CHAPTER 13

INTANGIBLE FIXED ASSETS

13.1 Introduction

IFAs are recognised as income as they are **debited / credited in determining the company's profit or loss.** The rules are similar to the loan relationship rules.

13.2 Intangible fixed assets

The term "Intangible Fixed Asset" has the same meaning as it has for accounting purposes. In particular it includes **intellectual property** which means any **patent,** registered **trademark**, design or **copyright** etc. It also **includes goodwill**, again as defined for accounting purposes.

IFAs include fungible assets. A fungible asset is defined as an asset which can be dealt in without identifying the particular assets involved. An example would be a milk quota in the dairy farming industry. Fungible assets of the same kind (e.g. successive acquisitions of milk quotas) held by the same person in the same industry are treated as indistinguishable parts of a single asset.

Certain assets are expressly excluded from the provisions. Where an asset is excluded an option or other right to acquire or dispose of such an asset is also excluded. CTA 2009, s.800

Assets entirely excluded are rights over tangible assets; oil licences; financial assets; rights in companies, trusts etc; and assets held for non commercial purposes etc. CTA 2009, s.803-809

Assets excluded except as regards royalties are; assets held for a life assurance business; assets held for any mutual trade or business; film and sound recordings; and computer software treated as part of cost of related hardware. CTA 2009, s.810-813

Assets excluded from the provisions to the extent specified are; research and development expenditure; and capital expenditure on computer software. CTA 2009, s.814 & s.815

CTA 2009, s.903

13.3 Trade and non-trade IFAs

It is important to classify IFAs according to whether they relate to a trade, a property business, or are non-trading.

Trading debits and credits form part of **trade profits** as they are accrued to the profit and loss account. CTA 2009, s.747

Debits and credits relating to a property business are treated as part of the expense/income of that property business. CTA 2009, s.748

Non-trading debits and credits are pooled. If the non-trading credits exceed non-trading debits then there is a **non-trading gain (IFA).** CTA 2009, s.751

If non-trading debits exceed non-trading credits then there is a **non-trading loss on IFAs.** Certain reliefs are available for this loss.

13.4 Relief for non-trading loss on IFAs

CTA 2009, s.753

A claim can be made to set the **whole or part** of the loss against the company's **total profits** for that period. There is **a two year time limit** for this claim.

A claim can be made to use the loss under the **group relief** provisions which we will look at later.

To the extent that the loss has not been used in a current year claim or surrendered as group relief it will be **carried forward** as a non-trading debit to the next accounting period.

13.5 Impact on tax computations

Royalty payments are allowed **on an accruals basis.** Their classification will depend on **whether they are paid for trade purposes or not.**

Patent and copyright royalties are paid gross between UK companies. Remember that all figures that appear in the tax computation must be gross figures.

Royalty receipts are taxed on an **accruals basis. Their classification** will depend on **whether they are held for trade purposes or not.**

Goodwill (which was previously part of the capital gains tax regime) will now only give rise to **income gains or losses.** Goodwill has **ceased to be a qualifying asset for capital gains tax rollover.** However, **a form of rollover relief is available**. The rules apply to goodwill **bought or created after 1 April 2002.**

For goodwill purchased and other IFA assets acquired or created after 1 April 2002 the company is allowed a **deduction for the amortisation or impairment charged** in the accounts. Alternatively they can claim a **straight line deduction of 4% on cost.** International Accounting Standard No 38 (IAS 38) does not allow a company to amortise goodwill. Goodwill will be stated in the balance sheet at fair value and subject to an impairment review. CTA 2009, s.729 CTA 2009, s.730

When a company first adopts IAS 38 it may be required to increase the carrying value of goodwill. Ensures that the write up is a taxable credit, limited to the amount of relief already given. Any impairment from written up cost will be deductible. CTA 2009, s.871

13.6 Realisation of IFAs.

Realisations of assets result in income gains or losses. However, rollover relief may be available. CTA 2009, s.733

A realisation is defined as any transaction resulting in, in accordance with generally accepted accounting practice, CTA 2009, s.734

(i) the asset ceasing to be recognised in the company's balance sheet; or CTA 2009, s.735

(ii) a reduction in the accounting value of the asset, usually where only part of the asset is sold or otherwise realised. CTA 2009, s.736

"Transaction" is defined as including any event giving rise to a gain recognised for accounting purposes. CTA 2009, s.737

Proceeds of realisation are those recognised for accounts purposes less incidental costs of realisation. CTA 2009, s.739

Where an asset has been written down for tax the gain is the difference between the proceeds and the TWDV. If no amounts have been written off for tax then the full cost may be brought in.

In the case of a part realisation the amount deducted is adjusted pro rata to the accounting value attributable to the realisation and the accounting value before realisation.

