

DEPRECIATION ON GOODWILL

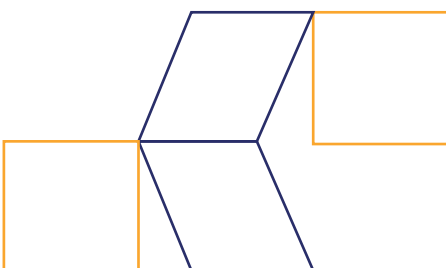
March 2021




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The issue regarding allowability of depreciation on goodwill has thus witnessed significant debate with the matter being deliberated in various judicial forums in several cases. Even after the pronouncement of judgement by the Supreme Court in this regard, there has been considerable litigation on this issue. The Finance Act, 2021 seeks to put rest to this prolonged debate and nullify the Supreme Court judgement by expressly specifying in the Act that goodwill of business or profession shall not be eligible for depreciation. The amendments enacted by the Finance Act, 2021 in relation to depreciation on goodwill are likely to have a far-reaching impact on M&A transactions. This publication outlines the genesis, the juris prudence which has developed over a period of time as well as the impact of the amendments enacted by the Finance Act, 2019 for transactions already entered into as well as any future acquisitions.

1.

Background on depreciation on intangible assets

- 1.1. The provisions relating to depreciation on assets are contained in section 32 of the Act. Section 32 of the Act provides for deduction in respect of depreciation of tangible assets and intangible assets. Such deduction is available at prescribed percentage of written down value ('WDV') of block of assets. Section 32 of the Act lists know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, acquired on or after 1 April 1998, as intangible assets eligible for depreciation.
- 1.2. The term 'block of assets' is defined under section 2(11) of the Act as under –
"block of assets" means a group of assets falling within a class of assets comprising—
(a) *tangible assets, being buildings, machinery, plant or furniture ;*
- (b) *intangible assets, being know-how, patents, copyrights, trade-marks, licences, franchises or any other business or commercial rights of similar nature,*
in respect of which the same percentage of depreciation is prescribed;
- 1.3. Depreciation is thus allowable on specified intangible assets acquired by the assessee. Specific intangible assets mentioned in section 32(1)(ii) of the Act are followed by the expression 'any other business or commercial rights of similar nature'. Applying the rule of *ejusdem generis*, the expression 'any other business or commercial rights of similar nature' may be construed to include such rights which can be used as a tool to carry on the business.





- 1.4. Goodwill can basically be viewed as a bundle of commercial benefits and rights which depends upon a variety of circumstances or a combination of them. The location, trade name, service, standing of business, honesty and repute of those who run it, marketing and distribution network, territorial know-how, including information or consumption patterns and habits of consumers in the territory, the lack of competition and many other factors go together to make up the goodwill.
- 1.5. In accounting parlance, goodwill represents excess consideration paid over the net assets taken over by the acquirer. Accounting Standard 14 on Accounting for Amalgamations provides that goodwill arising on amalgamation represents a payment made in anticipation of future income and it is appropriate to treat it as an asset to be amortized to income on a systematic basis over its useful life. Indian Accounting Standard 103 on Business Combinations defines the term 'goodwill' as an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized. For instance, Co A acquires the business of Co
- B for a total consideration of 100. Co A attributes 60 towards fair value of net assets acquired by it from Co B in its books of accounts. The balance amount of 40 is generally recorded as goodwill¹ and such excess payment is made by Co A for acquiring the intangible benefits associated with the business carried on by Co B which is now acquired by Co A.
- 1.6. Given the nature of goodwill, taxpayers have argued that it possesses all attributes of business and commercial rights and is hence an intangible asset eligible for depreciation. The issue regarding whether depreciation would get covered within the ambit of 'any other business or commercial rights of similar nature' and consequent allowability of depreciation on goodwill as an intangible asset has been a subject matter of protracted litigation.

1. Applying purchase method of accounting as per Accounting Standard 14 or as per acquisition method of accounting as per Indian Accounting Standard 103





2.

Position prior to Supreme Court judgement in Smifs Securities

- 2.1. The debate regarding allowability of depreciation on goodwill was put to rest by the decision of Supreme Court in the case of Smifs Securities Ltd². Even prior to the decision of Supreme Court, there have been favourable rulings upholding assessee's claim of depreciation on goodwill.
- 2.2. High Court of Delhi in case of Hindustan Coca Cola Beverages (P.) Ltd³ while deciding the validity of revisionary proceedings under section 263 of the Act observed that the acceptance of the claim of the assessee regarding depreciation on goodwill by the Assessing Officer would come in the compartment of taking a plausible view. The assessee's claim for depreciation on goodwill had been allowed in few other judicial precedents⁴ as well.
- 2.3. Panaji bench of Tribunal in Chowgule & Co. (P.) Ltd⁵ had however rejected the assessee's claim of depreciation on goodwill. It held that on the

appointed date, the undertaking of the transferor company did not have any asset and property as goodwill or such intangible asset in its accounts which could become a subject matter of transfer or vesting of the asset to the transferee company. There was thus no cost of acquisition on account of goodwill to the assessee. The High Court of Bombay⁶ however subsequently reversed the decision of the Tribunal and had allowed depreciation on goodwill by relying on the decision of Supreme Court in Smifs Securities (supra).

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2. CIT v. Smifs Securities Ltd [2012] 348 ITR 302
 3. CIT v. Hindustan Coca Cola Beverages (P.) Ltd [2011] 198 Taxman 104
 4. A.P. Paper Mills Ltd. v. ACIT [2010] 128 TTJ 596 (Hyderabad); B. Raveendran Pillai v. CIT [2010] 194 Taxman 477 (Kerala); Jeypore Sugar Co. Ltd v. ACIT [2011] 44 SOT 625 (Vishakhapatnam); Kotak Forex Brokerage Ltd v. ACIT [2009] 33 SOT 237
 5. Chowgule & Co. (P.) Ltd v. ACIT [2011] 9 ITR(T) 21
 6. Chowgule & Co. (P.) Ltd. v. ACIT (Tax Appeal No. 28 of 2012)

3.

