Bloomsbury Professional
Tax

Excerpt from Corporation Tax 2019/20 – Chapter 12 – Intangible Fixed Assets

Groups

Focus

The existence of a group relationship allows certain intra-group transfers of intangible fixed assets to be made without any tax impact; it can also facilitate reconstructions, and allow reinvestment relief on a group-wide basis. Where a company leaves a group owning a chargeable intangible asset acquired by intra-group transfer within the past six years, a degrouping charge may arise.

Meaning of a group

12.26

'Group' for intangible fixed assets purposes adopts the chargeable gains definition: see **16.24**.

Thus, a company (referred to here as the 'principal company') and its 75% subsidiaries (whether UK resident or not) form a group. If any of those subsidiaries have 75% subsidiaries, the group includes them and their 75% subsidiaries, but not so as to include a company that is not an effective 51% subsidiary of the principal company (*CTA 2009, ss 765, 766*).

A company is an 'effective 51% subsidiary' of the principal company if (and only if) the latter:

- is beneficially entitled to more than 50% of any profits available for distribution to equity holders of the subsidiary, and
- would be beneficially entitled to more than 50% of any assets of the subsidiary available for distribution to its equity holders on a winding up (*CTA 2009, s 771*).

The anti-avoidance rules in *CTA 2010, ss 158, 160* apply to determine the meaning of equity holders.

A company (A) cannot be the principal company of a group if it is itself a 75% subsidiary of another company (B). The exception to this rule is where A is prevented from being a member of B's group because it is not an effective 51% subsidiary of B. In this case, A can be the principal company of another group, unless this enables a third company (C) to be the principal company of a group of which A would then be a member (*CTA 2009, s 767*).

A company cannot be a member of more than one group. Where a company could otherwise belong to two or more groups, four criteria are applied to determine to which group the company belongs, in the following order: voting rights; profits available for distribution; assets on a winding up; and percentage of directly and indirectly owned ordinary shares (*CTA 2009, s 768*).

A group of companies remains the same group as long as the same company is the principal company of the group. If the principal company of a group becomes a member of another group, the groups are treated as the same group, and the question whether a company has ceased to be a member of a group is determined accordingly. The passing of a resolution for the winding up of a member of a group is not regarded as the occasion of that or any other company ceasing to be a member of the group (*CTA 2009, s 769*).

Intra-group asset transfers

12.27

Intra-group transfers of chargeable intangible assets have no tax effect except for tax-exempt friendly societies, dual resident investing companies, and (from 19 July 2011) transferor companies that have elected under *CTA 2009, s 18A* for exemption in respect of foreign permanent establishments (see **20.33**). Instead, the transferee company adopts the asset and stands in the shoes of the transferor company (*CTA 2009, ss 775, 776*).

Reinvestment relief (see **12.23–12.25**) on a group-wide basis is also available to group members, other than dual resident investing companies. Where the old asset is disposed of by one group company and the replacement assets are acquired by another, both companies involved are required to claim in respect of reinvestment relief. Group reinvestment relief is not available on intra-group asset transfers (*CTA 2009, s 777*).

Purchase by a company of the controlling interest in a non-group company that subsequently becomes a member of the group is treated for reinvestment relief purposes as a purchase of the underlying assets on which relief is available. In such a case, expenditure incurred by the company on its new purchase is treated as the lesser of the tax written down value of the underlying assets immediately before acquisition and the consideration paid for the controlling interest. If reinvestment relief applies, the tax value of the underlying chargeable intangible assets is reduced by the amount of the relief (*CTA 2009, ss 778, 779*).

Leaving a group

12.28

When a company leaves a group, having acquired a chargeable intangible asset by intra-group transfer within the past six years, there is a degrouping charge on the transferee based on a deemed disposal and reacquisition of the relevant asset by the transferee at its market value at the date of that intra-group transfer. A debit or credit adjustment is made in the accounting period in which the company leaves the group (*CTA 2009, s 780*).

Following the February 2018 consultation, the degrouping charge was amended so that there is no degrouping charge where the degrouping occurs as a result of a disposal of shares to which the substantial shareholding exemption (see **16.18–16.22**) applies (*CTA 2009, s 782A,* introduced by *FA 2019, s 26*). The new rule applies to disposals on or after 7 November 2019.

For intra-group transfers on or after 19 July 2011, there is no degrouping charge where two associated companies, who have made intra-group transfers of assets between them within the past six years, leave the group at the same time, provided that both companies are members of the same group or sub-group at all times from when the asset is transferred until immediately after they leave the original group. Before 19 July 2011, this exception from the degrouping charge applied on a narrower basis (*CTA 2009, ss 780, 783*).

