

**TAXATION OF INTELLECTUAL PROPERTY, GOODWILL AND
OTHER INTANGIBLE ASSETS: THE NEW REGIME
A TECHNICAL NOTE BY THE INLAND REVENUE**

Comments are invited on the points discussed in the Technical Note and should be sent to:

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to arrive no later than 31 May 2001.

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Once the outcome of the consultation is announced, we will make available, on request, responses to consultative documents, unless any respondent has asked for her or his comments to be treated as confidential. If you wish the whole of your comments, or your name and address, to be treated as confidential, please say so when you return your comments.

Government Code of Practice on written Consultation - the consultation criteria

1. Timing of consultation should be built into the planning process for a policy (including legislation) or service from the start, so that it has the best prospect of improving the proposals concerned, and so that sufficient time is left for it at each stage.
2. It should be clear who is being consulted, about what questions, in what timescale and for what purpose.
3. A consultation document should be as simple and concise as possible. It should include a summary, in two pages at most, of the main questions it seeks views on. It should make it as easy as possible for readers to respond, make contact or complain.
4. Documents should be made widely available, with the fullest use of electronic means (though not to the exclusion of others), and effectively drawn to the attention of all interested groups and individuals.
5. Sufficient time should be allowed for considered responses from all groups with an interest. Twelve weeks should be the standard minimum period for a consultation.
6. Responses should be carefully and open-mindedly analysed, and the results made widely available, with an account of the views expressed, and reasons for decisions finally taken.
7. Departments should monitor and evaluate consultations, designating a consultation co-ordinator who will ensure the lessons are disseminated.

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CONTENTS

| | |
|-----------|---|
| Chapter 1 | Introduction and summary |
| Chapter 2 | Scope and basic computational approach |
| Chapter 3 | Reinvestment |
| Chapter 4 | Groups and related parties |
| Chapter 5 | Transition and commencement |
| Chapter 6 | Special situations |
| Annex 1 | Summary of responses to November 2000 Technical Note |
| Annex 2 | Draft legislation |

Chapter 1 – Introduction and summary

Background

1.1 In Budget 2000, the Government announced that it was extending the review of the taxation of intellectual property to look at a more radical reform taking in goodwill and the full range of intangible assets. Two subsequent Technical Notes have considered how the Government's objectives could be achieved in practice. Following consultation, this further Technical Note sets out detailed proposals and includes, for illustrative purposes, draft legislation covering core elements of the new regime.

Summary

- 1.2 The new regime for intellectual property, goodwill and other intangible assets set out in this Technical Note:
- builds on the rules put in place in Finance Act 2000 for mobile telephone licences and telecommunications capacity rights;
 - provides relief for the costs of acquiring intangible assets where none had previously been available;
 - ensures that relief for future acquisitions of intangible assets will be given on a consistent basis, and eliminates artificial boundaries between different kinds of intangibles;
 - allows the rate of amortisation used in the accounts to be followed for tax purposes, simplifying the relationship between companies' commercial accounts and their tax computations;
 - treats sales of intangibles consistently, so that if the proceeds exceed the written down value, amortisation allowances already claimed can be recaptured, and any profits in excess of original cost taxed as income;

- allows profits over original cost to be deferred through a new roll-over relief if the proceeds are reinvested in newly acquired intangible assets within a qualifying period. This form of relief will also be available in certain circumstances where there is an acquisition of shares in a company and that company has itself incurred qualifying expenditure on the acquisition of intangible assets; and
- provides a transitional regime that preserves expectations and maintains consistency of treatment for existing intangible assets. Existing assets will continue to be subject to current rules except that roll-over relief, extended to capital gains on the disposal of intangible assets currently outside the scope of the relief, will be available within the new income regime.

Wider policy

1.3 The Government's objective is to ensure that UK businesses can compete effectively in the global economy. The Government has already introduced a series of reforms to the tax system to achieve this objective and to enhance the position of the UK as an attractive environment in which and from which to do business. A number of further measures have been announced in the November 2000 Pre-Budget Report and in Budget 2001. These include:

- a new tax incentive to encourage large companies to increase R&D and innovation;
- further consultation on proposals for introducing relief for companies on the disposal of substantial shareholdings;
- the abolition of the requirement to withhold tax on payments of interest and royalties between companies in the UK;

1.4 The current reform is an important further step to producing a modern and competitive framework for business tax .

Consultation

- 1.5 The Government intends to introduce the new regime at the earliest opportunity. The Government is grateful to business, the tax profession and representative bodies for their input so far into this consultative process. Responses to the current document should be sent by 31 May 2001.

- 1.6 The Government would particularly welcome views on the impact of the proposals in terms of administrative costs to business and on ways of ensuring that those costs are kept to the minimum necessary to ensure that the new regime achieves its objectives. The Government will be publishing a regulatory impact assessment in due course and would welcome the opportunity to discuss the issue of compliance costs in more detail with businesses and representative bodies. If you would like to be involved in these discussions please let us know.

Chapter 2 - Scope and basic computational approach

Introduction

- 2.1 The new rules will extend tax relief against current income to virtually the full range of intangible assets and purchased goodwill by basing relief as far as possible on the amortisation reflected in companies' accounts. This approach, as developed in two Inland Revenue Technical Notes published last year, has been generally welcomed by the business community and their advisers.
- 2.2 In particular the new rules will normally:
- give tax relief for expenditure on intangible assets which matches the write-off in the accounts under a system of statutory allowances tailored to a company's particular circumstances;
 - result in the book value of an asset in the accounts matching the written down value for tax, removing the need for adjustments in the tax computation;
 - ensure that relief against income becomes available for expenditure on intangibles which currently attracts none because the expenditure counts as capital for tax ('capital nothings');
 - take into account as income the profit or loss on the disposal of goodwill and intangible assets, subject to the new rollover relief described in Chapter 3.

Details

- 2.3 The new rules will apply for the purposes of corporation tax, in computing trading and non-trading profits and otherwise in computing the deductible expenses of investment companies.
- 2.4 To ensure that corporation tax relief is generally available for expenditure on goodwill and intangible assets in accordance with the accounting treatment, the new provisions will override current tax law where the expenditure would otherwise be classified as capital.

Similarly, receipts from the realisation of such assets will be revenue not capital.

- 2.5 There will be a backstop provision so that if, exceptionally, the accounting treatment actually adopted in a company's accounts does not properly reflect generally accepted accounting practice for the transactions in question for UK companies, then it may be replaced by a treatment which is in accordance with that practice. For this purpose it will be possible to have regard to the view taken of the expected useful life of assets in consolidated group accounts.
- 2.6 Subject to the adjustments discussed in the last Technical Note, the new rules will apply to goodwill and intangible fixed assets within the ambit of Financial Reporting Standard 10 (*Goodwill and Intangible Assets*). Particular points are summarised below.
- 2.7 The proposed regime will therefore **include-**
- abortive expenditure in connection with the creation, acquisition or realisation of goodwill and intangibles;
 - expenditure on computer software development which would be capital under current tax law (other than that treated as part of the cost of related hardware under FRS 10). However, companies will be able to elect for capital allowance treatment instead. This will ensure that smaller companies can continue to benefit, where appropriate, from the incentive rates of capital allowance available for investment in information technology.
- 2.8 But it will **exclude:**
- expenditure on research and development as currently defined for tax;
 - expenditure on oil and gas exploration and development;
 - receipts and expenditure within the current special rules for films;
 - farming quotas and fishing quotas, licences and 'track record'.

