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# TAXATION TIMES

March 2021

Taxation Times is a monthly newsletter published by UJA specifically with an intent and object to simplify and provide clarity on certain provisions of the Income Tax Act, discuss the implications of various amendments and circulars notified time and again, understand the judicial precedents as decided by various courts and interpret these.

The Taxation Times is an initiative to keep you abreast with the latest development in the realm of the Direct Taxes in India.

# Contents

By February 2021, India's economy had fully opened up & Covid – 19 had become a thing of the past. However, suddenly India witnessed a surge in cases – a second wave in which infections were spreading more quickly than the previous wave last year. If the situation doesn't improve and the authorities impose another lockdown, the economy will be hurt. The only way to save the economy is to expedite the vaccination drive to ensure that maximum people get vaccinated at the earliest to curb the spread of the virus menace.

Coming back to this month's Taxation Times, here's what this edition has in store:

- The Finance Bill 2021 (FB 2021) got the Presidential assent in March 2021. One of the amendments which was proposed by the FB 2021 was exclusion of 'goodwill' from the definition of intangible assets & no depreciation on the same. More about this amendment in the article.
- Some interesting judicial decisions from the Tribunals.
- Circulars & Notifications issued by the government during March 2021.
- Did You Know Series – encompassing tax happenings in March 2021.

Incase you have any feedback or need us to include any information to make this issue more informative, please feel free to write to us at info@uja.in

Happy Reading!

Best Regards,
UJA Tax Team

# Will Mergers & Acquisitions become tax – expensive?

Depreciation of goodwill has always been a contentious issue between taxpayers & the department.

Clause (11) of s. 2 of the Income Tax Act 1961 ('ITA') defines 'block of assets' to mean a group of assets falling within a class of assets comprising of *Tangible assets, being buildings, machinery, plant or furniture* and *Intangible assets, being know – how, patents, copyrights, trade – marks, licenses, franchises or any other businesses or commercial rights*

s. 32(1) of the ITA provides for deduction on account of depreciation on *tangible assets (building, machinery, plant & furniture) and intangible assets (know – how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature) acquired on or after 1st April 1998.*

Thus, ITA does not specifically include 'goodwill' within the definition of s. 2(11) or even s. 32.

The question as to whether goodwill of a business is an asset within the meaning of s. 32 of the ITA & depreciation on goodwill should be allowed came up before the **Hon'ble Supreme Court** in the case of **Smiff Securities Limited [(2012) 348 ITR 302 (SC)]** wherein it was held that ***goodwill acquired on amalgamation (being difference between the net book value of assets & consideration paid) was a capital right which fell within the expression 'any other business or commercial right of a similar nature' and hence eligible for depreciation while computing business income***. Thereafter, the **Apex Court** in the case of **PCIT V/s Zydus Wellness Ltd. (2020)** has dismissed the Special Leave Petition (SLP) *against the order of the High Court which upheld the decision of the Tribunal allowing the taxpayers claim for depreciation of goodwill.*

Thus, the Supreme Court has regarded goodwill as a commercial/business right eligible for depreciation under s. 32(1)(ii). Infact, the decision of the Apex Court in the case of Smiff Securities has been widely relied on Courts & Tribunals around the country to decide identical issues. However, this is still a matter of litigation before various courts.

The recent amendment by the Finance Bill 2021 to prohibit depreciation on goodwill has put the above controversy to rest. Below are the highlights of the amendment made:

"

Amendment by Finance Bill 2021

S. 2(11) provides that 'block of assets' shall not include the 'goodwill of a business or profession'.

S. 32(1)(iii) shall be amended to provide that 'goodwill of a business or profession' shall not be eligible for depreciation.

Explanation 3 to s. 32(1) defines 'asset'. However, it has been proposed that 'goodwill of a business or profession' shall not be treated as an 'intangible asset' for purpose of s. 32(1).

"

The aforementioned amendments make it explicitly clear that 'goodwill' cannot be regarded as an 'asset' or cannot fall within the definition of 'block of assets' for the purpose of depreciation under s. 32(1).

