HM Revenue & Customs

Capital v Revenue Expenditure Toolkit

2019-20 Self Assessment and Company Tax Returns

Published April 2020

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Introduction

Tax agents and advisers play an important role in helping their clients to get their tax returns correct. This toolkit is aimed at helping and supporting tax agents and advisers by providing guidance on the errors which we find commonly occur in relation to Capital v Revenue expenditure. It may also be helpful to anyone who is completing an Income Tax Self Assessment tax return or Company Tax return.

This toolkit should be used for financial years commencing 1 April 2019 for Company Tax returns and 6 April 2019 for Income Tax Self Assessment tax returns. Its use is entirely voluntary.

The content of this toolkit is based on HMRC's view of how tax law should be applied. Its application to specific cases will depend on the law at the relevant time and on the precise facts.

This version of the Toolkit was published in April 2020. The risks in this toolkit have been reviewed and updated where necessary for 2019-20.

For further information on using this toolkit and reasonable care under HMRC's penalty system see **Tax agent’s toolkits**.

For guidance on matters not dealt with in this toolkit you should refer to the **Business Income Manual (BIM)**.

Areas of risk within Capital v Revenue expenditure

‘Capital v Revenue expenditure’ is a term used throughout this toolkit. It refers to the distinction of capital from revenue expenditure for tax purposes. Expenditure that is capital is generally not allowable as a revenue deduction in computing taxable profits. Depending on the nature of the capital expenditure it may be possible to claim capital allowances.

There is no single, simple test that can be applied to decide which items are capital expenditure and which are revenue. This can only be determined by reference to the relevant facts that applied at the time the expenditure was incurred. In addition the classification of items as capital or revenue expenditure is intrinsically linked to the particular circumstances and the exact nature of the trade. The same item may correctly be categorised as capital in one trade, and as trading stock in another.

This toolkit does not reflect the cash basis which is available from 2013-14 for the simplest small businesses. For further information see **BIM70000+**.

Areas of risk within Capital v Revenue expenditure fall broadly into the following categories:

Record keeping

Good record keeping is essential as poorly kept records can contribute to difficulties in identifying whether a transaction is capital or revenue and treated correctly for tax purposes. It is therefore desirable to plan a system of record keeping that reflects the nature of expenditure clearly.

The distinction between capital or revenue expenditure for tax purposes can be complex and it is therefore important to consider the records kept and the business circumstances, for example whether the business has expanded, relocated or restructured during the accounting period or even merely attempted to do so.

For further guidance on record keeping see **Records for Corporation Tax**.

Acquisition, improvement and alteration of assets

Risks relating to the allocation of expenditure to revenue rather than capital will often arise from work done in the course of the purchase, refurbishment or repair of an asset. For example business premises may be acquired or altered, or other fixed assets may be purchased or improved.

It can be difficult to identify that apparently similar items of expenditure should be treated differently, particularly where there are many invoices to be considered, or the exact nature of the work carried out is not immediately apparent.

Legal and professional fees

Legal and professional fees can be incurred for a wide variety of reasons, for example on the acquisition of property or other assets, or on changing the way the ownership of the business is structured. In some cases the fees will be related to capital transactions and so will not be allowable as revenue expenditure.

Finance costs

It is important to be aware of what is included in finance charges, and then to consider which factors may be relevant in deciding whether they are capital or revenue, and to what extent.

Transactions relating to corporate lending and borrowing are the subject of specific rules however, the aim of which is broadly to follow generally accepted accountancy practice ('GAAP') in recognising receipts and expenses relating to corporate debt. Under the tax rules for corporate debt, no distinctions are made between capital and revenue items.

IT costs

It can be difficult to distinguish the function that computer hardware, software and information technology perform in the business, what kind of asset they represent, or how the costs associated with them should be handled in the accounts and tax computations. There are a number of complexities to consider for expenditure in this area.

