

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH 'C', NEW DELHI**

Before Sh. Amit Shukla, Judicial Member

Dr. B. R. R. Kumar, Accountant Member

(Through Video Conferencing)

ITA No. 4985/Del/2019 :Asstt. Year : 2015-16

&

SA No. 985/Del/2019 :Asstt. Year : 2015-16

JX Nippon Two Lubricants India Pvt. Ltd., Unit No. 1003, 10 th Floor, Vatika City Point, MG Road, Gurgaon, Haryana-122001	Vs	DCIT, Circle-2(1), Gurgaon-122001
(APPELLANT)		(RESPONDENT)
PAN No. AADCJ3601L		

Assessee by :Sh. NageswarRao, Adv.

Revenue by:Sh. VedPrakash Mishra, Sr.DR

Date of Hearing:13.01.2021

Date of Pronouncement: 02.03.2021

ORDER

Per Dr. B. R. R. Kumar, Accountant Member:

The present appeal and Stay Application has been filed by the assessee against the order of the Id. CIT(A)-1, Gurgaon dated 05.03.2019.

2. Following grounds have been raised by the assessee:

"1. On the facts and in circumstances of the case and in law, the order passed by Commissioner of Income Tax (Appeals) - 1, Gurgaon ("Ld. CIT(A)") and Deputy Commissioner of Income Tax, Circle - 2(1), Gurgaon ("Ld. AO") are bad in law and liable to be quashed.

2. That on facts and in circumstances of the case and in law, Ld. CIT(A) and Ld. AO has erred in

disallowing depreciation on goodwill amounting to Rs. 13,46,78,733/- claimed under section 32 of the Income Tax Act, 1961 ('the Act') without appreciating all relevant facts available on record and relying upon decisions which are distinguishable on facts.

3. That on facts and in circumstances of the case and in law, Ld. CIT(A) and Ld. AO has erred in disregarding material placed on record, submissions including various agreements and proceeded to deny Appellant's legitimate claims on mere suspicions, conjectures and surmises.

4. That Ld. CIT(A) erred in dismissing appeal without considering various intangible assets acquired by Appellant under Business Transfer Agreement ("BTA") and their apparent financial benefits to Appellant in early years of its operations.

5. That Ld. CIT(A) has erred in not appreciating that gain arising to transferor company under BTA amounting to Rs. 107.82 crores has already been offered to tax and amount of Rs. 24.43 crores has already been discharged as tax liability for AY 2015-16 by transferor company, which fact has not also been disputed by either of lower authorities.

6. That on facts and in circumstances of the case and in law, Ld. CIT(A) and Ld. AO has erred in not following decisions of Hon'ble Courts and granting relief as prayed.

7. The Ld. AO has erred on facts and in law in proposing to levy interest under section 234A, 234B and 234C of the Act.

8. The Ld. AO has erred, in facts and in law, by initiating penalty proceedings under section 271(1)(c) of the Act."

Antecedents of the assessee:

3. The assessee company, JX Nippon Two Lubricants India Private Limited (JX Nippon) was incorporated in India as a 50:50 joint venture between Tide Water Oil Company (India) Limited (TWO) and JX Nippon Oil and Energy Corporation, Japan (JXNOE) in order to transfer the "Eneos Business segment" (EBS) which includes business undertaking relating to Factory Fill (FF) oils business and Service Fill (SF) Oils) from TWO to JX Nippon. The company is engaged in the business of marketing, distributing, selling, manufacturing (including through toll manufacturing of lubricating oil.

4. The assessee during the assessment year had capitalized the goodwill totaling to Rs.107,74,29,864/- out of which the assessee had claimed depreciation of Rs.13,46,78,733/- under section 32(1)(ii)(b) of the act. It is also being observed that the assessee had capitalized the goodwill on account of excess consideration paid to the M/s Tide water oil Company (India) Limited" (TWO) on account of purchase of "Eneos business segment" (EBS) of the later company.

The core issue:

5. During the year, the assessee has purchased "Eneos business segment" of M/s Tide water oil Company (India) Limited" under business transfer agreement dated 24.09.2014 for a total consideration of Rs.106 crore and generated the goodwill as under:

<i>Particulars</i>	<i>Amount (Rs.)</i>
<i>Purchase consideration for 'Eneos Business segment' as per Business Transfer agreement dated 24/09/2014</i>	<i>108,00,00,000/-</i>
<i>Less: Net Assets taken over as per Business transfer agreement dated 24/09/2014</i>	<i>25,74,136/-</i>
<i>Excess Consideration recognized as goodwill in the books</i>	<i>107,74,29,864/-</i>

6. The Assessing Officer observed that only one asset got transferred by the above mentioned parties to the assessee i.e. Storage tank installed at Honda car premises, Land Fixed 30 KL lubricants Tank (1 tank) built in 2012 and utilized in the premises of Honda cars India limited located plot no A-1, sector-40/41, Surajpur, Kasna, Road, Greater Noida Industrial Development area, Distt. Gautam Budh Nagar, U.P.-201301.

