over relief when the proceeds are reinvested in IFAs, but disposals which fall within the chargeable gains regime are generally not eligible for relief. This can work both ways (see, for example, the more favourable treatment of degrouping charges in relation to pre-FA02 intangibles to which I refer below).
- The fact that relief offered in the UK for pre-FA02 intangibles is less generous can act as an incentive for groups to structure their IP holdings through other jurisdictions with more favourable regimes.
- Long standing businesses with established brands which were created before 2002 and so fall under the old regime are still, 16 years on, subject to those rules and unable to benefit from the accounts based treatment under the IFA regime. This remains the case even where brands have dramatically evolved and changed during the intervening period; they are still treated as pre-FA02 assets and, in many cases, always will be because it is the nature of these assets that they are rarely sold to a third party.

The government acknowledges in the consultation that the Office of Tax Simplification (OTS) has already identified the differential treatment of pre-FA02 intangibles as an area for potential reform. In the OTS's view, the multiplicity of tax treatments for intangible assets and goodwill are an 'over-complication'. The consultation poses a number of questions to seek views on this, including which assets are typically affected by the pre-FA02 rule, what difficulties or benefits the rule causes to businesses in practice, what the effect would be of bringing pre-FA02 intangibles within the IFA regime and (if they were brought in) what value they should be recognised at, and what the effect of such a change would be on the use of accumulated capital losses.

The consultation is also clear however that any decision on this front is likely to be driven by its effect on the government's finances. This suggests that the prospect of radical reform is unlikely: the same issues were present when the IFA regime was introduced in 2002. But if the government really wants to see the economic benefits of reform, perhaps now is the time to grasp this particular nettle.

## 2. FA 2015 restrictions on goodwill and customer-related intangibles

Restrictions were introduced in FA 2015, with effect for assets acquired from July 2015, on the application of the IFA regime to purchased goodwill and customer-related intangibles.

In summary, these rules deny amortisation deductions for goodwill, customer information, customer relationships and unregistered trademarks, and for licences in respect of any of these items. Instead, a deduction is given for the cost of these assets at the time of disposal (i.e. similar to treatment under the capital gains regime).

There has been criticism that these restrictions put the UK out of step with typical international practice in denying relief for accounts based amortisation of goodwill. The absence of relief for customer-related intangibles creates yet another area where the IFA regime is not aligned with accounting treatment and compares unfavourably with other jurisdictions.

The consultation seeks views on the effect of these restrictions, in particular their effect on the complexity and competitiveness of the regime, and asks for details of the approaches taken in other jurisdictions. The focus is on the extent to which changes could be made to this rule whilst keeping in the mind the original motivations for restricting the relief back in 2015.

## 3. Degrouping rules

When it was introduced in 2002, many provisions similar to those in the chargeable gains regime were incorporated within the IFA regime, such as provisions relating to tax neutral intragroup transfers, reorganisations and reconstructions, and also degrouping charges.

The degrouping provisions in the chargeable gains regime have since been reformed in certain important respects. In particular, in FA 2011, changes were made so that, in the context of a share sale, any capital gains degrouping charge is now incorporated into the gain or loss on the share disposal. This means that if the gain on the disposal of the shares is otherwise exempt, for example because the substantial shareholding exemption (SSE) applies, the degrouping charge is also excluded from the charge to tax. The scope of the SSE itself has also been widened to allow the disposal of a business of a division which has been transferred to a new subsidiary to qualify for exemption. Pre-FA02 intangibles, which fall within the chargeable gains regime, can benefit from these reliefs.

The same is not true for intangibles that fall within the IFA regime. Even though the IFA regime contained very similar provisions to the capital gains degrouping charges, similar changes to those made in FA 2011 have not been made to the IFA rules. There were some good reasons for this, arising from the cross-over between an income-based regime which allows for relief for amortisation of acquisition costs and the traditional capital gains regime. But the effect is another anomaly: on a disposal of shares which qualifies for SSE, degrouping charges relating to pre-FA02 intangibles are effectively exempt, but degrouping charges relating to post-FA02 intangibles remain taxable.

A similar point arises on demergers, where, in a typical demerger by a reduction of capital or liquidation scheme, degrouping charges on pre-FA02 intangibles will typically either be exempt under the SSE or eliminated by the interaction of the capital gains rules, but where there is a risk of a material degrouping charge on post-FA02 intangibles it may be necessary to bring the demerger within the more complex statutory demerger rules in order to ensure that no charge arises. This is not how any sensible tax system should operate.

There are various options for reform. One would be to amend the degrouping rules in the IFA regime so that they are

once again aligned with those in the capital gains rules (and so allow the SSE to exempt gains that have accrued on post-FA02 intangibles). HMRC's concern with that approach is likely to centre on the need to claw back relief which has been given to the selling group for amortisation of acquisition costs of the relevant intangible. That could be addressed by some limited form of balancing charge, which would add to the complexity of the rules, but may be a price worth paying for some coherence in the regime. In any event, the most intractable problems with degrouping charges tend to arise in relation to those post-FA02 intangibles for which no amortisation has been claimed (such as internally generated goodwill), which would not be affected by any such charge.

These points will become more acute if a decision is taken to bring pre-FA02 intangibles within the scope of the IFA regime. Again, some form of balancing charge to claw back relief given under an expanded IFA regime may present one way of mitigating the potential exchequer cost.

## 4. Election for 4% fixed rate of relief

The IFA regime allows companies to elect to receive a tax deduction at a fixed rate of 4% per annum of an asset's accounting cost, as an alternative to accounting amortisation. It is primarily a benefit in relation to intangibles for which there would be no or limited accounts based amortisation. The consultation records concerns that the fixed 4% rate is too low and out of step with what is typical practice internationally.

That having been said, and as the consultation identifies, although some other jurisdictions offer higher fixed amortisation rates, the availability of accounts-based deductions means that the UK's regime is broadly in line with most major jurisdictions. So this is perhaps not the most pressing area for reform. Nonetheless, the consultation seeks input on the circumstances in which companies typically elect for fixed rate relief, whether businesses think that the UK's approach deters international businesses from locating intangibles in the UK, and whether the way in which fixed rate relief is given should be changed.

## 5. Supporting economic growth

The final section on areas for reform is entitled 'Supporting economic growth'. However, in amongst questions around the fiscal and economic benefits of making changes to the IFA regime and whether such changes might make the UK more attractive as a location for mobile business activities, the consultation once again raises issues concerning the potential costs of reform.

One such question suggests linking proposals to widen the range of assets within the IFA regime to restrictions on the relief which is given, for example, by reference to income generated by the asset that is being amortised. This looks like a backward step after the attempts to remove some of the complications of loss-streaming in the recently rewritten corporation tax losses rules.

## The chances of radical reform?

This consultation is good news. It appears to address all of the key areas of concern and holds out the prospect of sensible reform, which could bring some consistency and coherence to an area of the corporate tax system which, for too long, has been left in a state of disarray. The risk is that the government's natural and understandable concerns about the costs of reform may restrict its vision and, if so, an opportunity could be lost.

The closing date for comments is 11 May 2018, and the government's response to the consultation is expected later this year. Time to get writing. ■