



Direct Tax Refresher Course

Impact of Finance Act 2021 on M&A with respect to slump sale and goodwill

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Impact of Finance Act, 2021 on transaction of slump sale / slump transaction



Transaction of slump sale under ITA – a background

- ▶ Restructuring of business by way of business sale / business purchase is not new in Indian context
- ▶ Sale of a business undertaking can be by way of slump sale or itemised sale
- ▶ Itemised sale is not defined under ITA
 - ▶ In itemized sale, each asset or each liability is priced separately, on a piece by piece basis, or on class by class basis
 - ▶ Sale deed may enlist values of each asset as part of schedule to deed or as part of main document – refer *Associated Clotheirs Ltd v CIT* [1967] 63 ITR 224 (SC), *Pandit Lakshmikanta Jha v CIT* [1970] 75 ITR 790 (SC)
 - ▶ A sale may be termed as itemised sale even where there is no mention of price of each asset in sale deed but there are evidences which suggests that sale price is determined by assigning price to each asset – refer *CIT v Artex Mfg. Co* [1997] 227 ITR 260 (SC)

Transaction of slump sale under ITA – a background

- ▶ When a business undertaking is transferred for a lump sum consideration i.e. without assigning any values to individual assets / liabilities, transaction is referred to as a slump sale
- ▶ **Statutory definition under section 2(42C) inserted vide Finance Act, 1999**
 - "slump sale" means the transfer of one or more undertaking as a result of sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales*
- ▶ Unlike itemised sale, key distinguishing feature is that value is assigned to an undertaking on a global basis, without negotiating values on individual assets
 - ▶ For example, DCF valuation; or valuation based on per customer or on the basis of footfall etc.
- ▶ Transfer of business activity may comprise of one or more undertaking or part of undertaking

Transaction of slump sale under ITA – a background

- ▶ A transaction of itemised sale was always taxable under ITA as if each asset is transferred individually and by assigning value to each asset
- ▶ However, up to assessment year 1999-2000, a transaction of transfer of business undertaking for slump consideration was held not taxable
 - ▶ SC in case of PNB Finance Ltd v CIT [2008] 307 ITR 75 held that section 45 of ITA fails, since, cost of acquisition of undertaking cannot be determined
 - ▶ SC in case of CIT v Equinox Solution Pvt Ltd [2017] 393 ITR 566 held that slump consideration cannot be broken up – say, to apply provisions of section 50 since what is transferred by taxpayer is a business undertaking and not individual assets

From GST levy perspective, kindly obtain fact specific advise

Slump sale became taxable w.e.f. A.Y. 2000-01

▶ Vide Finance Act, 1999 (w.e.f. 1 April 2000), following provisions were inserted under ITA to tax the transaction of slump sale as capital gains

▶ **Statutory definition under section 2(42C) inserted vide Finance Act, 1999, to be read with section 50B**

"slump sale" means the transfer of one or more undertaking as a result of sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales

▶ Inserted section 50B(2) – Providing artificial mechanism to compute the cost of acquisition of undertaking – net worth of the undertaking is deemed to be the cost of acquisition of undertaking

▶ Thus, section 50B supplemented charge to tax as also income computation provision

Controversy: Did charge fail in case of slump exchange??

- ▶ Post insertion of sections 2(42C) and 50B, vide Finance Act 1999, a controversy arose as to whether transaction of slump exchange is still outside net of taxation.
- ▶ For example, A Ltd transfer business undertaking to B Ltd. in lieu of newly allotted shares of B Ltd. or in lieu of shares of C Ltd. owned by B Ltd.
 - ▶ Refer, illustratively, Bharat Bijlee Ltd [2014] 365 ITR 258 (Bombay HC)
 - ▶ Presently, the matter is pending before SC
- ▶ Slump exchange taxability up to assessment year 2020-21 would hinge upon resolution of controversy by SC

