These notes refer to the Capital Allowances Act 2001 (c.2) which received Royal Assent on 22nd March 2001

CAPITAL ALLOWANCES ACT 2001

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Glossary

Part 7: Know-how allowances

Overview

1586. This Part provides for know-how allowances. The allowances are available to traders who incur qualifying expenditure on acquiring know-how for use in their trade. There is a defined class of know-how in relation to which qualifying expenditure can arise. Qualifying expenditure is pooled for the purpose of calculating entitlement to allowances and liability to charges.

1587. Chapter 1 requires a person to have incurred qualifying expenditure on acquiring know-how to get allowances. It also:

- defines “know-how” for the purposes of this Part; and
- treats know-how as property so that general provisions of this Act which refer to property can apply to know-how.

1588. Chapter 2 defines “qualifying expenditure” for a trader and sets out cases in which there is no qualifying expenditure. The same expenditure can only be qualifying expenditure in relation to one trade – so that relief is only given once.

1589. Chapter 3 deals with entitlement to allowances or liability to charges and the amounts involved. Qualifying expenditure is pooled to calculate allowances and charges. There is a separate pool for each trade for which there is qualifying expenditure. Disposal values can arise in relation to qualifying expenditure. Disposal values come out of the pool and thus effectively reduce allowances or result in balancing charges. There is no limit on disposal values in this Part. This Chapter also gives effect to allowances and charges. They are treated as trading expenses or receipts.

History

1590. Section 21 of FA 1968 introduced provisions giving traders capital allowances for capital expenditure on acquiring know-how. The allowances were given, broadly, on a straight line basis over six years. A balancing allowance was available if the trade permanently ceased before the end of the six-year period. There were also provisions dealing with receipts from the disposal of know-how. Section 21 was treated as if it was contained in Part I of CAA 1968. This legislation was consolidated as sections 386 and 387 of ICTA 1970 but still treated as if it was in Part I of CAA 1968.

1591. Section 65 of, and Schedule 18 to, FA 1985 altered the system of capital allowances for know-how so that expenditure is pooled. Allowances are no longer given on the separate items of expenditure but on the reducing balance in the pool. The earlier system of giving balancing allowances in relation to individual items of expenditure was also replaced by a system for balancing adjustments closer to, but not identical to, that for plant and machinery.

1592. The provisions in ICTA 1970 and Schedule 18 to FA 1985 were consolidated as sections 530, 531, 532 and 533 of ICTA. Sections 530, 531, 532 and 533 were treated as if they were in Part I of CAA 1968. Subsequently they were treated as if they were in CAA 1990.

Structure of this Part

1593. As nearly 15 years have passed since 1 April 1986 the previous system for giving capital allowances over six years does not need to be rewritten. Section 530(6) and (8) of ICTA is therefore not rewritten in this Act.

1594. This Part:

- brings the legislation dealing with capital allowances (broadly section 530 and parts of sections 531 to 533 of ICTA) into this Act in order to make it more accessible; and
- splits that material into separate Chapters having regard to both the structure of know-how allowances and the structure used for other allowances.

1595. Section 531 of ICTA deals with more than just capital allowances. Section 531(1) is relevant to trading income and section 531(4) is relevant for income taxed under Case VI of Schedule D. The parts of section 531 that are not about capital allowances remain in ICTA.

Chapter 1: Introduction

Overview

1596. This Chapter introduces know-how allowances. They are given to traders who incur qualifying expenditure. Chapter 2 defines "qualifying expenditure" and contains the condition that the person must be a trader. This Chapter defines "know-how" and treats it as property.

1597. Section 452 requires qualifying expenditure on acquiring know-how in order for allowances to be given and defines "know-how".

1598. Section 453 treats know-how as property.

Section 452: Know-how allowances

1599. This section is based on sections 532(1) and 533(7) of ICTA and section 161(2) of CAA 1990. It explains that allowances are only available to persons who incur qualifying expenditure on acquiring know-how. The section defines "know-how".

1600. *Subsection (3)(a)* omits the examples of geothermal energy in section 161(2) of CAA 1990. They are not needed. See *Note 46* in Annex 2.

Section 453: Know-how as property

1601. This section is based on section 532(5)(a) of ICTA. It treats know-how as property for this Act. This allows general provisions of this Act to apply to know-how. There would otherwise have to be specific provisions saying that this or that section applies to know-how as it does to property with the necessary modifications. An example of these general provisions is the provision dealing with apportionment of consideration on sales of property.

Chapter 2: Qualifying expenditure

Overview

1602. This Chapter defines "qualifying expenditure" and excludes certain expenditure from being qualifying expenditure.

1603. Section 454 defines "qualifying expenditure", stops a person taking it into account for more than one trade and deals with expenditure incurred before the trade starts.

1604. Section 455 stops certain expenditure being qualifying expenditure if:

- it is relieved in some other way;
- treated as on goodwill; or
- arises from a transaction between certain persons and there is common control.

Section 454: Qualifying expenditure

1605. This section is based on section 530(1) and (7) and section 531(3) of ICTA. It defines "qualifying expenditure".

1606. *Subsection (1)* lists the expenditure on acquiring know-how that is qualifying expenditure. A person must carry on a trade in order to have qualifying expenditure but that expenditure may be incurred before the trade starts.

