



In touch with intangibles

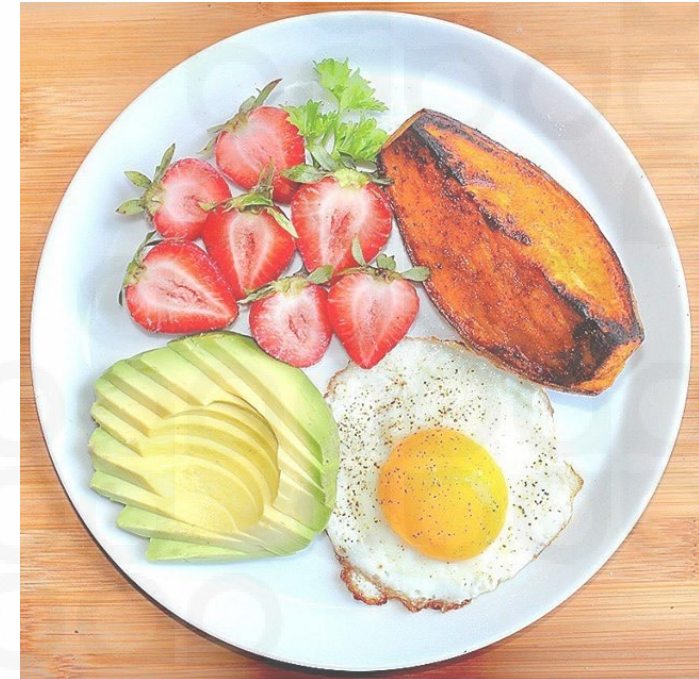
A conversation about intangible assets

YOUR KEY TO THE TAX COMMUNITY

Welcome

On the lunch plate today

1. **Tax focus points** touching on intangibles
 - a) S11(gB) and S11(gC)
 - b) Research and development approved by the Minister of Finance
2. **Accounting focus points** touching on intangibles (S18 of IFRS for SMEs)
 - a) What is an intangible asset really, and **how to identify** them
 - ☐ Definition of an IA
 - Identifiable
 - Non-monetary
 - Asset
 - No physical substance
 - b) Other basic principles
3. Conclusionary remarks



Tax focus points touching on intangible assets

Section 11(gB) and section 11(gC)

Section 11(gB): Registration or renewal of registration	Patent, design or trademark used in the production of income for trade purposes	100% of costs incurred
Section 11(gC): Purchase or acquisition @ R5 000 or less	Patent, invention, copyright or design used in the production of income for trade purposes	100% of costs incurred
Section 11(gC): Purchase or acquisition > R5 000	Patent, invention, copyright or design used in the production of income for trade purposes	5% of cost for patent, invention and copyright 10% of cost for design

Tax focus points touching on intangible assets

Research and development approved by the Minister of Finance

- Expenditure incurred on/after 1 January 2014, before 1 October 2022
- Must be qualifying research as defined in section 11D(1) (discovery / creation of knowledge; innovative improvement)
- Not applicable to:
 - routine testing, analysis, collection of information or quality control in the normal course of business;
 - development of internal business processes unless those internal business processes are mainly intended for sale or for granting the use or right of use or permission to use thereof to persons who are not connected persons in relation to the person carrying on that research and development;
 - market research, market testing or sales promotion;
 - social science research, including the arts and humanities;
 - oil and gas or mineral exploration or prospecting except research and development carried on to develop technology used for that exploration or prospecting;
 - the creation or development of financial instruments or financial products;
 - the creation or enhancement of trademarks or goodwill; or
 - any expenditure contemplated in [section 11 \(gB\)](#) or [\(gC\)](#).

Tax focus points touching on intangible assets

Research and development approved by the Minister of Finance

Operational research and development expenditure

- 150% of costs incurred

Capital research and development expenditure

- 150% of costs incurred

New and unused plant and machinery (s12C)

- 50/30/20

Building (s13(1))

- 5%

Other movable assets (s11(e))