Lacuna plugged w.e.f. A.Y. 2021-22 – All forms of slump transfer made taxable

- ▶ In order to cover all forms of transfer of business undertaking within the fold of capital gains, provisions of section 2(42C) were amended w.e.f. 1 April 2021

*"slump sale" means the **transfer** of one or more undertaking, **by any means**, for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales**

- ▶ Further, an Explanation is added to section 2(42C) to import meaning of term transfer from section 2(47)
- ▶ Additionally, section 50B net worth computation also amended to provide that :
 - ▶ Cost of acquisition of undertaking (net worth) goodwill (otherwise than by way of purchased goodwill) shall be NIL

* *Why the reference to 'sum' and 'sale'!!*

Finance Act 2021 simultaneously introduced artificial method of evaluating consideration

- ▶ As one major development, section 50B has been amended vide Finance Act 2021 to impose charge to capital gains on every form of slump transfer by adopting value of consideration on a normative / artificial methodology and ignoring actual consideration as charged by transferor
- ▶ **New basis of determining value of consideration received is as follows:**
 - ▶ Compute FMV 1 viz. compute, in prescribed manner, value of assets / liabilities comprised in the undertaking which are given up (transferred) by transferor
 - ▶ Compute by FMV 2 viz. compute in prescribed manner, value of consideration received by transferor from transferee
 - ▶ When consideration is received in form of assets, value of assets received as consideration will be in prescribed manner, whatever may be the fair market value of asset be
 - ▶ Higher of FMV 1 and FMV 2 to be adopted as chargeable value of consideration received by transferor; thus, determination is based on combination of normative value of what is given up and normative value of what is received

Fresh controversy – what is effective year of charge

- ▶ Amended section 50B envisages charge to tax on full value of consideration as per prescribed methodology ignoring the actual consideration
- ▶ Charge to tax depends on value of consideration as determined
- ▶ Prescribed methodology published / notified on 24th May 2021
 - ▶ Can prescribed methodology relate back to support charge to tax in AY 2021-22?
 - ▶ Can prescribed methodology dated 24 May 2021 support charge for transactions up to 23 May 2021?

To recall and summarise discussion so far

Nature of transaction	Taxable from which year
Transfer of business by itemised sale	Was always taxable even prior to Finance Act, 1999, and continues to be chargeable
Transfer of business undertaking by slump sale	Taxable post insertion of sections 2(42C) and 50B w.e.f. 1 April 2000 – AY 2000-01 and onwards
Transfer of business undertaking by slump exchange	Preponderant judicial view is that this transaction was not taxable up to AY 2020-21 But can be considered taxable as per amended law

Normative determination of FMV 1 component (value of assets given up)

- ▶ Full value of chargeable consideration = higher of FMV 1 and FMV 2
- ▶ FMV 1 represents value of assets transferred as a part of undertaking
 - ▶ Step 1: Find out book value of all transferred assets on balance sheet of undertaking, except transfer of specified assets
 - ▶ Step 2: Value of specified asset transferred as part of undertaking shall be determined as under:

Nature of specified asset	Value to be adopted as per Rule
Immovable property (not a defined term)	Stamp duty value as on the date of transfer of undertaking
Shares and securities – quoted or unquoted	Determined as per Rule 11UA(1)
Jewellery and artistic work	Price fetched in open market

- ▶ Step 3: Deduct or reduce the liabilities being transferred as part of undertaking

Normative determination of FMV 2 component (value of consideration received)

- ▶ FMV 2 represents the value of assets received as a consideration of slump sale / slump exchange

If consideration is in form of	How to determine the value?
Money	Value of monetary consideration
Immovable property (not a defined term)	Stamp duty value on date of transfer of undertaking
Shares and securities – quoted or unquoted	Value of asset determined as per Rule 11UA(1)
Jewellery, or artistic work etc.	Estimated value which asset would fetch in open market
Asset other than mentioned above	Value that asset would fetch in open market

