IN THE INCOME TAX APPELLATE TRIBUNAL
'A' BENCH, BANGALORE

BEFORE SHRI SUNIL KUMAR YADAV, JUDICIAL MEMBER
and
SHRI INTURI RAMA RAO, ACCOUNTANT MEMBER

ITA No.1395/Bang/2014
(Assessment year: 2006-07)

M/s. Sanyo BPL Pvt. Ltd.
Jubilee Bldg., II Floor,
No.45, Museum Road,
Bengaluru-560025. … Appellant
PAN: AAJCS 0332 B

Vs.

Deputy Commissioner of Income-tax,
Circle 12(3),
Bengaluru. … Respondent

Appellant by : Shri Nageswar Rao, Advocate.
Respondent by : Shri D.Sudhakar Rao, CIT(DR).

Date of hearing : 11/08/2016
Date of pronouncement : 04/11/2016

O R D E R

Per INTURI RAMA RAO, AM :

This is an appeal filed by the assessee directed against the order of the Commissioner of Income-tax (Appeals)-III,[CIT(A)], Bangalore, dated 11/08/2014 for the assessment year 2006-07.

2. Briefly facts of the case are that the assessee is a company duly incorporated under the provisions of the Companies Act, 1956. It is engaged in the business of manufacturing and trading of colour television and accessories. Return of income for the assessment year 2006-07 was filed on 28/11/2006 declaring total loss of Rs.50,93,13,937/-. After processing the return of income u/s 143(1) of the Income-tax Act,1961 ['the Act' for short], the

case was selected for scrutiny assessment by issuing necessary statutory notice u/s 143(2) of the Act. Finally, the assessment was completed u/s 143(3) of the Act vide order dated 29/12/2009 at a loss of Rs.35,86,32,378/-. While doing so, the Assessing Officer (AO) has disallowed the claim for depreciation on the value of intangible asset known as "distribution network" of Rs.5,53,72,500/- and depreciation on other fixed assets was disallowed Rs.9,53,09,059/- invoking the provision of Explanation 3 to Section 43(1) of the Act.

3. Facts leading to the addition are as under: The assessee-company was formed as a joint venture of M/s.Sanyo Electric Company Ltd., Japan and M/s.BPL Sanyo Ltd., on 50:50 basis. The assessee-company acquired business of manufacture and trading of colour television from M/s.BPL Ltd., on a slump purchase basis in terms of business transfer agreement dated 14/12/2005 for a consideration of Rs.360 crores. This purchase consideration was accounted in the books of assessee-company as per values assigned by M/s.Chowdhary & Associates, an independent registered Valuer, among various assets including the distribution network on the basis of market value. As per depreciation schedule, the total value of intangible assets was Rs.188,34,00,000/- and addition of Rs.268,53,00,000/- is shown. The break-up of intangible assets includes the value of distribution network of Rs.44,29,80,000/-. On this, the assessee-

company had claimed depreciation at 25%. The AO has rejected the contention of the assessee observing as follows:

> 7.2 The above contention of the assessee company was examined further. As per 'Accountants Report' on valuation for slump sale, paragraph 6.3 reads as under
>
> *"BPL had been in the manufacture inter alia of colour television (CTV) for long time and **owns contractual rights in respect of an extensive distribution network comprising of C & F Agent, Dealers, Distributors, galleries, CSD, Institutions, Service Franchise Networks and others**. Many of these customers have done business with the BPL for a number years of uninterrupted service'. **By virtue of slump sale of CTV business to JV-Co, JV-cO has acquired the customers of CTV business** and has therefore, been above to avoid the cost of having to develop its own market know how and build such a customer base. **One approach to value the customer base would be to quantify the marketing costs which are saved in having to build customer base through years of expenditure**. We have therefore, considered the saving in marketing cost approach for the purpose of valuing this intangible asset. However, **we have not considered C & F Agent and Service Franchise network** for the aforesaid customer base valuation because, as per the interviews with the representatives of JV-Co, selling's costs attributable to these entities is negligible. Valuation of customer base using this approach requires identification of selling costs associated with the generation of new customers. For this purpose we have taken the base of the financial data available from the audited accounts of BPL for the years ended on March 31, 2001 and 2005 as representative years because in between there is no certain trend of expenditure and new customers. Besides, there was a southern trend in revenue and selling cost because of the fund crunch. We have then arrived at the selling cost per active customer, based on the total cost saving for the reduction of customers as aforesaid over the decrement customer base. We have then applied such cost saved per active customer to the active customer base of CTV division of BPL at the time of its acquisition viz 15-12-2005 to arrive at the value for the intangible asset in the form of market know how comprising the valuable customer base at the time of acquisition of CTV division of BPL. The amounts arrived at by us as the fair value of the customer base works out to Rs.442.98 million(Rs.44.98 crores).*
>
> 7.3 Before going any further, it is important to note the following
>
> - **What is transferred in only the CTV division.** The other divisions of BPL like Automation, Printed Circuit Boards, Soft Cell division,

Medical appliances Division, Tool room and Electrical appliances Division continues to be with the BPL Ltd. The BPL Ltd is one of the leading companies engaged in the Indian Consumer Electronics and house hold goods sector for a number of years **having established 'BPL' brand, distribution and service network and manufacturing facilities in India.**

