

Part 1: Intellectual property: know-how and patents

Overview

1. This Part rewrites some special provisions in Chapter 1 of Part 13 of ICTA which charge to corporation tax certain receipts from intellectual property. The corresponding rules for income tax are rewritten in Chapter 2 of Part 5 of ITTOIA.
2. The Part applies to capital sums arising from the disposal of know-how in certain circumstances and capital sums from the sale of patent rights.
3. This Part does not rewrite those parts of the provisions in Chapter 1 of Part 13 of ICTA which apply to trades (such as section 531(1) to (3) of ICTA). Such parts of the source provisions are rewritten in Chapter 12 of Part 3 of the Bill.
4. The Part does not apply to amounts arising from intangible fixed assets within Part 9 of the Bill. The rules in Chapter 16 of Part 9 define which assets and amounts come within Part 9. If an asset is within Part 9 that Part gives all the tax rules that apply.
5. The rules in this Part largely mirror the corresponding rules for income tax and bring the corporation tax provisions back into line with their income tax counterparts. Where there are differences between the two they derive mainly from the way in which the two taxes are charged and the possibility that accounting periods, unlike tax years, will not be of 12 months' duration.

Chapter 1: Introduction

Clause 1: Overview of Part

6. This clause introduces the charges applied by the Part. It is new.
7. *Subsections (4) and (5)* alert readers to the primacy of the intangible fixed asset rules in Part 9 of the Bill. Very broadly, the rules in Part 9 apply only to intangible fixed assets that were created or acquired on or after 1 April 2002. Otherwise the rules rewritten in this Part continue to apply.
8. Royalties from intellectual property are an exception to this as they automatically fall within Part 9 if they are recognised for accounting purposes on or after 1 April 2002. Most income from intellectual property is in the form of royalties. So specific rules in the source legislation applying to royalties are obsolete in a way that rules applying to other (mainly capital) amounts are not. To the extent that, exceptionally, other income receipts from intellectual property not within Part 9 may arise (such as casual profits from the exploitation of intellectual property charged in the source legislation under Case V or VI of Schedule D) those receipts will be subject to the “sweep-up” charge in clause 912 of the Bill.
9. For this reason there is no need, in the corporation tax context, for rules equivalent to those in sections 579 to 582 of ITTOIA (which apply to royalties and other income from intellectual property).

Chapter 2: Disposals of know-how

Clause 2: Charge to tax on profits from disposals of know-how

10. The clauses in Chapter 2 deal with consideration received for the disposal of know-how. Clause 2 applies the charge to corporation tax on income to the proceeds of certain disposals of know-how. It is based on section 531 of ICTA. The corresponding rule for income tax is rewritten in section 583 of ITTOIA.

11. Under the source legislation, income from disposals of know-how is charged to tax under Schedule D Case VI of ICTA.

12. *Subsection (1)* applies the charge to corporation tax on income. Subsection (1)(b) is based on section 531(8) of ICTA but the words “whether absolute or qualified” are omitted since they are superfluous.

13. *Subsection (5)* restores a definition of “mineral deposits” that applied before CAA was enacted. This change reproduces Change 51 in ITTOIA and so brings the income and corporation tax codes back into line. See *Change 41* in the Bill (reproduced here in Annex 1).

Clause 3: Exceptions to charge under section 2

14. This clause sets out the exceptions to the charge under clause 2. It is based on section 531 of ICTA. The corresponding rule for income tax is rewritten in section 584 of ITTOIA.

Clause 4: Profits charged under section 2

15. This clause sets out the amount charged to tax under clause 2. It is based on section 531 of ICTA. The corresponding rule for income tax is rewritten in section 585 of ITTOIA.

16. *Subsection (3)* is new and gives a signpost to the clause which deals with contributions to expenditure. This is necessary because section 532 of ICTA treats section 531 of ICTA as if it were contained in CAA.

Chapter 3: Sales of Patent Rights

Introductory

Clause 5: Overview of Chapter

17. This clause introduces the rules in this Chapter about the sales of patent rights. It is new.

Taxation of the amount chargeable

Clause 6: Charge to tax on profits from sales of patent rights

18. This clause applies the charge to corporation tax on income to capital sums from the sale of patent rights. It is based on section 524 of ICTA. The corresponding rule for income tax is rewritten in section 587 of ITTOIA.

