HM Revenue & Customs

Corporation tax and income tax: disposal of stock other than in trade, and corporate intangibles

Who is likely to be affected?

Businesses liable to corporation tax and income tax.

General description of the measure

The measure clarifies the tax treatment of transfers between related or connected parties of trading stock and of intangible fixed assets.

It ensures that the correct overall value is taken into account in computing profits for tax purposes when rules imposing market value for the transfer and separate rules for transfer pricing both apply.

Policy objective

The measure will ensure that the tax rules applying to transfers of trading stock or intangible fixed assets between related parties bring into account the correct values for tax purposes. The intention is to prevent attempted avoidance by ensuring that, as far as possible, values brought into account are equivalent to those that would be achieved in a sale to an unconnected third party.

Background to the measure

The measure was announced at Summer Budget 2015.

Detailed proposal

Operative date

The measure will have effect for transfers of trading stock or intangible fixed assets made on or after 8 July 2015.

Current law

Current law in relation to transfers of stock is contained in Chapters 10 and 11 of Part 3 of Corporation Tax Act 2009 (CTA). The equivalent legislation in relation to income tax is in Chapters 11A and 12 of Part 2 of Income Tax (Trading and Other Income) Act 2005 (ITTOIA).

Current law in relation to transactions between related parties in relation to intangible fixed assets is contained in Chapter 13 of Part 8 of CTA. There is no equivalent for income tax.

These provisions ("market value rules") typically provide that transfers are treated as taking place at market value. However, the transfer pricing legislation contained in Chapter 1 of Part 4 of Taxation (International and Other Provisions) Act 2010 (TIOPA) takes priority over the market value rules, with the result that they do not apply if transfer pricing does.

Proposed revisions

Legislation will be introduced in Summer Finance Bill 2015 revising the interaction between the market value rules and Part 4 of TIOPA.

The proposed revisions ensure that transactions between related parties, within the ambit of Part 4, can remain subject to further adjustment required under the market value rules in CTA or ITTOIA. The amendments ensure that between them the amended rules will bring into overall charge, as intended, an amount not less than the market value of the trading stock or intangible asset that has been transferred.

Summary of impacts

<table>
<tr><td rowspan="3">Exchequer impact (£m)</td><td>2015-16</td><td>2016-17</td><td>2017-18</td><td>2018-19</td><td>2019-20</td><td>2020-21</td></tr>
<tr><td>+ 15</td><td>+ 30</td><td>+ 30</td><td>+ 20</td><td>+ 15</td><td>+15</td></tr>
<tr><td colspan="6">These figures are set out in Table 2.1 of Summer Budget 2015 and have been certified by the Office for Budget Responsibility. More details can be found in the policy costings document published alongside Summer Budget 2015.</td></tr>
<tr><td>Economic impact</td><td colspan="6">This measure is not expected to have any significant macroeconomic impacts.

The costing reflects a behavioural response by the population impacted by this measure.</td></tr>
<tr><td>Impact on individuals, households and families</td><td colspan="6">There is no impact on individuals and households because this is a change that affects businesses only. The measure is not expected to impact on family formation, stability or breakdown.</td></tr>
<tr><td>Equalities impacts</td><td colspan="6">The government does not consider this will have a detrimental impact on particular protected groups.</td></tr>
<tr><td>Impact on business including civil society organisations</td><td colspan="6">This measure clarifies the law on transfers of stock or intangible assets between related parties. There is expected to be no additional on-going burden to businesses and civil society organisations, although those businesses affected by the legislation may incur a negligible one-off cost of familiarising themselves with the measure.</td></tr>
<tr><td>Operational impact (£m) (HMRC or other)</td><td colspan="6">The additional costs for HMRC for implementing this change is anticipated to be negligible.</td></tr>
<tr><td>Other impacts</td><td colspan="6"><u>Small and micro business assessment</u>: this measure clarifies the law on transfers of stock or intangible assets between related parties. There is expected to be no additional on-going burden to businesses, although businesses affected by the legislation may incur a negligible one-off cost of familiarising themselves with the measure.

Other impacts have been considered and none have been identified.</td></tr>
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Monitoring and evaluation

This measure will be kept under review through communication with affected taxpayer groups.

Further advice

If you have any questions about this change, please contact Mark Bingham on 03000 511496 (email: mark.bingham@hmrc.gsi.gov.uk), or Kieran Jordan on 03000 524811 (email: kieran.jordan@hmrc.gis.gov.uk).

1 Changes in trading stock not made in course of trade

(1) In section 161 of CTA 2009 (changes in trading stock: transfer pricing rules to take precedence), after subsection (1) insert—

"(1A) Subsection (1B) applies in relation to a disposal or acquisition if—

(a) by virtue of subsection (1), section 159 or 160 does not apply, and

(b) the market value amount is greater than the Part 4 TIOPA amount.