- 2.9 The Government would welcome comments on these proposed exclusions from the new regime.
- 2.10 Generally, therefore, the expenditure incurred on the acquisition of goodwill or an intangible asset shown in the accounts will represent the cost for tax purposes. To that end the tax treatment of the intangible assets acquired along with other assets will normally follow the attribution of fair values to them under Financial Reporting Standard 7 (*Fair Values in Acquisition Accounting*).
- 2.11 No rules are proposed to override the operation of FRS 7 either to ensure an exact match with the treatment of the disposal proceeds in the vendor's tax computations, to reallocate the incidental costs of acquisition or in cases where the consideration is deferred or contingent.
- 2.12 Exceptionally, fair value accounting under FRS 7 for the limited range of intangible assets which have a readily ascertainable market value may lead to the creation or uplift of 'negative goodwill.' To enable amortisation relief for tax to be computed in these circumstances by reference to the values shown in the accounts, without giving relief for sums greater than the expenditure actually incurred, sums released to profits in respect of 'negative goodwill' will be subject to tax. Sums will be taxed in this way only to the extent necessary to bring to account any excess of the aggregate of the values allocated to the various assets for tax over the net acquisition cost of a business.
- 2.13 The sum deducted in a company's profit and loss account therefore for the amortisation of goodwill or an intangible asset will normally be deductible for tax. Similarly, any further sums deducted on an impairment review undertaken in accordance with Financial Reporting Standard 11 (*Impairment of Fixed Assets and Goodwill*) will be deductible.
- 2.14 Under FRS 10 it is possible for some of the most durable assets to be regarded as having an indefinite economic life and therefore not to be amortised in the accounts. The approach to amortisation relief

described in this chapter would mean that no tax relief was available for the acquisition of significant assets of this kind. The Government therefore recognises that, exceptionally, there may be a case for giving a measure of tax relief for the cost of acquiring such assets in spite of the accounting treatment. Comments are invited.

- 2.15 FRS 10 does not permit amortisation deductions to be written back to the profit and loss account to adjust the carrying value of an asset upwards. But sums written off an asset as a result of an impairment review can be written back in very limited circumstances. Sums written back in this way will be taxable.

Example 2.1

A company acquires an intangible asset for £1m. It proceeds to amortise the asset in its accounts over a 10 year period on a straight line basis. £100,000 is therefore written off the asset in the accounts each year. *No adjustment in the tax computation is necessary as a result. The £100,000 is deductible each year.*

In year 6 the asset is the subject of an impairment review because markets have gone into recession. The asset is written down from £500,000 to £200,000. *Again, no adjustment is needed. The £300,000 written off the asset is deductible.*

In year 7 markets unexpectedly recover and £150,000 of the write off on the impairment review is written back to the profit and loss account so that the asset's value is £350,000. *No adjustment is needed. The £150,000 is taxable and amortisation charges in the accounts based on the revised value of £350,000 continue to be deductible.*

- 2.16 Again in very limited circumstances FRS 10 permits sums to be credited to a revaluation reserve, rather than credited to the profit and loss account to reverse earlier charges to that account, so that for

example an internally generated asset may be recognised on the balance sheet. Credits of this kind will not be taxable. It follows that the subsequent writing off of that part of the revaluation of the asset which is not taxable will not be deductible for tax.

Example 2.2

A company acquires a franchise which proves unexpectedly successful. By year 5 an active market in this type of franchise has developed and the conditions for revaluing it in FRS 10 are satisfied. It is therefore recognised as an asset on the balance sheet at £1m by crediting the revaluation reserve. It is subsequently amortised at £100,000 a year. *The expenses of building up the franchise will be deductible as charged against profits (even if they represent expenditure on an asset which is capital under current law). The revaluation credit of £1m will not be taxable but the £100,000 a year amortisation charge will not be deductible.*

- 2.17 The sale of goodwill or an intangible asset will be taken into account in calculating taxable income, though that will be subject to a possible claim to the new roll-over relief described in Chapter 3. Where there has been no divergence between the tax and accounting treatment the whole of the accounting profit or loss on the sale of the asset, net of incidental costs, will be taxable. Where, however, there has been a divergence an adjustment will be necessary to ensure that it is the difference between tax written down value and the net sale proceeds which is recognised for tax.

Example 2.3

An asset is purchased for £3m and it is written down in the accounts over 5 years at £600,000 a year. This is challenged by the Inland Revenue on the grounds that it represents too pessimistic a view to constitute acceptable accounting practice. Eventually it is agreed that the asset should be written off for tax over 15 years at £200,000 a year. In year 4 the asset is sold for £3.2m. The carrying value in the accounts prior to sale is £1.2m (£3m - £1.8m) and the accounting profit on sale is £2m. *The taxable profit on sale is restricted to the excess of the sale proceeds (£3.2m) over the tax written down value (£2.4m), that is £800,000.*

- 2.18 Where a business including goodwill or intangible assets is sold, the part of the sale proceeds, net of incidental costs, to be allocated to those assets will be determined by a just apportionment, as already required for the purposes of capital allowances and capital gains.

Tax computation

- 2.19 In general, the new regime should minimise the number of adjustments needed in tax computations. But companies will need to maintain “capital allowance” style computations from one period to the next to enable roll-over relief to be claimed and any other necessary adjustments to be made. These computations will show the opening value of the different intangible assets (acquisition cost or tax value brought forward), the amortisation rate for each, and the “closing” value taken to the next accounting period. This will facilitate any adjustments that need to be made, for example because of roll-over relief or revaluation, or to establish the profit that can be rolled over.
- 2.20 A computation of this kind would meet the requirements of the information provision discussed in the November 2000 Technical Note.

Chapter 3 – Reinvestment

3.1. The Government proposes to introduce a reinvestment relief within the proposed income regime for intangible assets held by companies. This will be modelled broadly on capital gains roll-over relief.

3.2. In broad terms the new relief will operate as follows:

- profits on disposal of intangible assets within the regime will be able to be deferred if the proceeds are reinvested in new assets within the intangibles regime;
- the cost of the new assets for the purposes of subsequent amortisation deductions (and, if necessary, in calculating the profit or loss on their sale) will be reduced by the amount of profit rolled over
- the same time limits for reinvestment will apply as under current capital gains rules (one year before, to three years after the disposal of the old assets);
- it will be possible for the reinvestment to be made by another company in the same group.

3.3. The regime will need to identify a number of elements, such as the assets being disposed of (“old intangibles”) and the replacement assets (“new intangibles”). Additionally the rules will need to identify the proceeds of disposal, the amount of the profit which can be deferred, and the computational effect of the deferral, as well as providing procedural rules.

“Old intangibles”

3.4. It will be a necessary condition of the new relief that the old intangibles have been used:

- throughout the period of ownership by the company selling them;

- as fixed assets (although it will not be a requirement that they have been recognised as such on the company's balance sheet); and
- for the purposes of a trade or business carried on by that company.

"New intangibles"

3.5. The new intangibles must come within the new regime. Companies will be able to decide into what assets the profit should be rolled over rather than having to reinvest in the same class of intangible (eg goodwill). The only requirement will be that the new intangibles are used for the purpose of a trade or business carried on by the company. Or in the case of a non-resident company, that the replacement assets are within the scope of corporation tax.

Proceeds of disposal and amount of profit deferred

3.6. The profit that may be deferred will be limited to the excess of proceeds over original cost. The difference between tax written down value and original cost will remain taxable in order to recover amortisation relief previously given.

