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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

+ **ITA 40/2015**

TRIUNE ENERGY SERVICES PRIVATE
LIMITED

..... Appellant

Through: Mr Sanjeev Sabharwal, Senior
Advocate alongwith Mr Gautam Chopra and Mr
Deepak Sharma, Advocates.

versus

DEPUTY COMMISSIONER OF INCOME TAX Respondent

Through: Mr Rohit Madan and Mr Akash
Vajpai, Advocates.

AND

+ **ITA 189/2015**

COMMISSIONER OF INCOME TAX-9

..... Appellant

Through: Ms Suruchi Aggarwal, Senior
Standing Counsel with Ms Lakshmi Gurung,
Junior Standing Counsel and Ms Radhika Gupta,
Advocate.

versus

SAIPEM TRIUNE ENGINEERING PVT. LTD. Respondent

Through: Mr Sanjeev Sabharwal, Senior
Advocate alongwith Mr Gautam Chopra and Mr
Deepak Sharma, Advocates.

CORAM:

JUSTICE S. MURALIDHAR

JUSTICE VIBHU BAKHRU

ORDER

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19.11.2015

VIBHU BAKHRU, J

1. These appeals are directed against an order dated 25th July, 2015 passed by the Income Tax Appellate Tribunal (hereafter 'ITAT') in ITA No. 5239/Del/2012. The said appeal was preferred by the Assessee against an order dated 17th August, 2012 passed by the Commissioner of Income Tax (Appeals) [hereafter 'CIT(A)'] rejecting the Assessee's appeal against the assessment order dated 29th December, 2009 pertaining to Assessment Year (AY) 2007-08. Whereas the ITA No. 40/2015 has been filed by the Assessee, ITA 189/2015 has been filed by the Revenue.

2. The Assessee's appeal, ITA 40/2015, was admitted on 19th January, 2015 and the following question of law was framed:-

“Whether under the circumstances of the case the ITAT was justified in directing a remand to the assessing officer on the issue of calculation of the intangible given that it upset the findings of the lower authorities as to the genuineness and admissibility of such claim under Section 32(1b)?”

3. The principal grievance of the Assessee is that the ITAT has remitted the matter to the Assessing Officer (hereafter 'AO') to consider the question whether the valuation of goodwill of Rs.40.58 crore is appropriate. According to the Assessee, the value of Rs.40.58 crore has been arrived at

by reducing the value of fixed assets of Rs.2.56 crores and net current assets of Rs.2.71 crores – aggregating Rs.5.27 crores as reflected in the balance sheet as on 22nd September, 2006 – from the slump sale consideration of Rs.45.85 crores. The said consideration had been paid pursuant to an agreement dated 22nd September, 2006 which was accepted by the ITAT. The Assessee contends that the said agreement having been accepted, the question of imputing any other value to goodwill does not arise.

4. The aforesaid controversy arises in the backdrop from the following facts:-

4.1 The Assessee Company (formerly known as “Saijem Triune Energy Pvt. Ltd.) was incorporated during the financial year 2006-07. Fifty percent (50%) of the issued and subscribed share capital of the Assessee Company are held by M/s Saipem, Italy and a balance 50% are held by one Mr Binoy Jacob. The Assessee is a Design Engineering and Consultancy Company servicing industries engaged in Oil and Gas production and processing (offshore and onshore), Petroleum Refining, Petroleum Storage and Transportation, Chemicals and Petrochemicals.

4.2 Mr Binoy Jacob was also, at the material time, one of the principal

shareholders/promoters of the company Triune Projects Pvt. Ltd. (hereafter 'TPPL') and held 76.42% of the issued and subscribed share capital of TPPL.

4.3 TPPL was also a company, *inter alia*, engaged in providing engineering and design services to the oil and gas industry. On 22nd September, 2006, the Assessee company entered into a "slump sale/business transfer agreement" (hereafter also referred to as 'the Agreement') in terms of which TPPL sold its business, as a going concern to the Assessee for a consideration of Rs.45,85,00,000/-. The Assessee also took over the service contracts of the employees as on the closing date, which was specified as 22nd September, 2006 (unless otherwise agreed between TPPL and the Assessee). It is relevant to note that that TPPL also agreed to provide the balance sheet as on closing date and it was agreed that the same would be treated as a part of the Agreement and as an annexure thereto.

4.4 The Assessee took over the assets, liabilities and the business of TPPL with effect from the closing date, i.e., 22nd September, 2006. The balance sheet drawn up by the Assessee as on 22nd September, 2006 indicated that the Assessee had taken over the block of fixed assets at a depreciated value of Rs.2,56,24,470.60/- and net current assets at Rs.2,71,00,000/-. The

balance consideration paid to TPPL, Rs.40,58,75,529.40/-, was capitalised as goodwill.