- For the purpose of valuation of distribution network only **'dealers and distributors'** are considered.
- But **'dealers and distributors'** are dealers and distributors for all the BPL brand goods including electrical appliances and they are **'not exclusive dealers of CTV's'.** Further more, these dealers and distributors are not brand specific only to BPL , but the dealers sell CTV's of other brands and competitors also.
- The basis of valuation of distribution network is 'saving of future costs if marketed individually' and is based on estimation.
- **The BPL Ltd continues to be part of the assessee company being 50% share holder.** In other words, by virtue of BPL being the share holder in the assessee company, in reality, there is no actual transfer of distributor network. The network of dealers and distributors will continue without much difference. In other words, it is akin to absorption of employees of CTV division of BPL to the assessee company. Nothing changes on the ground but only on paper.

7.4 From the above, it is obvious that the valuation of the distribution network is on the higher side and has been done to claim depreciation. It is very important to note that what is transferred in only CTV division and BPL continues to do the other division on its own. The distribution network they are referring to is not CTV specific. The dealers/distributors are not dealers and distributors of CTV alone but other products of the BPL and CTV's and other products of various other brands. Besides, when the BPL is 50% share holder in new company and

the name still retains BPL along with Sanyo where is the question of transferring entire network. As discussed above, on the ground nothing has changed. The CTV's will be rolled out from BPL-Sanyo stable, to the same distributors/dealers who in turn will sell to the customers. No new network need to be established by M/s Sanyo BPL P Ltd., at all because the network already exists and brand BPL is inherent in the name of the assessee company and its products. Hence there is no question or need for the assessee company to establish the network again. There is no need to pay to the M/s BPL also, as M/s BPL is 50% stake holder in the assessee company and retains the brand name in the company name and the same is evident from the 'letter heads' of the assessee company. Even for the arguments sake, if we accept that distribution network is an intangible asset and is actually transferred, the depreciation can be given to 50% of Sanyo Corporation share only and not that of the BPL. Further more, the valuation of the assets are not proper. For example, the land (for which no depreciation can be claimed) is claimed to have been valued at fair value based on valuer's report. A perusal of 'schedule of fixed assets' , the land measuring 4000 sq mtrs or 43,040 sq ft at **no.24, Block C, Phase II, Noida** Gautham Budh is valued at only Rs.92,00,000/- which is certain on lower side. As per this valuation, the value per sq ft works out to Rs.213/- which is unimaginable in area like Noida. Even in the schedule of fixed assets of M/s BPL Ltd., which is part of the record, the land at Noida at cost is shown at Rs.1.57 crores. Besides, there existed a structure measuring 5000 sq ft. As per the sale deed dated 14-12-2005, the sale consideration paid by the assessee company to M/s BPL Ltd., was Rs.1.04,40,000/- for this land whereas the stamp duty paid was Rs.1,47,40,360/-. The stamp duty is generally 10% of the guidance value. This clearly shows that there is undervaluation of the land. Thus when the asset is revalued there cannot reduced cost of land which is ever appreciating by leaps and bounds. Thus it is clear that the assessee has undervalued the value of almost an acre of land in prime area like 'Noida'. Similarly, the land at Bangalore, Sy.no.s 23/1.23/2.24,25/2, 26/2 at Avalahalli, Old Madras Road

measures 11 acres and valued at Rs.5.3 crores as per revaluation which is totally absurd. It appears that, the total valuation was intended to be kept at the certain level and internal jugglery was made and was introduced in the name of 'distribution network'. For these reasons, I am of the opinion that the assessee has and its valuer has inflated the value of so called 'distribution network' to be included as part of the 'intangible assets' to claim higher rate of depreciation @ 25%. This opinion is further strengthened by the fact that the assets transferred stands at Rs.81 crores whereas the intangibles are valued at Rs.282 crores. Hence, the action of the assesee in considering and valuing the distribution network is totally unacceptable and liable to be rejected.

7.5 Having said that, whether the 'distribution network' can be considered intangible asset is examined. The assessee in doing so has drawn reference to Circular No.772 dated 23-12-1998 and has filed a submission before me and stated that definition of 'intangible assets' includes **business or commercial rights**, and 'distribution network' which is similar in character and not backed by any tangible assets is considered as intangible asset and is eligible for the depreciation @ 25%.

The Circular No.772 dated 23-12-1998 is reads as under

CIRCULAR NO. 772, DATED 23-12-1998 (EXPL.) [F. (No. 2) Act, 1998]

Clarificatory amendments in procedure for block assessment

To set at rest the controversy as to whether block assessment subsumes the regular assessments or is independent of the latter, the Act has inserted an Explanation after sub-section (2) of section 158BA of the Income Tax Act clarifying that assessments completed under Chapter XIVB shall be in addition to regular assessments in respect of each previous year included in the block period. Further, undisclosed income relating to the block period shall not include the income assessed in regular assessment. Similarly income in regular assessment shall not include the income of the block period assessed in block assessment.

