Is Goodwill an Intangible Asset Eligible for Tax Depreciation?

Intangible assets are those which create significant values for an organisation beyond its tangible assets and Goodwill is a part of it. However, some of the intangible assets are not capable of recognition in books of accounts in accordance with Accounting Standard-26. In spite of this, intangibles constitute a larger part of acquisition price in present era of mergers and acquisitions. Therefore, while structuring M&A deals, the prospective buyer, apart from considering other legal and commercial considerations, also considers tax cost and benefits involved in the deal. Thus, the acquirer is always interested to factor-in the tax incidence in the form of tax depreciation that would be eligible to him on intangible assets which are acquired and embedded within goodwill. Keeping this view in mind, the article explains accounting principles for recognition of goodwill in financial statements as per prevailing Accounting Standards. Whether goodwill recognised as above is eligible for tax depreciation? An attempt is also made to analyse some landmark judgements which provide valuable insights on eligibility of depreciation on intangible assets accounted for as goodwill.

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Section 32(ii) – Intangible Assets Eligible for Depreciation

Depreciation on intangible assets was, for the first time, recognised by Finance (No.2) Act, 1998. However, it is interesting to note that not all intangible assets qualify for depreciation. The legislature in its wisdom had identified few intangibles for depreciation. It is evident from provisions of Section 32(1)*(ii) of the Act which provides that "any know-how, patents, copyrights, trade marks, licences, franchises or any other business or commercial rights of similar nature, acquired by the assessee on or after 1-4-1998, shall be eligible for*

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depreciation allowance with effect from the assessment year 1999-2000."

Assets like know-how, patents, copyrights, etc., form a distinct category since all those items are specific and represent rights of business or commercial nature. It is, therefore, important to understand whether goodwill recognised in books pursuant to business purchase is an intangible asset and whether same qualifies for depreciation under Section 32(ii).

Goodwill – A Capital Asset under Income Tax Act

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Purchased Goodwill is Generally "Goodwill Embedded With Intangible assets"

Normally, purchased goodwill is the only type which appears in financial statements since self-generated goodwill cannot be recognised in books in accordance with AS – 26 on Intangible Assets. This purchased goodwill is valued as "the excess of price paid for a business as a whole over the agreed value of all tangible net assets purchased" unless any specific value has been allocated to it.

It is to be noted that alike self-generated goodwill, those intangible assets which cannot be identified separately or cannot be reliably measured, are also not recognised in the financial statements. Therefore, when a business is purchased such intangible assets are not assigned separate values, but are embedded together and recognised as "Goodwill" in accordance with AS-26, which states as follows, in respect of intangible assets acquired as part of amalgamation:

31. In accordance with this Statement:

(a) a transferee recognises an intangible asset that meets the recognition criteria in paragraphs 20 and 21 (i.e. future benefits attributable to the asset will flow to the enterprise and the cost can be measured reliably), even if that intangible asset had not been recognised in the financial statements of the transferor; and

(b) if the cost (i.e. fair value) of an intangible asset acquired as part of an amalgamation in the nature of purchase cannot be measured reliably, that asset is not recognised as a separate intangible asset but is included in goodwill.

Amortisation or Depreciation on Goodwill - Accounting Methodology vis-a-vis Tax Provisions

Further to above, it is pertinent to note that, for accounting purposes, goodwill recognised in financial statements is amortised over its systematic life (preferably five years) as per Indian Accounting Standards; whereas Goodwill as such is not included in the list of intangible assets eligible for depreciation under Section 32(ii) of Income-tax Act, 1961. Therefore, it can be said that provisions of said section do not appreciate the fact that consequent to existing accounting norms, such purchased goodwill recognised in books of accounts may have intangibles embedded within it which are eligible for depreciation.

Due to this non-alignment between provisions of Income-tax Act, 1961 and the accounting methods followed by assesses in respect of goodwill recognition and its subsequent amortisation and/or depreciation, allowance of depreciation on Goodwill (embedded with other intangible assets) has always been a subject matter of considerable uncertainty and litigation.

Jurisprudence for Eligibility of Depreciation on Goodwill

Although the few existing judicial precedents on this subject summarised below lends a possible view that goodwill is eligible for depreciation; these rulings have not been too successful in putting a conclusive end to this issue:

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Rulings	Facts of the Case	Decision Held
[1]*(CIT vs. Hindustan Coca Cola Beverages Pvt. Ltd).* (Delhi High Court)	1. Assessee was engaged in manufacturing and trading of non-alcoholic beverages.tt 2. It paid amounts to various bottlers for marketing and trading reputation, trading style and name, territory know-how, know-how related to business, customer database, distribution network, contact and other commercial rights 3. A part of slump price paid was allocated to aforesaid intangible assets and recognised under the head goodwill on which depreciation under Section 32 (ii) was claimed 4. Notes to income tax return stated the fact that Goodwill represented difference between consideration paid for business and value of tangible assets determined by a reputed valuer.	1. Nomenclature given to the entries in the books of accounts is not relevant for ascertaining real nature of transaction. 2. As per Section 32(ii), intangible assets includes, along with other things, any other business or commercial rights of similar nature 3. Commercial rights are rights for effectively carrying on business and commerce and therefore any such right is an intangible asset, and so as goodwill which has intangible assets i.e. know-how, patents etc. embedded within it 4. Depreciation on such Goodwill is allowed
[2]*(Jeypore Sugar Company Ltd. v ACIT)* *(Visakhapatnam ITAT)*	1. Assessee purchased Chagallu distillery and difference between price paid and assets taken over was recognised under Intangible assets as Goodwill. 2. Goodwill acquired vide sale/purchase agreement was defined as "*goodwill, interest and connection of transferor inand concerning business together with right to carry on business as going concern in succession but forbidding right to use existing name*	1. Goodwill is a bundle of **commercial benefits and commercial rights** and by virtue of Goodwill assessee acquired these benefits and rights to run Chagallu distillery. 2. Commercial benefits are not eligible for depreciation whereas commercial rights being akin to know-how, patents etc. is eligible for depreciation 3. Since cost of acquistion of commercial rights and commercial benefits cannot be made available, Goodwill should be bifurcated into two equal parts and allow depreciation thereon on 50% of Goodwill treated as cost of acquisition of commercial rights
[3]*(B.Raveendran Pillai vs. Commissioner of Income Tax)* (Kerala High Court (Ernakulam)	1. Assessee purchased hospital under two separate sale deeds, one for immovables and other for movables (covering trademark, goodwill etc. 2. A value was assigned in sale deed to Goodwill including name of hospital, its logo and trademark	1. Trade marks and franchises covers name, logo etc. value of which is included in Goodwill 2. It is important that assessee continued running the hospital in the very same building, same premises, same town and with same name. 3. Purchase of Hospital as going concern with its name and trade mark is nothing but acquisition of goodwill and cannot be termed anything other than a commercial/ business right and therefore Goodwill is entitled for depreciation.