Additionally, the following sections are also proposed to be amended:

- A new provison is proposed to be inserted into s. 50(2) that the CBDT may prescribe a manner to compute written Down Value ('WDV') of an asset & short term capital gain (if any) if goodwill is forming part of the block of assets and depreciation has been claimed on it.
- Consequential amendments are also proposed to be made to s. 55 which provide meaning of various terms including 'cost of acquisition' for the purpose of computation of capital gains.

The Bill which was introduced in 2021 did not amend s. 43(1) which defines WDV of block of assets. Consequently, the Finance Bill as passed by the Lok Sabha made the following amendments:

## Definition of Witten Down Value ('WDV')

The definition of WDV under s. 43(6)(c)(ii) of the ITA has been amended. WDV in the case of block of assets would now be further reduced by the actual cost of goodwill failing within the block as follows:

In respect of FY 2020 – 21, relevant to AY 2021 – 22, where goodwill of a business or profession was part of block of assets on which depreciation was claimed by the taxpayer in FY 2019 – 2020, the amount of deprecation reduced by the actual cost of goodwill would be decreased by:

**a.** Actual amount of depreciation on such goodwill allowed before AY 1988 – 89

**b.** Amount of depreciation allowable to the taxpayer on such goodwill from AY 1988 – 89 onwards as if goodwill was the only asset in the relevant block.

The amount of reduction cannot exceed the WDV of the block of assets.

## Rationale for making the amendment explained by the Memorandum

The term 'intangible asset' has been defined in s. 2(11) and Explanation 3 to s. 32 of the ITA. After the aforesaid amendments become effective, intangible assets will be defined as *intangible assets being know – how, patents, copyrights, trade – marks, licenses, franchises or any other business or commercial rights of similar nature* ***not being goodwill of a business or profession.***

The rationale behind exclusion of goodwill from the ambit of intangible assets is that *actual calculation of depreciation of goodwill is required to be carried out as per provisions of the Income Tax Act 1961. Once the relevant provisions are applicable, in some situations (like business re-organization) there could be no depreciation on account of actual cost being zero. It is further stated that goodwill, in general, is not a depreciable asset & it depends upon how the business runs, goodwill may see appreciation and in the alternative no depreciation to its value. Hence,* *for the said reasons there is no justification of depreciation in the manner there is a need to provide for depreciation incase of other intangible assets or plant & machinery.*

**Points to Ponder –**

1. The decision of the Apex Court in the case of Smiffs Securities Limited was delivered in the year 2012. More than 8 years after the pronouncement, the Government has decided to overturn it. Several organizations have taken the benefit of the depreciation on goodwill arising out of amalgamation or a business re - organization. An example of this would be Hindustan Unilever's acquisition of Horlicks in December 2018 from GlaxoSmithKline PLC, which had claimed high goodwill as depreciation and will now be impacted by this amendment as, tax experts said, goodwill claims are still pending of the previous years. Unilever had expected around 1.3 billion euros of the goodwill to be deductible for tax purposes from the Horlicks deal.[1]

2. As per the memorandum, the said amendments will take effect from 1st April 2021 and will be effective AY 2020 – 2021 onwards. Since this is a substantive amendment, it would not be possible to deny taxpayers benefits of depreciation accruing for the previous years.

3. The newly proposed amendment will open up new avenues for litigation. What constitutes 'goodwill' and what doesn't, would be possible be a matter of debate. The economy of M&A transactions would be altered a great deal in the future especially where intangible assets form a substantial chunk of the transaction.

4. The effects of the amendment are two fold on big ticket mergers and acquisitions – it would greatly bring down the negotiating power of the seller & also substantially increase the tax outflow as in the hands of the acquirer company considering that no benefit of depreciation shall be available.

## Conclusion

How businesses deal with this amendment as well as the impact on large value mergers & acquisitions would be seen in the long run. The rationale of the Government that the value of goodwill appreciates in the long run & therefore depreciation claim on this cannot be allowed holds valid. However, there are instances like Jet Airways India Ltd. which went into bankruptcy as well as Nokia (the number one mobile company during 2005 – 2010) which also highlight cases of goodwill losing its value. Under such situations, what could be the Government's stand – time to wait & watch.