To settle the controversy regarding meaning of the word execution while calculating the period of limitation in section 158BE of the Income Tax Act, the Act has inserted a new clarificatory Explanation. An authorisation is deemed to have been executed in the case of search on the conclusion of search as recorded in the last panchanama drawn in relation to any person in whose case the warrant of authorisation has been issued. In regard to requisition under section 132A of the Income Tax Act, the authorisation would be deemed to have been executed on actual receipt of books of account or other documents or assets by the authorised officer.

The above amendments will take effect retrospectively from 1st July, 1995 and will, accordingly, apply in relation to the assessment year 1996 97 and subsequent years.

The Act has amended section 158BB of the Income Tax Act to clarify that the deduction of salary, interest, commission, bonus or remuneration, by whatever name called, in Explanation (b) in sub-section (1) of section 158BB is in relation to any partner not being a working partner. This amendment is effective from 1st April, 1999 and will, accordingly, apply in relation to the assessment year 1999-2000 and subsequent years.

7.6 A plain reading of the circular no.772 dated 23-12-1998 makes it clear that the circular is not about 'intangible asset' but regarding the procedure of block assessment. Thus the assessee by reference to a circular which is not on the issue at hand is trying to mislead the undersigned and any reference to this circular is unacceptable. The Income Tax Act, refers to the intangible asset as

> **Intangible asset**s, being know-how, patents, copyrights, trade mark, licenses or franchises or any other business or commercial rights of similar nature, acquired on or after the 1st day of April, 1998.

From the above it can be ascertained that the 'distribution network' is covered in know how, patent, copy right, trade mark. The franchises have already been excluded in the accountant report it self. The only item thus left for discussion is 'business or commercial rights'. What is a business or commercial right is not defined. But from the discussion in paragraphs 7.2 to 7.4 it is clear that no

distribution net work is actually transferred on the ground. For these reasons, no claim of depreciation on 'distribution network' is allowable.

7.7 Having said that, I propose to disallow the sum so claimed. A perusal of 'Appendix 2 State of depreciation admissible', shows that the assesee has claimed depreciation @12.5%(being half of 25%) on intangible assets of Rs.191,02,53,000/- and claimed depreciation of Rs.23,87,81,625/- which includes 'Rs.44,29,80,000/- being the 'distribution net work as per assessee's valuation' and depreciation claimed on the same @ 12.5% is Rs.5,53,72,500/-. After the discussion in the preceding paragraphs, such depreciation on 'distribution network' is not admissible and hence Rs.5,53,72,500/- is hereby disallowed and added back.(Addition Rs.5,53,72,500/-)

4. By holding so, the AO has disallowed depreciation on distribution network of Rs.44,29,80,000/- and disallowed the claim for depreciation of Rs.5,53,72,500/-.

In respect of depreciation, the AO also disallowed depreciation on the assets acquired from BPL Ltd., valued by the assessee-company at Rs.810.94 millions. The AO was of the opinion that the assets were valued at higher side in the books of account in order to claim depreciation. Invoking provisions of Explanation 3 to section 43(1) of the Act, the AO had allowed depreciation on the value as increased by 25% of the closing WDV in the books of BPL Ltd., i.e., seller. The reasoning given for not accepting the values as accounted for in the books of account is given in para.8 of the assessment order which is as under:

8. **Depreciation of the acquired assets - Fixed assets:**

8.1 As said earlier, the assessee company has acquired the CTV division and has taken over all the assets. Thus the opening WDV of fixed asset should be that of closing WDV in the books of M/s BPL Ltd., as on 31-3-2006. Whereas the 'Accountants report on valuation', states that

> *"the fair value of the fixed assets of the CTV division has been assessed by M Choudhary and Associates, Registered valuer at Rs.810.94 million as on December 15, 2005 vide their report".*

8.2 In other words, the opening WDV for the FY 2005-06 as shown in the schedule of fixed assets is not the closing WDV in the books of M/s BPL.

8.3 Thus the valuer has revalued the WDV and the same is taken in the books of the assessee company and depreciation is claimed. In 'Significant Accounting Policies and Notes to accounts as on 31-3-2006' also, it is stated that 'Fixed assets taken over on re valued costs'.

8.4 During the course of assessment proceedings, the same was questioned and the assessee vide letter dated 15-12-2009 submitted that the assets were purchased by an independent entity Sanyo BPL P Ltd., from BPL Ltd.,. Even if the assets are purchased at a value higher than that of the WDV computed as per I T Act, 1961 of the selling company, the same would be considered as capital gains in accordance with provisions of S.50 in case of depreciable assets and such income would have been offered by the entity selling the asset(BPL Ltd.). Vide this letter the assessee has further argued that, the fact that the BPL Ltd., has 50% share in Sanyo BPL P Ltd., has no relevance in context of transfer of assets. Since Sanyo BPL P Ltd., is a separate legal entity, the purchase cost of assets for the purpose of depreciation would be the amount agreed to and paid by Sanyo BPL P Ltd., to BPL Ltd.,. The assessee further added that, no where in the Income Tax Act does it specify that assets purchased from a related party should be taken at the WDV computed as per I T Act, 1961 of the transferor company. Thus, the assessee is contending that if the assets are purchased for value more than Closing WDV, the consideration so paid would have got reflected in the books of the seller and the capital gains tax would have been paid, on positive income, if any. This is immaterial and cannot be the yard stick for determining actual WDV and depreciation thereof. Secondly, the assessee is trying to down play, the 50% share holding of BPL Ltd., which is incorrect as this is substantial share holding and BPL Ltd., will have say in all the aspects of the new born company.

