

Budget 2021 - Impact On Mergers And Acquisitions (Part 3)

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Availability of depreciation on acquired goodwill has often been a subject matter of debate. The Finance Bill, 2021 (**Bill**) proposes to settle the law and exclude goodwill as a depreciable asset. The proposed changes would include goodwill acquired pursuant to an earlier transaction and hence depreciation claim would not be allowed post amendment. Another important proposal is the change in the definition of slump sale. There have been cases where business transfers are carried out for a non-cash consideration thereby treating them as slump exchange and hence not taxable. The proposals seek to amend the definition of slump sale to include all forms of transfers and rope within its ambit slump exchange.

We discuss some of these developments below.

1 Exclusion of goodwill as a depreciable asset

Under the Income Tax Act (**ITA**), specified tangible and intangible assets are eligible for tax depreciation. The ITA specifically provides that the following intangible assets are eligible for tax depreciation: know-how, patent, copyrights, trademarks, licenses, franchise, or *any other business/commercial rights of similar nature*. The ITA does not specifically mention goodwill as an intangible asset eligible for tax depreciation. Accordingly, whether goodwill can be included within the phrase '*any other business/commercial rights of similar nature*' has historically been a matter of debate in various cases before the courts.

The Supreme Court of India, in the case of *Smifs Securities Limited*, held that goodwill generated in an amalgamation (i.e. the excess of the consideration paid over the book value of the assets) is an intangible asset for the purposes of claiming tax depreciation. Following the ruling of the Supreme Court, several judicial precedents held that goodwill is an intangible asset eligible for tax depreciation.

From a transaction tax perspective, implementation of the key proposals in the Budget 2021 would have an impact on valuations in M&A. Goodwill is proposed to be excluded as a depreciable asset and depreciation claim on any past goodwill in prior years will not be available going forward. Additionally, its proposed to cover slump exchange under tax framework for slump sale.

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The Bill now proposes that goodwill of a business or profession will not be considered as a depreciable asset under the ITA and that depreciation on goodwill of a business or profession will not be available in any situation.

The Bill further proposes that in a case where goodwill is purchased by a taxpayer, the purchase price of such goodwill will continue to be considered as cost of acquisition for the purposes of computation of capital gains under the ITA, subject to the condition that in case depreciation was claimed by the assessee in relation to such goodwill prior to assessment year 2021-22, the depreciation so availed will be reduced from the amount of the purchase price of the goodwill.

This amendment is likely to have a far-reaching impact on M&A transactions and transactions consummated based on certain assumptions with respect to the availability of depreciation on goodwill may need to be revisited and renegotiated.

The amendments proposed under the Bill are to take effect from 1 April 2021.

2 Definition of slump sale widened

A transfer of business undertaking whereby non-monetary consideration (by way of issuance of shares or bonds or other instruments) is discharged for the transfer is called a slump exchange. Certain High Courts took the view that by discharging a non-monetary consideration the transaction (slump exchange) fell outside the purview of tax framework governing 'slump sale'.

The Bill proposes to widen the contour of slump sale under Section 2(42C) to include all types of transfers within its scope. According to the Memorandum to the Bill this amendment seeks to look at the 'substance' of the transfer. The Bill proposes to include transfer of one or more business undertakings '*by any means*' to constitute 'slump sale'. Further, the proposal links the word '*transfer*' with the general definition of the same under the ITA which is widely worded and includes *inter-alia* sale, exchange, relinquishment of an asset. In effect, this widens the definition of 'slump sale' to include transaction in the nature of 'slump exchange' and hence fall within the tax net.

The Memorandum to the Bill also relies on the Supreme Court rulings in case of *Dhampur Sugar Mills* and *Artex Manufacturing* to cover non-monetary consideration within the meaning of 'transfer' which in effect and substance is in the nature of a sale. The proposal effectively overrules the Bombay High Court ruling in case of *Bharat Bijlee* where the distinction was drawn between slump sale and slump exchange. This amendment will ensure certainty in taxation while structuring transactions going forward and will take effect from 1 April 2021.

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- [Rationalisation of Equalisation Levy provisions](#)
- [Impact on mergers and acquisitions](#)
- [Tax incentives for International Financial Services Centre](#)
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