We use the following formula:

$$\text{Cost or TWDV before realisation} \times \frac{\text{Reduction in Accounting Value}}{\text{Previous Accounting Value}}$$

Reduction in accounting value is the difference between the accounting value immediately before the realisation compared with that immediately after the realisation.

Previous accounting value is the accounting value immediately before the realisation.

Illustration 1

An asset has a book value of £2,200. It is partly realised for £1,650. The book value of the retained part is £825. The amount written off for accounting purposes is then £1,375. The tax written down value is £1,800

The accounting profit is £1,650 – £1,375 = £275.

The tax deduction will be £1,125 (i.e. £1,800 × £1,375/£2,200).

The taxable credit will be £525 (£1,650 – £1,125). An adjustment of £250 is needed in the computation (£525 - £275)

13.7 Rollover relief for IFAs

CTA 2009, s. 754

If an IFA is sold then any gain arising will be an income gain.

Illustration 2

A Ltd purchased goodwill on 1 May 2009 for £250,000 and sold it for £300,000 on 31 December 2009. The company amortised the goodwill at 10% per annum. Its year end is 30 June.

The amortisation charged for the 8-month period for which the company owned the goodwill (1 May to 31 December 2009) will be:

£250,000 x 10% x 8/12 = £16,667

The written down value of the goodwill is:

	£
Cost	250,000
Less: amortisation to date	(16,667)
	233,333

The sale takes place in the accounting period ended 30 June 2010 and the income gain will be:

	£
Proceeds of sale	300,000
Less: WDV	(233,333)
Income gain	66,667

Where a company reinvests the proceeds of sale in other goodwill (or other IFA) it can claim rollover relief. The proceeds need to be reinvested in the period **12 months before to 36 months after** the sale of the old IFA. To get **full relief** the **whole of the proceeds need to be reinvested**.

CTA 2009, s.756 -758

Illustration 3

Continuing the example of Company A Ltd. The company buys replacement goodwill for £400,000. All proceeds have been reinvested so rollover relief will be available in full.

The amount rolled over will be:

	£
Proceeds reinvested	300,000
Less: cost of old IFA	(250,000)
	£50,000

Note that we do **not** take account of the amounts written off the cost in this calculation.

	£
Income gain	66,667
Amount rolled over	(50,000)
	£16,667

Following the claim, the company will still show a credit in its P&L of £16,667 representing a reversal of the amortisation write-off.

The cost of the new goodwill going forward will be:

	£
Cost of new IFA	400,000
Less: income gain rolled over	(50,000)
	£350,000

If only **part of the proceeds are reinvested,** the amount available for **rollover** is the **amount by which the amount reinvested exceeds the cost of the old asset.** CTA 2009, s.758(3)

Illustration 4

If A Ltd above decides to reinvest only £270,000, as this is less than the proceeds received, relief will only be available for:

	£
Amount reinvested	270,000
Less: cost of old asset	(250,000)
	£20,000

The gain for the year will be:

	£
Income gain	66,667
Amount rolled over	(20,000)
	£46,667

The cost of the new asset going forward will be:

	£
Cost of new IFA	270,000
Less: income gain rolled over	(20,000)
	£250,000

Special rules apply where the asset sold was created before 1 April 2002. IFAs that existed before this date stay within the capital gains tax regime however, they **do not stay within the capital gains tax rollover relief rules.**

On disposal the asset will give rise to a capital gain which can only be rolled over under the rules in relation to intangible fixed assets contained in Ch 7 Part 8 CTA 2009.

This is achieved by making certain amendments to the rollover provisions that we looked at above. CTA 2009, s.898

The net proceeds received (i.e. proceeds less incidental cost of disposal) are compared to cost. Cost is defined as net proceeds less the chargeable gain as calculated for capital gains tax in other words we include indexation allowance where applicable.

Illustration 5

X Ltd sells goodwill it has held since December 1990 for £300,000 paying solicitors fees of £30,000 in relation to the sale. The goodwill originally cost £55,000. Indexation allowance is 20%. X Ltd is considering the following investments in a new IFA:

a) £280,000

b) £220,000

The gain arising will be:

	£
Proceeds	300,000
Less: expenses	(30,000)
Net proceeds	270,000
Less: Cost	(55,000)
	215,000
IA £55,000 x 20%	(11,000)
Chargeable gain	£204,000

Under option a) there will be full reinvestment as the new asset costs £280,000 which is more than the net proceeds for the old asset of £270,000.

The gain that can be rolled over is £204,000 giving a base cost for the new asset of £280,000 - £204,000 = £76,000.

Under option b) there will be partial reinvestment. The new asset cost £220,000 which is less than the net proceeds received of £270,000.

The gain that can be rolled over will be £220,000 - £66,000 = £154,000. This gives the same result to that which would have arisen under the CGT rules whereby net proceeds not reinvested remain chargeable.