There is no degrouping charge if the entire group becomes a member of another group. However, if the transferee ceases to qualify as a member of the new group within six years of having acquired a chargeable intangible asset by intra-group transfer, it is treated as having sold and reacquired the asset at the time of that intra-group transfer. Any adjustment is included in the corporation tax computation for the period in which the company leaves the new group (*CTA 2009, s 785*).

No degrouping charge arises where a transferee company ceases to be a member of a group as part of a merger, where the merger is carried out for genuine commercial reasons and the avoidance of tax is not its main purpose or one of its main purposes (*CTA 2009, s 789*).

A degrouping charge arising to a transferee company can, by joint election between that transferee company and any other member of the relevant group at the relevant time, be passed to that other group company to be treated as accruing to it as a non-trading credit. The company taking on responsibility for this credit must be either resident in the UK, or carrying on a trade in the UK through a permanent establishment that is not exempt from corporation tax on income or chargeable gains under *TIOPA 2010, s 2(1)*, and it must not be a friendly society or a dual resident holding company (*CTA 2009, ss 792, 793*).

Unpaid tax may be recovered from any group members or controlling directors of non-UK resident companies carrying on a trade in the UK, if not paid by the relevant company (*CTA 2009, s 795*).

If payments are made between group companies in respect of group reinvestment relief or the reallocation of a degrouping charge, they are left out of account for corporation tax purposes, provided they do not exceed the amount of relief (*CTA 2009, s 799*).

Reconstructions

12.29

In general, reconstructions avoid a tax charge. In order to ensure this effect, a clearance procedure is available (*CTA 2009, s 832*).

In a scheme of reconstruction where the whole or part of a business of one company is transferred to another company and the transferor receives no part of the consideration (otherwise than by the transferee taking over the whole or part of the liabilities of the business), and where the transfer includes assets which are chargeable intangible assets of the transferor immediately before and of the transferee immediately after the transfer, the transfer of the chargeable intangible assets is tax-neutral. Neither transferor nor transferee may be a friendly society or a dual resident investing company. The reconstruction must be effected for genuine commercial reasons, and must not form part of a scheme or arrangements of which the main purpose, or one of the main purposes, is avoidance of corporation tax, capital gains tax or income tax (*CTA 2009, ss 818, 831*).

There are similar provisions to ensure that transfers of chargeable intangible assets may be tax-neutral on the transfer of the whole or part of the UK business of an EU company resident in one EU member state to an EU company resident in another EU member state, provided that the transfer is wholly in exchange for securities issued by the transferor to the transferee. The chargeable intangible asset is transferred to the transferee company complete with its tax history (*CTA 2009, ss 819, 820*).

Where a UK company's overseas permanent establishment transfers all or part of a trade to a non-UK resident company, the gain on chargeable intangible assets included in the transfer may be deferred. The transfer of trade must include the whole of the assets used for the purposes of the trade or part trade, or the whole of those assets other than cash. The transfer must be made wholly or partly in exchange for securities which comprise at least one quarter of the ordinary share capital of the transferee or bring the transferor's total holding in the transferee to at least that level. The transfer must be effected for genuine commercial reasons, and must not form part of a scheme or arrangements of which the main purpose, or one of the main purposes, is avoidance of corporation tax, capital gains tax or income tax (*CTA 2009, ss 827, 828, 831*). If the securities are later sold otherwise than by intra-group transfer, a credit equal to the deferred gain must be brought into account by the transferor. Also, if at any time within six years after the transfer the transferee disposes of the relevant chargeable intangible assets, a credit must be brought into account by the transferor equal to the deferred gain (*CTA 2009, ss 829, 830*). Relief for any foreign tax is available if there is no deferral of the gain (*TIOPA 2010, s 117*).

Where a pre-*FA 2002* asset (see **12.2**) is transferred under a reconstruction to which *TCGA 1992, s 139, 140A* or *140E* applies, the asset remains a pre-*FA 2002* asset in the hands of the transferee (*CTA 2009, ss 892–900*).

Transfers between related parties

12.30

Transfers of chargeable intangible assets between related parties that are not companies within the same group take place at market value for most tax purposes, whether or not the related party is a company, subject to the transfer pricing provisions (*CTA 2009, ss 845, 846*). Where transfer pricing applies and the transfer takes place on or after 8 July 2015 (unless acquired under an unconditional contractual obligation made before that date), there may be a further adjustment if necessary to ensure that the full market value of the asset is brought into account for tax purposes (*CTA 2009, s 846(1A)–(1C)*, as inserted by *F(No 2)A 2015, s 39*).