8.5 Thus, the case was examined further in the light of provisions of S.43(6)©. The assessee filed its submission for this query vide letter dated 22-12-09. In its detailed submission the assesee stated that this provision will not apply in the case of the assessee. The assesse has referred to S.43(6)© and

has stated that the assets and liabilities were taken on slump sale basis and referred to all the explanations therein and submitted that as this is a joint venture and not transfer from holding company to subsidiary (51% share holding is not there) or vice versa nor a merger/demerger nor amalgamation nor transfer of assets by recognized stock exchange and hence these provisions are not applicable.

8.6 The submissions of the assessee are examined carefully. If the provisions of S.43(6) does not apply, then the section to be referred to is S.43(1) which reads as under,

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

In the case of assets, which were put to use, before the acquisition by the assessee, the explanation 3 is applicable which reads as under

> *Explanation 3 : Where, before the date of acquisition by the assessee, the assets were at any time used by any other person for the purposes of his business or profession and* ***the [Assessing] Officer is satisfied that the main purpose of the transfer of such assets, directly or indirectly to the assessee, was the reduction of a liability to income-tax (by claiming depreciation with reference to an enhanced cost), the actual cost to the assessee shall be such an amount as the [Assessing] Officer may, with the previous approval of the [Joint] Commissioner, determine having regard to all the circumstances of the case.***

8.7 In the light of the above and for the sake of clarity, the following facts are enumerated

- The assessee company is engaged in the business of manufacture and trade of colour television and accessories. Vide agreement dated 14-12-2005 between BPL ltd and M/s Sanyo Electric Co, Japan, the colour TV business of the BPL Ltd was transferred on slump sale basis to the newly formed 50:50 joint venture of M/s

BPL Ltd and M/s Sanyo Electric Co, Japan namely M/s Sanyo BPL Pvt Ltd., i.e., the assessee company.

As per schedule of fixed assets the assessee has shown the value of fixed assets at Rs.81.19 cr including assets held for sale. Out of the above, the land is shown at Rs.6.22 crores and other fixed assets at Rs.73.83 crores and assets are revalued. As per the closing WDV of M/s BPL Ltd., the value of such fixed assets excluding land is Rs.15.75 crores. The assessee has submitted that, it need not adopt the closing WDV of the transferor because it is neither a subsidiary nor the transaction between two companies can be termed as merger, de merger, amalgamation etc.,

However, a perusal of the closing WDV of the transferor and the value adopted by the assessee company shows that the assets valuation are on the higher side. The difference between the closing WDV of the transferor and the opening WDV of the assessee company as per valuation is Rs.58.08 crores. This is further clear by the fact that lands at Delhi and Bangalore are devalued. The BPL Ltd., was established in 1960s and the CTV division was established in 1982 in Phalgat. Later, somewhere in 1986 the CTV division was moved to Bangalore. The assessee company owns land at Phase II Noida measuring 4000 sq mtrs or 43,040 sq ft which was valued at paltry Rs.92 lakhs. the value per sq ft works out to Rs.213/- which is unimaginable in area like Noida. Even in the schedule of fixed assets of M/s BPL Ltd., which is part of the record, the land at Noida at cost is shown at Rs.1.57 crores. Besides, there existed a structure measuring 5000 sq ft on this land. As per the sale deed dated 14-12-2005, the sale consideration paid by the assessee company to M/s BPL Ltd., was

Rs.1.04,40,000/- for this land whereas the stamp duty paid was Rs.1,47,40,360/. The stamp duty is generally 10% of the guidance value. This clearly shows that there is undervaluation of the land.

- The land at Bangalore, Sy.no.s 23/1.23/2.24,25/2, 26/2 at Avalahalli, Old Madras Road measures 11 acres and valued at Rs.5.32 crores which cannot be true. In FY 2005-06, value per acre in that area was not less than Rs.1.5 crore per acre. Thus it is clear that the assessee company has undervalued the land and increased the value of other fixed assets. This is obvious from the following table

Particulars	Closing WDV in books of BPL Ltd.,	As per valuation report	Difference
Buildings	3,77,41,417	11,12,50,000	7,35,08,583
Plant & machinery	7,70,89,627	40,59,44,996	32,88,55,369
Dies/tools/moulds	2,20,85,296	15,60,58,136	13,39,72,840
Electrical installations	13,43,226	2,46,36,909	2,32,93,683
Air conditioning	18,60,191	1,18,92,082	1,00,31,891
Canteen equipments	1,856		1,856
Fire fighting equip	1,62,557	16,79,233	15,16,676
Office equipments	3,95,998	15,06,952	11,10,954
Computers	9,50,588	76,17,438	66,66,850
Furniture/fixtures	1,58,33,733	1,77,85,358	19,51,625
Total	**15,74,64,490**	**73,83,71,104**	**58,09,06,614**

8.8 It is not clear, how the value of depreciable items such as plant & machinery, dies, tools and moulds, electrical installations, air-conditioning, fire fighting equipments, computers, furniture and fixtures can be increased from Rs.15.75 crores to Rs.73.83 crores. Even if we consider, the cost of installation of any second hand machinery and time lag for that purpose and rate of

transferor. The increase cannot be more than 25% of the closing WDV of the transferor.

