ICAEW

REPRESENTATION 53/18

REVIEW OF THE CORPORATE INTANGIBLE FIXED ASSETS REGIME

Issued 11 May 2018

ICAEW welcomes the opportunity to respond to the Review of the corporate Intangible Fixed Assets regime rules consultation published by HMT and HMRC on 19 February 2018.

This response of 11 May 2018 has been prepared by the ICAEW Tax Faculty. Internationally recognised as a source of expertise, the Tax Faculty is a leading authority on taxation and is the voice of tax for ICAEW. It is responsible for making all submissions to the tax authorities on behalf of ICAEW, drawing upon the knowledge and experience of ICAEW's membership. The Tax Faculty's work is directly supported by over 130 active members, many of them well-known names in the tax world, who work across the complete spectrum of tax, both in practice and in business.

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EXECUTIVE SUMMARY

1. Intellectual property/Intangible assets are driving the growth of individual countries and of the global economy. A recent report from the World Intellectual Property Organisation, a specialised agency of the UN, states that "Intellectual Property and other intangibles add twice as much value to products as tangible capital" see report http://www.wipo.int/edocs/pubdocs/en/wipo_pub_944_2017.pdf

2. This is a topic that is incredibly important to the potential success of the UK economy and it is going to be equally important to ensure that the tax regime successfully matches the need to incentivise successful UK activity in this vital area while at the same time ensuring that any new regime is proportionate and cost effective.

3. The current Intangible Fixed Assets regime (IFA) was introduced in 2002 and has been amended on a couple of occasions since then, mainly to deal with perceived avoidance and to ensure fairness, but it has not been subject to any detailed review or amendment.

4. The new, 2002, regime did not apply to intangible assets in existence as at 1 April 2002 which remained in the 'old' capital gains tax regime.

5. This has created, in effect, two parallel tax regimes for intangible assets: those existing pre April 2002 and those intangible assets brought into existence after that or intangible assets which have been transferred between third parties after 1 April 2002. In the latter case the acquiring party is treated as acquiring an intangible asset to be treated under the new regime.

6. A further difference between the two parallel regimes was created in 2011 in respect of the de-grouping charges which applies to both regimes but after 2011 any de-grouping charge applicable to pre April 2002 intangible assets would now, post 2011, be incorporated into the gain or loss on the share disposal. This means that if such a 'share' gain is exempt because the substantial shareholding exemption applies then the de-grouping charge is also exempt from any charge to tax.

7. A further change to the IFA regime is explained in chapter 3 of the consultation document under which there is a restriction to the tax relief for a number of elements of business goodwill so that there is no relief under the tax regime until purchased goodwill is actually disposed of.

8. The financial reporting system does not recognise the value of internally generated intangible fixed assets unless they are sold to a third party, in which case the cost is recognised by that third party. Any overview of the contribution that the tax system can make to enhancing the impact intangible fixed assets can have on the UK economy needs to consider what, if anything, could ensure that the tax system makes an appropriate contribution to the influence of intangible fixed assets.

ANSWERS TO SPECIFIC QUESTIONS

Q1: What types of asset are typically affected by the pre-FA02 rule?

9. The asset most commonly impacted by the grandfathering of pre-April 2002 assets is generic business goodwill which is deemed to be a pre-Apr 2002 asset as the trade existed pre-April 2002. This view of the enduring nature of goodwill is contradictory to modern accounting which tends to amortise such assets over 10 years and commercial

views which generally consider it necessary to continually invest in business goodwill to maintain it, rather than seeing it as an inherently enduring asset.

10. Where non-goodwill intangibles such as brands pre-date April 2002, they are often the large internally-generated brands which are not recognised for accounting purposes and are only rarely sold. Otherwise the only large category of such grandfathered IFA is likely to be in the arts, where some periodicals and artworks endure for significant periods, technological IFAs tend not to endure for such periods before being superseded by successor technology.

Q2: What difficulties or benefits has the need to distinguish between pre- and post-FA02 assets caused for your business? How has the significance of these issues changed over time? If possible, please provide details of any extra administration and cost this imposed.

11. There is an Administrative burden caused by the need to maintain two systems and records of when intangible assets were acquired and from whom (ie third-party/related party and the need to determine when first acquired by the group).

12. Over time, fewer IFAs are pre-2002 IFAs, which has two effects on clients – for some it's easier because they have fewer pre-2002 IFAs to worry about but for others it can lead to pre-2002 IFAs falling through the gap because they are not faced with the distinction on such a regular basis.