Will be impacted if the research
constitutes funded research

Intangible Assets

**What is an intangible asset really,
and how do you identify it?**

Examples of intangible assets

Marketing Related	Customer or supplier related	Technology Related	Artistic related
<ul style="list-style-type: none"> • Trademarks • Trade names • Certification marks • Trade dress (unique color, shape or package design) • Internet domains • Non-compete agreements • ... 	<ul style="list-style-type: none"> • Advertising agreements • Licensing, royalty agreements • Servicing contracts • Franchise agreements • Customer relationships • Customer lists • ... 	<ul style="list-style-type: none"> • Contractual or non contractual rights to use : <ul style="list-style-type: none"> • Patented or unpatented technologies • Data bases • Formulae • Designs • Softwares • Processes • Recipes 	<ul style="list-style-type: none"> • Royalties from artistic works : <ul style="list-style-type: none"> • Plays • Books • Films • Music • Royalties from non-contractual copyright protection

EXAMPLES OF INTANGIBLE ASSETS



- Easements
- Water Rights
- Timber Rights
- Patents
- **Trademarks**
- Computer Software



More examples...

Marketing-related:

- Trademarks, trade names, service marks, collective marks, certification marks
- Trade dress (unique color, shape, package design)
- Newspaper mastheads
- Internet domain names
- Noncompetition agreements

Customer-related:

- Customer lists
- Order or production backlog
- Customer contracts and related customer relationships
- Noncontractual customer relationships

Artistic-related:

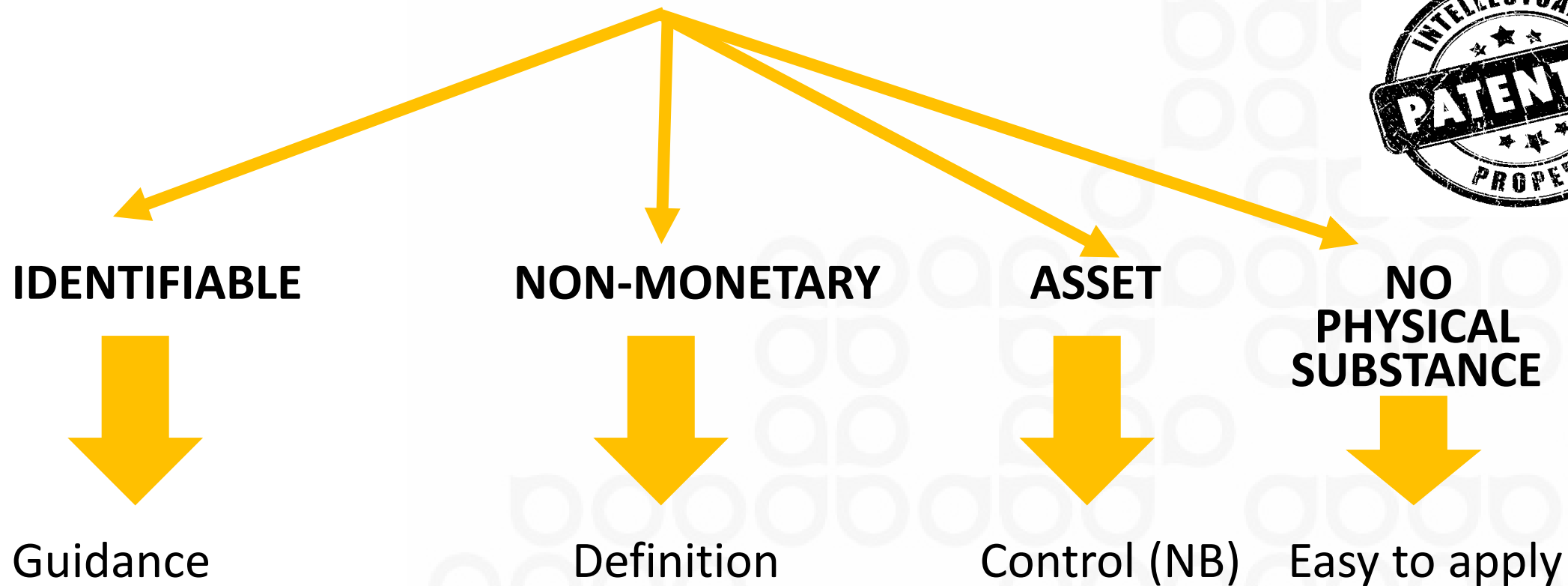
- Plays, operas, ballets
- Books, magazines, newspapers, or other literary works
- Musical works (e.g., compositions, song lyrics, advertising jingles)
- Pictures and photographs
- Video and audiovisual material (e.g., motion pictures, music videos, television programs)

Contract-based:

- Licensing, royalty, standstill agreements
- Advertising, construction, management, service or supply contracts
- Lease agreements (whether the acquirer is lessee or lessor)
- Construction permits
- Franchise agreements
- Operating and broadcast rights
- Servicing contracts (e.g., mortgage servicing contracts)
- Employment contracts

The definition...

