

## Depreciation on Goodwill- Ind AS vs. Income Tax Act

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#### 1. What is goodwill?

In general, when someone acquires a business as a going concern and purchase consideration paid for the business is more than the net assets acquired, the difference is recognized as goodwill in accounting. It is an intangible asset arising from business connections or trade name or reputation of an enterprise. Goodwill conveys a positive reputation built by a person/company/business concern over a period of time. It is built painstakingly over the years through special efforts.

#### 2. Ind AS and Goodwill:

Ind AS 103, dealing with Business Combinations, defines goodwill as under:

**Goodwill:** *An asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognised.*

*Recognising and measuring goodwill or a gain from a bargain purchase:*

**32. The acquirer shall recognise goodwill as of the acquisition date measured as the excess of (a) over (b) below:**

(a) the aggregate of:

(i) the consideration transferred measured in accordance with this Indian Accounting Standard, which generally requires acquisition-date fair value (see paragraph 37);

(ii) the amount of any non-controlling interest in the acquiree measured in accordance with this Indian Accounting Standard; and

(iii) in a business combination achieved in stages (see paragraphs 41 and 42), the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree.

(b) the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with this Indian Accounting Standard.

From the above it can be said that goodwill in a business combination is recognized as an asset. It is the difference between consideration and net balance of assets and liabilities assumed (measured in accordance with Ind AS 103).

Further, there may also be self-generated goodwill which is not acquired but created by the enterprise itself. In this regard, Ind AS [38](#) - Intangible Assets provides as under:

*'Internally generated goodwill:*

48. Internally generated goodwill shall not be recognised as an asset.

49. In some cases, expenditure is incurred to generate future economic benefits, but it does not result in the creation of an intangible asset that meets the recognition criteria in this Standard. Such expenditure is often described as contributing to internally generated goodwill. Internally generated goodwill is not recognised as an asset because it is not an identifiable resource (i.e it is not separable nor does it arise from contractual or other legal rights) controlled by the entity that can be measured reliably at cost.

50. Differences between the market value of an entity and the carrying amount of its identifiable net assets at any time may capture a range of factors that affect the value of the entity. However, such differences do not represent the cost of intangible assets controlled by the entity.'

**Hence, neither self-generated goodwill shall be recognized as an asset nor depreciation is normally allowed on it in accounting.**

### **3. Income tax Act on depreciation on goodwill:**

Under section 32(1) of the Act, deduction on account of depreciation allowance is available on tangible and intangible assets while computing income under the head '*profit and gains of business and profession*'.

As per Explanation 3 to S. 32(1), intangible assets eligible for depreciation are know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature acquired on or after April 1, 1998. However, 'goodwill' is not mentioned separately in the list of intangible assets eligible for depreciation.

The Supreme Court in the case of **CIT v. Smifs Securities Ltd.** [\[TS-639-SC-2012\]](#) has held that goodwill acquired on amalgamation (being difference between cost of assets and consideration paid) was a capital right which would fall under the expression 'any other business or commercial right of a similar nature' and, hence, eligible for depreciation while computing business income.

Gujarat High Court, in the case of **Vimalachal Print & Pack Pvt. Ltd.** , ruled that the difference between the cost of assets and the amount paid constituted goodwill, which was acquired in the process of amalgamation.

Recently, Bombay High court in the case of **CIT v. Aditya Birla Nuvo Ltd.** [\[TS-346-HC-2011\(BOM\)\]](#) has also held the goodwill would be eligible for depreciation. The High Court simply followed decision in *Smifs Securities* case (*supra*).

### **4. Depreciation on goodwill arising on Amalgamation/Demerger:**

Even though the Supreme Court in the case of **Smifs Securities** (*supra*) has decided that goodwill is depreciable asset, one may note that the contention before the court was not as to whether difference arising out of amalgamation was goodwill eligible for depreciation.

*The said ruling of the Hon'ble Supreme Court is only on the point whether the goodwill falls in the category of intangible assets or any other business or commercial rights of similar nature as per the provisions of section 32(1) of the Act. Therefore there is no quarrel on the issue that goodwill is eligible for depreciation. However the said judgment would not over-ride the provisions of 5th proviso to Section 32(1) of the Act which restricts the claim in the cases specified thereunder.... [United Breweries [\[TS-7201-ITAT-2016\(BANGALORE\)-O\]](#).*

Bangalore Tribunal has dealt with this issue of allowability of depreciation on goodwill created in a merger. The Tribunal in the case of **United Breweries** (*Supra*), has argued that based on the fifth proviso to section [32\(1\)](#), the total claim of depreciation to the amalgamating company and the amalgamated company in the case of an amalgamation shall not exceed in any previous year, the deduction as if the amalgamation had not taken place. Any such deduction shall be apportioned between the amalgamating company and the amalgamated company in the ratio of the number of days for which the assets were used by them.

The Tribunal further substantiates its argument by the *Explanation 3* to section 43(1) which provides specific anti-abuse provisions in the event the Assessing Officer is satisfied that the main purpose of the transfer of assets previously used for the purposes of business was the reduction of tax liability by way of an increased depreciation claim.

This is also clear if we refer to section 55(2)(a)(ii) r.w.s. 49(1)(iii)(e) r.w.s. 47(vi)/(vib) of the Act. On combined reading of these provisions, it can be observed that:

- *Cost of acquisition' of **goodwill of a business** means the amount of the purchase price in case the goodwill is purchased by the assessee from a previous owner.*

- Cost of acquisition' of self generated goodwill of a business shall be taken to be NIL

- *Where the goodwill became the property of the assessee under any transfer as is referred to in clause (vi)/(vib) of section 47 (transfer in a case of amalgamation or demerger), the cost of acquisition of the goodwill shall be deemed to be the cost for which the previous owner of the property acquired it.*

Thus, cost of acquisition of goodwill acquired as a result of amalgamation/demerger in the hands of amalgamated/resulting company shall be deemed to be the cost for which the previous owner (amalgamating /demerged company) acquired it, i.e. **NIL**.

**It is interesting to note that decisions favouring the proposition that depreciation is allowable on goodwill arising out of amalgamation, various section, such as 5<sup>th</sup> proviso to section 32 (1), Explanation 7 to section 43(1) and section 55(2)(a)(ii) r.w.s. section 49(1)(iii)(e) r.w.s. 47 were not referred.**

#### **Conclusion:**

As per the decision of the Supreme Court goodwill falls in the category of intangible assets or any other business or commercial rights of similar nature as per the provisions of section 32(1) of the Act. Therefore, *prima facie* depreciation is allowable on the goodwill recognized as per Ind AS 103 discussed above.

Goodwill acquired in any business combination (amalgamation or otherwise) shall be recognized in accounts as per Ind AS 103, however, depreciation cannot be claimed on goodwill arising out of amalgamation under the existing provisions of the Income-tax Act, 1961.

In view of Ind AS 38, neither self-generated goodwill shall be recognized as an asset nor is depreciation allowed on it under Income Tax Act.