

Finance Bill 2009
New Tax Relief Scheme for Capital Expenditure on Intangible Assets

Section 13 of the Finance Bill 2009 provides for a new scheme of tax relief for companies incurring capital expenditure on intangible assets. Under the scheme, relief in the form of capital allowances against trading income is given on capital expenditure incurred by companies on the provision of intangible assets for the purposes of a trade. A new section 291A is included in Part 9 Chapter 2 of the Taxes Consolidation Act 1997 (TCA) for this purpose. Intangible assets coming within the scheme are treated as machinery or plant so that the normal rules in regard to wear and tear allowances, balancing allowances and charges for expenditure on machinery or plant will also apply for capital expenditure on qualifying intangible assets, subject to the specific provisions of section 291A.

1. What Intangible Assets Come within the Scheme?

The scheme applies to intangible assets

- which are recognised as intangible assets under generally accepted accounting practice and
- which are listed as *specified intangible assets* in the new section.

It does not apply to all intangible assets.

Under current accounting practice, for an asset to be regarded as an *intangible asset* it must be

- an identifiable non-monetary asset without physical substance
- controlled by an enterprise as a result of past events (e.g. purchase or self-creation) and
- an asset from which future economic benefits (e.g. revenues or reduced costs) are expected.

An asset may be recognised as an intangible asset in a company's accounts only if the cost of the asset can be reliably measured *and* it is probable that future economic benefits attributable to the asset will flow to the enterprise.

The full list of *specified intangible assets*, which qualify for relief under the scheme, is given in the Appendix to this note.

2. What Allowances are available?

Companies will be eligible for a writing-down allowance in accordance with the accounts-based depreciation of the intangible asset, but they can opt instead for a fixed write-down period of 15 years for the asset.

The ***accounts-based writing down allowance*** for a specified intangible asset will reflect the depreciation of the asset for accounting purposes computed in line with existing accounting standards. The allowance will be based on the amount charged to the profit and loss account of the company for the accounting period in respect of the amortisation or depreciation of the asset relative to the actual cost of the asset, or if greater, the value of the asset on which such amortisation or depreciation charge is computed. The rate of write down will therefore vary from asset to asset depending on the expected useful life of, and pattern of economic benefits deriving from, the intangible asset as determined in accordance with generally accepted accounting practice.

Under IAS 38, the cost less residual value of intangible assets with finite lives should be amortised over the life of the asset. The amortisation method should reflect the pattern of benefits deriving from the asset but if this cannot be reliably determined, a straight line method should be used. The amortisation period should be reviewed annually. IAS 38 provides that an intangible asset with an indefinite useful life (e.g. a brand) should not be amortised.

As an alternative to using accounts based depreciation, companies will be able to opt for a ***fixed write-down period of 15 years***, with allowances provided at 7 per cent per annum of the actual cost of the asset and 2 per cent in the final year. This option is likely to be used in the case of non-depreciating assets having an indefinite useful life and for which no amortisation charge to the profit and loss account is allowed under accounting practice. Companies opting for a fixed write-down period can do so by making an election to this effect in the return for the accounting period in which the expenditure on the provision of the specified intangible asset was first incurred. An election for a fixed write-down period will then apply to *all* capital expenditure incurred on the asset.

3. Will a balancing charge or allowance apply on the disposal of an intangible asset?

The *normal rules* in relation to balancing allowances/ charges will apply on the disposal of an intangible asset, with a *significant exception*:

There will be no claw-back of allowances

- where an intangible asset is disposed of more than 15 years after the beginning of the accounting period in which the asset was first provided for the trade and
- where the disposal does not result in a connected company claiming allowances in respect of capital expenditure on the asset.

[This exception will also apply in relation to other events specified in section 288(1), e.g. where the asset ceases to be used for the purposes of the trade.]