The base cost of the new asset will be £220,000 - £154,000 = £66,000.

13.8 Groups

For IFA purposes, groups are essentially the same as those defined for **capital gains** purposes. We examine this definition in a later chapter.

Transfers of IFAs within a group are **tax neutral**, provided that the asset is a chargeable IFA before and after the transfer. CTA 2009, s.775

Rollover is allowed on a group wide basis provided that the company that buys the new asset is within the same group at the time of purchase and is not a dual resident investment company. In addition the new asset must be bought from outside the group. CTA 2009, s.777

Relief is also available where a company buys a controlling interest in another company which holds IFAs. For the purposes of a rollover claim the purchasing company is treated as buying the underlying IFA at the lower of: CTA 2009, s.778

- tax written down value;
- cost of the controlling interest.

The purchasing company can make a rollover claim provided it and the company with the underlying IFA sign the claim. As a result the TWDV of the underlying asset will be written down to the extent of the claim.

13.9 Companies leaving a group

CTA 2009, s.780

Where a company **leaves a group within six years of an IFA transfer** and still holds the IFA, it is treated as having the **sold and repurchased the IFA at market value on the date of the transfer.** The resulting debit or credit will be treated as **arising immediately before the transferee leaves the group.**

Where a degrouping charge arises the company about to leave the group together with another group member **can jointly elect to treat the degrouping charge or any part of it as arising in that other group company.** The gain will be treated as a non-trade credit arising in that other company immediately before the first company leaves the group. CTA 2009, s.792

Payments within the group in relation to rollover or degrouping charges are not taxable so long as they do not exceed the amount of the relief.

Note: It would be advisable to look at these sections of this chapter again once you have completed all of the chapters dealing with groups of companies.

13.10 Related Parties

There are rules relating to transactions with related parties. The definition of a related party is similar to that used for transfer pricing.

A related party can be a company, individual or other sort of person. Parties are related when: CTA 2009, s.835

- both parties are companies and one controls the other or has a major interest in the other; CTA 2009, s.836
- both parties are companies and another person controls both of them (this does not apply where both are controlled by a government or an international organisation);
- where the company is a "close company", a person is related if they are a participator of the company, or a participator in another company that has control of, or a major interest in the company; or CTA 2009, s.837

- both parties are companies and they are members of the same 75 per cent group.

For these purposes a person has "control" of a company if he has the power to secure that the affairs of the company are conducted in accordance with his wishes, either through:

(*a*) holding shares or the possession of voting power in the company or any other company; or

(*b*) by virtue of any powers conferred by the articles of association or other document regulating the company or any other company.

A person has a "major interest" in a company if:

(*a*) he and one other person together have control of that company; and

(*b*) each of those two persons has control on their own of at least 40% of the rights and powers by means of which they exercise that control.

The "major interest" test is designed to cover joint ventures where two shareholders own 40% each. Although neither shareholder alone controls the joint venture, in practice in this sort of arrangement, the shareholders will normally co-operate with each other to exercise significant influence over the joint venture.

Transactions between related parties must take place at market value. CTA 2009, s.845

Royalties to related parties are deducted on a paid basis if not paid within 12 months of the paying company's period of account. CTA 2009, s.851

Rollover relief cannot be claimed on transactions with related parties. CTA 2009, s.850

The related party rules continue to apply regardless of any administration, liquidation or other insolvency proceedings or equivalent arrangements that any company or partnership may be involved in.

Transactions with related parties cannot create new assets. A pre 1 April 2002 IFA bought from a related party will stay within the capital gains rules. CTA 2009, s.882

13.11 Change of accounting policy

CTA 2009, s.871

There are rules to deal with the situation where a change in the accounting treatment applied to an IFA results in a difference between the value at which an intangible fixed asset is carried in a company's accounts at the end of one accounting period and the value at which it is shown in its accounts at the beginning of the next.

In particular the rules deal with the move from UK GAAP to IAS

The resulting difference in value is brought into account for tax purposes for the accounting period in which the change of accounting treatment takes effect.

Where the accounting value of the old asset and its tax written down value were not the same, the difference between the carrying value of the old asset and the value at which the new asset is reflected in the company's accounts is proportionately increased or reduced.

Using the formula

$$\text{Accounting difference} \times \frac{\text{Tax value}}{\text{Accounting value}}$$ CTA 2009, s.872(4)

Where there is a credit, the amount of the credit that is brought into account for tax purposes is restricted to the aggregate amount of relevant tax debits that have previously been brought into account in respect of that asset.

The aggregate amount of relevant tax debits that have previously been brought into account is defined as the total amount of debits which have been previously brought into account for tax purposes less the total amount of credits previously brought into account for tax purposes in respect of that asset.

Similar rules apply when assets are disaggregated.