4.5 The AO noticed that the Assessee had not only acquired the designs knowhow and other physical assets of TPPL but also its business as a going concern including manpower and other live assignments/lease/deeds. According to the AO, this was in the nature of succession, which was covered under Section 170 of the Act. The AO reasoned that in terms of the fifth proviso to Section 32 of the Act, the claim of the Assessee for depreciation was restricted to the opening Written Down Value of assets at the beginning of the Previous Year, in the hands of TPPL. Thus, the AO did not admit the Assessee's claim for depreciation on goodwill, which was value at the slump sale consideration less the value of net tangible assets. The AO further held the slump sale agreement was a colourable device to minimise the tax liability in the hands of TPPL and to maximise the claim of depreciation in the hands of the Assessee.

4.6 The AO also did not accept the valuation report that was submitted during the course of proceedings whereby the value of goodwill had been bifurcated into (a) technical knowhow at Rs.26.18 crores; (b) valuation for the business on hand as on 22nd September, 2006 at Rs.12.5 crores; (c) and

non compete fees of Rs.1.86 crores. In view of his findings, the AO disallowed the Assessee's depreciation claim of Rs.10,14,68,882/- and added the same to the taxable income of the Assessee.

4.7 Aggrieved by the decision of the AO, the Assessee preferred an appeal before CIT(A). The CIT(A) observed that Mr Binoy Jacob was a principal promoter of TPPL and also held 50% shares in the Assessee Company. He also observed that while Mr Binoy Jacob had acquired 50% shares of the Assessee at Rs.10 per share, the other investor, M/s Saipem, Italy had acquired the balance 50% shares at a premium of Rs.45,840/- per share of Rs.10/- each. Further, almost the entire sum collected from M/s Saipem, Italy had been paid to TPPL. On the aforesaid basis, CIT(A) concluded that the provisions of Section 40A of the Act were applicable and the purchase price paid by the Assessee to TPPL was excessive and unreasonable. The CIT(A) further upheld the AO's view that the Agreement was a colourable device entered into only for the purposes of obtaining an undue tax advantage. The CIT(A) also did not accept the valuation report whereby the value of goodwill had been bifurcated into different components. The CIT(A) rejected the Assessee's claim that it had acquired any knowhow from TPPL and in any event found that the valuation of

Rs.26.20 was exaggerated. Similarly, the CIT(A) did not accept the valuation of business at hand of Rs.12.50 crores as well as payment for non-compete at Rs.1.88 crores. The CIT(A) also did not accept the alternate claim of the Assessee that the consideration paid by the Assessee less the value of tangible assets be considered as goodwill and depreciation be allowed on the same.

4.8 The CIT(A) held that the consideration paid by the Assessee was excessive and on the said basis made an addition of Rs.30,44,06,647/- under Section 40A of the Act. The ITAT held that the addition of Rs.30,44,06,647/- made by the CIT(A) to the income of the Assessee was not sustainable as the same was not claimed as an allowance or a deduction and, therefore, any addition under Section 40A was not sustainable. The ITAT further held that the conclusion of CIT(A) and the AO that the scheme of slump sale (i.e. the Agreement) was a colourable device was also unsustainable. Accordingly the ITAT set aside the said conclusion.

4.9 Insofar as the claim of depreciation is concerned, the ITAT held that no credible material had been brought out in the valuation report submitted by the Assessee on the basis of which a specific valuation could be ascribed to any specific intangible asset and, therefore, held that the AO and CIT(A)

were justified in holding that the Assessee was not entitled to depreciation on technical knowhow, valuation of business and non-compete fee mentioned in the report. In respect of the alternative claim of the Assessee that the entire sum of Rs.40,58,75,529/- paid towards intangibles be considered as a goodwill, the ITAT – following the decision of Supreme Court in **CIT v. Smifs Securities Ltd.: 348 ITR 302 (SC)** – upheld the Assessee’s contention that depreciation could be claimed on goodwill; but, remanded the matter for the purposes of valuation of goodwill.

5. Mr Sabharwal, learned Senior Advocate appearing for the Assessee submitted at the outset, that the trifurcation of goodwill into separate components viz. technical know-how, ‘brand name’ and ‘non-compete’, were done by the Assessee after the conclusion of the slump sale and, thus, should be ignored; according to him, the entire amount of Rs.40.58 crores should be considered as a goodwill. Mr Sabharwal referred to the slump sale agreement and the balance sheet of the Assessee prepared as on 22nd September, 2006, which clearly reflected Rs.40,58,75,529/- as goodwill. He referred to the decision of the Supreme Court in ***Smifs Securities Ltd.*** (*supra*) in support of his contention that the depreciation was allowable on goodwill. He submitted that the scope of Section 32 had been widened by

Finance Act (2) Act, 1988 and depreciation was now allowable on intangible assets acquired on or after 1st April, 1998. He further submitted that the consideration paid by the Assessee in excess of the value of tangible assets was attributable to the corporate name, the business set up, various licenses and commercial rights acquired by the Assessee as a part of the going concern of TPPL. Mr Sabharwal also referred to Accounting Standard 10 in support of his contention that the excess amount payable was to be accounted as goodwill.

