A better business landscape?

Large Corporate

01 July 2020

Rob Keogh and *Sarah Goodman* consider changes announced to the intangible fixed assets (IFA) regime and amendments to research and development (R&D) relief

Key Points

What is the issue?

Changes announced at the Spring Budget to the intangible fixed assets (IFA) regime and amendments to research and development (R&D) relief seek to continue to drive the government's aim of reinforcing the attractiveness of the UK as a place to do business.

What does it mean for me?

Intangible fixed assets acquired by a company on or after 1 July 2020 will now be subject to the Part 8 regime, which will also apply where an IFA is brought into the UK corporation tax net after that date without there being an acquisition event.

What can I take away?

Finance Bill 2019-21 introduces a further increase in the rate of the RDEC from 12% to 13% for qualifying expenditure incurred on or after 1 April 2020. The government also announced its intention to consult on widening the definition of qualifying R&D expenditure on software and IT costs.

This article considers how the changes announced at the Spring Budget to the intangible fixed assets (IFA) regime and amendments to research and development (R&D) relief continue to drive the government's aim of reinforcing the attractiveness of the UK as a place to do business.

The intangible fixed assets regime

The intangible fixed assets regime at Corporation Tax Act 2009 Part 8 ('the Part 8 regime') is now over 18 years old. In general, the IFA regime provides that debits and credits relating to IFAs are taxed as income in line with the underlying accounting treatment. This means that companies can be entitled to relief for amortisation and impairment debits relating to IFAs.

Whilst the fundamental mechanics of the regime have remained largely unchanged, there have been some significant practical changes; for example, the removal of relief for expenditure on goodwill (and other relevant assets) for assets created or acquired from 8 July 2015, and then the (partial) reinstatement of relief from 1 April 2019. However, the commencement provisions are core aspects of the regime that have remained throughout. Specifically, where IFAs were created prior to 1 April 2002, these assets continue to be grandfathered out of the Part 8 regime unless acquired from an unrelated party after that date. These 'pre-FA 2002' assets are generally taxed in line with the provisions set out in the Taxation of Chargeable Gains Act 1992, under which no relief is allowed for amortisation or impairment and costs incurred on acquiring IFAs are only deductible in computing the capital gain/loss on disposal.

In 2018, the government consulted on various aspects of the regime, including whether to remove the '2002 borderline'. Respondents noted that the existence of parallel tax systems appeared arbitrary, created considerable compliance costs, and made the UK less attractive as a location for holding IFA; however, at the end of the consultation period the government decided against changes to the commencement provisions. Yet only 18 months later, the government has now made a move towards removing the '2002 borderline'.

The scope of Part 8

The draft legislation contained in Finance Bill 2019-21 extends the scope of Part 8 in two significant ways.

First, assets created prior to 1 April 2020 acquired from a related party on or after 1 July 2020 (the 'commencement date') will now be subject to the Part 8 regime. This is a significant and welcome change, making the UK a more attractive location for multinationals to hold their IFAs where some (or all) of those IFAs were created by the group pre-2002. A foreign-parented group, for example, transferring an IFA created prior to 1 April 2002 to a UK tax resident subsidiary after the commencement date will (subject to the restrictions set out below) now be entitled to relief against income on an ongoing basis for the acquisition expenditure.

Second, the scope of Part 8 is also extended where an IFA is brought into the UK corporation tax net after the commencement date without there being an acquisition event. The most common situations in which this will apply include where a foreign company either migrates to the UK or allocates an IFA to its UK permanent establishment.

The draft legislation also introduces a new concept of 'restricted asset' into Part 8. Several 'cases' or transactions can give rise to a restricted asset but it is worth noting two examples here. An asset will be a restricted asset where, in very broad summary, it is acquired by a company from a related party and:

- on the commencement date the asset was a pre-FA 2002 asset (i.e. within the charge to UK corporation tax, but outside the scope of the IFA regime); or
- the asset was created prior to 1 April 2002 and immediately before the commencement date it was held by a person other than a company (for example, a foreign partnership).