[1] This ruling of Delhi High Court in Hindustan Coca Cola Beverages [(ITA Nos. 1391/2010, 1394/2010 & 1396/2010) / (2011-TMI-201786)] has been followed by Mumbai Tribunal in case of Koch Chemical Technology Group India Pvt. Ltd. vs. Deputy Commissioner of Income Tax in ITA No. 2680/ Mum/09 (AY 2009-10)

[2] [(ITA Nos. 255 & 256 (Vizag) of 2010) / (2010-TMI-203250-ITAT)]

[3] [2011] 332 ITR 0531 / 2010-TMI-203081

Rulings	Facts of the Case	Decision Held
[4](*KEC International Ltd vs. Addl. Commissioner of Income Tax)* (ITAT Mumbai)	1. Assessee acquired Power Transmission Business and revalued the assets acquired. It valued Brand and Goodwill and recognised the same separately in its books 2. Brand valuation was conducted under three methods and value assessed in valuation report was recognised	1. Brand is an intellectual property right and can be equated with Trademark. Hence, it falls within the ambit of Section 32(ii) and hence depreciation should be granted 2. When arms length price is determined in valuation report, it must be regarded as actual cost 3. Depreciation will be allowed on Brand but not on Goodwill

[4] [ITA No. 4420/Mum/2009] / [2010-TMI-204449-ITAT]

A combined reading of aforesaid cases reveals that:

i. The true basis for claiming depreciation is the real nature of intangible asset with reference to rights obtained by the acquirer. Nomenclature given to entries in books of accounts is not relevant for ascertaining actual nature of the transaction.

ii. Goodwill is made up of many components. Depreciation is eligible on intangible assets recorded as goodwill if same can be established by the taxpayer.

Therefore, the views expressed by judicial authorities in above rulings highlights that it may be possible to claim depreciation on goodwill, where the facts demonstrate that, it represents underlying benefits in the nature of know-how, trademark, brands, or such rights which could be considered as any other business or commercial rights of similar nature, etc. which per se are eligible for depreciation.

Like various other issues, allowability of tax depreciation on goodwill is also surrounded by contrary rulings. Having regard to what is discussed above, attention is also invited to these cases where depreciation was not allowed on goodwill based on the relevant facts of the case and the matter is still pending before Special Bench

i. *R.G.Keswani v. Assistant Commissioner of Income Tax [2009] 308 ITR (A.T.) 0271*

ii. *Borker Packaging 40 DTR 29 (Panaji)*

iii. *Madular Infoyech 131 TTJ 243 (Pune)*

Depreciation on Intangibles under DTC Regime

On a concluding note, a visit to provisions of Direct Tax Code 2010 (DTC) in respect of depreciation on intangible assets is of considerable importance. Under DTC, assets are divided into two categories i.e. (1) Business Asset and (2) Investment Asset. Business Asset is further classified into (a) Business Trading Asset and (b) Business Capital asset.

Section 314(39) of the Code defines a **"Business Capital Asset" as:**

(a) any capital **asset self-generated** in the course of business;

(b) any intangible capital asset in the nature of—

(i) **goodwill** of a business .....

Therefore as specified above, goodwill whether self-generated or acquired will be classified as a business capital asset under DTC regime and any income arising from transfer, demolition, destruction or discardment of a business capital asset will be classified as income from business for the transferor of such asset.

As regards depreciation allowance on intangible assets under DTC; it is important to note that there is no change in the status of a prospective buyer of intangible assets (including goodwill). As per provisions of Section 37 of the Code, depreciation will be allowed on those business capital assets which are listed in the Fifteenth Schedule. *The said Schedule includes and defines intangible assets as follows for the purposes of depreciation:*

(1) *Any right by way of license or franchise, to operate a business or to use a know-how, patent, copyright, trademark or any other business or commercial right of similar nature.*

Further to above, Section 38(1)(b) of the Code specifically provides that *"depreciation would be nil in case of those assets which are not specified in Fifteenth Schedule"*

Having regard to above, it is well established that goodwill, as such, is not included in the list of intangible assets eligible for depreciation under proposed DTC regime also. Therefore, uncertainty and litigation on eligibility of depreciation on intangible assets embedded within goodwill is expected to continue due to lack of clarity on the subject and contrary views held by the judicial authorities. ■