Corporate intangible assets

The corporate intangible assets regime represents a significant departure from the previous rules governing the capital or revenue treatment of intangible assets. The regime affects assets created or acquired by companies on or after 1 April 2002. In general, the tax rules relating to these assets follow the treatment of generally accepted accountancy practice ('GAAP'). So for example, disposal proceeds on qualifying intangible assets would, subject to any statutory provisions, follow GAAP. Similarly, if expenditure on qualifying assets is written off, normally by way of amortisation, the deduction for tax purposes will generally also follow GAAP. However, changes to the regime made in 2014, 2015 and 2019 now mean that the tax deductions for goodwill amortisation are more limited.

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Blue underlined text are links within this document.

Green bold text are hyperlinks to external documents on the internet (access to the internet is necessary to view these).

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Giving HMRC feedback on toolkits

HMRC would like to hear about your experience of using the toolkits to help develop and prioritise future changes and improvements. HMRC is also interested in your views of any recent interactions you may have had with the department.

Send HMRC your feedback

Client Name:	Period Ended:

Checklist for Capital v Revenue expenditure

		Yes	No	N/A	N/K
	Acquisition, improvement and alteration of assets				
1	Has all capital expenditure on the purchase of assets been identified and allocated appropriately?	☐	☐	☐	☐
2	Have all items of expenditure on the improvement or alteration of an asset been treated correctly?	☐	☐	☐	☐
3	Has any expenditure on essential repairs to a newly acquired asset been treated correctly?	☐	☐	☐	☐
4	Has any incidental expenditure incurred when acquiring or disposing of an asset been treated correctly?	☐	☐	☐	☐
	Legal and professional fees				
5	Has any expenditure on an unsuccessful attempt to obtain an asset or other advantage for the enduring benefit of the business been treated correctly?	☐	☐	☐	☐
6	Has any expenditure incurred in connection with the capital structure of the business been treated correctly?	☐	☐	☐	☐

Legal and professional fees continued

7 Have any costs incurred on the recruitment of additional partners to a partnership been treated correctly?

☐ ☐ ☐ ☐

8 Have any costs incurred on training for the proprietor or a partner in the business been treated correctly?

☐ ☐ ☐ ☐

Finance costs

9 Where any financial payment includes a capital element has it been treated correctly?

☐ ☐ ☐ ☐

10 Have all payments made by a proprietor or partnership to acquire a franchise been treated correctly?

☐ ☐ ☐ ☐

11 Are the arrangement fees for any long term security correctly spread over the lifetime of the security in accordance with GAAP?

☐ ☐ ☐ ☐

IT costs

12 Has the cost of any computer software acquired been treated correctly?

☐ ☐ ☐ ☐

13 Has any expenditure incurred on website development been allocated correctly?

☐ ☐ ☐ ☐

Corporate intangible assets

14 Has the correct tax treatment been followed for any amortisation of goodwill acquired by a company?

☐ ☐ ☐ ☐

15 Has the correct tax treatment been followed for the transfer or licencing of an asset within the corporate intangible assets regime either to or from a related party?

☐ ☐ ☐ ☐

General

16 Has depreciation been added back to the accounts profit in the tax computation?

☐ ☐ ☐ ☐

Explanation and mitigation of risks

Acquisition, improvement and alteration of assets

1. Has all capital expenditure on the purchase of assets been identified and allocated appropriately?

Risk
Capital expenditure on the purchase of assets may have been charged to the profit and loss account, for example, fixtures and fittings included in repairs and renewals, expenditure on items of computer hardware included in IT costs, or vehicles purchased included in motoring expenses.

Mitigation
Consider whether any items of capital expenditure on the purchase of assets might have been treated as revenue expenditure in the profit and loss account. Developments in the business, such as relocation or expansion, may suggest potential areas in which this may have occurred.

A review of accounts such as repairs and renewals, other expenses, motoring expenses etc. may reveal items of a capital nature, which are not allowable as revenue expenditure. However a capital allowances claim may be possible.

For further guidance on distinguishing capital from revenue expenditure see **BIM35005+**.

For further guidance on capital allowances see the **Capital Allowances Manual (CA)**.

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2. Have all items of expenditure on the improvement or alteration of an asset been treated correctly?

Risk
When a business carries out refurbishment of an existing or newly acquired asset, such as a property, some or all of the expenditure may relate to improvement or alteration of the asset. This expenditure will normally be capital for tax purposes, but it may have been included in repairs and renewals or other profit and loss account headings in the accounts. It is not possible to treat some of the expenditure on improvements as ‘notional repairs’.

