



Intellectual Property is not required to be registered to claim depreciation

Background

The Kolkata Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Landis Gyr Limited¹ (the taxpayer) held that the Intellectual Property (IP) being 'know-how' is not required to be registered with the government authority to claim depreciation on such IP. Mere non-registration of the same does not make the transaction sham.

The Tribunal while allowing an additional ground of appeal, allowed taxpayer's claim of depreciation on goodwill following the decision of the Supreme Court in the case of Smifs Securities Ltd.²

Facts of the case

Depreciation on know-how

- The taxpayer is a closely held company engaged in the business of manufacturing and distribution of electric meters and related components. The taxpayer had been a manufacturer and supplier of electro-mechanical meters till 2005 while the market had migrated from electro-mechanical meters to static meters, due to the availability of anti-tampering features and communication facilities in static meters.
- The taxpayer did not have any dedicated Research & Development (R&D) wing to support any electronic business. The central electricity authority has notified the installation and operation of meter regulations, which inter alia provided that all interface meters, consumer meters and energy accounting and audit meters shall be of a static

type. The meters not complying with these regulations were to be replaced.

- Faced with these challenges, the taxpayer had acquired a sole proprietorship unit named 'Technology & Research – STPI (TECRES)' vide business transfer agreement. The IP rights acquired by the taxpayer consisted of designs, software, database, R&D material and facility, technical know-how, process know-how, confidential information, basic and detailed drawings, operation and maintenance manuals relating to the business carried out by TECRES.
- During the year under consideration, the taxpayer classified IP under the category of intangible assets and claimed depreciation on the same.
- The Assessing Officer (AO) observed that the Income-tax Rules, 1962 (the Rules) recognises intangible assets such as know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature and these assets must possess certain certification/authenticity/sanctity and recognition from government or from competent authority. Further, the AO observed that the nature of the IP assets acquired by the taxpayer does not fall in any of the category or similar nature as mentioned in the Rules. Therefore, the assets are not intangible assets and not eligible for depreciation.
- The Dispute Resolution Panel (DRP) upheld the order of the AO.

¹ Landis Gyr Limited v. DCIT (ITA No. 37/Kol/2012) – Taxsutra.com
This decision also covers other issues, however, this flash news only deals with the issue pertaining to the claim of depreciation on intellectual property and goodwill.

² CIT v. Smifs Securities Ltd [2012] 348 ITR 302 (SC)

Depreciation on goodwill

- Relying on Supreme Court's decision in the case of Smifs Securities Ltd. the taxpayer raised an additional ground of appeal before the Tribunal that depreciation should be allowed on goodwill. The taxpayer claimed that the benefit of Supreme Court's decision in the case of Smifs Securities Ltd. was not available during the pendency of proceedings before the AO.

Tribunal's ruling

Depreciation on know-how

- The Organisation for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines for multinational enterprises and tax administrations issued in July 2010 provides that the term 'intangible property' includes rights to use industrial assets such as patents, trademark, trade names, designs or models. It also includes literary and artistic property rights and IP such as know-how and trade secrets. These intangibles are assets that may have considerable value even though they may have no book value in the company's balance sheet.
- OECD/G20 Base Erosion and Profit Shifting (BEPS) Report on Actions 8-10 (2015) – aligning Transfer Pricing outcomes with value creation, provides that in some situations, the transfer or secondment of one or more employee may, depending on the facts and circumstances, result in the transfer of valuable know-how or other intangibles from one associated enterprise to another. Even though in the instant case, the transaction is between two unrelated enterprises, the principles enunciated therein is applicable to the facts of the present case. OECD has laid down the principle that IP in the form of know-how is not required to be registered. The transfer of employees would also result in the transfer of know-how.
- Explanation 4 to Section 32(1) of the Act defines 'know-how' as any industrial information or technique likely to assist in the manufacture or processing of goods or in the working of a mine, oil-well or other sources of mineral deposits (including searching for discovery or testing of deposits for the winning of access thereto).
- On a combined reading of OECD principles, the definition of know-how and provisions of Section 32 of the Act in respect of intangible assets, it could be concluded that depreciation is allowable on IP being know-how, and such IP is not required to be registered with any government authority.
- Know-how is an intangible property, rights in respect of which can be bought and sold. As per the Law Lexicon dictionary, 'know-how' indicates something essentially different from secret and confidential information. It indicates the way in which a skilled man does his job with his skill and experience. It was also stated that know-how is a closely held unpatented inventions, formulae, design, drawings, procedures, and methods together with accumulated skills and experience in the hands of a licensor firm's professional personnel.
- The Pune Tribunal in the case of Modular Infotech P Ltd³ held that where taxpayer took over business of a firm at value assessed by professionals and value so determined was made part of agreement, it was wrong to presume that there was a notional amount which was transacted between parties, hence disallowance of depreciation on IP rights on ground that value was assigned to an asset which was nonexistent was not justified. Facts of the present case are also similar to the facts before the Pune Tribunal.
- The turnover of the taxpayer had substantially increased from the year under appeal on account of activities of the R&D centre which the taxpayer had acquired. The element of know-how is inherent in the static meters manufactured by the taxpayer pursuant to the acquisition of TECRES. It is not in dispute that the entire R&D team of TECRES along with their developed codes and domain depository has joined the taxpayer. Hence, it cannot be said that the taxpayer had not acquired any intellectual properties.
- Nowhere the Act mandates the registration of the intellectual properties for the purpose of granting depreciation under Section 32 of the Act. Getting the intellectual properties registered is within the domain of the taxpayer, and it only offers protection to the taxpayer from preventing other parties to use the same. The tax department cannot thrust the mandate of registration of the same. Mere non-registration of the same does not make the transaction non-genuine or sham. Accordingly, the AO is directed to rework the opening Written Down Value (WDV) of the asset in the subsequent year and rework the allowability of depreciation on the same.

