DEPRECIATION- WHEN TO BE CHARGED? - AVAILABLE FOR USE v/s PUT TO USE

INTERPRETATION AS PER INCOME TAX ACT, 1961 AND RELEVANT LEGAL PRONOUNCEMENTS

INTRODUCTION

Section 32 of the Income-tax Act, 1961 allows deduction of depreciation in respect of tangible and intangible assets owned, wholly or partly, by the assessee and used for the purposes of the business or profession. Thus, for allowance of deduction of depreciation, the asset must be 'used for the purposes of the business or profession' of the assessee.

'USED' INCLUDES 'READY FOR USE' OR 'PASSIVE USE'

2. The first school of interpretation describes the word 'used' as including 'ready for use' or 'passive use' or 'potential use'. That means if the asset was 'ready for use' during the previous year but it could not be actually used, then also, depreciation is allowable on such asset. The following are some of the case laws that come into support of this school of interpretation—

- *Whittle Anderson Ltd.* v. *CIT* [1971] 79 ITR 613 (Bom.);
- *Capital Bus Service (P.) Ltd.* v. *CIT* [1980] 123 ITR 404 /4 Taxman 309 (Delhi);
- *CIT* v. *O.P. Khanna & Sons* [1983] 140 ITR 558 /[1982] 10 Taxman 243 (P&H);
- *CIT* v. *Geo Tech Construction Corpn.* [2000] 244 ITR 452 / 112 Taxman 373 (Ker.);
- *CIT* v. *Pepsu Road Transport Corpn.* [2002] 253 ITR 303 / 121 Taxman 232 (P&H);
- *Anil Bulk Carriers (P.) Ltd.* v. *CIT* [2005] 276 ITR 625 / 142 Taxman 673 (All.).

The aforesaid case-laws present the following reasons for such interpretation—

The depreciation is admissible on 'trial run' of the plant or machinery."

a) Section 32 confers benefit on the assessee. The provision should be so interpreted and the words used therein should be assigned such meaning as would enable the assessee to secure the benefits intended to be given by the Legislature to the assessee. Therefore, the word 'used' as appearing in that section must be given a larger interpretation. The word 'used' must be taken to include the words 'ready for use' within its ambit.

b) The word 'used' is capable of wider as well as narrower interpretation. If the word 'used' is given narrower interpretation, then, it becomes necessary that asset must be actually used in the year in which depreciation thereon is sought to be claimed. However, it is well-settled law that where there are two possible interpretations of a taxing provision, the one which is favourable to the assessee should be preferred. Therefore, the word 'used' must be given wider interpretation so as to include, within its ambit, 'ready for use'.

c) The object of the Legislature in granting depreciation allowance under section 32 of the Act is to give due allowance to the assessee for wear and tear suffered by the assessee so that net income (total income) is duly arrived at. Since asset depreciates not only due to 'use' but also on account of 'wear and tear' or 'passage of time', the word 'used' must be interpreted in its widest sense.

d) There is normal depreciation in value of asset even when the assets are kept in store. Keeping in view such aspect, depreciation must be allowed even if the asset could not be actually used for the purposes of business or profession of the assessee.

e) There are some assets, which are always kept ready for use, such as 'spare engines' or 'standby equipments like a generator', but the occasion for actual use thereof may or may not arise. While such assets are meant for use, they are actually used only in case of need. Depreciation on such assets, kept 'ready for use', is allowable, keeping in view the needs and nature of the business.

WHETHER 'TRIAL RUN' BEFORE COMMERCIAL USE IS 'USED FOR THE PURPOSES OF BUSINESS OR PROFESSION'?

This issue came up for consideration before the respective High Courts in the following cases—

(a) V. Ramakrishna & Sons (P.) Ltd. v. *CIT* [1984] 149 ITR 554 / 16 Taxman 433 (Mad.);
(b) Asstt. CIT v. *Ashima Syntex Ltd.* [2001] 251 ITR 133 / [2002] 122 Taxman 230 (Guj.);
(c) CIT v. *Vindhyachal Distilleries (P.) Ltd.* [2005] 272 ITR 583 / 147 Taxman 127 (MP).

Depreciation is avail-able only on 'actual use' of the asset for the purposes of the business or profession of the assessee."