Specific attention may be required in respect of the integral features rules. See explanation below.

Mitigation
Where a business carries out work to repair or refurbish either a new or an existing asset, review the expenditure to identify any items that represent improvements or alterations rather than repairs and ensure that they are treated as capital expenditure as appropriate for tax purposes.

Explanation
A repair to an asset restores it to what it originally had been and is normally an allowable revenue expense. For example the cost of replacing roof tiles blown off by a storm. The cost of alterations, however, are normally capital for tax purposes as they involve improving or changing an asset and so providing an enduring benefit to the business, rather than simply restoring it to its previous state. For example extending the area of the roof or taking off the roof and building another storey.

For further guidance see **BIM46900+**.

A repair or replacement of a part of an asset using modern materials may look like an improvement, but if the new materials are broadly equivalent to the old materials then the cost is normally an allowable expense. For example, replacing single-glazed windows with double glazed windows. For further guidance on using different materials see **BIM46925**.

If the work results in the renewal or replacement of an asset as a whole, then all of the expenditure incurred should be treated as capital expenditure.

The importance of good record keeping is also relevant in cases where it may be possible to apportion the total of the expenditure between capital and revenue. For example a debit in the profit and loss account may read "building works" in an amount of £100,000. However an analysis of the detailed invoices may indicate that £40,000 was spent on an identifiable improvement of the building, which would correctly be capital in nature and the balance of £60,000 was identified as revenue expenditure. This would allow for an acceptable apportionment of the total expended of £100,000 and result in the balance of £60,000 being a revenue expense of the business as repairs.

Where the records kept do not allow for such an apportionment to be identified then all the expenditure will be treated as capital. An example of mixed expenditure could be legal fees incurred in relation to a planning permission application, part of which involves new or extended planning permissions (capital) and part of which relates to a renewal of an existing planning permission (revenue) If the invoices do not split the legal fees incurred between these two elements, then, ordinarily, all the legal fees should be treated as being capital in nature.

The possibility of expenditure on improvement or alteration should particularly be considered where a newly acquired asset is being subjected to a change of use, and therefore needs to be altered to adapt it for its new purpose.
For further guidance on improvements and alterations see **BIM46915**.

There are also special rules relating to expenditure on specified parts of buildings called ‘integral features’. The following are integral features:

- an electrical system (including a lighting system)
- a cold water system
- a space or water heating system, a powered system of ventilation, air cooling or air purification, and any floor or ceiling comprised in such a system
- a lift, an escalator or a moving walkway
- external solar shading.

Under these rules if expenditure on an integral feature represents the whole, or more than 50%, of the cost of replacing the integral feature, then the whole of the expenditure is to be treated as capital expenditure on the replacement of an integral feature for capital allowances purposes. No deduction is then available for the expenditure in computing the profits of the trade (except under the capital allowances rules).

For further guidance see **CA22310+** and **CA22340**.

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3. Has any expenditure on essential repairs to a newly acquired asset been treated correctly?

Risk
If an asset cannot be used as soon as it is acquired because of its poor condition and the purchase price was substantially reduced to reflect the need for repairs, then the cost of those repairs may be capital expenditure.

Mitigation
Identify any instances where the business has acquired an asset at a reduced cost because essential repairs are required, and the business is prevented from bringing the asset into use until the repair work is done. Consider whether these repair costs should be treated as capital expenditure.

Explanation
There are circumstances in which the cost of repairs may constitute capital expenditure even though the work does not improve the asset but merely restores it to an acceptable condition.

Factors that may be relevant are:

- whether the asset could be used in the business without being repaired
- whether the asset could only be used in the short term as its long term use was dependent upon the repairs being carried out
- whether the purchase price of the asset was substantially reduced because the asset needed repairing.

Example
A business purchases a vehicle that has failed its MoT and cannot be used; this was reflected in the purchase price. Carrying out the repairs necessary to obtain a MoT certificate will not improve the vehicle. However it will contribute to the cost of acquiring an asset of lasting benefit to the business. In these circumstances the cost of the repairs constitute capital expenditure for tax purposes and a revenue deduction is not available in computing the taxable profits. However a capital allowances claim may be possible.