7. Therefore, the AO held that apart from the above, the assessee has not purchased/got anything except the storage tank which the assessee is legally bounded to pay the consideration.

8. Before the AO the assessee filed, the "Business purchase agreement" dated 24.09.2014 as executed between M/s Tide water oil Company (India) Limited, assessee company and M/s JX Nippon Oil & Energy corporation (JX NOE). After perusal of the business transfer agreement, the AO noted the following points:

- a. Under the business transfer agreement the assessee, M/s Tide water oil Company (India) Limited and M/s JX Nippon Oil & Energy corporation (Japan) are the parties to the agreement.

- b. M/s Tide water oil Company (India) Limited is being a transferor and assessee company is the transferee company to the contract pursuant to which the transferor intend to sell the business undertaking on a slump sale under section 2(42C) of the act to reorganize the SF oils Business at the total consideration for the amount of Rs. 108 crore.
- c. The agreement further stated that the assessee shall enter into the technical assistance agreement with JX NOE pursuant to which the JX NOE shall grant to the transferee a royalty bearing the right and license to use JX NOE technology, knowhow and trademarks to manufacturing)including though toll manufacturing by the transferor). Market, distribution and/or sell the licensed products with a right to sub license the use of technical information, knowhow and trademarks to the transferor and the other authorized sub licenses approved by JX NOLI (Reliance is placed on Para 2.4 (b) of the business transfer agreement).
- d. Vide Para 2.4(h) of the. Business transfer agreement, it is inferred that the transferor and transferee enter into the franchisee agreement for reorganization and conduct of the SF oils business pursuant to which the transferee shall appoint the transferor as its industrial franchisee of the SF oils Business and. grant to the transferor a franchisee fee bearing right and sub license to use JX NOE technology and knowhow (and trademark for the SF oils branded with JX NOE trademarks) to 'manufacture, sell and distribute in

the territory the SF Oils strictly in accordance with the provisions set forth in the such agreement.

- e. Under the franchisee agreement, the transferee would agree to undertake the marketing activities relating to SF oils and provide the transfer with certain strategic support, arid services in relation to the undertaking of the SF oils business.

9. The Assessing Officer examined these facts and noted that the appellant and the transferee company are related parties and therefore to verify the genuineness of the business transfer agreement asked the appellant to justify the claim of depreciation on goodwill.

10. The assessee submitted that the valuation of 'Eneos Business Segment' at Rs.108 crores was based on detailed business valuation earned out by reputed firm of Chartered Accountant and the consideration paid over and above the net asset required amounting to Rs.107,74,29,864/- had been rightly recognized as goodwill on which depreciation had been claimed in accordance with the decision of the Hon'ble Supreme Court in the case of CIT Vs. Smirfs Securities Ltd. (348 ITR 302) (2012).

11. The Assessing Officer pointed out that the assessee had relied upon the valuation report which was based on the business or commercial rights of similar nature but the appellant had failed to produce any cogent material on the basis of which it could be concluded that the consideration had been paid for any commercial or business rights.

12. The Assessing Officer referred to the franchisee agreement between the appellant and "TWO" and pointed out the following facts in the agreement:

- i. The assessee shall have the exclusive right to supply the lubricant oils for automobile, agricultural machine and construction machinery within India to Japanese and Korean OEMs listed in annexure of the JV agreement.
- ii. The assessee is responsible for defining the strategy with respect to the SF oils Business within this arrangement.
- iii. The transferor desired to use the technology, trademarks and trade names and intellectual property and avail itself of the strategic services and marketing and sales support function in conducting the SF oils business in the territory and assessee is willing to grant the franchisee to the transferor to conduct the SF oils business using the aforesaid intellectual property.
- iv. The franchisee agreement contain the non-exclusive sublicense grants clause under which the assessee company grants transferor company a non-exclusive and non-transferable license to service the customers in relation to the SF oils business in the territory.

13. The Assessing Officer referred to the business transfer agreement and the franchisee agreement and drew the following conclusions:

- a. The assessee company, being Joint venture, was incorporated as on 08/08/2014. The incorporation of the assessee was made with the prior arrangement which was being executed between M/s Two Water oil company

(India) Limited (herein after TWO) and JX Nippon oil energy corporation Japan (herein after JXNOE).

