

BUDGET 2021

AXES TAX DEPRECIATION ON GOODWILL

Compiled by:



CA Kintan Narendra Maru

Until 2019, the Finance Bill as introduced on the budget day would get enacted as The Finance Act except for changes on account of disputed matters, relief measures, certain omissions and inadvertent errors. However final version of Finance Bill 2020 & 2021 had 104 and 127 amendments respectively. In this article, an attempt has been made to elaborate on amendments proposed in Lok Sabha pertaining to Goodwill exclusion from W.D.V of Block of Assets.

Background

- The Supreme Court (SC), in a landmark decision in 2012 in the case of SMIFS Securities Limited (CIT vs. SMIFS Securities Ltd. [2012] 348 ITR 302 (SC)) put debate to rest and held that that 'goodwill' is an intangible asset in the nature of business or commercial right akin to other intangibles mentioned in the Income Tax Act, 1961 and that it should be eligible for depreciation.
- Depreciation is an allowance under Section 32(1) of the Income-tax Act which is computed as per the written-down value (WDV) method on basis of the relevant block of assets.
- **As per Section 43(6)(c) of Income Tax Act, 1961, Written Down Value of a 'Block of Asset' is computed as follows:-**

**Intangible Assets
Rate of Dep - 25%**

	Particulars	Amount
	Opening WDV of Block of Assets	XXX
Add:	Actual Cost of Asset Acquired during the Previous Year	XXX
Less:	Money payable in respect of any asset, sold, destroyed discarded, or demolished during the previous year together with the scrap value, if any	(XXX)
	Closing WDV of Block of Assets	XXX

Amendments Proposed by the Finance Bill, 2021

- Goodwill depends upon how the Business is run; thus, it may appreciate or may remain stagnant over the future course of business. Thus, there may not be a justification of depreciation on Goodwill as compared to other Intangible and Tangible Assets.
- Therefore, the Finance Bill, 2021 proposed that goodwill of a business or profession will not be considered as a depreciable asset and there would not be any depreciation on goodwill of a business or profession in any situation with below mentioned amendments in various sections of Income Tax Act, 1961.

Sr. No.	Section	Proposed Amendment
1	2(11)	Proposed that Block of Asset shall not include Goodwill of a business or profession
2	32(1)(ii)	Proposed that Goodwill of a Business or Profession shall not be eligible for Depreciation.
3	Expl. 3	Proposed that Goodwill of a Business or Profession shall not be treated as an Intangible Asset.
4	50(2)	Proposed that in a case where goodwill of a business or profession forms part of a block of asset for the assessment year beginning on April 1, 2020 and depreciation thereon has been obtained by the assessee under the Act, the written down value of that block of asset and short term capital gain, if any, shall be determined in such manner as may be prescribed
5	55	Proposed that where the capital asset, being goodwill of a business or profession, in respect of which a deduction on account of depreciation under section 32(1) has been obtained by the assessee in any previous year preceding the previous year relevant to the assessment year commencing on or after April 1, 2021, the provisions of sub-clauses (i) and (ii) shall apply with the modification that the total amount of depreciation obtained by the assessee under Section 32(1) before the assessment year commencing on the April 1, 2021 shall be reduced from the amount of purchase price.

Ambiguity in the Finance Bill, 2021

- The Finance Bill introduced during the Budget sought to amend above sections but consequent amendments in Section 43(6)(c) of Income Tax Act, 1961 were missing.
- Thus, the questions arose what would happen to the amount of goodwill which formed part of an existing block of assets. Once an asset forms part of the 'block of assets', it loses its identity and depreciation is allowed on the whole block of asset. So, if an assessee has a block of intangible assets and in any previous year he has acquired the goodwill, which formed part of such block of assets, then how the depreciation shall be allowed on such block of assets.