For further guidance see **BIM46915** and **BIM35450+**.

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4. Has any incidental expenditure incurred when acquiring or disposing of an asset been treated correctly?

Risk
Incidental expenditure incurred when acquiring or disposing of an asset should be treated as capital expenditure. The most common example of such expenditure is legal and professional fees incurred in acquiring or disposing of an asset. Incidental expenditure may also include the cost of such items as the transportation and installation of the asset.

Mitigation
Consider whether any incidental costs have arisen as a consequence of the acquisition of new assets or the disposal of assets. Review the profit and loss account for any such incidental costs of a capital nature, and ensure that they are treated appropriately.

Explanation
Expenses incurred in the course of capital transactions are not allowable as revenue expenditure, except where incurred by a company in relation to intangible assets, where the corporate intangible assets regime may apply.

For further guidance on the corporate intangible assets regime see **BIM35501** and **Corporate Intangibles Research & Development Manual (CIRD) CIRD10000**.

Costs such as Stamp Duty or legal and professional fees, for example architects', engineers' or surveyors' costs, incurred when acquiring or disposing of an asset should be treated as capital expenditure.

Costs incurred in bringing a new asset into use, such as transporting it to its intended site or erecting and installing it should also be capitalised as part of the cost of the asset. However the cost of removing trading stock, stores, equipment or plant and machinery for the purpose of relocation to new premises will generally be allowable in computing the taxable profits, where the relocation is not part of a more general plan to expand the business.

For further guidance see **BIM42530**.

Professional fees, such as legal costs, survey fees, architects' fees, or quantity surveyors' fees, may qualify for capital allowances as expenditure on the provision of plant or machinery if they relate directly to the acquisition, transport and installation of the plant or machinery.

For further guidance see **CA20070**.

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Legal and professional fees

5. Has any expenditure on an unsuccessful attempt to obtain an asset or other advantage for the enduring benefit of the business been treated correctly?

Risk
When a business incurs expenditure on an unsuccessful attempt to obtain an asset or other advantage that will be of enduring benefit to the business the expenditure is classified as capital for tax purposes, just as it would have been if the attempt were successful.

Mitigation
Establish whether the business was involved in any unsuccessful attempt to obtain an asset or other advantage for enduring benefit of the business during the period, and if so whether any related legal and professional fees or other costs incurred are capital for tax purposes. These costs are not allowable as revenue expenditure for tax purposes, except where the corporate intangibles regime applies.

Explanation
Incidental expenditure incurred in trying to obtain something that will be of enduring benefit to the business is normally not deductible for tax purposes, even if the attempt was unsuccessful. The costs incurred in these circumstances are sometimes known as ‘abortive expenditure’.

A typical example of ‘obtaining something of enduring benefit’ is the acquisition of an asset, but it may also mean trying to dispose of, or alter a burdensome asset, if the advantage delivered by doing so is sufficiently enduring.

An example of abortive expenditure, depending on the nature of the trade, is the cost of an unsuccessful planning application. If the application is successful the expenditure will be capitalised. Where the application fails, and no asset is acquired or modified, the expenditure will normally be charged to the profit and loss account, but should be treated as capital expenditure for tax purposes.

For further guidance see **BIM35325**.

However where the abortive expenditure relates to an attempt to obtain an intangible asset by a company, rather than a sole trader or partnership, the expenditure may be covered by the corporate intangible assets regime, in which case the accounting treatment may be followed for tax purposes.

For further guidance on the corporate intangible assets regime see **BIM35501** and **CIRD10000**.

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6. Has any expenditure incurred in connection with the capital structure of the business been treated correctly?

Risk
Legal and professional fees incurred in connection with changes in how the ownership of a business is structured are generally regarded as capital for tax purposes and not allowable as a revenue deduction. For example, changing from a sole trader or partnership to a limited company is a change in the capital structure of a business, as is a change in the membership of a partnership.

Mitigation
Establish if any legal and professional fees have been incurred on issues relating to the ownership or capital structure of the business, and ensure they have been treated correctly.

