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HMRC internal manual

Corporate Intangibles Research and Development Manual

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CIRD27080 - Finance leasing of intangible assets: lessors: computational rules: change of use

Intangible asset begins or ceases to be finance leased

Assets excluded except as regards royalties

As explained in CIRD27060 (https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird27060), finance leased intangible assets which under the general rule are excluded from CTA09/PART8 except as regards royalties are wholly excluded in the hands of the lessor company . It is possible that a company may hold an intangible fixed asset in this partially excluded category for a period but, either before or after that period, it may finance lease the asset (so that it is then wholly excluded). To ensure that royalties are properly taxed, whether under CTA09/PART8 or under the general CT rules, in these (exceptional) circumstances the regulations provide that:

- CTA09/PART8 only applies to royalties recognised for accounting purposes before or after the period it is finance leased; and
- those royalties are not to be taxed again under the general rules; but
- royalties already taxed under the general rules (for the period of a finance lease) are not to be taxed again under CTA09/PART8 for a later period.

Computation when intangible fixed asset begins to be finance leased

Where an intangible asset already within the scope of CTA09/PART8 begins to be finance leased it will change its character in the finance lessor's accounts (from an intangible fixed asset to a financial asset) and may also be revalued in accordance with FRS102 s20 (or IAS17/FRS105 s15/SSAP21) (see CIRD27020 (https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird27020)). The revaluation will generate an accounting profit or loss.

The regulations provide for the purposes of CTA09/PART8 that in these circumstances the asset is treated as realised (so that the rules described in CIRD13210 (https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird13210) onwards apply) for proceeds which include the initial value of the asset under FRS102 s20 (or IAS17/FRS105 s15/SSAP21). This ensures that any accounting profit or loss is recognised on the inception of the finance lease.

It is possible that only a part of the intangible fixed asset within CTA09/PART8 may become the subject of a finance lease. Under the rule described above this transaction is regarded as giving rise to a part realisation of the asset. To establish what proportion of the cost of the asset should be set against the deemed part realisation proceeds the rules described in CIRD13260 (https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird13260) apply. The regulations ensure that these work as intended by providing that in computing the reduction in the accounting value of the partly realised asset the initial value of the asset under FRS102 s20 (or IAS17/FRS105 s15/SSAP21) is excluded.

Example

A company holds an intangible fixed asset (say some computer software) which it uses in its own business. The asset comes within CTA09/PART8 and has a tax value (equal to its carrying value) of £900. It begins to finance lease half of the software. The initial cost under GAAP of the financial asset thereby created is £500 and a profit of £50(£500 - [½ x £900]) is recognised.

Under the rules described CIRD13260 on the part realisation of an asset, a proportion of the tax cost of the asset needs to be set against the part realisation proceeds to arrive at the taxable credit or deductible debit on the realisation. This cost is calculated by multiplying the tax value of the asset in the ratio of the reduction in the accounting value of the asset (as a result of the realisation) to the accounting value immediately prior to the realisation. If this approach is applied as it stands to the deemed part realisation on the inception of the finance lease, the amount of the cost to be set against the deemed proceeds is too small.

This is because, in calculating the reduction in the accounting value of the asset, the accounting value immediately after the realisation is deducted from the value immediately beforehand. The accounting value immediately after the realisation arguably includes not only the value of the part of the asset which is not finance leased (£450) but also the initial value of the finance leased asset (£500).

Without amendment therefore the fraction of the cost to be set against the deemed proceeds would be:

- the accounting value before realisation,
- minus the accounting value of the part of the asset not finance leased,
- plus the accounting value of the part of the asset finance leased,
- divided by the accounting value before realisation.

In figures that would be (£900 - [£450 + £500]) / £900. The answer is a negative fraction so that no part of the cost of the asset could be set against the part realisation and the whole of the deemed proceeds (£500) would represent the taxable profit on the transaction.

By excluding the accounting value of the asset (£500) immediately after the deemed realisation from the fraction, it become (£900 - £450) / £900 = 0.5. Half the accounting value of the asset immediately before the part realisation (£900) can be set against the deemed proceeds of £500. The taxable credit is therefore £500 - (0.5 x£900) = £50, the same as the accounting profit.

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