February 2018

Building a better working world

Review of the corporate intangible fixed assets regime

On 19 February 2018, the Government launched its much anticipated consultation on the corporate intangible fixed assets regime (IFA regime). The consultation will review the operation of the IFA regime and consider whether there is scope for targeted, value-for-money reforms that support the regime's administration and international competitiveness.

The consultation runs from 19 February 2018 to 11 May 2018 and the Government intends to publish its response to the consultation together with any proposed changes in the second half of 2018. Based on discussions with HM Treasury, any changes that are to be taken forward could potentially be implemented quickly.

The consultation follows discussions we have been having with HM Treasury for some time on whether a review of the regime would be beneficial, and its timing is important given recent international tax changes including US tax reform and output from the BEPS review, as many international groups will be looking at the location of their intangible assets and supply chain more generally. However, not just international groups would be affected by the scope of the changes to the IFA regime being considered by the Government.

The potential revisions to the IFA regime that are discussed in the consultation document are predicted to come at a cost to the Exchequer and therefore the Government is keen to understand from relevant stakeholders what economic and fiscal benefits the changes would bring to the UK. Businesses' response to this consultation will be very important to the outcome of the review and therefore to the tax treatment of groups' intangible assets and goodwill.

Background

The introduction of the IFA regime in 2002 changed the way the UK corporation tax system treats intangible fixed assets (such as copyrights, patents and trademarks) and goodwill by, in general, aligning the tax treatment of assets within the scope of the regime with the accounting treatment. All references hereafter to 'intangible assets', 'intangible fixed assets' or 'assets' include goodwill.

Broadly speaking, the commencement rules to the IFA regime mean that it does not apply to assets that existed at 1 April 2002 unless the assets were acquired from an unrelated party on or after that date.

Prior to the introduction of the IFA regime the tax system did not allow relief for amortisation or impairment of intangible fixed assets. Changes in the value of the asset were generally only recognised for tax purposes under the capital gains regime when an asset was sold (with some limited classes of assets qualifying for capital allowances).

A key change occurred to the regime in 2015, when relief for amortisation for goodwill and customer related intangibles was removed.

The Government believes that in light of the growing importance of intangible assets to the productivity of modern business, and the restructuring of intangible assets ownership within multinational groups in response to recent international tax changes, it is now the right time for a more comprehensive review of the regime.

The Government has identified a number of specific areas where it is seeking stakeholders' views:

- the impact of the 1 April 2002 commencement rules and whether assets created or acquired before that date (Pre-FA 2002 assets) should be brought within the IFA regime
- the impact of the denial of relief for amortisation of goodwill and customer related intangibles and whether relief could be given in a way that addresses concerns of the cost of this to the Exchequer
- what changes could be made to the de-grouping charge to reduce adverse commercial implications in M&A transactions while still preserving the Exchequer's ability to claw-back deductions given in excess of the economic cost
- the use and competitiveness of the election for a 4% per annum fixed rate

The Government is also generally interested in understanding whether there are targeted changes that could be made to the IFA regime to support its policy objectives, and deliver value-for-money in terms of the economic and fiscal impacts on the UK.

Pre-FA 2002 assets

Pre-FA 2002 assets are excluded from the IFA regime by the commencement rules. In many cases the chargeable gains rules govern the treatment of these assets.

Concerns have been raised that the pre-FA 2002 rule could be making the UK a less attractive location in which to hold intangible assets. In particular, there are concerns that:

- the lack of relief for pre-FA 2002 intangible fixed assets means the UK provides less generous tax treatment than some other major economies
- the 2002 boundary can lead to similar assets being treated in different ways without a clear justification (for example, the creation date of a patent by reference to registration date versus the date of creation of associated know how)
- the pre-FA 2002 rule introduces complexity into transactions by requiring companies to identify which tax regime applies to which of their intangible assets. This is particularly the case where transactions involve bundles of assets and frequently requires consideration of what the asset actually is to determine when it was created, along with value attribution to different asset types and between pre- and post-FA 2002 assets. The pre-FA 2002 rule in respect of goodwill is particularly complex
- the pre-FA 2002 rule can produce unfair outcomes, such as the absence of relief where a pre-FA 2002 intangible asset is brought into the UK from a newly-acquired foreign subsidiary where it is taxed on exit

The Government would like to understand the significance of these concerns and what impact the pre-FA 2002 rule is having on business decisions in practice.

Before making a decision to bring pre-FA 2002 intangibles into the IFA regime the Government has made it clear that they would need to be convinced that there is an economic case for doing so, and that this change would represent value for money to the Exchequer.

There would also be transitional issues to consider if pre-FA 2002 intangibles were brought into the IFA regime, in particular the value that they would be recognised at and the interaction with capital losses. The Government is seeking views on how the transitional issues could be addressed.

Goodwill and other relevant assets

In Finance Act 2015, the Government introduced a new restriction to the IFA regime denying amortisation or impairment relief for 'relevant assets', which include goodwill and other customer related intangibles including:

- customer information
- customer relationships
- unregistered marks or signs
- a licence in respect of any of these things

The changes took effect from 8 July 2015 and apply to relevant assets acquired on or after that date. The changes mean that, instead of giving a tax deduction for expenditure on these relevant assets when the cost is recognised for accounting purposes as amortisation or impairment losses, the IFA regime now only gives a deduction at the time of disposal. The Government says that the change was introduced as amortisation relief for these assets has a high cost to the Exchequer and it had concerns that it encouraged transactions to be structured as a trade and asset purchase rather than a share purchase.

