



Government authorisation/approvals are not eligible for depreciation. The same has not been treated as goodwill for the purpose of depreciation

Background

The Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Pitney Bowes India (P) Ltd ¹ (the taxpayer) held that the government authorisation/approvals are neither a license nor the rights of business or commercial nature which could be transferred to the taxpayer. Therefore, depreciation is not allowed on the value assigned to government authorisation/approvals.

The alternative plea of the taxpayer for allocating the value of government authorisation towards goodwill was also not accepted since the valuation has been carried out from a valuer at the request of the taxpayer.

Facts of the case

Disallowance of depreciation on government authorization/approvals

- Kilburn Office Automation Limited (KOAL) was authorised by the parent company of the taxpayer, to sell various models of franking machines to customers in India and Nepal which included postal department of government, banks and others. In this regard, KOAL was granted approvals from the regulatory authorities.

- The business of sale of franking machine was transferred from KOAL to the taxpayer through a Business Transfer Agreement (BTA) on a slump sale transaction. In the 'BTA' executed, no value was assigned to the government approvals, which were listed as one of the 13 assets acquired by the taxpayer. The various other assets acquired by the taxpayer included all properties, non-compete agreements, customer and vendor lists, transferred employees, contracts, and all other rights in respect of mailing business of KOAL.
- After a period of one year, the taxpayer assigned values to the non-compete fee and government authorization/approvals, on the basis of valuation conducted by a consultant at the request of the taxpayer. On the assigned value to government authorisation/approvals, the taxpayer claimed depreciation at the rate of 25 per cent treating the same as a depreciable intangible asset.
- The AO observed that no value was assigned by the taxpayer in the 'BTA' while acquiring the mailing business from KOAL and no payment was made towards acquiring these approvals. KOAL had not paid any sum to regulatory authorities to acquire such authorisation/approvals and it had not assigned any monetary value in its financial statement. Therefore, it was not an asset in the books of transferor, when the taxpayer acquired the business. The AO held that government authorization/approval do not qualify as an

¹ Pitney Bowes India (P) Ltd v. DCIT (ITA Nos. 289 to 293/Del/2013) – Taxsutra.com Note – This decision deals with various issues, however, this flash news has been prepared only on the issue of claim of depreciation on government authorisation/approvals and goodwill

intangible asset under Section 32(1)(ii) of the Income-tax Act, 1961 (the Act) as the rights mentioned in the said section are in the nature of intellectual property rights and thus the general word of similar nature, ought to be confined to the category of similarly placed assets and not government authorisation/approvals.

Accordingly, the AO denied the claim of depreciation on government authorisation/approvals.

- The Commissioner of Income-tax (Appeals) [CIT(A)] upheld the order of the AO.

Disallowance of depreciation on goodwill

- The taxpayer raised an additional ground regarding the claim of depreciation on goodwill. The claim was raised for the first time before the CIT(A) in appeal arising from reassessment and no claim was made in the return of income or before the AO in original assessment proceedings or in the first round of appellate proceedings before CIT(A) or before the Tribunal.
- The taxpayer claimed that the amount shown as government authorisation can be considered as 'goodwill' or as residual intangible assets.

Tribunal's decision

Disallowance of depreciation on government authorization/approvals

- The Tribunal in the case of ONGC Videsh Ltd.² has held that rights granted by way of license to have an access and to carry on of business of exploration and development of mineral oil would fall within the category of asset and depreciations is allowable on the same under Section 32(1)(ii) of the Act. Similarly, the Supreme Court in the case of Techno Shares and Stocks Ltd.³ held that intangible assets can be in the nature of business or commercial rights, which is not in the nature of intellectual property. Therefore, the Supreme Court held that membership of the stock exchange by a member has been held as intangible assets eligible for depreciation.
- In the present case, the taxpayer has not produced the approval granted by the department of post or other regulatory authority, issued to KOAL, which the taxpayer is claiming as a license for marketing of franking machines in India and sold to the taxpayer under a slump sale.