1607. *Subsection (2)* stops capital allowances being given more than once on the same qualifying expenditure. This provision does not appear explicitly in ICTA. See *Note 59* in Annex 2.

1608. *Subsection (3)* ensures that qualifying expenditure qualifies for allowances when the relevant trade starts in the case of qualifying expenditure incurred before that trade starts.

1609. *Subsection (4)* defines a term used in subsection (3).

Section 455: Excluded expenditure

1610. This section is based on sections 530(1) and 531(2) and (7) of ICTA. It deals with those cases in which expenditure on know-how is not qualifying expenditure.

1611. *Subsection (1)* excludes expenditure that has been deducted in some other fashion – for example under section 531(5) of ICTA.

1612. *Subsections (2)* and *(3)* exclude expenditure if the buyer and seller are under common control.

1613. *Subsection (4)* excludes expenditure that section 531(2) of ICTA treats as expenditure on goodwill for all the purposes of corporation tax, income tax and capital gains tax.

Chapter 3: Allowances and charges

Overview

1614. This Chapter deals with allowances and charges on qualifying expenditure. Qualifying expenditure is pooled. There is a separate pool for each trade. Disposal values can arise in relation to qualifying expenditure. Disposal values effectively reduce allowances or lead to balancing charges.

1615. Section 456 requires pooling of qualifying expenditure to be carried out separately for each trade concerned.

1616. Section 457 sets out whether there is an allowance or a charge for a chargeable period.

1617. Section 458 deals with the amount of the allowance or charge.

1618. Sections 459 to 461 set out how to find "AQE" which is a term used in the earlier sections.

1619. Section 462 deals with when a disposal value is to be brought into account, and its amount, in respect of qualifying expenditure.

1620. Section 463 gives effect to allowances and charges as trading expenses or trading receipts.

Section 456: Pooling of expenditure

1621. This section is drafted to introduce pooling explicitly.

1622. *Subsection (2)* provides explicitly that there is a separate pool in respect of each trade for which there is some qualifying expenditure. It can be inferred from section 530(2)(b) of ICTA that there are separate pools for separate trades.

Section 457: Determination of entitlement or liability

1623. This section is based on section 530(2) and (3) of ICTA. It decides if a person is entitled to an allowance or liable to a charge.

1624. Section 459 defines "AQE" in the pool for a chargeable period. Section 462 decides if a disposal value is brought into account for a chargeable period (and how much).

Section 458: Amount of allowances and charges

1625. This section is based on section 530(2) and (3) of ICTA. *Subsections (1)* to *(3)* set out the calculation of a writing-down allowance for a chargeable period. The rate at which writing-down allowances are given is 25% per year. The amount of a writing-down allowance is adjusted if the chargeable period is more or less than a year and if the trade is carried on for only part of the chargeable period.

1626. There is a minor change.*Subsection (4)* allows a person to claim a writing-down allowance of less than the full entitlement for the chargeable period. See *Change 38* in Annex 1.

1627. *Subsections (5)* and *(6)* set out the calculation of a balancing charge or balancing allowance for a chargeable period.

Section 459: Available qualifying expenditure

1628. This section is based on section 530(4) of ICTA. It defines "available qualifying expenditure" in a pool for a chargeable period. That is essentially any unrelieved qualifying expenditure brought forward from the previous chargeable period plus any qualifying expenditure added to the pool for the current chargeable period.

Section 460: Allocation of qualifying expenditure to pools

1629. This section is based on section 530(4)(a) of ICTA. It sets out when qualifying expenditure can be added to a pool.

1630. There is a minor change. This section allows qualifying expenditure to be added to a pool either in the chargeable period in which it is incurred or in a later chargeable period. This is in line with the approach taken in this Act to plant and machinery allowances in Part 2. It gives taxpayers flexibility – albeit it is only likely to be of practical interest in unusual circumstances. See *Change 54* in Annex 1.

Section 461: Unrelieved qualifying expenditure

1631. This section is based on section 530(4)(b) of ICTA. It sets out the amount that is carried forward in a pool from one chargeable period to the next chargeable period.

1632. *Subsection (3)* stops any amount being carried forward after the trade is permanently discontinued. This makes explicit the fact that the pool ceases to exist on the ending of the trade in relation to which that pool exists. There would only be unrelieved qualifying expenditure if the taxpayer were to choose, for some reason, not to claim all of a balancing allowance that is available on the trade cessation. See *Note 60* in Annex 2.

Section 462: Disposal values

1633. This section is based on sections 530(5) and 531(2) of ICTA. It determines disposal values and the periods for which they are to be brought into account.

1634. *Subsection (2)* gives the amount brought into account. It limits the amounts to capital sums, which makes explicit the fact that receipts that are income do not come out of the pool in addition to being taxed as income. ICTA does not limit the disposal value to capital sums. See *Change 55* in Annex 1.

Section 463: Giving effect to allowances and charges

1635. This section is based on section 532(1) of ICTA and sections 140(2), 144(2) and 161(2) and (5) of CAA 1990. It gives effect to allowances and charges as trading expenses or receipts. This makes explicit the way in which effect is given to allowances and charges. See *Note 61* in Annex 2.