19. Section 524(5) of ICTA is not rewritten because it does not appear to add anything to the proposition set out in clause 6(3) of the Bill (which defines the scope of the charge to corporation tax on a non-UK resident company trading in the UK through a permanent establishment in the UK). Any non-capital proceeds of the sale of patent rights will be amounts of income forming part of a non-UK resident

company's chargeable profits by virtue of clause 19(3)(b) of the Bill (which defines the chargeable profits of a non-UK resident company). So the company will be within the charge to corporation tax in respect of such amounts.

Clause 7: Profits charged under section 6

20. This clause sets out the amount charged to tax under clause 6. It is based on section 524 of ICTA. The corresponding rule for income tax is rewritten in section 588 of ITTOIA.

21. This clause is subject to the spreading rules in clauses 8 to 11.

22. *Subsection (2)* defines deductible costs as the capital cost of the rights sold plus any incidental expenses of sale. This makes it explicit that such expenses may be deducted. The types of expenses which may be allowed under this clause are not listed. Incidental expenses which relate to both capital sale proceeds and other sums not chargeable to tax under clause 6 are effectively apportioned under the rules about net proceeds of sale in clause 23.

23. *Subsection (5)* is new and includes a signpost to clause 20 which deals with contributions to expenditure. This signpost is necessary because section 532 of ICTA treats section 524 of ICTA as if it were contained in CAA.

Clause 8: UK resident companies: spreading rules

24. This clause sets out the spreading rules if the company chargeable by virtue of clause 6 is UK resident and does not receive the proceeds of sale in instalments. It is based on section 524 of ITTOIA. The corresponding rule for income tax is rewritten in section 590(1) to (3) and (6) of ITTOIA.

25. The approach in this clause differs from that in section 590 of ITTOIA. The latter also deals with the case where the taxpayer is UK resident and receives the proceeds of sale in instalments but in this Part that case is dealt with in a separate clause (see clause 9).

26. *Subsection (5)* states the time limit for elections under *subsection (4)*. Unlike the source legislation this clause does not specify to whom the election must be made. But the general rules about claims and elections in Schedule 18 to FA 1998 require elections to be made in a return or, if that is not possible, to "an officer of Revenue and Customs" in accordance with Schedule 1A to TMA.

Clause 9: UK resident companies: spreading where proceeds of sale received in instalments

27. This clause sets out the spreading rules if the company chargeable by virtue of clause 6 is UK resident and receives the proceeds of sale in instalments. It is based on section 524 of ICTA. The corresponding rule for income tax is rewritten in section 590(1) and (4) to (6) of ITTOIA.

28. *Subsection (5)* states the time limit for elections under *subsection (4)*. Unlike the source legislation this clause does not specify to whom the election must be made. But the general rules about claims and elections in Schedule 18 to FA 1998 require

elections to be made in a return or, if that is not possible, to “an officer of Revenue and Customs” in accordance with Schedule 1A to TMA.

Clause 10: Non-UK resident companies: election for spreading

29. This clause sets out how non-UK resident companies are taxed on capital sums from the sale of patent rights if the sale proceeds are not received in instalments. It is based on section 524 of ICTA. The corresponding rule for income tax is rewritten in section 591 of ITTOIA.

30. *Subsection (4)* states the time limit for making an election under *subsection (3)*. The reference in section 524(6) of ICTA to “the Board” has not been reproduced and this clause does not specify to whom the election must be made. But the general rules about claims and elections in Schedule 18 to FA 1998 require elections to be made in a return or, if that is not possible, to an “officer of Revenue and Customs” in accordance with Schedule 1A to TMA. This change reproduces Change 149 in ITTOIA and so brings the income and corporation tax codes back into line. See *Change 1* in the Bill (reproduced here in Annex 2).

Clause 11: Non-UK resident companies: spreading where proceeds of sale received in instalments

31. This clause sets out how non-UK resident companies are taxed on capital sums from the sale of patent rights if the sale proceeds are received in instalments. It is based on section 524 of ICTA. The corresponding rule for income tax is rewritten in section 592 of ITTOIA.

32. *Subsection (2)* makes explicit what was implicit in the source legislation.

