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Goodwill arising on amalgamation is an asset eligible for depreciation

In brief

In the recent case of Smifs Securities Ltd.¹ (the assessee or the company), the Supreme Court of India (SC) held that goodwill is an intangible asset within the meaning of section 32(1)(b) of the Income-tax Act, 1961 (the Act) and depreciation on goodwill is allowable under this section.

Facts of the case

- YSN Shares and Securities Pvt. Ltd. (YSN) amalgamated with the assessee in accordance with a scheme sanctioned by the Bombay and the Calcutta High Courts.

- The excess consideration paid over the value of net assets acquired from YSN was considered as goodwill arising on amalgamation. Depreciation was claimed on it.
- The assessing officer (AO) disallowed the assessee's claim on the ground that goodwill was not an asset under explanation 3 to section 32(1)(b) of the Act.

Further, the AO contended that no amount was actually paid on account of goodwill. On appeal, the Commissioner of Income-tax (Appeals) (CIT(A)) held that, the difference between the cost of an asset and the amount paid constituted goodwill. The assessee, in the process of amalgamation, acquired a capital right in the form of goodwill because of which the market worth of the assessee increased.

¹ CIT v. Smifs Securities Ltd. [TS-639-SC-2012]

- On appeal, the Income-tax Appellate Tribunal (Tribunal) held that,
 - Goodwill is an intangible asset in terms of explanation 3 to section 32(1)(b) of the Act.
 - Further the Tribunal upheld the finding of fact by the CIT(A) to the effect that the difference between the cost of an asset and amount paid was consideration for goodwill.
- The High Court rejected the revenue department's contention and upheld the decision of the Tribunal.
- The revenue department appealed to the SC against the decision of the Calcutta High Court.

Issue before the Supreme Court

Whether goodwill is an asset within the meaning of section 32 of the Act and whether depreciation on 'goodwill' is allowable under the relevant section

Revenue's contentions

Goodwill is not covered within the category of intangible assets defined by explanation 3 to section 32(1) of the Act so as to be eligible for depreciation.

Supreme Court ruling

- The principle of *ejusdem generis* should strictly apply while interpreting the expression 'any other business or commercial rights of similar nature'.
- Goodwill is covered by the expression 'any other business or commercial right of a similar nature'. Hence, goodwill is an asset in terms of explanation 3(b) to section 32(1) of the Act.

PwC comments

The Supreme Court judgement is a landmark one with respect to claiming depreciation on goodwill. Pursuant to this judgement, companies would be in position to claim depreciation on 'acquired' or 'paid' goodwill.

Transactions done over the past years had resulted in significant amounts allocated towards goodwill instead of any other specific intangible asset. The ruling has provided an interpretation to 'any other business or commercial rights of similar nature', and which would provide certainty to tax position on deductibility and claim of depreciation.

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