8.9 To deal with this type of situation, wherein the assets are transferred between the related parties and cost of the assets are revalued with an intention to claim higher depreciation, explanation 3 to S.43(1) is included in the Act. As per *Explanation 3 :* Where, before the date of acquisition by the assessee, the assets were at any time used by any other person for the purposes of his business or profession and the [Assessing] Officer is satisfied that the main purpose of the transfer of such assets, directly or indirectly to the assessee, was the reduction of a liability to income-tax (by claiming depreciation with reference to an enhanced cost), the actual cost to the assessee shall be such an amount as the [Assessing] Officer may, with the previous approval of the [Joint] Commissioner, determine having regard to all the circumstances of the case.

8.10 In the light of the above discussion, I am of the opinion that the cost of such fixed assets cannot be increased by more than 25% for the reasons stated above and proper step would be to increase the value of closing WDV of the transferor (BPL Ltd.,) by only 25% and disallow the depreciation claimed on the value of assets, over and above 25% of the closing WDV of the transferor. As per Explanation 3 above mentioned, the approval of Addl. CIT, Range 12 was sought vide letter dated 23-12-09. The Addl. CIT Range 12, vide letter dated 24-12-09 granted approval for adopting the actual cost of the assets other than land as closing WDV of those assets in the books of the transferor company plus 25% of such WDV and allow depreciation accordingly for AY 2006-07.

Accordingly depreciation of Rs.9,53,09,059/- was disallowed.

5. Being aggrieved, an appeal was filed before the CIT(A) who vide paras.8.1 to 9 of his order has confirmed the disallowance of depreciation and distribution network vide paras.10 and 10.1 upheld restricting depreciation allowance on the value of closing WDV of the transferor company as increased by 25%.

6. Being aggrieved, the assessee-company is in present appeal raising the following grounds of appeal:

1. In view of the facts and circumstances of the case and in law, the order passed by the CIT (A) is arbitrary, bad in law and without jurisdiction.

2. The CIT (A) has erred on the facts and law in confirming the disallowance of ₹ 5,53,72,500/- made by the AO while not allowing the depreciation on one of the intangible asset of the Appellant i.e. "Distribution Network".

3. The CIT (A) has erred on the facts and law in not considering that for the intangible asset namely "Distribution Network", the Appellant has paid sales consideration and the same was valued as per the valuation report prepared by the independent registered valuer (s) and was reflected under the category of intangible assets by the Appellant.

4. The CIT (A) has erred on the facts and law in not considering that the intangible asset namely "Distribution Network" is duly covered under the provisions of section 32(1) (ii) of the Income Tax Act, 1961.

5. The CIT (A) has erred on the facts and law in confirming the disallowance of ₹ 9,53,09,059/- made by the AO while not allowing the depreciation claimed by the Appellant on the revalued value of the fixed assets.

6. The CIT (A) has erred on the facts and law in not considering that the Appellant has not overvalued the value of the fixed assets as the value of the fixed assets was determined on the basis of on the valuation report obtained from an Independent Registered Valuer.

7. The CIT (A) has erred on the facts and law in not considering that that the Appellant has not overvalued the value of the fixed assets, as in the case of Slump Sale, the entire business undertaking is transferred for lump-sum consideration and the allocation of the purchase consideration is made on fair market value basis, as is made by the Appellant in this case based on the valuation report.

8. The CIT (A) has erred on the facts and law in confirming the observation/decision of the AO that the Appellant has undervalued its lands in Bangalore and Noida.

9. The CIT (A) has erred on the facts and law in not considering that if the land was valued by the independent valuer at a price less than the value in the books of the transferor i.e. BPL Ltd., does not *per se* mean that the same value as in the books of Transferor has to be adopted by the Appellant.

10. The order of the CIT (A) on the facts and circumstances of the case is perverse as it does not take into consideration the relevant documents brought on record i.e. the copies of the agreement(s), valuation reports, case laws relied by the Appellant and submissions/rejoinder of the Appellant.

11. The Appellant craves leaves to add, alter or modify the aforesaid ground and craves leaves to file additional grounds.

12. The aforesaid grounds are taken without prejudice to each other.

7. Ground No.1 is general in nature and does not require any adjudication.

8. Ground Nos.2 and 3 challenge the disallowance of claim for depreciation on distribution network. The AO has denied the claim for depreciation on two counts: (1) valuation of distribution network is on very high side and (2) there was no transfer of any distribution network of M/s.BPL Ltd. The AO was of the view that even if depreciation is to be allowed it can be allowed only to the extent of 50% i.e. percentage of shares held by M/s.Sanyo Electric Company Ltd., The fact that valuation of land was shown at lesser value than value fixed as per guidance value under stamp valuation Act led AO to believe that the value apportioned to various assets is not fair market value but done with intention of claiming higher depreciation i.e. ulterior motive of tax evasion. Therefore, the AO disallowed the claim.