33. *Subsection (4)* states the time limit for elections under *subsection (3)*. The reference in section 524(6) of ICTA to “the Board” has not been reproduced and this clause does not specify to whom the election must be made. But the general rules about claims and elections in Schedule 18 to FA 1998 require elections to be made in a return or, if that is not possible, to “an officer of Revenue and Customs” in accordance with Schedule 1A to TMA. So, as with that clause, Change 149 in ITTOIA is reproduced to bring the income and corporation tax codes back into line. See *Change 1* in the Bill (reproduced here in Annex 2).

34. Section 524(10) of ICTA is not rewritten. Section 524 of ICTA prescribes particular tax treatments with alternatives available by election. Section 524(10) of ICTA requires claims for relief under section 524 to be made to the Board. The claim relates to the spreading over six years of capital sums received from the sale of patent rights for the purposes of charging the sum to tax. As spreading is automatic for UK resident companies, the claim can be relevant only to non-UK resident companies. However, section 524(6) of ICTA, which deals with spreading rules for non-UK resident companies, refers to an election the rules for which are fully stated in that subsection and rewritten in clauses 10 and 11. Section 524(10) of ICTA is, therefore, superfluous.

Clause 12: Winding up of a body corporate

35. This clause deals with a body corporate which is chargeable to corporation tax under clause 6 if it commences to be wound up. It is based on section 525 of ICTA. The corresponding rule for income tax is rewritten in section 594 of ITTOIA.

Miscellaneous

Clause 13: Deduction of tax from payments to non-UK resident companies

36. This clause provides rules relating to the deduction of tax from payments to non-UK resident companies which are liable for tax under clause 6 on profits from the sale of the whole or part of any patent rights. It is based on section 524 of ICTA. The corresponding rules for income tax are rewritten in section 595 of ITTOIA.

Clause 14: Adjustments where tax has been deducted

37. This clause provides a rule relating to adjustments which may be necessary if tax is deducted from payments to a non-UK resident company under clause 13. It is based on section 524 of ICTA. The corresponding rule for income tax is rewritten in section 596 of ITTOIA.

Clause 15: Licences connected with patents

38. This clause provides that certain matters relating to the acquisition or grant of a licence in respect of patent rights are treated for the purposes of the Chapter as a purchase or (as the case may be) sale of patent rights. The clause is based on section 533 of ICTA. The corresponding rule for income tax is rewritten in section 597 of ITTOIA.

Clause 16: Rights to acquire future patent rights

39. This clause brings rights to acquire future patent rights within the patent rights rules in this Chapter. It is based on section 533 of ICTA. The corresponding rule for income tax is rewritten in section 598 of ITTOIA.

Clause 17: Sums paid for Crown use etc treated as paid under licence

40. This clause provides that sums paid for Crown use, or by a government of a country outside the United Kingdom are, in certain circumstances, to be treated as paid under a licence. It is based on section 533 of ICTA. The corresponding rule for income tax is rewritten in section 599 of ITTOIA.

41. The reference in section 533(4) of ICTA to “sections 46 to 49 of the Patents Act 1949” has not been reproduced in this section. This is because patents granted under these provisions have ceased to have effect so it is unnecessary to reproduce this reference. The removal of this unnecessary material follows the line adopted in section 482 of CAA and mirrors what was done in section 599 of ITTOIA.

42. The words “used” and “use” in this clause (which correspond with the relieving legislation in section 482 of CAA) are intended to be read widely and cover “make” and “sell”.

Chapter 4: Relief from corporation tax on patent income

Clause 18: Relief for expenses: patent income

43. This clause provides relief for certain expenses in connection with patents. It is based on sections 526 and 528 of ICTA. The corresponding rule for income tax is rewritten in section 600 of ITTOIA.

44. The relief is on the basis of expenses incurred. This relaxes any requirement in the source legislation that fees have to be paid before a deduction can be made.

45. *Subsection (2)* defines “patent application and maintenance expenses” for the purposes of this clause. Relief for such expenses is excluded from the scope of this clause if the expenditure is incurred for the purposes of a trade carried on by the payer. This is because there is a similar provision for trading expenses connected with patents (in clause 88 of the Bill).

46. *Subsection (4)* gives a signpost to the clause which deals with contributions to expenditure. This is necessary because section 532 of ICTA treats section 526 and 528 of ICTA as if those provisions were contained in CAA.

Clause 19: How relief is given under section 18

47. This clause sets out how relief is given when a claim is made under clause 18 for patent expenses to be set against patent income. It is based on sections 526, 528 and 533 of ICTA. The corresponding rule for income tax is rewritten in section 601 of ITTOIA.

