



GOODWILL RETHINK

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The changes to corporate tax relief add a significant layer of complexity to goodwill and intangibles, explains **Peter Rayney**

Perhaps the biggest surprise that sprung from the Chancellor's Summer Budget box was the abolition of tax relief for the amortisation of goodwill and customer-related intangible assets.

Under UK GAAP, companies are usually required to amortise the cost of goodwill acquired over its useful economic life. It has always been a fundamental tax principle that accounting depreciation is not allowed as a deduction against profits.

Since 1 April 2002, companies have generally been able to deduct the amortisation charge for goodwill and intangibles acquired after 31 March 2002. However, Finance (No 2) Act 2015 (F(No 2)A 2015) has now abolished this tax relief for goodwill/customer-related intangibles purchased after 7 July 2015. Clearly, this has major implications for companies structuring business acquisitions.

These rules have no impact on sole traders and partnerships, etc – they have always treated all type of goodwill and most types of intangibles as 'chargeable assets' for capital gains tax (CGT) purposes. Broadly speaking, there are now three main types of goodwill/intangible assets for corporate tax purposes:

- Goodwill purchased or internally created before 1 April 2002;
- Goodwill/intangibles acquired/created

between 1 April 2002 and 7 July 2015; and

- Goodwill/intangibles acquired/created after 7 July 2015.

Sometimes there can be arguments about when internally generated goodwill was acquired. The legislation resolves this arbitrarily by stipulating that goodwill is created when the relevant trade starts (which would be based on established tax principles) – s884, Corporation Tax Act 2009 (CTA 2009).

The tax treatment of each of these three types of goodwill/intangibles is considered in detail below.


PRE-1 APRIL 2002 GOODWILL

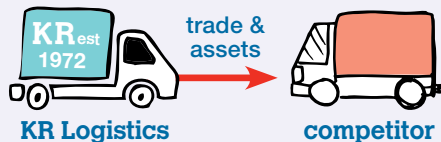
Goodwill acquired or created by a company before 1 April 2002 remains firmly within the corporate 'capital gains' regime. Consequently, despite the accounting treatment, there is no tax amortisation relief for such goodwill. The tax is dealt with on a realisation basis when the company sells or transfers goodwill. Only at this point will the company deduct its acquisition cost from the sale proceeds in calculating its capital gain.

However, if the goodwill is organically grown, the company is unlikely to have any base cost unless it can benefit from March 1982 rebasing. For example, if a company was trading successfully in March 1982, it can often establish a significant base cost for its trading goodwill

EXAMPLE 1


SALE OF PRE-MARCH 1982 GOODWILL

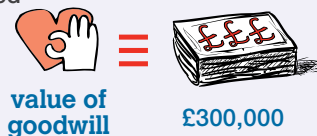
 KR Logistics Ltd has traded successfully since 1972 as a road haulage company, based in Barnsley. In August 2015, it agreed to sell its trade and assets, including goodwill, to a competitor (a share sale was ruled out).



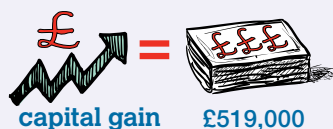
The consideration received for the sale of the goodwill was £1,500,000.



 Since KR Logistics Ltd carried on the trade in March 1982, it can benefit from March 1982 rebasing. The value of goodwill at 31 March 1982 agreed with HMRC was £300,000.



The capital gain on the sale of the goodwill would be £519,000, calculated as:



Sale proceeds	£1,500,000
Less: March 1982 value	(£300,000)
Indexation at 227%	(£681,000)
Capital gain	<u>£519,000</u>

held at 31 March 1982, which will be significantly enhanced by indexation relief (see example 1).

Capital gains on goodwill can be rolled-over but only against purchases of goodwill/intangibles. It is not, therefore, possible to roll-over a pre-March 2002 goodwill gain under the business asset roll-over relief rules in Chapter 1, Part 5, Taxation of Chargeable Gains Act 1992 (TCGA 1992) (for example, against reinvestment in trading premises, fixed plant and machinery, and so on).

PURCHASES BETWEEN 1 APRIL 2002 AND 7 JULY 2015

Goodwill and other intangible assets acquired after 31 March 2002 come within the corporate intangibles regime (now dealt with in Part 9, CTA 2009). In such cases, tax relief is given on the goodwill amortisation charged in the company's accounts. As an alternative, companies could opt for a 4% straight-line goodwill deduction instead.

