

## Depreciation on Goodwill & Intangibles - Revisiting the Reform

Dec 03, 2021



### S. Vasudevan

Executive Partner, Lakshmikumaran & Sridharan Attorneys



### Ankur Kishanpuria

Principal Associate, Lakshmikumaran & Sridharan Attorneys



### Sonali Bansal

Associate, Lakshmikumaran & Sridharan Attorneys

There has been a prolonged battle on the issue of allowability of depreciation on goodwill. While taxpayers have been claiming depreciation on goodwill treating it is an intangible asset under section 32(1) of Income-Tax Act (**'IT Act'**), income tax department has consistently disallowed the same. This dispute has been laid to rest to some extent by the decision of Apex Court in the case of *Smifs Securities Ltd.*<sup>[1]</sup> wherein the Hon'ble court held that goodwill is an intangible asset under section 32(1) and hence, eligible for depreciation. Relying on the aforesaid decision, many taxpayers have claimed depreciation on goodwill arising out of business reorganisation.

In the above background, the legislature has specifically excluded goodwill from the definition of assets with effect from Assessment Year 2021-22. Thus, no depreciation will be available on goodwill, as a class of asset, irrespective of the manner in which such goodwill had arisen.

The said amendment has had a major impact on business reorganisation transactions wherein the consideration (at fair market value) payable by transferee exceeds the net worth of the transferred undertaking. Even if such excess consideration is recorded as goodwill, transferee will not be eligible to claim depreciation. A possible solution to the above issue is that the transferee may get a detailed valuation report for the all the assets acquired from the transferor including intangible assets like business contracts, business records, territorial know-how, manufacturing rights, marketing rights etc., even if the same were not recognized in the books of the transferor. In this manner, a significant part of the excess consideration can be allocated to intangible assets other than goodwill. Now, the issue is whether such intangible assets can be considered as 'assets' eligible for depreciation under section 32 of the IT Act.

Section 32(1) of the IT Act allows depreciation on various tangible and intangible assets. Post amendment by the Finance Act, 2021, the scope of “intangible assets” covers know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, not being goodwill of a business or profession.

As per Explanation 3 to section 32(1), any business or commercial rights which are similar in nature to know-how, patents, copyrights, trademarks, licences and franchises will be considered as intangible assets eligible for depreciation under section 32(1). Now, the issue which arises is what kind of intangible assets can be considered as ‘*any other business or commercial rights of similar nature*’ to be eligible for depreciation. Can intangible assets like business contracts, business records, distribution network, territorial know-how etc. be considered as business or commercial rights eligible for depreciation?

In this regard, reference is made to the following judicial precedents, wherein the aforesaid issue was dealt with -

- ***Techno Shares & Stocks Ltd. vs. CIT***[\[2\]](#)

The Hon’ble Apex Court held that intangible assets owned by the assessee and used for the business purpose which enables the assessee to access the market and has an economic and money value is a “license” or “akin to a license”. As membership card of a stock exchange enables the member to access the stock exchange, it is a licence or business or commercial right similar to licence and hence, eligible for depreciation under section 32(1)(ii).

- ***Areva T & D India Ltd. vs. DCIT*** [.\[3\]](#)

The Hon’ble High Court held that the nature of “business or commercial rights” cannot be restricted to only the six intangible assets specified in section 32(1)(ii) and it is sufficient if its nature is of the same genus as that of the six specified assets. The High Court further observed **that all the specified intangible assets fall in the genus of intangible assets that form part of the tool of trade of an assessee facilitating smooth carrying on of the business.**

Thereafter considering the facts of the case, the Hon’ble High Court noted that intangible assets (like business contracts, business records, business information, skilled employees and know how) acquired by the assessee pursuant to slump sale gives a head start to the assessee, without which the assessee would have had to start the business from scratch. Hence, the said intangible assets are similar to licence for carrying on the business. Accordingly, the High Court held that the said intangible assets are business or commercial rights of nature **similar to licence** and are eligible for depreciation.

- ***CIT vs. Hindustan Coca Cola Beverages (P.) Ltd*** [.\[4\]](#)

The Hon’ble High Court agreed to the order of ITAT, wherein the ITAT had treated intangible assets like marketing and trading reputation, trade style and name, marketing and distribution and territorial know-how as business or commercial rights of similar nature eligible for depreciation.

- ***PCIT vs. Bayer Vapi (P.) Ltd*** [.\[5\]](#)

The Hon’ble High Court upheld the order of ITAT. The Hon’ble ITAT relying on the decision of Delhi High Court in case of *Areva T & D India Ltd. vs. DCIT* (Supra) held that intangible assets (like manufacturing rights, marketing rights, other commercial rights and other assets relating to development, manufacturing process, registration, use, sale marketing and distribution of product) acquired pursuant to slump sale are intangible assets eligible for depreciation.

- ***SKS Micro Finance Ltd. vs. DCIT***[.\[6\]](#)

The Hon’ble ITAT observed that the customer base acquired by the assessee pursuant to acquisition of business of transferor has provided as impetus to its as customers acquired have a proven track record. The customer base is an assured source of economic benefit and **certainly are tools of trade which facilitates the assessee to carry on the business smoothly and effectively** . Hence, the customer base is business or commercial right of similar nature eligible for depreciation.

- **India Capital Markets (P) Ltd. vs. DCIT.** [\[7\]](#)

The Hon'ble Mumbai ITAT held that client base acquired by the assessee is a business or commercial right of similar nature, **as such client base is used as tool to carry on the business of the assessee.**

In light of the above judicial pronouncements, it can be inferred that the intangible assets which form part of tools of trade in facilitating smooth functioning of the business are '*business or commercial rights of similar nature*' in terms of section 32(1). Since, intangible assets like business contracts, business records, business information, manufacturing rights, marketing rights, customer base facilitate in smooth and effective running of business, it may be said that they are '*business or commercial rights of similar nature*' eligible for depreciation.

On the basis of the above discussion, one may explore the possibility of obtaining appropriate valuation of the intangible assets acquired pursuant to business reorganisation and claim depreciation thereon. However, such claim is not free from dispute and the revenue may always contend that the acquired intangible assets are not of nature similar to the six intangible assets specified in Explanation 3 to section 32(1) and disallow depreciation. To settle the issue, the legislature may consider clarifying the phrase '*business or commercial rights of similar nature*' and to define the scope of the term '*goodwill*'. Such a move can bring clarity as to which intangible assets will be eligible for depreciation.

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[\[1\] \[TS-639-SC-2012-O\]](#)

[\[2\] \[TS-139-SC-2010-O\]](#)

[\[3\] \[TS-189-HC-2012\(DEL\)-O\]](#)

[\[4\] \[TS-7-HC-2011\(DEL\)-O\]](#)

[\[6\] \[TS-6900-ITAT-2013\(HYDERABAD\)-O\]](#)

[\[7\] \[TS-883-ITAT-2012\(MUM\)-O\]](#)