TAX TALK - AMORTIZATION FOR INTANGIBLE BUSINESS ASSETS

FS: What is the purpose of this new provision?
A/CEO: This is a tax incentive to assist businesses make a deduction on intangible business assets. It recognizes that intangibles are just as important asset as plant and equipment, and therefore provide for capital right off of intangibles as well as tangibles. Prior 2016, businesses were only able to claim depreciation deduction on tangible assets like plant, equipment, machinery; however, effective 1 January 2016, businesses will be able to amortize intangible business assets.

FS: What is a Business intangible?
A/CEO: Business intangible is an intangible asset or expenditure that loses value over its useful life as it is used to derive taxable business income. As with depreciable assets, the cost of a business intangible is deducted over the useful life of the intangible rather than as an outright deduction in the year the cost is incurred. This allocates the cost of the intangible to the tax years in which it is consumed in deriving taxable business income.

FS: How do we determine a business intangible asset?
A/CEO: An intangible asset must satisfy the following conditions – (a) the intangible asset has a limited useful life; (b) the intangible asset must be, wholly or partly, used to derive taxable business income (i.e. business income included in gross income).

FS: How about intangible assets with unlimited life?
A/CEO: An intangible asset with an unlimited useful life for financial accounting purposes is not a business intangible. An intangible asset with an unlimited useful life is not amortised for financial accounting purposes but, rather, is tested annually for impairment. Only intangible assets that have a limited useful life are amortised for both financial accounting and income tax purposes. This means, for example, that goodwill is not a business intangible. This is because goodwill does not have a limited useful life. Thus, goodwill is an intangible asset for the purposes of the Act (and, therefore, subject to capital gains tax) but not a business intangible. All intangible assets are included as capital assets.

FS: So how do we determine the allowable deduction for amortization?
A/CEO: The new Income Tax Act allows a deduction for the decline in value of a person's depreciable assets through use in deriving amounts included in gross income during the tax year. It also allows a deduction for the decline in value of a person's business intangibles through use in deriving amounts included in taxable business income during the tax year. These deductions effectively allocate part of the capital cost of depreciable assets and business intangibles to a tax year.

FS: What Business Intangibles would be allowed a deduction for amortisation purpose?
A/CEO: A deduction is allowed for the decline in value of a business intangible for a tax year only if the decline in value has occurred during the year through the use of the intangible in deriving business income included in gross income. The following are some business intangibles – (1) A copyright, patent, design or model, plan, secret formula or process, trademark, or other like property or right used to derive business income included in gross income. (2) Contractual rights (including rights arising as a result of a prepayment of expenses) with a benefit for a period of more than one year used to derive business income included in gross income. (3) A customer list, distribution channel, or unique name, symbol, or picture, or other marketing intangible to derive business income included in gross income. (4) Expenditure incurred to derive business income included gross income when the expenditure provides an advantage or benefit for a period of more than one year, other than expenditure incurred to acquire

any tangible personal or real property. (5) A fine, premium, or other capital amount paid or payable upon grant or transfer of a lease of land or a structural improvement to land provided the land or structural improvement is wholly or partly used to derive business income included in gross income. Also included is expenditure incurred pursuant to an obligation to effect improvements to land or to a structural improvement to land, provided the land or structural improvement is wholly or partly used to derive business income included in gross income. (6) Pre-commencement expenditure. This is any expenditure incurred before the commencement of a business if the income to be derived by the business will be wholly and exclusively included in business income included in gross income, other than expenditure incurred in acquiring real property, a depreciable asset or an intangible.

FS: How do we calculate amortization for an intangible business asset?
A/CEO: Amortisation deductions for business intangibles are computed on a straight-line basis. Amortization is calculated by applying the rate of amortization against the cost of the business intangible. The rate of amortisation for pre-commencement expenditure is 25%. The rate of amortisation of a business intangible that has a useful life of more than ten years is 10%. This is particularly relevant for business intangibles that are industrial and intellectual property rights that are recognised under statute for more than 10 years. This, in effect, puts a ceiling on the write off period for business intangibles of ten years. The rate of amortisation of a business intangible that is (i) fine, premium, or other capital amount paid or payable upon grant or transfer of a lease of land or a structural improvement to land or (ii) expenditure incurred pursuant to an obligation to effect improvements to land or a structural improvement to land the subject of a lease, is the 100% divided by the term of the lease.
Example 1- If the lease is for a term of 5 years, the amortisation rate is 20%. (100% ÷ 5)

Example 2 - B pays A $100,000 as consideration for being appointed the exclusive distributor of A's products in Fiji for four years. The agreement is entered into on January 1, 2016. The rights acquired by B under the distribution agreement are a business intangible. Under generally accepted accounting principles, the useful life of the business intangible is four years (i.e. the term of the agreement) and, therefore, the amortisation rate is 25%. B is allowed an amortisation deduction of $25,000 ($100,000 x 25%) for each of the 2015, 2016, 2017 and 2018 tax years.

Example 3 - Suppose, instead, that the term of the agreement is 12 years. The intangible is deemed to have a useful life of ten years and, therefore, the amortisation rate is 10%. B is allowed an amortisation deduction of $10,000 ($100,000 x 10%) for each of the first ten tax years of the agreement.

FS: What if the intangible business asset was partly used?
A/CEO: If an intangible asset is used only partly to derive taxable business income, then the amortisation deduction will be apportioned.

Example, if the term of the agreement is 12 years, amortisation deductions are allowed only for the first ten years (as the amortisation rate is 10%). At the end of the tenth year, the cost of the intangible has been completely amortised.