[1] https://www.business-standard.com/budget/article/m-a-costs-to-go-up-after-budget-2021-axes-tax-depreciation-on-goodwill-121020300252_1.html

# Case Laws

"Interest paid by the taxpayer on borrowed loan from bank of a commercial building project & further borrowed amount to repay the earlier loan is allowed as a deduction under s. 24(b) of the Income Tax Act 1961."

**Facts:**

The taxpayer[2] is engaged in the business of construction, development of real estate projects and renting of commercial buildings. In the return of income filed, the taxpayer had declared 'income under the head house property' & claimed deduction in respect of interest paid on capital borrowed for the purpose of construction of the property. The breakup of the interest paid is as under:

| | |
|---|---|
| Pre – Construction Interest | 19,52,752 |
| Interest on term loan during FY 10 – 11 | 20,19,618 |
| Interest on unsecured loan for FY 10 - 11 | 30,22,041 |

The taxpayer borrowed money from Corporation Bank for the purpose of construction and letting of commercial property. Later, in order to repay the loan from Corporation Bank, the taxpayer borrowed monies from Mrs. Kaveri Bai. The interest on unsecured loan of INR 30,22,041/- claimed in the return of income was paid to Mrs. Kaveri Bai. The Ld. Assessing Officer disallowed the entire claim of interest under s. 24(b) of the Income Tax Act ('ITA').

On further appeal, the Hon'ble Commissioner of Income Tax Appeals ('CIT(A)') allowed the interest payment made to Corporation Bank but denied the claim of the taxpayer in respect of interest payment to Mrs. Kaveri Bai.

The taxpayer has preferred an appeal before the Hon'ble Income Tax Appellate Tribunal ('ITAT').

[2]Indraprastha Shelters (P) Ltd V/s Dy. Commissioner of Income Tax [2021] 124 taxmann.com 569 (Bangalore – Trib)

**Issues under Consideration:**

When the taxpayer takes a sum to repay an earlier loan taken for construction of house property, interest paid on such loan was also deductible in computing deduction under s. 24(b) of the ITA?

**Decision:**

1. The Ld. Counsel for the taxpayer placed reliance on the CBDT Circular No. 28 dtd. 20th August 1969 issued in context of s. 24(1)(vi) as existed prior to 1st April 2002 & holds good even under the present s. 24(b) as the nature of deduction while computing income from house property remains the same under both provisions viz. deduction on account of interest paid for constructing or acquiring the said property. He further emphasized that s. 24(b) is applicable to all properties whether commercial or residential or any other property. The Counsel further submitted that the provisos to s. 24(b) applies to a particular category of case filling within s. 23(2) viz. property being the house for residence. It does not in anyway affect deduction of interest for construction of commercial or any other property.

2. The Ld. CIT(A) while passing his order had stated that the Circular on which the taxpayer has placed reliance is misplaced as the provisions of s. 24 have undergone change w.e.f 1.04.2002.

   Earlier the provisions of s. 24(1)(vi) were applicable to all kinds of property, however w.e.f 1.04.2002 there is a specific proviso in the section which restricts such benefit of interest paid on new loan only to the property covered by section 23(2) of the Act. The Ld. DR for the taxpayer relied on the order of the CIT(A).

3. The Hon'ble ITAT emphasized on the provisions of s. 24(b) and the erstwhile s. 24(1)(vi) of the ITA. Also, CBDT Circular No. 28 dtd. 20.08.1969 was brought on record. The said Circular explained that when a loan is taken to repay the loan taken for construction of a property interest paid on such

loan is also deductible in computing under the head income from house property. The CIT(A) held that this circular is not applicable because the same was issued when erstwhile sec. 24(1)(*vi*) of the Act was in force and that by the Finance Act, 2001 *w.e.f.* 1-4-2002 Sec. 24 of the Act was reframed. It is not correct on the part of the CIT(A) to conclude that the aforesaid circular is not applicable as it was issued under the erstwhile provisions of sec. 24 as it stood prior to 1-4-2002. The new provisions of sec. 24 are also on the same lines with regard to the scheme of determination of income under the head income from house property and in particular with regard to allowability as deduction of interest paid on loans borrowed for the purpose of constructing the property. Therefore one of the reason given by the CIT(A) for not allowing the claim of the taxpayer is therefore unsustainable.