In April 2002, the intangibles regime was seen as giving companies a valuable tax break for business acquisitions. Therefore, when this benefit was taken away for goodwill/certain intangibles acquired after 7 July 2015, it is perhaps not surprising that this was

viewed as an 'unfriendly' business measure. However, the good news is that tax-deductible amortisation for goodwill acquired/created between 1 April 2002 and 7 July 2015 is retained. Thus, the new restrictions have no effect on companies that were already claiming goodwill tax relief before 7 July 2015 (see example 2).

Since the tax relief is generally based on the amortisation charged to the profit and loss account in accordance with GAAP/FRS 102, *Financial Reporting Standard applicable in the UK and Ireland*, the 'write-off' period drives the timing of the tax relief.

The vast majority of companies are now required to adopt FRS 102 or FRS 105, *Financial Reporting Standard applicable to the Micro-entities Regime*, which is replacing the FRSS, *Financial Reporting Standard for Smaller Entities* (FRSSE) for accounting periods commencing after 31 December 2015.

As before, goodwill and other intangibles are capitalised and then amortised over their expected useful economic life. However, it is likely that FRS 102 will often shorten the write-off period. If the company is unable to make a reliable estimate of the useful life, the default write-off period becomes five years (compared to the practical limit of 20 years under the previous standard FRS 10, *Goodwill and Intangible Assets*). Consequently, under FRS 102, goodwill is likely to be written off over a much shorter period.

If the (post-31 March 2002) goodwill/intangibles were subsequently sold, the accounting profit would often represent the taxable 'trading' profit. Strictly, the profit/loss would represent the excess of the sale proceeds over the tax written down value of the asset » xx

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Changes announced in Summer Budget 2015 are outlined in a policy paper, Corporation tax: restriction of CT relief for business goodwill amortisation, at <http://bit.ly/1Ly0U1g>

EXAMPLE 2

TAX-DEDUCTIBLE AMORTISATION OF GOODWILL

5 Jan 2015 On 5 January 2015, Wild Goose Holdings Ltd concluded its negotiations for the purchase of the trade and assets of Kate Ltd's high-tech sports equipment business.



31 Dec Wild Goose Holdings Ltd draws up accounts to 31 December each year. The allocation of the purchase consideration booked in the accounts (with no fair value adjustments) is as follows:

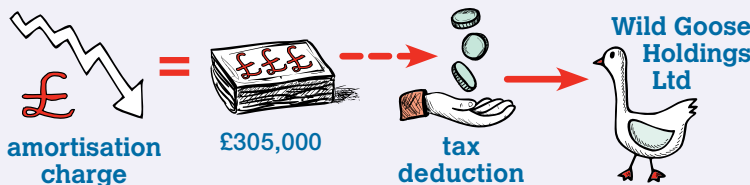
Freehold property	£1,500,000
Plant and equipment	£1,100,000
Goodwill	£500,000
Patent rights	£800,000
Know-how	£500,000
Trade debtors (net of trade creditors and other liabilities)	£200,000
Net consideration, satisfied in cash	£4,600,000

Wild Goose Holdings Ltd will amortise its intangible fixed assets over the following periods:



31 Dec 2015 Wild Goose Holdings Ltd will be able to claim a (trading debit) tax deduction based on its goodwill/amortisation charge of £305,000 for the year ended 31 December 2015, calculated as:

	P&L charge
Goodwill (£500,000/5 years)	£100,000
Patent rights (£800,000/10 years)	£80,000
Know-how (£500,000/4 years)	£125,000
Total amortisation	£305,000



but without any indexation allowance. Profits arising on the sale of goodwill could be rolled-over under the intangibles regime by purchasing new goodwill/intangible assets only.

CLAMPDOWN ON GOODWILL ACQUIRED ON INCORPORATION

Goodwill acquired as a result of an incorporation transfer between 3 December 2014 and 7 July 2015 is effectively a sub-set of the 'second' type of goodwill. As part of the clampdown on tax-efficient business incorporations, Finance Act 2015 (FA 2015) blocked amortisation tax relief for post-March 2002 goodwill purchased by a 'connected' company after 2 December 2014

(s849B-D, CTA 2009).

However, the legislative ink on these provisions had barely dried when they were abolished on 8 July 2015. Following the wider abolition of tax relief for goodwill on all post-7 July 2015 transactions (see below), they simply were no longer required.

GOODWILL/INTANGIBLES ACQUIRED/ CREATED AFTER 7 JULY 2015

The third category relates to goodwill and customer-related intangibles acquired after 7 July 2015. The (new) s816A, CTA 2009 makes it clear that 'no debits' are tax-deductible for these 'relevant assets', which are defined as:

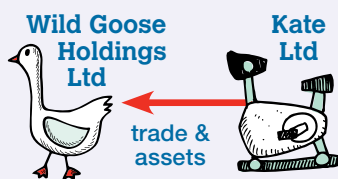
- Goodwill;
- Information relating to customers or potential customers;
- Contractual or non-contractual relationships with customers;
- Unregistered trade marks or other signs used in the business; and
- A licence or right relating to any of the above assets.