3.7. Full deferral relief will be available only when the entire proceeds of sale of the old intangible are reinvested. If the full amount is not reinvested in new intangibles, then the profit eligible for relief will be reduced by the amount not reinvested.

Computational effect

3.8. The profit to be deferred will be excluded from the company's profits for the year. It will be deducted from the acquisition cost of the new intangibles for tax purposes. Amortisation relief in respect of the new intangible will then be given on the adjusted acquisition cost, on a pro rata basis over the life of the new asset.

Example 3.1

A company sells an intangible asset with an original cost of £100,000 for £150,000. Amortisation tax deductions of £40,000 have been given. *So the taxable profit on disposal will be £90,000, and the amount eligible for relief will be £50,000.*

The company acquires a new intangible asset one year later at a cost of £200,000, which it will amortise over 10 years on a straight line basis. *As the full amount of proceeds of the old intangible have been reinvested the full profit of £50,000 gets relief. So tax relief on amortisation is given on £150,000 (£200,000-£50,000) over the same 10 year life span (£15,000 p.a.)*

- 3.9. If there is only partial reinvestment of the proceeds of sale of the old intangibles then similarly the amortisation relief is restricted pro rata.

Example 3.2

Assume instead that the new intangible costs £120,000 (and that it will be amortised over 10 years). This means that £30,000 of the proceeds of sale of the old intangible are not reinvested. *As a result the profit eligible for relief is reduced to £20,000 (£50,000-£30,000). Tax relief for the new asset is then given on £100,000 (£120,000-£20,000) over the same 10 year life span (£10,000 p.a.)*

- 3.10. When a new intangible asset against which relief has been obtained is subsequently sold, the amortisation restriction is taken into account in calculating the taxable profit. Provided the full proceeds are reinvested, the amount that can subsequently be deferred will include profits previously rolled over.

Example 3.3

Assume that the company in example 3.1 sells the new asset after 5 years for £250,000. At that time amortisation relief of £75,000 has been allowed for tax (£15,000 x 5 years). The tax value of the asset is £75,000 because the original cost (£200,000) was also reduced by the £50,000 profit on the intangible previously owned to £150,000. *So the taxable profit will be £175,000 (Sale proceeds of £250,000 minus the tax value of £75,000). That taxable profit is made up of the profit above original cost (£50,000), the rolled-over profit on the sale of the first asset (£50,000) and the recovery of the amortisation relief (£75,000). The profit eligible for relief on subsequent reinvestment will be £100,000 (£50,000+£50,000).*

- 3.11. All of the above deals with outright disposals of assets. However, a transaction may involve, as an ordinary incident in the course of a business, the disposal of just a small proportion of an asset perhaps for a limited period, for example the granting of a licence to exploit a patent for a few years in a particular location. The case for granting roll-over relief in the latter circumstance is not compelling – the receipt would almost certainly be on revenue account under current law. But in drawing the distinction between part disposals attracting roll-over relief and those which would not, relying on the capital/revenue divide would be contrary to the thrust of these reforms.

- 3.12. One approach therefore would be to require as a pre-condition for roll-over relief that the book value of the part of the asset retained immediately after the disposal must be less than 25% of the book value immediately prior to disposal. Furthermore, the rule that relief would be given only if the proceeds exceed the original cost of the asset would apply to part, as well as outright, disposals. The Government would welcome comments on this approach.
- 3.13. Where a profit is realised on a part disposal, it will not be possible to roll that profit into the acquisition cost of the asset from which the part disposal arose, even if that acquisition was within the 12 months prior to the disposal and the part-disposal conditions discussed above were otherwise fulfilled.

Basic procedural points

- 3.14. Where companies reinvest in a range of new intangible assets, they will be able to decide into which assets to roll over as they wish.
- 3.15. As far as possible the approach will follow the rules for capital gains roll-over relief. Claims for relief will be necessary, although provisional relief will also be given when a declaration that the proceeds will be reinvested has been made.
- 3.16. Reinvestment must take place within the same four-year window as for capital gains roll-over relief. This will include a discretionary power for the Board of Inland Revenue to extend the reinvestment time limit in either direction.

Groups

- 3.17. The relief will apply to groups of companies in a similar way to capital gains roll-over relief, as it stands following the amendments introduced in section 102 of Finance Act 2000 concerning non-resident companies and groups.

3.18. The Government also proposes to extend the roll-over relief in order to achieve greater neutrality between acquisitions in asset and share form. Companies will be able to roll profits over on the disposal of intangible assets into the acquisition of a company, provided that the newly acquired company has assets which already attract relief under the intangibles regime. The amount of profit eligible for roll-over relief would be deducted from the tax written down value of the intangibles held by the newly acquired subsidiary at the time of acquisition. The Government would welcome comments on the practical operation of such a rule.

Chapter 4 – Groups and related parties

4.1 The November 2000 Technical Note proposed that intra-group transfers should be made on a tax neutral basis, and there was general support for this kind of approach. Some respondents suggested that there was nonetheless a case for adopting the values actually used, as this would reflect the accounts position in the minority of cases in which transfers take place at other than book value.

4.2 In broad terms the approach to related party transactions will be as follows:

- assets transferred intra-group will be on a “stand in shoes” basis, so the company acquiring the asset will inherit the tax written down value and the asset’s tax history;
- other transfers between related parties will in general take place at market value for the purposes of the new regime;
- assets held pre-commencement will remain outside the new regime when transferred between related parties (see Chapter 5);

What do we mean by a group?

4.3 The definition of a group will be modelled broadly on the definition for capital gains purposes rather than the definition for group relief purposes. This will enable assets to be transferred from a group member in the course of winding up to another group member under the special rules described in this Chapter. More generally, a transfer between the UK members of the same world-wide group will also be subject to those rules, including for example the case where an asset used by a United Kingdom branch or agency of a non-resident company is transferred to a resident company.

Treatment on intra-group transfer

- 4.4 The group company acquiring the asset will “stand in the shoes” of its predecessor, provided that the asset is within the charge to UK corporation tax immediately before and after the transfer. This means it will inherit the tax written down value at the time of transfer, as well as the “tax history” of the asset. That will enable a subsequent adjustment on revaluation to be based on the original cost of the asset to the group. Similarly, if the asset is sold outside the group it will allow the profit eligible for roll-over relief to be calculated.
- 4.5 This will mean that in the majority of cases in which assets are transferred at book value, the transfer will not be a cause for divergence from the accounts figures.

Example 4.1

Company A transfers a patent to Company B, a member of the same group at a common accounting date. The original cost of the patent to A was £100,000, and it has an expected life of 10 years. It was transferred after 5½ years of ownership at book value. *Company B assumes the tax written down value of £45,000 and writes off £10,000 for the following 4 years, with the balance of £5,000 amortised in the final year.*

Transfer at other than book value

- 4.6 In some circumstances a company has no choice but to make a transfer at market value (for example, to satisfy minority interests). In these circumstances the actual treatment will be followed subject to the approach described in paragraphs 15 and 16 of Chapter 2 on impairment adjustments and the exclusion of revaluations. In all other respects, the acquiring company will still be treated as “standing in the shoes” of its predecessor. A transfer at market value which is below book value will only be recognised in this way if it can be justified as an impairment under FRS 11 (*Impairment of Fixed Assets and Goodwill*).

