

TAX FLASH NEWS

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Payment over and above net assets acquired is towards goodwill under slump sale transaction and depreciation is allowed on the same

Background

Recently, the Chennai Bench of Income-tax Appellate Tribunal (the Tribunal) in the case of Dorma India Pvt Ltd.¹ (the taxpayer) dealt with the eligibility of depreciation on goodwill under the slump sale agreement. The Tribunal held that the excess payment made by the taxpayer over and above book value of tangible movable assets (net of liabilities) acquired is towards intangible assets (acquired by the taxpayer in the form of business contracts, customer orders, customer business information, etc.). Thus, payments made by the taxpayer over and above net assets acquired is towards goodwill and depreciation is allowed on the same.

Facts of the case

The taxpayer is engaged in manufacturing and wholesale trading of automatic door operators, door controls and accessories. During the Financial Year (FY) 2008-09, the taxpayer entered into a Business Transfer Agreement (BTA) with two of its business partners to acquire the distribution segment on a going concern basis. The acquisition of business reflects the acquisition of assets and liabilities of two entities pursuant to BTAs executed. The net assets were taken over at book value and goodwill was created as a result of such acquisition. Inadvertently, the taxpayer did not claim depreciation on goodwill in the original as well as revised return of income. However, during the assessment proceedings of assessment year (AY) 2010-11 to 2012-13, the taxpayer relying on various decisions² claimed that depreciation should be allowed.

The Assessing Officer (AO) rejected contention of the taxpayer and held that depreciation cannot be allowed on goodwill. The AO observed that the taxpayer has allocated lesser value out of business consideration towards tangible assets. If proportionate allocations in value were done towards tangible assets based on book value, then there would not be any allocation remaining towards goodwill. The AO observed that fair market value (FMV) of each of the asset was not considered by the taxpayer. If the taxpayer had considered FMV of each of the assets and also FMV of liabilities, then there was a case for goodwill. In the absence of such an exercise, it could not be said that the taxpayer incurred certain amounts for goodwill. Thus, depreciation cannot be allowed on goodwill. The AO relied on the decision of Toyo Engineering India Ltd.³ The AO observed that in slump sale agreements entered into by the taxpayer, there was a condition of non-compete clause. Therefore, if there was any consideration paid over and above the net worth of the business assets taken over by taxpayer, the same should be considered towards non-compete fee and not towards goodwill. The Commissioner of Income Tax (Appeals) [CIT(A)] held the decision in favour of the taxpayer. Aggrieved, the tax department filed an appeal before the Tribunal.

Tribunal's decision

On careful perusal of slump sale agreements, it indicates that the taxpayer had only acquired running businesses on going concern basis and related installation services along with all business assets,

¹ ACIT v. Dorma India Pvt Ltd. (ITA No. 1664 to 1666/chny/2019) – Taxsutra.com

² CIT v. Smifs Securities Ltd. [2012] 348 ITR 302 (SC), Areva T & D India Ltd., v. DCIT [2012] 345 ITR 421 (Del), CIT v. Hindustan Coca Cola Beverages (P) Ltd. [2011] 331 ITR 192 (Del)

³ DCIT v. Toyo Engineering India Ltd. - [2013] 33 Taxman.com 560 (Mum)

customers, business contracts, business intangibles key employees, installation employees and other employees. The agreements were composite agreements for acquiring running business of the two entities. The tangible assets which were acquired under these two agreements were mainly computer hardware, printers, fax machines, and other office equipment/appliances, inventories, accounts receivables, loans and advances etc. which were existing in the books of accounts of the two entities on effective date which were incorporated by the taxpayer in its books of accounts at their book value.