Supreme Court judgement in Smifs Securities

- 3.1. The Supreme Court in Smifs Securities (supra) held that goodwill is an asset within the meaning of section 32 of the Act and depreciation on goodwill is allowable under the said section.
- 3.2. The Supreme Court noted that goodwill had arisen in the books of the assessee company on account of excess consideration paid by it over the net assets taken over in the scheme of amalgamation. The assessee claimed depreciation on such goodwill arising on amalgamation by contending that extra consideration was paid towards the reputation which the amalgamating company was enjoying in order to retain its existing clientele. The Supreme Court allowed the claim of the assessee by holding that goodwill would fall under the expression 'any other business or commercial right of a similar nature' in section 32 of the Act.
- 3.3. The Supreme Court however did not discuss the following provisions of the Act while ruling on allowability of depreciation on goodwill –



Sixth proviso to section 32(1) – In a case of succession/amalgamation/demerger during the previous year, depreciation is to be calculated as if the succession or amalgamation or demerger has not taken place during the previous year and is to be apportioned between the predecessor and the successor, or the amalgamating company and the amalgamated company, or the demerged company and the resulting company, as the case may be, in the ratio of the number of days for which the assets were used by them.

Explanation 7 to section 43(1) – the actual cost of the capital asset transferred to the amalgamated company shall be taken to be the same as it would have been if the amalgamating company had continued to hold the capital asset for the purposes of its own business. Explanation 7A to section 43(1) of the Act contains similar provisions in case of demerger.

Explanation 2 to section 43(6) – the actual cost of the block of asset in the hand of the amalgamated company would be the WDV of that block in the immediately preceding previous year in the case of amalgamating company as reduced by depreciation actually allowed in that preceding previous year. Explanation 2A to section 43(6) of the Act contains similar provisions in case of demerger.



- 3.4. A judgement rendered by a court is considered to be *per incuriam* when it has been decided by the court without reference to a statutory provision or an earlier judgement that would have been relevant. However, decision of the Supreme Court should be considered to have binding effect and to have considered all relevant provisions of law. Under Article 141 of the Constitution of India, the law declared by the Supreme Court shall be binding on all courts. Supreme Court in case of *Dunlop India Limited*⁷ upheld the proposition that decisions of the Supreme Court must necessarily be binding on all lower authorities and that the argument of *per incuriam* is only relevant as regards the right of the Supreme Court itself to decline to follow its earlier decisions. It does not confer any right on a lower authority to disregard judgments passed by higher courts on the ground that such judgments were rendered *per incuriam*. Also, Supreme Court in case of *Ballabhadras Mathuradas Lakhani*⁸ has held that the decision in a judgement of the Supreme Court cannot be ignored on the ground that certain aspects were not considered, or the relevant provisions were not brought to the notice of the Court. Thus, even where the Supreme Court did not expressly deal with the provisions stated in above para in its judgement, it should be regarded as having considered these provisions while pronouncing its order.
- 3.5. The above provisions may also be evaluated independently to determine their applicability while computing depreciation on goodwill. These provisions are relevant in case of computation of depreciation by the transferee / resulting company in respect of block of assets received from transferor company pursuant to the scheme of amalgamation / demerger. These provisions imply that the transferee company will not be entitled for depreciation on enhanced cost of assets. Rather, it would be entitled to same cost base of assets for computing depreciation as available to transferor company immediately before the amalgamation / demerger. In case of scheme of amalgamation / demerger, where goodwill is not appearing in the books of the transferor company and is rather recognized in course of the scheme, a proposition may be put forth by the taxpayer that Explanation 7 to section 43(1) and Explanation 2 to section 43(6) of the Act should not apply since they should apply only in case of assets that already appear in the books / tax block of the transferor company.
- 3.6. Further, sixth proviso to section 32(1) of the Act seeks to limit the amount of depreciation available to the transferee company post amalgamation / demerger to the extent of the amount of depreciation which would have been available to the transferee company, had there not been any amalgamation / demerger. Where there is no entry of goodwill in the books of accounts of the transferor company, a potential argument could be that the sixth proviso should not apply since it deals only with the assets recorded in the books of accounts of the transferor company. Mumbai bench of Tribunal in *Archroma India Pvt Ltd*⁹ held sixth proviso to section 32(1) to be applicable only to the extent of computation of depreciation on WDV of assets taken over from the transferor company and not to goodwill (being difference between consideration for slump sale and amount of assets taken over). Even where the sixth proviso to section 32(1) of the Act is considered to be applicable in a scheme of amalgamation / demerger / succession, considering that it refers to aggregate deduction in respect of depreciation allowable to predecessor and successor, arguably, its applicability should be restricted only to the first year i.e., the year in which such amalgamation / demerger / succession has taken place and not to subsequent years.
- 3.7. Thus, even where Explanations provided in section 43 and sixth proviso to section 32(1) are sought to be applied by the Revenue, the taxpayer may consider resorting to the above-mentioned arguments to defend its claim of depreciation on goodwill.

7. *Asst. Collector of Central Excise v. Dunlop India Limited* 1985 AIR 330

8. *Ballabhadras Mathuradas Lakhani vs Municipal Committee* AIR 1970 SC 1002

9. *ITO v. Archroma India Pvt Ltd* I.T.A. No. 306/Mum/2019



3.8. The Memorandum explaining the provisions of the Finance Act, 2021 relating to depreciation on goodwill states that while the Supreme Court has held that goodwill is a depreciable asset, the actual calculation of depreciation on goodwill is required to be carried out in accordance with the above-mentioned provisions of the Act [i.e., Explanations in section 43 and sixth proviso to section 32(1)]. The Memorandum further states that once these provisions are applied, in some situations (like that of business reorganization)

there could be no depreciation on account of actual cost being zero and the WDV of that assets in the hand of predecessor/amalgamating company being zero. It may be noted that the Memorandum to a Finance Act is not a binding document of law. Also, as stated above, it could be argued that these provisions should not be applied blanketly in every case and their applicability should be restricted to scenarios where goodwill is already appearing in the books of accounts / tax block of transferor company.