Normative determination of FMV 1 (value of assets give up)

$$\text{FMV 1} = \text{A} + \text{B} + \text{C} + \text{D} - \text{L}$$

Constituent	Assets transferred	Manner of computation
A		Book value of all assets of undertaking transferred other than covered by B, C and D
B	Jewellery	<ul style="list-style-type: none"> Price it would fetch in open market on the date of sale of undertaking It should be basis valuation report of registered valuer
	Artistic work	
C	Shares and securities	<ul style="list-style-type: none"> Quoted shares and securities shall be based on lowest quoted price on RSE on date of sale of undertaking Unquoted equity shares shall be based on normative valuation Other shares and securities shall be based on price it would fetch in open market
D	Immovable property	Stamp duty value of immovable property
L	Liabilities	Book value of liabilities of undertaking transferred other than equity share capital and amount set apart for payment of dividends on shares where dividend is not declared before the date of transfer at general meeting

Normative determination of FMV 2 (value of consideration as received)

$$\text{FMV 2} = \text{E} + \text{F} + \text{G} + \text{H}$$

Constituent	Form of Consideration	Manner of computation
E	Monetary consideration	Cash consideration received
F	Jewellery	<ul style="list-style-type: none"> Price it would fetch in open market on the date of sale of undertaking It should be basis valuation report of registered valuer
	Artistic work	
	Shares and securities	<ul style="list-style-type: none"> Quoted shares and securities shall be based on lowest quoted price on RSE on date of sale of undertaking Unquoted equity shares shall be based on normative valuation Other shares and securities shall be based on price it would fetch in open market
H	Immovable property	Stamp duty value of immovable property
G	Any other asset	<ul style="list-style-type: none"> Price it would fetch in open market on the date of sale of undertaking It should be basis valuation report of registered valuer

Case study 1: Slump sale of business undertaking for cash consideration

- ▶ Artificial intelligence solution unit/undertaking of A Pvt. Ltd. is transferred to B Pvt. Ltd. for cash consideration of Rs. 50 lakhs.
- ▶ As is typical, major value of the company was commanded by intangibles
- ▶ A Pvt Ltd maintains separate accounts qua undertaking and same is as under:

Liabilities	Amt (Rs)	Assets	Amt (Rs)
Equity Capital	1,00,000	Assets (being book debts, software and machinery)	10,00,000
Reserves & surplus	8,00,000		
Current liabilities	1,00,000		
Total	10,00,000	Total	10,00,000

Computation of capital gains after ascertainment of FMV 1 and FMV 2

- ▶ FMV 1 represents value of consideration which law expects seller to receive having regard to his assets and liabilities being transferred
- ▶ FMV 2 represents value of consideration received on the basis of normative valuation rules
- ▶ Both the components deal with determination of chargeable consideration to be subjected to tax
- ▶ Higher of FMV 1 and FMV 2 represents chargeable value of gross consideration received
- ▶ From this value, deduction is given for cost of acquisition of undertaking such that the residue is capital gains or capital loss
- ▶ There is no material change in the basis of computing cost of acquisition

Computation of full value of consideration under Rule 11UAE

Component	Particulars		
Determination of FMV 1 (fair value of assets given up) – A + B + C + D - L			
A	Value of assets on the balance sheet	10,00,000	
B / C	Value of jewellery, artistic work, immovable property, shares and securities	Nil	No specified assets within the undertaking
L	(Less) Value of liabilities	-1,00,000	
FMV 1		9,00,000	
Determination of FMV 2 (fair value of assets received) – E + F + G + H			
E	Cash consideration	50,00,000	
F / G / H	Value of immovable property, shares and securities and other assets received	Nil	No specified assets within the undertaking
FMV 2		50,00,000	
FMV as per Rule 11UAE		50,00,000	(Higher of FMV 1 and FMV 2)

Case study 2: Slump sale of business undertaking for shares

- ▶ A Co is a domestic company engaged in pharmaceutical business
- ▶ B Co is domestic company also engaged in pharmaceutical business
- ▶ B Co is to acquire pharmaceutical business of A Co and consideration for the same will be discharged by issuance of 10,000 shares of B Co
- ▶ Normative value of shares of B Co is Rs. 1,000 per share (Rule 11UA)
- ▶ Commercial value of shares of B Co is Rs. 300 (on account of huge contingent liability)
- ▶ A Co maintains separate accounts qua undertaking and same is as under:

