

Legal Issues in ‘Proprietary & Confidential Information’

Topic: ‘Is Proprietary Business Information eligible as Depreciable Intangible Asset under the Income Tax Act?’

Relevant Legal Provisions

❖ Section 32, The Income Tax Act, 1961

“32. Depreciation.

(1) In respect of depreciation of—

(i) buildings, machinery, plant or furniture, being tangible assets;

(ii) know-how, patents, copyrights, trade marks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets acquired on or after the 1st day of April, 1998, [not being goodwill of a business or profession,]

...

Explanation 3.—*For the purposes of this sub-section, the expression "assets" shall mean—*

(a) tangible assets, being buildings, machinery, plant or furniture;

(b) intangible assets, being know-how, patents, copyrights, trade marks, licences, franchises or any other business or commercial rights of similar nature[, not being goodwill of a business or profession].”
(Emphasis supplied)

Relevant Judicial Decisions

❖ **Sharp Business System v. The Commissioner of Income Tax-III, (2012) 254 CTR (Del) 233**

*“11. As discussed earlier, each of the species of rights spelt-out in Section 32(1)(ii), i.e. know-how, patent, copyright, trademark, license or franchise as or any other right of a similar kind which confers a business or commercial or any other business or commercial right of similar nature has to be "intangible asset". The nature of these rights mentioned clearly spell-out an element of exclusivity which enures to the assessee as a sequel to the ownership. In other words, but for the ownership of the intellectual property or know-how or license or franchise, it would be unable to either access the advantage or assert the right and **the nature of the right mentioned or spelt-out in the provision as against the world at large or in legal parlance "in rem" ...**” (Emphasis supplied)*

Relevant Judicial Decisions (Contd.)

❖ **Fortis Hospitals Ltd. v. ACIT, Circle-9(2) (ITA 132/2021, Delhi High Court, Judgement dated July 29, 2021)**

“17. On merit, this Court in Sharp Business Systems (supra) has held, as under:

...

13. For the above reasons, this Court is of the opinion that the words "similar business or commercial rights" have to necessarily result in an intangible asset against the entire world which can be asserted as such to qualify for depreciation under Section 32(1)(ii) of the Act.” (Emphasis supplied)

4

Relevant Judicial Decisions (Contd.)

- ❖ **DCIT v. EAC Industrial Ingredients India P. Ltd (ITAT Delhi, ITA No. 1801/Del/2011, Order dated December 28, 2017)**

“The Id CIT(A)...According to him, any right which is obtained for carrying on the business will fall in the definition of intangible asset. ...However, this issue squarely is covered against the assessee in view of the decision of the Hon'ble Delhi High Court in case of Sharp Business Systems Vs CIT, ITA No. 492/2012 dated 05.11.2012 wherein, in para No. 11 to 13 Hon'ble High Court has decided...the words “similar business or commercial rights” have to necessary result in an intangible asset against the entire word which can be asserted as such to qualify for depreciation u/s 32(1)(ii) of the Act...” (emphasis supplied)

Relevant Judicial Decisions

❖ **Srivatsan Surveyors P. Ltd. v. The Income Tax Officer, [2009] 32 SOT 268 (Chennai)**

“8....The dictum of EJUSDEM GENERIS...means of the same kind, class or nature. The rule is that when general words follow particular and specific (sic) the general words must be confined to the things of the same kind as those specified...”

9. Right as to know-how, patents, copyrights, trademarks, licences, franchises, etc can be construed to be 'right in rem' which can be claimed against the world at large. Right in restrictive covenant is 'right in personam' which is available against the contracting parties only. As such right in restrictive covenant is not of similar nature. Therefore depreciation on restrictive covenant is not allowable as per the prescription of Section 32(1)(ii). ...” (Emphasis supplied)

Relevant Judicial Decisions (Contd.)

- ❖ **Commissioner of Income-tax, Bangalore v. Ingersoll Rand International Ind. Ltd. (ITA No. 452 of 2013, Karnataka High Court, Order dated June 30, 2014)**

“7. ...the expression ‘business or commercial rights of similar nature’ need not answer the description of know-how, patents, copyrights, trade marks, licenses, franchises, but must be of similar nature as the specified assets. ...meaning of the word ‘similar’ ...corresponding to or resembling to in many respects somewhat like or having a general likeness. The statute does not contemplate that goods classified under the words of similar description, shall in all respects be the same. ...” (Emphasis supplied)

Relevant Judicial Decisions (Contd.)

- ❖ **Commissioner of Income-tax, Bangalore v. Ingersoll Rand International Ind. Ltd. (ITA No. 452 of 2013, Karnataka High Court, Order dated June 30, 2014) (Contd.)**

“8. ...the intangible assets enumerated in Sec.32 of the Act effectively confer a right upon an assessee for carrying on a business more efficiently by utilizing an available knowledge or by carrying on a business to the exclusion of another assessee....The object of acquiring a know-how, patents, copyrights, trade marks, licences, franchises is to carry on business against rivals in the same business in a more efficient manner or to put it differently in a best possible manner. ...The term ‘or any other business or commercial rights of similar nature’ has to be interpreted in such a way that it would have some similarities as other assets mentioned in C1.(b) of Expln 3. Here the doctrine of ejusdem generis would come into operation...When once the expenditure incurred for acquiring the said right is held to be capital in nature, ... the depreciation provided under Sec.32(1) (ii) is attracted and the assessee would be entitled to the deduction as provided in the said provision...” (Emphasis Supplied)

Relevant Judicial Decisions (Contd.)