4. Position after Supreme Court judgement in Smifs Securities

4.1. The decision of Supreme Court in Smifs Securities (supra) thus established that goodwill is an intangible asset eligible for depreciation under section 32 of the Act. Relying on the decision of Supreme Court, the claim of taxpayer regarding depreciation on goodwill arising in the course of restructuring before the judicial forums stood fortified. Subsequent to the decision of Supreme Court in Smifs Securities (supra), there were a plethora of favourable decisions allowing

the claim of depreciation on goodwill including in the case of Zydus Wellness Ltd¹⁰ wherein the SLP filed by Revenue against the order of High Court of Gujarat was dismissed by the Supreme Court¹¹.

10. PCIT vs. Zydus Wellness Ltd [2017] 87 Taxmann.com 82 (Guj.)

11. PCIT vs Zydus Wellness Ltd (SLP (Civil) Diary No(s). 29859/2018)



- 4.2. The decision of Hyderabad bench of Tribunal in case of Mylan Laboratories Ltd¹² is also worth noting. In this case, Mylan Laboratories had acquired shares of two entities (target entities). The target entities which became wholly owned subsidiaries of Mylan Laboratories by virtue of share acquisition were subsequently merged into Mylan Laboratories following purchase method of accounting. The difference between the investment in wholly owned subsidiaries cancelled and fair value of net assets taken over on merger was recorded as goodwill and depreciation was claimed thereon under section 32 of the Act. The Tribunal, relying upon the decision of Supreme Court in *Smifs Securities (supra)* allowed the claim of the assessee company.
- 4.3. Thus, while in a normal case involving share acquisition, the acquirer entity could not have availed deduction of cost of acquisition of target against its business income, by undertaking a subsequent step of amalgamation of target entities into acquirer entity and consequent recognition of goodwill in the books, the acquirer entity could avail deduction in respect of depreciation on goodwill under section 32 of the Act. Delhi bench of Tribunal had allowed depreciation on goodwill in similar facts in case of *Aricent Technologies Holdings Ltd*¹³.
- 4.4. Mumbai bench of Tribunal in case of *Toyo Engineering India Limited*¹⁴ relying on Supreme Court decision allowed depreciation on goodwill arising on amalgamation of wholly owned subsidiary into the assessee company. The Tribunal in its earlier decision¹⁵ had disallowed the depreciation by stating that goodwill in this case was only a book entry. The Tribunal had held that in absence of valuation exercise undertaken by the assessee, there was no goodwill in the nature of commercial rights purchased by the assessee. The High Court of Bombay¹⁶ had restored the matter to the Tribunal for fresh decision on merits and in accordance with law in view of the decision of Supreme Court in *Smifs Securities (supra)*.
- 4.5. In a scenario involving amalgamation of subsidiary into its parent as discussed above, there would not be any issue of shares by the parent to the extent of its shareholding in the subsidiary. The shares held by the parent in its subsidiary would stand cancelled upon amalgamation. Goodwill recognized in the books of parent (amalgamated company) in such case would essentially be the excess of investment cancelled over net assets of subsidiary taken over by the parent. In such case, in absence of issue of shares, a view exists that there is no consideration discharged by the parent for acquiring the business of its subsidiary on amalgamation and hence the question of goodwill does not arise. Goodwill recorded in the books of accounts of the parent in such case is merely due to an accounting entry. An alternate view could be that cancellation of investment held by the parent in its subsidiary is in essence the consideration discharged by the parent for taking over the subsidiary and hence the difference between the consideration (being cancellation of investment) and net assets taken over is goodwill eligible for depreciation under section 32 of the Act. While arguments are available both in favour as well as against the taxpayer in such case, this aspect is yet to be tested before judicial forums.
- 4.6. The Bangalore bench of Tribunal in case of *United Breweries Ltd*¹⁷ took a contradictory view and did not allow depreciation on goodwill arising in course of amalgamation. In this case, the assessee company's subsidiary, viz. *Karnataka Breweries & Distillery Ltd. (KBDL)*, was amalgamated with the assessee company. The difference between fair value of assets taken over and consideration (being amount paid by assessee company for acquiring shares of KBDL) was treated as goodwill. The Tribunal rejected the assessee company's claim of depreciation on goodwill by holding that in view of fifth proviso to section 32(1) of the Act (now sixth proviso), the assessee (being amalgamated company) cannot claim or be allowed depreciation on the assets acquired in the scheme of amalgamation more than the depreciation is allowable to the amalgamating company.

12. *Mylan Laboratories Ltd v. DCIT* (ITA No. 2335/Hyd./2018)

13. *Aricent Technologies Holdings Ltd v. ACIT* (ITA No.5708/Del/2019)

14. *DCIT v. Toyo Engineering India Limited* (ITA No. 3279/M/2008) dated 13 October 2014

15. *DCIT v. Toyo Engineering India Limited* (ITA No. 3279/M/2008) dated 25 May 2012

16. *Toyo Engineering India Ltd v. DCIT* (ITA (L) No. 1330 of 2012)

17. *United Breweries Ltd v. ACIT* [2016] 76 taxmann.com 103



4.7. The Tribunal noted that in view of decision of Supreme Court in case of Smifs Securities (supra), there is no quarrel on the issue that goodwill is eligible for depreciation. It however remarked that the judgment of Supreme Court would not override the provisions of fifth proviso to section 32(1) of the Act (now sixth proviso) which restricts the claim in the cases specified thereunder. As mentioned earlier, even if sixth proviso to section 32(1) is held to be applicable, the applicability of sixth proviso ought to be restricted to the first year in which amalgamation has taken place and not to subsequent years.

4.8. In case of United Breweries, goodwill was already shown in the books of the amalgamating company, i.e., KBDL at INR 7.45 crores which was enhanced in the books of accounts of the assessee company to INR 62.30 crores upon amalgamation. Considering that goodwill was already appearing in the books of amalgamating company, the Revenue's contention of applicability of fifth proviso to section 32(1) was on a stronger foothold.