Liabilities	Amt (Rs)	Assets	Amt (Rs)	Rule 11UA
Equity Capital	1,00,000	Assets (other than specified assets)	10,00,000	
Reserves & surplus	11,00,000	Immovable property	1,00,000	3,00,000
Current liabilities	4,00,000	Shares of subsidiary	5,00,000	15,00,000
Total	11,00,000	Total	16,00,000	

Computation of full value of consideration under Rule 11UAE

Component	Particulars		
Determination of FMV 1 (fair value of assets given up) – A + B + C + D - L			
A	Value of assets on the balance sheet	10,00,000	
B	Value of jewellery and artistic work	Nil	No specified assets within the undertaking
C	Value of shares and securities	15,00,000	Rule 11UA(1)
D	Immovable property	3,00,000	Stamp duty value
L	(Less) Value of liabilities	-4,00,000	
FMV 1		24,00,000	
Determination of FMV 2 (fair value of assets received) – E + F + G + H			
E	Cash consideration	Nil	No cash consideration
F	Value of shares and securities	1,00,00,000	(10,000 x Rs 1,000) – Rule 11UA(1) despite commercial value being Rs. 30 lacs only
G / H	Value of immovable property and other assets	Nil	No specified assets within the undertaking
FMV 2		1,00,00,000	
FMV as per Rule 11UAE		1,00,00,000	(Higher of FMV 1 and FMV 2)

Case study 3: Slump sale of business undertaking for cash and shares consideration

- ▶ Artificial intelligence solution unit / undertaking of A Pvt. Ltd. is transferred to B Pvt. Ltd for cash consideration of Rs. 10,00,000 and consideration in kind being newly allotted 10,000 shares of B Co
- ▶ B Pvt. Ltd. is also a valuable company with build up of valuable intangibles
- ▶ Normative value of B Pvt. Ltd. as per Rule 11UA(1) is Rs. 50 per share
- ▶ Fair value of shares of B Pvt. Ltd. is Rs. 600 per share
- ▶ A Pvt. Ltd. maintains separate accounts qua undertaking and same is as under:

Liabilities	Amt (Rs)	Assets	Amt (Rs)	Rule 11UA
Equity Capital	1,00,000	Assets (other than specified assets)	10,00,000	
Reserves & surplus	8,00,000	Immovable property	1,00,000	3,00,000
Current liabilities	2,00,000			
Total	11,00,000	Total	11,00,000	

Computation of full value of consideration under Rule 11UAE

Component	Particulars		
Determination of FMV 1 (fair value of assets given up) – A + B + C + D - L			
A	Value of assets on the balance sheet	10,00,000	
B / C	Value of jewellery, artistic work, shares and securities	Nil	No specified assets within the undertaking
D	Immovable property	3,00,000	Stamp duty value
L	(Less) Value of liabilities	-2,00,000	
FMV 1		11,00,000	
Determination of FMV 2 (fair value of assets received) – E + F + G + H			
E	Cash consideration	10,00,000	
F	Value of shares and securities received	5,00,000	(10,000 x Rs 50) as per Rule 11UA(1); despite commercial value being Rs. 60 lacs
G / H	Value of immovable properties and other assets	Nil	No specified assets within the undertaking
FMV 2		15,00,000	
FMV as per Rule 11UAE		15,00,000	Higher of FMV 1 and FMV 2

Whether normative determination of transferor impacts valuation of transferee

- ▶ Normative value provided in FMV 1 or FMV 2 does not impact cost of acquisition in the hands of purchaser
- ▶ From perspective of buyer the cost of acquisition of undertaking is sum of:
 - ▶ Consideration discharged in money
 - ▶ Consideration discharged by issuance of own shares (commercial value of the shares shall be considered)
 - ▶ Consideration discharged by transferring any assets owned (commercial value of asset given up shall be considered)

Add on controversies

- ▶ Whether the acquirer of undertaking by way of slump purchase can suffer taxation under section 56(2)(x)?
- ▶ Whether transfer pricing provisions are applicable even in presence of Rule 11UAE where transfer of undertaking is between associated enterprises?
- ▶ Whether provisions of section 194Q / 206C(1H) can be applied on the basis that 'undertaking' constitutes goods?

