



## **Global Business Tax Alert** Sharp Insights

**<sup>1</sup>Delhi ITAT rejects depreciation claim on 'government authorization / approvals', non-compete fees and goodwill**

**Issue no:** GBTA/46/2017

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<sup>1</sup> M/s. Pitney Bowes India (P) Ltd. vs. DCIT [ ITA Nos. 289 to 293/Del/2013]

## Background

### Government Authorizations / Approvals

- M/s. Pitney Bowes India (P.) Ltd. (the 'taxpayer') is a subsidiary of M/s. Pitney Bowes International Holding Inc USA ('PBIH'). PBIH is involved in manufacturing of franking machines and tax meters.
- Prior to formation of the taxpayer, the machines manufactured by PBIH, were marketed in India by M/s. Kilburn Office Automation Limited ('KOAL'). In this respect, KOAL was granted approvals from regulatory authorities in India. After formation of the taxpayer, the business of sale of franking machine was transferred from KOAL to the taxpayer through a Business Transfer Agreement ('BTA') executed on a slump sale basis, where no specific value was assigned to individual assets. One of the assets listed to be transferred vide the BTA was 'government authorization'.
- Based on valuation report, the taxpayer assigned values to government authorization and claimed depreciation at the rate of 25% treating the same in the nature of license/commercial rights acquired from KOAL and eligible for depreciation, being intangible asset.
- According to the Assessing Officer ('AO'), no value was assigned by the taxpayer in the BTA while acquiring the mailing business from KOAL and no payment was made towards acquiring these approvals. Further, KOAL had not paid any sum to regulatory authorities to acquire such authorization/approvals and therefore it had not assigned any monetary value in its financial statement. Thus, it was not an asset in the books of transferor, when the taxpayer acquired the business. The AO held that such government authorizations do not qualify to be intangible asset and denied depreciation on the same.
- The Commissioner of Income Tax (Appeals) and the Tribunal upheld the position taken by the AO on the grounds that neither KOAL has paid any sum to the government in order to obtain such authorization, nor has the taxpayer paid any sum to the government in order to transfer such authorization in its name. Thus the taxpayer has not acquired any asset 'tangible' or 'intangible' from KOAL to claim depreciation on government authorizations.

### Non-compete fee

- Further, the AO denied the claim of depreciation on non-compete fee by the taxpayer on the grounds that "business or commercial rights of similar nature" mentioned in sub clause (ii) of subsection (1) of section 32 of the Income-tax Act, 1961 is related to a class of rights which are intellectual property rights whereas the alleged payment was for non-compete fee.
- On further appeal, the Commissioner of Income Tax (Appeals) upheld the disallowance of depreciation on non-compete fees relying on the decision of the Delhi ITAT<sup>2</sup>.

### Goodwill

- As regards the claim of depreciation on goodwill acquired from KOAL vide the BTA, the taxpayer raised additional ground first time before the Commissioner of Income Tax (Appeals) in appeal arising from reassessment only and no claim was made either in the return of income or before the Assessing Officer in original assessment proceedings or in the first round of appellate proceedings Commissioner of Income Tax (Appeals) or before the Tribunal.

- The Commissioner of Income Tax (Appeals) observed that there was neither any reference of transfer of any goodwill in the BTA nor was there any mention of goodwill in the valuation report and accordingly rejected the additional ground raised by the taxpayer.

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<sup>2</sup> M/s. Sharp business systems (India) limited in ITA No. 4564/Del/2004

## **Observation and Ruling of the Tribunal**

### **Government Authorizations / Approvals**

- The ITAT observed that the taxpayer has not produced any approvals granted by the Department of Post or other regulatory authority to M/s KOAL. Further, the taxpayer only submitted a letter where Department of Post had approved specific models of Electronic Franking Machine of Pitney Bowes, Inc., USA, which were utilised for sales of stamp papers in India.
- The ITAT observed that the letter issued communicating approvals of machines of PBIH to KOAL, was not because of any kind of eligibility criteria of KOAL, but would be in its agent status and compliance of which was dependent on supply of machines by PBIH.
- The ITAT opined that the letter communicating government authorization/approval, was neither a license or business or commercial rights in the hands of KOAL nor was it having any right to transfer those approvals to any person of its choice. The right to sale of franking machine was as a result of distribution rights granted by PBIH and not due to government approvals.
- Thus, the ITAT held that government authorization/approvals are neither license nor the rights of business or commercial nature in the hands of KOAL, which could be transferred to the taxpayer and therefore no depreciation on the value assigned to government authorization/approvals by the taxpayer, could be allowed.

### **Non-compete fee**

- The ITAT upheld the disallowance of depreciation on non-compete fee following the decision of the Delhi High Court<sup>3</sup>, wherein the court held that non-compete fee neither confers any exclusive right to carry on the primary business activity on the assessee, nor can it be said to be alienable or transferable.

### **Goodwill**

- The ITAT upheld the contention of the taxpayer that goodwill qualifies to be an intangible asset eligible for depreciation under section 32 of the Act following the decision of the Apex Court in Smifs Securities<sup>4</sup>.
- However, since the claim of depreciation was first raised before the Commissioner of Income Tax (Appeals) in appeal arising from reassessment only, the ITAT denied the claim of depreciation for the year under consideration on the reasoning that the proceedings for reassessment are for the benefit of the Revenue and not for the taxpayer<sup>5</sup>.

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<sup>3</sup> M/s. Sharp business systems (India) Limited vs. CIT (2012) 27 taxmann.com 50 (Delhi)

<sup>4</sup> CIT vs Smifs securities Ltd. (2012) 348 ITR 302 (SC)

<sup>5</sup> CIT vs State Agro Development Corporation (2001) 248 ITR 487 (J&K)

## Conclusion

The ITAT denied the claim of depreciation on intangible asset being government authorization / approval on the basis that, in the facts of the present case, mere letter of approval from the government cannot be equated with 'any business or commercial right of similar nature'. Further, it disallowed depreciation on non-compete fee following decision of the jurisdictional High Court, wherein, it was held that non-compete fee does not amount to an intangible asset. However, the Karnataka High Court in CIT vs. Ingersoll Rand International Ind. Ltd. (2014) 48 taxmann.com 349 (Kar.) has held that depreciation is allowable on non-compete fee. The ITAT acknowledged that, in the facts of the present case, although depreciation on goodwill was allowable based on Apex Court ruling in Smifs Securities, it rejected the claim as the taxpayer made the claim pursuant to re-assessment proceedings.

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