However, the drafting of the rule is potentially broad and it has created extra complexity and uncertainty, causing some businesses to invest in other jurisdictions instead.

The Government wants to understand where these rules impact business decisions and consider whether there could be ways to provide relief for goodwill amortisation without an excessive tax cost to the Exchequer. For example, it suggests that one option would be to allow relief for amortisation of such assets but restrict that relief to the income generated from the assets.

De-grouping

Under the IFA regime any transfer of assets between companies in the same UK group takes place on a 'tax-neutral' basis. This means that the transferor company is not taxed when the asset is transferred. Instead, the acquiring company inherits the tax history of the transferor in relation to the asset and is taxed based on the transferor's original purchase cost if and when it sells the asset to a third party.

However, a 'de-grouping charge' applies if a company leaves a group while holding assets that were transferred to it by another group company on a tax-neutral basis within the previous six years. On leaving the group the company is deemed to dispose of and reacquire those assets at their market value immediately after the time of the tax-neutral transfer, realising taxable gains or losses as appropriate.

Both the tax-neutral transfer rule and the de-grouping charge are similar to provisions in the chargeable gains regime. However, since 19 July 2011 a chargeable gains de-grouping charge has generally been exempt from tax in cases where the Substantial Shareholding Exemption applies to the disposal of the asset-owning company. The assets to which the charge applies are therefore rebased to market value, with no tax consequences. This is not a feature of the IFA regime.

The difference in treatment between intangible fixed assets within the IFA regime and assets within the chargeable gains regime was pointed out to the Government at the time the exemption for chargeable gains assets was introduced but the Government has not until now been minded to consider this.

One potential downside of bringing pre-FA 2002 assets into the IFA regime would be to increase the occurrence of de-grouping charges. The Government is therefore considering what changes could be made to the de-grouping charge to reduce adverse commercial implications in M&A transactions while still preserving the Exchequer's ability to claw-back deductions given in excess of the economic cost.

The 4% fixed rate election

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 costs, instead of allowing a tax deduction for an amount equal to the accounting debits recognised in respect of that asset in a company's profit and loss account. This can be beneficial for assets that are not amortised or are amortised over a period of more than 25 years.

The Government considers that the IFA regime's default accounts-based rule is generally the right basis for relief, as it considers it to be an appropriate measure of the economic cost to the company.

The Government accepts that while some overseas regimes offer higher fixed amortisation rates, it considers that the availability of the accounts-based deduction means the UK's regime is broadly on a par with most major nations. The Government also questions the extent to which varying the fixed rate of relief would impact on business decisions on the basis that such a change would not impact on the tax charges recognised in companies' accounts, given that it would be matched by a movement in deferred tax assets or liabilities.

The Government would like to understand whether the UK's elective fixed rate relief deters international business from locating intangibles in the UK and how it might be changed.

Supporting economic growth

The changes to the IFA regime that have been raised in the consultation are expected to come at a cost to the Exchequer and therefore the Government is keen to understand what economic and fiscal benefits the changes would bring to the UK. In particular, it wants to understand the extent to which the changes:

- would make UK businesses more likely to invest in intangible assets
- would make the UK more attractive as a location for mobile business activities
- would make the UK more attractive as a place for multinational groups to own intangible assets and, in the light of the BEPS transfer pricing reforms, the impact that would have on the location of skilled personnel and value-generating functions in the UK

The Government is also seeking views as to how the IFA regime could be more cost effective whilst securing the economic benefits identified above.

It is considered that one way of achieving this might be to widen the range of assets that are eligible for relief under the IFA regime, but restrict the relief that is given, for example by reference to the income generated by the asset that is being amortised.

The Government suggests that this could focus the relief, limiting it to situations where the expenditure that is relieved generates additional economic activity.

Next steps

The proposals outlined in the consultation have the potential to have a significant impact on groups and improve the international competitiveness of the UK. However, before making the changes, the Government wants to understand whether the economic and fiscal benefits the changes would bring to the UK outweigh the potential cost to the Exchequer.

Without evidence of this, it is likely that changes to the regime will not happen and therefore it is important that groups engage with Government and respond to this consultation if they would like to see the changes set out in the document. In this regard, in addition to the specific questions set out in the consultation document it might be helpful for groups to think about the following:

- does your group hold intangible fixed assets outside the UK which you may consider moving into the UK if there is a favourable law change?
- have you restructured intangible fixed assets in the past and would they have been brought to the UK if the regime had been more favourable?
- might your group acquire intangible fixed assets in the future and would the UK tax regime influence your decision to bring them to the UK?
- did you bring intangible assets to the UK pre 8 July 2015 and was the availability of a tax deduction for goodwill and customer related intangibles a key factor in your choice of location?
- did the current regime prevent an M&A transaction from taking place, alter the terms of the transaction or cause a subsequent reorganisation?

The consultation runs until 11 May 2018, and the Government intends to publish its response to the consultation together with any proposed changes in the second half of 2018.

The Government is aware that there could be advantages to the UK of implementing these changes very quickly given that groups are looking at the location of their IP, and supply chain more generally, in light of international changes, including the US tax reform and the output of the BEPS project.

Groups may therefore like to carefully assess the possible impact these proposals may have on them and consider what action to take, including making representations to the Government.

Further information

For further information, please get in touch with your usual EY contact or one of the following:

Claire Hooper	chooper@uk.ey.com	020 7951 2486
Rob Peers	rpeers@uk.ey.com	0113 2982 259