Impact of Finance Act, 2021 on provisions relating to goodwill



Goodwill – whether a depreciable asset?

- ▶ Section 32 provides allowance of depreciation on assets which inter alia includes 'intangible assets'
- ▶ Definition of intangible assets included - being know-how, patents, copyrights, trade-marks, licences, franchises or any other business or commercial rights of similar nature
- ▶ There was a view that goodwill of business / profession is an advantage and not an enforceable right and not a qualifying depreciable asset
- ▶ SC in case of CIT v Smifs Securities Ltd [2012] 348 ITR 302 held that goodwill (which is represented by reputation of amalgamating company and existing clientele of amalgamating company) constituted a business or commercial right in the hands of amalgamated company and hence eligible for depreciation allowance

Goodwill – whether a depreciable asset?

- ▶ SC in case of Smifs Securities (supra) held that goodwill arising on amalgamation is eligible for claim of depreciation in the hands of amalgamated company
- ▶ SC settled the controversy surrounding eligibility of goodwill as a depreciable intangible
- ▶ There still survived scope of litigation on scope of S.43(1) and S.43(6) in case of tax neutral amalgamation or demerger
- ▶ Based on the SC rulings in case of Smifs Securities (supra), slew of rulings endorsed the claim of depreciation on goodwill arising on tax neutral amalgamation and demerger
- ▶ Tax authority was litigating both the issues viz. (i) whether goodwill, as an asset was depreciable in nature (ii) even if depreciable whether in case of tax neutral amalgamation / demerger, limit the allowance of depreciation WDV of predecessor

Overarching amendment by Finance Act, 2021 w.e.f. 1 April 2021

- ▶ As a reaction to SC ruling in case of Smifs Securities (supra), the law in relation to claim of depreciation on goodwill is amended vide Finance Act, 2021 w.e.f. 1 April 2021 i.e. AY 2021-22 and onwards
- ▶ The amended law provides that the expression 'intangible asset' will include assets such as know-how, brand, copyright etc. as well as business and commercial rights not being goodwill irrespective of mode of acquisition of goodwill
- ▶ It would have been much better to make some specific provision for denial of depreciation on goodwill arising on tax neutral restructuring rather than change in fundamental character of a depreciable asset
- ▶ Reasons for making amendment is not convincing
 - ▶ Cost incurred in acquisition of goodwill is treated at par with cost of acquisition of land
 - ▶ From AY 2021-22, goodwill remains a capital asset but not a depreciable asset
 - ▶ Seller of goodwill will pay tax; however, buyer will not be eligible to claim depreciation

Recapitulation of some issues which will arise

- ▶ **Status of allowance of depreciation on goodwill up to AY 2020-21**
 - ▶ Having regard to SC ruling in case of Smifs Securities (supra), there was no serious doubt on eligibility of depreciation on goodwill arising otherwise than by way of tax neutral amalgamation / demerger
 - ▶ Litigation will continue to endure whether SC ruling in case of Smifs Securities (supra) was strong enough to permit grant of depreciation even in cases of tax neutral amalgamation / demerger without reference to predecessor's WDV
 - ▶ The outcome of litigation will decide the prospect of claim up to AY 2020-21
- ▶ Effective from AY 2021-22, question arises whether price paid for depreciation can be considered as revenue expenditure and eligible for deduction in computing the total income
 - ▶ What is acquired is capital asset having enduring benefit
 - ▶ As in case of land, amount is neither eligible for depreciation nor deductible as revenue expenditure