(1B) An amount equal to the market value amount less the Part 4 TIOPA amount is to be brought into account in calculating the profits of the trade (in addition to the Part 4 TIOPA amount).

(1C) In subsections (1A) and (1B)—

"market value amount" means the amount referred to in section 159(2)(a) or 160(2)(a);

"Part 4 TIOPA amount" means the amount which, following the application of Part 4 of TIOPA 2010 to the relevant consideration, is brought into account in respect of the relevant consideration in calculating the profits of the trade."

(2) In section 172F of ITTOIA 2005 (changes in trading stock: transfer pricing rules to take precedence), after subsection (1) insert—

"(1A) Subsection (1B) applies in relation to a disposal or acquisition if—

(a) by virtue of subsection (1), section 172D or 172E does not apply, and

(b) the market value amount is greater than the Part 4 TIOPA amount.

(1B) An amount equal to the market value amount less the Part 4 TIOPA amount is to be brought into account in calculating the profits of the trade (in addition to the Part 4 TIOPA amount).

(1C) In subsections (1A) and (1B)—

"market value amount" means the amount referred to in section 172D(2)(a) or 172E(2)(a);

"Part 4 TIOPA amount" means the amount which, following the application of Part 4 of TIOPA 2010 to the relevant consideration, is brought into account in respect of the relevant consideration in calculating the profits of the trade."

(3) The amendments made by this section apply in relation to a disposal or acquisition made on or after 8 July 2015, unless it is made pursuant to an obligation, under a contract, that was unconditional before that date.

(4) For the purposes of subsection (3), an obligation is "unconditional" if it may not be varied or extinguished by the exercise of a right (whether under the contract or otherwise).

2 Valuation of trading stock on cessation

(1) In section 162 of CTA 2009 (valuation of trading stock on cessation), after subsection (2) (transfer pricing rules to take precedence) insert—

"(2A) Subsection (2B) applies if—

(a) by virtue of subsection (2), no valuation of the stock under this Chapter is required, and

(b) the market value of the stock is greater than the Part 4 TIOPA amount.

(2B) An amount equal to the market value of the stock less the Part 4 TIOPA amount is to be brought into account in calculating the profits of the trade (in addition to the Part 4 TIOPA amount).

(2C) In subsections (2A) and (2B)—

"market value", in relation to stock, is the value the stock would have been determined to have if it had been valued in accordance with sections 164 to 167, and

"Part 4 TIOPA amount" is the amount which, following the application of Part 4 of TIOPA 2010 in relation to the provision referred to in subsection (2), is brought into account in respect of that provision in calculating the profits of the trade."

(2) In section 173 of ITTOIA 2005 (valuation of trading stock on cessation), after subsection (2) (transfer pricing rules to take precedence) insert—

"(2A) Subsection (2B) applies if—

(a) by virtue of subsection (2), no valuation of the stock under this Chapter is required, and

(b) the market value of the stock is greater than the Part 4 TIOPA amount.

(2B) An amount equal to the market value of the stock less the Part 4 TIOPA amount is to be brought into account in calculating the profits of the trade (in addition to the Part 4 TIOPA amount).

(2C) In subsections (2A) and (2B)—

"market value", in relation to stock, is the value the stock would have been determined to have if it had been valued in accordance with sections 175 to 178, and

"Part 4 TIOPA amount" is the amount which, following the application of Part 4 of TIOPA 2010 in relation to the provision referred to in subsection (2), is brought into account in respect of that provision in calculating the profits of the trade."

(3) The amendments made by this section apply in relation to a cessation of trade on or after 8 July 2015.

3 Transfer of intangible assets not at arm's length

(1) In section 846 of CTA 2009 (transfers of intangible assets not at arm's length),

after subsection (1) insert—

“(1A) Subsection (1B) applies in relation to the transfer of an intangible asset where—

(a) by virtue of subsection (1), section 845 does not apply, and

(b) the market value of the asset is greater than the Part 4 TIOPA amount.

(1B) An amount equal to the market value of the asset less the Part 4 TIOPA amount is to be brought into account for the purposes of corporation tax in relation to the transfer (in addition to the Part 4 TIOPA amount).

(1C) In subsections (1A) and (1B)—

“market value”, in relation to an asset, has the meaning given in section 845(5);

“Part 4 TIOPA amount” means the amount which, following the application of Part 4 of TIOPA 2010 in relation to the consideration for the transfer, is brought into account in respect of the consideration for the purposes of corporation tax.”

(2) The amendment made by this section applies in relation to a transfer which takes place on or after 8 July 2015, unless it takes place pursuant to an obligation, under a contract, that was unconditional before that date.

(3) For the purposes of subsection (2), an obligation is “unconditional” if it may not be varied or extinguished by the exercise of a right (whether under the contract or otherwise).