Exceptions to the market value rules

12.31

The market value rule for transfers between related parties does not apply in the following situations:

- Where a transfer pricing adjustment must be considered, because the provision is not on arm's-length terms, even if no adjustment is actually made. Where transfer pricing applies and the transfer takes place on or after 8 July 2015 (unless acquired under an unconditional contractual obligation made before that date), there may be a further adjustment if necessary to ensure that the full market value of the asset is brought into account for tax purposes (*CTA 2009, s 846(1A)–(1C)*, as inserted by *F(No 2)A 2015, s 39*).
- These rules were extended by *FA 2018, s 21*, introducing *CTA 2009, ss 849AB–849AD*, so that the grant of a licence by a company to a related party, or *vice versa*, is deemed to be made at market value. This rule applies as long as the asset is a chargeable intangible asset of the grantor, or the licence or right is a chargeable intangible asset of the grantee, immediately after the right or licence is granted.
- Where the transfer is to an employee at undervalue or from an employee at overvalue (*CTA 2009, s 847*). If the market value rule applied, the transfer would be deemed to be at market value and there would be no taxable benefit under the earnings and benefits rules for income tax purposes.
- Where the transfer is to a shareholder at undervalue or from a shareholder at overvalue (*CTA 2009, s 847*). If the market value rule applied, the transfer would be deemed to be at market value and there would be no distribution for income tax purposes.

Related parties and gift relief

12.32

Where a chargeable intangible asset is transferred to a company and the transferor (being an individual) claims capital gains tax hold-over relief under *TCGA 1992, s 165*, in respect of a gift of business assets (see *Capital Gains Tax 2019/20* (Bloomsbury Professional)), the transfer is treated as taking place at market value less the amount of the reduction in the transferor's chargeable gain (*CTA 2009, s 849*).

Example 12.5—Related parties and hold-over relief

Facts

In 2005, Colin personally acquired the rights to certain intellectual property rights (IPR). These rights are used by his company, Colin Ltd, and on 1 January 2015 he transferred the rights to the company for no consideration, claiming hold-over relief under *TCGA 1992, s 165*, on his gift of business assets.

Analysis

On his disposal, Colin's capital gain is held over. For corporation tax purposes, Colin Ltd is treated as having acquired intangible fixed assets (ie the IPR) for their open market value less the amount of the gain that was held over. Accordingly, this reduced transfer value is used as the basis for calculating the company's amortisation of the patent rights for tax purposes.

Roll-over relief on realisation and reinvestment is not available to a company where there is a part realisation and, resulting from it, an acquisition by a related party (*CTA 2009, s 850*). Royalty payments to a related party, not paid within 12 months of the accounting period in which they are accrued and not brought in as a credit by the recipient company, are not allowed as a deduction by the payee (*CTA 2009, s 851*).

See **12.10** for details of restrictions imposed from 3 December 2014 or 24 March 2015 until 7 July 2015 where a company acquired internally generated goodwill or certain other 'relevant assets' from a related individual, or from a partnership involving a related individual.

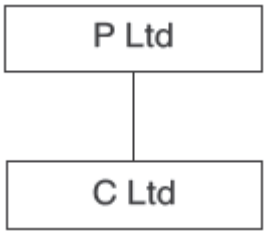
Related parties

12.33

Parties are 'related parties' in the following circumstances:

Case 1

P Ltd and C Ltd are related parties if either company has control of, or a major interest in, the other company (*CTA 2009, s 835(2)*).



For this purpose, P Ltd controls C Ltd if P Ltd has power to secure that the affairs of C Ltd are conducted in accordance with the wishes of P Ltd, whether (*CTA 2009, s 836*):

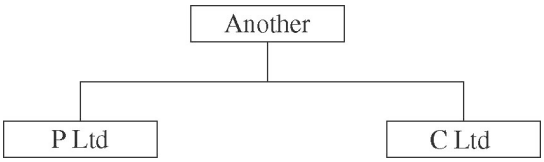
- by means of the holding of shares or the possession of voting power in or in relation to C Ltd or any other company; or
- as a result of powers conferred by the articles of association or other document regulating C Ltd or any other company.

P Ltd has a major interest in C Ltd if (*CTA 2009, s 837*):

- P Ltd and another person together have control of C Ltd; and
- the rights and powers by means of which they have such control represent, in the case of each of them, at least 40% of the total.

