

IT : This issue is no more *res integra* in view of the judgment of the Summit court in *CIT v. Smifs Securities Ltd.* [2012] 348 ITR 302 (SC) in which it has been held that "goodwill will fall under the expression 'or any other business or commercial rights of similar nature'" and, hence, qualifies for depreciation u/s 32(1)

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[2018] 95 taxmann.com 219 (Delhi - Trib.) (SB)

IN THE ITAT SPECIAL BENCH, NEW DELHI

CLC & Sons (P.) Ltd.

v.

Assistant Commissioner of Income-tax, Circle- 3 (1), New Delhi

G.D. AGRAWAL, PRESIDENT R.S. SYAL, VICE-PRESIDENT

AND BHAVNESH SAINI, JUDICIAL MEMBER

IT APPEAL NO. 1976 DELHI OF 2006

[ASSESSMENT YEAR 2001-02]

JULY 19, 2018

Rohit Jain, Adv. Deepesh Jain and Mrs. Meenal Goyal, CA's for the Appellant. Vijay Varma for the Respondent.

ORDER

R.S. Syal, Vice-President - The Division Bench which heard the instant appeal, made a reference to the Hon'ble President for constitution of a Special Bench on 31.08.2009 on the question of entitlement of depreciation on goodwill by mentioning contrary sets of decisions viz., one set allowing depreciation on goodwill and the other not allowing it. The Special Bench espoused the matter. It was put forth on behalf of the assessee that the Tribunal allowed depreciation on goodwill in the case of a related concern, namely, CLC Global Pvt. Ltd., and the Revenue took the matter before the Hon'ble High Court, which was still pending. The assessee prayed that the hearing of the Special Bench be kept in abeyance as its decision can impinge on the issue either way before the Hon'ble High Court. The Special Bench acceded to the request made on behalf of the assessee and vide its order dated 19.03.2010, *inter alia*, reframed the following question for consideration and decision by the Special Bench:-

"Whether on the facts and in the circumstances of the case, the assessee is entitled to claim depreciation u/s 32 of the Income Tax Act on the intangible assets termed "goodwill" acquired by the assessee for Rs.10 crore."

2. The assessee has now moved a fresh application requesting for the disposal of its appeal. This is how, the Special Bench has been re-constituted by the Hon'ble President to decide the question already formulated by the predecessor combination of the Special Bench.

3. The factual panorama is that the assessee company was incorporated on 21.08.1997 with the original subscribers of shares viz., Shri Mukund Chaudhary, Shri Kapil Chaudhary and Shri Ajay Kumar Chaudhary. The assessee company took over all the assets and liabilities of M/s CLC & Sons, a partnership firm with effect from 01.04.2000. An agreement for transfer of all the assets and liabilities was signed between the assessee company and CLC & Sons on 11.02.2000. As per clause 2 of the said Agreement, all the assets in the books of the partnership firm were taken over by the assessee company at book value of Rs. 1,20,54,320/-. In addition, goodwill of the partnership firm was valued at Rs.10 crore,

which was also transferred to the assessee company. In all, the assessee agreed to issue shares to the partners of the firm worth Rs.11,20,54,320/- (Rs.10 crore towards goodwill and Rs.1.20 crore towards capital of the partners as on 31.03.2000). During the course of assessment proceedings, the AO noticed that CLC & Sons had five partners on 31.03.2000, namely, Shri Ajay Kumar Chaudhary, Shri Mukund Chaudhary, Shri Kapil Chaudhary, Smt. Romila Chaudhary and Smt. Ritu Chaudhary. On taking over the partnership firm, the first three partners of the firm were appointed as directors of the assessee company. On being called upon to explain the basis of valuation of goodwill of the partnership firm, the assessee company furnished a Valuation report dated 25.01.2000, computing the amount of goodwill on the basis of six years' purchase of super profits. Such calculation of goodwill has been set out on page 7 of the assessment order. The AO found certain infirmities in such calculation by observing that : (i) Profit before tax of various years taken by the Valuer was excessively high and unrealistic; (ii) The Valuer had wrongly taken rate of yield of the business at 9%, being, the average interest on fixed deposits; and (iii) The Valuer had wrongly valued the goodwill at six years purchase of super profit. After considering the impact of the above three and certain other related factors, the AO came to hold that if the past performance of the firm and the declining profits were to be taken into account, there would be Nil value of goodwill of the partnership firm. Notwithstanding the above, the AO observed in para 6.5 of his order that it is a case where the firm is succeeded by a company and all the partners have become the shareholders of the company, which was promoted by the partners themselves. In the above hue, he held that no transfer of goodwill in real sense was involved. It was thus opined that the whole exercise done by the assessee in valuing the goodwill and issuing shares of equal amount to the erstwhile partners of the firm was a win-win situation, aimed at benefitting such partners on one hand with increase in their capitals by Rs.10 crore and on the other hand by claiming depreciation on such goodwill in the hands of the successor company. After observing in para 7 of the assessment order that though there was no goodwill of the partnership firm capable of transfer to the assessee company, the AO still proceeded to discuss the legal issue of depreciation on goodwill as claimed by the assessee. On going through the mandate of section 32(1), he concluded that the expression "other business or commercial rights of similar nature" employed in section 32(1) did not encompass goodwill of a business as the same was different in nature from know-how, patent, copyrights and trade marks etc., used by the legislature in the earlier part of the provision. *Ex consequenti*, the AO disallowed depreciation of Rs.2.50 crore claimed by the assessee on the amount of goodwill. The ld. CIT(A) countenanced the view taken by the AO on this point.