Some issues arising on claim of depreciation going forward

- ▶ **If there is already an existing block of asset of intangible up to AY 2020-21, will depreciation be denied on the same from AY 2021-22**
 - ▶ Section 43(6)(c) has been amended to provide a mechanism by which WDV pertaining to goodwill needs to be excluded to deny depreciation w.e.f. AY 2021-22
- ▶ **Will depreciation continue to be available with regard to all other intangibles and also with regard to all commercial rights other than goodwill?**
 - ▶ The specifically listed intangibles assets such as trademark, know-how, patents and the like will continue to be depreciable as before
 - ▶ These intangible assets are different from goodwill
 - ▶ Business or commercial rights, unless classifiable as goodwill, continue to be depreciable as before
 - ▶ As per commercial concept, goodwill is only that residual component in Purchase Price Allocation which is not capable of being identified as a standalone business or commercial rights

Some issues arising on claim of depreciation going forward

- ▶ **If depreciation on goodwill admissible till AY 2020-21 has remained unabsorbed due to paucity of profit, can right to carry forward such depreciation be denied effective from AY 2021-22**
 - ▶ The embargo is merely in connection with fresh allowance admissible as such effective from AY 2021-22
- ▶ **Given that the amendments tax effective from AY 2021-22, will a taxpayer who acquired business in year May 2020 without notice of amendment in Feb 2021 forfeit his right to claim depreciation ?**
 - ▶ To this extent, the amendment may be regarded as retrospective in nature
 - ▶ The legal effect relates back to AY 2021-22
- ▶ **Whether the amendment carried out by FA 2021 to make goodwill a non-depreciable asset has major impact on accounting in relation to accounting of DTA / DTL?**

Some issues arising on claim of depreciation going forward

- ▶ **Can a taxpayer, who acquires a business in FY 2021-22, for a slump price identify or allocate purchase price between various intangible assets and contend that disallowance of depreciation should be limited only to residual component of goodwill**
 - ▶ Any value which can be identified with any intangible asset ought to be allocated as such under Purchase Price Allocation
 - ▶ Only residual value can be attributed to goodwill
- ▶ **Can a taxpayer who, in the past year, did not undertake Purchase Price Allocation accurately and bundled many assets as part of goodwill now reclassify the block and limit denial of depreciation only to the value of goodwill?**
 - ▶ The issue under consideration is not free from doubt
 - ▶ Onus will be on taxpayer to show evidences that separate asset existed though recorded as goodwill
 - ▶ Accounting under Ind AS specifically requires identification of separable assets and only residual amount is treated as goodwill
 - ▶ The norms of amortisation differ for identifiable assets while goodwill is tested for impairment

Going forward can depreciation or amortization be claimed on goodwill in computing book profits?

- ▶ The amendment carried out by FA 2021 does not have any impact on computing book profit under section 115JB of ITA
- ▶ **Under IGAAP:**
 - ▶ Depreciation is amortized over a period of 5 years from the date of acquisition or as per court order
 - ▶ Amortized amount is debited to Profit & Loss A/c
 - ▶ Such amount debited to Profit & Loss A/c is allowable as deduction in computing book profit in terms of section 115JB
- ▶ **Under Ind AS accounting:**
 - ▶ There is no depreciation / amortization on goodwill
 - ▶ On year on year basis, goodwill is checked for impairment and if impaired, the amount is debited to Profit & Loss A/c
 - ▶ If the impairment is in nature of write off, the amount will be allowed as deduction in computing book profit

Whether goodwill is to be taken into account in computing net worth for section 50B?

