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Whether Goodwill could be considered as an Intangible Asset for Depreciation?

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Abstract: ***Intangible assets are gaining importance as a source of economic growth and tax revenue. It is the fact that their non-physical nature makes it easier for taxpayers to engage in tax strategies such as income-shifting or transfer pricing, tax authorities. Intangibles are not tangible; incapable of being perceived by the sense of touch, as incorporeal or immaterial things; impalpable. Good will has been defined as, " The current value of expected future income in excess of normal return on the investment in net tangible assets not as a record or reported amount unless paid for. Statutory provisions of IT Act, sec 32(1)(ii), the goodwill acquired by the assessee does not come under the expression of 'any other Business or Commercial rights of the nature'. This article focuses on whether Goodwill being an intangible asset eligible for depreciation? Interpretation of the rule of 'noscitura sociis' which is wider than the rule of 'ejusdem generis' and other Acts of IPRs, viewed that the word ' Good will' can be said to be a part of the genus or the nature of intangible assets given in section32 (2) (ii) of Income Tax Act. Therefore, there is a need for reviewing the eligibility of Goodwill for depreciation.***

Keywords: Intangible assets, Goodwill, Depreciation, Judicial decisions.

I. INTRODUCTION

Intangible assets are gaining importance as a source of economic growth and tax revenue. It is the fact that their non-physical nature makes it easier for taxpayers to engage in tax strategies such as income-shifting or transfer pricing, tax authorities. International organizations have been designing ways to link intangible assets to the place where they are created, and defining them nexus. Contrary to other assets, these assets may suffer from typical market failures of non-rivalry and non-excludability. **This article focuses on whether Goodwill being an intangible asset eligible for depreciation?**

II. LITERATURE REVIEW

Intangibles are not tangible; incapable of being perceived by the sense of touch, as incorporeal or immaterial things; impalpable. An **intangible asset** lacks physical substance unlike physical assets such as machinery, software and buildings. Usually, its evaluation is very difficult. These assets include intellectual property such as brand, copy right, patent trademarks trade dress, newspaper mastheads, internet domains, video and audiovisual material (e.g. motion pictures, television programmes), franchises, customer lists, marketing rights, mortgage servicing rights, import quotas, licensing, royalty and standstill agreements and goodwill. The general interpretation also includes soft ware and other intangible computer based assets, patented technology, computer software, databases and trade secrets. Definition of "intangibles" differs from standard accounting, in US state governments may refer to stocks and bonds as "intangibles.

International Accounting Standards Board, Sec (38), defines an intangible asset as: "an identifiable non-monetary asset without physical substance." This definition is in addition to the standard definition of an asset which requires a past event that has given rise to a resource that the entity controls and from which future economic benefits are expected to flow. Thus, the extra requirement for an intangible asset under IAS 38 is identifiability. This criterion requires that an intangible asset is separable from the entity or that it arises from a contractual or legal right. Financial Accounting Standards Board (FASB) & Accounting Standard Codification 350 (ASC 350) defines an intangible asset as an asset, other than a financial asset, that lacks physical substance. Both the IASB and FASB definitions specifically preclude monetary assets in their definition of an intangible asset. This is necessary in order to avoid the classification of items such as accounts receivable, derivatives and cash in the bank as an intangible asset. IAS 38 contains examples of intangible assets, including: computer software, copyright and patents.

Intangibles can be classified into either definite or indefinite according to their respective life expectancy and other the specifics of that asset. If a company purchases a copy right / patent with no plans of extending it after the agreed period, it would be classified as a definite asset as it would have a limited life. A company brand name is considered to be an indefinite asset, as it stays with the company as long as the company is in existence. Intangible assets have either an identifiable or indefinite useful life. Intangible assets with identifiable useful lives are amortized on straight-line basis over their economic or legal life, whichever is shorter. Intangible assets with indefinite useful lives are reassessed each year for impairment. If impairment has occurred, then a loss must be recognized. An impairment loss is determined by subtracting the asset's fair value from the asset's book/carrying value. Trademarks and goodwill are examples of intangible assets with indefinite useful lives. Goodwill has to be tested for impairment rather than amortized. If impaired, goodwill is reduced and loss is recognized in the Income statement.

