Think Ahead ACCA

Review of the corporate intangible fixed assets regime

A public consultation issued by HM Treasury and HM Revenue & Customs

Comments from ACCA to HM Revenue & Customs
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SUMMARY

ACCA welcomes the opportunity to comment on this timely review of the corporate intangibles fixed asset regime. As technology drives the rise of new business models, intangible assets have become central to how businesses around the world generate economic value. The IFA regime therefore has a crucial part to play not only in protecting the UK's international competitiveness, but also in addressing the domestic productivity challenge. Technology, new business models and drivers of value have formed the focus of ACCA's research[1], and we would welcome further opportunities to share our findings to support the Government's policy-making in this area.

Changes to the IFA regime can lead to Exchequer impacts, and we understand that ensuring reliefs are efficient and effective is therefore a central concern. In our view, tax simplification contributes as much to cost reduction as the scope and rate of relief. Simpler tax rules reduce compliance costs for businesses, and administrative costs for HMRC. Ultimately, a simpler, more certain tax system allows businesses, large and small, to generate more economic value, thus increasing tax revenues. In this respect, we believe the Treasury should consider:

- ending the different tax treatment for pre-FA 2002 assets,
- reducing exceptions and elections, including the restriction on relevant assets, and
- aligning tax treatments as much as possible to the accounting treatment, in terms of definitions and boundaries as well as in terms of the basis of relief

In advocating for simplification, ACCA believes that the many types of intangible assets used for the purposes of the trade serve the same function as tangible assets: that is, to 'produce economic benefits[2]' flowing to the business. As we look ahead to an increasingly intangibles-driven economy, the basis for distinguishing between tangible and intangible assets needs to be reconsidered. If the UK's tax policies are to support international competitiveness and productivity growth, it will be necessary to align the IFA regime and the capital allowances regime for tangible fixed assets.

In making changes to the IFA regime, it is important to preserve tax symmetry. The value of intangible assets, including goodwill, is taxed in the hands of the vendor in an acquisition. It should therefore be reasonable to allow deductions to the acquirer in respect of the same assets. Further, considering the pattern of business investment and income generation over a longer-term horizon, it is clear that the fair value of intangible assets – and the value of goodwill - represents the acquirer's expectations about the assets' ability to generate future cash inflows. Such inflows represent future taxable profits. The cost of tax deductions granted therefore lead to future tax revenues. This longer-term perspective is core to encouraging long-term innovation, another focus of the Treasury that we fully support.

[1] See, for example, *Business Models of the Future: Emerging Value Creation*, 2017 (http://www.accaglobal.com/an/en/professional-insights/pro-accountants-the-future/business-models-of-the-future.html)

[2] Definition of an asset in IASB's Conceptual Framework (revised 2018)

Finally, it is important for any changes to the IFA regime to apply to all business forms, including LLPs and partnerships. This is key both to achieve simplification, and also to avoid any tax distortions.

AREAS FOR SPECIFIC COMMENT:

Question 7: In what situations do companies pay more for a business than the fair value of individual assets, and what does this difference represent?

Companies pay more for a business than the fair value of individual assets for a wide variety of reasons, so it is difficult to generalise.

While fair values reflect individual assets' ability to generate future cash flows – and therefore future taxable profits – accounting is not designed to reflect the real market value of a business. IFRS does not, for example, permit the recognition on the balance sheet of some internally-generated intangible assets, such as customer lists. In addition, reliable market values may not be available (for example where the market is illiquid), so an asset may be recognised at cost. As a result, it is quite common for businesses to have a higher disposal value than the total value of its net assets.

In addition, the acquirer's plans for the acquired business could influence the expected return on investment, and therefore the amount it is prepared to pay. A customer list may be put to different use by the acquirer, and therefore the associated forecast cash flows may also be different. A group acquiring operations in a key new market may pay more for the combination of assets it acquires than the total fair value of individual assets, for example.

Question 9: To what extent could changes be made in this area in a way that deals with the issues that motivated the removal of relief in 2015?

The Government should consider removing the restriction denying relief for relevant assets. Aligning both the boundaries of the regime and the basis of relief with the accounting treatment benefits the UK's international competitiveness, as it provides greater simplicity and certainty to businesses.

Paragraph 3.4 notes that allowing deductions for the amortisation of goodwill is an expensive relief. We would argue, however, that the deductions should not be seen in isolation. The disposal value would, in most cases, have triggered tax on the vendor in the form of chargeable gains – it should therefore be reasonable to make the corresponding relief available to the acquirer. Further, as the Government considers its response to the taxation of the digital economy[3], in particular establishing a right to tax the value that businesses extract from their customer bases, it is important that the symmetry between tax charges and deductions arising from similar assets are maintained.

