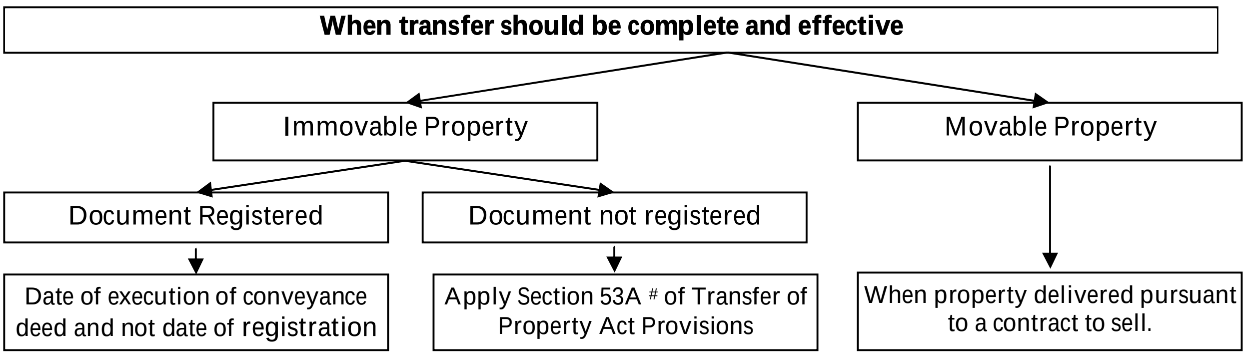
Depreciation - Related Issues

1.1 Section 32: Depreciation allowance

- ❖ Portion of that cost of a fixed asset which **is allocated** to a particular accounting year is called depreciation. The main intention to provide depreciation allowance is to provide a fund which equals the value of the asset which has depreciated by normal wear and tear.
- ❖ An asset (movable or immovable) must be **owned by the assessee** and **used for** the purpose of business or profession. It is not necessary that assessee should be a registered owner. Full control of an asset, exclusive possession right is the relevant factor.
- ❖ To arrive at true profit or correct income it is mandatory that depreciation has to be provided in books
- ❖ An asset should be used during the relevant previous year. Depreciation **commences once it is put to use**. It is not necessary that an asset should be used throughout the previous year.
- ❖ When an asset is acquired and put to use **for less than 180 days** during the relevant previous year, then 50% of the eligible depreciation is allowed as deduction. This restriction applies **only to the year of acquisition** and not for the subsequent years.
- ❖ The owner is a person who is entitled to receive income from the property in his own right. Owner includes the beneficial owner to claim depreciation.
- ❖ Depreciation is available on tangible and intangible asset. Here tangible asset includes Plant, Machinery, Building (except land) and Furniture. Intangible asset includes ***Know-how, patents, copyright, licenses, any other business or commercial rights.***
- ❖ Written down value method is used to claim depreciation allowance. **Note**: Straight line method in case of power generation or distribution.
- ❖ Depreciation is calculated on actual cost, hence revaluation of asset is not considered for deprecation.



\# **Section 53A of Transfer of Property Act:-**

(i) There should be a contract in writing.

(ii) The transferee has taken possession of property.

(iii) The transferee has paid consideration or willing to perform his obligation. Entries in the books of accounts are not relevant consideration to determine transfer.

- ❖ The assessee is a non-banking finance company engaged in the business of leasing and hire purchase. Section 32 imposes a twin requirement of **"ownership" and "usage for business"** as conditions for claim of depreciation there under. The term usage refers the asset must be used in the course of business. It does not mandate actual usage by the assessee itself. Lessor would be the owner of the asset in the eyes of law, if the assessee is the exclusive owner of the vehicle at all points of time **(and)** the assessee is empowered to repossess the vehicle, in case the lessee committed a default **(and)** at the end of the lease period, the lessee was obliged to return the vehicle to the assessee **(and)** the assessee had a right of inspection of the vehicle at all times. It can be seen that the proof of ownership lies in the lease agreement itself, which clearly points in favour of the assessee. The assessee was entitled to claim depreciation in respect of vehicles leased out since it has satisfied both the requirements of section 32. **{(In re I.C.D.S. Ltd.)(2013)(SC)}**
- ❖ Expenses incurred on acquisition of software should be treated as revenue expenditure because the advancement in the area of software is enormous and software becomes obsolete in matter of days. **{(In re**

