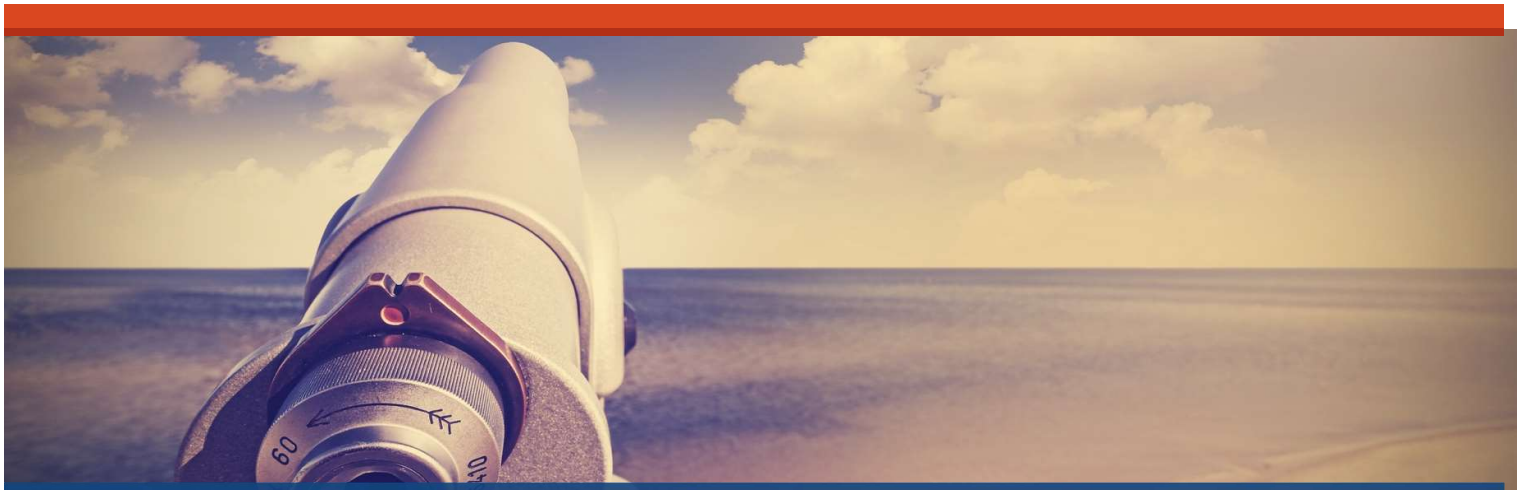

Depreciation on goodwill arising on merger, a permissible deduction

The Hyderabad Bench of Income-tax Appellate Tribunal ('Tribunal') in a recent decision[1] allowed the claim of depreciation on goodwill arising as a result of scheme of amalgamation.

Background

The taxpayer, Mylan Laboratories Limited, acquired shares of two entities i.e. M/s Agila Specialities Limited ('ASPL') and Onco Therapies Limited ('OTL') on December 5, 2013. The sale consideration was negotiated at the enterprise value of the two entities. Post the acquisition of shares, ASPL and OTL became the wholly owned subsidiaries of the taxpayer and thereafter merged with the taxpayer from appointed date of December 6, 2013. On merger, the taxpayer followed the 'Purchase Method' of accounting. Accordingly, the excess of fair value of net assets taken over by the taxpayer, after adjusting the amount of investments cancelled pursuant to the merger, was accounted as goodwill and depreciation on such goodwill was claimed by the taxpayer for income-tax purposes. The said deduction was a subject matter of litigation. The key takeaways of the decision are briefly discussed below.

Taxpayer's contention

- The taxpayer contended that, pursuant to the scheme of merger, the assets and liabilities of ASPL and OTL vested with it. On merger, the taxpayer followed the 'Purchase Method'

1 ITA No.12/Hyd./2019

of accounting as per Accounting Standard 14. This method of accounting required the taxpayer to record the assets and liabilities at fair value and, since the consideration was in excess of the fair value of assets, the same was accounted as goodwill. This goodwill was therefore recorded as an 'intangible asset' in the books of the taxpayer and was eligible for depreciation.

- The taxpayer relied on the decision of Supreme Court in case of Smifs Securities Limited[2] to support its contention that depreciation should be allowed on goodwill arising on merger and recognised as per the accounting standard.
- The taxpayer also argued that the sixth proviso to section 32(1)[3] of the Income-tax Act, 1961 ('Act') is only a mechanism of allocating depreciation that is otherwise allowable on the written down value of assets owned by the amalgamating company and has no applicability for any new asset arising on account of amalgamation. The taxpayer further argued that the purpose of the sixth proviso to section 32(1) was to curb the practice of claiming depreciation on the same assets, by both the predecessor company and the successor company in the case of merger/succession. Therefore, the said proviso is not applicable to the taxpayer.

Department's contention

- The Assessing Officer ('AO') disallowed the depreciation on the basis that, since the goodwill was not in existence in the books of the amalgamating company and was introduced as a part of the scheme of merger, the sixth proviso to section 32(1) of the Act should apply and the depreciation should be restricted to the amount that would be allowed to the amalgamating company had the merger not taken place.
- The AO placed reliance on the decision of the Tribunal (Bangalore bench) in case of M/s. United Breweries Ltd[4] wherein depreciation on goodwill was disallowed.
- The transfer by way of merger is an exempt transfer and claiming goodwill on this exempt transfer would be a case of making profit out of oneself.

Tribunal's ruling

- The Tribunal held that the consideration paid by the taxpayer to the transferor for acquiring the shares of ASPL and OTL cannot be doubted since the transferor was not a related party and such consideration was arrived at after negotiations between the taxpayer and the transferor. The consideration paid for the acquisition of shares of the merged entities is much more than the value of assets taken over by the taxpayer, therefore the excess consideration has to be treated as goodwill which should be eligible for depreciation.

2 *CIT* v. *Smifs Securities Ltd.* [2012] 348 ITR 302 (SC)

3 The sixth proviso to section 32(1) of the Income-tax Act, 1961 provides that depreciation allowable to a successor, shall not exceed in any previous year, the deduction that would be allowed to a taxpayer had the succession not taken place

4 United Breweries Ltd. v. ACIT [2016]76 taxmann.com 103(Bangalore-Trib.)

- The Tribunal affirmed the reliance placed by the taxpayer on the decision of Supreme Court in case of Smifs Securities Limited (supra).
- The Tribunal also held that the goodwill is arising out of the amalgamation and it is not self-generated goodwill as claimed by the AO.
- Further, the Tribunal distinguished the present case from that of United Breweries Limited on account of the fact that the merger under consideration is in the nature of 'purchase' whereas the merger in case of United Breweries Limited was a merger of a wholly owned subsidiary with its parent company.

Dhruva's comments

In the present case, the Tribunal has reiterated that depreciation on goodwill which arises on account of amalgamation scheme can be claimed as a deduction. The decision also distinguishes the ruling expressed in the case of United Breweries Limited by holding that the present case involves an amalgamation by 'purchase'. Also, the Tribunal distinguished goodwill arising on merger of the businesses acquired from third party vis a vis a merger within the group entities.

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