9. The CIT(A) also confirmed the addition holding that there is no transfer of distribution network. He further held that it does not fall within the definition of any other business or commercial rights.

10. We heard rival submissions and perused the material on record. This issue can also considered from another angle. Even assuming that there is no intangible assets as distribution network as claimed by the assessee, excess of consideration paid over assets taken over constitutes goodwill as per judicial precedents in the light of the decision of the Hon'ble Delhi High

Court in the case of Triune Energy Services (P) Ltd. In ITA Nos.40 & 189 of 2015. Intangible assets qualifying for depreciation in terms of the law laid down by the Hon'ble Supreme Court in the case of *CIT vs. Snifs Securities Ltd.*(348 ITR 302). Thus the law is fairly settled to the extent that excess of consideration paid over assets taken over assets constitutes goodwill and the same is eligible for depreciation. But the matter does not end there. Valuation of goodwill is also the bone of contention between the assessee and the revenue. Depreciation is admissible on the actual cost as the actual cost is required to be determined. The term 'actual cost' has been defined u/s 43(1) which reads as under:

> *"43. In sections 28 to 41 and in this section, unless the context otherwise requires—*
>
> > *(1)"actual cost" means the actual cost[37] 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: "*

The Legislature has prefixed the word 'actual' to the word 'cost' in section 43(1) which suggests that the intention of the Legislature was to curb the malpractices and tendencies to inflate capital costs for obtaining higher depreciation while not burdening the other with any material tax liability and to exclude collusive, inflated and fictitious cost. In this connection, observation made by the Hon'ble Delhi High Court in the case of *CIT vs. Dalmia* (125 ITR 510) are apt. The provisions of section 43(1) are considered by their Lordships as under:

We have heard the parties and given our utmost consideration to all the circumstances. As is clear from the narration of facts, in the books of Bhagwati Glass, the total expenditure incurred by it in the execution of the contract jobs was Rs. 3,11,954. As against that the assessee has paid Rs. 7,70,000 to it for execution of those jobs. This, on the face of it, appears to be a very high payment, specially when the Tribunal has noted that the jobs did not require any specialised or sophisticated skill. It was mostly a labour contract as the material was entirely supplied by the assessee. It is next also clear that the assessee and Bhagwati Glass were connected concerns indirectly owned by R. Dalmia, and that Bhagwati Glass had a carried forward loss of over Rs. 7 lakhs this year. The result has been that although Bhagwati Glass enjoyed a profit of about Rs. 4,58,000 in the execution of this contract, no tax liability ensued to it and the entire profit was wiped off against the large brought forward loss. At the same time, the assessee has claimed to be entitled to depreciation, etc., on the capital value of those works at Rs. 7,70,000. The Income-tax authorities were, therefore, right in observing that there was considerable element of collusion in the entire affair which could not be treated as the result of normal commercial considerations. The capital cost has no doubt been inflated in the hands of the assessee to enable it to claim higher depreciation, etc.

We find that the term "actual cost" came up for consideration before the Supreme Court in the case of *Guzdar Kajora Coal Mines Ltd.* v. *CIT* [1972] 85 ITR 599 . It was observed that the original cost of a particular asset is a question of fact which has to be determined on the evidence of the material produced before or available to the Income-tax authorities. Any document or formal deed mentioning the consideration or the cost paid for the purchase of an asset by an assessee would be a piece of evidence and, prima facie, the statements or figures given therein would show how much the cost of the asset to the assessee is. But if circumstances exist showing that a fictitious price has been put on the asset or there is fraud or collusion between the vendor and the vendee and there has been inflation or deflation of value for ulterior purpose, it is open to the Income-tax authorities to refuse to accept the price mentioned in the deed or alleged by the assessee and to ascertain what the actual cost was. These observations in our view render the approach adopted by the Tribunal in the present case as unsustainable when it observed that collusion and inflation would not entitle the Income-tax authorities to substitute their own figure of actual cost.

In the case of *Guzdar Kajora Coal Mines Ltd.* [1972] 85 ITR 599 (SC), the deed of conveyance executed in favour of the assessee purported to transfer certain assets for a consideration of Rs. 6 lakhs paid by the assessee. Those assets included machinery, plants, stores, buildings, etc. The Income-tax authorities found that some of the directors and shareholders of the assessee and the vendor-company were the same and connected, and there were certain inflations and deflations of the written down values of the assets. No provision had been made for goodwill of the business. The Income-tax Officer, therefore, allocated part of Rs. 6 lakhs to goodwill. The value of the depreciable assets was computed at Rs. 33,973 only. The Appellate Tribunal then rejected the assessee's claim holding, inter alia, that the allocation in the deed of conveyance was arbitrary. On a reference of the question whether the Income-tax Officer was competent to go beyond the conveyance and fix a valuation of the assets on his own, the High Court answered the question in the affirmative. On appeal to the Supreme Court, it was held that there was no error or infirmity that would justify interference by the Supreme Court.