Citicorp overseas software ltd)(2004)(Mum)}

- Section 32(1)(ii) allows depreciation on "business or commercial rights". The expression "business or commercial rights" means rights obtained for effectively carrying on business or commerce. Commerce is a wider term which encompasses business in its fold. Therefore, any right which is obtained for carrying on business effectively and profitably has to fall within the meaning of the term "intangible asset" eligible for depreciation. **{In re Tirumala Music Centre (P) Ltd (2013)(ITAT)**
- The expression "used for the purpose of business" is mandatory for claim of depreciation. The Court held that so long as the business was a going one and the machinery got ready for use but could not be put to use due to certain extraneous circumstances, depreciation u/s 32 would be allowable. **{(In re Chennai Petroleum Corporation Ltd.)(2013)(Mad)}**

1.2 Section 2(11): Block of assets

- Block of assets includes **a group of assets falling within a class of assets** comprising tangible and intangible assets in respect of which rate of depreciation percentage is prescribed.
- **Rule 5 of Income tax Rules, 1962 : Rate of depreciation**

Block Number	Nature of an asset		Rate of Depreciation
I	**Building**		
	(i)	Residential building other than hotel and boarding house.	5%
	(ii)	Office, factory, godowns and building not for residential use	10%
	(iii)	Temporary erection	100%
II	**Furniture**		
	(i)	Furniture including electrical fitting	10%
III	**Plant and machinery**		
	(i)	Ocean going ship, vessels, speed boat	20%
	(ii)	Computer including computer software, printers, UPS etc.	60%
	(iii)	Air/water pollution control equipment	100%
	(iv)	Buses, lorries used in business and running them on hire.	30%
	(v)	Any plant and machinery used other than for commercial use.	15%
	(vi)	Wind mills and special devices installed before 01.04.2014	15%
Noti. No. 43/2014		*Wind mills and special devices installed* ***on or after 01.04.2014***	*80%*
	(vii)	Aero planes, aero engines	40%
	(viii)	Books owned by assessee carrying on profession in respect of annual subscription 100% and others	60%
	(ix)	Books owned by assessee on business of lending libraries	100%
	(x)	Energy saving devices	80%
	(xi)	Motor cars other than those used in a business of running them on hire, acquired or put to use on or after 01.04.1990	15%
		Annual publication owned by assessees carrying on profession	100%
IV	**Intangible assets**		
	(i)	Know-how, patents, copyright, licenses, **any other business or commercial rights**	25%

- Depreciation is mandatory to claim. If assessee fails to claim depreciation, assessing officer is duty bound to consider the depreciation to arrive at the assessed income.
- The second hand machinery purchased from outside India by the assessee is for use as spare parts for the existing old machinery, the same had to be allowed as revenue expenditure**.** For determining year of accounting due consideration is given on transfer of ownership of an asset. Since the entire sale consideration was paid on 31st March of the relevant previous year and the machinery was also dispatched by the vendor from USA, the sale transaction was complete on that date, though the goods reached India only in August next year**.{(In re Dr. Aswath N. Rao)(2010)(Kar)}**
- Section 32 when used with respect to discarded machinery would mean the use in the business, not in the

relevant previous year, but in the earlier previous years. The discarded machinery may not be actually used in the relevant previous year but depreciation can be claimed as long as it was used for the purposes of business in the earlier years provided the block continues to exist in the relevant previous year.**{(In re Yamaha Motor India Pvt. Ltd)(2010)(Del)}**

- ❖ EPABX and mobile phones are treated as communication equipment and not as computers hence higher depreciation at 60%is not available.**{(In re Federal Bank Ltd)(2011)(Ker)}**
- ❖ Depreciation is allowable on both tangible and intangible assets. Goodwill is paid for acquiring a business and commercial right and it was comparable with trade mark, franchise, copyright etc. hence depreciation is available. **{(In re B. Raveendran Pillai)(2011)(Ker)}**
- 🕮 ❖ The use of the general words after the specified intangible assets such as ***Know-how, patents, copyright, licenses*** 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. Specified intangible assets (goodwill) acquired under the slump sale agreement by the assessee are in the nature of intangible asset under the category "***other business or commercial rights of similar nature"*** specified in section 32(1)(ii) and are accordingly good will eligible for depreciation.**{(In re Areva T and D India Ltd.)(2012)(Del)}**
- 🕮 ❖ In the process of amalgamation, the amalgamated company had acquired a capital right in the form of goodwill because of which the market worth of the amalgamated company stood increased. It was held that 'Goodwill' is an asset under "***other business or commercial rights of similar nature"*** and depreciation is allowable.**{(In re Smifs Securities Ltd.)(2012)(SC)}**
- 🕮 ❖ Abkari licence is a business right given to the party to carry on liquor trade by Govt. such licence is eligible for depreciation.**{(In re S. Ambika)(2011)(ker)}**
- 🕮 ❖ Where an assessee is declared owner of property by Civil Court, transfer did not require registration. Accordingly. Assessee should be entitled to depreciation.
- 🕮 ❖ The assessee owned two units located in different places with separate staff, management, funds and accounts. The assessee decided to hive-off one unit by forming a subsidiary company. The assessee when sold an undertaking to its subsidiary company formed for the purpose, it is a case of succession and not an outright sale. The transferor company and the transferee company can claim depreciation in terms of the fifth proviso to section 32(1) and the proviso is meant to limit the total allowance of depreciation claim in the ratio of the number of days, the assets were used by the predecessor and the successor company. **{In re Sree Jayajothi & Co Ltd (2013)(Mad)}**