4. Is relief available for both externally- acquired and internally- developed intangible assets?

Yes. Once the expenditure is capital in nature and was incurred (on or after the commencement date, i.e. 8 May 2009) for the purposes of a trade, allowances will be available whether the expenditure is incurred on the acquisition of a specified intangible asset or on the development or enhancement of an externally acquired or an internally created intangible asset.

5. Does the scheme apply to connected party transactions as well as third party transactions?

Yes. Relief will be available whether the intangible asset is acquired from a third party or from a connected person, subject to certain conditions.

- An ***arm's length rule*** will apply so that, in the case for example of an asset transferring between connected companies, any amount over and above that which would be payable between independent parties acting at arm's length will not qualify for relief.

- There is also a restriction on the provision of allowances for *intra-group transfers* of intangible assets whereby allowances are not available to an acquiring company where the transfer is subject to capital gains tax group relief under section 617 of the TCA (i.e. where there is no capital gains tax charge on the transfer of the asset and the acquiring company is treated as having acquired the asset for a consideration of such an amount that neither a gain nor a loss accrues to the transferring company on the transfer of the asset). [However, the companies involved may jointly elect not to avail of group relief under section 617, in which case the acquiring company may claim an allowance under the scheme while the transferring company may be subject to a capital gains tax charge on the transfer.]

6. Are allowances available for offset against company profits generally or are there restrictions on use of allowances under the scheme?

There are a number of restrictions applying so as to ensure that

- (i) relief is targeted to business *activities* (amounting to the conduct of a *trade*) in which the specified intangible assets are used and
- (ii) there is a limit on the aggregate amount of capital allowances and related interest which may be claimed in any accounting period. Related interest for the purpose of this latter restriction is interest incurred as a trading expense on borrowings to fund expenditure on intangible assets for which capital allowances are claimed.

As regards (i) above, allowances are only available against income from activities which consist of managing, developing or exploiting a specified intangible asset or assets [referred to as '*relevant activities*' in subsection (5) of section 291A] and which are carried on by a company as part of a trade. Such relevant activities, which may include activities comprising the sale of goods or services deriving the greater part of their value from intangible assets, are to be treated as a separate trade [referred to as a '*relevant trade*' in subsections (5) and (6) of section 291A] and income from such activities is to be assessed separately.

Where the *relevant activities* are carried on in a separate company there should be no difficulty in ascertaining the profits from such activities. However, where the managing, developing or exploiting of a specified asset is carried on as part of a wider business, an apportionment of receipts and expenses will be necessary to ensure that the correct amount of income is attributable to the deemed separate trade. Such apportionment is to be done on a just and reasonable basis. The amount of income attributed to the relevant trade should not exceed the amount that would be attributed to a distinct and separate company engaged in the relevant activities if it were independent of, and dealing at arm's length with, the company availing of relief under the scheme.

As regards (ii), the aggregate amount of capital allowances and related interest expense that may be claimed for any accounting period shall not exceed 80% of the trading income of the relevant (i.e. separate) trade for that period excluding such allowances and interest. This means, in effect, that a minimum 20% of income from the relevant trade is left in charge for any accounting period and that a loss cannot be created by such allowances or interest expense. In applying this restriction, capital allowances for expenditure on the provision of specified intangible assets are to be restricted before interest on related borrowings is restricted. Where, by virtue of the 80% limit, it is not possible to utilise all the capital allowances available for an accounting period, the excess allowances will be carried forward and added to any allowances which are available for offset against trading income of the relevant trade for the next succeeding accounting period and so on for each succeeding accounting period. Similarly, any excess interest expense arising in an accounting period will be carried forward and added to any interest deductible against trading income of the trade for the succeeding accounting period and so on for each succeeding accounting period.