6. Mr Rohit Madan did not dispute that the depreciation was allowable on goodwill and he without prejudice to the Revenue's contention in ITA 189/2015, supported the ITAT's conclusion to remand the matter for valuation of goodwill.

7. Ms Suruchi Aggarwal, learned senior standing counsel appearing for the Revenue in ITA 189/2015 submitted that the ITAT had erred in holding that Rs.40.58 crores was paid towards acquisition of goodwill. She contended that no consideration could be attributed to goodwill as the slump sale agreement was silent on this aspect.

8. Countering the aforesaid arguments, Mr Sabharwal referred to the

Agreement, which expressly interprets goodwill for the purposes of the Agreement as “*includes the goodwill in relation to the name, associated to the business of the seller.*” He also referred to the balance sheet of the Assessee prepared as on 22nd September, 2006 which is based on the balance sheet of TPPL as on the said date. The said balance sheet included the value of goodwill at Rs.40,58,75,529.40/-.

9. We have heard the learned counsel for the parties.

10. The issue whether depreciation is allowable on goodwill is no longer *res integra*. In ***Smifs Securities Ltd.*** (*supra*), the Supreme Court had answered the question “*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*” in favour of the Assessee.

11. The Supreme Court had further held as under:-

“We quote hereinbelow 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, licences, franchises or any other business or commercial rights of similar nature :"

10. Explanation 3 states that the expression "asset" shall mean an intangible asset, being know-how, patents, copyrights, trademarks, licences, 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).

11. In the circumstances, we are of the view that "goodwill" is an asset under Explanation 3(b) to section 32(1) of the Act."

12. In the present case the 'Business Identification Schedule' appended to the Agreement specified the business of TPPL, which was sold to the Assessee. Apart from the tangible assets the said Schedule also included the following:-

"3) TPPL Contracts:

The benefits and liabilities of TPPL's ongoing contracts as well as any other letters of intent/contracts/orders related to the Business up to the 22nd September 2006 and any revenue to be still received on 22nd September 2006.

The ongoing TPPL contracts are listed in Appendix 4 to this Schedule. A copy of each of the contracts listed in Appendix 4 as well as any other letters of intent/contracts/orders related

the business upto 22nd September 2006 shall be provided within 22nd September 2006.

4) TPPL Business Records and Know How:

Know how, expertise, capabilities, references, track records related to clients and/or suppliers, agents, distributors, business and production plans, forecast, correspondence, orders, inquiries, proprietary information, patent, data, archives, design specification, manuals, research data, instructions, all past and present information and whatever can be directly or indirectly referred to the Business etc, including the books, records and material embodying the above.

5) TPPL Employees:

All the Employees of TPPL as on 22.09.2006 as listed in Appendix 5B to this Schedule. Any modification in the number or substitution of any employees as well as any modification to their respective employment contracts between as on 31.03.2006 as listed in Appendix 5A shall be subject the previous written approval of Saipem, BJ and TPPL. A copy of each of the employment contracts for the employees listed in Appendix 5B shall be available by 22nd September, 2006.

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9) Goodwill:

Goodwill includes the goodwill in relation to the name associated to the Business.”

13. Goodwill is an intangible asset providing a competitive advantage to an entity. This includes a strong brand, reputation, a cohesive human resource, dealer network, customer base etc. The expression “goodwill” subsumes within it a variety of intangible benefits that are acquired when a

person acquires a business of another as a going concern.

14. In **CIT v. B.C. Srinivasa Setty**: (1981) 128 ITR 294 (SC), the Supreme Court had explained that:-

“Goodwill denotes the benefit arising from connection and reputation. The original definition by Lord Eldon in Crutwell 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. ”

The Court had further explained that:

“A variety of elements goes into its making, and its composition varies in different trades and in different businesses in the same trade, and while one element may preponderate in one business, another may dominate in another business. And yet, because of its intangible nature, it remains insubstantial in form and nebulous in character. Those features prompted Lord Macnaghten to remark in IRC v. Muller and Co.'s Margarine Limited [1901] AC 217 (HL) that although goodwill was easy to describe, it was nonetheless difficult to define. In a progressing business goodwill tends to show progressive increase. And in a failing business it may begin to wane. Its value may fluctuate from one moment to another depending on changes in the reputation of the business. It is affected by everything relating to the business, the personality and business rectitude of the owners, the nature and character of the business, its name

and reputation, its location, its impact on the contemporary market, the prevailing socio economic ecology, introduction to old customers and agreed absence of competition. There can be no account in value of the factors producing it. It is also impossible to predicate the moment of its birth. It comes silently into the world, unheralded and unproclaimed and its impact may not be visibly felt for an undefined period. Imperceptible at birth it exists enwrapped in a concept, growing or fluctuating with the numerous imponderables pouring into, and affecting, the business.”