- An intangible asset is an identifiable, non-monetary asset without physical substance



“IDENTIFIABILITY”

- What makes an asset identifiable?

- If it is separable (i.e., capable of being separated/divided from entity and sold, transferred, licensed, rented or exchanged etc.);

OR

- Arises from rights, either contractual/legal (regardless of whether the rights are separable/transferrable)

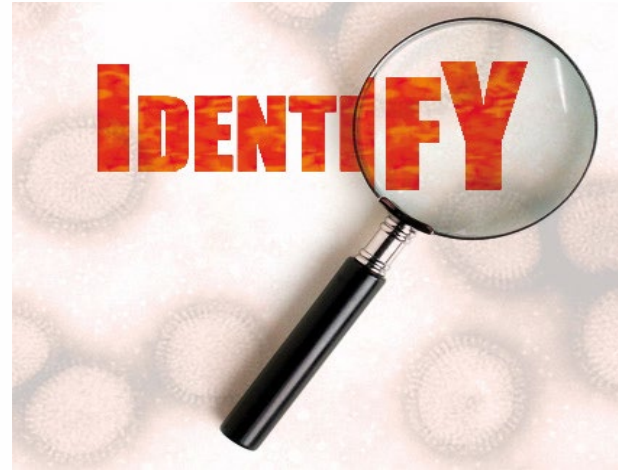
The degree of clarity of which a televised image broadcast signal is received

def·i·ni·tion n. 1.
The teacher gave definition of the new words.
of an image (picture)



“IDENTIFIABILITY”

- separate and sell (1)



Intent to sell? An intangible asset that the *acquirer* would be able to sell, license or otherwise exchange for something else of value meets the **separability criterion** even if the acquirer does not intend to sell, license or otherwise exchange it.

Evidence of transactions? An *acquired* intangible asset meets the separability criterion if there is evidence of exchange transactions for that type of asset or an asset of a similar type, even if those transactions are infrequent and regardless of whether the acquirer is involved in them.

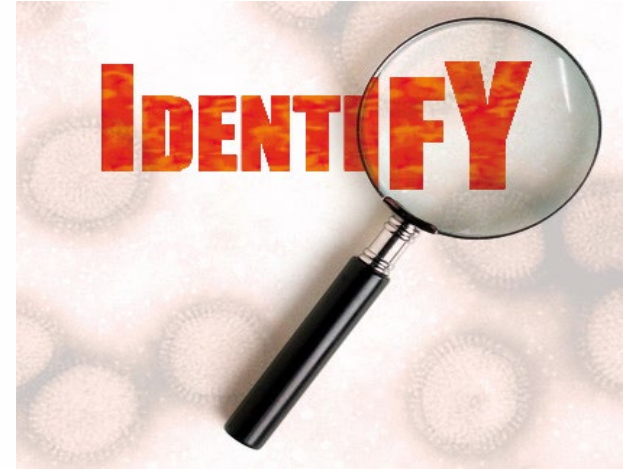
Example: **customer and subscriber lists** are frequently licensed, and thus meet the separability criterion. Even if an acquiree believes its customer lists have characteristics different from other customer lists, the fact that customer lists are frequently licensed generally means that the *acquired* customer list meets the separability criterion. However, a customer list *acquired* in a *business combination* would not meet the separability criterion if the terms of confidentiality or other agreements prohibit an entity from selling, leasing or otherwise exchanging information about its customers. *Also think of POPI Act in South Africa, in this regard!*

“IDENTIFIABILITY”

- separate and sell (2)

Example:

An *acquiree* owns a registered trademark and documented but *unpatented* technical expertise used to manufacture the trademarked product.