Where a transaction involves a restricted asset, amortisation relief is denied. This is achieved by deeming it to have acquired the asset at no cost for the purposes of computing tax relief outside of a realisation. The government's rationale for the introduction of this rule is to prevent related party transactions being used to 'obtain a tax advantage by bringing assets into Part 8 at market value'.

Whilst the broadening of these rules is welcome, some may observe that an opportunity was missed to open the IFA regime to all acquisitions of intellectual property into the UK and put the UK on a par with other major economies as regards the availability of tax relief for acquisitions of intangibles. Alongside the changes made in respect of the IFA regime, the chancellor also announced a number of measures relating to the R&D landscape.

The R&D regime

Respective governments have constantly sought to improve the R&D regime since its introduction in 2000, in order to encourage greater R&D spending in the UK. Both the small and medium-sized enterprises (SME) and large company regimes have seen increases in the rate of relief over the years, and in 2013 there was a move to recognise the R&D benefit 'Above the Line' with the introduction of the Research and Development Expenditure Credit (RDEC).

Finance Bill 2019-21 introduces a further increase in the rate of the RDEC from 12% to 13% for qualifying expenditure incurred on or after 1 April 2020. The RDEC is a taxable credit that can be offset against a company's tax liability, or paid as cash in certain circumstances. Whilst the anticipated reduction in the corporation tax rate to 17% was repealed, the positive news is that the increase in the RDEC rate does leave claimants better off with an increased post-tax benefit of 10.53%. This would have been 9.96% had the RDEC rate remained at 12% and the corporation tax rate dropped to 17%.

The government also announced its intention to consult on widening the definition of qualifying R&D expenditure on software and IT costs, under both the SME and RDEC regimes. Currently, it is possible for companies to claim costs related to software used either wholly or in part to support R&D activities, as defined in Corporation Tax Act 2009 s 1125. However, this excludes any data or cloud computing costs.

The provision of software and IT services to customers has changed substantially since software was first introduced as a qualifying cost category in Finance Act 2002; a consultation on expanding the definition to include data and cloud computing is a positive step in supporting innovation.

While these changes show the government's commitment to R&D, it is also recognised that the generous nature of the R&D regimes may be open to tax abuse. The reintroduction of a PAYE cap on the payable tax credit receivable by SMEs has been subject to ongoing consultation. The proposed cap would limit the SME repayable cash credit to three times the PAYE and NIC paid by the company in respect of employees during the relevant accounting period. The reintroduction of a cap is intended to prevent R&D claims from entities with little or no employment activity in the UK.

The chancellor announced that the cap is intended to be applicable to accounting periods beginning on or after 1 April 2021, to allow more time for consultation on the design of the measure. The government wants to stamp out abuse, whilst avoiding inadvertently penalising businesses that rely more heavily on third party resources than employees.

Whilst there were no specific measures relating to the patent box in the Spring Budget, a more joined-up approach to the management of intangible property will be required when the new patent box nexus regime becomes mandatory for all companies from 1 July 2021. From this date, the patent box benefit will become dependent on where and how R&D is carried out, and R&D and patent box claims further aligned.

Summary

The Spring Budget included clear signals from the government that it wishes to continue to support the innovation lifecycle in the UK. Bringing more IFAs within the scope of the Part 8 regime is clearly a welcome step towards making the UK a more competitive tax regime. Some complexity still remains, as the limitation of amortisation relief where a restricted asset is involved (such as transactions involving foreign partnerships) means that some groups will continue to have to keep track of whether their assets were created pre or post 1 April 2002. Together with the measures restricting relief for acquired goodwill (and other relevant assets) in Finance Act 2019, this may continue to deter some foreign-parented groups from bringing their IP to the UK.

The changes to the scope of the Part 8 regime may represent, in part, a missed opportunity to make the UK a significantly more attractive jurisdiction for groups to locate their IFAs. However, various other measures in the Spring Budget and Finance Bill take broader steps to encourage investment in innovation in the UK through a number of positive announcements in respect of R&D tax relief.