Intangible assets have been argued to be one possible contributor to the disparity between company value as per their accounting records, and company value as per their market capitalization. Considering this argument, it is important to understand what an intangible asset truly is in the eyes of an accountant. Intangible assets have the obvious material value like factory equipment etc, they can prove very valuable for a firm and can be critical to its long-term success or failure. For example, Coca-Cola company wouldn't be nearly as successful was it not for the high value obtained through its brand-name recognition. In spite, brand recognition is not a physical asset to see or touch, its positive effects on bottom-line profits proved extremely valuable to firms as brand strength drives global sales year after year.

III. Taxation

For personal income tax purposes, some costs with respect to intangible assets must be capitalized rather than treated as deductible expenses. Treasury regulations generally require capitalization of costs associated with acquiring, creating, or enhancing intangible assets. For example, an amount paid to obtain a trademark must be capitalized. Certain amounts paid to facilitate these transactions are also capitalized. Some types of intangible assets are categorized based on whether the asset is acquired from another party or created by the taxpayer. The regulations contain many provisions intended to make it easier to determine when capitalization is required.

IV. Goodwill

Eric L. Kholer's , A Dictionary for Accountants, Good will has been defined as, " The current value of expected future income in excess of normal return on the investment in net tangible assets not as a record or reported amount unless paid for . In other words, the excess of the price paid for a business as a whole over its' book value, over the computed or agreed value of all tangible net assets purchased. Normally purchased goodwill is the only type appearing on the books of account and in financial statements.

V. Judicial Definitions

According to CIT Vs. B.S. Srinivas setty (1981), goodwill is defined as it is nothing more than 'the probability that the old customers would resort to old places." This definition was expanded by Wood V.C. in Churton Vs. Douglas (1859) John, 74, 'to encompass every positive advantages 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 name of the old firm, or with any other matter carrying with it for the benefit of the business. CIT.Vs. Chunnilal Prabhudas & co. (1970)76ITR 566, gave an exhaustive definition of Goodwill ," It has been horticulturally and botanically viewed as a 'seed sprouting' or an ' a corn growing into the mighty oak of Goodwill'.

Goodwill represents assets that are not separately identifiable. Goodwill does not include identifiable assets that are capable of being separated or divided from the entity and sold, transferred, licensed, rented, or exchanged, either individually or together with a related contract, but identifiable asset, or liability regardless of whether the entity intends to do so. Goodwill also does not include contractual or other legal rights regardless of whether those are transferable or separable from the entity or other rights and obligations. It is classified as an intangible asset on the balance sheet, since it can neither be seen nor touched. Under US GAAP and IFRS, goodwill is never amortized. Instead, management is responsible for valuing goodwill every year and to determine if an impaired. If the fair market value goes below historical cost (what goodwill was purchased for), impairment must be accounted for in books, to bring it down to its fair market value. However, an increase in the fair market value would not be accounted for in the financial statements. Private companies in the United States, however, may amortize goodwill over a period of ten years or less under an accounting alternative from the Private Company Council of the FASB. However, Goodwill has not been defined in the IT Act, though it is recognised all it is 'capital asset' for the purposes of Sections 48&49. Its cost of acquisition is to be taken as 'Purchase consideration', when it is purchased from the previous owner and in any other case, it is considered as nil.

The value of goodwill typically arises in an acquisition when one company is purchased by another company. The goodwill amounts to the excess of the "purchase consideration" (the money paid to purchase the asset or business) over the total value of the assets and liabilities. In other words, the amount the acquiring company pays for the target company over the target's book value usually accounts for the value of the target's goodwill. If the acquiring company pays less than the target's book value, it gains "negative goodwill," meaning that it purchased the company at a bargain in a distress sale.

Goodwill is difficult to price, but it does make a company more valuable. For example, a company like Coca-Cola (which has been around for decades, makes a wildly popular product based on a secret formula and is generally positively perceived by the public), would have a lot of goodwill. A competitor (a small, regional soda company that has only been in business for five years, has a small customer base, specializes in unusual soda flavours and recently faced a scandal over a contaminated batch of soda), would have far less goodwill, or even negative goodwill.