48. *Subsection (2)* allows relief for expenditure against patent income in the accounting period in which the expenditure is incurred. However, if the expenses exceed the patent income in the accounting period, the surplus expenses cannot be used to create a loss under this clause. Any such surplus is dealt with in accordance with *subsection (3)*.

Chapter 5: Supplementary

Clause 20: Contributions to expenditure

49. This clause restricts expenditure allowable under clause 4, clause 7 and clause 18 to the extent that the expenditure is met by a public body or someone other than the company. It is based on section 532 of ICTA and section 532 of CAA. The corresponding rule for income tax is rewritten in section 603 of ITTOIA.

50. *Subsection (3)* is new and excludes the application of this clause to incidental expenses incurred by the seller of patent rights (see clause 7(2)(b)). This is because section 524 of ICTA only bites in the first place on the net proceeds of a sale.

Clause 21: Contributions not made by public bodies nor eligible for tax relief

51. This clause qualifies the general rule in clause 20 by providing that contributions not made by public bodies may still be eligible as deductible expenditure in certain circumstances. The clause is based on section 532 of ICTA and section 536 of CAA. The corresponding rule for income tax is rewritten in section 604 of ITTOIA.

Clause 22: Exchanges

52. This clause extends the definition of a sale of property to include exchanges of property for the purposes of this Part. It is based on section 532 of ICTA and section 572 of CAA. The corresponding rule for income tax is rewritten in section 605 of ITTOIA.

Clause 23: Apportionment where property sold together

53. This clause provides for the apportionment of sale proceeds and expenditure on a just and reasonable basis if property within the scope of this Part is sold with

other property. It is based on section 532 of ICTA and section 562 of CAA. The corresponding rule for income tax is rewritten in section 606 of ITTOIA.

Clause 24: Questions about apportionments affecting two or more persons

54. This clause provides for questions relating to apportionment under clause 23 that affect two or more persons to be determined by the body of Commissioners prescribed by section 563 of CAA. It is based on section 532 of ICTA and section 563 of CAA. The corresponding rule for income tax is rewritten in section 607 of ITTOIA.

Clause 25: Meaning of “capital sums” etc.

55. This clause applies section 4 of CAA (which defines “capital expenditure” and “capital sums”) for the purposes of the Part. It is based on section 532 of ICTA. The corresponding rule for income tax is rewritten in section 608 of ITTOIA.

ANNEX 1

Change 41: Trading income: disposal of know-how: restore an express definition of mineral deposits

This change restores a previous definition of “mineral deposits”.

It brings the income tax and corporation tax codes back into line.

The definition of “mineral deposits” in these clauses is in substance the definition that applied for the purposes of the definition of “know-how” in the source legislation for clause 169 and clause [shown here as] 2 of this Bill. That definition applied before certain amendments of Chapter 1 of Part 13 of ICTA were made by CAA.

Section 531 of ICTA makes provision about the tax treatment of certain disposals of know-how. Different provision is made about disposals of know-how that has been used in the course of a trade and other disposals of know-how. The former provision is rewritten in clauses 170 and 171 of this Bill.

Section 533 of ICTA defines know-how for the purposes of section 531 of ICTA as:

any industrial information and techniques likely to assist in the manufacture or processing of goods or materials, or in the working of a mine, oil-well or other source of mineral deposits (including the searching for, discovery or testing of deposits or the winning of access thereto), or in the carrying out of any agricultural, forestry or fishing operations.

Before certain amendments of ICTA were made by CAA, the following definition applied to the expression “mineral deposits” in that definition:

“mineral deposits” includes any natural deposits capable of being lifted or extracted from the earth and, for this purpose, geothermal energy, whether in the form of aquifers, hot dry rocks or otherwise, shall be treated as a natural deposit.

The history of that definition is as follows. The provisions of section 531 of ICTA derive from section 21 of FA 1968, which included the following definition:

(7) In this section “know-how” means any industrial information and techniques likely to assist in the manufacture or processing of goods or materials, or in the working of a mine, oil-well or other source of mineral deposits (including the searching for, discovery, or testing of deposits or the winning of access thereto), or in the carrying out of any agricultural, forestry or fishing operations.

