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Depreciation on assets acquired on slump sale cannot exceed depreciation available to transferee and consideration exceeding cost of assets acquired qualifies as goodwill, eligible for depreciation

The Mumbai Bench of the Indian Income-tax Appellate Tribunal (ITAT) rendered its decision that depreciation on assets acquired on slump sale cannot exceed the depreciation computed on written down value as appearing in transferor's books. Further, the difference between purchase consideration paid and the cost of assets taken over on slump sale qualifies as goodwill, eligible for consequent depreciation.

Facts of the case:

- Archroma India Private Ltd. (the taxpayer)¹ during the Financial Year (FY) 2013-14, corresponding to Assessment Year (AY) 2014-15, entered into a Business Transfer Agreement (BTA) with an Indian company (transferor) for purchase of an undertaking under slump sale scheme.
- The taxpayer acquired various assets, goodwill, etc. from the transferor as per the BTA. The taxpayer got aggregate of the fair value of the assets belonging to each block ascertained and accordingly, added them to the block of assets at such fair value.
- During the course of audit, the Assessing Officer (AO) held that the purchases amounted to succession and the provisions thereof under section 170(1) of the Indian Income-tax Act, 1961 (ITA) relating to manner of taxation of income between predecessor and successor were applicable. Accordingly, based on the specific provisions relating to depreciation in case of succession provided under the fifth proviso to section 32(1) of the ITA, the AO computed proportionate depreciation in the hands of the taxpayer on the basis of the value and rates of the transferor.

As per the fifth proviso to section 32 of the ITA, depreciation on assets (both tangible and intangible) in case of succession / amalgamation / demerger has to be computed as if the succession / amalgamation / demerger has not taken place. Further, such depreciation is to be apportioned based on the number of days for which the assets were used by predecessor and successor / amalgamating company and amalgamated company / demerged company and resulting company.

Further, the AO noted that the taxpayer had recorded and claimed depreciation on an additional block of assets i.e. "customer distribution network" (CDN) which was not appearing in the books of the transferor. The AO accordingly disregarded the said block of assets and disallowed depreciation on the same to the taxpayer.

¹ ITO v. Archroma India Pvt. Ltd. (ITA No.306/Mum/2019 and ITA No. 6919/Mum/2018)

To the extent of reduction in the value of block of assets, the AO did not make corresponding upward revision to the cost of goodwill.

- On appeal, the Commissioner of Income-tax Appeals [CIT(A)] held as follows:
 - Relying on the case of Saipem Truine Engineering Pvt. Ltd. v. DCIT², the transfer of assets under the BTA did not qualify as succession.
 - The fair value of the assets was to be taken as the cost of the assets belonging to each block.
 - Considering that section 170 of ITA was not applicable, the difference between consideration for business acquisition and the cost of individual assets was to be treated as goodwill.

Decision of the ITAT:

- On appeal before the Mumbai Bench of the Income-tax Appellate Tribunal (ITAT), the ITAT held as follows:
 - The specific provisions under section 170 of the ITA dealing with taxation in case of succession, were applicable in case of transfer of assets (pursuant to succession of business) by any person otherwise than on death.

Based on facts of the case under consideration, the said provisions were applicable as the taxpayer had acquired the assets under a BTA and hence, the taxpayer had succeeded the transferor.

- There was no exclusion provided for slump sale under section 32 of the ITA and the fifth proviso to section 32 of the ITA dealt with depreciation on transfer of assets in case of succession, amalgamation and demerger.

Based on the principle of construction in the dictum *Noscitur a sociis* (i.e. meaning an unclear word may be known from the accompanying words) the assets transferred under slump sale were covered under fifth proviso to section 32 of the ITA. The same applied independent of the applicability of provisions of section 170 of the ITA.

In view of the above, the fifth proviso to section 32 of the ITA was applicable in the case under consideration while computing depreciation in respect of assets taken over from the transferor. Accordingly, the depreciation as computed by the AO on proportionate basis in terms of the fifth proviso to section 32 of the ITA was correct.

- Based on past rulings³, the ITAT held that the balancing figure between the value of slump sale and the value of WDV of assets taken over qualified as goodwill and the taxpayer was eligible for consequent depreciation thereon.

² Saipem Triune Engineering Pvt. Ltd. v. DCIT (ITA No. 5239/Del/2012)

³DCIT v. Areva T&D India Ltd. SLP No. 21227 / 2012 (SC) and Triune Energy Services Private Limited Vs. DCIT [2016] 65 taxmann.com 288 (Delhi HC)

Comments:

- Post amendment to section 32 of the ITA, the fifth proviso to section 32 of the ITA is now placed as the sixth proviso to section 32 of the ITA.
- Whether slump sale qualifies as succession based on facts (making the fifth proviso to section 32 of the ITA applicable), is a subject matter of litigation. This ruling lays down an important principle that the fifth proviso to section 32 of the ITA applies in cases of slump sale. Consequently, the depreciation available to transferee cannot exceed the depreciation computed based on the WDV of the assets as appearing in the books of the transferor.
- Eligibility of depreciation on goodwill (being difference / balancing figure between purchase consideration of assets and the WDV of assets) is a subject matter of litigation. This ruling emphasises that the balancing figure between the value of slump sale and the value of WDV of assets taken over qualifies as goodwill, eligible for depreciation.
- Taxpayers may want to evaluate impact of this ruling based on their facts.



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