Explanation
Fees incurred in connection with the acquisition, alteration or enhancement of how the ownership of a business is structured should generally be disallowed. This will include costs incurred on items such as the following:

- forming, varying or dissolving a partnership
- the incorporation of a sole trader's or a partnership's business
- a partnership becoming a limited liability partnership
- defending a petition by shareholders to wind up a company.

For further guidance see **BIM46435**.

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7. Have any costs incurred on the recruitment of additional partners to a partnership been treated correctly?

Risk
Costs incurred by a partnership on recruiting new partners will normally be allowable as revenue expenditure. However, there are some circumstances in which these costs may be viewed as capital expenditure for tax purposes and so would not be allowable as a revenue deduction.

Mitigation
Where a partnership has incurred expenditure on the recruitment of a new partner or partners, check the circumstances surrounding the recruitment. Examples of where it may be necessary to consider whether the recruitment costs are capital expenditure include:

- Where the admission of the partner has a fundamental impact on the structure of the firm's business. However this must involve more than a mere expansion of the business
- Where the partner is recruited as part of the acquisition of a business
- Where the new partner's capital contribution is a material factor in the recruitment.

In any of these circumstances however, whether or not the costs of recruitment are capital expenditure will be a question of fact and degree

Explanation
In general, the cost of recruiting both equity and salaried partners to a partnership, whether they are replacement or additional partners, is revenue expenditure. In most cases the firm is paying to recruit a fee earner, who will generate profits for the firm, not to change the firm's structure or to obtain a capital contribution. It is only where there is a significant additional factor relevant to the recruitment of a partner, such as those outlined above, where consideration may need to be

given as to whether the expenditure is capital and therefore not allowable as a revenue deduction.

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8. Have any costs incurred on training for the proprietor or a partner in the business been treated correctly?

Risk
In some circumstances where costs are incurred on training and development for a proprietor or partner acquiring new skills etc., these may be regarded as capital expenditure for tax purposes and therefore not allowable as a revenue deduction.

Mitigation
Establish whether training and development undertaken by business proprietors or partners is to update expertise which they already possess, or to give them new expertise, knowledge or skills. In the latter case, if the training brings into existence an advantage of sufficiently enduring benefit the expenditure incurred may be capital for tax purposes and if so not allowable as a revenue deduction.

Explanation
In addition to the Capital v Revenue expenditure test, to be allowable the costs of training and development for the proprietors or partners must also be incurred wholly and exclusively for the purpose of the trade or profession at the time the training is undertaken. For example, where a completely new specialisation or qualification is acquired as a result of the expenditure, it is possible that the expenditure will not be wholly and exclusively for the purposes of the existing trade. Consideration should therefore be given to the allowability of the expenditure on the basis of the 'wholly and exclusively' test as well as Capital v Revenue grounds.

For further guidance see **BIM42526** and **BIM35660**.

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Finance costs

9. Where any financial payment includes a capital element has it been treated correctly?

Risk
Payments made in respect of finance costs, for example a mortgage, hire purchase (HP) agreement or leasing of assets used in the business may include both capital and revenue elements. Following the generally accepted accounting practice for any particular financial obligation will normally ensure that only the revenue element is allowed under income tax Self Assessment.

Mitigation
Review any expenditure charged to the profit and loss account in respect of finance payments, such as for mortgage, HP or leasing costs. Identify the exact nature of any such finance payments, and the generally accepted accounting practice that is appropriate in respect of each of them. Following the generally accepted accounting practice will normally produce the correct allocation of expenditure to capital or revenue for tax purposes.

If any interest has been capitalised as part of the initial asset costs, relief may be available for tax purposes by means of an adjustment in the tax computation.

For further guidance see **BIM45665+** and **BIM45351**.

Transactions relating to corporate lending and borrowing are subject to specific rules on the taxation of loan relationships, under which relief is typically allowed for both revenue and capital elements.

For further guidance see **Corporate Finance Manual (CFM) CFM30150**, **CFM30170** and **CFM33160**.

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10. Have all payments made by a proprietor or partnership to acquire a franchise been treated correctly?