A business can invest to increase its reputation, by advertising or assuring that its products are of high quality, such expenses can be capitalized and added to goodwill, which is technically an intangible asset. Goodwill and intangible assets are usually listed as separate items on a company's Balance sheet. Because the components that make up goodwill have subjective values, there is a substantial risk that a company could overvalue goodwill in an acquisition. This overvaluation would be bad news for shareholders of the acquiring company, since they would likely see their share values drop when the company later has to write down goodwill. In fact, this happened in the AOL-Time Warner merger of 2001.

Goodwill is a special type of intangible asset that represents that portion of the entire business value that cannot be attributed to other income producing business assets, tangible or intangible. Goodwill as an intangible asset emerges only during the purchase of a business for a price greater than the fair market value of the net assets acquired during the sale. For many assets, like cash, the fair market value (what an unpressured buyer would pay in an open marketplace) of an asset matches book value. For other assets, such as property, plant, and equipment, an independent appraisal shows fair value. Net assets are total assets minus total liabilities. The following figure shows how ABC Corp., the purchaser, figures goodwill. For example, a private limited company software company may have net assets (consisting primarily of miscellaneous equipment and/or property, and assuming no debt) valued at $1 million, but the company's overall value (including customers and intellectual capital), is valued at $10 million. Anybody buying that company would book $10 million in total assets acquired, comprising $1 million physical assets and $9 million in other intangible assets. And any consideration paid in excess of $10 million shall be considered as goodwill. In a private company, goodwill has no predetermined value prior to the acquisition; its magnitude depends on the two other variables *by* definition. Whereas in public limited company, it is subject to a constant process of market valuation, so goodwill will always be apparent.

VI. Goodwill as an Intangible Asset allowed for Depreciation

Goodwill as an intangible asset emerges only during the purchase of a business for a price greater than the fair market value of the net assets acquired during the sale. For many assets, like cash, the fair market value (what an unpressured buyer would pay in an open marketplace) of an asset matches book value. For other assets, such as property, plant, and equipment, an independent appraisal shows fair value. Net assets are total assets minus total liabilities. Grounds given by ITAT for rejecting the claim of depreciation include, as it is not falling under intangible assets specified under ITAT i.e. Know-how, Patents, Copyrights, Trademarks, Licences, Franchises. The only remaining category is “Residual one’ or ‘any other business commercial rights of similar nature’. Therefore Goodwill fall under residuary category.

VII. Ejusdem Generis Rile

It is the rule of following more specific one. The rule says that when the general words follow specific words of same nature, general words must be confined to the things of the same kind as those specified. This rule interpretation makes an attempt to reconcile incompatibility between the specific words and general words. Accordingly, the specific words in the intangible assets included, Know-how, Patents, Copyrights, Trademarks, Licences, Franchises, form a distinct genesis as all these items are specific and elucidated rights of Business or commercial nature. Therefore, In the light of statutory provisions of IT Act, sec 32(1)(ii), the goodwill acquired by the assessee does not come under the expression of ‘ any other Business or Commercial rights of the nature’.

Smt. Sipra DEyVs.Ajit Kumar Dey AIR, 1998 Cal28, it was held that a word like a man is often known by the company it keep and hence it is to be understood in the context and collection is used. This rule of interpretation ‘ noscitura sociis’ which is wider than the rule of ‘ ejusdem generis’ viewed that the word ‘ Good will’ can be said to be a part of the genus or the nature of intangible assets given in section32 (2) (ii) of Income Tax Act.

Design Act, 1911, The copy Rights Act, 1957, Trade and Merchandise Act, 1958, and Patents Act, 1970, are available for infringement of goodwill rights under the general civil and criminal laws of the country and in this sense the goodwill can certainly said to be covered under the expression ‘the business or commercial rights in the same nature of the items specified from i to vi in section 32(2) (ii) of IT Act. Moreover, the valuation of the commercial value of goodwill is as difficult as valuation of commercial value of IPRs and its coverage is wider and comprehensive. Therefore, it cannot be said that goodwill is not in the nature of intellectual property rights (IPRs).

VIII. Conclusion

Philosophically, goodwill has been held to be an intangible, though it immaterial, it is materially valued. In terms of comparative dynamics, goodwill is the differential of profit. Architecturally, it is the ‘cement’ binding together the business and its assets as a whole as a going and developing concern. In the light of the several views expressed above, Goodwill may be considered as an intangible asset and it entitles for depreciation. Therefore, this needs to be viewed by appropriate authorities.

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