REGULATORY IMPACT ASSESSMENT (RIA)

REFORM OF THE TAXATION OF INTANGIBLE ASSETS

Purpose and intended effects

1. The existing corporation tax regime for intangibles has developed in a piecemeal way as the nature of these assets has evolved. It involves:

    - different rules for the various types of intangible assets. Some are eligible for capital allowances but there is no tax relief on the purchase of goodwill and many other intangible assets;

    - a range of treatments for taxing sales of intangible assets.

2. The purpose of the reforms is to produce a comprehensive tax regime for intangible assets that gives relief on a consistent basis and reflects the key role of intangible assets in the knowledge-based economy. This is part of the Government's programme to create a modern, fair and competitive tax system for companies.

Risks

3. Without reform, the UK would continue to treat intangible assets less favourably than many other countries to the disadvantage of companies based here. Maintaining tax rules for intangibles that are complex, inconsistent and out-of-date would also be a barrier to the Government's drive to create a modern tax system.

4. The proposed new approach involves novel features, particularly basing relief on accounting amortisation. It has also had to take into account trade-offs between the need to prevent abuse of the new reliefs and the importance of facilitating the efficient pursuit of genuine commercial activity. The transitional regime has had to balance the importance of preserving expectations for existing assets against the benefits of moving rapidly to a single system that covers all assets.

Options

No change

5. Keeping the present system was considered. But it would have major drawbacks:

    - the different treatment of different assets involves complexity and difficult borderlines. It also creates distortions for which there is no economic justification;

    - the absence of relief for many intangibles means they are treated much less favourably than in other countries, putting businesses based in the UK at a competitive disadvantage;

    - retaining outdated rules would be a brake on the Government's drive to create a modern tax system.

6. Responses to consultations have said that reform is needed and is overdue.

Options considered in consultations

7. Various options for the key elements of the structure of the new regime have been examined and subjected to consultation. These include:

   - ***basis for relief.*** An accounts-based approach and an expanded system of capital allowances have been considered. Responses to consultations generally favoured the former as simpler and in tune with commercial decision-making;

   - ***assets included***. The original idea was to include only intellectual property in the new regime. But this has been extended to all intangible assets and goodwill, in part to avoid the boundary issues resulting from a more limited regime;

   - ***treatment of proceeds of sales of intangible assets***. Under the initial proposal, all sales would have been taxed in line with accounting figures. But the approach has been developed following consultations to include a new roll-over relief that defers the tax charge;

   - ***coverage***. The proposals have been focused on company taxation where the need for reform is pressing and the proposed approach is easier to apply;

   - ***transitional arrangements***. A number of options for handling the change to the new regime were considered, including a rapid change with existing assets brought in immediately. But in the light of concerns that reliefs on sales of such assets should be maintained, the proposals have been developed to allow for a gradual transition, with the new rules generally applying only to assets acquired after commencement.

8. The present proposal has been developed in the light of extensive consultation. It is designed to provide a system that balances the objectives of fairness and competitiveness and is sufficiently straightforward that it will encourage companies to exploit intangible assets.

9. Its main components are:

   - relief for expenditure on the full range of intangible assets and goodwill based on amortisation rates in companies' accounts;

   - profits on sales of assets to be taxed as income;

   - tax on sale profits in excess of original cost can be deferred through a new form of roll-over relief if the company reinvests in newly acquired intangibles;

   - transitional rules under which existing assets continue to be taxed under current rules, although the new roll-over relief will apply to sales of such assets.

Benefits - impact on businesses

10. The new regime will provide relief for depreciation on goodwill and other intangibles – including brands, franchises and a range of other rights and commercial information –

where none had previously been available. This will reduce corporation tax bills for companies that acquire such assets. Investment in assets such as patents and computer software that currently qualify for capital allowances will also be relieved in line with the accounts. The impact will depend on companies' particular accounting policies, but for many it will mean relief is obtained faster than now.

11. The new income basis for taxation will mean that companies will no longer be entitled to capital gains reliefs on sales of assets created after the commencement of the new regime. But the transitional rules mean that indexation and capital loss relief will still be available on sales of existing assets. Companies that sell intangible assets will also be able to defer tax on sales of all intangibles where they reinvest in new intangible assets.

12. The new regime will in principle apply to all companies. But in practice only a small proportion of companies undertakes transactions in intangible assets in any year and hence will be directly affected by the reforms. Our provisional estimate is that the number affected will build up to some 20 to 30 thousand companies.

Benefits - wider economic impact

13. The reforms will eliminate the distortions created by the varying rules for different types of intangible asset. The more neutral treatment should create a more efficient allocation of investment between different types of intangible assets.

14. A modern system for taxing these assets will encourage UK business to take advantage of new opportunities in knowledge-based activities. With the growing role of such activities in the economy, this will help meet the Government's goal of increasing productivity and improving overall economic performance.

Policy costs

15. The annual cost of the policy (that is the net cost to the Exchequer of the additional relief to companies) is estimated to be £70m in 2002-03, £160m in 2003-04 and £190m in 2004-5. Costs are expected to rise for a number of years after the introduction of the policy.

Compliance costs to business

16. The proposed new regime will reduce companies' compliance costs in a number of ways. The use of accounting depreciation will reduce the computational burden compared to a system of capital allowances. A single income-based regime for all intangibles will also remove borderline issues that arise at present and eliminate the need for some complex capital gains calculations. We estimate that this will save companies an average of around £1000 per year, building up to between £20 million and £30 million per year in total.

17. There will be some additional one-off costs as companies and their advisers will need to familiarise themselves with the new rules and make any necessary adaptations to their systems. We estimate that this will cost companies on average around £1000, between £20 million and £30 million in total.

18. There are also some aspects of the new regime that will offset some of the savings. The new rollover relief will operate by reducing the amortisation reliefs that can be claimed on replacement assets and will require adjustments to be made to accounting entries. The transitional arrangements will also involve separate regimes for new and existing assets for a period, which will impose additional costs on some companies. Both these features were the subject of consultation, and respondents generally wished them to be included in the new regime despite their extra compliance burden. We estimate that this will cost companies around £750 per year on average, building up to between £15 million and £23 million per year in total.

Administrative cost to Government

19. There are unlikely to be major effects on Inland Revenue administration costs. There will be some one-off costs in training staff for the new regime, but it is not anticipated that there will be significant on-going costs. We estimate that the one-off cost to the Inland Revenue will be around £350,000.

Securing compliance

20. The draft legislation contains targeted anti-avoidance measures. The Revenue will monitor how these work in practice. The new regime will be administered as part of the corporation tax self-assessment system and will be subject to the existing compliance procedures. The Revenue plans to provide guidance and support to companies on the practical operation of the new regime.

Impact on small businesses

21. The new regime will apply to all companies regardless of their size. In practice, it is likely that the proportion of small companies involved in transactions in intangible assets will be smaller than that for larger companies.

Consultation

22. The present proposals follow active consultations with industry and representative bodies, including discussions with a consultative group. They have been developed in the light of responses to a series of consultative documents.

Monitoring and evaluation

23. The Inland Revenue intends to put in place arrangements to monitor the effectiveness of the new regime and of its administration. Information on the actual cost to the Exchequer will be gathered from companies' tax returns and computations.

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Statement of Ministerial Approval

I have read the regulatory impact assessment and I am satisfied that the benefits justify the costs.

Signed by the responsible Minister:

Dawn Primarolo

Paymaster General

Date: 15 April 2002