Case 2

P Ltd and C Ltd are related parties if they are companies under the control of the same person, whether or not that third person is a company (*CTA 2009, s 835(3)–(4)*).



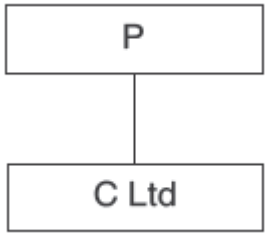
However, P Ltd and C Ltd are not related parties by virtue of the fact that they are both under the control of:

- the Crown;
- a Minister of the Crown or a government department;
- the Scottish Ministers;
- the National Assembly for Wales;
- a Minister within the meaning of the *Northern Ireland Act 1998* or a Northern Ireland department;
- a foreign sovereign power; or
- an international organisation.

Case 3

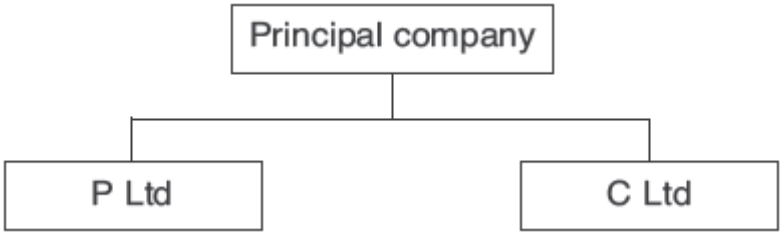
P and C Ltd are related parties if C Ltd is a close company and P is (*CTA 2009, s 835(5)*):

- a participator or an associate of a participator in C Ltd (*CTA 2010, s 454*; close company definitions apply: see **10.9**, **10.11**); or
- a participator in a company that has control of, or holds a major interest in, C Ltd.



Case 4

P Ltd and C Ltd are related parties if they are companies in the same group (*CTA 2009, s 835(6)*).



As explained above, a person has control of a company if they are able to secure that the company's affairs are conducted in accordance with their wishes, whether by shareholdings, voting power or by powers conferred by the articles of association. A major interest exists if two persons have control of a company and each of them has at least 40% of the total shareholding (*CTA 2009, s 837(1), (2)*). Rights and powers that a person owns singly or jointly are taken into account; these include rights and powers that he is entitled to acquire at a future date or will, at a future date, become entitled to acquire and other rights and powers that can be exercised on his behalf, under his direction or for his benefit. Rights and powers of a person connected with him are also taken into account, but not

persons connected to a connected person (*CTA 2009, ss 838, 839*). Loan security arrangements are not taken into account (*CTA 2009, s 838(7)*). Rights and powers of a person as a member of a partnership are only taken into account if the person has a major interest (40%) in the partnership (*CTA 2009, s 840*).

Connected persons

12.34

In relation to a person, connected persons include (*CTA 2009, s 843*; CIRD45190):

- their spouse or civil partner;
- their relatives (ie brothers, sisters, ancestors and lineal descendants);
- the spouse or civil partner of any relative;
- any relative of their spouse or civil partner; and
- the spouse or civil partner of any relative of their spouse or civil partner.

A trustee of a settlement is connected with the settlor, a person connected with the settlor and any company connected with the settlement, and for this purpose the company must be a close company (or only not close because it is not UK resident) and the participators must include the trustees of the settlement (*CTA 2009, s 843*).

A person is connected with a company if they are related parties because of common control, and for this purpose a company includes any body corporate or unincorporated association (*CTA 2009, s 843*; *CTA 2010, s 1121(1)*; see also **1.2**).

Related parties and the participation condition

12.35

From 25 November 2015, in considering whether a person is a related party in relation to another person, it is now necessary to consider whether the participation condition in *TIOPA 2010, s 148* is satisfied (*FA 2016, s 53,* amending *CTA 2009, s 845*). The draft legislation is not entirely clear but it appears that the participation condition is satisfied if one of the persons directly or indirectly participates in the management, control or capital of the other person, or if the same person or persons directly or indirectly participates in the management, control or capital of both parties.

The result of the new rule is that a gain on an intangible fixed asset arising to a partnership or LLP is a chargeable realisation gain, to the extent that it is attributed to the corporate member under *CTA 2009, s 1259*.

The rule was introduced because HMRC had 'identified arrangements that use bodies such as partnerships or LLPs to transfer assets in ways that aim to bring the assets within the new rules without an effective change of economic ownership', in a way that circumvented the market value rule (Explanatory Notes to *Finance Bill 2016*).

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Call: 01444 416119
Email: bptax@bloomsbury.com

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