Example 4.2

Assume that there were minority interests in Company A in Example 4.1. The transfer takes place at market value of £30,000, which is consistent with FRS 11. The tax written down value at the time of transfer is £45,000, as before. *Company B recognises the impairment for tax, and so there is an additional deduction of £15,000. The revised tax written down value of £30,000 is amortised over the remaining 4½ years life.*

Other related party transactions

- 4.7 Subject to exceptions described elsewhere in this Technical Note, transfers between related parties other than fellow members of a group of companies will be treated for tax as taking place at open market value.
- 4.8 Chapter 5 outlines the special arrangements that will apply to transfers of assets between related parties in relation to intangible assets held at commencement.

Incorporation of foreign branches

- 4.9 Where a United Kingdom resident company transfers a non-UK trade to a non-resident company in exchange for shares in that non-resident company, there will be provision to allow any profit on sale of intangible assets arising from the transfer (over and above the recapture of any amortisation relief which has been given) to be deferred until the disposal of the shares acquired in exchange.

Reconstructions and amalgamations

- 4.10 Special rules will also apply where assets which are part of a business are transferred as part of a scheme of reconstruction or amalgamation. These will ensure stand in shoes treatment for such transfers.

4.11 The existing capital gains relief covering reconstructions and amalgamations is subject to anti-avoidance rules with an advance clearance procedure. This procedure would be extended to transfers of intangible assets.

EC mergers directive

4.12 The new intangibles regime will need to meet the requirements of the EC Mergers Directive on transfers of trades between companies resident in the EU. To comply with this, a “stand in shoes” rule will apply to ensure that no tax charge arises on the change of ownership.

4.13 As with domestic reconstructions, the current capital gains rules on transfers of trades between companies resident in the EU are subject to anti-avoidance rules with an advance clearance procedure. This procedure would again be extended to transfers of intangible assets.

Safeguards

Degrouping

4.14 There is a rule in the capital gains code which taxes gains on assets transferred to a subsidiary in the six year period before its sale. Before this rule was put in place a company could transfer assets to its subsidiary in exchange for shares and then sell it. As the capital gains rules allow the assets to be transferred at no gain/no loss, there would have been no tax on the increase in value. And because the shares given in exchange would have a value equal to the open market value of the assets at the time of transfer, the capital gains computation on the sale of shares would not reflect the increase in the value of the assets either.

4.15 There will be an equivalent rule which will apply to intangibles transferred to a fellow group member in the preceding six year period if the company receiving the asset leaves the group. This will introduce a tax charge on the vendor group on the difference between open

market value and the tax written down value at the time of the original transfer. This charge would be subject to relief under the new roll-over provisions for intangibles. The company which left the group will be eligible for additional amortisation tax relief on this difference in the normal way.

- 4.16 There will be provisions to ensure that the degrouping charge does not inhibit the contribution of companies to joint ventures. This would be along the lines of the approach adopted under the capital gains regime which facilitates such mergers by exempting transfers, under certain circumstances, from the degrouping charge.

Exit charge

- 4.17 If a company with intangible assets changes its tax residence so that the assets no longer remain within the charge to UK corporation tax, there will be a deemed disposal of the asset at the date of the change and a tax charge based on the market value of the asset at that time. The same approach will apply if a company ceases to employ assets in a trade carried on through a branch or agency in the UK.

Transfer pricing adjustments

- 4.18 The detailed provisions in Sch 28AA of the Taxes Act for the computation of arm's length prices will take priority over the simple open market value rule proposed above where the transaction falls within the scope of those provisions.

Contrived or artificial transactions between related parties

- 4.19 There will be rules to address the artificial reduction of the life of assets to accelerate amortisation deductions or of their open market value in advance of a disposal to a related party.

Chapter 5 – Transition and commencement

Broad approach

- 5.1 Following the consultation on the November 2000 Technical Note, the Government considers that the current tax treatment of goodwill and intangible assets in existence prior to the commencement date should be preserved so long as they stay in the hands of their existing owners or in the same economic family. This approach is referred to as the 'grandfathering' of existing assets. Assets held in other circumstances, including those created on or after the commencement date, will come within the new rules.
- 5.2 Internally generated intangible assets and goodwill may be developed over a significant period of time straddling the commencement date. Precisely when such an asset came into existence is a question of fact but it is not a wholly novel issue. Broadly equivalent questions will have arisen in applying the capital gains rules to these assets. The approach in this context can therefore be founded on the experience gained in the capital gains field.

Capital gains assets

- 5.3 Assets currently within the capital gains regime will not therefore qualify for amortisation relief in their current ownership. On disposal, they will be taxed under existing rules, with one important modification. A capital gain will be computed in the normal way, allowing for any base cost (which may be a 31 March 1982 valuation) and indexation relief and for offset by capital losses. However, goodwill will now qualify under the new intangibles roll-over regime for companies rather than the existing capital gains rollover regime.
- 5.4 Where the proceeds from the disposal of goodwill outside the new regime, on or after the commencement date, are reinvested in assets

within it, the capital gain may be rolled over against the acquisition cost of those assets, just as income profits from the disposal of assets already within the new regime may be rolled over (see Chapter 3). Capital gains from the disposal of intangible assets may be rolled over in the same way.

Example 5.1

A company has two intangible assets, a trademark acquired before commencement at a cost of £50,000 and a patent acquired after commencement at a cost of £100,000. The patent is being amortised over ten years. Both assets are then sold to a third party at the time that the patent had been owned for three years for £100,000 each. *As the trademark was owned pre-commencement it is grandfathered and the profit on sale (£100,000 proceeds less £50,000 cost) is taxed under the capital gains rules (and so indexation will apply for example). The profit on the patent is taxed under the new regime (£100,000 proceeds less £70,000 tax written down value).*

Capital allowances assets

5.5 Patents, industrial know-how and software currently qualify for capital allowances. Consistent with the 'grandfathering' principle, qualifying assets which are in existence prior to the commencement date will continue to be written down for tax under the current rules. On disposal the vendor will again be taxed under current rules. So, for example, the sale of a pre-commencement patent right will be subject to a Case VI charge (spread over six years) as now.

Other assets

5.6 A different approach is required for certain assets which are already within an income regime.

- 5.7 Third generation mobile telephone licences and certain telecommunications capacity rights (or 'indefeasible rights of use', known as IRUs) were the subject of legislation in Finance Act 2000 (Schedule 23). These assets will be brought into the new regime allowing them to benefit from the new roll-over provisions.
- 5.8 Lloyd's syndicate capacity is also subject to an income regime for the purposes of corporation tax. The treatment of Lloyd's syndicate capacity under the new regime is discussed in more detail in Chapter 6.

Acquisition from related parties

- 5.9 Relief will not be available under the new regime in respect of assets held prior to the commencement date. This rule will cover not only assets held by the company itself, but also assets in the ownership of the same economic family. Otherwise the principle of grandfathering existing assets would be undermined. For example, assets could be transferred within a capital gains group to obtain relief without triggering any capital gains charge.
- 5.10 Acquired assets will therefore enter the new regime only where the acquisition takes place on or after the commencement date and, contrived situations apart, the transferor is:
- an unrelated party; or
 - a related company which was entitled to new regime treatment in respect of the assets transferred; or
 - a related party which acquired the assets on or after the commencement date from an unrelated party.

5.11 There will also be a timing rule addressed at attempts artificially to present acquisitions before the commencement date as post-commencement acquisitions.