4. With regard to the other reason given by the revenue authorities for denying deduction of interest paid to Mrs. Kaveri bai is by applying the 3rd proviso to sec. 24(*b*) of the Act. On perusal of the provisions of section 24(*b*), it is clear that the deduction is allowed on account of interest paid on any borrowed capital which is used for the purpose of acquiring, constructing, repairing, renewing or reconstructing property. The expression used in sec. 24(*b*) is 'property' and not residential or commercial property. Therefore, irrespective of the nature of the property whether it is residential or commercial, deduction has to be allowed under section 24(*b*) of the Act. As far as the 3rd proviso to section 24(*b*) of the Act is concerned, all the provisos to sec. 24(*b*) of the Act deal with property referred to in section 23(2) of the Act which refers to a residential property. The proviso only carves out an exception to section 24(*b*) of the Act, in so far as it relates to property used for residential purposes and does not deal with or curtail the right of a taxpayer to get deduction on interest paid on loans borrowed for the purpose of constructing commercial property.

5. Accordingly, the action of the taxpayer to claim a deduction of interest in respect of loan borrowed to repay an earlier loan in respect of commercial house property is allowable under s. 24b.

"The taxpayer[3] can claim exemption under s. 54F of the ITA when he has invested the sale consideration on transfer of capital asset in purchasing a new residential house property in the name of his married widow daughter."

## Facts

The taxpayer & his family members (his wife, son & widowed daughter) are the sole owners of a property which was sold. The capital gain arising from the sale of the said property was declared in their individual names using their PAN. The other family members did not have any other sources of income. The taxpayer invested the sale consideration received on sale of capital asset in purchase of a residential house property in the name of his married widow daughter who along with her children was staying with the taxpayer.

The AO denied the claim of deduction. The Ld. CIT(A) also upheld the order of the Ld. AO.

Aggrieved, the taxpayer has preferred an appeal before the Hon'ble ITAT.

## Issue for Consideration

Can the taxpayer claim deduction under s. 54F in respect of capital gains arising on transfer of capital asset in name of widow married daughter?

## Decision

1. The Authorised representative for the taxpayer submitted that the taxpayer, his wife, son & daughter are legal heirs to the property which was transferred. The said property was acquired by way of Partition Deed dtd. 23rd November 1971. The capital gain was declared in the individual name using their PAN's. The taxpayer invested the sale consideration received on sale of the said property in the name of his married widow daughter and claimed exemption under s. 54F of the ITA. She along with her children were staying with the taxpayer & have no independent source of income. The taxpayer had not made the investment in the name of an unknown person. Admittedly, in this

[3] Krishnappa Jayaramiah V/s ITO, Ward 6(3)(4), Bang [2021] 125 taxmann.com 110

case the purchase consideration for the new house was out of sale consideration of the property sold. There is a direct nexus between the sale consideration received & utilised investing in residential house property in name of married widow daughter. Attention was drawn to various judicial precedents to support the claim of the taxpayer.

2. The Ld. DR submitted that the taxpayer sold the property & invested the capital gain in his married widow daughters name & claimed exemption under s.54F which is not permitted. According to the Ld. DR the taxpayer should make the investment in his own name in order to claim exemption under s. 54F of the ITA. According to then Ld. DR, the ITA needs to be given a legal interpretation & not liberal interpretation

3. The Hon'ble ITAT heard arguments of both sides & placed on record provisions of s. 54F of the ITA. Further, it stated that if the word 'assessee' used in the ITA is to be given liberal interpretation, it would tantamount to giving a free hand to the assessee & it's legal heirs, it shall curtail the revenue of the Government which the law does not permit. Also, in the instant case, there is a direct nexus between the sale consideration received and utilised investing in residential house in the name of his married widow daughter. It is to be noted that purposive consideration is to be preferred against literal consideration, more so when even in calling literal consideration, there is nothing s. 54F of the ITA to show that the house should be purchased in the name of the assessee only. As a matter of fact, s. 54F of the ITA doew not require that the new residential house property should be purchased in the name of the assessee, it merely states that the assessee should have purchased/ constructed a 'residential house.'