- b. The assessee was incorporated with the intent that there is 50:50 percent interest in the joint venture as executed between TWO and JX NOE. The assessee company at the time of incorporation subscribed with the Rs.10000/- share capital which is 5000 share to each party at the face value of Rs.10/- each.
- c. Further, the facts from the perusal of the financial statement revealed that the both TWO and JX NOE contribute the following amount which is as follows:

<i>S.no</i>	<i>Name</i>	<i>No of shares</i>	<i>Face value</i>	<i>Security Premium</i>	<i>Price per share</i>	<i>Total Amount</i>
1	M/s Two Water oil company (India) Limited	550000	10	1070	1080	594000000
2	JX Nippon Oil & energy Corporation	550000	10	1070	1080	594000000
						1188000000

- d. From the perusal of the cash flow statement of the assessee company, it is further observed that the above capital contribution has been used to pay the sale consideration amounting to Rs.108 crore of the business segment which is purchased from the M/s TWO water oil company (India) limited. Hence, approximate the 92% of the capital as introduced in the company was used to pay

the sales consideration for the business segment which having the meager net assets value to the tune of Rs.25,74,136/-.

- e. Further, as per the business purchase agreement, TWO had sold the business segment comprising of FF oil and SF lubricant oil to the assessee company. But after purchase of business the assessee under the franchisee agreement again incarcerated the manufacturing segment to the TWO. It only remains with the marketing or distribution department with it.
- f. Here, it is pertinent to note the role of JX NOE which is always being the party to the business purchase agreement and entails that it would provide all the intellectual property support be in the nature of knowhow, trademarks, patents, technology to manufacturing the SF or FF lubricant oils.

14. The Assessing Officer pointed out that under the business agreement, the "Two" had transferred business segment namely "Eneos Business Segment (EBS) to the assessee and observed that the Eneos brand was in fact owned by JX NOE, Japan since its incorporation. The Assessing Officer also referred to the valuation report provided by the assessee and pointed out that the valuation report did not contain any analogy regarding the commercial rights which "Two" who was having. **The Assessing Officer pointed out that the assessee did not purchase or acquire any rights under the agreement and in fact the agreement between the assessee and Two would cease to exist once JX NOE cancels the license of intellectual property in terms of Eneos as in that case "Two" would not be able to**

manufacture and market the product. The Assessing Officer observed that the assessee did not bring any cogent material apart from the business purchase agreement to show that any intangible benefit on account of this agreement. The Assessing Officer referred to the valuation report filed by the assessee and pointed out that there was no reference with regard to the determination intangible asset in the valuation report. There was no material to support any valuation of intangibles acquired by the assessee. The Assessing Officer referred to the decision of the Co-ordinate Bench of the Tribunal in the case of Chowgule & Co. Pvt. Ltd. Vs Asstt. CIT, Margao (2011) 10 taxman.com 224 (Panaji) and observed that the Tribunal had held that goodwill was not eligible for depreciation in that case.

15. After considering all the facts of the case, the Assessing Officer held as under:

"The assessee grossly failed to provide the any cogent and reliable material on the basis of which, the claim of depreciation was allowed to it. The agreement when read into contextual manner then it leads to only one irretrievable conclusion that the whole exercise was carried out by the assessee, JX NOE and TWO to provide the franchisee to the assessee and create the huge amount of goodwill in the books of the assessee on which the depreciation could be claim whereby income of the concerned assessment year or thereafter would get reduce by virtue of such goodwill As I have already been discussed, as supra, that the all the intellectual property would be vested with the JX NOE and TWO is in a counterpart in India has been used to sale the "ENEO" branded product. TWO did not have any rights or if any which are only based on the IPR of the JX NOE therefore could not said to be ceded the rights which it did not hold. Therefore, it is

concluded that sum of Rs.107,74,29,864/- was not expended for the purpose of purchase or any commercial rights or goodwill etc. As the assessee had claimed only the depreciation amounting to Rs.13,46,78,733/- on the above stated payment hence the claim of such depreciation is hereby disallowed."

16. The Id. CIT (A) concurred with the order of the Assessing Officer holding that the valuation of assets transferred without any basis and has been done to claim depreciation on the goodwill generate.

17. While observing so, the Id. CIT (A) held that there is **no dispute regarding the depreciation on goodwill but whether the depreciation is allowable on goodwill acquired pursuant to a scheme of slump sale which is applicable to the case of the assessee.** The Id. CIT (A) held that, effectively what was transferred is only the business undertaking pertaining to "sale" of FF oil to the OEMC while the other two divisions of "TWO" namely Videol and manufacturing of FF oil continues with and marketing of SF oil of Enios continues to be with "TWO Ltd." While coming to such conclusion, the Id. CIT (A) relied upon the various clauses of business transfer agreement which are as under:

- TWO shall transfer the Business undertaking relating to sale of FF and SF oil to OEMs namely 'Eneos business segment' by way of 'Slump sale' (as defined u/s 2(42C) of the Act) for consideration of INR 108 crores.
- TWO shall transfer to the assessee all its business relationships with the OEMs as mentioned above relating to supply of FF oils to such OEMs. Also, TWO and the

assessee would enter into a separate agreement namely "Manufacturing Agreement" whereby TWO has agreed to act as a toll manufacturer of FF oils. TWO shall have no responsibility to provide any services or assume any liability in relation to the supply of FF Oils to OEMs.

