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News Alert
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Consideration paid for acquiring ‘licenses and client base’ under a merger scheme is a ‘business and commercial rights of similar nature’, eligible for depreciation under section 32(1)(ii) of the Income-tax Act

In brief

The Income-tax Appellate Tribunal (Tribunal), Pune has recently delivered a judgment in the case of Cosmos Co-op Bank Limited¹, (the taxpayer or the Company) on the issue of eligibility of depreciation on the *business advantages* in the form of license and client base acquired pursuant to a merger scheme. In this case, relying on the Delhi High Court (HC) ruling in Areva T&D India Limited² (Areva T&D) and Hyderabad Tribunal ruling in SKS Micro Finance Limited³ (SKS

Micro Finance), the Tribunal held that the excess consideration paid under the merger scheme by the taxpayer for acquiring the license and client base constituted a *‘business and commercial rights of similar nature’* and hence was eligible for depreciation under section 32(1)(ii) of the Income-tax Act, 1961 (the Act).

¹ The Cosmos Co-op Bank Ltd v. DCIT [TS-47-ITAT-2014(PUN)]

² Areva T&D India Ltd. v. DCIT [2012] 208 Taxman 252 (Delhi)

³ SKS Micro Finance Ltd. v. DCIT [2013] 37 taxmann.com 192 (Hyderabad - Trib.)

Facts

- During the AY 2007-08, the taxpayer, pursuant to a scheme of merger, took over four banks along with its assets and liabilities.
- The taxpayer took over the entire business including the customers' accounts, employees, licenses and other statutory approvals of the merged banks.
- The taxpayer paid INR 26.68 crores in excess of the net worth of the undertakings acquired. The taxpayer took a position that the excess consideration paid towards various *business advantages* was in the nature of an '*intangible asset*' under section 32(1)(ii) of the Act eligible for depreciation.
- The tax officer (TO) disallowed the taxpayer's claim of depreciation, which was confirmed by Commissioner of Income-tax (Appeal) [CIT(A)].
- The taxpayer then filed an appeal before the Tribunal.

Issues before the Tribunal

Whether the excess payment made pursuant to a merger scheme was in the nature of a business advantage (derived in the form of license and client base) which qualified as an '*intangible asset*' under section 32(1)(ii) of the Act for the purposes of claiming depreciation?

Taxpayer's contentions

- Pursuant to the merger of four banks with the Company, the taxpayer has taken over all assets and liabilities of the banks including the statutory licenses, client base etc. of the merged banks.

- The excess consideration paid over the intrinsic net worth of the merged banks was in the nature of *business advantage* derived pursuant to the merger scheme.
- Relying on Areva T&D India and SKS Micro Finance, the taxpayer contended that the excess payment was in the nature of a business advantage (derived in the form of license and client base) and thus qualified as an *intangible asset* under section 32(1)(ii) of the Act.

Revenue's contentions

- Excess consideration paid over the intrinsic net worth did not represent any business or commercial rights under section 32(1)(ii) of the Act.
- As merger was in the form of "pooling of interests" method according to Accounting Standard 14 (AS-14), no intangible asset could be said to have been acquired by the taxpayer.

Tribunal Ruling

- The Tribunal referred to the merger scheme and observed that pursuant to the merger, the taxpayer had taken over the entire business apparatus of the merged banks including its client base, operational branches, statutory licenses etc.
- In interpreting the expression '*business or commercial right of similar nature*', the Tribunal relied on the judgments of Areva T&D and SKS Micro Finance, wherein the taxpayer was allowed depreciation on '*client base*', '*business or commercial rights*' in the nature of business claim, business information, know how etc.
- The Tribunal noted that the accounting method for the merger could not determine the claim for depreciation under the Income-tax Act. The Tribunal

held that the excess sum paid over the net worth of the merged banks represented '*business or commercial rights*' and was eligible for depreciation under section 32(1)(ii) of the Act.

PwC's observations

- The Tribunal ruling provides a useful precedent for claiming the depreciation allowance for residuary/ other category of intangible assets pursuant to merger schemes. While the earlier judgments in the cases of Areva T&D and SKS Micro Finance were in relation to claims of depreciation on intangible assets arising pursuant to slump sale, Pune Tribunal has applied the same principle for merger schemes and allowed the depreciation allowance under section 32(i)(ii) of the Act.
- The Pune Tribunal decision is in line with the Supreme Court judgment in the case of Smifs Securities Limited⁴ that had clarified the position regarding depreciation allowance on goodwill pursuant to merger.
- Section 43 of the Act provides the manner in which the 'actual cost' of the depreciable assets is determined in the hands of the amalgamated company post amalgamation. Accordingly, the actual cost of assets is the Written Down Value of the block in the hands of the amalgamating company. This aspect has not been dealt with in the decision of the Pune Tribunal.

⁴ CIT v. Smifs Securities Ltd. [2012] 210 Taxman 428 (SC)

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