Risk
An initial payment made by a sole trader or partnership for the acquisition of a franchise is usually capital expenditure, as are any related legal fees. This is the case whether the payment is made in one sum or in instalments over a period of years.

Deductions should not be made on the basis that elements of the initial payment relate to allowable revenue expenditure for specific services, unless they are clearly supported by both the franchise agreement and the facts.

Mitigation
Ensure that all payments relating to an initial fee are treated as capital expenditure, and that any deductions made in the accounts for amortisation are added back. Review legal and professional fees and disallow any costs associated with the acquisition of the franchise. Consider the franchise agreement and the facts before seeking any alternative deduction on the basis that an element of the initial payment is deductible in respect of actual services provided.

Explanation
Generally the annual fees payable in respect of a franchise agreement will be an allowable revenue expense. The initial payment however, together with any related legal fees, is usually capital expenditure for tax purposes and not allowable as a revenue deduction. An initial fee for the acquisition of a franchise will still be capital expenditure even if it is paid by instalments over a number of years.

In some cases a deduction may be possible for an element of the initial payment on the basis that it relates to the provision of services by the franchisor, but only if both of the following conditions are met:

- specific services are actually provided by the franchisor in accordance with the franchise agreement
- the agreement stipulates that these services are paid for by reference to the initial payment and not the annual fees.

and then only to the extent that the amount allocated to revenue expenditure is commensurate with the services provided.

For companies, initial payments for franchises may be covered by the corporate intangible assets regime, and accordingly their amortisation over the lifetime of the franchise agreement is normally allowable.

For further guidance see **BIM57600+**.

For further guidance on the corporate intangible assets regime see **BIM35501** and **CIRD10000**.

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11. Are the arrangement fees for any long term security correctly spread over the lifetime of the security in accordance with GAAP?

Risk
Fees paid for the arrangement of long term loans or securities will generally be spread over the lifetime of the loan in accordance with generally accepted accounting practice.

For companies, generally accepted accounting practice for arrangement fees should be followed for tax purposes. For sole traders or partnerships, relief may be claimed for incidental costs of loan finance under **S58** and **S59 Income Tax (Trading and Other Income) Act 2005 (ITTOIA)**.

Mitigation
Review long term loans or securities to identify any arrangement or rearrangement fees. Where any such fees are incurred by a company, ensure that generally accepted accounting practice is followed for tax purposes. For sole traders or partnerships ensure that, if appropriate, relief is claimed for such fees as incidental costs of loan finance.

Explanation
For companies, long term securities and expenses incurred in respect of them (such as bank arrangement fees) are governed by specific rules on the taxation of loan relationships. These rules specify that generally accepted accounting practice should be followed for tax purposes.

For further guidance see **CFM30170** and **CFM33060**, and for special rules relating to loan relationships between connected parties **CFM35000**.

Proprietors and partnerships (except partnerships including companies) are not covered by these loan relationship rules. **S58** and **S59 ITTOIA** however gives relief for certain incidental costs of obtaining loan finance where these would otherwise be disallowed as incidental costs of the capital transaction of obtaining finance.

For further guidance see **BIM46430** and **BIM45800+** and **BIM45801** in particular for timing of these deductions.

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IT costs

12. Has the cost of any computer software acquired been treated correctly?

Risk
Where a lump sum payment is made for the acquisition of a software licence, it will be accepted for tax purposes that the expenditure is revenue where the useful life of the software is expected to be less than two years. Where the expected useful life of the software is longer the correct tax treatment will depend on the circumstances, as set out in the explanation below.

Mitigation
Identify all payments for the acquisition of new software licences, and distinguish between regular periodical payments and lump sum payments. For any lump sum payments establish what the useful life of the software is expected to be for the business. For proprietors and partnerships where the expenditure is capitalised and the expected useful life is more than two years, any amortisation is not allowable as a revenue deduction, and a claim should be made for capital allowances. For companies the appropriate tax treatment will depend on the exact nature of the software involved.

Explanation
Most off-the-shelf computer software is now acquired under licence. If the licence is paid for by regular periodical payments then these should be treated as revenue expenditure and normally spread over the useful life of the software.