4.9. Ahmedabad bench of Tribunal in case of Bodal Chemicals Ltd¹⁸ did not concur with the contention of the assessee that Explanation 2 to section 43(6) and Explanation 7 to section 43(1) of the Act deal only with the assets already recorded in the books of accounts of the transferor company and do not deal with the intangible assets acquired in the scheme of amalgamation. The Tribunal observed that -

There was no entry in the books of the transferor company for the intangible assets/goodwill being self-generated assets and hence the impugned transaction of amalgamation for claiming the deduction on account of the depreciation is an arrangement for claiming the higher depreciation which is unwanted under the provisions of law.

The intent of the Legislature is to make amalgamation a tax neutral scheme for companies as well as for the shareholders and not to provide a tax planning mechanism to either of them.

The claim of assessee regarding depreciation on goodwill was however allowed by the Tribunal following the principle of consistency since assessee was already allowed such depreciation in the first year of amalgamation.

4.10. In a recent decision in case of Urmin Marketing (P.) Ltd.¹⁹, the Ahmedabad bench of Tribunal in a detailed well-reasoned order has however allowed the claim of depreciation on goodwill arising in course of amalgamation by holding that sixth proviso to section 32, Explanation 7 to section 43(1) and Explanation 2 to section 43(6) of the Act cannot be applied to the case on hand. The relevant observations of the Tribunal are mentioned below -

6th proviso to section 32, Explanation 7 to section 43(1) and Explanation 2 to section 43(6) of the Act deal with respect to the assets available/recorded in the books of the transferor company.

The same does not apply to goodwill acquired in the scheme of amalgamation from the amalgamating company because there was no entry in the books of accounts of the transferor company reflecting the value of the goodwill.

18. Bodal Chemicals Ltd v. ACIT [2019] 112 taxmann.com 217

19. Urmin Marketing (P.) Ltd. v. DCIT [2020] 122 taxmann.com 40



5.

Amendments enacted by Finance Act, 2021

The Finance Act, 2021 has enacted the following amendments in the Act with respect to depreciation on goodwill w.e.f. AY 2021-22.

5.1. Amendment to section 2(11) – Block of Asset

5.1.1. The definition of the expression ‘block of assets’ under section 2(11) of the Act prior to amendment by the Finance Act, 2021 read as under –

“block of assets” means a group of assets falling within a class of assets comprising—

(a) tangible assets, being buildings, machinery, plant or furniture ;

(b) intangible assets, being know-how, patents, copyrights, trade-marks, licences, franchises or any other business or commercial rights of similar nature.

in respect of which the same percentage of depreciation is prescribed;

5.1.2. The definition of ‘block of asset’ provided in section 2(11) of the Act has been amended by the Finance Act, 2021 to expressly provide that ‘block of asset’ shall not include goodwill of a business or profession.

5.2. Amendment to section 32 of the Act – Depreciation

5.2.1. Section 32 of the Act provides that depreciation on specified tangible and intangible assets shall be allowed as deduction at specified percentage of written down value (‘WDV’) of block of assets.

Clause (ii) of section 32(1) of the Act lists the intangible assets eligible for depreciation which essentially includes the same assets as provided in the aforementioned definition of block of assets under section 2(11) of the Act.

Further, Explanation 3 to section 32(1) of the Act defines the term ‘assets’ to mean specified tangible and intangible assets. This list of assets is also same as contained in section 2(11) and section 32(1)(ii) of the Act.

The provisions of section 32(1)(ii) and Explanation to section 32(1) of the Act have been amended by the Finance Act, 2021 to expressly provide that goodwill of a business or profession shall not be considered as an asset for the purpose of these provisions.

5.3. Amendment to section 43(6) of the Act – Definition of WDV

5.3.1. Section 43(6) of the Act defines the written down value (‘WDV’) of block of assets. The Finance Act, 2021 has amended item (ii) of sub-clause (c) of section 43(6) of the Act by providing that WDV of block of assets shall be further adjusted by –

(A) *the increase or reduction referred to in item (i), not being increase on account of goodwill of business or profession;*

(B) *the reduction by an amount which is equal to the actual cost of goodwill falling within that block as decreased by –*

(a) ...

(b) *the amount of depreciation that would have been allowable to the assessee for such goodwill for any assessment year*



commencing on or after the 1st day of April 1988 as if the goodwill was the only asset in the relevant block of assets,

in respect of the previous year relevant to the assessment year commencing on the 1st day of April, 2021, in a case where the goodwill of business or profession was part of the block of assets on which depreciation was obtained by the assessee for immediately preceding previous year, so, however, that the amount of such reduction does not exceed the written down value.

5.4. Amendment to section 50 of the Act – Special provision for computation of capital gains in case of depreciable assets

5.4.1. Section 50 of the Act contains special provisions that are applicable for computing capital gains in case of depreciable assets. Sub-section (2) of section 50 of the Act prior to amendment by the Finance Act, 2021 read as under –

“Where any block of assets ceases to exist as such, for the reason that all the assets in that block are transferred during the previous year, the cost of acquisition of the block of assets shall be the written down value of the block of assets at the beginning of the previous year, as increased by the actual cost of any asset falling within that block of assets, acquired by the assessee during the previous year and the income received or accruing as a result of such transfer or transfers shall be deemed to be the capital gains arising from the transfer of short-term capital assets.”

5.4.2. Finance Act, 2021 has inserted a proviso to section 50(2) of the Act as under –

“Provided that in a case where goodwill of a business or profession forms part of a block of asset for the assessment year beginning on the 1st day of April, 2020 and depreciation thereon has been obtained by the assessee under the Act, the written down value of that block of asset and short term capital gain, if any, shall be determined in such manner as may be prescribed.”

5.5. Amendment to section 55 of the Act – Meaning of cost of acquisition of capital asset

5.5.1. Section 55 of the Act inter alia stipulates the cost of acquisition under specific scenarios and for specific assets. Section 55 has been amended by the Finance Act, 2021 by substituting clause (a) of sub-section (2) to provide that cost of acquisition in relation to a capital asset, being goodwill of a business or profession, or a trademark or brand name associated with a business or profession, or a right to manufacture, produce or process any article or thing, or right to carry on any business or profession, or tenancy rights, or stage carriage permits, or loom hours, –

- a) in the case of acquisition of such asset by the assessee by purchase from a previous owner, means the amount of the purchase price;
- b) in the case falling under sub-clause (i) to (iv) of section 49(1) and where such asset was acquired by the previous owner (as defined in that section) by purchase, means the amount of the purchase price for such previous owner;
- c) in any other case, shall be taken to be nil.