4. Before espousing the question posed before the Special Bench, it is apposite to note that the AO made other additions/disallowances in the assessment order, which have also been assailed before the Tribunal. Besides, the assessee has not only challenged the view taken by the authorities that there was no goodwill in the business of the partnership firm which could have been transferred to the assessee company by succession and its valuation, the assail is also to the *per se* non-granting of depreciation on goodwill u/s 32(1) of the Income-tax Act, 1961 (hereinafter also called 'the Act').

5. We have heard the rival submissions and perused the relevant material on record. It is vivid from the discussion made *supra* that *qua* the issue of depreciation on goodwill, the authorities below have divided it into two broader compartments by holding that i) no depreciation can be legally allowed on the amount of genuine goodwill in terms of section 32 of the Act; and ii) when a firm is succeeded by a company and all its net assets vest in the company, there is no transfer of goodwill in real sense and further the valuation of goodwill done by the assessee in the instant case is fallacious.

6. Insofar as the legal question of depreciation on genuine goodwill, being the first broader aspect, is concerned, the controversy can be better appreciated on the touchstone of the prescription of section 32, whose relevant part is extracted as under : -

'(1) In respect of depreciation of—

- (i) buildings, machinery, plant or furniture, being tangible assets;
- (ii) know-how, patents, copyrights, trade marks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets acquired on or after the 1st day of April, 1998, owned, wholly or partly, by the assessee and used for the purposes of the business or profession, the following deductions shall be allowed—

....'

7. It is overt from the command of clause (ii) of section 32(1) of the Act that depreciation is permissible in respect of intangible assets listed herein, acquired on or after 01.04.1998. This clause contains certain specified and unspecified species of intangible assets. Whereas the specified intangible assets enshrined in the provision include know-how, patent and copyrights etc., the unspecified intangible assets have been described with the expression 'or any other business or commercial rights of similar nature.' It is nobody's case that goodwill is a specified intangible asset. The assessee has sought to cover 'goodwill' within the expression deployed to define unspecified intangible assets. *Au contraire*, the A.O. has canvassed a view that the expression used in the provision for defining unspecified intangible assets cannot embrace something which is inextricably linked with the business of the assessee. He bolstered his point of view by noting that the specified assets in the provision are such which are detachable from the business of the assessee and transferrable individually and separately. In this light, he held that the expression 'or any other business or commercial rights of similar nature' would include only such assets which are transferrable distinctly. Goodwill of a business, being, an intangible asset which cannot be transferred separately *de hors* the transfer of business, was, ergo, held to be not includible in the expression used in the provision to explain the unspecified intangible assets. In our considered opinion, this issue is no more *res integra* in view of the judgment of the Hon'ble Summit court in *CIT v. Smifs Securities Ltd.* [2012] 348 ITR 302 (SC) in which it has been held: "*that goodwill will fall under the expression 'or any other business or commercial rights of similar nature'*" and, hence, qualifies for depreciation u/s 32(1) of the Act. We, therefore, answer the legal issue raised in the question before the Special bench in affirmative by holding, in principle, that depreciation is available on genuine goodwill.

8. It has been noted above that the A.O. has classified discussion on the issue of depreciation on goodwill in two broader limbs. Firstly, he held that no depreciation can be granted on genuine goodwill in terms of section 32(1) of the Act, which opinion stands overturned hereinabove. Secondly, he held that in the facts and circumstances of the instant case, a firm has been succeeded by a company and net assets of the firm have vested in the company, and consequently there is no transfer of goodwill in real sense and further the valuation of goodwill done by the assessee in the instant case was erroneous. Both the sides candidly accepted that the second broader limb involved in the instant appeal does not precisely emanate from the substance of the question referred to the Special bench. It was urged that the same may be returned to the Division Bench for disposal along with the other grounds raised by the assessee. We agree with such a common contention and, accordingly, send the matter back to the Division Bench for disposing off the appeal in above terms.

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