4. The Hon'ble ITAT relied on the decision of CIT V/s Natrajan[4] wherein it was held that s. 54F shall be available even when the assessee had purchased the house property in the name of his wife. Similarly, in the case of Late Gulam Ali Khan V/s CIT[5] the court observed that the object of granting exemption u/s. 54F of the Act, is that a person who sells a residential house to purchase another convenient house must be given exemption so far as capital gains are concerned. As long as the sale of the house and purchase of another house are part of the same scheme, the lapse of sometime between the sale and purchase makes no difference. The word "assessee" must be given a wide and liberal interpretation so as to include his legal heirs also. There is no warrant for giving too strict an interpretation to the word "assessee" as that would frustrate the object of granting the exemption.

5. In the instant case, the taxpayers married widow daughter is having no independent source of income & is fully dependent on the taxpayer. Being so, in our opinion, the statute should be construed liberally; since the provisions permit economic growth has to be interpreted liberally, restriction on it to has to be construed so as to advance the objective of the provisions not to frustrate it. Accordingly, we are of the opinion that the claim of taxpayer under s. 54F is to be allowed.

[4] *CIT* v. *Natarajan* [(2007) 287 ITR 271 (Mad.)]
[5] *Late Gulam Ali Khan* v. *CIT* [165 ITR 228 (AP)]

# Did You Know?

## "Cess and Surcharge not a subject in the domain of Finance Commission"

The government had recently accepted much of the 15th Finance Commission's recommendations in its final report, including giving States a 41 percent share of the divisible pool of taxes and revenue deficit grants of 2.95-lakh crore for 17 States over the next five years (2021-22 to 2025-26).

https://www.thehindubusinessline.com/economy/cess-and-surcharge-not-a-subject-in-the-domain-of-finance-commission/article33957301.ece

## "Direct Tax mop – upset to exceed revised FY 21 target"

At 8.2-lakh crore, advance tax collection shortfall narrows to 5.5%; transactions yet to be fully reconciled.

https://www.thehindubusinessline.com/economy/advance-tax-collections-at-82-lakh-cr-fy21-mop-up-55-per-cent-short-of-2019-20s/article34085640.ece

## "CAG calls for improved handling of indirect tax cases"

Comptroller and Auditor General (CAG) has recommended a full overhaul of the system of issuing show cause notices in Central Board of Indirect Taxes and Custom (CBIC) including GST regime.

https://www.thehindubusinessline.com/economy/cag-calls-for-improved-handling-of-indirect-tax-cases/article34152331.ece

## "2020-21: Net tax receipts seen up by Rs 1.2 lakh crore over revised estimate"

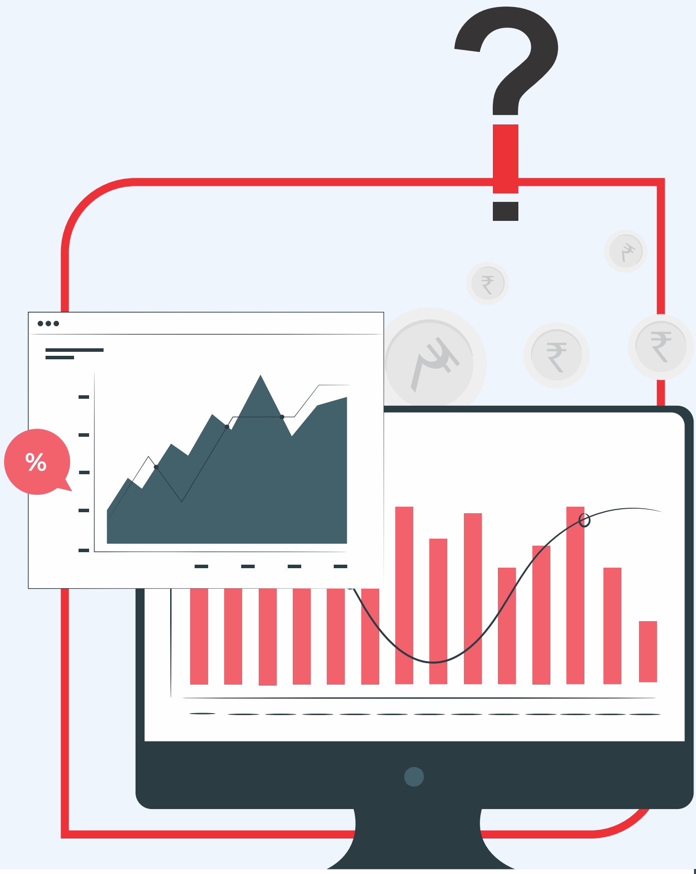
Customs collections are seen on target. Since a lot of accounting flexibility is available for the Centre on the GST front due to the floating I-GST account, an estimate of Central GST mop-up at this stage is prone to corrections. Of course, there is no shortfall seen on this account.

