

INCOME TAX (TRADING AND OTHER INCOME) ACT 2005

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 2: Trading income

Chapter 14: Disposal and acquisition of know-how

Section 194: Disposal of know-how as part of disposal of all or part of a trade

797. This section sets out the main exception to the general rule in section 193. It is based on section 531(2) and (3) of ICTA.
798. *Subsection (1)* establishes that the section applies if the know-how is disposed of as part of the disposal of a trade.
799. *Subsection (2)* provides that a payment for know-how as part of the disposal of a trade is generally treated as a capital receipt for goodwill. This rule applies only if the person making the disposal is liable to income tax. If that person is liable to corporation tax the rule in section 531 of ICTA continues to apply.
800. *Subsection (3)* deals with the person acquiring the know-how. Again, the payment for the know-how is generally treated as a capital payment for goodwill and the rule applies only if the person acquiring the know-how is liable to income tax.
801. The capital treatment in section 531(2) of ICTA also applies for capital gains tax purposes. That part of the rule is inserted as a new section 261A into TCGA (see paragraph 444 of Schedule 1 to this Act).
802. *Subsection (4)* is an exception to the capital treatment in subsections (2) and (3). It applies if the trade was carried on wholly abroad by the person disposing of the know-how.
803. *Subsection (5)* allows the parties to the transaction to elect for the payment not to be treated as one for goodwill. The effect of an election for the purchaser is that the payment may qualify for capital allowances under Part 7 of CAA. Or, exceptionally, the purchaser may be able to treat the payment as a trading expense. As such an election may affect both parties to the transaction the election has to be made by both.
804. The question whether the election is made under this section or under section 531(3) of ICTA is decided by reference to the position of the person disposing of the know-how. If that person is liable to income tax this section applies; if the person is liable to corporation tax, ICTA applies.
805. This section does not specify that the election is to be made to “the inspector”. Section 878(4) of this Act draws attention to the rules in TMA, which apply for the purposes of this Act. Those rules require elections to be made to “an officer of the Board”.

*These notes refer to the Income Tax (Trading and Other Income)
Act 2005 (c.5) which received Royal Assent on 24 March 2005*

806. *Subsection (6)* gives the time limit for the election. Most elections in this Act have to be made on or before the “first anniversary of the normal self-assessment filing date”. But in this case one of the persons making the election may be chargeable to corporation tax. So the time limit for an election is based on the date of the disposal.
807. *Subsection (7)* deals with a disposal by an income tax payer to a corporation tax payer. An election under section 531(3) of ICTA is treated as an election under this section. The corresponding rule for a disposal by a corporation tax payer to an income tax payer is in section 531(3A) of ICTA (inserted by paragraph 207 of Schedule 1 to this Act).