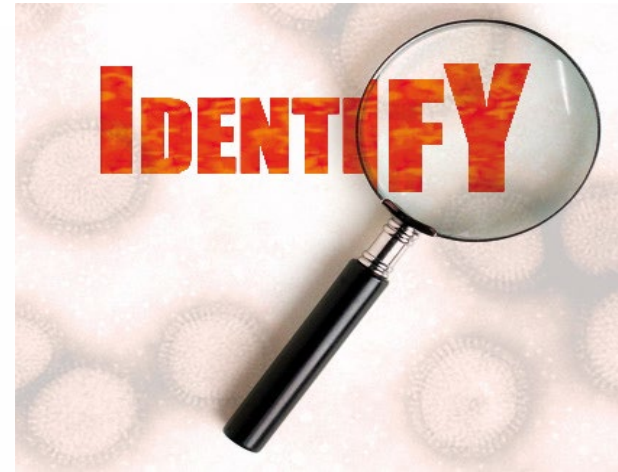
To transfer ownership of a trademark, the owner is also required to transfer everything else necessary for the new owner to produce a product or service indistinguishable from that produced by the former owner.

Because the *unpatented* technical expertise must be separated from the acquiree, and sold if the related trademark is sold, it meets the separability criterion.

“IDENTIFIABILITY”

- arising from rights

(legal/contractual)



Example

An *acquiree* owns and operates a nuclear power plant. The **licence to operate** that power plant is an intangible asset that meets the contractual-legal criterion for recognition separately from goodwill, even if the acquirer cannot sell or transfer it separately from the acquired power plant. *An acquirer may recognise the fair value of the operating licence and the fair value of the power plant as a single asset for financial reporting purposes if the useful lives of those assets are similar.*

Example

An acquiree owns a **technology patent**. It has **licensed** that patent to others for their exclusive use outside the domestic market, receiving a specified percentage of future foreign revenue in exchange. Both the technology patent and the related licence agreement meet the contractual-legal criterion for recognition separately from goodwill even if selling or exchanging the patent and the related licence agreement(s) separately from one another would not be practical.

“NON-MONETARY”

- what does this mean?

- **Monetary** assets are:
 - Money held; and
 - Assets to be received in fixed or determinable amounts of money
- Hence, **non-monetary** assets are the rest...
- **Example: Inventory that can only be sold for cash**
- **vs**
- **Example: Trade receivables to be collected**
- Hence: monetary assets are mostly financial assets (i.e., financial instruments). An intangible asset is a non-financial asset (also PP&E, investment properties, inventories, NCAHFS, prepaid expenses)



ASSET AND “CONTROL”

- *vital part of the definition of an asset...*

- An asset is a resource **controlled** by an entity as a result of past events, and from which future economic benefits are expected to flow to the entity (old asset definition)
- Important principles not to miss
 - Control = the **power to obtain** the FEB's flowing from the resource; **AND**
 - Control = the **ability to restrict** access of others to those FEB's
 - Control **usually stems from legal/contractual rights**, but the latter are not a requirement to illustrate control, they are just usually present...



Contentious examples...

- are these intangible assets? (1)



• Intensive market and technical knowledge

- Identifiable? Yes, we can separate and sell the knowledge
- Non-monetary? Yes, it is not money held nor assets to be received in fixed/determinable amounts of money
- Asset? If the definition is satisfied! **Crux: do we control the knowledge?**
 - Do we have the power to obtain FEB's from the knowledge? Yes, we use it to produce revenue in the future etc.
 - Can we restrict others' access to these FEB's? Potentially, if the knowledge is protected by legal rights (e.g., copyrights, restraints of trade, legal duty on employees to maintain confidentiality)
- Without physical substance? Yes, no physical substance to market/technical knowledge



Contentious examples...

- are these intangible assets? (2)

• Highly skilled staff/staff skills/management/technical talent

- Identifiable? Yes, FEB's produced arise from legal employment contracts with staff
- Non-monetary? Yes, it is not money held nor assets to be received in fixed/determinable amounts of money, but rather services/skills/talents and FEB's
- Asset? If the definition is satisfied! **Crux: do we control the staff and their skills?**
 - Do we have the power to obtain FEB's from the staff and their skills? Yes, we use it to produce revenue in the future etc.
 - *Can we restrict others' access to these FEB's? This is a point of debate in practice, as employees can leave the employ at any time... But: while they work for us, certainly we can?*
- Without physical substance? Yes, the asset lies in the ABILITIES/TALENTS of the staff, and not the actual human bodies
- Even IFRS does not provide finality... *"unlikely to meet the definition of an intangible asset, unless it is protected by legal rights to use it..."*
- The revised CF (2018) makes it even more tricky to decide...