All the aforesaid case law clearly hold that 'trial run' comes within the ambit of the word 'used' and, therefore, the depreciation is admissible on the plant or machinery 'used' in 'trial run'. The reasons for such an interpretation are listed below—

a) The settled position in law is that it is not necessary that the machinery must be used for a particular number of days so as to entitle it to depreciation but it requires that it should be used for the purpose of business or profession. The trial run of the machinery is obviously for the purpose of business and not for any other purposes.

b) What is required to be seen is that the machinery must be 'used' for the purpose of the business and keeping in mind the wider meaning ascribed by various decisions of various courts to the term 'use', even trial production of machinery would fall within the ambit of the expression 'used for the purpose of business'.

c) Further, as the statute does not prescribe a minimum time-limit for 'use' of the machinery, the assessee cannot be denied the benefit of depreciation on the ground that the machinery was used for a very short duration for trial run.

d) There is a thin line between 'trial run' and 'actual production'/'commercial production'. There may be some cases wherein after commencement of the production, the machine may not give proper results - may be on account of failure of certain parts, may be on account of requirement of certain additional machinery, etc. In such a case, the production obtained at the initial stage would be considered as trial production. The law does not require that there must be optimum production for granting the benefit. Law only requires that there must be use of plant and machinery for the purpose of business. Whether the plant and machinery were used up to the extent of its efficiency is irrelevant for the purpose of deciding depreciation.

Thus, on the basis of the aforesaid arguments, the depreciation is held admissible on 'trial run' of the plant or machinery.

'USED' MEANS 'ACTUALLY USED' FOR THE PURPOSES OF BUSINESS OR PROFESSION

The another school of interpretation described the word 'used' to mean 'actually used' for the purposes of business or profession of the assessee. Hence, proponents of this view contend that depreciation is allowable only when the asset is actually used for the purposes of the business of the assessee. This view rejects the contention that 'used' includes 'ready for use' within its ambit. This view founds support from the following case-laws—

(a) B. Malani & Co. v. *CIT* [1993] 214 ITR 192 / [1995] 79 Taxman 398 (Bom.);
(b) CIT v. *J.K. Transport* [1998] 231 ITR 798 / 96 Taxman 152 (MP);
(c) Dineshkumar Gulabchand Agrawal v. *CIT* [2004] 267 ITR 768 / 141 Taxman 62 (Bom.).

A combined reading of the aforesaid judgments exhibits the following reasons in support of the view set out in such judgments—

(i) The word 'used', as appearing in section 32, cannot be given such a wide interpretation so as to allow depreciation on acquisition or installation of machinery. 'Used' is different from 'acquired' or 'installed'. If the intention of the Legislature was to give benefit of depreciation only on acquisition/installation of an asset without ensuring 'actual use' thereof, then, the Legislature would have used the words 'acquired/installed for the purposes of the business of the assessee' instead of the words 'used for the purposes of the business of the assessee'. Thus, depreciation is available only on 'actual use' of the asset for the purposes of the business or profession of the assessee.

(ii) The word 'used' is a word in past tense, *i.e.,* it denotes an action of 'use' in past. It denotes 'actually used in past' for the purpose of the business and not merely kept 'ready for use in future'. Thus, for being entitled to depreciation under section 32, the asset must have been actually used for the purposes of business or profession of the assessee.

Depreciation is allowable in the year of acquisition of the asset only if the asset is put to use in that year. If the asset is not put to use even for a single moment during the previous year in which it is acquired, no depreciation is allowable thereon."

(iii) The words 'used for the purposes of the business' obviously mean used for the purpose of enabling the owner to carry on the business and earn profits in the business. In other words, the machinery or plant must be used for the purpose of that business, which is actually carried on and the profits of which are assessable under section 28. In order to attract the operation of section 32, the machinery and plant must be such as were used, in whatever sense that word is taken, at least for a part of the accounting year. If the machinery and plant have not at all been used at any time during the accounting year, no allowance can be claimed under section 32 in respect of them.

The basic concept underlying depreciation allowance is that depreciation should result as a consequence of the machinery being actually used or employed in the earning of income. That being so, it is not material whether or not the machinery is kept ready for use so long as it is not actually used in the earning of income. Thus, the wider interpretation of the word ‘used’ is unacceptable.

NO DEPRECIATION IF BUSINESS REMAINS CLOSED - In *CIT* v. *Udaipur Mineral Development Syndicate (P.) Ltd.* [2004] 269 ITR 263 (Raj.) the Rajasthan High Court had an occasion to deal with a case where the assessee was claiming depreciation on assets even when his business had remained closed during whole of the previous year. The Hon’ble High Court denied depreciation claim of the assessee, holding that - ‘Depreciation is permissible only in cases where the machinery has been actually used for production. When the machinery in question was not put to use in the year under consideration even for a day and the business remained closed, there is no justification to allow the depreciation on such machinery. The Tribunal had committed an error in allowing the depreciation on machinery which has not been used even for a day in the previous relevant year in question.’