- TWO shall transfer to Assessee certain assets exclusively used for the "Eneos business segment". These assets only includes storage tank installed at Honda car premises. Thus the only asset transferred was a Storage tank installed at Honda car premises.
- As a part of BTA, TWO and the Assessee entered into a "Franchise Agreement" whereby TWO has agreed to be appointed as industrial franchisee of the Assessee in respect of the SF Oils Business. Thus, TWO will be manufacturing SF Oils and provide warehouse & logistics, sales, invoicing, accounting & collection for the SF Oils business.
- TWO shall also distribute and sell such SF Oils using its sales and distribution network and sales and distribution network of OEMs. Assessee would undertake the marketing activities relating to SF oils and provide TWO with certain strategic support and services in relation to undertaking of the SFs Oils Business.

18. Before us during the argument, the Id. AR reiterated the submission filed before the Id. CIT (A).

- 1) the Assessee is engaged in the business of marketing, distributing, selling, manufacturing through granting sub licenses or toll manufacturing of factory fill and service fill

lubricating oils for automobiles, motorcycles and construction machinery and industrial equipment to be fed into the original machinery or equipment (OEMs) at customer's factories or distributed into the retail market through distributors or dealers.

a) Tide Water Oil Company (India) Limited ('TWO')

TWO is one of the leading manufacturers and marketers of lubricants in India. It is a company which is listed on the both the Indian stock exchanges — NSE and BSE. TWO is catering to the automotive and industrial segments since 1928. Before the formation of assessee company, TWO was engaged in manufacturing, marketing and distribution of products in India under two business segments

- i) "Veedol" - owned by TWO; and
- ii) "Eneos" - a OEM business segment under the technical assistance of JX NOE

The extensive distribution network consists of 50 distributors and over 650 direct dealers servicing over 50,000 retail outlets. The network is fed by 5 plants and over 55 depots located strategically across the country. Its repertoire of automotive products includes engine oils for trucks, tractors, commercial vehicles, passenger cars, and two/three wheelers. It also produces gear oils, transmission oils, coolants, and greases for automobiles. For industrial application it manufactures industrial oils,

greases, and specialty products like metal working fluids, quenching oils, and heat transfer oils.

b) JX Nippon Oil & Energy Corporation ('JX NOE')

JXNOE (Now renamed JXTG Nippon Oil and Energy Corporation) is a fully integrated petroleum products company, headquartered in Tokyo, Japan and is a part of JXTG Group. JXTG Holdings Inc. a company listed on Tokyo Stock Exchange.

JXTG group offers petroleum products and services throughout the world. Through partnerships with world class customers, JX NOE produces technologically advanced motor oils and transmission fluids that reduce carbon emissions, improve fuel economy and reduce wear on critical components.

ENEOS is the brand name for products manufactured and sold by JX NOE, the largest oil company in Japan. ENEOS products are the high quality lubricants available in the marketplace today.

19. Over the period, TWO entered into agreements with various two wheelers automobile companies as well as certain non-automotive clients (OEMs). Pursuant to these agreements, OEMs have granted to TWO, right and license to use certain trademarks and other related intellectual property of such OEMs in connection with the manufacturing, marketing, distributing and/or selling the Eneas Oil. The lists of clients being served by TWO were as under:

- Honda Motorcycle & Scooter India Private Limited
- Hero MotoCorp Limited
- Honda Siel Power Products Limited
- India Yamaha Motor Private Limited
- Honda Siel Cars India Limited
- Kobelco Construction Equipment India Private Limited
- Kobelco Cranes India Private Limited
- Honda Motor India Private Limited
- Kubota Agricultural Machinery India Private Limited
- Isuzu Motors India Private Limited
- Nissan Motor India Private Limited
- Toyota Kirloskar Motor Private Limited
- Mitsubishi Motor Corporation SML Isuzu Limited
- Hyundai Motor India Limited
- Hyundai Construction Equipment India Private Limited
- Maruti Suzuki India Limited
- Tata Hitachi Construction Machinery Company Limited
- George Majjo Industries Private Limited (Yamalube products)

20. excerpts of Business Transfer Agreement (BTA) - In view of expanding lubricant market in India and increase of Japanese automobile manufacturers in India, JXNOE established a joint venture alongwith TWO to transfer the business segment related to "Eneos" range of products i.e. the OEM business segment, Considering the same, the assessee company was incorporated and OEM business segment namely Eneos business segment was acquired by the assessee company from TWO for a consideration of Rs.108 crores vide Business Transfer Agreement (BTA) dated