- The taxpayer has submitted a copy of a letter issued by the department of post to the taxpayer. On reference to the contents of the letter, it manifests that the department of post had approved specific electronic franking machine of Pitney Bowes, Inc., USA. However, the taxpayer has not produced copies of these approvals to verify as to whom those approvals were addressed.
- Issuing the letter of approval of machines of 'Pitney Bowes Inc, USA' to KOAL cannot create any rights in favour of KOAL. The letter issued to KOAL would be in its agent status and compliance of which was dependent on supply of machines by the Pitney Bowes Inc, USA to KOAL. The moment, the Pitney Bowes Inc USA, terminates the agreement of distribution of its machines, the letter issued by the Department of post in the name of KOAL also loses its sanction. The KOAL has not got any rights to sale in favour due to letter issued by the department of post.
- It has been observed that the letter communicating government authorisation/approval, was neither a license or business or commercial rights in the hands of KOAL nor it was having any right to transfer those approvals to any person of its choice. It is the department of post, who was having authority to approve electronic franking machines in India and approval of machines of Pitney Bowes Inc USA, has not created any kind of rights in the hands of KOAL, which could be transferred to any third party.
- In the case of Sharp Business System⁴, the Delhi High Court has held that for any right to be in the 'nature of business or commercial right' as laid down in Section 32(1)(ii) of the Act, two criteria should be met. First that it should be 'right in rem' and the second it should be alienable or transferable.
- In the case of ONGC Videsh Ltd., the taxpayer acquired the right to production in a consortium from parties, who were having such right of production in their independent capacity. Similarly in the case of Techno shares in stocks Limited, holding of membership of the stock exchange by a member has been held as intangible assets eligible for depreciation. In both the cases the

² ONGC Ltd v. DCIT [2010] 37 SOT 97 (Del)

³ Techno Shares and Stocks Ltd. v. CIT [2010] 327 ITR 323 (SC)

⁴ Sharp Business System v. CIT [2012] 254 CTR 0233 (Del)

rights of business or commercial nature were possessed by the taxpayers, whereas in the present case, the approval has been granted to machines of 'Pitney Bowes Ins, USA' only and not to KOAL, which even it could not transfer to any person of its choice. Thus, facts of the present case are distinguishable from the cited cases.

- Since it has been held that the government authorisations/approvals are not any kind of intangible asset in the hand of the KOAL, the other arguments of the parties that KOAL has not paid any value for purchase of these government approvals and the value assigned by the valuer appointed by the taxpayer, was a hypothetical value only etc. are not required to be considered.
- Accordingly, it has been held that government authorisation/approvals are neither license nor the rights of business or commercial nature in the hands of KOAL, which could be transferred to the taxpayer and therefore no depreciation on the value assigned to government authorisation/approvals by the taxpayer, could be allowed to the taxpayer.

Disallowance of depreciation on Goodwill

- In the case of Smifs Securities Ltd.⁵, the Supreme Court had decided a question of law. In the case of Areva T & D India Ltd.⁶, the Delhi High Court, held that the business information, business records, contracts, skilled employee, know-how etc., is treated as business and commercial rights eligible for depreciation under Section 32(1)(ii) of the Act, however the issue of eligibility of goodwill for depreciation was not decided. The Delhi High Court after considering the arguments of the rival parties upheld the eligibility of goodwill for depreciation which is allowable under section 32(1)(ii) of the Act in view of the decision of Supreme Court in the case of Smifs Securities Ltd.
- On reference to the facts of the present case it has been observed that in this case, in the BTA there is no mention of goodwill. Further, the unit of KOAL, which was acting as agent for sale of electronic franking machines, etc. of Pitney Bowes Inc, USA, in India and Nepal has been transferred to the taxpayer.

- It was the machines of Pitney Bowes Inc., USA which are approved by the Department of Post due to their technical competency. All the intellectual property rights in those machines were tied with Pitney Bowes Inc. USA. Thus, it was the brand name of the 'Pitney Bowes' on which KOAL was floating.
- In the BTA, a list of transferred assets is mentioned which included real property leased, tangible assets like furniture equipment's machinery etc., contract license agreements, etc., inventories of the seller in existence, government authorisations, computer hardware and proprietary software, customer and vendor list, business know-how, rights of the seller under sales and purchase orders, transferred employee and transferred retailers, all advances received by the seller from its customers, all earnest money deposits etc.
- The taxpayer has got valuation of government authorisations and non-compete fee from the valuer. The valuer has assigned value to government authorisations and value to non-compete agreements, however, no value was assigned to other intangible assets.
- Accordingly, it has been observed that list of transferred asset included business know-how, customer and vendor list etc., which are business or commercial rights of similar nature as specified in Section 32(1)(ii) of the Act, which constitute part of the 'goodwill' of the business, transferred as going concern to the taxpayer.
- Since in the case tangible assets along with other business/commercial rights, have been transferred to the taxpayer, the value of 'goodwill' should be computed by reducing the value of all liabilities, the tangible assets, government authorisations valued by the valuer and non-compete fee valued by the valuer, out of the slump sale consideration and then depreciation should be allowed at the rate prescribed for the intangible assets under Section 32(1)(ii) of the Act.