DISMISSAL OF SLP BY THE SUPREME COURT - In *Dinesh Kumar Gulab Chand Agrawal’s* case (*supra*), the Bombay High Court had held that the word ‘used’ means ‘actually used’ for the purposes of the business of the assessee and not merely ‘ready for use’ and had, therefore, denied depreciation to the assessee on vehicles kept ‘ready for use’. Against such judgment the assessee preferred a petition for special leave to appeal (SLP) before the Supreme Court. The Supreme Court has dismissed such petition, as reported in [2004] 266 ITR (St.) 106.

No doubt, the denial of SLP by the Supreme Court does not necessarily mean approval of the ratio set out in the judgment against which such SLP was preferred, but it certainly means that the Supreme Court was not inclined to interfere in circumstances of that case. This will certainly give rise to another spate of litigation.

RECONCILIATION OF THE DIFFERING VIEWS

The decisions rendered hereinbefore give rise to two contradictory views for the interpretation of the words ‘used’ as appearing in section 32. In fact, the decisions are not so contrary to each other that they cannot be reconciled. They simply reflect differing opinions of the High Court’s expressed in the facts and circumstances of the case, which had come up for consideration before them. Such differing views are capable of reconciliation in the following manner—

There is no question of allowability of depreciation of asset in the year of its acquisition until it is put to use at least for a single day."

(a) *No depreciation on an asset not ‘available for use’* - An asset that was acquired during the previous year but could not be made available for use in that year, cannot be eligible for depreciation. Even if the word ‘used’ is understood to mean ‘ready for use’, then also, an asset which was not available for use cannot become eligible for depreciation. The expression ‘ready for use’ predicates ‘availability for use’ and if an asset was not available for use, how can it be termed as ‘ready for use’. For example, an assessee in Gujarat acquires machinery on March 29, 2006 from a trader in Rajasthan. The trader in Rajasthan dispatches the machinery on that date and same is received in Gujarat by the assessee only on April 1, 2006. In that case, the machinery was not available for use until April 1, 2006. Thus, the machinery cannot be termed even as ‘ready for use’, so far as the previous year 2005-06 is concerned. Hence, in this case, no depreciation would be allowable to the assessee for the assessment year 2006-07.

(b) *No depreciation in the year of acquisition of asset until it is put to use* - Even if the asset was available for use in the year of its acquisition, no depreciation can be allowable thereon until it is put to use in that year itself. That means, depreciation is allowable in the year of acquisition of the asset only if the asset is put to use in that year. If the asset is not put to use even for a single moment during the previous year in which it is acquired, no depreciation is allowable thereon.

This view gets its support from the second proviso to section 32(1), which provides that if an asset is acquired by the assessee during the previous year and is put to use for the purposes of business or profession for a period of less than 180 days then, deduction under section 32 shall be restricted to 50 per cent of the normal depreciation calculated at the prescribed rate.

The above proviso clearly reveals that the material factor for allowability of depreciation is not the acquisition/installation of asset, but the factor is 'use' of the asset.

Thus, there is no question of allowability of depreciation of asset in the year of its acquisition until it is put to use at least for a single day.

Law does not mandate optimum use of the asset. It requires 'actual use' of the asset. Thus, even if the machinery is used for 'trial run', depreciation is admissible thereon

(c) *No depreciation in subsequent years if asset/block of assets not used at all during the previous year* - So far as the years subsequent to the year of the acquisition of the asset are concerned, no depreciation can be allowed in a previous year if the 'asset' or the 'block of assets' was not actually used even for a single day in that previous year. That means, in subsequent years also, 'actual use', at least for a single day during the relevant previous year, is necessary for allowability of depreciation.

The only difference in subsequent years from the treatment in first year of acquisition is emphasis on use of 'block of assets' instead of the 'asset'. While an asset maintains its separate identity from the 'block of assets' in the year in which such asset is acquired, it loses such identity when it becomes the part of block of assets. Thus, in subsequent years, 'use' must be understood as 'use of the block of assets'. Therefore, depreciation is deniable in subsequent years if the block of assets, as a whole, is not used for the purposes of the business or profession during the previous year.