Contentious examples...

- are these intangible assets? (3)



- Portfolio of customers/market share/customer loyalty

- Identifiable? Can entity separate and sell customers/market share/loyalty? Is there evidence available of similar exchanges? Then, yes. They also do not arise from rights (legal/contractual)
- Non-monetary? Yes, it is not money held nor assets to be received in fixed/determinable amounts of money, but rather potential of FEB's
- Asset? If the definition is satisfied! **Crux: do we control the customers/loyalty?**
 - Do we have the power to obtain FEB's from customers and their loyalty? Yes, we use it to produce revenue in the future, etc.
 - *Can we restrict others' access to these FEB's? No, there is no legal protection in place in most instances (sometimes, the relationships are legally protected)*
- Without physical substance? Yes, the asset lies in the potential of the relationship and not the physical customer
- IFRS does not provide finality... *"the entity usually has insufficient control to meet the definition of an asset..."*
- *The question in this instance is: is there any legal way to protect FEB's so that others cannot access the same FEB's than the entity?*

Intangible Assets

Other important aspects of intangible assets
- A look at the basic principles -

Basic principles (1)

- Firstly, the old CF applies i.r.o. recognition of IA's
 - Item must satisfy the **definition** of an intangible asset; and
 - The **recognition criteria** (probable FEB inflows and reliable measurement)
- IA's can arise via separate **acquisition** (easiest)
 - Focus here on what the costs are that are capitalised to the cost of the IA
- IA's can be **acquired** as part of a business combination (NB)
 - The intangible asset is to be measured at its **fair value** at acquisition
 - Probability reflected in fair value, hence assumed to be satisfied
 - If IA is **identifiable** at acquisition, there is enough info to reliably measure its fair value, hence reliable measurement always assumed to be satisfied for IA's acquired in a business combination (rebuttable presumption)
 - Recognition of the IA by the acquiree is **not a requirement** for acquirer to recognise

Basic principles (2)

- IA's can be acquired (received) in a government grant
- Initially measure IA at fair value
- IA's can be acquired (received) by means of exchanges of assets
- Measured at fair value of IA given up, otherwise at fair value of IA received
- Internally generated goodwill (differentiate from GW in a BC!!)
- Never capitalised as an IA (or any other asset)
- Many don't know what internally generated goodwill is...
 - Expenditure incurred by an entity to create FEB's...
 - Cannot be assigned to any particular individual asset/intangible asset
 - It is not identifiable, as it does not arise from rights (legal/contractual) and cannot be separated
 - It relates to the pervasive difference between the fair value of an entity and its NAV

Basic principles (3)

- IA's can arise through internal generation
- Relates mostly to research and development costs
- Internally-generated research **and** development costs are all expensed, not capitalised, in terms of the IFRS for SMEs
- *Different to full IFRS, where research costs expensed and qualifying development costs capitalised*
- What about subsequent expenditure incurred on an IA?
- Recognised as an expense, unless:
 - It forms part of the cost of an IA that meets the recognition criteria; OR
 - The item is acquired in a business combination and cannot be recognised as an intangible asset, then subsumed into goodwill at acquisition (asset)
 - Good examples of expenses = internally generated brands, logos, mastheads, start-up costs, training costs, advertising, and relocation of a division or entity
 - Once recognised as expense, cannot subsequently recognised as IA
 - Except in a business combination

Basic principles (4)

- Subsequent measurement of IA's
- Only the historic cost model permitted in IFRS for SMEs
- *Full IFRS allows the revaluation model (adjustments in OCI) if used with reference to an active market (most IA's do not have active markets)*
- What is the amortisation period, useful life and residual value of an IA?
- IAs amortised over their useful lives
- If entity cannot estimate useful life, use best estimate of management (but not more than 10 years!)
- Reviewed only if there is significant change in the asset or how it is used (change in estimate, applied prospectively)

Basic principles (5)

- Impairment of IA's
 - Done in terms of IFRS for SMEs (Section 27)
- Derecognition of IA's
 - Certainty that no further FEB's will be generated from the IA
 - Derecognition mainly due to **retirements** or **disposals**

Digital assets?

- E.g., crypto-currency?
 - Financial instrument?
 - Inventory?
 - Intangible asset?
- Consensus... for now!





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