⁵ CIT v. Smifs securities Ltd [2012] 348 ITR 302 (SC)

⁶ Areva T & D India Ltd v. DCIT [2012] 341 ITR 421 (Del)

- The tax department contended that after completion of original assessment proceedings the matter was taken by the taxpayer to the Supreme Court, however, in all those appellate proceedings, the taxpayer did not file any claim for depreciation on the goodwill. Thereafter, reassessment proceedings have been taken up by the AO wherein the claim of depreciation on government authorisation and non-compete fee was disallowed. In appellate proceeding before the CIT(A), consequent to the reassessment order, the taxpayer first time filed the claim of depreciation on goodwill. The tax department also relied on the decision of the Jammu and Kashmir High Court in the case of State Agro Development Corporation⁷. The Tribunal agreed with the contention of the tax department.
- Though, it has been held that following the decision of the Supreme Court in the case of Smifs Securities Ltd., depreciation on goodwill is allowable, but in view of the decision of the Jammu and Kashmir High Court, the claim of the depreciation on goodwill cannot be allowed in the year under consideration.
- The alternative plea for allocating the value of government authorisation towards goodwill is not accepted as the valuation has been carried out by the taxpayer from a valuer and the taxpayer is claiming the same as independent valuer, the taxpayer is bound to accept the value assigned to government authorisations. Accordingly, this alternative plea of the taxpayer is rejected.

Our comments

Allowability of depreciation on intangible assets has been a matter of debate before various Courts/ the Tribunal.

This decision deals with the eligibility of depreciation on government authorisation/approvals and goodwill. With respect to the government authorisation/approvals the Tribunal held that such approvals are neither a license nor the rights of business or commercial nature which could be transferred to the taxpayer. Therefore, depreciation is not allowed on the same.

⁷ CIT v. State Agro Development Corporation [2001] 248 ITR 487 (J&K)

The Mumbai Tribunal in the case of India Capital Markets P Ltd.⁸ held that the purchase of the clientele business of a sub-broker is a right which can be used as a tool to carry on the business. Further, the consideration paid for acquiring the clientele is an 'intangible asset' and the same is eligible for depreciation under Section 32(1)(ii) of the Act.

However, the Mumbai Tribunal in the case of Ind Global Corporate Finance Private Limited⁹ has held that the payment for transfer of business along with contracts, clients and client relationship would not be eligible for depreciation as there was no material produced by the taxpayer to show that any part of the payment was related to any know-how which can be considered as an 'intangible asset' for the purpose of Section 32(1)(ii) of the Act.

The Tribunal also rejected the alternative plea of the taxpayer for allocating the value of government authorisation/approvals towards goodwill disregarding Supreme Court's decision in the case of Smifs Securities Ltd.

The Tribunal observed that the taxpayer has not made claim of depreciation on goodwill under the original assessment till the matter reached the Supreme Court. It was for the first time it made a claim in appellate proceedings corresponding to reassessment proceedings. The Tribunal relying on the decision of the Jammu and Kashmir High Court, did not allow the claim of the depreciation on goodwill.

The Jammu and Kashmir High Court in the case of State Agro Development Corporation observed that where original assessment has been concluded against the taxpayer, it was not permissible for the taxpayer in reassessment proceedings to seek the review of the concluded assessment for the computation of escaped income.

It is important to note that the Supreme Court in various cases¹⁰ has held that a fresh ground can be taken up before the appellate authorities.

It would be interesting to see how Courts will deal with this decision and whether they will allow depreciation on goodwill following the decision in the case of Smifs Securities.

⁸ India Capital Markets P Ltd v. DCIT [2013] 56 SOT 32 (Mum)

⁹ Ind Global Corporate Finance Private Limited v. ITO [2013] 19 ITR(T) 483 (Mum)

¹⁰ National Thermal Power Co. Ltd. v. CIT [1998] 229 ITR 383 (SC), Jute Corporation of India Ltd. v. CIT [1991] 187 ITR 688 (SC)

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