



Intangible assets: How must the costs incurred be capitalized?

These days, most businesses have some intangible assets. The tax treatment of these assets can be complex.

What makes intangibles so complicated?

IRS regulations require the capitalization of costs to:

- Acquire or create an intangible asset,
- Create or enhance a separate, distinct intangible asset,
- Create or enhance a “future benefit” identified in IRS guidance as capitalizable, or
- “Facilitate” the acquisition or creation of an intangible asset.

Capitalized costs can't be deducted in the year paid or incurred. If they're deductible at all, they must be ratably deducted over the life of the asset (or, for some assets, over periods specified by the tax code or under regulations). However, capitalization generally isn't required for costs not exceeding \$5,000 and for amounts paid to create or facilitate the creation of any right or benefit that doesn't extend beyond the earlier of 1) 12 months after the first date on which the taxpayer realizes the right or benefit or 2) the end of the tax year following the tax year in which the payment is made.

What's an intangible?

The term “intangibles” covers many items. It may not always be simple to determine whether an intangible asset or benefit has been acquired or created. Intangibles include debt instruments, prepaid expenses, non-functional currencies, financial derivatives (including, but not limited to

options, forward or futures contracts, and foreign currency contracts), leases, licenses, memberships, patents, copyrights, franchises, trademarks, trade names, goodwill, annuity contracts, insurance contracts, endowment contracts, customer lists, ownership interests in any business entity (for example, corporations, partnerships, LLCs, trusts, and estates) and other rights, assets, instruments and agreements.

Here are just a few examples of expenses to acquire or create intangibles that are subject to the capitalization rules:

- Amounts paid to obtain, renew, renegotiate or upgrade a business or professional license;
- Amounts paid to modify certain contract rights (such as a lease agreement);
- Amounts paid to defend or perfect title to intangible property (such as a patent); and
- Amounts paid to terminate certain agreements, including, but not limited to, leases of the taxpayer's tangible property, exclusive licenses to acquire or use the taxpayer's property, and certain non-competition agreements.

The IRS regulations generally characterize an amount as paid to "facilitate" the acquisition or creation of an intangible if it is paid in the process of investigating or pursuing a transaction. The facilitation rules can affect any type of business, and many ordinary business transactions.

Examples of costs that facilitate acquisition or creation of an intangible include payments to:

- Outside counsel to draft and negotiate a lease agreement;
- Attorneys, accountants and appraisers to establish the value of a corporation's stock in a buyout of a minority shareholder;
- Outside consultants to investigate competitors in preparing a contract bid; and
- Outside counsel for preparation and filing of trademark, copyright and license applications.

Are there any exceptions?

Like most tax rules, these capitalization rules have exceptions. There are also certain elections taxpayers can make to capitalize items that aren't ordinarily required to be capitalized. The above examples aren't all-inclusive, and given the length and complexity of the regulations, any transaction involving intangibles and related costs should be analyzed to determine the tax implications.

Need help or have questions?

Contact us to discuss the capitalization rules to see if any costs you've paid or incurred must be capitalized or whether your business has entered into transactions that may trigger these rules. You can also contact us if you have any questions.