

# Differences in Accounting and Tax Treatment of Intangible Assets in Self-developed Enterprises

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**Abstract:** In order to respond positively to the national support for the innovation ability of small and medium-sized enterprises and reduce the operating burden of small and medium-sized enterprises, corresponding policy regulations has been made in the field of accounting and tax law for enterprises in dealing with intangible assets. This article takes the self-developed intangible assets as the starting point, probes into the differences in accounting and tax law treatment, explains the tax effect it brings about to enterprises based on the differences between the two, and puts forward suggestions of improvement on the unclear identification of expense and capitalization.

**Keywords:** Self-R&D; Intangible Assets; Accounting; Tax Law

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## 1. Concept and characteristics of intangible assets

### 1.1 Concept of intangible assets

An intangible asset refers to an asset without a physical form of identifiable non-monetary asset owned or controlled by an enterprise.

### 1.2 Characteristics of intangible assets

Intangible assets are the resources owned or controlled by enterprises and can bring economic benefits. This means that an enterprise has the ownership of intangible assets, and the intangible assets can bring future economic benefits to the enterprise in turn<sup>[1]</sup>. Meanwhile, intangible assets do not have physical forms. They are invisible and untouchable. Even if the existence of some intangible assets depends on the physical carrier, it still doesn't change its own nature. Different from fixed assets to bring future economic benefits to enterprises by wear and transfer of physical value, intangible assets, to a large extent, bring future economic benefits to enterprises through their own advantages such as technology. Although intangible assets do not have physical forms, they must be identifiable as assets<sup>[2]</sup>. Because this nature can help us to separate or divide intangible assets from enterprises and use them separately for sale or transfer, etc, arising from contractual or other legal rights. Finally, intangible assets are classified as non-monetary assets, which are caused by the uncertainty that intangible assets have no developed trading market and are generally not easily converted into cash and bring future economic benefits to enterprises in the holding process.

## 2. Comparison of accounting and tax law differences between self-developed intangible assets

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## 2.1 Comparison in the R & D stages

The treatment principle under the accounting system is that under the old system, the accounting treatment of research expenses in China is treated as expenses, which is included in the current profit and loss. After the research and development (R&D) activities, whether successful or not, it is not exactly considered intangible assets, and is not in line with the importance, relevance and reliability of accounting information. Therefore, under the new accounting standards, China divides the research and development of intangible assets into two stages<sup>[3]</sup>, which are the research stage and the development stage. It will spend all expenses in the research stage into the current profit and loss (management expenses). The development stage payment is qualified to do capitalization treatment, and is not qualified into the current profit and loss. If we cannot make accurate judgement, all R&D expenditures are fully expensed and recorded into current gains and losses.

However, in terms of tax law, according to the regulations of the Enterprise Income Tax Law, if an enterprise fails to account for the profits or losses of the current period in order to develop new technologies, new products and new processes, it shall, on the basis of the actual deduction, add 50% of the R&D expenses and amortize the intangible assets according to 150% of the cost of intangible assets (75% plus and 175% amortization for small and medium-sized technological enterprises)<sup>[4]</sup>.

On June 1, 2009, company A, as a ordinary enterprise, carried out a study on intangible assets. On December 31, 2009, the intangible assets reached their intended use state. Assuming that in the process of research and development of intangible assets, the total expenditure of enterprises is 2,000,000 CNY, of which 400,000 CNY is spent on research stage; 1,600,000 CNY is spent on development stage, and the pre-tax profit of enterprises deducting R&D expenditure in that year is 2,000,000 CNY (Enterprise income tax rate applicable to enterprises is 25%).

## 2.2 Accounting treatment

Borrowing:

expenditure on R&D — expense expenditure 400,000

expenditure on R&D — capitalized expenditure 1,600,000

Loan:

payable to employee / raw material 2,000,000

accounting treatment in place as at 31 December 2009

Borrowing:

intangible assets 1,600,000

management costs 400,000

Loan:

expenditure on R&D — expense expenditure 400,000

expenditure on R&D — capitalized expenditure 1,600,000

Tax law treatment: the amount deductible for the expense component is  $400,000 \times 150\% = 600,000$

Forming part of intangible assets are amortized according to 150% of the cost of intangible assets, that is  $1,600,000 \times 150\% = 2,400,000$ , and the tax law stipulates that the amortization expenses of intangible assets calculated according to the straight line method shall be deducted, and the amortization period shall not be less than 10 years, assuming that the amortization period of the intangible assets of company A is 10 years and the net residual value is 0.

Then, the amount amortized by enterprise a for 2009 is  $1,600,000 \times 150\% / 10 = 240,000$ .