Explanatory Note

Clause 1: Changes in trading stock not made in course of trade

Summary

1. This clause amends legislation that applies where trading stock is acquired or disposed of other than by way of trade. It ensures that where transfer pricing rules apply to the acquisition or disposal (whether or not those rules actually give an adjustment) there can also be a further adjustment if necessary to ensure that the acquisition or disposal proceeds are recognised at full market value for tax purposes. It applies to acquisitions or disposals of trading stock made on or after 8 July 2015. Related changes are made by clauses 2 and 3.

Details of the clause

2. <u>Clause 1</u> amends section 161 of the Corporation Tax Act 2009 (CTA 2009) and section 172F of the Income Tax (Trading and Other Income) Act (ITTOIA) 2005.

3. <u>Subsection (1)</u> inserts new <u>subsections (1A), (1B) and (1C)</u> into section 161 of CTA 2009.

4. <u>New subsection (1A)</u> of section 161 of CTA 2009 ensures that, where the transfer pricing rules of Part 4 of the Taxation (International and Other Provisions) Act (TIOPA) 2010 apply, there can also be an adjustment or further adjustment under section 161. This is to ensure that the minimum amount to be brought into account for the acquisition or disposal of the trading stock in computing profits for corporation tax purposes is the market value. The subsection compares the market value amount that should be recognised for the acquisition or disposal with the amount actually recognised for the acquisition or disposal, having applied the transfer pricing rules. If the market value amount is the higher of the two amounts, <u>subsection (1B)</u> then applies.

5. <u>New subsection (1B)</u> of section 161 of CTA 2009 directs that, if the market value amount is greater than the transfer pricing amount, a further adjustment is made to ensure that the amount recognised for tax purposes in respect of the acquisition or disposal is the market value.

6. <u>New subsection (1C)</u> of section 161 of CTA 2009 defines the two key amounts - the market value amount, and the amount brought into account after the application of Part 4 of TIOPA 2010.

7. <u>Subsection (2)</u> inserts <u>new subsections (1A), (1B) and (1C)</u> into section 172F of ITTOIA 2005, to achieve the same effect for income tax as the new subsections (1A), (1B) and (1C) of section 161 of CTA 2009 have for corporation tax.

8. <u>Subsection (3)</u> sets out the commencement rule. The changes have effect for acquisitions or

disposals made on or after 8 July 2015, unless they were made to meet an obligation, under a contract, which was unconditional before 8 July 2015.

9. Subsection (4) defines when a contract is unconditional for the purposes of the commencement rule in subsection (3).

Background note

10. When a business acquires or disposes of trading stock other than through its normal business, specific tax rules apply. The aim of those rules is to ensure that the full value of the stock is brought into account in computing profits for income tax and corporation tax purposes. The starting point for computing taxable profits is the profit shown in the accounts of the business, drawn up in accordance with recognised accounting practice. However, accounting rules do not always bring into account the market value. Tax legislation therefore provides for an adjustment to be made.

11. It is also possible that the transfer pricing rules in Part 4 of TIOPA 2010 could apply. The outcome reached under transfer pricing could be lower than the market value that would be given by the CTA 2009 or ITTOIA 2005 rules. However, because the transfer pricing rules apply, the rules in CTA 2009 and ITTOIA 2005 are prevented from applying. The result is that the full value might not be brought into account for tax because of the way the transaction is treated in the accounts.

12. This change ensures that the amount recognised for tax purposes for the acquisition or disposal is never less than the market value. Similar changes are made by clause 2 on the cessation of a trade, and by clause 3 in connection with the transfer of intangible fixed assets.

Explanatory Note

Clause 2: Valuation of trading stock on cessation

Summary

1. This clause amends the legislation that applies where trading stock needs to be valued for tax purposes on the cessation of a trade. It ensures that where the transfer pricing rules apply to the value in connection with the cessation of a trade, there can also be a further adjustment if necessary to ensure that the full value of the stock is brought into account for tax purposes. It will apply to a cessation of a trade occurring on or after 8 July 2015. Related changes are made by clause 1 and clause 3.

Details of the clause

2. Clause 2 amends section 162 of the Corporation Tax Act 2009 (CTA 2009) and section 173 of the Income Tax (Trading and Other Income) Act (ITTOIA) 2005.

3. Subsection (1) inserts new subsections (2A), (2B) and (2C) into section 162 of CTA 2009.

4. New subsection (2A) of section 162 of CTA 2009 ensures that, where the transfer pricing rules of Part 4 of the Taxation (International and Other Provisions Act) (TIOPA) 2010 apply, there can also be an adjustment or further adjustment under section 162 of CTA 2009. This ensures that the value of the trading stock to be used in computing profits for corporation tax purposes is the full value, determined under sections 164 to 167 of CTA 2009. The subsection compares the market value that should be recognised on the cessation with the amount actually recognised, having applied the transfer pricing rules. If the market value is the higher of the two amounts, subsection (2B) then applies.