If a lump sum payment is made for the software licence, and it is evident that the useful life of the software is greater than two years, consideration should be given to treating the payment as capital expenditure.

For proprietors and partnerships any amortisation of capital expenditure in these circumstances should be disallowed, and a claim should be made for capital allowances. The same treatment will apply to companies if the software acquired is in the nature of an operating system, or similar system designed to bring a computer system into its intended use within the business, which may be regarded as a tangible asset.

For further guidance see **BIM35801+** and for further guidance on capital allowances see **CA11110+** and **CA23081**.

However where expenditure may be regarded as an intangible asset, then for companies such expenditure may fall within the corporate intangible assets regime. In these circumstances any amortisation of the capitalised expenditure may be allowed for tax purposes, or alternatively the company may elect to exclude the expenditure from the intangible assets regime and claim capital allowances instead.

For further guidance see **CA11110+** and **CIRD25140**, and in relation to capital allowances elections see **CIRD25180** and **CIRD25190**.

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13. Has any expenditure incurred on website development been allocated correctly?

Risk
The appropriate treatment of expenditure on developing a website is dependent on the nature of the expenditure and the function the website performs for the business. If the costs incurred create an enduring asset, consideration should be given to treating the expenditure as capital. If such costs are not identified, there is a risk that these may be incorrectly claimed as revenue expenditure.

Mitigation
Review all payments relating to the business website(s), bearing in mind that these may be posted to marketing, advertising or IT costs. Where these include any expenditure on website development, consider whether this creates an enduring asset and should be treated as capital expenditure.

Explanation
Even though expenditure on website development may be shown in the accounts as advertising, marketing or IT costs, this does not necessarily mean that it is allowable as revenue expenditure. In order to identify the correct tax treatment the exact nature of the website costs should be examined.

Application and infrastructure costs, including domain name, hardware and operating software that relates to the functionality of the website should normally be treated as capital expenditure. Design and content development costs should normally be treated as capital expenditure to the extent that an enduring asset is created. One such indication may be an expectation that future revenues less attributable costs to be generated by the website will be no less than the amounts capitalised.

A website that will directly generate sales, subscriptions, advertising or other income will normally be regarded as creating an enduring asset and consideration should be given to treating the costs of developing, designing and publishing the website as capital expenditure.

Whilst a revenue deduction would not therefore be allowable, this capital expenditure will generally qualify as expenditure on plant and machinery for capital allowances purposes. Expenditure on initial research and planning, prior to deciding to proceed with development, is normally allowable as revenue expenditure.

The cost of maintaining or updating a website (in relation to price changes, for example) should be treated as revenue expenditure.

For further guidance see **BIM35800**, **BIM35300** and **CIRD25145**.

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Corporate intangible assets

14. Has the correct tax treatment been followed for any amortisation of goodwill acquired by a company?

Risk
The goodwill of a business carried on by a company or a related party at any time before 1 April 2002 does not qualify for inclusion within the corporate intangible assets regime. Relief is therefore not available for amortisation of this goodwill until it is acquired by an unrelated company after that date.

Mitigation
Where a company's accounts and tax computations include any deductions in respect of goodwill, consider the history of the goodwill and its acquisition by the company. If the goodwill was that of a business carried on by any party before 1 April 2002 then it does not fall within the corporate intangible assets regime until it has been acquired by an unrelated party, and until that time any amortisation of it should be disallowed in computing taxable profits.

If a company acquires the goodwill from a related individual or firm ("goodwill on incorporation") between 3 December 2014 and 7 July 2015 then the amortisation should also be disallowed, even if the business started after 1 April 2002. Any part of the goodwill amortisation that relates to goodwill previously purchased by the individual or firm from an unrelated party may still be an allowable deduction.

All amortisation for goodwill acquired between 8 July 2015 and 31 March 2019 should be disallowed regardless of when the goodwill was created and from which party it was acquired.

For goodwill acquired on or after 1 April 2019 relief is available unless it is goodwill acquired from a related individual or firm. The goodwill must be acquired together with qualifying intellectual property (IP) and both must belong to the same business that is being acquired. Where these conditions are met the cost of goodwill up to a limit of 6 times the value of the qualifying IP acquired can be relieved at a fixed rate of 6.5%.

