Comment

The trouble with intangibles

Speed read

The intangible fixed assets (IFA) regime has on the whole been good news in terms of the corporation tax treatment of IP. It is a consistent, generally logical set of rules and was, when it was introduced, a big improvement on the myriad tax rules that exist for pre-2002 IP. However, the proposed review of the regime is welcome as there are areas where the rules could be improved. In particular, there are difficulties in applying the group treatment rules to intra-group exclusive licences for fixed sums and the potential for such licences to be taxed under transfer pricing rules; there is an illogical distinction between IFAs and chargeable gains assets created in 2011 when the de-grouping rules were changed; and there are difficulties in applying the rules to partnerships and LLPs. The pre-2002 IP rules should potentially be included within the IFA regime.

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With every passing year, the intangible fixed assets (IFA) rules, as set out in CTA 2009 Part 8, seem further removed from the equivalent chargeable gains position. This gives rise to anomalies which are getting in the way of what would otherwise be perfectly sensible commercial transactions.

In the recent Autumn Statement, the government announced that it will consider a review of the IFA regime as part of the *Business tax roadmap*. With this in mind, this article sets out a few examples of areas which can provide traps for the unwary and which one would hope might be considered in any such review.

Intra-group transfers

The IFA rules contain group relief provisions in Chapter 9 of Part 8 which are based on the chargeable gains rules, including provisions mirroring the de-grouping rules. However, these provisions apply to 'transfers' of IFAs (CTA 2009 s 775). In many situations, there will be no transfer but instead an exclusive long term licence which would nevertheless be treated as a 'realisation' within CTA 2009 s 734. You would think this would be within the rules, as it would certainly be considered a disposal or part disposal under CGT principles. HMRC, however, may take a different view. Its *Corporate Intangibles Research & Development Manual* at CIRD40250 says:

'Tax neutral treatment only applies to the transfer of such an asset. Not all transactions realising an asset … involve the transfer of an asset. Depending on the particular facts, there may be no transfer of an asset where one company grants another a licence, for example, to exploit a patent for a lump sum.'

So, in these circumstances, intra-group treatment may or may not apply. This makes it extremely difficult to undertake a group reorganisation, as you have to plan on the basis that the transfer is both taxable now and that it is tax neutral but with the potential for a subsequent de-grouping charge.

It would also be helpful if legislation specifically dealt with intra-group novations. An assignment cannot be made of the burden of a contract. Therefore, where a company has granted an IP licence (e.g. exclusively for a particular jurisdiction or field of use) and its retained interest is subsequently assigned, the assignment does not transfer the obligations in the licence agreement. A formal novation of the licence would amount to a grant and re-grant of the licence. However, where this happens within a group, this re-granted licence could give rise to tax or future de-grouping issues.

Intra-group licences

Licences may be taxed under the market value rule at CTA 2009 s 845. However, if the licence does not amount to a 'transfer', HMRC states that in 'those circumstances, tax neutral treatment is not available but for the same reason the market rule in [CTA 2009 s 845] does not apply to the transaction' and 'in these circumstances, no adjustment to the terms of the transaction agreed by the parties will normally be necessary for the purposes of [Part 8]' (CIRD40350).

> This regime contains a number of traps and could do with an overhaul

However, this misses the point that transfer pricing could well apply. This is confirmed at CIRD45040 but, rather oddly, HMRC states that this applies where 'the transfer is between a UK resident company and a related party outside the UK tax net'.

There is nothing in the rules which would limit transfer pricing to transactions with overseas parties. Therefore, if an intra-group licence does not amount to a transfer, but does amount to a 'realisation', then tax will be payable on an arm's length provision unless the company meets the SME exemption. This could potentially apply to what most people would consider an intra-group transfer (e.g. an exclusive long term licence), given the lack of clarity in the guidance above.

If an arm's length provision is imposed for transfer pricing purposes, although a compensating adjustment may be available, this could give rise to tax deductible amortisation rather than an upfront tax deduction. Even worse, there may be no deduction at all, following the recent changes to the rules relating to acquisition of goodwill, customer lists and unregistered trademarks (F(No. 2)A 2015 s 33).

Divisionalisation

Another well documented area is around the rules introduced for CGT purposes in FA 2011. For chargeable gains purposes, de-grouping charges can be deemed to arise in a parent company as an adjustment to the calculation on the sale of shares (TCGA 1992 s 179(3A–3E)). These changes effectively also allow newly established companies to meet the substantial shareholding exemption (SSE) conditions, if a trade has been transferred to it which has been carried on within the group for at least 12 months (TCGA 1992 Sch 7AC para 15A). Therefore, there is often no tax on chargeable gains on disposal of a business, if it is hived down into a new group company which is then sold out of a group.

This change to the legislation was welcomed as providing a fair playing field between those companies operating through subsidiaries against those operating through divisions. However, for those working with technology and emerging companies, these rules are almost obsolete, given that they do not apply to gains on IFAs. Although degrouping charges on such assets can be reallocated to another group company under CTA 2009 s 780, they retain their character as IFA credits and therefore cannot benefit from the SSE.