24th September 2014 (copy of agreement is enclosed as Annexure 7 of Paper book). Further, considering the large manufacturing facilities available with TWO and its existing distribution network, as an integral part of such transfer of Business undertaking, following terms were agreed upon between TWO and JX Nippon i.e. the Assessee vide this business transfer agreement:

- TWO shall transfer the Business undertaking relating to sale of FF and SF oil to OEMs namely 'Eneos business segment' by way of 'Slump sale' (as defined u/s 2(24C) of the Act) for consideration of INR 108 crores.
- TWO shall transfer to the Assessee all its business relationships with the OEMs as mentioned above relating to supply of FF oils to such OEMs. Also, TWO and Assessee would enter into a separate agreement namely "Manufacturing Agreement" whereby TWO has agreed to act as a toll manufacturer of FF oils. TWO shall have no responsibility to provide any services or assume any liability in relation to the supply of FF Oils to OEMs.
- TWO shall transfer to Assessee certain assets exclusively used for the "Eneos business segment". These assets only includes storage tank installed at Honda car premises.
- As a part of BTA, TWO and the Assessee entered into a "Franchise Agreement" whereby TWO has agreed to be appointed as industrial franchisee of the Assessee in respect of the SF Oils Business Thus, TWO will be manufacturing SF Oils and provide warehouse & logistics, sales, invoicing, accounting & collection for the SF Oils business.

- TWO shall also distribute and sell such SF Oils using its sales and distribution network and sales and distribution network of OEMs. Assessee would undertake the marketing activities relating to SF oils and provide TWO with certain strategic support and services in relation to undertaking of the SFs Oils Business.
- Thus, by virtue of the above agreements assessee has been able to take care of the manufacturing as well marketing activities as part of the BTA. Had TWO not agreed for the above functions it was impossible for the assessee to earn profit from day one. In a competitive market the assessee would have incurred losses for first few years to make an entry into a new segment, develop its reputation and brand. Thus, the assessee has got a huge benefit in terms of the BTA.
- TWO shall doing the same on a "risk neutral" basis in accordance with manufacturing and distribution plans prepared by the Assessee in consultation with TWO, Assessee shall assume the risk of the SF Oil business including the risk of any unsold inventory manufactured by TWO in accordance with Franchise Agreement.

21. With regard to the Business Valuation, it was submitted that the value based on detailed business valuation carried out by a reputed firm of Chartered Accountants.

22. Owing to Business Transfer Agreement all existing customer relationships with OEMs with regard to Eneos Business segment (SF & FF) were transferred to the Assessee.

23. It was argued that the business valuation was carried out on the basis of Income Approach i.e. Discounted Cash Flow (DCF) Method, taking into consideration the future revenues expected to be generated out of the said business segment from the customers of TWO who will become customers of JV i.e. the appellant.

24. It was argued that the profit estimated at the time of valuation, has been actually achieved by the assessed which shows the accuracy of estimation and valuation. It was argued that the assessed has also acquired Intangible Assets by way of Business Transfer Agreement such as transfer of existing OEM business relating to SF and FF oil, right to use manufacturing facilities to TWO, right to use customer data base to get sales support services from TWO.

25. The Id. AR also submitted the details of profits and subsequent to the BTA, which is as under:

2014-15	Rs.1.95 crores
2015-16	Rs.20.1 crores
2016-17	Rs.20.2 crores
2017-18	Rs.28.6 crores

26. On the basis of the result, it was argued that the valuation has been rightly undertaken and the payments were justified even based on the profits earned subsequently to the tune of Rs.70.8 crores in less than four years. It was also argued that the payment made by the assessee of Rs.108 crores has been duly offered to tax by the recipient "TWO" and long term capital gain of Rs.24.43 crores has been paid. Further, it was argued

that since the goodwill is classified as an intangible assets within the meaning of Section 32(1)(ii) of the Act, the depreciation has been rightly claimed.

27. Heard the arguments of both the parties and perused the material available on record.

28. On going through the entire facts and circumstances, the issue to be decided before us as determined is "whether the payment made by the assessee of Rs.108 crores for Business Transfer Agreement (BTA) to Tide Water Oil Company (India) Ltd. (a listed company) is excess and if so whether the goodwill raised by the assessee in the books of accounts over and above the value of the net asset obtained out of such agreement is correct as per the accounting standard and if so whether such goodwill raised is eligible for depreciation u/s 32(1)(ii) of the I.T. Act"

29. With regard to the amount paid by the assessee for BTA, we have gone through the valuation report.

Valuation of the TWO-EBS:

30. We have gone through the report of the PWC dated 14.07.2014 which went through the value analysis by taking into consideration where average cost of the capital and financial performance of the EBS. The "TWO" holding structure consists of 26% of the company "Andrew Yule & Co. Ltd." as promoter, institutional public share holding at 14% and non-institutional public shareholding of the remaining 60%. The company is listed in BSE and NSE and for the purpose of the

case manufactures and markets lubricants under the brand "Eneos". The "TWO" has marketing and distribution network of 100 distributors, 300 dealers and 20000 sub-dealers across India. The brand was established in 2001 and owned by JX and OE which are sold by the company TWO to OEMs. The growth rate of the "Eneos Segment" has been 32 to 44% from the financial years 2010 to 2012 with compound growth rate of 37%. The market share of factory fields increased from 28 to 39% historically, pre-agreement. The operative margins ranging from 8.7 to 11% over a period 3 years after considering various approaches namely income approach, market multiple approach, net asset value approach. The assessee accepted the income approach otherwise called as discounted cash flow method for valuation of the EBS. Based on that the specified business, financial performance has been projected at with EBITDA margin varying from 6.6 to 7.1%. Based on the forecast, the operating income, post tax was estimated at Rs.98 to 184 millions per year over a period of 5 years. According to market multiple approach, the value range was determined at Rs.987 to 1062 millions. The valuation report has also taken into consideration, the guidelines companies such as Gulf Oil Corporation Ltd. and Castrol India Ltd.

31. The taxable income of the "TWO" was Rs.214 Crores for the A.Y. 2015-16 which included the tax on the long term capital gains. No prudent businessmen would transfer a running business at net asset value (Rs. 25.7 lakhs in present case) which is giving return of Rs.70.89 crores within just 3.5 years of transfer. The income earned by the assessee post BTA was to the tune of Rs.70 crores over a period of 3 years against the

purchase value of BTA of Rs.108 crores. The proof of the pudding is in the eating. Thus, we find that the price paid by the assessee for entering into BTA cannot be suspected or alleged to be with any other motive.

32. Now, having determined that the price paid by the assessee for BTA cannot be disputed, the issue to be examined is whether the action of the assessee to raise goodwill of Rs.107.75 crores on account of BTA being the difference in the payment of consideration of Rs.108 crores and in the net book value of the assets of Rs.25.75 lacs transferred to the assessee.

33. Business goodwill is an intangible asset owned by and associated with the operation of a company. Goodwill is the premium that is paid when a business is acquired. If a business is acquired for more than its book value, it can be said that the acquiring business is paying for intangible items such as intellectual property, brand recognition, and customer loyalty. Business goodwill is an intangible asset that adds value to a company. Factors such as proprietary or intellectual property and brand recognition are reflected in goodwill. While goodwill is not easily quantifiable, it is calculated by subtracting the difference between the fair market value of a company's assets and liabilities from its purchase price. Companies must record the value of goodwill on their financial statements and record any impairment.

34. The presence of goodwill implies that a company's value is greater than its combined raw assets. The effect of goodwill on a company's value is better understood by learning the factors

that create business goodwill. The three factors in the creation of a company's goodwill include its going concern value, excess business income, and the expectation of future economic benefits.

1. The going concern value indicates that the company can produce income by applying existing capital (equipment, employees, management, and resources) effectively.
2. The excess business income implies that a company is earning additional income due to the presence of its goodwill.
3. The overall value further increases when expectations for economic growth are added to the equation.

35. While "goodwill" and "intangible assets" are sometimes used interchangeably, there are significant differences between the two in the accounting world.

36. Goodwill is a premium paid over the fair value of assets during the purchase of a company. Hence, it is tagged to a company or business and cannot be sold or purchased independently whereas other intangible assets like licenses, patents, etc. can be sold and purchased independently.

37. The Assessing Officer has resorted to Explanation 3 to Section 32(1) and held that the expression asset shall mean an intangible asset being know-how, patents, copyrights, trademarks, licenses, franchises and any other business or commercial rights of similar nature. The AO rejected the claim on the basis that "goodwill" was not an "intangible asset".

38. On going through the judgment of the Hon'ble Apex Court in the case of CIT Vs. Smifs Securities, we hereby hold that "goodwill" would fall under the expression any other business or commercial right of a similar nature as per Section 32(1)(ii).reliance is placed on the following judgments

39. DHL Logistics Private Limited Vs DCIT (ITAT Mumbai)

"We have to consider whether goodwill is an intangible asset under section 32, hence, eligible for claim of depreciation. In our view, this issue is no more *res integra* in view of the decision of Hon'ble Supreme Court in Smifs Securities Ltd. (supra) where the Hon'ble Supreme Court has held that goodwill is in the nature of any other business or commercial rights as provided under Explanation-3(b) of section 32(i) r/w section 32(1)(ii). In view of the same Assessee is eligible for Depreciation On Goodwill Resulting From Acquisition Of Business Unit Of Lee & Muirhead Pvt. Ltd. in A.Y. 2008-09".