The amount of the debit or credit arising from the change in accounting treatment as a result of the provisions will be restricted to the extent that the debit or credit has already been taken into account for the purposes of s732 (reversal of accounting gain), s723 (gain on revaluation) or s725 (reversal of accounting loss).

13.12 Anti avoidance and "existing assets"

Anti avoidance measures have been brought in to stop companies taking advantage of the rules relating to IFAs that were in existence at 1 April 2002.

The rules deal with two avoidance schemes as follows.

a) avoidance schemes involving substantial advance payments of royalties. These schemes rely on an assumption that where such a payment is accounted for by the recipient as a realisation of an existing asset, the effect will be to bring the receipt in question into a realisation calculation within the IFA rules contained in Chapter 4 Part 8 of CTA 2009. The effect of this treatment would be to allow the accounting cost of the existing asset to be deducted against the receipt.

   The effect of the anti-avoidance provision is to put beyond doubt that a royalty receipt cannot be dealt with under the IFA rules as a realisation of an 'existing asset'.

b) avoidance schemes involving lump sum licensing arrangements which seek to convert 'existing assets' into newly created assets that fall within the IFA rules.

The rules provide that where an asset created after 1 April 2002 is acquired from a related party and that asset derives its value from an asset which after 5 December 2005 has been an 'existing asset' in the hands of a related party of the transferee or transferor, the newly created asset will be treated as an existing asset. Therefore, tax relief under the IFA rules contained in Part 8 CTA 2009 will not be available.

Where only part of the value of an asset is derived from an existing asset, the acquired asset will be treated as a separate existing asset to the extent that its value is so derived. An apportionment rule (to be applied on a just and reasonable basis) provides for these circumstances.

13.13 Tax avoidance

CTA 2009, s.864

There is a specific anti-avoidance provision applying to realisation credits where there are "tax avoidance arrangements".

Arrangements are defined widely as including any scheme, agreement or understanding, whether or not legally enforceable. There is tax avoidance if the main object or one of the main objects of the arrangements is to enable a company to avoid having to bring into account a credit, or to reduce the amount of the credit brought into account.

If this paragraph applies, all debits and credits in respect of intangible fixed assets are to be brought into the tax computation as if no tax avoidance arrangements had been made.

13.14 Commencement of the rules for IFAs

The legislation applies to intangible fixed assets bought or created from 1 April 2002 onwards.

An asset **bought or created partly before and partly after** 1 April 2002 is **treated as two assets.** The expenditure on the purchase or creation of the asset is apportioned on a just and reasonable basis.

Internally generated goodwill is treated as created under the old rules if the company carried on the business before 1 April 2002.

The transitional rules relating to rollover relief on assets that stay within the capital gains tax rules are set out above.

Example 1

Theo Ltd purchased goodwill on 1 March 2007 for £500,000 and sold it for £800,000 on 31 December 2010. At 31 March 2010 the goodwill had a book value of £350,000.

Theo Ltd has a March year end and has not made an election under s730 CTA 2009.

You are required to show:

a) The debit or credit in respect of the sale of the goodwill assuming no reinvestment of the proceeds;

b) The position if Theo Ltd buys a trademark from Pisci Ltd for £600,000;

c) The position if, instead of buying the trademark, Theo Ltd purchases 100% of the shares in Pisci Ltd. The balance sheet of Pisci Ltd shows IFAs with a written down value of £950,000;

d) The position if instead of option b) or c) Theo Ltd purchases a building from Pisci Ltd for £700,000. The building will be used in the trade of Theo Ltd;

e) Assuming that Theo Ltd buys the trademark in option b) on 1 April 2011 above, show the amortisation that can be claimed in the year to 31 March 2012 if the accountants decide to write the trademark off over 10 years on a straight line basis. No election is made under s730 CTA 2009.

Answer 1

a) The sale takes place in the accounting period ended 31 March 2011. The income gain will be:

	£
Proceeds of sale	800,000
Less: WDV (same as accounts)	(350,000)
Income gain	£450,000

b)

	£
Amount reinvested	600,000
Less: cost of old asset	(500,000)
	£100,000

The gain for the year will be:

	£
Income gain	450,000
Amount rolled over	(100,000)
Taxable income	£350,000

c)

There is full reinvestment.

The amount rolled over will be:

	£
Proceeds reinvested	800,000
Less: cost of old IFA	(500,000)
	£300,000

Note that we do **not** take account of the amounts written off the cost in this calculation.

	£
Income gain	450,000
Amount rolled over	(300,000)
Taxable income	£150,000

d) No rollover is possible as a building is not an IFA

e)

Amortisation in accounts	£600,000/10 = £60,000
Tax written down value	£600,000-£100,000 = £500,000
Tax deduction for amortisation	500,000/600,000 x £60,000 = £50,000