5. New subsection (2B) of section 162 of CTA 2009 directs that, if the market value is greater than the transfer pricing amount, a further adjustment is made to ensure that the amount recognised for tax purposes is equal to the market value.

6. New subsection (2C) of section 162 of CTA 2009 defines the two key amounts - the market value, and the amount brought into account after the application of Part 4 of TIOPA 2010.

7. Subsection (2) inserts new subsections (2A), (2B) and (2C) into section 173 of ITTOIA 2005, to achieve the same effect for income tax as the new subsections (2A), (2B) and (2C) of section 162 of CTA 2009 have for corporation tax.

8. Subsection (3) sets out the commencement rule. The changes have effect for a cessation of a trade that takes place on or after 8 July 2015.

Background note

9. When a business ceases, it is necessary to bring into account a value for the remaining trading stock in computing the profit or loss of the business. There are different bases for calculating the value depending on what happens to the trading stock. Those rules are contained in sections 163 to 167 of CTA 2009 (for corporation tax), and in sections 173 to 178 of ITTOIA 2005 (for income tax).

10. It is also possible that the transfer pricing rules in Part 4 of TIOPA could apply to the value of the trading stock on cessation. The outcome reached under transfer pricing could be lower than the value that would be given by the CTA 2009 or ITTOIA 2005 rules. However, because the transfer pricing rules apply, the rules in CTA 2009 and ITTOIA 2005 are prevented from applying. The result is that the full value might not be brought into account for tax because of the way the transaction is treated in the accounts.

11. This change ensures that where the transfer pricing rules of TIOPA apply, an adjustment or further adjustment can also be made under section 162 of CTA 2009 or section 173 of ITTOIA 2005 to ensure that not less than the full value of trading stock is brought into account on the cessation of a trade.

12. Similar changes are made by clause 1 in connection with trading stock transferred otherwise than at arm's length, and by clause 3 in connection with transfers of intangible fixed assets.

Explanatory Note

Clause 3: Transfer of intangible assets not at arm's length

Summary

1. This clause amends the legislation that applies when intangible fixed assets need to be valued for tax purposes when they are transferred between related parties. It ensures that where transfer pricing applies, there can also be a further adjustment if necessary to ensure that the full market value of the asset is brought into account for tax purposes. The change applies to a transfer of intangible assets made on or after 8 July 2015. Related changes are made by clauses 1 and 2.

Details of the clause

2. Clause 3 amends section 846 of the Corporation Tax Act (CTA) 2009.

3. Subsection (1) inserts new subsections (1A), (1B) and (1C) into section 846 of CTA 2009.

4. New subsection (1A) of section 846 of CTA 2009 ensures that, where the transfer pricing rules of Part 4 of the Taxation (International and Other Provisions) Act (TIOPA) 2010 apply, there can also be an adjustment or further adjustment under section 846 of CTA 2009. This ensures that an amount equivalent to the full market value of the intangible asset is used in computing profits for corporation tax purposes. The subsection compares the market value that should be recognised on the transfer of the asset with the amount actually recognised, having applied the transfer pricing rules. If the market value is the higher of the two amounts, subsection (1B) then applies.

5. New subsection (1B) of section 846 of CTA 2009 directs that, if the market value amount is greater than the transfer pricing amount, a further adjustment is made to ensure that the amounts recognised for tax purposes in respect of the transfer of the asset are equal to the market value.

6. New subsection (1C) of section 846 of CTA 2009 defines the two key amounts - the market value, and the amount brought into account after the application of Part 4 of TIOPA 2010.

7. Subsection (2) sets out the commencement rule. The changes have effect for transfers of intangible fixed assets to which section 846 applies that are made on or after 8 July 2015, unless they were made to meet an obligation, under a contract, that was unconditional before 8 July 2015.

8. Subsection (3) defines when an obligation is regarded as unconditional for the purposes of the commencement rule in subsection (2).

Background note

9. When a company transfers intangible fixed to a related party, specific tax rules apply (sections 845 and 846 of CTA 2009). The aim of those rules is to ensure that the full value of the assets is brought into account in computing profits for corporation tax purposes.

10. It is also possible that the transfer pricing rules in Part 4 of TIOPA 2010 could apply. The amount recognised after the application of the transfer pricing rules could be lower than the market value, because of the way that the transaction is treated in the accounts. This could have the result that less than the market value is brought into account for tax.

11. This change ensures that where transfer pricing rules apply, an adjustment can be made under section 845 of CTA 2009 to ensure that not less than the market value of the transferred assets is brought into account for corporation tax purposes.

12. Similar changes are made by clause 1 on the transfer of trading stock otherwise by way of trade, and by clause 2 in connection with the cessation of a trade.