Q3: What would be the impact (positive or negative) of allowing pre-FA02 assets to come within the IFA regime?

13. It would be more satisfactory to determine what is the appropriate treatment of intangible assets under the future UK tax regime so that their benefit to the UK economy more generally can be maximised.

Q4: If pre-FA02 assets were brought within the IFA regime, at what value should they be recognised, and why?

14. We believe that a key consideration should be to ensure that whatever course of action is chosen the possibility of tax nothings should be avoided. If the relevant assets are currently held at below cost a deduction should be given, at some point, for the historic impairment / amortisation. On the other hand if the asset is currently held at above cost the tax value should be restricted to cost.

Q5: How significant would the transitional issues around capital losses and other reliefs be in practice, and what do you consider would be the best way of addressing this potential unfairness?

15. We believe that there may not be significant capital losses within trading companies.

Q6: Do you anticipate any other transitional issues? If so, please provide details.

16. If the most common assets affected by the transitional provisions are business goodwill then there could be problems allocating amounts to "relevant assets" as defined by Finance Act 2015 and other assets.

Q7: In what situations do companies pay more for a business than the fair value of the individual assets, and what does this difference represent?

17. Takeovers on the quoted market places need to be at a premium to the current listed price to have any chance of success.

18. In general accounts do not reflect "fair value" rather they record the cost of acquisition.

19. But if an acquirer is prepared to pay more than the fair value of an asset it is likely to be because the benefit of the assets to be acquired, in the new integrated business, are going to exceed the purchase price.

Q8: How has the scope of the 2015 restriction – which extends beyond goodwill to customer-related intangibles – impacted on your business? Please explain both the positive and negative impacts, and provide specific examples where possible.

20. Some of our members tell us that they have not yet been impacted by the 2015 restriction. But for some it meant the effective abolition of the IFA regime for business goodwill as it was too difficult to extract the value of those assets that did continue to qualify from those that didn't.

Q9: To what extent could changes be made in this area in a way that deals with the issues that motivated the removal of relief in 2015?

21. The rationale for the new rules, as set out in paragraph 3.4 of the consultation document, is that it was expensive to give relief to the purchaser and it removed the incentive for the purchaser to structure his purchase as "an acquisition of a business as a trade and asset (including goodwill) purchase rather than a share purchase".

22. It seems that the underlying rationale at that time was to limit the cost of the relief. In the current review we hope there will be a more fundamental approach to determine how the tax system can best support continued investment in intangible assets.

Q10: To what extent does the IFA de-grouping charge cause difficulties with M&A transactions in practice? Please provide specific examples where possible.

23. As there is no logic to post 2002 assets being caught by the de-grouping charge but not assets in existence in 2002 this can easily be overlooked and if understood in time the sale of 2002 assets has to be restructured to minimise the impact of the charge.

Q11: Do you consider that the IFA de-grouping charge could be modified to eliminate such difficulties? How could this be achieved affordably, while preserving the Exchequer's ability to claw-back deductions given in excess of the economic cost?

24. One suggestion is that any change could model the interaction of capital gains tax and capital allowances on fixtures with property where the regime claws back any capital allowances claimed to the original cost and any increase is subject to capital gains tax: this can be covered by the Substantial Shareholding Exemption for trading companies where the necessary conditions for the exemption are met.

Q12: In what circumstances do companies typically elect for fixed rate relief?

25. Our understanding is that typically they do not make this election.

Q13: Do you consider that the UK's approach to the elective fixed rate relief deters international businesses from locating intangibles in the UK?

26. The experience is that most businesses do not opt for the fixed rate relief regime although they might if it were more generous.

27. There are other advantages to holding intangibles in the UK, including a generous R&D regime, the patent box and the low headline corporate tax rate.

Q14: Should the way in which fixed-rate relief is given under the IFA regime be changed? How would this impact on business decisions?

28. Some businesses would welcome a more generous fixed rate relief regime and this could be targeted at those assets denied relief under the 2015 changes.

Question 15: What are the benefits to the UK of international businesses holding intangible assets in the UK?

29. To the extent that intangible assets drive economic growth then it is potentially to the benefit of the UK for such intangible assets to be located in the UK if that growth is generated locally.

Question 16: How could the IFA regime be made more cost-effective?

30. We are concerned that this approach seems to be a throw back to government policy aimed at identifying winners rather than creating an environment in which growth and enterprise can flourish. Seeking to link relief given to income generated may create more bureaucracy but will not necessarily benefit the UK economy.

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see https://goo.gl/x6UjJ5).