https://www.financialexpress.com/economy/2020-21-net-tax-receipts-seen-up-by-rs-1-2-lakh-crore-over-revised-estimate/2222321/

## "Centre Hikes Tax-Free PF Interest Threshold to Rs 5 Lakh For Cases of No Employee Contribution"

Finance Minister Nirmala Sitharaman recently raised the limit for tax exemption on interest earned on provident fund contribution by employees to Rs 5 lakh per annum in specified cases as against Rs 2.5 lakh proposed in the Budget.

https://thewire.in/government/provident-fund-tax-free-interest-threshold-limit-raised



# Notification & Circulars

CBDT issues new ITR forms for filing of tax returns

https://www.incometaxindia.gov.in/communications/notification/notification_21_2021.pdf

Section 35(1)(ii)/(iii) of the Income Tax Act 1961 – Scientific Research Expenditure – Approved Scientific Research Institution

https://www.incometaxindia.gov.in/communications/notification/notification_12_2021.pdf

Order under s. 119 of the Income – Tax Act 1961 to keep in abeyance reporting under Clause 30C & clause 44 of the Tax Audit Report upto 31st March 2022

https://www.incometaxindia.gov.in/communications/notification/notification_21_2021.pdf

Circular under s. 10 of the Vivad Se Vishwas Act 2020

https://www.incometaxindia.gov.in/communications/circular/circular_3_2021.pdf

Insertion of Rule 29BA and Form No. 15E

https://www.incometaxindia.gov.in/communications/notification/notification_18_2021.pdf

Residential status of certain individuals under Income Tax Act 1961

https://www.incometaxindia.gov.in/communications/circular/residency-circular-02-of-2021.pdf

Amendment in Form No. 16 and Form No. 24Q, Substitution of Form 12BA

https://www.incometaxindia.gov.in/communications/notification/notification_15_2021.pdf

## CORPORATE HEAD OFFICE:

**PUNE**
201, Tower S4, Phase II, Cyber City,
Magarpatta Township,
Hadapsar, Pune - 411 013, INDIA
91 20 2689 8860
91 20 2689 9980

**BRANCH OFFICES**

**MUMBAI**
203, 2nd floor, Mahinder Chambers,
W. T. Patil Marg, Opp. Dukes Factory,
Chembur, Mumbai - 411 071, INDIA
91 22 2520 0561
91 22 2520 5992

**GURGAON**
248, 2nd Floor, Tower-B, Spazedge
Commercial Complex, Sector 47,
Sohna Road, Gurgaon – 122 001, INDIA
91 12 4407 8407
91 12 4407 9407

## INTERNATIONAL OFFICES:

**FRANCE – OCA, Organisation, Conseil, Audit**
63, Avenue de Villiers
75017, Paris – FRANCE

**SPAIN – TREBEKI**
Juan De Ajuriaguerra 6,1, IZQ 0,
48009, Bilbao, SPAIN

**UAE – T.C.A. INTERNATIONAL FZE**
Office No. 214, Business Centre 2,
Rak Free Trade Zone,
Ras Al Khaimah, UAE

**GERMANY – btu Beraterpartner**
Feldbergstrasse 27-29
D-61440, Oberursel, GERMANY

**JAPAN – KOMIYAMA & Co.**
3-6-9 Roppongi, Minato-ku
Tokyo, - 106-0032, JAPAN

**VIETNAM – BHG**
176 Alley, Doi Can Street,
Ba Dinh /District, Hanoi, VIETNAM

**ITALY – Studio Vienna**
Via Hoepli 3 - 20121
Milano - ITALY