5.5.2. Further, a proviso has been inserted to clause (a) of section 55(2) to provide that in case of goodwill of business or profession acquired by the assessee by way of purchase from a previous owner [either directly or through modes specified under sub-clause (i) to (iv) of section 49(1)] and any deduction on account of depreciation under section 32 of the Act has been obtained by the assessee in previous year 2019-20 or earlier, then the cost of acquisition will be the purchase price as reduced by the depreciation so obtained by the assessee in previous year 2019-20 or earlier.

5.6. Applicability from which year

5.6.1. The above amendments will take effect from assessment year 2021-22 (financial year 2020-21) onwards.



6.

Impact of the amendments enacted by the Finance Act, 2021

6.1. Permissibility of depreciation on goodwill from FY 2020-21 (AY 2021-22) onwards

6.1.1. The Finance Act, 2021 has amended the Act to provide that goodwill will not be considered as a depreciable asset and depreciation will not be allowed on goodwill.

6.1.2. This amendment nullifies the decision of Supreme Court in case of Smifs Securities Ltd²⁰ wherein it was held that goodwill would fall under the expression 'any other business or commercial right of a similar nature' in section 32 of the Act and depreciation was held to be allowable on goodwill under section 32 of the Act.

20. CIT v. Smifs Securities Ltd [2012] 348 ITR 302



6.1.3. Further, the amendments do not provide for any distinction between goodwill recognized in the course of tax neutral reorganizations (merger, demerger) vs. goodwill recognized in the course of a taxable transaction (slump sale); nor does it provide for any differential treatment for transactions between related parties vs. transactions between unrelated parties. Considering the amendments enacted by the Finance Act, 2021, depreciation shall not be allowed on goodwill in any such scenarios.

6.1.4. Considering the aforesaid amendment, where an assessee acquires goodwill in FY 2020-21 or in subsequent financial year, such goodwill will not be regarded as a depreciable asset and the assessee will not be allowed any depreciation on the same. This would impact the acquisitions that have taken place in the current financial year where the acquirer would have factored depreciation on goodwill as an eligible tax break. Where such acquisition has already been concluded, the acquirer would need to consider interest liability on account of non-payment / short payment of advance tax in earlier quarters due to depreciation on goodwill not being eligible as a deduction w.e.f. FY 2020-21. For instance, a taxpayer has acquired a business in the first quarter of FY 2020-21 and also paid for goodwill for such acquisition. It may have considered such goodwill to be eligible for depreciation under section 32 of the Act by placing reliance on Supreme Court decision in case of Smifs Securities (supra) and may have accordingly computed its advance tax liability for the first three quarters. In light of the amendment enacted by the Finance Act, 2021, the taxpayer's advance tax liability for the first three quarters would increase resulting in interest liability under section 234C.

6.1.5. It has been held in certain judicial precedents²¹ that interest under section 234B / 234C should not apply due to advance tax liability arising due to retrospective amendment. Courts have held that an assessee should not be

fastened with interest liability on additions made on the basis of subsequent amendment, since the assessee could not have foreseen the liability, at the time of estimating his income for the purpose of payment of advance tax.

6.1.6. It would be interesting to test the contention of non-applicability of interest liability under section 234C of the Act by resorting to these judgements, by taking a plea that while making payment of advance tax in the first three quarters, the taxpayer could not have pre-empted such amendments and hence it could not have foreseen the consequent tax liability at the time of payment of installments of advance tax.

6.1.7. Further, where the acquisitions have not been concluded, the acquirer may need to revisit the acquisition modalities, purchase price allocation and the valuation / acquisition price with the acquisition becoming expensive due to denial of tax break for depreciation on goodwill.

6.2. Allowability of depreciation on goodwill claimed in years prior to FY 2020-21

6.2.1. Considering that the amendments enacted by the Finance Act, 2021 are effective from FY 2020-21, depreciation on goodwill legitimately claimed in earlier years should not be impacted by the amendment. The ratio of judgement of Supreme Court in case of Smifs Securities should continue to apply to such depreciation claimed in earlier years.

6.2.2. However, the Memorandum to the Finance Act, 2021 explaining the amendments with respect to depreciation claim on goodwill appear to imply that the depreciation on goodwill arising out of tax neutral business acquisitions in any case was always impermissible. As per the settled legal position, the Budget Speech of the Finance Minister, Notes on Clauses, circulars etc. are only secondary aids to

21. CIT vs JSW Energy Limited (2015) 379 ITR 36; DCIT v. Reliance Industries Ltd. (ITA No.7499/Mum/2018); DCIT v. Indo Rama Textiles Ltd. I.T.A. Nos. 678 & 679/Del/2012



interpretation and cannot be considered to be binding and cannot be referred to for the purpose of construing the provision when the words used in the provision are clear and unambiguous; nor can they be used for cutting down the plain meaning of the words in the provision.²² Thus, to the extent the Memorandum appears to imply a position that depreciation on goodwill arising on tax natural re-organisations was never admissible, the said observation seems to be incorrect and also irrelevant, since it should have no impact on the overall legal position. Depreciation already claimed in years prior to AY 2021-22 should be tested applying the ratio of the decision of Hon'ble Supreme Court in the case of Smifs Securities (supra) without any reference to the Memorandum to the Finance Act, 2021 or the amendments which are effective from AY 2021-22.

6.3. Depreciation on goodwill for FY 2020-21 and subsequent years when goodwill is already forming part of block of assets of intangible assets as on 1 April 2020

6.3.1. As mentioned above, the amendments relating to depreciation on goodwill are effective from FY 2020-21 onwards. An issue that arises for consideration is whether the amendment would impact only new goodwill that is acquired in FY

2020-21 or in subsequent years or does it also seek to impact goodwill that was acquired in earlier years and already forms part of block of assets as on 1 April 2020. In other words, one needs to evaluate whether goodwill which is already forming part of block of assets as on 1 April 2020 would be eligible for depreciation in FY 2020-21 and in subsequent years.