Similarly, the Calcutta High Court in *jogta Coal Co. Ltd.* v. *CIT* [1965] 55 ITR 89, observed that if the circumstances showed than an assessee had arranged to put a fictitious price on his assets in a contract or conveyance, it was open to the Income-tax authorities to refuse to accept that price, go behind the contract or conveyance and ascertain what the original cost was. The Lahore High Court (Pakistan) has also in the case of *Pindi Kashmir Trans-port Co. Ltd.* [1954] 26 ITR 595 (Lah-Pak), observed that the Income-tax authorities were justified in law in going behind the contract for determining the original cost to the company, for the purpose of making allowance of depreciation.

So far as the *Explanations* added to section 43 of the Act, specially *Explanation No. 3,* under which -alone the Tribunal has observed the interference by way of determination of actual cost can be made, we are of opinion that such *Explanations* are only elaborative and tend to bring out some of the circumstances in which the main provision of the law can operate. They can by no stretch be treated as exhaustive or to otherwise limit the wide scope which the provision of law may embrace. Rather the incorporation of some of these *Explanations* by itself shows that the Legislature envisaged interference in given circumstances in the amount of purported actual cost.

We are further of opinion that the Tribunal was not justified in restricting the operation of the actuality of cost to cases where part of that consideration was not paid or ploughed back or covered some other items. In these cases, the cost would be what is in fact paid. What was not paid or was returned would never be considered as cost. This will be independent of the provisions contained in the Income-tax Act. The provisions of this Act have not been introduced for this purpose. They have rather a special objective and is directed towards nullifying the malpractices, sometimes indulged in some quarters, of disproportionately inflating capital cost in order to earn high depreciation, and pass on in collusion substantial amounts to sister concerns or closely connected parties to whom those amounts may have little or negligible bearing on the incidence of tax. This is what appears to have happened in the present case. In our opinion, when the Legislature has prefixed the word "actual" to the word "cost", it was to lay emphasis on the reality and genuineness thereof and exclude collusive, inflated, deflated or fictitious costs.

Thus, the assessing authority has ample power to determine the 'actual cost' of the asset which is eligible for depreciation as the circumstances of the case would justify. In the present case, the very fact that the seller of the business had 50% interest in the company i.e. assessee-company by virtue of holding 50% shares, and the assessee-company had failed to controvert the misgivings of the AO as to the inflation of the actual cost of the asset. These circumstances would certainly justify the AO to infer that fictitious price has been put on the asset in order to avail higher depreciation under the IT Act, perhaps with some other ulterior motive which the AO had chosen not to probe. In any event, right to use distribution network does not result in creation of any intangible asset as either the transferor company or the assessee-

company had paid any money to the distributors for giving them distributorship of dealing in the products of the assessee-company. Therefore, we hold that the AO is justified in denying depreciation claim on the intangible asset of distribution network on the inflated value of the asset. It is very ingenious attempt by the assessee-company to claim higher depreciation and avoid payment of tax in the hands of the transferor of the business by claiming to be slump sale transaction. Thus it is nothing but a colourful device adopted with the intention of tax avoidance and the principles enunciated by the Hon'ble Apex Court in the case of McDowell& Co. Ltd v. CTO (1984) *(*154 ITR *148)* are squarely applicable. Thus, the grounds of appeal are dismissed.

11. Ground Nos.5 to 10 challenge the addition made by the AO invoking Explanation 3 to section 43(1) of the Income-tax Act, 1961 [hereinafter referred to as 'the Act' for short].

12. Learned counsel for assessee argued that the claim for depreciation was made on the basis of valuation done by an independent valuer among various assets. He submitted that the AO has disallowed depreciation on fixed assets alleging over-valuation of fixed assets in order to claim depreciation. The AO had come to opinion that the assets are over-valued without any basis and evidence. In respect of disallowance of depreciation on distribution network learned counsel for assessee submitted that

even assuming that distribution network has not resulted any intangible asset, excess price paid for acquisition of the business should be treated as goodwill which is eligible for depreciation in the light of decision of the Hon'ble Supreme Court in the case of (340 ITR 302). Learned counsel for assessee further submitted that excess consideration paid for assets taken over is nothing but depreciation in terms of law laid down by the Hon'ble Delhi High Court in the case of *Truine Energy Services Pvt. Ltd*. in ITA Nos.40 & 189/15. The sum and substance of the argument of learned counsel for assessee is that even assuming that no intangible assets are acquired on account of acquisition of erstwhile BTV Manufacturing of BRI Ltd., The excess of consideration should be treated as a goodwill which is eligible for depreciation in terms of law laid down by the Hon'ble Supreme Court in the case of *CIT vs. Snifs Securities Ltd.*(340 ITR 302).

On the other hand, learned CIT(DR) placed reliance on the orders of the lower authorities.