Subsection (9) of that section required the above definition to be construed as if it were contained in Part 1 of the Capital Allowances Act 1968, so that the following definition of “mineral deposits” applied:

“mineral deposits” includes any natural deposits capable of being lifted or extracted from the earth.

That definition was amended by paragraph 2(3) of Schedule 13 to FA 1968, which added the words from “and, for this purpose” onwards.

The relevant provisions were consolidated in 1970 and again in 1988. Section 532 of ICTA originally provided for the definition of “know-how” to be construed as if it

were contained in Part 1 of the Capital Allowances Act 1968. A reference to “the 1990 Act” was substituted by CAA 1990. This attracted the definition of “mineral deposits” which is set out above in the fifth paragraph of this note, and applied throughout that Act.

CAA rewrote provisions about know-how allowances that were previously in Chapter 1 of Part 13 of ICTA. In consequence of the repeal of CAA 1990, CAA also amended section 532 of ICTA so that it provides for the definition of “know-how” to be construed as if it were contained in the 2001 Act. However, no definition of “mineral deposits” applies for the purposes of CAA as a whole. So the consequential amendment failed to preserve the application of CAA 1990 definition of “mineral deposits” to the remaining provisions of Chapter 1 of Part 13 of ICTA (including those on which clause 169 and clause [shown here as] 2 are based).

It is noteworthy that a version of the definition of “mineral deposits” is carried forward in CAA to apply to the rewritten material about know-how allowances. See section 452(3) of that Act.

The failure to preserve the application of CAA 1990 definition of “mineral deposits” to the remaining provisions of Chapter 1 of Part 13 of ICTA is believed to have resulted from an oversight. The inclusion of a definition of “mineral deposits” in clauses 169 and clause [shown here as] 2 corrects this error.

The definition of “mineral deposits” in clause 169 and clause [shown here as] 2 of this Bill differs from the definition formerly in section 161(2) of CAA 1990 in that the words “whether in the form of aquifers, hot dry rocks or otherwise” are omitted. The definition of “mineral deposits” in section 452(3) of CAA also omits these words. The omission was made in that Act on the basis that the words are merely illustrative and that leaving them out does not change the legal effect of the definition. They are omitted in this Bill for the same reasons. A fuller discussion of this point can be found in Note 46 in Annex 2 to the Explanatory Notes to CAA.

This change clarifies the law by making it certain that the definition of “mineral deposit” continues to apply for the purposes described above.

This change clarifies the law and removes uncertainty. But it is expected to have no practical effect as it is in line with generally accepted practice.

ANNEX 2

Change 1{jc209}: References to “officer of Revenue and Customs”

This change replaces references to the “Board of Inland Revenue” in the source legislation with references to “an officer of Revenue and Customs”.

It brings the income and corporation tax codes back into line.

References in the source legislation to the “Board of Inland Revenue” are treated by section 50(1) of the Commissioners for Revenue and Customs Act 2005 (CRCA) as references to “the Commissioners for Her Majesty’s Revenue and Customs”. The rest of this note accordingly refers to the Commissioners for Her Majesty’s Revenue and Customs (“the Commissioners”) rather than to the Board of Inland Revenue.

The provisions affected by this change will in future authorise or require things to be done by or in relation to an officer of Revenue and Customs rather than by or in relation to the Commissioners. This reflects the way in which Her Majesty’s Revenue and Customs is organised and operates in practice. Section 13 of CRCA allows nearly all functions conferred on the Commissioners to be exercised by any officer. All of the functions affected by this change, which are in the main concerned with administrative processes, are in fact exercised by officers of the Commissioners, and the Commissioners themselves are not personally involved in their exercise.

Where the source legislation provides for a claim or election to be made to the Commissioners, this Bill does not expressly state to whom such a claim or election is to be made. Where a notice to deliver a corporation tax return has been issued paragraphs 57 and 58 of Schedule 18 to FA 1998 require the claim to be made in the return or by amendment of the return if possible. A return must be made to the officer who issued it. A notice amending a return must be made to an officer. Similarly, where the claim is made outside a return or amendment, paragraph 2(1) of Schedule 1A to TMA requires the claim to be made to an officer.

Each provision affected by the conversion of references to the Commissioners will be identified in the Table of Origins by a cross-reference to this change.

This change has no implications for the amount of tax due, who pays it or when. It affects (in principle and in practice) only administrative matters.