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Goodwill is an intangible asset eligible for depreciation

In brief

In the case of Taj Sats Air Catering Ltd.¹ (the assessee), the Bombay High Court has acknowledged that goodwill is an intangible asset eligible for depreciation under section 32 of the Income-tax Act, 1961 (the Act) by following the decision of the Supreme Court in the case of **Smifs Securities Ltd**².

Facts

- The assessee purchased the catering business on a slump-sale basis for INR 2064 million from Indian Hotels Company Ltd. on 1 October 2001. As per the

valuation report obtained by the assessee, INR 1354 million was apportioned towards other assets and the remaining INR 710 million was allocated towards goodwill. Based on the above, the assessee capitalised the value of goodwill in the books of account and claimed depreciation on the same.

- This issue came up before the assessing officer (AO) for the first time in respect of assessment year (AY) 2003-04. The AO disallowed the claim of the assessee on the ground that goodwill is not eligible for depreciation.
- The Commissioner of Income-tax (Appeal) (CIT (A)) confirmed the disallowance made by the AO.
- Before the Income-tax Appellate Tribunal (the Tribunal), the assessee furnished a fresh valuation report, which gave a further break up of the

¹ Taj Sats Air Catering Ltd. v. CIT [TS-682-HC-2012(Bom)]

² CIT v. Smifs Securities Ltd. [TS-639-SC-2012]

amount of INR 710 million comprising other intangible assets apart from goodwill. Based on this additional evidence, the Tribunal held that depreciation is allowable on all intangible assets other than goodwill and remanded the case to the AO to consider this fresh evidence.

- In respect of AY 2006-07, the same issue came up before the Tribunal and it rejected the valuation report relied upon by the assessee. The Tribunal held that, no depreciation is allowable on the entire amount of INR 710 million classified as goodwill in the books of account³.
- Aggrieved, the assessee is in appeal before the High Court(HC).

Issue

Whether depreciation is allowable under section 32(1)(ii) of the Act on various intangible assets classified as goodwill on a consolidated basis.

HC ruling

- The HC took on record, the assessee's reliance on the decision of the Supreme Court in the case of **Smifs Securities Ltd.** (above) wherein it was held that goodwill would be covered under the expression '*any other business or commercial rights of similar nature*' as enunciated in Explanation 3(b) to section 32(1) of the Act entitled for depreciation.

³ The Tribunal has rejected the claim of the assessee and disregarded its decision with respect to AY 03-04 on the same question on the following grounds:

The assessee furnished the valuation report bifurcating goodwill, after eight years of the business transfer agreement. The report was obtained after the CIT(A) passed the order rejecting the claim of depreciation on goodwill. This was clearly an afterthought as observed by the AO. Even the valuer has mentioned in the valuation report that it was prepared at the instance of the assessee and on the basis of the material provided.

(The above extract is drawn from the Tribunal order, the facts of which are not discussed by the HC.)

- The assessee would benefit from the rejection of the valuation report by the Tribunal as the entire amount of INR 710 million attributable to goodwill is eligible for depreciation.
- To ensure consistency in respect of the same question for different assessment years, the appeal was remanded back to the AO.

Conclusion

- Although the HC has remanded the case back to the AO, the remark that rejection of valuation report is beneficial could allow relief to the assessee on claim of depreciation on goodwill.
- The HC has acknowledged that goodwill is an intangible asset which is eligible for depreciation under section 32 of the Act.

PwC observations

The ruling will ease the activity process connected with mergers and acquisition, as the residual consideration (unallocated portion of total consideration) paid as goodwill is held to be eligible for depreciation under the Act.

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