

Tribunal holds that depreciation cannot be claimed on non-compete as it is not an intangible asset

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In brief

In an appeal filed by the Income-tax Department (Revenue) in the taxpayer's¹ case, the Delhi bench of the Income-tax Appellate Tribunal (Tribunal) has held that non-compete fees paid for acquiring a running business as a going concern does not qualify as an intangible asset eligible for claim of depreciation under section 32 of the Income-tax Act, 1961 (Act). In doing so, the Tribunal relied on an order² of the jurisdictional Delhi High Court.

In detail

Facts

- The taxpayer acquired a trading unit as a going concern on slump sale basis *vide* a business transfer agreement for a total consideration of INR 24.4 crores.
- The taxpayer allocated a sum of INR 3.58 crores towards non-compete fees for a duration of 5 years.
- In its books of accounts for the year under consideration, the taxpayer debited 1/5th of the non-compete fees to its profit and loss account considering that the restrictive covenant was effective for a period of 5 years. Under the Act, the taxpayer considered non-compete fees as an

intangible asset under section 32(1)(ii) and claimed depreciation at 25%.

- The tax officer (TO) denied the claim of depreciation holding that the taxpayer has not acquired any intangible asset by making payment of the non-compete fees. The taxpayer contested the action of TO before the first appellate authority who gave relief to the taxpayer.
- Aggrieved with above, the Revenue filed an appeal before the Tribunal.

Issue before the Tribunal

Whether the consideration paid by the taxpayer towards non-competition was an intangible asset within the meaning of section 32(1)(ii) of

the Act, and hence eligible for depreciation?

Revenue's contentions

Non-compete fee payment is not an "intangible asset" as ruled by the jurisdictional Delhi High Court² and accordingly depreciation on the same could not be allowed.

Taxpayer's contentions

- Rights under a non-compete covenant partake character of a right "similar" in nature to know-how, patents, copyrights, trademarks and licenses. Depreciation on the same was allowable in view of the decision of the Supreme Court³.
- The taxpayer also placed reliance on a decision⁴ of the Karnataka High Court.

¹ ITA No. 1801/Del/2011

² Sharp Business Systems [2012] 254 CTR 233 (Delhi)

³ Smifs Securities Ltd. [2012] 24 taxmann.com 222 (SC)

⁴ Ingersoll Rand International Ind. Ltd. [2014] 48 taxmann.com 349 (Karnataka)

Tribunal's decision

- Issue of allowability of depreciation of non-compete fees was covered against the taxpayer by the jurisdictional High Court which held that the words “*other business or commercial rights of similar nature*” have to necessarily result in an intangible asset

against the entire world which could be asserted as such to qualify for depreciation under section 32(1)(ii) of the Act which non-compete fees lacks.

- The Tribunal also distinguished Smifs Securities’ ruling as it was with respect to goodwill and not non-compete fees.

The takeaways

Deduction for depreciation on non-compete fees has not reached finality.

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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