The taxpayer had also acquired along with customers, business contracts, customer orders, business information etc. which were intangibles assets associated with these businesses. Thus, it indicates that the taxpayer did not acquire the two companies per-se but acquired businesses of these two companies concerning trading of Dorma Products and related installation services business. The agreement was a composite agreement to acquire aforesaid businesses run by these two entities for composite lumpsum consideration. A perusal of agreement also indicates that consideration paid by taxpayer does not include any payments towards acquisition of land and building but these were mainly for acquiring movable assets such as computers, laptop, printers, fax machines, air conditioners, refrigerators, business stocks, accounts receivables, loans and advances etc. along with intangible assets such as business contracts, customers, business information, right to continue business as going concern basis, non-compete clauses etc. which stood acquired by the taxpayer under these agreements for aforesaid consolidated lump sum consideration.

The decision relied on by the AO in the case of Toyo Engineering India Limited is distinguishable on facts of the present case. In the case of Toyo, the acquisition consisted predominantly of land and building and hence non-allocation of FMV of land and building on the date of transfer weighed heavily on Tribunal in coming to conclusion that no payment for goodwill was made. However, in the instant case the taxpayer acquired business by way of slump sale agreements which is in the form of tangible assets which are mainly business movable assets such as computers, laptops, fax machines, printers, etc., and it cannot be said that incorporating these assets in books of accounts of the taxpayer at book value existing on the date of acquisition has led to distortion in presentation of books of accounts of the acquirer. It cannot be said that merely because the tangible business movable assets were included by the taxpayer in its books of accounts at the book value existing in the books of seller on effective date will disentitle the taxpayer from claiming depreciation on the excess consideration paid over and above book value of tangible assets acquired of seller. Therefore, the value of these tangible movable assets acquired by the taxpayer and the value incorporated in books of accounts by the taxpayer reflect their FMV, unless rebutted by the tax department.

The Tribunal held that the book value of the tangible movable assets acquired by taxpayer was indeed their FMV. The excess paid by the taxpayer over and above book value of tangible movable assets acquired was towards intangibles assets acquired by taxpayer in the form of business contracts, customer orders, etc. Thus, consolidated payments made by the taxpayer over and above net assets acquired by it under a composite contract was towards goodwill and non-compete agreement and depreciation were allowable both on the amount. The Tribunal relied on the various decisions⁴. Thus, even if the taxpayer has not filed claim of depreciation in original return of income as well as in revised return of income but has made claim during the course of assessment proceedings, the taxpayer would be entitled for depreciation under Section 32 of the Act.

Our comments

The eligibility of depreciation under Section 32 of the Act on goodwill has been subject matter of litigation before the Courts/Tribunal.

The Supreme Court in the case of Smifs Securities Ltd.⁵ had put the long-drawn controversy at rest and held that goodwill being a difference between the amount paid and cost of shares is an asset eligible for depreciation under Section 32 of the Act. The High Court in the case of Triune Energy Services (P.) Ltd.⁶ held that consideration paid in excess of value of tangible assets can be classified as goodwill eligible for depreciation.

While the Supreme Court decision has been consistently followed by various courts, in the case of United Breweries Ltd.⁷, the Bangalore Tribunal held that the difference between the fair value of assets and the total consideration paid under amalgamation cannot be shown as goodwill by the amalgamated company and no depreciation is allowable on the same. It distinguished the decision in the case of Smifs Securities Ltd. by holding that the Supreme Court dealt only with the issue of whether 'goodwill' is an intangible asset or not and that the said ruling would not override provisions of Section 32 of the Act.

The Tribunal in the present case has held that the excess paid by the taxpayer over and above book value of tangible movable assets (net of liabilities) acquired is towards intangible assets acquired by the taxpayer in the form of business contracts, customer orders, customer business information, etc. Thus, consolidated payments made by the taxpayer over and above net assets acquired is towards goodwill and depreciation is allowed on the same.

⁴ Pentasoft Technologies Ltd., v. DCIT [2014] 41 taxmann.com 120 (Mad), Rentokil India Private Limited v. DCIT (ITA No.2660/Mds/2016), CIT v. Smifs Securities Ltd. [2012] 348 ITR 302 (SC)

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

⁶ Triune Energy Services Pvt Ltd. v. DCIT [2016] 65 taxmann.com 288 (Del)

⁷ United Breweries Ltd. v. ACIT [2016] 76 taxmann.com 103 (Bang)

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