Illumination by the Finance Bill, 2021 (Lok Sabha)

- The Finance Bill, 2021 as passed by the Lok Sabha proposes to make necessary amendments to Section 43(6)(c) to provide that WDV of block of assets shall be reduced by the actual cost of goodwill falling within such block of assets.
- However, the actual cost of goodwill shall be first decreased by the:
 - a) Amount of depreciation actually allowed to the assessee for such goodwill before the Assessment Year 1988-89, and

- b) Amount of depreciation that would have been allowable to the assessee from the Assessment Year 1988-89 as if the goodwill was the only asset in the relevant block of assets.
- It should be noted that while computing the WDV for the assessment year 2021-22, if the depreciation was claimed on the goodwill forming part of the block of assets in the immediately preceding previous year, the amount of reduction calculated above shall not exceed the WDV of the block of assets.

Illustration

XYZ Limited is running a manufacturing business. On April 10, 2018; it acquired the following intangible assets in an M&A transaction:

- Goodwill worth Rs. 100 crores;
- Trademarks worth Rs. 50 crores; and
- Licenses and franchise agreement worth Rs. 50 crores.

Compute the WDV of the block of intangible assets of XYZ Ltd. as on March 31, 2021 in the following two situations:

Situation 1 - In April 2019, XYZ Ltd. sold the trademarks in Rs. 40 crores.

Situation 2 - In April 2019, XYZ Ltd. sold the trademarks in Rs. 80 crores.

Computation of WDV as on March 31, 2021

(In Crores)

Particulars	Situation 1	Situation 2
Previous Year 2018-19		
Intangible assets acquired on April 10, 2018		
Goodwill	100.00	100.00
Trademark	50.00	50.00
Software	50.00	50.00
Block of intangible assets [A]	200.00	200.00
Less: Depreciation [B = A * 25%]	(50.00)	(50.00)
WDV as on March 31, 2019 [C = A-B]	150.00	150.00
Previous Year 2019-20		
Opening WDV [C]	150.00	150.00
Less: Intangible assets sold during year [D]	(40.00)	(80.00)
Less: Depreciation [E = (C - D) * 25%]	(27.50)	(17.50)
WDV as on March 31, 2020 [F = C - D - E]	82.50	52.50

Particulars	Situation 1	Situation 2
Previous Year 2020-21		
Opening WDV [F]	82.50	52.50
Adjustment on account of goodwill		
Less: Actual cost of goodwill included in block of assets as reduced by the previous years' depreciation [G]	(56.25)	(52.50)
Cost of Goodwill - 100.00		
Less: Dep on Goodwill		
PY . 2018-19 [100*25%] - (25.00)		
PY . 2019-20 [(100-25)*25%] - <u>(18.75)</u>		
56.25		
Less: Depreciation [H = (F - G) * 25%]	(6.56)	-
WDV of block of intangible assets as on March 31, 2021	19.69	52.50

Note: If the goodwill forms part of block of assets on which depreciation is claimed in previous year 2019-20 then the 'amount of reduction' on account of such goodwill shall not exceed the WDV assuming that the goodwill is the only asset in that block. As in the situation 2, the 'amount of reduction' is calculated at Rs. 56.25 which exceeds the WDV of Rs. 52.50, the reduction of WDV on account of goodwill shall be restricted to Rs. 52.50.

Conclusion

- The proposed amendments would override Decisions of Supreme Court which will strip the benefit derived by Assesse of claiming Depreciation on Goodwill Asset till now.
- Companies who would have entered into Scheme of restructuring and Amalgamation would be dissented with the said Amendment as it would be increase their Tax Liability thereby affecting Cash flows.

Challenges

- It is pertinent for Business to relook into the positions taken by them in their Books to avoid Litigation.
- Further Department may now further contend other Intangibles on par with Goodwill and deny benefit of Goodwill.

Impact of Existing Litigation pertaining to the Past Years

- Whether the Department can take a stand that the assesses must not be allowed depreciation on goodwill for previous years which is in litigation, by applying the new amendments?
- It can be inferred from the Memorandum explaining the Finance Bill, 2021 that the said amendments will take effect from April 1, 2021 and will accordingly apply to the assessment years 2021-22 and subsequent assessment years.
- Therefore, this being a substantive amendment, it would not be possible to deny the assesses the benefit of depreciation on goodwill for the periods prior to AY 2021-22 by applying the new amendments.

References

- *Finance Bill, 2021* • *Memorandum to Finance Bill 2020-21* • *Amendment to Finance Bill 2021 (Lok Sabha)*
- www.taxmann.com