Chapter 6 - Special situations

- 6.1 The application of the new regime to particular types of company, business or asset raises special considerations. The Government would be grateful for comments on the issues discussed below.

Companies carrying on life insurance and related business

- 6.2 The computation of the taxable trading profits from the 'long-term' business of insurance companies has as its starting point the accounts included in the prudential return required to be made to the Financial Services Authority. Neither goodwill nor intangible assets can be recognised or therefore amortised in those accounts. This special approach has generally proved satisfactory to the industry and to the Government even though the prudential accounts do not purport to show a true and fair view or apply accounting standards.
- 6.3 The Government plans to maintain the existing tax treatment of intangibles relating to life assurance business, whether under the chargeable gains or capital allowances rules, for any assets acquired after commencement as well as to assets to which the transitional rules described in Chapter 5 apply.

Finance leasing

- 6.4 Under Statement of Standard Accounting Practice 21 the parties account for a finance lease as in essence a loan. Hence the leased assets appear in the balance sheet of the lessee along with assets owned outright (though separately identified). Lease rentals are analysed into repayment of what is effectively a loan and what is effectively interest on that loan. Conversely, the asset does not appear in the lessor's balance sheet. Instead the total sums due from the lessee by way of rentals, less the interest element, appears as a loan.
- 6.5 In computing business profits the lessee is entitled under current law to deduct the whole of lease rental payments, as they remain revenue items for tax. The lessor is taxed on rentals received and, as the legal

owner of the leased asset, is entitled to any capital allowances available.

- 6.6 Since a finance leasing company does not recognise the leased asset in its balance sheet, the rules described in this note would be of doubtful application. And finance lessees already obtain relief for rental payments broadly in accordance with correct accounting treatment. The Government's initial view therefore is that assets which are the subject of finance leases should remain within existing law.

Corporate members of syndicates at Lloyd's

- 6.7 The right to participate in a Lloyd's syndicate and therefore to undertake insurance business at Lloyd's is a marketable asset. 'Syndicate capacity' is accounted for under FRS 10 as a balance sheet asset. Under the special tax rules for Lloyd's members, profits and losses on the purchase and sale of syndicate capacity are taken into account in computing trading profits from insurance business.
- 6.8 It can be argued therefore that the general approach of grandfathering existing intangible assets is inappropriate for existing syndicate capacity and instead an approach akin to that proposed for telecommunications rights, which are also already treated as revenue items, should be adopted. On this approach the amortisation of capacity prior to the commencement date and not relieved for tax would then be taken into account in computing the profit or loss on sale or disposal. On the other hand, existing syndicate capacity could be allowed to remain in the current income regime, as proposed for patent rights and industrial know-how.
- 6.9 The Government would be grateful for comments on these alternatives.

Collective investment vehicles

- 6.10 Some collective investment vehicles within the charge to corporation tax are exempt from tax on their capital gains. These are authorised unit trusts, investment trusts, venture capital trusts and open-ended investment companies. Transferring any goodwill or intangible assets

they may own from a capital gains to an income regime therefore has different consequences for them than for most companies.

- 6.11 The scope and volume of intangible assets held by such vehicles is likely to be very small - and it is even less likely that they would hold any goodwill. In these circumstances the Government would welcome comments on the appropriate treatment for such vehicles.

Mutual traders, including those carrying on general insurance business

- 6.12 The profits derived from trading on a mutual basis are exempt from corporation tax but the capital gains of mutual traders are taxed in the usual way. The effect of the new rules therefore, if applied to mutual traders without amendment, could well be to exclude from direct tax altogether mutual traders' profits and losses on the disposal of goodwill or intangible assets. And amortisation deductions against taxable profits, from which other traders would benefit, would have no impact on mutual traders' tax position.
- 6.13 The Government's initial view is that the treatment of mutual traders' goodwill and intangible assets under current law should continue to apply both to existing assets and those created or acquired after the commencement date of the new regime.

Corporate members of partnerships which include individuals

- 6.14 A partnership, consisting of companies within the charge to corporation tax and other members within the charge to income tax, may have among its assets goodwill and intangibles. The basis of computation for the two types of partner in respect of goodwill and intangible assets will be different as these will remain capital assets for income tax purposes.
- 6.15 A similar issue arose in the context of the legislation on foreign exchange gains and losses which, like these proposals, applies for corporation tax but not income tax purposes. Separate computations of the partnership profit are therefore required for the purpose of

determining the share attributable to each type of partner. That is supported by an Inland Revenue statement of practice.

6.16 The Government is minded to adopt the same approach here.

Building Societies

6.17 A building society, being a body corporate, is within the new provisions in the same way as companies. However, where there is a transfer of the whole of a building society's business to a company in accordance with section 97 and the other applicable provisions of the Building Societies Act 1986, that event will have a neutral effect under the intangibles regime. The new provisions will operate in these circumstances in a similar way to those relating to the transfer of assets within the capital gains code from a society to a company.

ANNEX 1: RESPONSES TO NOVEMBER 2000 TECHNICAL NOTE

A1. The November 2000 Technical Note discussed how an accounts-based reform, taking in intangible assets and goodwill, could work. It also set out two options for handling the transition from the old regime to the new. 42 responses were received.

Definition and scope of the reform

A2. Most respondents were satisfied with the approach to definition set out in the Technical Note. There was general support for basing the tax definition of intangibles on the relevant accountancy definition. And respondents were also generally content with the specific exclusions and extensions discussed in the Technical Note, although some points of detail were raised.

A3. The majority of respondents expressed continued concern at the removal of capital gains reliefs (particularly roll-over relief on goodwill) and did not accept that the transitional arrangements proposed in the Technical Note provided a satisfactory basis on which to incorporate goodwill within a full income regime. There was also concern at the interaction between this reform and proposals for a new relief for companies' gains on the disposal of substantial shareholdings.

A4. A variety of proposals were put forward to deal with this issue. A number of respondents thought that the profits on sale of intangible assets and goodwill should continue to be taxed as capital gains where this was currently the case. Others wanted to see roll-over relief incorporated within the proposed new regime.

A5. Other suggestions included a reduced rate of tax for disposals of goodwill or all intangibles and options to allow groups to choose whether to sell in asset or share form without incurring any additional tax cost.

- A6. Other respondents took the view that these issues could be resolved by more generous transitional arrangements. While some thought that it would be preferable to exclude goodwill from the new regime (at least if the issues they had raised could not be resolved).
- A7. The Technical Note suggested that in the longer term it might be possible to extend the reform to cover consolidated goodwill by means of a provision along the lines of Section 338 of the Internal Revenue Code. Most respondents welcomed this suggestion.

Accounts based reform in practice

- A8. There were mixed views on the treatment of acquisition costs and sale proceeds on the sale and purchase of a business. Responses were evenly divided between those who saw maintaining symmetry of tax treatment between purchaser and vendor as the overriding priority and those who thought the objective should be to follow the accounting treatment, and in particular not to disturb the purchaser's allocation of the cost of the business under the fair value principles laid down by FRS7.
- A9. There was general opposition to the suggestion that unrealised profits on the revaluation of assets should be taxed. Respondents preferred that these profits and the additional amortisation which followed should be left out of account for tax.
- A10. Most respondents supported the 'tax neutral' approach to intra-group transfers suggested in the Technical Note, although some called for a more flexible approach, for example to avoid the creation of stranded losses.
- A11. There were mixed views on the proposal that the accounting treatment in the relevant consolidated accounts should be taken into consideration in determining relief under the new regime. Some were content with the rule; some thought it unnecessary; while others felt that such a rule should not apply to overseas group accounts which

they saw as irrelevant in the context of a regime which aimed to follow correct UK accounting practice.