40. From the perusal of the above, it is evident that the intangible assets characterized 'goodwill' and acquired under, the Business Transfer Agreement are towards MIS, Internal Control systems, Procedure & Manual, Cresa brand logo, copyrights, client acquisition cost, certain corporate service and non-compete fee. The AO has taken the view that these would not constitute goodwill for the reasons (a) that there could not have been any good in micro finance business related to unorganized sector (b) both the entities are under same control & management (c) not shown in the balance sheet of the society (d) not falling within the purview of Sec.32.

41. In this regard, it is relevant to understand what constitutes goodwill. The Hon'ble High Court of Delhi in the case of Areva T&D India Ltd. &Ors. Vs. DCIT (345 ITR 421) has discussed the nature of goodwill and the relevant discussion is extracted as under:

42. In this regard, it would not be out of place to refer to the decision in CIT Vs B.C. Srinivasa Setty [1981] 128 ITR 294 (SC) wherein the concept of goodwill has been understood in the following terms:

"Goodwill denotes the benefit arising from connection and reputation. The original definition by Lord Eldon in *Cruttwell v. Lye* [1810] 17 Ves 335 that goodwill was nothing more than "the probability that the old customers would resort to the old places" was expanded by Wood V.C. in *Churton v. Douglas* [1859] John 174 to encompass every positive advantage 'that has been acquired by the old firm in carrying on its business, whether connected with the premises in which the business was previously carried on or with the name of the old firm, or with any other matter carrying with it the benefit of the business'. In *Trego v. Hunt* [1896] AC 7 (HL.) Lord Herschel] described goodwill as a connection which tended to become permanent because of habit or otherwise. The benefit to the business varies with the nature of the business and also from one business to another. No business commenced for the first time possesses goodwill from the start. It is generated as the business is carried on and may be augmented with the passage of time. Lawson in his *Introduction to the Law of*

Property describes it as property of a highly peculiar kind. In CIT v. Chunilal Prabhudas & Co. [1970] 76 ITR 566 the Calcutta High Court reviewed the different approaches to the concept (pp.577, 578)

To quote the Hon'ble court:

"Though immaterial, it is materially valued. Physically and psychologically, it is a "habit" and sociologically it is a "custom". Biologically, it has been described by Lord Macnaghten in Trego v. Hunt [1896] AC 7 [HL] as the "sap and life" of the business. Architecturally, it has been described as the "cement" binding together the business and its assets as a whole and a going and developing concern".

43. Goodwill is commonly understood as future benefits from assets that are not capable of being both individually identified and specifically recognized. Goodwill as defined in Lexis Nex in Tax Law. Dictionary is as under (discussed by the Hon'ble ITAT, Delhi in the case of Cyber India Online Ltd Vs ACIT)" should be recorded in the books only when some consideration in money or money's worth has been paid for it. Whenever business is acquired for a price (payable in cash or in shares or otherwise) which is in excess of the value of the net assets of the business taken over the excess should be termed as 'goodwill'

44. Any excess of cost over the fair value of the net assets acquired is recorded as goodwill. In Eric Koblens: A dictionary for Accountants, the term Goodwill has been defined as:

“The current value of expected future income in excess of a normal return on the investment in net tangible assets not as a recorded or reported amount unless paid for. The excess of the price paid for a business as a whole over its book value or over the computed or agreed value of all tangible net assets purchased.”

45. The next issue arises whether the impugned intangible rights acquired under the Business Transfer Agreement would be eligible for depreciation under section 32(1)(ii). In this regard, it is relevant to refer to the discussion of the Hon'ble Apex Court on the issue whether goodwill is an asset within the meaning of Sec.32 of the I.T. Act. The Hon'ble Apex Court in the case of CIT Vs. Smifs Securities 348 ITR 302 discussed as under:

Question No.[b]

“Whether goodwill is an asset within the meaning of Section 32 of the Income Tax Act, 1961 and whether depreciation on “goodwill” is allowable under the said Section:”

Answer:

In the present case, the assessee had claimed the deduction of Rs. 54,85,430/- as depreciation on goodwill. In the course of hearing, the explanation regarding origin of such goodwill was given as under:

“In accordance with Scheme of Amalgamation of YSN Shares & Securities (P) Ltd with Smifs Securities Ltd (duly sanctioned by Hon'ble High Courts of Bombay and Calcutta) with retrospective effect from 1st April, 1998, assets and liabilities of YSN Shares

& Securities (P) Ltd were transferred to and vest in the company. In the process goodwill has arisen in the books of the company.”

46. It was further explained that excess consideration paid by the assessee over the value of net assets acquired of YSN Shares and Securities Private Limited [Amalgamating Company] should be considered as goodwill arising on amalgamation. It was claimed that the extra consideration was paid towards the reputation which the Amalgamating Company was enjoying in order to retain its existing clientele.