❖ **Areva T and D India Ltd. and Ors. v. The Deputy Commissioner of Income Tax and Ors., [2012] 345 ITR 421 (Delhi)**

12. ...On a perusal of the meaning of the categories of specific intangible assets referred in Section 32(1)(ii) of the Act preceding the term "business or commercial rights of similar nature", it is seen that the aforesaid intangible assets are not of the same kind and are clearly distinct from one another. The fact that after the specified intangible assets the words "business or commercial rights of similar nature" have been additionally used, clearly demonstrates that the Legislature did not intend to provide for depreciation only in respect of specified intangible assets but also to other categories of intangible assets, which were neither feasible nor possible to exhaustively enumerate. ...”

Relevant Judicial Decisions (Contd.)

❖ **Areva T and D India Ltd. and Ors. v. The Deputy Commissioner of Income Tax and Ors., [2012] 345 ITR 421 (Delhi) (contd.)**

*“... The nature of "business or commercial rights" can be of the same genus in which all the aforesaid six assets fall. All the above fall in the genus of intangible assets that form part of the tool of trade of an assessee facilitating smooth carrying on of the business. In the circumstances, it is observed that in case of the assessee, intangible assets, viz., business claims; business information; business records; contracts; employees; and knowhow, are all assets, which are invaluable and result in carrying on the transmission and distribution business by the assessee, which was hitherto being carried out by the transferor...therefore, comparable to a license to carry out the existing transmission and distribution business of the transferor. In the absence of the aforesaid intangible assets, the assessee would have had to commence business from scratch and go through the gestation period whereas by acquiring the aforesaid business rights along with the tangible assets, the assessee got an up and running business. This view is fortified by the ratio of the decision of the Supreme Court in **Techno Shares and Stocks Ltd...**” (Emphasis Supplied)*

Relevant Judicial Decisions (Contd.)

❖ **Techno Shares & Stocks Ltd. v. CIT, 2010 (327) ITR 323 (SC)**

“17. ...The right to participate in the market has an economic and money value. It is an expense incurred by the assessee which satisfies the test of being a “licence” or “any other business or commercial right of similar nature” in terms of Section 32(1)(ii).”

Relevant Judicial Decisions (Contd.)

- ❖ **Principal Commissioner of Income-tax v. Ferromatic Milacron India (P.) Ltd. (R/Tax Appeal No. 1233 of 2018, Gujarat High Court, Order dated October 9, 2018)**

*“10. In the present case, Mr. Patel was erstwhile partner of the assessee. The assessee had made payments to him to ward off competence and to protect its existing business. Mr. Patel, in turn, had agreed not to solicit contract or seek business from or to a person whose business relationship is with the assessee. Mr. Patel would not solicit directly or indirectly any employee of the assessee. **He would not carry confidential information which would include the past and current plan, operation of the existing business, trade secrets, customer lists etc. It can thus be seen that the rights acquired by the assessee under the said agreement not only give enduring benefit, protected the assessee's business against competence, that too from a person who had closely worked with the assessee in the same business. The expression "or any other business or commercial rights of similar nature used in Explanation 3 to sub-section 32(1)10) is wide enough to include the present situation.”***

(Emphasis Supplied)

Relevant Judicial Decisions (Contd.)

❖ **Pr. Commissioner of Income Tax v. Music Broadcast Pvt. Ltd. [ITA No. 675 of 2018, Bombay HC]**

“8. Therefore, by paying...non-compete fees...the rights acquired by assessee was not only giving it enduring benefit but also protected assessee's business against competition, that too from a person who had closely worked with assessee.”

Conclusion

- ❖ Proprietary business information, in the past, was bundled together with other intangibles such as dealer network, marketing rights, etc. and depreciation was claimed on the entire amount as goodwill. The interpretation of “any other business or commercial rights of similar nature” becomes particularly important in light of the Finance Act, 2021 which amended the Income Tax Act to exclude goodwill from the definition of an intangible asset eligible for depreciation.
- ❖ A set of judgements have held that “any other business or commercial rights of similar nature” includes proprietary business information as business and commercial rights refer to intangible assets for a business purpose which enable the assessee to access the market and has an economic and money value.
- ❖ On the other hand, judgements have held that “any other business or commercial rights of similar nature” must necessarily result in an intangible asset against the entire word to be eligible for depreciation, thereby excluding rights in proprietary business information from the ambit of depreciable intangible assets.

14

Thank you!
Questions?

Priyanshi Rastogi, Associate

15

© ALG India Law Offices LLP, 2023.

Disclaimer: Views, opinions, and interpretations are solely those of the presenters, not of the firm (ALG India Law Offices LLP) nor reflective thereof.

This presentation hosted at: https://www.algindia.com/wp-content/uploads/2023/11/LIS_Nov-13_v3.pdf