Partnerships

The interaction of the partnership rules and the IFA rules is virtually incomprehensible.

Statement of Practice D12 applies for CGT purposes and is not stated to apply for the purposes of the IFA regime. Does this mean that it does not apply at all? If so, does this mean that every time a new partner joins or leaves a general partnership, or there is a change in the profit sharing ratio, then there is a deemed part disposal or part acquisition of IP by a corporate partner?

The rules on transparency and CGT are relatively clear. Legislation for partnerships and LLPs intends them to be transparent for tax purposes. In particular, general partnerships and LLPs are both treated as transparent for chargeable gains purposes (TCGA 1992 ss 59 and 59A). TCGA 1992 s 59A clarifies that where an LLP carries on a trade or business with a view to profit, assets held by the LLP are treated as held by its members as partners. CTA 2009 Part 17 provides that, for corporation tax purposes, a firm is not regarded as a separate entity; and that the profits of the firm are calculated according to corporation tax principles and then allocated to the members according to the profit sharing ratio. CTA 2009 s 1273 affirms the transparency principle for LLPs and clarifies that 'the property of the limited liability partnership is treated as held by the members as partnership property'.

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The rules on transparency and the IFA regime do not have the same clarity, particularly when it comes to an LLP. Despite the assertion in CTA 2009 s 1273 that the LLP's property is treated as owned by the partners, CTA 2009 s 807 states that the IFA rules do not apply to 'an asset so far as it represents … the interests of a partner in a firm', unless it is an 'interest that for accounting purposes falls to be treated as representing an interest in partnership property that is an intangible fixed asset'. The problem with this approach for IFAs held by an LLP is that the accounting rules are likely to treat an interest in an LLP as an interest in a subsidiary entity, rather than an interest in the underlying assets, as highlighted in *Armajaro Holdings Ltd v HMRC* [2013] UKFTT 571. HMRC states (CIRD25060) that:

'Where the assets of the partnership consist of intangible fixed assets, the exclusion of partnership interests in para 76 will not prevent the partnership from computing its profits in accordance with the rules in Sch 29. These will then be attributed to the member company in accordance with its interest in the partnership.'

The logic of the tribunal in the *Armajaro* case is confusing, though. In particular, the tribunal stated: 'We agree that s 118ZA(1) and (2) provides for a look through, but that only applies for corporation tax purposes and for all purposes in the Corporation Tax Acts.' However, it later continued: 'We do not accept that s 118ZA provides for a general look-through and specifically it does not apply for accounting purposes.'

It is difficult to reconcile this concept (that the partnership is opaque for accounting purposes) with the rule in CTA 2009 s 716 that the credits and debits to be taken into account are those in the 'company's' profit and loss account. It seems illogical that the tax position for LLPs and general partnerships should differ in this respect. The rules should not be this confusing.

The changes made in this year's Autumn Statement make the position even more confusing. In particular, the draft legislation provides that transactions between a partnership and its partners are at market value. This change fully undermines the historic position that many of us may have (incorrectly) assumed, i.e. that parts of SP D12 must by analogy apply to the IFA rules. If I understand the proposed legislation correctly, a company which is a 99.99% partner in a business owning IFAs and which wants to collapse the structure would have to pay tax at market value on 100% of the assets of the partnership.

Pre-2002 IP

As a final thought, I would add that perhaps now would be a good time to look at the transitional rules which have applied since the introduction of the IFA regime. Perhaps pre-2002 assets should be incorporated into the IFA regime, possibly without any right to obtain tax deductible amortisation. This would remove a significant amount of complexity around the tax treatment of IP and business transfers, in particular the potentially difficult job of separating pre-2002 IP from post-2002 IP when dealing with business sales, group reorganisations, etc.

Where does this leave us?

The IFA regime has, on the whole, been good news in terms of the corporation tax treatment of IP. It is a consistent, generally logical set of rules and its introduction was a big improvement on the myriad tax rules that exist for pre-2002 IP. However, there are areas where the rules could be improved.

The recent changes to the market value rules in relation to partnerships have been made to counteract schemes which provide benefits that are not 'intended', when in fact the intention of the legislation is becoming far from clear. As time moves on, the predominant code for considering tax on gains made by companies has become the IFA regime. This regime contains a number of traps and could do with an overhaul both in terms of stating and restating how it is intended to work and perhaps making small changes. I have highlighted some areas that could do with being changed and that would help groups to deal with their IP in a way which both accords with business practice and falls within the relevant reliefs. There are, no doubt, a number of other areas which readers will have found to be problematic. To my mind, as a minimum it would be extremely helpful if HMRC could provide better guidance on the effect of the legislation in the areas highlighted. ■

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- Autumn Statement 2015: summary of tax announcements (26.11.15)
- Cases: *Armajaro Holdings Ltd v HMRC* (6.11.13)
- Back to basics: Intangible fixed assets (Simon Groom, 29.3.10)