³ Modular Infotech P Ltd v. DCIT [2010] 131 TTJ 243 (Pune)

Depreciation on goodwill

- The Supreme Court in the case of Smifs Securities Ltd. held that the taxpayer is entitled to claim depreciation on goodwill. In the present case, it is not in dispute that the taxpayer had paid consideration towards the acquisition of goodwill. This issue is now well settled and not with any dispute.
- The facts relating to the claim of depreciation on goodwill are already on record and do not require any investigation. Accordingly, additional ground with regard to the claim of depreciation on goodwill is allowed in the light of the decision of the Supreme Court in the case of NTPC Ltd⁴. Subsequently, following the ratio laid down by the Supreme Court in the case of Smifs Securities Ltd, the claim of the taxpayer with regard to the depreciation on goodwill is to be allowed.

Our comments

Allowability of depreciation on intangible assets such as goodwill and know-how has been a subject matter of litigation before the courts.

The Tribunal in the present case dismissed the contention of the tax department that IP needs to be registered. The Tribunal based on the OECD principles, the definition of 'know-how' and provisions of Section 32 of the Act in respect of intangible assets, held that depreciation is allowable on know-how and such IP is not required to be registered with any government authority. Further mere non-registration of the same does not make the transaction sham.

As per Section 32 of the Act, to claim depreciation, the asset must be used in the business of the taxpayer. There is no specific requirement that the asset should be registered. The Supreme Court in the case of Mysore Minerals Ltd.⁵ observed that anyone in possession of property in his own title exercising such dominion over the property and having the right to use and occupy the property would be the owner of the buildings though a formal deed of title may not have been executed and registered. The Supreme Court in the case I.C.D.S. Ltd⁶ held that depreciation cannot be denied where vehicles were registered in the name of the lessee. The Supreme Court observed that the lessor is the owner of the vehicles, even though the vehicles were registered in the name of the lessee.

The issue with respect to granting of depreciation on motor vehicles/ships has been debated before the Courts. Various Courts have held that the depreciation should be available to the beneficial owner of motor vehicle⁷/ships⁸ even though such motor vehicle/ships were not registered in the name of the taxpayer.

The Tribunal while allowing an additional ground of appeal, allowed taxpayer's claim of depreciation on goodwill following the decision of the Supreme Court in the case of Smifs Securities Ltd. However, the Panaji Tribunal in the case of Chowgule & Co. (P.) Ltd⁹ denied the claim of depreciation on goodwill relying on the Explanation 7 to Section 43(1)¹⁰ of the Act which aspect has not been examined by the Supreme Court.



⁷ CIT v. Mohd bux Shokat Ali (No.2) [2002] 256 ITR 357 (Raj), CIT v. Navdurga Transport Co. [1999] 235 ITR 158 (All), CIT v. Dilip Singh Sardarsingh Bagga [1993] 201 ITR 995 (Bom)

⁸ CIT v. Essar Shipping Ltd [2007] 291 ITR (AT) 209 (Mum)

⁹ Chowgule and Co. (P) Ltd. v. ACIT [2011] 137 TTJ 596 (Panaji)

¹⁰ "Section 43

In sections 28 to 41 and in this section, unless the context otherwise requires —

(1) "actual cost" means the 'actual cost' of the assets to the assessee, reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any other person or authority;

Explanation 7.—Wherein a scheme of amalgamation, any capital asset is transferred by the amalgamating company to the amalgamated company and the amalgamated company is an Indian company, the actual cost of the transferred capital asset to the amalgamated company shall be taken to be the same as it would have been if the amalgamating company had continued to hold the capital asset for the purposes of its own business."

⁴ NTPC Ltd v. CIT [1998] 229 ITR 383 (SC)

⁵ Mysore Minerals Ltd. v. CIT [1999] 106 Taxman 166 (SC)

⁶ I.C.D.S. Ltd v. CIT [2013] 350 ITR 527 (SC)

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