Accounting amortization amount:  $1,600,000 / 10 = 160,000$

Accounting profit total:  $2,000,000 - 400,000 - 160,000 = 1,440,000$

Taxable income:  $2,000,000 - 600,000 - 240,000 = 1,160,000$

Income tax payable:  $1,160,000 \times 25\% = 290,000$

### **3. Differences in the subsequent measurement of intangible assets**

In the follow-up process of intangible assets, there are still differences in amortization and decrease in value in accounting and tax law. In short, the difference between the two is mainly reflected in the intangible assets with uncertain service life. Accounting for the intangible assets with uncertain service life do not need to be amortized, and only need to carry out asset impairment test at the end of each year, and the impairment can be calculated<sup>[5]</sup>. However, under the tax law, all intangible assets except goodwill are amortized, regardless of their duration, can be deducted from the income tax of the enterprise. Based on the above analysis, because of differences in accounting and tax law, the division of the two stages of self-developed intangible assets does not clearly indicate the criteria for division in policy. Therefore, there are often many problems as enterprises dealing with daily business processing. The following content is to discuss on the actual problems accordingly encountered by enterprises.

#### **3.1 Problems that enterprises may have in practice**

To a certain extent, accounting and tax laws divide the boundaries of enterprises for the treatment of self-developed intangible assets, but in the actual operation process, there are many difficulties. The new guidelines require enterprises capitalize by utilizing the following conditions. Firstly, it is technically feasible to improve and perfect intangible assets so that they can be used or sold. It is therefore determined that the intangible asset is developed with the intention of completing the intangible asset and using or selling it. The second is to explain how intangible assets generate economic benefits, including the ability to prove that the product produced by the use of the intangible asset exists in the market or that the intangible asset itself exists in the market, and that the intangible asset used internally should prove its usefulness<sup>[6]</sup>. Furthermore, there is sufficient technical, financial and other resources to support the development of the intangible asset and the ability to use or sell the intangible asset. This is mainly for the intangible asset development process to has technical reliability, property and other resources support, to prove the enterprise needs the technology, the property and other resources in the development process, and its enterprise obtains these resources related plan. Finally, expenditure attributable to the intangible asset development phase can be reliably measured.

Therefore, when enterprises actually study and develop intangible assets, there are often expenses and unclear capitalization boundaries, which require the accountants and managers of the company to judge and divide<sup>[7]</sup>. However, for the above two subjects, they often do not participate in the research and development of intangible assets of enterprises. At the same time, because the way that intangible assets bring benefits to enterprises is different from the way that fixed assets bring future economic benefits to enterprises through the wear and transfer of physical value, most of them are related to the trade secrets of enterprises, especially for high-tech enterprises. Therefore, these self-developed core technologies, often will not be known by other individuals outside the research team in order to better protect these business secrets, which also leads to the daily operation of the enterprise. In the accounting treatment of these two stages, enterprises are often difficult to make accurate divisions. The division of these two stages in accounting and tax law treatment gives enterprises discretionary power. Although, under the premise of rational use of this discretion, enterprises can appropriately reduce the tax burden for enterprise development, thus alleviating the inevitable shortage of funds for the vast majority of small and medium-sized enterprises in the current economic environment, which is conducive to the further development of enterprises. However, at the national level, this initiative may make the book value of intangible assets lower than the real value, thus creating the suspicion of tax evasion, or may make the profits of enterprises undervalued, affecting the investment and financing situation of enterprises. Therefore, enterprises in their own judgment, should proceed from their own reality, consider the impact of various aspects, find a truly suitable treatment for the development of the enterprise itself as far as possible, and ensure that on the basis of not violating the provisions of the state to maximize the interests of enterprises. Through the discussion of the above questions, the following suggestions are put forward<sup>[8]</sup>.

#### **3.2 Recommendations and measures for improvement**

First of all, we should improve the accounting treatment system between industries. For different industries, some industry leaders can be brought together to establish a set of accounting standards belonging to the industry. Meanwhile, enterprises themselves can also set their own enterprise standards under the big industry standards to facilitate the accounting practitioners of enterprises, and to make corresponding accounting judgment and processing, and is also conducive to the reduction of the differentiation of accounting treatment within the industry, and is convenient for the overall management of different industries<sup>[9]</sup>. While giving enterprises some policy flexibility, we should strengthen the external supervision system of enterprises. Any activity in today's society should be monitored accordingly to prevent abuse of rights. In the process of dealing with intangible assets, because of the particularity of intangible assets themselves, there will be all kinds of financial fraud in the process of actual implementation. Therefore, strengthening the external supervision of enterprises can make enterprises carry out their behavior more accurately. Finally, we should strengthen the training system for the relevant financial personnel: as the financial personnel to evaluate the value of intangible assets of the enterprise. It is necessary to minimize the difference in the judgment of different stages, which requires the financial workers to strengthen the professional judgment ability of this, so as to reduce the large cognitive differences between people due to different perceptions of the same thing<sup>[10]</sup>.

## 4. Conclusion

Through the appeal to the intangible assets concept, the accounting and the tax law processing difference contrast, the enterprise may exist in the processing actual question and the corresponding improvement plan elaboration, causes us to further understand the importance of correctly handling the enterprise intangible assets accounting and the tax law policy difference, and provides the corresponding suggestion for the enterprise to deal with the intangible assets correctly the stage division, and is advantageous for the enterprise to make the corresponding adjustment in the daily operation activity.

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