This means that the goodwill/intangible amortisation (or impairment) of these assets would be added back as an adjustment to profit in a company's tax computations. Any taxable profit or tax loss would crystallise when a 'relevant asset' was subsequently sold (which would be different from the profit/loss reported in the accounts). The 'credit' (profit) would

EXAMPLE 3

TAX TREATMENT POST-7 JULY 2015 ACQUISITION OF GOODWILL AND OTHER INTANGIBLES

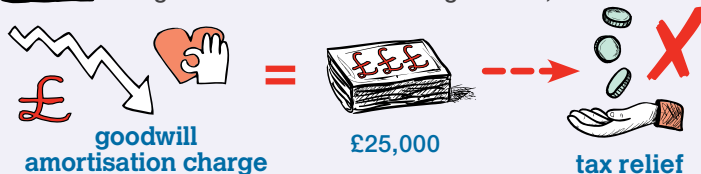
1 Oct 2015 Assume the same facts as in example 2, except that the acquisition of Kate Ltd's high-tech sports equipment business was delayed until 1 October 2015.



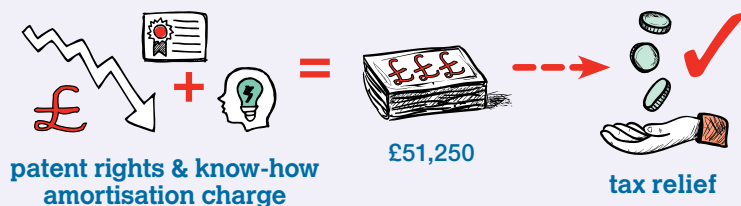
31 Dec 2015 Wild Goose Holdings Ltd charges only a pro-rata amortisation of the purchased goodwill and other intangibles to its profit and loss account for the year ended 31 December 2015, as shown:

		P&L charge
Goodwill (£100,000 x 3/12)		£25,000
Patent rights (£80,000 x 3/12)		£20,000
Know-how (£125,000 x 3/12)		£31,250
Total amortisation		£76,250

7 Jul 2015 Since the goodwill was acquired after 7 July 2015, Wild Goose Holdings Ltd cannot claim any tax relief for the goodwill amortisation charge of £25,000.



Because the patent rights and know-how are not 'relevant assets' within s816A, CTA 2009, tax relief is still available for the total £51,250 amortisation relating to these assets in 2015, as well as on future amortisation charges relating to them.



invariably be treated as a trading receipt under s747, CTA 2009.

Any tax loss arising on (post-31 March 2002) goodwill/intangibles is normally treated as part of the company's tax-adjusted trading results. Thus, if a loss on trading goodwill is sufficient to create a 'trading' tax loss, that loss could be relieved by offset against future trading profits.

However, there is now an unpleasant rule for losses arising on (post-7 July 2015) relevant assets. In such cases, the loss on disposal is treated as a non-trading debit (s816A (4), CTA 2009). Companies can deduct non-trading debits against their other profits of the same accounting period (s753(1), CTA 2009) or group relieve them (s99(1), CTA 2010).

However, there is a subtle point here – any 'excess' non-trading debits cannot be

carried forward to shelter future trading profits, thus restricting access to future tax relief.

TAX-DEDUCTIBLE POST-7 JULY 2015 GOODWILL/INTANGIBLES

Intangible fixed assets that do not fall within the above 'relevant asset' definition are not subject to any restrictions. Intangibles amortisation relief is therefore still available for intellectual property (IP) assets such as patents, know-how, registered designs, copyright or design rights and so on (see example 3).

Therefore, when structuring any trade and asset acquisitions that include these intellectual property assets, these items should be 'carved-out' out separately in the sale and purchase agreement with a commercial price being allocated to each of them.

The shake-up in the corporate tax treatment of goodwill adds another significant layer of complexity. As shown above, there are now three main 'classes' of goodwill/intangibles. When dealing with goodwill and intangibles, it will clearly be important to establish the date the goodwill was created or acquired as this will determine the tax treatment.

In many ways, the F(No2)A 2015 tax relief prohibition for goodwill and customer-related intangible assets almost puts companies back to the pre-31 March 2002 position, with any profit or loss only being taken on disposal (but with no indexation allowance reducer).



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