In computing cost of acquisition of transferred undertaking, how to factor cost of goodwill being transferred as part of undertaking

Manner of acquisition of goodwill	Cost of acquisition
Self generated goodwill	Nil
By inheritance	Nil (unlike section 49(1))
By gift as a part of undertaking	Nil (unlike section 49(1))
Purchased for a price by any mode	Cost of acquisition represented by book value of goodwill appearing in the Balance Sheet (net off depreciation claimed if any in past) Is purchase wide enough to accommodate all forms of acquisition?? Refer, CIT v T N Aravinda Reddy [1979] 120 ITR 46 (SC)

Revaluation of goodwill is to be ignored

Principle and methodology of identifying goodwill and other intangible assets in a business acquisition / combination



Basis of allocation / valuation of goodwill

- ▶ This is a subject which belongs to the expert valuers rather than to tax professionals
- ▶ If my understanding is right, modern day valuation techniques (including under Ind AS) do not value goodwill
- ▶ What is predominant is to value each intangible assets which is reflected as a separable / identifiable intangible asset
- ▶ The residue which cannot be attributed to identifiable intangible asset is considered to be a business or commercial right in the nature of goodwill
- ▶ Any reasoned expert opinion, based on acceptable commercial valuation / accounting principles cannot be easily challenged; the challenger may need to establish that the report of an expert is perverse, or if it is wholly contradicted by a better opinion from another expert

Breaking up of purchase price is mandatory

- ▶ In a typical business acquisition (popularly known as business combination) an undertaking comprising of several assets / rights and liabilities are acquired
- ▶ In a business acquisition between unrelated parties, pursuant to Ind AS, management ought to break up price into different components
- ▶ Under Ind AS, it is imperative to identify each distinct intangible (including business or commercial right) if it meets norms of separate identification
- ▶ Residue constitutes value embedded in a commercial or business right in the nature of goodwill, to be reflected as such
- ▶ Under Ind AS, goodwill is neither amortized or depreciated; rather every year goodwill is evaluated for impairment
- ▶ Very arguably, commercial accounting norms which also have statutory recognition can be used for identifying the existence and cost of asset – refer, illustratively, SC ruling in case of Challapali Sugar Ltd. v CIT [1975] 98 ITR 167

Basis for identifying business or commercial asset as a distinct / separate intangible asset on Balance Sheet

- ▶ On satisfaction of following **3 conditions cumulatively**, business or commercial right acquires status of an intangible asset under Ind AS
- ▶ **Condition 1:**
 - ▶ Business or commercial right is enforceable as a legal, statutory or contractual right
- OR**
- ▶ Right is separable / encashable without closing down the business
- ▶ **Condition 2:** Purchaser considers right to have future economic value
- ▶ **Condition 3:** Purchaser is entitled to (and not precluded from) exploiting the right / advantage – being a factor which signifies control over the asset

Basis for identifying business or commercial asset as a distinct / separate intangible asset on Balance Sheet

Illustration 1: Contract for supply of raw material to the enterprise

- ▶ As part of business acquisition, purchaser inherits right to receive raw material for a specified duration as per contractual terms
- ▶ Issue under examination is whether the contract can be identified as a separate asset on Balance Sheet
- ▶ Firstly, business/commercial right is enforceable as a contract even if it is not separable from business, because, if it is not assignable, except along with business
- ▶ Secondly, by securing this right, purchaser adds to future economic value
- ▶ Thirdly, acquirer is not precluded from exploiting this right
- ▶ All three conditions enlisted earlier are satisfied on a cumulative basis
- ▶ On a totality, this right will be reflected as a separate/distinct intangible asset, rather than as goodwill

Basis for identifying business or commercial asset as a distinct / separate intangible asset on Balance Sheet

Illustration 2: Acquisition of customer database as part of business enterprise

- ▶ A platform for social interaction has built up huge database
- ▶ Purchaser acquires database as part of business combination
- ▶ Firstly, even if there is no contractual right attached to database, it can contribute to profit without being stripped of business
- ▶ Secondly, by securing this right, purchaser adds to future economic value
- ▶ Thirdly, purchaser is not precluded from exploiting this right
- ▶ All three conditions enlisted earlier are satisfied on a cumulative basis
- ▶ On a totality, this right will be reflected as a separate/distinct intangible asset, rather than as goodwill

Thank You!

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