For further guidance see **CIRD44050+**.

The restrictions introduced in 2014, 2015 and 2019 apply to all relevant assets, including goodwill, customer related intangible assets such as; customer information, customer relationships and unregistered marks, signs and logos, and licenses in respect of those assets.

Explanation
The corporate intangible assets regime affects assets created or acquired from an unrelated party on or after 1 April 2002. UK accounting standards consider that goodwill and intangible assets have a finite useful life and so should be amortised on a systematic basis over those

lives. For assets falling within the corporate intangible assets regime the tax treatment generally followed that accounting treatment and allowed tax relief for the amortisation. Changes to the regime made in 2014, 2015 and 2019 now mean that the tax deductions for goodwill amortisation and fixed rate deductions are more limited.

As an alternative to following the accounting treatment a company may elect for deductions at a fixed rate of 4 per cent per year of the tax cost of a particular intangible asset. However, the 2014 and 2015 goodwill restrictions also restrict fixed rate deductions.

For further guidance see **CIRD11505+**, **CIRD11625+** and **CIRD48290**, and for guidance on the fixed rate of deductions see **CIRD12905+**.

For further guidance on the definition of 'related party' see **CIRD45105**.

For guidance on the changes to the treatment of goodwill and 'relevant assets' related to goodwill see **CIRD44000+**.

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15. Has the correct tax treatment been followed for the transfer or licencing of an asset within the corporate intangible assets regime either to or from a related party?

Risk
Where there is a transfer of an asset between related parties, and the asset is a chargeable intangible asset in the hands of at least one of those parties, the transfer is generally deemed to have taken place at market value for both parties. There is also a valuation rule that applies to the grant of a licence between related parties on or after 22 November 2017. If the existence of a related party transaction of this kind is not identified then the wrong amount may be taken into account for tax purposes.

Mitigation
Establish whether any disposals or acquisitions by the company to or from a related party during the accounting period were of assets within the corporate intangible assets regime. For any such transaction, ensure that the amount brought into account for tax purposes reflects the market value of the asset at the date of the transfer.

Explanation
The corporate intangible assets regime affects assets created or acquired on or after 1 April 2002. In general, the tax rules relating to such assets follow the accounting treatment so if expenditure on qualifying assets is written off there is usually a corresponding tax deduction. Similarly, the taxation of disposals of qualifying intangible assets will follow the accepted accounting treatment.

However when a company transfers an asset within the regime to a related party, or acquires such an asset from a related party, the transaction is deemed to have taken place at market value in most cases. Rules were also introduced from 22 November 2017 to remove any tax advantages where licences are granted between related parties. Consequently, for tax purposes, for an acquisition, including a licence arrangement, from a related party any amortisation charged should therefore reflect the market value or arms-length price of the asset. Similarly for a disposal or grant of a licence the higher of arms-length price or market value, rather than any other value, should be treated as the disposal proceeds for tax purposes.

The notion of a 'related party' is similar to that of a 'connected person' used in other areas of specific tax legislation, but is modified in a number of respects to reflect the particular requirements of the corporate intangible assets regime. For further guidance on the definition of 'related party' see **CIRD45105**.

For other relevant guidance see **CIRD45010+** and **CIRD11625+**. For guidance on the treatment of related party licences see **CIRD48350**.

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General

16. Has depreciation been added back to the accounts profit in the tax computation?

Risk
Depreciation of capital items is generally not an allowable expense for tax purposes, except where the asset is within the corporate intangible assets regime.

There is a risk that the depreciation may not be added back to profit in the tax computation where appropriate. Depreciation of capital items should be added back in the computation even where capital allowances have not been claimed.

Mitigation
Ensure that depreciation of capital items is added back to the profit in the tax computation where appropriate.

Explanation
For companies the amortisation of goodwill and other fixed intangible assets is allowable in certain circumstances. Further information concerning risks associated with corporate intangible assets can be found at Q14 and Q15.

For further guidance see **BIM42051** and **BIM35501**.

In addition, any profit or loss on disposal should be deducted or added back in the computation as appropriate.

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