- A12. Respondents generally felt that the Revenue ought to be content to accept the entries in audited accounts, with as little additional information and as few enquiries as possible, and with no special dispute resolution procedures. Specifically on the proposal for an information requirement, views were mixed. Some respondents favoured the idea of a standard information requirement, accepting that this had the potential to reduce compliance costs overall. But others thought this requirement potentially too onerous and preferred either a more generalised requirement or no requirement at all, leaving it to companies and their inspectors to resolve any information needs.
- A13. There was strong opposition to the idea that relief for acquisitions from connected parties overseas should be 'ring-fenced' against income derived from exploitation of the same asset. Respondents felt that existing legislation gave the Revenue adequate protection in this area.

Transition

- A14. The Technical Note floated two options for handling the transition to the new regime. Under option 1, existing assets would be brought straight into the new regime at balance sheet value and all disposals would be taxed as income, but with a transitional spreading relief over the first six years of the new regime. Under option 2, profits on sale of existing assets were to be apportioned between a pre-commencement capital gain and a post-commencement income profit. The capital gain element was to be based on a valuation of the asset in question on commencement date.
- A15. There was little enthusiasm for either of these two options. Option 2 was generally regarded as unworkable. Option 1 was viewed more favourably; but it was generally seen as insufficiently fair and very few respondents saw it as enough, on its own, to make a full income regime in steady state acceptable.

A16. Although most respondents, naturally, wanted amortisation relief to be given on existing assets, some thought that grandfathering would be a fairer approach. This would mean that sales of existing assets would be taxed under current rules, while amortisation relief would be limited to new assets only. A variety of suggestions were made involving grandfathering of existing assets. Some suggested that grandfathering should be time limited, others that it should be elective so that companies could choose whether to keep assets within the capital gains regime or to bring them under the new rules for both relief and the tax charge on sale.

ANNEX 2: DRAFT LEGISLATION

This annex contains draft legislation for the proposed new regime. The clauses published here cover only certain aspects of the new regime and are included for information only, in order to give a clearer picture of how the new rules will operate. We are not therefore seeking comments on the detail of the clauses at this stage.

The illustrative clauses which follow cover:

- introductory/general
- computation of profits, gains and losses;
- roll-over relief on reinvestment
- how amounts are brought into account for tax;
- excluded expenditure and assets;
- supplementary provisions.

They do not cover the application of the new rules to groups of companies, transition, measures needed to protect against abuse and a range of special situations where rules will be needed. The operation of the new regime in these respects is discussed in the main body of the Technical Note.

DRAFT CLAUSES/SCHEDULES

SCHEDULE

TAXATION OF INTANGIBLE ASSETS AND GOODWILL

PART A

GENERAL

5 *Introduction*

A1.—(1) Profits, gains and losses arising to a company from intangible assets and goodwill shall be brought into account for tax purposes, as taxable receipts or allowable expenses, in accordance with this Schedule.

(2) The provisions of this Schedule have effect—

- 10 (a) regardless of any distinction between items of a capital and revenue nature, and
- (b) notwithstanding any other enactment or rule of law as to when an item is or is not to be brought into account for tax purposes.

Intangible assets and goodwill

15 A2.—(1) For the purposes of this Schedule “intangible asset” and “goodwill” have the same meaning as they have for accounting purposes.

(2) This Schedule applies to all intangible assets, subject to the provisions of Part E.

(3) References in this Schedule to an asset, unless otherwise indicated—

- 20 (a) are to an intangible asset to which this Schedule applies, and
- (b) include goodwill.

Meaning of “for tax purposes”

A3. In this Schedule “for tax purposes” means for the purposes of corporation tax.

25 *Meaning of “for accounting purposes”*

A4.—(1) In this Schedule—

- (a) “for accounting purposes” means for the purposes of accounts drawn up in accordance with normal accounting practice, and
- 30 (b) “normal accounting practice” means normal accounting practice in relation to the statutory accounts of companies incorporated in a part of the United Kingdom.

(2) In sub-paragraph (1)(b) “statutory accounts” means accounts that are required by law to be prepared and which meet the requirements of—

- (a) section 226 of the Companies Act 1985, or 1985 c. 6.
- 35 (b) in Northern Ireland, Article 234 of the Companies (Northern Ireland) Order 1986. S.I. 1986/1032 (N.I. 6).

SCH.

Company not drawing up correct accounts

A5.—(1) If for any period of account a company does not draw up accounts in accordance with normal accounting practice—

- (a) the provisions of this Schedule apply as if accounts (“correct accounts”) had been drawn up in accordance with normal accounting practice, and
- (b) the amounts referred to in this Schedule as being recognised for accounting purposes are those that would have been recognised if correct accounts had been drawn up.

(2) Sub-paragraph (1) applies in relation to a period of account for which correct accounts are drawn up so far as the amounts recognised in the accounts for that period are determined by reference to the accounts for an earlier period—

- (a) for which the company did not draw up correct accounts, or
- (b) which was itself a period to which this sub-paragraph applies by reason of the company not drawing up correct accounts for an earlier period.

(3) So far as is necessary for its operation in relation to periods of account after the coming into force of this Schedule, this paragraph applies in relation to periods of account before this Schedule came into force. 20

Reference to consolidated group accounts

A6.—(1) In determining whether a company’s accounts are correct, reference may be made to any view as to the useful life of an asset taken for the purposes of consolidated group accounts prepared for any group of companies of which the company is a member. 25

(2) In sub-paragraph (1)—

“consolidated group accounts” means group accounts that satisfy the requirements of—

1985 c. 6.
S.I. 1986/1032
(N.I. 6).

- (a) section 227 of the Companies Act 1985, or
- (b) in Northern Ireland, Article 235 of the Companies (Northern Ireland) Order 1986,

or the corresponding requirements of the law of a country outside the United Kingdom; and

“group of companies” means a group as defined in—

- (a) section 262(1) of the Companies Act 1985, or 35
- (b) in Northern Ireland, Article 270(1) of the Companies (Northern Ireland) Order 1986,

or the corresponding provision of the law of a country outside the United Kingdom.

PART B

SCH.

COMPUTATION OF PROFITS, GAINS AND LOSSES

Introduction

5 B1. The profits, gains and losses arising to a company in respect of an asset for a period of account, and the resulting taxable receipts and allowable expenses, shall be computed as follows.

Accounting entries to be taken into account

B2. Subject to the following provisions of this Part, the amounts recognised by the company for accounting purposes in respect of—

- 10 (a) the creation or acquisition of the asset,
(b) the amortisation or writing off of the asset,
(c) the revaluation of the asset, and
(d) the disposal of the asset,

15 shall be used for tax purposes in accordance with the following provisions of this Schedule.

Costs of creation or acquisition

B3.—(1) For tax purposes the cost of creation or acquisition of an asset shall be adjusted so as to exclude any expenditure to which this Schedule does not apply by virtue of any provision of Part E.

20 (2) The amount of the cost of acquiring an asset may also fall to be adjusted for tax purposes under—

- (a) [provisions of this Schedule relating to intra-group transactions]; or
(b) Schedule 28AA to the Taxes Act 1988 (transfer pricing etc.); or
25 (c) under the provisions of Part C of this Schedule (roll-over relief on reinvestment).

