

M&A IMPACT – DEPRECIATION ON GOODWILL

Budget Proposal

The Finance Bill 2021 has proposed that goodwill of a business or profession will not be considered as a depreciable asset and accordingly depreciation would not be allowed on goodwill of a business or profession **in any situation**.

Accordingly, the meaning of intangible assets under section 32 of the IT Act and corresponding changes under various other provisions are proposed to be amended to exclude goodwill of a business or a profession.

Impact

It is settled position by judicial pronouncements, including the decision of Hon'ble Supreme Court in the case of Smif Securities Limited [(2012) 348 ITR 302 (SC)], that goodwill is an asset that arises on account of consideration paid being in excess of fair value of assets and liabilities being acquired, irrespective of the fact whether consideration is discharged in cash or shares. The mode of acquisition of business may be via a merger, demerger or business purchase.

However, the silver lining is that consideration paid for acquisition of such goodwill will continue in the tax books as non-depreciable asset, the cost of which will be available as a deduction in computing capital gains on any subsequent sale.

ELP's Insights

The proposal is to disallow allowability of depreciation on goodwill in all situations without making any distinction, including that of a business purchase. Goodwill by definition is a residual asset the value of which cannot be attributed to a specific tangible asset or intangible asset. But nonetheless, the buyer has paid value for this asset and there is no reason why such benefit should be denied unless it has been abused by way of an internal restructuring which otherwise can be arrested under the provisions of General Anti Avoidance Rules. Further IND AS 103 also does not allow recognition of goodwill in a "common control business combinations".

This proposal would severely impact pay-back calculations in every commercial M&A deal. Depreciation on goodwill was an essential element in calculating post tax return of an acquisition proposal.

