

Non-compete right held to be an intangible asset eligible for depreciation

November 25, 2016

In brief

The Bangalore bench of the Income-tax Appellate Tribunal (Tribunal), in the taxpayer's¹ case, held that the payment made by the taxpayer towards non-compete right was towards acquiring an intangible asset eligible for depreciation.

In detail

Facts

- The taxpayer¹ acquired tangible assets, trademarks and other assets through an Asset Purchase Agreement for an aggregate consideration of INR 13 crores.
- The taxpayer allocated INR 1.8 crore towards depreciable tangible assets, INR 0.7 crore towards other assets, and the balance INR 10.5 crore towards goodwill, and claimed depreciation on tangible assets and goodwill.
- It was also agreed between the taxpayer and the seller that the seller would not do anything for 12 months that could be deemed to be in competition with the taxpayer's business.
- The assessing officer (AO) treated the amount of INR 10.5 crore to be payment

towards non-compete agreement, and not as payment for acquisition of goodwill, and disallowed the depreciation thereon.

Issues before the Tribunal

Was the consideration paid by the taxpayer towards goodwill/non-compete right an intangible asset within the meaning of section 32(1)(ii) of the Act, and hence eligible for depreciation?

Taxpayer's contentions

Even if the AO's contention was to be accepted, non-compete right was a depreciable intangible asset,² and depreciation should be allowed thereon.

Revenue's contentions

- Non-compete fee payment did not qualify for depreciation under section 32(1)(ii).³
- The non-compete rights in the taxpayer's case were not transferable. Hence, the

ratio of the Delhi High Court decision³ was applicable, and that of Karnataka High Court² was not applicable.

Tribunal's ruling

- The taxpayer had the right to enforce the performance of the agreement terms, restricting the seller from competing with it. Hence, the right could be said to be transferable.
- The facts of the taxpayer's case were similar to those in the case of M/s. Ingersoll Rand International, and could not be distinguished.

Therefore, the Tribunal ruled that the non-compete right was an intangible asset, and that the taxpayer was eligible to claim depreciation thereon.
- In view of this, it was academic whether such rights were treated as goodwill or non-compete fees.

¹ ITA No. 1185 & 1186 (Bang) 2016

² Ingersoll Rand International (2014) 48 taxmann.com 349 (Karnataka)

³ Sharp Business Systems (2012) 254 CTR 233 (Delhi)

The takeaways

- The Tribunal has reiterated that payment for non-compete rights is an intangible asset within the meaning of section 32(1)(ii), and is eligible for depreciation thereunder. This view is supported by the decision in the case of Ingersoll Rand International.

- It is important to note that in the case of Sharp Business Systems, the Delhi High Court had ruled that non-compete right was not an intangible asset within the meaning of section 32(1)(ii). The Tribunal has observed that the decision of the Delhi High Court was on the basis that the non-compete rights cannot be transferred to

any other person. This observation should be considered while drafting the agreement.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor.

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