The simplified examples below illustrate how these restrictions apply:

| <u>Example 1</u> | <u>Accounting Period 1</u> | <u>Accounting Period 2</u> |
|---|-----------------------------------|-----------------------------------|
| Income from relevant trade before allowances: | 10m | 11m |
| Capital allowances available under scheme: | 9m. | 9m |
| Allowances carried forward from previous AP: | NIL | 1m |
| <u>Calculation of restriction</u> | | |
| 80% of income from relevant trade: | 8m. | 8.8m |
| <u>Computation of income</u> | | |
| Income from relevant trade before allowances: | 10m. | 11m |
| Capital allowances [restricted as above]: | 8m | 8.8m |
| Income chargeable: | 2m | 2.2m |
| Allowances carried forward to next AP: | 1m | 1.2m |

| Example 2 | Accounting Period 1 | Accounting Period 2 |
|---|----------------------------|----------------------------|
| Income from relevant trade before allowances: | 10m | 11m |
| Capital allowances due under scheme: | 7m. | 7m |
| Interest deductible under the scheme: | 3m | 3m |
| Allowances carried forward from previous Accounting Period: | NIL | 2m |
| <u>Calculation of restriction</u> | | |
| 80% of income from relevant trade: | 8m. | 8.8m |
| <u>Computation of income</u> | | |
| Income from relevant trade before allowances and interest: | 10m. | 11m |
| Capital allowances [restricted]: | 5m | 5.8m |
| Interest deductible: | 3m | 3m |
| Income chargeable: | 2m | 2.2m |
| Allowances available for carry forward: | 2m | 3.2m |

| Example 3 | Accounting Period 1 | Accounting Period 2 |
|--|----------------------------|----------------------------|
| Income from relevant trade before allowances and interest: | 10m | 11m |
| Capital allowances due under scheme: | 9m. | 9m |
| Interest deductible under the scheme: | 2m | 1m |
| Allowances carried forward from previous AP: | NIL | 3m |
| <u>Calculation of restriction</u> | | |
| 80% of income from relevant trade: | 8m. | 8.8m |
| <u>Computation of income</u> | | |
| Income from relevant trade before allowances and interest: | 10m. | 11m |
| Capital allowances [restricted]: | 6m | 7.8m |
| Interest deductible: | 2m | 1m |
| Income chargeable: | 2m | 2.2m |
| Capital allowances carried forward to next AP: | 3m | 4.2m |
| Interest carried forward to next year: | NIL | NIL |

7. What restrictions will apply in respect of interest on borrowings incurred to fund expenditure on which allowances are claimed under the scheme?

As indicated above, where a company claiming allowances on expenditure incurred on the provision of a specified intangible asset also pays interest on borrowings to fund such expenditure, the amount of such interest is included in the 80% limit on the aggregate amount of allowances and interest expense which may be set against trading income of the relevant trade for the accounting period.

The scheme also provides for a restriction on the amount of interest deductible by an investing company (under section 247 of the TCA) where that company provides funds to the company engaged in the relevant trade, either by way of subscription for share capital or the loan of money, and the latter company uses the funds to provide specified intangible assets in respect of which an allowance is to be made under the scheme. The restriction will be applied to the interest paid by the investing company on the loan - less any *chargeable* dividends, distributions (i.e. *not* franked investment income) or interest received from the other company in respect of the moneys advanced – and ensures that such interest cannot exceed the amount of interest that would have been deductible in the hands of the company engaged in the relevant trade had that latter company incurred the interest expense. Any amount of interest that has been restricted under the scheme may be carried forward to be treated as interest paid in the next accounting period of the company and so on for each succeeding period.

Example

A group company [Company A] lends money to a fellow group company [Company B] and that company uses the funds to acquire a specified intangible asset for use in its relevant trade. Interest incurred by company A on monies borrowed and advanced to IP company is 200,000 in the accounting period and the interest paid by company B in respect of the loan is NIL i.e. interest-free loan. The income of Company B from the relevant trade in the accounting period is 1,000,000. Capital allowances due under the scheme to company B are 700,000.

