Further written evidence submitted by the Chartered Institute of Taxation (FB02b)

Intangible fixed assets: exceptions to degrouping charges etc
Clause 25

Executive Summary

We welcome the change to the degrouping rules applicable to intangible fixed assets (IFA): this will remove an artificial barrier in the tax system to merger and acquisition transactions created by the fact that there are currently different degrouping rules for chargeable gains assets and assets within the IFA regime.

We also welcome the further change announced at Budget 2018, and expected to be included in the Finance Bill by way of a government amendment, which will re-introduce some relief for the cost of acquired goodwill.

However, the amount of the relief is limited and is insufficient if the policy intent of attracting business to the UK is to be achieved.

1 Background

1.1 These changes follow a review of the corporate Intangible Fixed Assets (IFA) regime which was undertaken earlier this year. The consultation[1] explored changes in several areas, including the degrouping charge and the restriction on relief for the cost of purchased goodwill introduced in 2015.

1.2 Alongside the Finance Bill, the government published its summary of responses[2] to the corporate IFA regime consultation, which included details of the proposed changes.

1.3 The IFA regime, contained in Part 8 of the Corporation Tax Act 2009 (CTA 2009), is the UK's main body of corporation tax rules for the taxation of identifiable intangible fixed assets and goodwill. It gives companies relief for the cost of acquiring such assets by allowing a deduction from income broadly in line with a company's accounts.

1.4 Intangible fixed assets include things such as patents, copyright and trademarks as well as goodwill.

1.5 Although the regime is now found in CTA 2009, the underlying rules were introduced with effect from 1 April 2002, creating a distinction between intangible fixed assets created or acquired prior to 1 April 2002 (pre FA02) and those created or acquired afterwards.

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1 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/682159/Review_of_the_corporate_Intangible_Fixed_Assets_regime_consultation.pdf

2 https://www.gov.uk/government/consultations/review-of-the-corporate-intangible-fixed-assets-regime

1.6 The aim of the review was to explore whether targeted, value-for–money reforms could be made to the regime that would simplify its administration and improve its international competitiveness.

2 Degrouping charges

2.1 Degrouping charges are relevant when a company leaves a group of companies. This is because where a company acquires certain assets from another group company this is often done on the basis that there is no tax immediate effect for either the disposing or acquiring company (this is referred to as a disposal on a no gain/no loss basis). The tax code then imposes a charge when the acquiring company leaves the group within six years of the transfer while it holds the relevant asset – a degrouping charge. Degrouping charges exist for capital assets, intangible fixed assets, loan relationships and derivative contracts. There are, however, exemptions from the degrouping charge which apply in certain circumstances.

2.2 We welcome the change proposed which will ensure that in certain circumstances – where there is a qualifying share disposal – no tax charge or allowance shall arise in respect of intangible fixed assets. This will mean that the rules for intangible fixed assets will apply in broadly the same way as the rules that apply in respect of capital gains and losses in a degrouping situation. Prior to this change, a different tax treatment could arise depending upon whether a degrouped company owned pre or post FA02 assets. This increased the complexity of merger and acquisition transactions.

2.3 Exempting the degrouping charge as proposed will remove a tax barrier from commercial transactions and simplify mergers and acquisitions.

2.4 The change will ensure that the IFA regime mirrors the capital gains degrouping rules, so far as possible, and, in particular, that where the Substantial Shareholding Exemption (SSE) is available, taxable degrouping gains should not arise on assets within the IFA regime. The current position is an artificial barrier in the tax system created by the fact that there are different degrouping rules for chargeable gains assets and assets within the IFA regime.

3 Relief for cost of acquired goodwill

3.1 Goodwill is the amount paid for a business that exceeds the fair value of its individually recognised assets and liabilities.

3.2 Finance (No2) Act 2015 introduced a restriction (2015 restriction) denying relief for “relevant assets” which included goodwill and certain other assets. While the government highlighted at that time concerns that the IFA regime provided an incentive to buy assets rather than shares, our view was that in some cases there was a bias in the tax system in favour of share sales as a result of the substantial shareholding exemption (SSE) and that the introduction of the 2015 restriction exacerbated this.

3.3 The 2015 restriction came after the removal of the corporation tax deduction for goodwill acquired by a company on the incorporation of a business, which was introduced by Finance Act 2015 and took effect from 3 December 2014. We accept that the initial change, removing relief following an incorporation of a business, addressed legitimate avoidance concerns. However, the second change, in July 2015, seemed less about avoidance concerns and has had a significant impact on commercial transactions and the attractiveness of the UK.

3.4 Thus we strongly support the Budget proposal to partially remove the 2015 restriction. It will help to make the UK more competitive and attractive to businesses (particularly inbound investments). At a more basic level, the acquisition of goodwill is a genuine cost for business. To be competitive with other regimes, it is our view that relief should be given for this cost over the life of the asset rather than only on its disposal.

3.5 However, the proposal is to only allow relief to the extent that the goodwill value has a strong connection to intellectual property (IP) owned by the acquired business. To this end, it is intended that the amount of relief available in respect of the cost of acquired goodwill will be limited to the fair value of the eligible IP in the acquired business.

3.6 In our view the limit being imposed means that the intention of the change of attracting business to the UK will not be fully realised.

3.7 We understand the rationale behind the limit. However, we consider that the resulting relief being given is insufficient to address the concern identified in the responses to the consultation on the IFA regime, and accepted by the government, of the negative impact on the acquisition of IP-intensive businesses that a restriction on relief for the cost of goodwill causes.

3.8 To the extent that the limit on the relief available is being driven by the anticipated cost to the Exchequer that may arise from a complete reversal of the 2015 restriction, there are a number of different elements that need to be considered.

3.9 We expect more new business to be brought to the UK if the cap on relief is raised and this should be net-accretive to the UK. For assets already in the UK, we appreciate that there could be a cost compared to the current position; however, this reflects the amortisation relief that results from a genuine commercial cost to the business for which we believe relief should always have been available. More fundamentally, a change would, we believe, reduce the amount of business that is likely to be lost from the UK absent a more generous change. The relative competitiveness of the UK has changed substantially in recent years as a result of a number of significant factors including reform in other territories, most notably US tax reform, Brexit and other UK changes and proposals that result in the UK being (or at least perceived as being) less competitive.

3.10 Notwithstanding the above, if Exchequer cost remains a constraint to increasing the amount of relief available, then it should be considered whether the restriction targeted at incorporation transactions (introduced in December 2014, but made redundant by the more general 2015 restriction) should be reinstated. As noted above, we accept that removing relief following an incorporation of a business addressed legitimate avoidance concerns. Reinstating this restriction would eliminate a potentially large population of smaller, domestic tax motivated transactions for which there is otherwise disproportionate compliance costs for HMRC. This would allow the relief to be targeted at transactions which would be base accretive to the UK.

3.11 We also understand that consideration is being given to some deferral of relief for goodwill up to a period of 15 years, as opposed to the 10 year useful life assumed by FRS 102 to fund a higher cap on relief and we encourage such creative thinking.

3.12 Fundamentally, the relief available for the cost of acquired goodwill needs to be increased if the policy intent of attracting business to the UK is to be achieved.

4 The Chartered Institute of Taxation

4.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT's 18,000 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

The Chartered Institute of Taxation
November 2018