6.3.2. Section 32 of the Act provides that depreciation in case of block of assets shall be allowed as a certain percentage of written down value ('WDV') of such block of assets. WDV in case of block of assets is defined under section 43(6)(c) of the Act as WDV of block of assets in the immediately preceding previous year as reduced by the depreciation actually allowed in respect of that block of assets in relation to the said preceding previous year and adjusted by the following –

- a. Increase by the actual cost of any asset falling within that block, acquired during the previous year; and

22. Frick India Ltd. vs. Union of India AIR 1990 SC 689
CIT vs. Ahmed Bhai Umar Bhai AIR 1950 SC 134
Nalinakhya Bysack vs. Shyam Sundar Haddar AIR 1953 SC 148;
(ii) Western India Theatres Ltd. vs. Municipal Corporation, Poona AIR 1959 SC 586;
(iii) Nandini Satpathy vs. P.C. Dani AIR 1978 SC 1025.





b. Reduction of the moneys payable in respect of any asset falling within that block, which is sold or discarded or demolished or destroyed during that previous year together with the amount of the scrap value, if any.

6.3.3. The term WDV is thus expressly defined under the Act and is to be computed in a specified manner. Finance Act, 2021 has amended the definition of WDV by providing that WDV of block of assets shall be further reduced by an amount equal to actual cost of goodwill falling within that block as decreased by the amount of depreciation that would have been allowable for such goodwill as if the goodwill was the only asset in the block of assets. Such reduction is to be undertaken in respect of financial year 2020-21 in a case where the goodwill of business or profession was part of the block of assets on which depreciation was obtained by the assessee for immediately preceding financial year.

6.3.4. Considering the amendment to definition of WDV enacted by the Finance Act, 2021, goodwill forming part of block of assets as on 1 April 2020 would not be eligible for depreciation under the Act from FY 2020-21 onwards.

6.4. Impact on unabsorbed depreciation brought forward in FY 2020-21

6.4.1. Section 32(2) of the Act provides that where full effect cannot be given to allowance for depreciation under section 32(1) in any previous year, owing to there being no profits or gains chargeable for that previous year, or owing to the profits or gains chargeable being less than the allowance, then, subject to the provisions of section 72(2) and 73(3) of the Act, the allowance or the part of the allowance to which effect has not been given, as the case may be, shall be added to the amount of the allowance for depreciation for the succeeding financial year and deemed to be part of that allowance, or if there is no such allowance for the

said financial year, be deemed to be the allowance for that financial year, and so on for the succeeding financial years.

6.4.2. It is likely that an assessee had claimed depreciation on goodwill in earlier years which he was not able to set-off against the profits in its entirety. This would result in unabsorbed depreciation being available to the assessee as on 1 April 2020 for set-off in FY 2020-21 and subsequent years. The amendments enacted by the Finance Act, 2021 are silent on the treatment for such unabsorbed depreciation and do not specify whether the same would be eligible for set-off against the profits or not.

6.4.3. The tax department can contend that since unabsorbed depreciation is deemed to be depreciation of current year, unabsorbed depreciation pertaining to goodwill should not be allowed as deduction since goodwill per se is not treated as depreciable asset from FY 2020-21. This proposition could be more strictly applied in cases where unabsorbed depreciation is solely due to depreciation on goodwill.

6.4.4. However, It could be very well argued that unabsorbed depreciation of earlier years should be allowed to be set-off against profits of current year even though depreciation on goodwill is not allowable from FY 2020-21. The High Court of Gauhati in Singh Transport Co.²³ has held that section 32(2) of the Act is a complete code in itself and that unabsorbed depreciation allowance never loses its nature or character as depreciation allowance and is always required to be set off and carried forward by virtue of provisions of section 32(2) of the Act itself.

6.4.5. Further, it can be contended that in absence of any specific restriction for disallowing depreciation pertaining to goodwill from the quantum of unabsorbed depreciation, the amount of unabsorbed depreciation need not be disturbed and should be allowed to be set-off in full

23. CIT v. Singh Transport Co. [1980] 123 ITR 698 (Gauhati)



subject to the amount of profits during current year (balance amount being eligible for carry forward to subsequent years). In the context of section 115BAA and 115BAB of the Act, the legislature has specifically provided that unabsorbed depreciation pertaining to specified deductions / incentives shall not be allowed to be carried forward. No such similar treatment has been provided for carving out depreciation on goodwill out of unabsorbed depreciation.

6.4.6. The High Court of Bombay in *Shri Laxmi Printing & Dyeing Works (P.) Ltd.*²⁴ has held that the only qualification for unabsorbed depreciation to be treated as an allowance for the current year is that it must have been properly allowed in earlier years and by reason of its not being absorbed, must have been allowed to be carried forward to the subsequent year. The qualification of it being allowable on the basis of the machinery in respect of which it was claimed being in use was properly satisfied when the depreciation was allowed. There was nothing in clause (b) of the proviso to section 10(2)(vi) of the Indian Income-tax Act, 1922 (corresponding to section 32(2) of the 1961 Act) which required the qualification to be satisfied again, viz., that the machinery in respect of which it had been claimed in past years was in use in the assessment year also. Going by this premise, it could be argued that unabsorbed depreciation once properly allowed in earlier years should be allowed to be carried forward and set-off in current year even though such unabsorbed depreciation relates to goodwill.

6.5. Importance of purchase price allocation in case of new acquisition

6.5.1. Finance Act, 2021 restricts the scope of intangible assets by excluding goodwill from its purview for the purpose of allowing depreciation. However, depreciation on know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature (not being goodwill) acquired

by an assessee would still continue to be available.

6.5.2. High Court of Delhi in case of *Areva T&D India Ltd*²⁵ held that intangible assets such as business claims; business information; business records; contracts; employees and know-how acquired under slump sale agreement were in the nature of 'business or commercial rights of similar nature' specified in section 32(1)(ii) and were accordingly eligible for depreciation. Relying on the decision of Supreme Court in *Smifs Securities*, High Court of Bombay in *Birla Global Asset Finance Co. Ltd.*²⁶ allowed depreciation on business and commercial brand equity under section 32 of the Act.