15. From an accounting perspective, it is well established that ‘goodwill’ is an intangible asset, which is required to be accounted for when a purchaser acquires a business as a going concern by paying more than the fair market value of the net tangible assets, that is, assets less liabilities. The difference in the purchase consideration and the net value of assets and liabilities is attributable to the commercial benefit that is acquired by the purchaser. Such goodwill is also commonly understood as the value of the whole undertaking less the sum total of its parts. The ‘Financial Reporting Standard 10’ issued by Accounting Standard Board which is applicable in United Kingdom and by Institute of Chartered Accountants of Ireland in respect of its application in the Republic of Ireland, explains that *“the accounting requirements for goodwill reflect the view that goodwill arising on an acquisition is neither an asset like other assets nor an immediate loss*

in value. Rather, it forms the bridge between the cost of an investment shown as an asset in the acquirer's own financial statements and the values attributed to the acquired assets and liabilities in the consolidated financial statements".

16. The abovementioned Financial Reporting Standard 10 also provides for accounting of purchased goodwill as *"the difference between the cost of an acquired entity and the aggregate of the fair values of that entity's identifiable assets and liabilities. Positive goodwill arises when the acquisition cost exceeds the aggregate fair values of the identifiable assets and liabilities. Negative goodwill arises when the aggregate fair values of the identifiable assets and liabilities of the entity exceed the acquisition cost."*

17. At this stage, it is also relevant to refer to Accounting Standard 10 as issued by the Institute of Chartered Accountants of India. The relevant extract of which reads as under:-

"16.1 Goodwill, in general, is recorded in the books only when some consideration in money or money's worth has been paid for it. Whenever a business is acquired for a price (payable either 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 is termed as 'goodwill'. Goodwill arises from business

connections, trade name or reputation of an enterprise or from other intangible benefits enjoyed by an enterprise.”

18. It is also relevant to note that **Smifs Securities Ltd.** (*supra*) was a case where assets of company – YSN shares and Securities (P.) Ltd. were transferred to Smifs Securities Ltd. under a scheme of amalgamation. And, the excess consideration paid by the Assessee therein over the value of net assets of YSN Shares and Securities (P.) Ltd. acquired by the Assessee, was accounted as goodwill.

19. In view of the above, we are inclined to accept the contention advanced on behalf of the Assessee that the consideration paid by the Assessee in excess of its value of tangible assets was rightly classified as goodwill.

20. In the facts of the present case, the ITAT has rejected the view that the slump sale agreement was a colourable device. Once having held so, the agreement between the parties must be accepted in its totality. The Agreement itself does not provide for splitting up of the intangibles into separate components. Indisputably, the transaction in question is a slump sale which does not contemplate separate values to be ascribed to various

assets (tangible and intangible) that constitute the business undertaking, which is sold and purchased. The Agreement itself indicates that slump sale included sale of goodwill and the balance sheet drawn up on 22nd September, 2006 specifically recorded goodwill at Rs.40,58,75,529.40/-. As indicated hereinbefore Goodwill includes a host of intangible assets, which a person acquires, on acquiring a business as a going concern and valuing the same at the excess consideration paid over and above the value of net tangible assets is an acceptable accounting practice. Thus, a further exercise to value the goodwill is not warranted.

21. In view of the aforesaid, the question framed is answered in the negative, that is, in favour of the Assessee and against the Revenue. The Assessee's appeal (ITA 40/2015) is, accordingly, allowed.

22. The Revenue has projected the following questions of law in its appeal (ITA 189/2015):-

- “i WHETHER on the facts and in the circumstances of the case, the ITAT is correct in holding that the residual amount of Rs.40.58 Crores is towards acquisition of goodwill when the slump sale agreement is silent on this issue?
- ii. WHETHER on the facts and circumstances of the case, findings of the ITAT are perverse?”

23. Insofar as the first question is concerned, the same does not arise, in the facts and circumstances of the case as the 'Business Identification Schedule' appended to the Agreement expressly includes transfer of goodwill.

24. Ms Suruchi Aggarwal, learned counsel for the Revenue also did not canvass any ground, which could remotely indicate the order of ITAT to be perverse. In our view, no substantial questions of law arise in the Revenue's appeal (ITA 189/2015). Accordingly, the said appeal is dismissed.

25. Parties are left to bear their own costs.

VIBHU BAKHRU, J

S. MURALIDHAR, J

NOVEMBER 19, 2015
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