The aforesaid view finds support from rule 5(1) of the Income-tax Rules, 1962, which is reproduced hereinbelow—

"*Depreciation.*—(1) Subject to the provisions of sub-rule (2), the allowance under clause (*ii*) of sub-section (1) of section 32 in respect of depreciation of any block of assets shall be calculated at the percentages specified in the second column of the Table in Appendix I to these rules on the written down value of such block of assets as are used for the purposes of the business or profession of the assessee at any time during the previous year."

Rule 5(1) takes care of the fact that depreciation is allowed at prescribed percentages only on the written down value of such block of assets as are used for the purposes of the business or profession of the assessee at any time during the previous year. Thus, the use of the block of assets for at least a single moment during the previous year is pre-requisite for allowability of depreciation in that previous year.

Thus, if the business remains closed during the whole of the previous year, then, the block of assets cannot be said to be 'actually used' at any time during the previous year. Therefore, no depreciation can be allowed thereon, as was held by the Rajasthan High Court in *Udaipur Mineral Development Syndicate (P.) Ltd.'s* case (*supra*).
In respect of assets on which depreciation is admissible under section 32(1) (*i*) at prescribed percentage of actual cost thereof (*i.e.,* Straight Line Method), the requirement of 'used at any time during the previous year' shall apply to each asset because each asset maintains its separate identity. The same is evident from the wording used in rule 5(1A), which is also reproduced hereinbelow—

"(1A) The allowance under clause (*i*) of sub-section (1) of section 32 of the Act in respect of depreciation of assets acquired on or after 1st day of April, 1997 shall be calculated at the percentage specified in the second column of the Table in Appendix 1A of these rules on the actual cost thereof to the assessee as are used for the purpose of the business of the assessee at any time during the previous year."

(d) *Depreciation allowable on 'Trial Run', as 'trial run' is 'use'* - For the reasons set out in the judgments referred to in para 3 of this article, it can be safely concluded that law does not mandate optimum use of the asset. It requires 'actual use' of the asset. Thus, even if the machinery is used for 'trial run', it is 'actually used for the purposes of the business of the assessee' and thus, depreciation is admissible thereon.

(e) *Depreciation allowable on spare engines/standby equipments* - Spare engines or standby equipments kept 'ready for use in case of need', can be said to be 'actually used for the purposes of the business or profession of the assessee' in the sense that such spare engines/standby equipments are required for efficient conduct of the business of the assessee.

The specific nature of the business of certain assessees requires them to keep some engines or equipments as spare or as standby for use in case of need. When an asset is devoted to the needs of the business, it is actually used for the needs of the business. Thus, depreciation cannot be denied thereon.

CONCLUSION

Thus, for allowability of depreciation under section 32, it is imperative that the asset must have been actually used for the purposes of the business or profession of the assessee at any time during the relevant previous year. If the asset was not at all used for the business/profession of the assessee during the year under consideration, no depreciation is allowable thereon. The accounting treatment or treatment under Company Law cannot override provisions of a taxing statute. The allowability of depreciation on account of 'wear and tear' or 'passage of time' may be justified for accounting purposes, but the same does not hold good for the purposes of a taxing statute. The requirements of law are to be complied with *in toto* and there can be no excuse for the same.

DEPRECIATION AS PER ICDS V (NEW) ISSUED BY CBDT

- Depreciation to be calculated as per the provisions of the Income Tax Act, 1961
- Disclosure to made in respect of when the asset is put to use

INTERPRETATION AS PER ACCOUNING STANDARD 10- ISSUED BY ICAI AND NOTIFIED BY MCA

AS 10- Property, Plant and Equipment- As per Para 57 in Page 14-

"Depreciation of an asset begins when it is **available for use**, *i.e.*, when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Depreciation of an asset ceases at the earlier of the date that the asset is retired from active use and is held for disposal and the date that the asset is derecognised. Therefore, depreciation does not cease when the asset becomes idle or is retired from active use (but not held for disposal) unless the asset is fully depreciated.

INTERPRETATION AS PER COMPANIES ACT, 2013

Schedule II
(*See* section 123)
USEFUL LIVES TO COMPUTE DEPRECIATION
PART 'A'

Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life. The depreciable amount of an asset is the cost of an asset or other amount substituted for cost, less its residual value. **The useful life of an asset is the period over which an asset is expected to be available for use** by an entity, or the number of production or similar units expected to be obtained from the asset by the entity.

Declaration of dividend

123.

(2) For the purposes of clause (a) of sub-section (1), depreciation shall be provided in accordance with the provisions of Schedule II.