NPV & ASSOCIATES
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CAPITALIATIZATION OF BRAND BUILDING EXPENSES

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ISSUE:
Can the expenses relating to brand building be capitalized towards intangible assets?

PROVISIONS:
In relation to Intangible assets, **Accounting Standard 26** lays down the fundamentals. I am presenting the relevant provisions and interpretations as below:

Applicability:
Para 3- This Standard applies to, among other things, expenditure on advertising, training, start-up, research and development activities. Research and development activities are directed to the development of knowledge. Therefore, although these activities may result in an asset with physical substance (for example, a prototype), the physical element of the asset is secondary to its intangible component, that is the knowledge embodied in it.

Definitions:
Para 6 –
An intangible asset is an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.

An asset is a resource:
(a) Controlled by an enterprise as a result of past events; and
(b) From which future economic benefits are expected to flow to the enterprise.

Illustrations of Intangible Assets:
Para 7 - Enterprises frequently expend resources, or incur liabilities, on the acquisition, development, maintenance or enhancement of intangible resources such as scientific or technical knowledge, design and implementation of new processes or systems, licences, intellectual property, market knowledge and trademarks (including brand names and publishing titles). Common examples of items encompassed by these broad headings are computer software, patents, copyrights, motion picture films, customer lists, mortgage servicing rights, fishing licences, import quotas, franchises, customer or supplier relationships, customer loyalty, market share and marketing rights.

Recognition criteria of Internally generated Intangible asset:
Para 39 - To assess whether an internally generated intangible asset meets the criteria for recognition, an enterprise classifies the generation of the asset into:
(a) A research phase; and
(b) A development phase.

Research Phase
Para 41 - No intangible asset arising from research (or from the research phase of an internal project) should be recognised. Expenditure on research (or on the research phase of an internal project) should be recognised as an expense when it is incurred

Development Phase:
Para 44 - An intangible asset arising from development (or from the development phase of an internal project) should be recognised if, and only if, an enterprise can demonstrate all of the following:

(a) The technical feasibility of completing the intangible asset so that it will be available for use or sale;
(b) Its intention to complete the intangible asset and use or sell it;
(c) Its ability to use or sell the intangible asset;

(d) How the intangible asset will generate probable future economic benefits. Among other things, the enterprise should demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset;
(e) The availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and
(f) Its ability to measure the expenditure attributable to the intangible asset during its development reliably

Para 50 - Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance should not be recognised as intangible assets.

Recognition of Expense:
Para 56: In some cases, expenditure is incurred to provide future economic benefits to an enterprise, but no intangible asset or other asset is acquired or created that can be recognised. In these cases, the expenditure is recognized as an expense when it is incurred. For example, expenditure on research is always recognised as an expense when it is incurred (see paragraph 41).

Examples of other expenditure that is recognised as an expense when it is incurred include:
(a) Expenditure on start-up activities (start-up costs), unless this expenditure is included in the cost of an item of fixed asset under AS 10. Start-up costs may consist of preliminary expenses incurred in establishing a legal entity such as legal and secretarial costs, expenditure to open a new facility or business (pre-opening costs) or expenditures for commencing new operations or launching new products or processes (pre-operating costs);

(b) expenditure on training activities;

(c) expenditure on advertising and promotional activities; and

(d) expenditure on relocating or re-organising part or all of an enterprise.

CONCLUSION:
There are two possibilities here.

1) The expenses incurred for promotions and brand building result in a creation of Intangible Asset (as defined under AS 26). In such a case, the expenses can be capitalized (both as per Accounting Standard and as per Income Tax Provisions)

2) The expenses incurred do not result in an intangible asset. In this situation, they will be required to be expensed out in the statement of profit and loss account. (both as per Accounting Standard and as per Income Tax Provisions)