

## UK publishes response to consultation on corporate intangible fixed assets regime and draft legislation

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### Executive summary

On 7 November 2018, the United Kingdom (UK) Government published a response to the consultation on the corporate intangible fixed assets regime (IFA regime). The consultation explored changes in several areas of the IFA regime, including the exclusion of assets created prior to 1 April 2002 (pre-FA02 assets) from the regime, the 2015 restriction on relief for goodwill and other relevant assets, the de-grouping charge and the elective 4% fixed rate of relief.

As announced in the Budget on 29 October 2018,<sup>1</sup> the response to the consultation confirms that the Government intends to:

- ▶ Introduce a targeted relief for goodwill arising on the acquisition of businesses with eligible intellectual property (IP) from 1 April 2019. The draft legislation to enact these changes has not yet been released, but after a brief consultation on the detailed design of the policy, the Government intends to legislate for the changes in Finance Bill 2018-19 through Government amendment
- ▶ Make changes to the de-grouping charge rules so that a charge will not arise where de-grouping is the result of a share disposal that qualifies for the Substantial Shareholding Exemption (SSE). Draft legislation in Finance Bill 2018-19 will have effect for de-groupings occurring on or after 7 November 2018

The Government has confirmed that it does not intend to change the treatment of pre-FA02 assets (as it does not consider that the benefits of removing the pre-FA02 exclusion would outweigh the likely costs and negative impacts on businesses), or to the 4% fixed rate election (as it considers that the election supports the policy objectives of the IFA regime by enabling companies to access effective relief for long-life assets).

## Detailed discussion

### Goodwill and other relevant assets

The Government intends to introduce a targeted relief for goodwill arising on the acquisition of businesses with eligible IP from 1 April 2019. The proposal is to allow relief for the cost of acquired goodwill up to the accounting value of the eligible IP in the acquired business. The initial assumption by the Government is that accounting value equates to fair value which will not necessarily be the case, for example if a company adopts merger accounting on the acquisition of a business and therefore brings the assets onto balance sheet at their historic book values.

The Government has stated that the measure will not extend to customer-related intangibles (being assets comprised by customer information, customer relationships, unregistered trademarks or any licenses or other rights in respect of these items).

The new relief for goodwill is intended to operate as follows: Company A acquires the business of company B for £100m. At the time of acquisition, company A accounts for the cost as £20m of eligible IP assets, £50m of tangible capital assets, and £30m of goodwill. The new relief would provide relief for the amortization of £20m of that goodwill.

The example given assumes that amounts are recognized at fair value. Whatever accounting values are used it will be necessary to consider where either transfer pricing or the market value rule in the IFA regime is engaged, which could result in different tax values being used in place of the accounting values.

### Eligible IP

The Government proposes that eligible IP will "broadly correspond" to the existing definition of IP in the IFA regime (not the wider definition of intangible assets), and will include patents, registered trademarks, registered designs

and copyright or design rights. It is not the Government's current intention that know how will be included among the categories of eligible IP.

### Rate of relief

The proposal is that the rate at which relief will be given will continue to be based on accounting amortization and impairment debits, subject to the optional 4% fixed rate election. However, as noted above, the amount of goodwill that qualifies for relief will be capped at the value of eligible IP or the total value of goodwill, whichever is lower.

### Commencement provisions

The intention is that the new rules will apply in respect of goodwill arising on acquisitions of businesses occurring on or after 1 April 2019. Goodwill arising on acquisitions prior to that date will continue to be subject to the tax treatment that applied at the time it was acquired.

### Next steps

The draft legislation to enact these changes has not yet been released, but after a brief consultation on the detailed design of the policy, the Government intends to legislate for the changes in Finance Bill 2018-19 through Government amendment.

### Impact

While additional relief for goodwill will be broadly welcomed by many groups, for those who are considering the UK as an IP holding location in response to changes in the international tax landscape there will be a degree of disappointment. In particular, the amount of goodwill that qualifies for relief will be capped at the value of the eligible IP, which in turn is expected to exclude know how. For groups who have already acquired goodwill by 1 April 2019 there will be no relaxation of the 2015 rules prohibiting the deduction for amortization/impairment of goodwill.

There is now likely to be an intensive period of engagement between Government and stakeholders but groups have limited time to act if they would like to engage with Government before the draft legislation is published.

### De-grouping

Draft legislation has been included in the Finance Bill that makes changes to the IFA regime's de-grouping charge rules with effect from 7 November 2018.

Prior to the changes, a company holding an asset within the IFA regime would be subject to a de-grouping charge where that asset had been transferred to it by another group member and the company had gone on to leave the group within six years of the transfer. Unlike the equivalent rule in the chargeable gains code, where the de-grouping gain is added to the consideration for the disposal of shares (and therefore often exempted by SSE), there was a deemed disposal and reacquisition at market value - an upfront charge under the IFA regime and subsequent amortization on the re-based amount.

From 7 November 2018, a de-grouping charge will not arise under the IFA regime where the de-grouping is the result of a share disposal that qualifies for the SSE.

In such circumstances the assets that would have been subject to a de-grouping charge will remain at their tax written-down value and continue to attract relief as they

did prior to the share disposal. This treatment will not apply if the share disposal is part of an arrangement under which the acquirer of the shares is to dispose of any of them to another person.

### Impact

The Government has said that the measure is intended to reduce frictions that inhibit commercial mergers and acquisitions and more closely align the de-grouping charge rules in the IFA regime to the equivalent rules in the chargeable gains regime. The measure both simplifies the application of the IFA regime and removes what many perceived to be an anomaly in comparison to the chargeable gains rules on de-grouping. It will therefore be a positive development for business.

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## Endnote

1. See EY Global Tax Alert, [United Kingdom: Highlights of Budget 2018 documents and other consultations](#), dated 30 October 2018.

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