47. The Assessing Officer held that the goodwill was not an asset falling under Explanation 3 to Section 32 (1) of the Income Tax Act, 1961 [‘Act’ for short].

48. We quote herein below Explanation 3 to Section 32(1) of the Act: “Explanation 3. For the purposes of this sub-section, the expressions “assets” and “block of assets” shall mean –
[a] tangible assets, being buildings, machinery, plant or furniture;
[b] intangible assets, being know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature.

Explanation 3 states that the expression “asset” shall mean an intangible asset, being know-how, patents, copyrights; trademarks, licenses, franchises or any other business or commercial rights of similar nature. A reading the words ‘any other business or commercial rights of similar nature in clause

(b) of Explanation 3 indicates that goodwill would fall under the expression "any other business or commercial right of a similar nature; The principle of ejusdem generis would strictly apply while interpreting the said expression which finds place in Explanation 3(b).

49. In the circumstances, we are of the view that "Goodwill" is an asset under Explanation 3(b) to Section 32(1) of the Act. The Hon'ble Apex court held that

One more aspect needs to be highlighted. In the present case, the Assessing Officer, as a matter of fact, came to the conclusion that no amount was actually paid on account of goodwill. This is a factual finding. The Commissioner of Income Tax (Appeals) [CIT(A), for short] has come to the conclusion that the authorized representatives had filed copies of the Orders of the of the High Court ordering amalgamation of the above two Companies; that the assets and liabilities of M/s. YSN Shares and Securities Private Limited were transferred to the assessee for a consideration; that the difference between the cost of an asset and the amount paid constituted goodwill and that the assessee Company in the process of amalgamation had acquired a capital right in the form of goodwill because of which the market worth of the assessee- Company stood increased. This finding has also been upheld by Income Tax Appellate Tribunal. We see no reason to interfere with the factual finding".

50. In the instant case ,the revenue has taken the view that the impugned intangible rights do not fall within the purview of any of the clauses of Sec.32(1) and is not in the 'nature of commercial or business right' so as to be eligible to claim depreciation u/s 32.

51. In this regard, it is relevant to refer to the decision of the Hon'ble ITAT, Hyderabad bench in the case of M/s SKS Micro Finance Ltd.

52. The facts in that case are that the assessee company acquired the micro finance business from the society Swayamkrishisangam and has paid Rs 3.97 crores towards customer costs, one time reimbursement of Rs.82 lakh towards cost of Internal control systems, computer software and towards corporate, services including strategic planning, market survey, introduction of new products, impact assessment etc. The AO therein took the view that the client acquisition cost of Rs.3.97 crores would not be eligible for depreciation as it is not in the nature of intangible asset or in the nature of commercial business rights. The Ld. CIT(A) in that case took the view that the customer base acquired by the assessee cannot be termed as know-how, patent, copyright or trademark or franchise; and it cannot be considered as license. or business or commercial, right of similar nature and relied on the decision of the Hon'ble Bombay High Court in the case of CIT Vs. Techno Shares Stocks Ltd (225 CTR 337). The Hon'ble Tribunal following the decision of the Hon'ble Delhi High Court in the case of Areva T&D India Ltd. & Others (345 ITR 421) and the Apex Court decision in the case of Smifs Securities Ltd held that the client acquisition cost would fall within the category of 'business or commercial rights' referred in clause (ii) of Sec. 32(1) and would be eligible for depreciation.

53. Depreciation could not be denied to the Taxpayer merely for the reason that the assets were classified as 'goodwill' in

the books of account without appreciating the true nature of the assets if they can fall under the scope of 'any other business or commercial rights of similar nature'. We are of the view that the specified intangible assets acquired under slump sale agreement were in the nature of "business or commercial rights of similar nature" specified in section 32(1)(ii) of the Act and were accordingly eligible for depreciation under that section.

54. Owing to the entire facts and circumstances of the case Viz., the value paid by the assessee, the valuation report, , the profits earned by the assessee, the tax payment by the recipient, the right and process of the assessee to raise the goodwill and the accounting thereof, the provisions relating to depreciation on intangibles, the judgments relating to treating of intangibles as goodwill, it can be concluded that **the difference between the cost of the asset and the consideration paid would constitute goodwill and that goodwill is an asset eligible for depreciation under section 32(1)(ii) of the I.T. Act.**

56. In the result, the appeal of the assessee is allowed.

57. Owing to the disposal of the appeal of the assessee, the Stay Application No. 985/Del/2019 is treated as redundant.

Order Pronounced in the Open Court on 02/03/2021.

Sd/-

(Amit Shukla)
Judicial Member

Dated: 02/03/2021

Subodh

Sd/-

(Dr. B. R. R. Kumar)
Accountant Member