| Investing company A | |
|---|-----------|
| Interest incurred by company A on monies advanced to company B: | 200,000 |
| Interest paid by company B in respect of the loan: | NIL |
| Amount on which restriction is to be calculated: | 200,000 |
| Company B | |
| Income from relevant trade: | 1,000,000 |
| Restriction under scheme (80% of 1,000,000): | 800,000 |
| Computation of income for company B | |
| Income from relevant trade: | 1,000,000 |
| Capital allowances: | 700,000 |
| Income chargeable: | 300,000 |

| Restriction of interest in Company A (I.E. rework computation of Company B as if €200,000 interest incurred by Company B): | |
|---|-----------|
| Income from relevant trade: | 1,000,000 |
| 80% of income from relevant trade: | 800,000 |
| Capital allowances: | 700,000 |
| Interest deductible under scheme: | 200,000 |
| Allowances and interest: | (900,000) |
| Restriction required (set wholly against company A interest): | 100,000 |
| Interest available for carry forward in company A: | 100,000 |

8. Are there any restrictions where intangible assets are acquired as part of the acquisition of a trade or business?

There are no restrictions in such circumstances. Allowances will be available under the scheme for specified intangible assets forming part of the trade or business acquired, including any goodwill (to the extent that it can be directly attributed to other specified intangible assets). For the purposes of computing allowances, the value attributed to such assets will be in accordance with accounting standards and subject to the arm's length principle. This value should reflect the current and future income stream deriving from the asset over the asset's useful life and it will be up to the company claiming relief to demonstrate that the value attributed to particular assets is appropriate. Provision is also made in the legislation for Revenue to engage an expert, where necessary, to determine the appropriate value attributable to an asset on which relief is claimed.

9. What is the position with regard to assets (e.g. computer software, know-how and patent rights) for which relief is currently available under the Tax Acts?

- The allowances currently available for capital expenditure on the provision of **computer software** (under section 291 of the TCA) are being retained and the new scheme does *not* therefore apply to computer software.
- **Patent rights** and **know-how**
 - are being included in the new scheme,
 - the existing relief's for capital expenditure on patent rights (section 755 of the TCA) and know-how (section 768 of the TCA) are being discontinued for companies,
 - but there is provision for companies to elect for these relief's to apply for expenditure on know-how or patent rights for a 2 year period ending 7th May 2011.

10. When does the new scheme come into effect?

The new scheme applies to expenditure incurred by a company after 7 May 2009.

APPENDIX

List of Specified Intangible Assets Included in Scheme

- (a) any patent, registered design, design right or invention,
- (b) any trade mark, trade name, trade dress, brand, brand name, domain name, service mark or publishing title,
- (c) any copyright or related right within the meaning of the Copyright and Related Rights Act 2000,
- (d) any supplementary protection certificate provided under Council Regulation (EEC) No. 1768/92 of 18 June 1992¹,
- (e) any supplementary protection certificate provided for under Regulation (EC) No. 1610/96 of the European Parliament and of the Council of 23 July 1996²,
- (f) any plant breeders' rights within the meaning of section 4 of the Plant Varieties (Proprietary Rights) Act 1980, as amended by the Plant Varieties (Proprietary Rights) (Amendment) Act 1998,
- (g) know-how within the meaning of section 768 of the Taxes Consolidation Act 1997,
- (h) any authorisation without which it would not be permissible for—
 - (i) a medicine or
 - (ii) a product of any design, formula, process or invention to be sold for any purpose for which it was intended,
- (i) any rights derived from research, undertaken prior to any authorisation referred to in paragraph (h), into the effects of—
 - (i) a medicine or
 - (ii) a product of any design, formula, process or invention,
- (j) any licence in respect of an intangible asset referred to in any of paragraphs (a) to (i),
- (k) any rights granted under the law of any country, territory, state or area, other than the State, or under any international treaty, convention or agreement to which the State is a party, that correspond to or are similar to those within any of paragraphs (a) to (j), or

¹ OJ No. L198, 8.8.1996, p.30

² OJ No. L182, 2.7.1992, p.1

- (l) goodwill to the extent that it is directly attributable to anything within any of paragraphs (a) to (k).