(3) References in this Schedule to the cost recognised for tax purposes are to the amount after any adjustment under sub-paragraph (1) or any of the provisions mentioned in sub-paragraph (2).

Apportionment of acquisition costs

30 B4.—(1) Where assets are acquired together, so much of the costs of acquisition as on a just and reasonable apportionment are properly attributable to each asset is treated as the cost of acquiring that asset.

(2) An apportionment made for accounting purposes by the company acquiring the assets is regarded as just and reasonable if it accords with
35 normal accounting practice.

(3) No deduction may be made under any other provision of the Tax Acts for incidental costs of acquisition that in accordance with normal accounting practice are allocated by the company to goodwill.

SCH.

Amortisation or writing off

- B5.—(1) A debit recognised in the profit and loss account in any period—
- (a) by way of amortisation of an asset, or
 - (b) as a result of an impairment review,

shall be taken into account for tax purposes as an allowable expense in the 5
same period.

(2) Where the cost of creation or acquisition of the asset is adjusted for tax purposes under paragraph B3(1), or any of the provisions referred to in paragraph B3(2), the amount taken into account under sub-paragraph (1) 10
above as an allowable expense shall be correspondingly adjusted.

Treatment of revaluation profit

B6.—(1) An increase on the revaluation of an asset for accounting purposes shall be taken into account as a taxable receipt in the period in which it is recognised for accounting purposes to the extent that it reverses debits previously taken into account for tax purposes. 15

Any amount not so taken into account is an “untaxed revaluation profit”.

(2) Subsequent accounting debits in respect of the asset shall be disregarded for tax purposes to the extent that they represent an untaxed revaluation profit.

For this purpose accounting debits in respect of an asset shall be identified 20
primarily with untaxed revaluation profits in respect of the revaluation of the same asset.

(3) References in this paragraph to revaluation include the restoration of past losses.

Profit on disposal 25

B7.—(1) This paragraph applies where on the disposal of an asset the company disposes of more than 75% of the value currently recognised for accounting purposes.

(2) In the case of an asset that has been subject to amortisation or writing down— 30

- (a) any excess of the disposal proceeds over the tax written-down value of the asset is a taxable receipt, and
- (b) any amount by which the disposal proceeds fall short of the tax written-down value of the asset is an allowable expense for tax purposes. 35

(3) For the purposes of sub-paragraph (2) the “tax written-down value” is given by:

$$C - (D - R)$$

where— 40

C is the cost of the asset recognised for tax purposes,

D is the total amount of debits recognised for tax purposes in respect of the amortisation or writing off of the asset, and

R is the amount of any revaluation profit to the extent that it has been recognised for tax purposes.

SCH.

(4) In the case of an asset for which a value is shown in the balance sheet but which has not been subject to amortisation or writing down—

- 5 (a) any excess of the disposal proceeds over the cost of the asset recognised for tax purposes, is a taxable receipt, and
 (b) any amount by which the disposal proceeds fall short of the cost of the asset recognised for tax purposes is an allowable expense.

10 (5) In the case of an asset for which no value is shown in the balance sheet, the whole amount of the disposal proceeds is a taxable receipt.

(6) In this paragraph the “disposal proceeds” means the proceeds recognised for accounting purposes after deducting any incidental costs of disposal.

15 (7) This paragraph has effect subject to Part C (roll-over relief on reinvestment).

Apportionment of disposal proceeds

B8. Where assets are disposed of together, so much of the disposal proceeds as on a just and reasonable apportionment is properly attributable to each asset shall be treated as proceeds of the disposal of that asset.

20 *Abortive expenditure on acquisition or disposal*

B9. Where the acquisition or disposal of an asset is not completed, incidental costs which—

- (a) are incurred in connection with the proposed acquisition or disposal, and
 25 (b) fall to be charged to the profit and loss account in accordance with normal accounting practice,

shall be treated for tax purposes as an allowable expense.

Treatment of negative goodwill

30 B10.—(1) Credits to the profit and loss account in respect of negative goodwill are treated as taxable receipts, but only to the extent that the negative goodwill is attributable to the fair value of readily marketable intangible assets.

(2) Where a business is acquired which includes readily marketable intangible assets and other assets, the amount of negative goodwill 35 attributable to the former shall be determined on a just and reasonable basis.

(3) For the purposes of this paragraph an asset is “readily marketable” if it belongs to a class of assets that are equivalent in all material respects and for which there is an active market.

SCH.

PART C

ROLL-OVER RELIEF ON REINVESTMENT

Introduction

C1.—(1) This Part provides for relief where a company carrying on a trade or business— 5

- (a) disposes of an asset (the “old asset”) in circumstances in which a taxable profit would (apart from the relief) accrue, and
- (b) acquires other assets (the “new assets”).

(2) In this Part a “taxable profit” on the disposal of an asset means an amount that is a taxable receipt under paragraph B7 (profit on disposal). 10

Entitlement to relief

C2.—(1) The company is entitled to relief if—

- (a) the old asset is a qualifying old asset,
- (b) the new assets are qualifying new assets and are acquired within the reinvestment period (see paragraph C3), and 15
- (c) the acquisition cost of the new assets exceeds the original cost of the old asset as recognised for tax purposes.

(2) The old asset is a qualifying old asset if it has been used or held for the purposes of a trade or business carried on by the company throughout the period during which it was owned by the company. 20

(3) The new assets are qualifying new assets if—

- (a) they are used or held for the purposes of a trade or business carried on by the company, and
- (b) in the case of a company not resident in the United Kingdom, they are chargeable assets in relation to the company immediately after 25 their acquisition.

(4) For the purposes of sub-paragraph (3)(b) an asset is a chargeable asset at any time if a profit on its disposal at that time would be a taxable profit.

Period within which new assets to be acquired

C3. The reinvestment period is the period— 30

- (a) beginning twelve months before the date of disposal of the old asset or at such earlier time as the Inland Revenue may by notice allow, and
- (b) ending three years after the date of disposal of the old asset or at such later time as the Inland Revenue may by notice allow. 35

Amount and method of giving relief

C4.—(1) A company which is entitled to, and claims, the relief is treated for the purposes of this Schedule as if—

- (a) the proceeds of disposal of the old asset (“DP”), and
- (b) the cost of acquisition of the new assets (“NAC”), 40

were each reduced by the amount available for relief.

(2) If DP is equal to or greater than NAC, the amount available for relief is the difference between NAC and the original cost of the old asset as recognised for tax purposes (“OC”).

SCH.

(3) If DP is less than NAC, the amount available for relief is the difference between DP and OC.

(4) This does not affect the treatment for any purpose of the Tax Acts of the other party to the transaction involving the old asset, or of the other party to the transaction involving the new assets.

Declaration of provisional entitlement to relief

10 C5.—(1) A company which disposes of an asset may make a claim for relief by making a declaration of provisional entitlement in its company tax return for the accounting period in which the disposal takes place.

(2) A declaration of provisional entitlement is a declaration that—

- 15 (a) the company has disposed of an asset that is a qualifying old asset, and
- (b) the requirements of this Part have been or will be met in relation to the acquisition of new assets, and
- (c) the company is accordingly provisionally entitled to relief of a specified amount.

20 (3) While a declaration of provisional entitlement continues in force, this Schedule applies as if—

- (a) the new assets had been acquired, and
- (b) the requirements of this Part were met in relation to those assets.