6.5.3. Traditionally, any amount of consideration being in excess of net value of the assets was being recorded as goodwill without clearly bifurcating between various intangibles and commercial rights. Taxpayers may now consider undertaking a detailed purchase price allocation exercise in order to attribute excess of such consideration paid over net assets acquired towards spectrum of intangible assets in nature of business or commercial rights instead of outrightly treating such difference as goodwill. This should be substantiated with a valuation report justifying the payment for acquisition of such intangible assets. Para B31 of Indian Accounting Standard 103 on Business Combinations also requires an acquirer to recognize, separately from goodwill, the identifiable intangible assets acquired in a business combination. Valuation would thus become an important factor while undertaking any business acquisition. Further, what constitutes goodwill is not defined under the Act. It is commonly understood as the balance, unrecognizable and un-allocable component of the excess of purchase

24. *Shri Laxmi Printing & Dyeing Works (P.) Ltd. v. CIT* [1968] 70 ITR 148 (Bom.)

25. *Areva T & D India Ltd. v. DCIT* [2012] 20 taxmann.com 29 (Delhi)

26. *CIT v. Birla Global Asset Finance Co. Ltd* [2014] 41 taxmann.com 262 (Bombay)



price distinct from the clearly identifiable intangibles. While, the legislation clearly still permits depreciation on other business and commercial rights, it needs to be seen how the tax department deals with the amendment - whether it would permit such a claim and contest the valuation or would persist the same to be a component of goodwill and deny the claim all together.

6.6. Goodwill of profession also covered under section 55(2)(a)

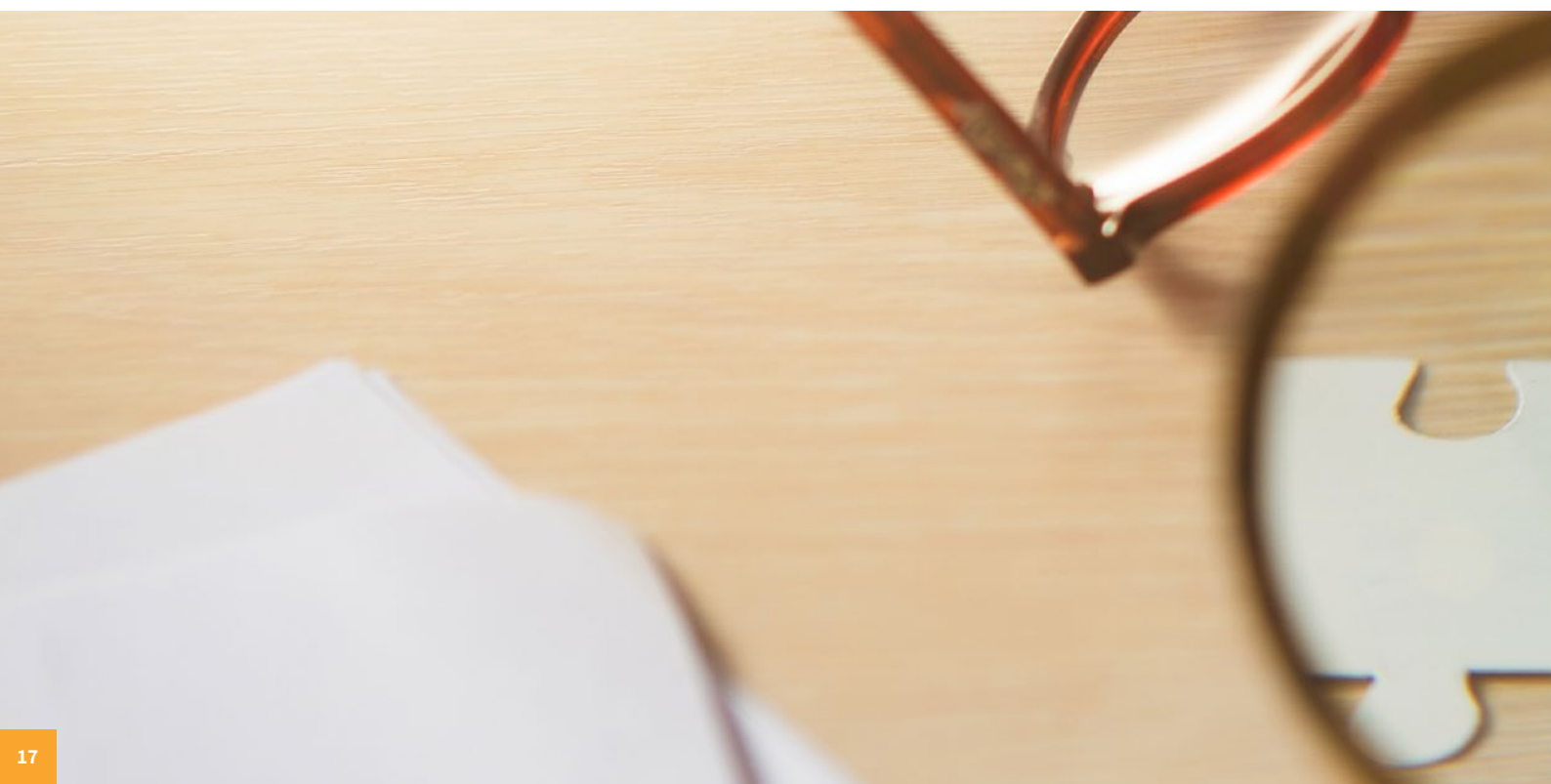
6.6.1. Section 55(2)(a) of the Act provides that cost of acquisition in case of specified self-generated capital assets is to be considered as Nil. Section 55(2)(a) of the Act was amended by Finance Act, 1987 to provide cost of goodwill of business as Nil. Other assets specified in section 55(2)(a) of the Act (prior to amendment by Finance Act, 2021) are trademark, brand name associated with a business or a right to manufacture, produce or process any article or thing or right to carry on any business or profession, tenancy rights, stage carriage permits and loom hours. Thus, while goodwill of business was expressly covered; goodwill of profession was not covered under section 55(2)(a) of the Act prior to amendment by the Finance Act, 2021. It has been held that

the terms “business” and “profession” are separate and distinct, and business does not include profession²⁷. In absence of deeming fiction under section 55(2)(a) providing for cost of acquisition of goodwill of profession as Nil, relying on the decision of Supreme Court in *B. C. Srinivasa Setty*²⁸, one could plausibly argue that in absence of computation mechanism under the Act, capital gains tax would not be payable in case of transfer of goodwill of profession. This is also supported by CBDT Circular explaining the amendments introduced by Finance Act, 1987 (which had provided for cost of acquisition of self-generated goodwill as Nil) which provided that the new provisions would not apply to professional firms.

