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## Taxes Vs. Intangibles

by Kevin Johnston



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Intangible assets create a need for special tax accounting for small businesses. An intangible asset is "an identifiable non-monetary asset without physical substance," according to Deloitte. The small-business owner expects the intangible asset to produce income in the future. Trademark and copyrights are examples. You must know how to account for intangible assets for the Internal Revenue Service.

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### Tax on Income from Intangible Assets

While the IRS doesn't tax intangible assets, it does tax income from them. Trademarks and copyrights, along with patents, can produce income for your small business. That income is taxed by the Internal Revenue Service. On your financial accounting, you might assign a monetary value to intangibles, but in your tax accounting, you only count the income, not the value of the asset itself.

### Deductons for Expenses for Intangible Assets

Intangible assets do not depreciate like a vehicle or a building. Instead, you can deduct the expenses for creating the intangible asset. This includes your research and development costs, legal fees and licensing fees for creating copyrights, patents, trademarks and computer software.

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### Foreign Jurisdictions for Royalty Assets

Countries such as Ireland and the Netherlands have created havens for royalty owners by offering lower tax rates for income from royalties. If your small business creates a foreign research and development subsidiary in a country that offers tax breaks for royalty income, you can legally claim half ownership, and the half with your foreign subsidiary will incur reduced taxes.

### State Property Taxes

Most states do not tax intangible assets as property. However, each state has exceptions. For example, Kentucky does not tax copyrights and patents, but does tax research libraries. Delaware and Nevada do not tax intangibles, but Oklahoma, New Jersey and West Virginia have collected taxes on companies that claim they are incorporated in Nevada and Delaware while operating in other states. This tax includes property tax on intangibles.

### Sale of Intangible Rights

If your business sells an intangible asset such as a patent, you must pay tax on the sale as regular income. Only song catalogs can be sold and taxed at the capital gains rate. You must determine your cost basis for intangibles. According to the IRS, the cost basis for copyrights and patents included fees for attorneys and licenses. Neither the inventor's time nor the author's time can be counted as part of the cost basis. For research and development, if you deduct associated costs as current business expenses, you may not count them as part of the cost basis. You pay tax on any income from the sale of an intangible above the cost basis.

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### About the Author

Kevin Johnston writes for Ameriprise Financial, the Rutgers University MBA Program and Evan Carmichael. He has written about business, marketing, finance, sales and investing for publications such as "The New York Daily News," "Business Age" and "Nation's Business." He is an instructional designer with credits for companies such as ADP, Standard and Poor's and Bank of America.

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