25 (4) A declaration of provisional entitlement shall cease to have effect if or to the extent that it is—

- (a) withdrawn, or
- (b) superseded by a further claim for relief.

30 (5) If or to the extent that a declaration of provisional entitlement has not been withdrawn or superseded, it shall cease to have effect on the fourth anniversary of the last day of the accounting period in which the disposal took place.

(6) On a declaration of provisional entitlement ceasing to have effect, in whole or in part, all necessary adjustments shall be made by making or amending assessments or by repayment or discharge of tax.

35 Such adjustments may be made notwithstanding any limitation on the time for making assessments or amendments.

Provisional claim where assets to be acquired under contract

40 C6.—(1) If an unconditional contract for the acquisition of the new assets is entered into, relief may be claimed on a provisional basis without waiting to see whether or not the new assets are acquired in pursuance of the contract.

(2) When it is known whether or not the new assets have been acquired in pursuance of the contract, all necessary adjustments shall be made, by assessment or otherwise.

SCH. This applies notwithstanding any limitation on the time within which assessments or amendments may be made.

PART D

HOW AMOUNTS ARE BROUGHT INTO ACCOUNT FOR TAX PURPOSES

Assets linked with trade or property business 5

D1.—(1) To the extent that the asset is used or held for the purposes of a trade or property business carried on by the company, the receipts and expenses are taken into account in computing the profits of the trade or business.

(2) Receipts and expenses arising from accounting credits or debits for a period of account before the company begins to carry on a trade or property business are taken into account for tax purposes in the period in which the company first carries on the trade or business.

(3) In this paragraph “property business” means a Schedule A business or overseas property business. 15

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PART E

EXCLUDED EXPENDITURE AND ASSETS

Excluded expenditure: general

E1. This Schedule does not apply— 20

- (a) to expenditure on the creation of an asset which is not incurred directly on bringing the asset into existence, or
- (b) to expenditure on the maintenance or preservation of an asset.

Expenditure on research and development

E2.—(1) This Schedule does not apply to expenditure on research and development. 25

(2) In sub-paragraph (1) “research and development” has the meaning given by section 837A of the Taxes Act 1988 and includes oil and gas exploration and appraisal.

Oil licences 30

E1.—(1) This Schedule does not apply to an oil licence or an interest in an oil licence.

(2) In sub-paragraph (1) an “oil licence” means a UK oil licence or a foreign oil concession.

(3) In this paragraph— 35

“UK oil licence” means a licence under—

- (a) Part I of the Petroleum Act 1998 (“the 1998 Act”), or
 - (b) the Petroleum Production (Northern Ireland) Act 1964 (“the 1964 Act”),
- authorising the winning of oil; and 40

1998 c. 17.

1964 c. 28 (N.I.).

“foreign oil concession” means any right which—

SCH.

(a) is a right to search for or win oil that exists in its natural condition in a place to which neither the 1998 Act nor the 1964 Act applies, and

5 (b) is conferred or exercisable (whether or not under a licence) in relation to a particular area.

(4) In sub-paragraph (1) “interest in an oil licence” includes, if there is an agreement which—

(a) relates to oil from the whole of a part of the licensed area, and

10 (b) was made before the extraction of the oil to which it relates, any entitlement under the agreement to, or to a share of, that oil or the proceeds of its sale.

(5) In sub-paragraph (4)(a) “licensed area” means—

15 (a) in relation to a UK oil licence, the area to which the licence applies, and

(b) in relation to a foreign oil concession, the area in relation to which the right to search for or win oil is conferred or exercisable under the concession.

(6) In this paragraph “oil”—

20 (a) in relation to a UK oil licence, means any substance won or capable of being won under the authority of a licence granted under Part I of the 1998 Act or the 1964 Act, other than methane gas won in the course of making and keeping mines safe, and

25 (b) in relation to a foreign oil concession, means any petroleum (as defined by section 1 of the 1998 Act).

Expenditure on production or acquisition of films

E4.—(1) This Schedule does not apply to expenditure on the production or acquisition of a film.

30 (2) The reference in sub-paragraph (1) to the production or acquisition of a film is to the production or acquisition of—

(a) the master negative, master tape or master audio disc of a film as defined in section 43 of the Finance (No.2) Act 1992, and

1992 c. 48.

(b) any rights in the film (or its soundtrack) that are held or acquired with the master negative, master tape or master audio disc.

Agricultural and fishery quotas

35

E5.—(1) This Schedule does not apply to

(a) milk quotas;

(b) potato quotas;

(c) ewe and suckler cow premium quotas;

40 (d) fish quota;

(e) any other quota or similar right excluded from this Schedule by order of the Treasury.

45 (2) In sub-paragraph (1)(a) “milk quota” means a right to sell dairy products without being liable to pay milk levy or to deliver dairy produce without being liable to pay a contribution to milk levy.

SCH. (3) In sub-paragraph (1)(b) “potato quota” means a right to produce potatoes without being liable to pay more than the ordinary contribution to the Potato Marketing Board’s Fund.

(4) In sub-paragraph (1)(c) “ewe and suckler cow premium quota” means rights in respect of any ewes or suckler cows to receive payment by way of any subsidy entitlement to which is determined by reference to limits contained in a Community instrument. 5

(5) In sub-paragraph (1)(d) “fish quota” means an allocation of quota to catch fish stocks which derives from the Total Allowable Catches set in pursuance of Article 8(4) of Council Regulation (EEC) No.3760/92, or under any replacement Community instruments. 10

(6) An order under sub-paragraph (1)(e)—

(a) may make different provision for different cases,

(b) may contain such incidental, supplementary and transitional provision as appears to the Treasury to be appropriate, and 15

(c) shall be made by statutory instrument which shall be subject to annulment in pursuance of a resolution of the House of Commons.

Election to exclude expenditure on computer software

E6.—(1) A company may elect that capital expenditure on computer software incurred by it shall be excluded from this Schedule. 20

(2) The election must specify the capital expenditure to which it relates, and must be made—

(a) in writing,

(b) to the Inland Revenue,

(c) before the end of the period of two years from the end of the accounting period in which the expenditure was incurred. 25

(3) An election under this paragraph is irrevocable.

(4) Subject to any such election, this Schedule applies to any asset resulting from expenditure on computer software.

(5) The references in this paragraph— 30

(a) to capital expenditure, and

(b) to the time when such expenditure is incurred,

2001 c. 00. have the same meaning as if this paragraph were contained in the Capital Allowances Act 2001.

(6) This paragraph does not apply to expenditure that falls to be treated for accounting purposes as part of the costs of the related hardware. 35

PART F

SCH.

SUPPLEMENTARY PROVISIONS

Disposals and part disposals

5 F1.—(1) In this Schedule references to a disposal of an asset include a part disposal of the asset.

(2) For the purposes of this Schedule—

- (a) there is a part disposal of an asset where an interest or right in or over the asset is created by the disposal, as well as where it subsists before the disposal, and
- 10 (b) generally, there is a part disposal of an asset where on the company making a disposal any description of property derived from the asset remains undisposed of.

Assets acquired or disposed of together

15 F2.—(1) Any reference in this Schedule to the acquisition or disposal of an asset includes the acquisition or disposal of that asset together with other assets.

(2) For the purposes of this Schedule assets acquired or disposed of as a result of one bargain are treated as acquired or disposed of together even though—

- 20 (a) separate prices are, or purport to be, agreed for separate assets, or
- (b) there are, or purport to be, separate acquisitions or disposals of separate assets.