

Goodwill and customer-related intangibles (Lecture B1405 – 14.00 minutes)

The intangible fixed asset (IFA) regime for companies came in from 1 April 2002 and is complex in the way that it operates. The underlying principle is that a company can claim a deduction for corporation tax purposes for amortisation and impairment of their IFAs. If the company owns the IFA for trading purposes, the debits and credits are dealt with in computing trading profits, if the asset is held for non-trading purposes, the debits and credits are netted off to give a single non-trading IFA credit or non-trading IFA debit.

One area of particular confusion relates to the treatment of goodwill and other customer-related intangible fixed assets.

The legislation refers to these as 'relevant assets' which means:

- Goodwill in a business;
- An IFA consisting of information relating to customers or potential customers of a business;
- An IFA consisting of a relation (contractual or otherwise) between a person carrying on a business and customers of that business;
- An unregistered trademark or other sign used in the course of a business;
- A licence (or other right) in respect of an asset within any of these categories.

The complexity of these rules lies mainly with the number of changes we have had in the provisions.

Created or acquired before 1 April 2002

This is a capital asset for corporation tax purposes with no relief for amortisation or impairment. On disposal, a capital gain or capital loss will arise.

Acquired between 1 April 2002 and 3 December 2014

The basic principle is that amortisation and impairment relief is available (or the 4% straight-line deduction as an alternative). However, where the asset was acquired from a related party, the asset will be treated as a pre-FA2002 asset (i.e. subject to capital gains rules) unless the related party created it on or after 1 April 2002 or acquired it from an unconnected party on or after 1 April 2002. For these purposes, the asset is treated as created on the date that the original business commenced.

Acquired after 3 December 2014 but before 8 July 2015

Amortisation relief and impairment relief is available only where the asset is acquired from an unconnected party.

Acquired on or after 8 July 2015 and before 1 April 2019

No amortisation or impairment relief available regardless of who the vendor was and whether any connection existed between the parties. Where a debit is generated on the realisation of a relevant asset, this will always be treated as a non-trading debit. This is likely to be a provision designed to remove the possibility of creating significant trading losses on sale of IFAs although this has now been superseded to an extent by the 2017 rules on corporate losses.

1 April 2019 onwards

Amortisation relief of a fixed annual rate of 6.5% is available for relevant assets acquired as part of a business acquisition which also involves the acquisition of qualifying IP assets. However, this fixed rate of amortisation relief is restricted to an amount equal to six times the value of the qualifying intellectual property (IP).

Any debit on the realisation also has to be split along the same proportions between trade and non-trade debits.

There are exceptions where the asset is acquired under certain related party transactions or where the asset is a pre-FA2019 asset. These are anti-avoidance provisions and will not be covered here in detail as they will mainly relate to historical transactions.

Qualifying IP in the context of these rules means an IFA that meets the following two conditions:

1. The asset is (or is equivalent under non-UK law to) a
 - a. Patent
 - b. Registered design
 - c. Copyright
 - d. Design right
 - e. Plant breeders right
 - f. Right under the Plant Varieties Act 1997
 - g. A licence in respect of any of the above
2. The asset is not to any extent an excluded asset, a pre-FA 2002 asset or computer software. Excluded assets are covered in changes in FA2020 and not included here but are mainly acquired from connected parties.

In simple terms, the value of the relevant assets are compared with the value of the qualifying IP and the amortisation relief calculated accordingly.

Example

A business is acquired on 1 May 2019 with £100,000 being incurred on qualifying IP assets and £1,000,000 on relevant assets.

Solution

The amortisation at a fixed rate of 6.5% would appear to be £65,000 per annum but the actual allowable amount has to be adjusted.

The maximum amount on which amortisation is allowed is 60% as this represents 6 times the value of the qualifying IP (£600,000 compared to the £1,000,000 actual cost of relevant assets).

The allowable amortisation is therefore £39,000 (60% x £65,000) per annum.

As noted above, there is a calculation to be done when the asset is sold if a loss is made on sale as this has to be split between trading and non-trading debits.

The restriction on relief on realisation is calculated as follows.

The allowable trading debit is calculated as $D1 \times RA$.

D1 is the amount of debit which would (in the absence of any restriction) be allowable in an accounting period.

RA is the relevant amount which is the ratio of expenditure on qualifying IP assets to expenditure on relevant assets.

The non-trading debit equals $D2 - TD$, where:

- TD is the trading debit;
- D2 is the tax written down value having regard to the restriction on previously allowed debits.

Example (cont)

In the above example, the relevant assets are sold at the start of year 3 for £550,000.

Solution

The asset is sold after two years. The TWDV in each year is £65,000 but only £39,000 is allowed for tax purposes.

The TWDV without regard to the restrictions (D1) is $(£1,000,000 - 2 \times £65,000)$ £870,000 and with regard to the restrictions (D2) is $(£1,000,000 - 2 \times £39,000)$ £922,000.

The debit on sale ignoring restrictions is $(£870,000 - £550,000)$ £320,000 and the amount of this representing a trading debit is 60% = £192,000. The non-trading debit is the debit on sale with regard to restrictions which is $(£922,000 - £550,000)$ £372,000 less the trading debit (£192,000) = £180,000.

Reconciling those figures:

Purchase cost less sale proceeds = $(£1,000,000 - £550,000)$ £450,000.

This is made up of amortisation debit of $£39,000 \times 2$, plus trading debit on realisation of £192,000 and non-trading debit on realisation of £180,000.

HMRC challenges

Historically we have seen challenges by HMRC where goodwill has been transferred to a limited company on incorporation where HMRC have challenged the valuation of the goodwill. Related party transactions have to take place at market value so they can challenge on that basis. It reduces the ability of the company to claim amortisation relief and also restricts the ability of the individual to create a large loan account which can be withdrawn. Reduction in the business asset disposal relief lifetime limit would probably have limited this planning even if the above provisions for IFA purposes had not been allowed. The outcome of some of these challenges have been seen recently in cases such as *R&C Commrs v Conran & JC Vision Ltd v R&C Commrs* UKUT 00166.

Contributed by Ros Martin