13. We heard rival submissions and perused material on record. In the present appeal, the issue involved is whether the AO was justified in invoking Explanation 3 to section 43(1) for the purpose of determining the actual cost to allow depreciation thereon on distribution network which constitutes intangible assets which is eligible for depreciation. Whether the claim of

depreciation on enhanced value of asset is admissible. Undisputed facts are that the assessee-company acquired manufacturing of colour television from BPL Ltd., on a slump sale basis for a consideration of Rs.360 crores. M/s.BPL Ltd., has 50% share holding in the assessee-company. Thus, M/s.BPL Ltd., has got a substantial interest in the assessee-company by virtue of holding shares for more than 20%. There is no dispute that the business of manufacturing and trading of colour TV was acquired from M/s.BPL Ltd., on a slump sale basis which means the consideration paid by the purchaser i.e the assessee-company to M/s.BPL Ltd., is not apportioned asset-wise by the seller i.e. M/s.BPL Ltd., But the purchaser i.e. the assessee-company apportioned the value which could be reasonably attributed to assets acquired through the scheme of slump sale based on an independent expert valuer's opinion. In the present case, assessee-company valued fixed assets at Rs.81.19 crores out of which value for land was shown at Rs.6.22 crores and other fixed assets on which depreciation was claimed was valued at Rs.73.83 crores. As against this, closing WDV of these assets in the books of M/s.BPL Ltd., transferor company was only Rs.15.75 crores. Thus, difference between closing WDV in the hands of the seller i.e. M/s.BPL Ltd., and the values of the fixed assets on which depreciation was claimed by the assessee-company is Rs.58.8 crores. The contention of the assessee-company is that fixed assets acquired on account of purchase of business are valued

based on the valuation made by independent valuer. Though the AO accepted in principle, the method of apportionment of values to the fixed assets based on the valuation of independent valuer, but AO found fault in the method of valuation done by the valuer as, according to him, the immovable property owned by the assessee-company at Noida, the value was shown lesser than the value as per the stamp duty. This made the AO to suspect that the methodology adopted by the Valuer is not free from doubt and therefore, the AO had not accepted the values assigned by the assessee-company to the assets and felt that the assets were overvalued in order to claim depreciation with the intention of avoiding tax liability and therefore, invoked the provisions of Explanation 3 to section 43(1) of the Act. While doing so, the AO accepted that higher value of 25% over and above closing WDV in the hands of M/s.BPL Ltd. i.e. transferor. Permission as envisaged under provisions of Explanation 3 to section 43(1) from higher authorities was also obtained. The only objection of the assessee-company seems to be that except subjective opinion of Assessing Officer, there was no material referred by the AO indicating overvaluation of the assets of the assessee-company. Thus, it was contended that the AO should not have invoked the provisions of Explanation 3 to section 43(1) of the Act.

14. It is needless to mention that depreciation is admissible only on actual cost incurred by the assessee-company. When the

assessee-company purchased as a going concern at a slump price, identification of the actual cost in respect of different assets poses certain problems. It is an accepted practice that consideration paid for acquisition of business allocation towards various assets based on report of expert. In the instant case, the assessee-company exactly did the same thing but the report of the expert in this case i.e. M/s.Chowdharu & Associates was not accepted by the AO on noticing that the valuer had assigned lesser value to land property and more value in respect of other assets which are eligible for depreciation. This prompted the AO to ignore the valuer report and estimate the actual cost at 25% higher than value of closing WDV in the books of M/s.BPL Ltd. invoking the provisions of Explanation 3 to section 43(1) of the Act. The said provisions read as under:

> *"Where, before the date of acquisition by the assessee, the assets were at any time used by any other person for the purposes of his business or profession and the [Assessing] Officer is satisfied that the main purpose of the transfer of such assets, directly or indirectly to the assessee, was the reduction of a liability to income tax (by claiming depreciation with reference to an enhanced cost), the tax (by claiming depreciation with reference to an enhanced cost), the actual cost to the assessee shall be such an amount as the [Assessing] Officer may, with the previous approval of the [Joint Commissioner], determine having regard to all the circumstances of the case."*

15. From a bare reading of the provisions of Explanation 3 to section 43(1), it is clear that nowhere the provisions speaks of market value being determined by the AO but speaks of actual cost being determined by the AO with approval of the Joint

Commissioner in the specified circumstances. The pre-requisite condition necessary for invoking of the said Explanation 3 to section 43(1) are only - (1) that the asset at any time was used by any other person for the purpose of business. In this case, it is undisputed fact that M/s.BPL Ltd., from whom the assessee-company had acquired the assets had used the asset and claimed depreciation. Thus this condition is satisfied. (2) The main purpose of transfer of such assets directly or indirectly to the assessee-company was for reduction of liability to income-tax. In the present case, transaction of acquisition business as a going concern is between two related parties and the seller had a substantial interest by holding 50% share. The assets were already depreciated in the hands of the seller i.e. M/s.BPL Ltd., higher values were assigned by the assessee-company in order to avoid tax liability. Thus, ingredients which are necessary for invoking Explanation 3 to section 43(1) are satisfied and the AO is justified in his action in restricting the allowance of depreciation on WDV at higher than 25% of the closing stock. The findings given by us in respect of depreciation on distribution network vide para 10 equally holds good even in respect of valuation of depreciable assets. Thus, grounds of appeal Nos.5 to 10 are dismissed.

In the result, the appeal by the assessee is dismissed.

Order pronounced in the open court on 4th November, 2016

Sd/-	*Sd/-*
(SUNIL KUMAR YADAV)	**(INTURI RAMA RAO)**
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

Place : Bangalore
D a t e d : 04/11/2016

srinivasulu, sps

Copy to :

1 Appellant
2 Respondent
3 CIT(A)
4 CIT
5 DR, ITAT, Bangalore.
6 Guard file

By order

Assistant Registrar
Income-tax Appellate Tribunal
Bangalore