



## Depreciation on goodwill is allowed under Section 32 of the Income-tax Act

### Background

Recently, the Gujarat High Court in the case of Zydus Wellness Ltd<sup>1</sup> (the taxpayer) applying the decision of the Supreme Court in case of Smifs Securities Ltd.<sup>2</sup> held that the taxpayer is entitled to claim depreciation on goodwill under Section 32 of the Income-tax Act, 1961 (the Act). It was observed that there is no material provided by the Assessing Officer (AO) to hold that the claim of depreciation was fictitious.

Further, the High Court observed that if a claim though available in law is not made either inadvertently or on account of erroneous belief of complex legal position, such claim cannot be shut out for all times to come merely because it is raised for the first time before the appellate authority without resorting to revising the return before the AO.

### Facts of the case

- During the Assessment Year (AY) 2010-11, the taxpayer had not raised a claim of depreciation on goodwill. However, during the course of assessment proceedings, the taxpayer presented revised computation which included the taxpayer's claim of depreciation of INR71.9 million on the goodwill expanded at the time of amalgamation of the companies. The taxpayer claimed that such claim would be allowable by virtue of the decision of the Supreme Court in case of Smifs Securities Ltd.

- The AO disallowed the claim on two grounds. Firstly, that the claim was not made in the original return nor did the taxpayer file the revised return. The second ground was that the claim was fictitious and the goodwill has been accounted as a balancing factor in the hands of the taxpayer without acquisition of an intangible asset as contemplated under Section 32 of the Act.
- The Commissioner of Income-tax (Appeals) [CIT(A)] as well as the Tribunal both ruled in favour of the taxpayer. With respect to raising an additional claim without revising the return, the Tribunal relied on the decision of the Bombay High Court in case of Pruthvi Brokers & Shareholders (P.) Ltd.<sup>3</sup> With respect to the claim of depreciation on the acquisition of goodwill, the Tribunal relied on the decision of the Supreme Court in case of Smifs Securities Ltd.
- Aggrieved, the tax department filed an appeal before the Gujarat High Court.

### High Court's decision

- The issue of the tenability of a claim though not raised in the original return is examined by the courts in various decisions. The Gujarat High Court in case of Mitesh Impex<sup>4</sup> referred to and relied on several decisions of the Supreme Court and High Courts including the decision of Bombay High Court in case of Pruthvi Brokers & Shareholders (P.) Ltd. and observed that if a claim though available in law is not made either inadvertently or on account

<sup>1</sup> PCIT v. Zydus Wellness Ltd [2017] 87 taxmann.com 82 (Guj)

<sup>2</sup> CIT v. Smifs Securities Ltd. [2012] 348 ITR 302 (SC)

<sup>3</sup> CIT v. Pruthvi Brokers & Shareholders (P.) Ltd. [2012] 349 ITR 336 (Bom)

<sup>4</sup> CIT v. Mitesh Impex [2014] 225 Taxman 168 (Guj)

of erroneous belief of complex legal position, such claim cannot be shut out for all times to come merely because it is raised for the first time before the appellate authority without resorting to revising the return before the AO.

- With respect to the claim of depreciation, the decision of Supreme Court in case of Smifs Securities Ltd. is applicable. There is no material provided by the AO to hold that the claim of depreciation was fictitious. If the High Court read his entire expression in this respect, the AO seems to be suggesting that being an intangible asset acquisition thereof would not qualify for depreciation. If that be so, the view of the AO was opposed to the decision of the Supreme Court in case of Smifs Securities Ltd. On the other hand, if the observations of the AO can be seen as his findings that the claim itself was baseless, there was no discussion or reference to any material to enable him to come to such a conclusion.

### Our comments

The issue with respect to the allowability of depreciation on goodwill under Section 32 of the Act has been a matter of debate before the Courts/Tribunal. The Courts/Tribunal in some of the cases<sup>5</sup> have held that depreciation is not allowable on goodwill because it is not of similar nature to that of intangible assets viz. know-how, patents, trademarks, licenses, franchise, etc. as specified under Section 32 of the Act. In other words, it will not get covered under the expression 'any other business or commercial rights of similar nature'. On the other hand, in some of the cases<sup>6</sup>, the Courts/Tribunal held that payment on account of goodwill is similar to assets like patents, copyrights, trademarks, licenses referred to in the definition of 'block of assets' in the sense that the function of all these assets is to restrict their misuse and to earn maximum profits in the business. The function of goodwill acquired by the taxpayer is also same in view of the fact that it maximises the profits of the company. Therefore, the taxpayer's goodwill being a valuable commercial asset similar to other intangibles specified in the definition of 'block of assets' is eligible for depreciation.

<sup>5</sup> Bharatbhai J. Vyas v. ITO [2005] 97 ITD 248 (Ahd), R.G. Keswani v. ACIT [2009] 116 ITD 133 (Mum), Borkar Packaging (P.) Ltd. v. ACIT [2010] 131 TTD 99 (Panaji), CIT v. Mangalore Ganesh Beedi Works [2003] 128 Taxman 351 (Kar)

<sup>6</sup> CIT v. Hindustan Coca Cola Beverages (P) Ltd. [2011] 198 Taxman 104 (Del), B. Raveendran Pillai v. CIT [2010] 194 Taxman 477 (Ker), KEC International Ltd. v. ACIT [2010] 41 SOT 43 (Mum)

The Supreme Court in the case of Smifs Securities Ltd. put the above controversy at rest and held that the goodwill being a difference between the amount paid and cost of shares in case of amalgamation scheme, is an asset eligible for depreciation under Section 32 of the Act. The Supreme Court has applied the principle of ejusdem generis and held that the expression 'any other business or commercial rights of a similar nature' includes goodwill for the purpose of allowability of depreciation.

The Bombay High Court<sup>7</sup> relying on the decision of Supreme Court in the case of Smifs Securities set aside the decision of the Mumbai Tribunal in Toyo Engineering India Limited and allowed the claim of depreciation on goodwill.

On the similar lines, the Gujarat High Court, in the instant case, relied on the decision of Supreme Court in the case of Smifs Securities and allowed the claim of depreciation on goodwill. The claim of depreciation is allowed even though the same was made through revised computation of income during the course of assessment proceedings without filing a revised return of income.



<sup>7</sup> Toyo Engineering India Limited v. DCIT [ITA (L) No. 1330 of 2012]

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