6.6.2. Finance Act, 2021 has included even goodwill of profession expressly within the purview of section 55(2)(a) of the Act. In view of this amendment, the argument of cost not being ascertained in case of goodwill of profession would thus no longer be available.

27. *G.K. Choksi & Co v. CIT* [2007] 295 ITR 376 (SC); *Ashok M. Wadhwa, Mumbai vs ACIT*, ITA No. 1871/Mum/2012

28. *CIT v. B. C. Srinivasa Setty* [1981] 128 ITR 294

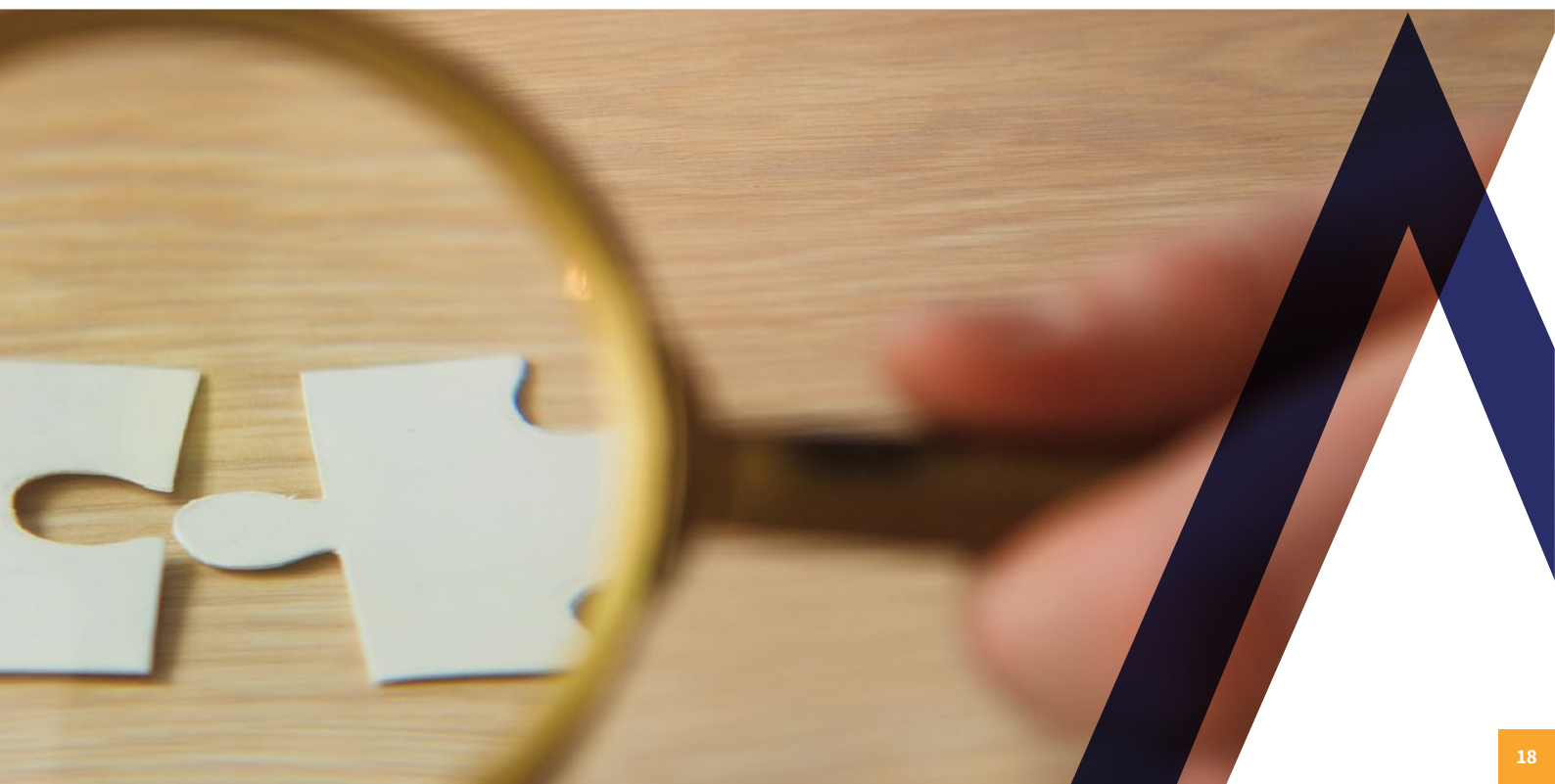


7.

Closing remarks

The amendments under the Finance Act, 2021, would have an overarching impact on any acquisition going forward. The post COVID era is likely to witness more traction in M&A space due to consolidation in many sectors and increase in acquisitions of stressed entities by leveraging on attractive valuations. Denial of tax break on the goodwill component would increase the cost of such acquisitions significantly. While conventionally a share acquisition and a subsequent consolidation by merger was the most common acquisition mode, M&A transactions going forward would also witness business acquisitions and non-tax neutral consolidations being resorted to. Applicability

of the amended provisions from FY 2020-21 has caught India Inc unaware, especially in case of deals that have already been concluded in current financial year. In such cases, one may now consider re-looking at their valuation report to undertake a more comprehensive PPA thereby recording clearly identifiable intangibles as against parking everything as goodwill. While the amendment clearly extends clarity by seeking to bring closure to a highly litigated issue, considering goodwill pursuant to non-tax neutral acquisitions as also impermissible for depreciation, is quite a dampener and needs reconsideration.





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