We note that the restriction was introduced to remove tax incentives to structure acquisitions of businesses as a trade and asset purchase rather than a share purchase.

[3] HM Treasury Position Paper: Corporate Tax and the Digital Economy (https://www.gov.uk/government/consultations/corporate-tax-and-the-digital-economy-position-paper)

However, there are key differences in the nature of trade purchases and share purchases, and the choice between the two is likely to be driven more by business considerations than by tax. At the same time, other tax distortions resulted from the restriction. Customer data, for example, may be separately purchased much in the same way as patents are, but while the latter attracts tax deductions, the former does not.

We recognise that the value of goodwill is subject to volatile market forces, and could lead to Exchequer impact where goodwill arising from the acquisition of over-valued businesses result in large impairments in subsequent years. In this respect, the treatment of unutilised IFA deductions as non-trading losses does restrict the scale of impact to some extent. There are existing mechanisms, such restrictions on the deductibility of corporate interest expense and limitations to loss relief, which would provide a model for further approaches to prevent abuse.

Question 13: Do you consider that the UK's approach to the elective fixed rate relief deters international businesses from locating intangibles in the UK?

The elective fixed rate relief could deter international businesses from investing and setting up operations in the UK. The rate of the fixed rate relief, and the added complexity that the election entails, could both be influencing factors.

We recognise the Government's intention to encourage investments in intangibles with a long or indefinite useful life. However, given the fast pace of change in terms of technology and consumer behaviour, assets with a useful economic life of over 25 years are likely to become increasingly rare.

From an accounting point of view, assets are recognised on the balance sheet when it is probable that economic benefits will flow to the entity: in this context, few intangible assets recognised by businesses today can be expected to continue to generate cash inflows in 2043. Although it is subject to judgement, accounting standards do generally provide a sufficiently clear framework for the determination of assets' useful economic lives. On this basis, we believe that accounts-based tax deductions do reflect the economic reality of assets.

We understand businesses do claim 4% fixed rate deductions for those intangible assets which are not amortised in the accounts. However, such assets are reviewed for impairment, and accounts-based tax deductions would provide appropriate relief in these cases.

In addition to the rate of the relief, the additional complexity that arises from this election could also deter investment. For businesses, choosing between the two treatments requires an additional decision to be taken by management, and leads to further tax compliance and accounting complexity (as a related deferred tax asset would need to be recognised and measured). For HMRC, the administration of the election could also involve additional costs and resources.

Question 14: Should the way in which fixed rate relief is given under the IFA regime be changed? How would this impact on business decisions?

On the basis of the reasons set out in our response to Question 13, we would recommend that the elective 4% fixed rate can be phased out. Given the limited range of assets which have very long useful economic lives, this should have relatively little impact on business decisions, beyond prompting some businesses to reconsider the suitability of their amortisation policy.

Question 16: How could the IFA regime be made more cost-effective?

It would not be feasible, using the tools and methodologies that are currently available, to accurately link additional economic activity to specific types of expenditure, as suggested in paragraph 6.4. The same intangible asset may be used differently by different businesses, and their effectiveness and generating income also depends on each business's value-generating model. Indeed, additional revenue streams could be attributable to more than one intangible asset.

Recent initiatives, such as the International <IR> Framework[4], seek to make the link between non-financial resources and value creation. However, this is based on the premise that each business will have its own individual value creation model: ACCA's research[5] shows that what are considered key resources, and their measurable outputs and outcomes, vary greatly from one business to another.

ACCA therefore believes that it would not be possible, or desirable, to limit relief to expenditure that generates additional economic activity as paragraph 6.6 proposes. At the same time, we note that the link between assets and cash inflows already underlie the definition of assets in generally accepted accounting frameworks.

Instead, cost savings for businesses and for the tax administration could come from tax simplification. Achieving greater alignment between tax and accounting treatments and removing exceptions (in the form of the fixed rate election and the different treatment of pre-FA2002 assets), will make the intangible fixed asset regime more cost-effective for companies to comply with and for HMRC to operate.

In the longer term, greater efficiency could be further achieved by aligning the tax regime for tangible and intangible assets, for example by reviewing complex and low-rate allowances such as the 8% special rate pool allowances for integral features and long-life tangible assets.

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[4] http://integratedreporting.org/resource/international-ir-framework/

[5] *Insights into Integrated Reporting 2.0: Walking the Talk* (2018) http://www.accaglobal.com/an/en/professional-insights/global-profession/Insights-into-integrated-reporting-2-walking-the-talk.html