1.3 Section 43(1): Actual cost of depreciable asset

(i)	The actual cost incurred by the assessee for acquiring asset	XXX
(ii)	**Less**: The proportion of cost met by any person or authority(ex: Govt. cash subsidy)	(XX)
(iii)	Actual cost of depreciable asset	XXX

Explanation to section 43(1): Actual cost in specified cases

Expl.	Situation	Notional actual cost
1	An asset previously used in scientific research	Actual cost **less** deduction u/s 35
2	Acquired by gift or inheritance	Actual cost of previous owner **less** depreciation allowed/ allowable to that owner.
3	Asset acquired at higher than Fair Market Value to claim higher depreciation and reduce tax	Actual cost as determined by assessing officer with prior approval of Joint Commissioner.
4	Reacquisition of an asset previously used and transferred by the assessee.	Written down value in the hands of transferor (or) amount paid to reacquire asset, **whichever is lower**.
4A	Sale and lease back transaction	Written down value in the hands of **transferor at the time** of transfer.

5	Self acquired building converted into business purpose.	The cost of purchase or construction – deemed depreciation by applying section 32 provision as if building used in business from the date of purchase or construction.
6	Assets mutual transfer between holding company and wholly owned subsidiary company.	Written down value to the transferor company (Transferee company should be an Indian company)
7, 7A	Transfer in the scheme of amalgamation/ demerger	Written down value of amalgamating or demerged company
8	Interest pertaining to post-acquisition period	Interest up to asset put to use is form part of actual cost.
9	Actual cost of CENVAT claimed asset	Actual cost less duty of excise for which credit of Cenvat has been taken
10	Portion of acquired asset met by some other person	Actual cost less cost met by some other person
11	Asset bought into India by a non-resident	Actual cost of an asset less notional depreciation of holding period of an asset outside India.
12	Asset acquired by a company under a scheme for corporatization of recognised stock in India	Notional actual cost had there been no such corporatization
13	Specified business asset u/s 35AD transferred u/s 47	Actual cost of such asset to transferee company shall be taken as NIL.

- **Explanation 10 to section 43(1)** covers only a case of **subsidy, grant or reimbursement** but not a case of waiver of loan. The term actual cost u/s 43(1) refers the actual cost of the assets to the assessee, as reduced by that portion of the cost, if any, as has been met directly or indirectly by any other person or authority. Waiver of loan given to the assessee by the Government of India from Steel Development Fund (SDF) to meet the capital cost of asset is reduced to arrive at the actual cost as per section 43(1) for computing depreciation u/s 32. **{(In re Steel Authority of India Ltd)(2012)(Del)}**
- The manner of repayment of loan cannot affect the cost of the assets acquired by the assessee. If the loan is not repaid it will not reduce actual cost. But if the loan is specifically waived then it may dilute actual cost. **{(In re Cochin Co. P. Ltd)(1990)(ker)}**
- A gas cylinder attached to the body of a truck continues to be a gas cylinder and is accordingly entitled to depreciation. **{(In re H.B. Leasing & Finance Ltd (2014)(Del)}**
- Depreciation is allowable at the rate of 60% on the printers, Ups and computer peripherals. **{(In re CNB Finwiz Ltd (2014)(ITAT)}**

1.4 Section 43A: Change in rate of exchange of currency

- Applicable when assets acquired from a country outside India through a loan in foreign currency or foreign supplier's credit.
- Foreign exchange adjustment is made only in the previous year in which actual payment is made to the foreign supplier or repay the foreign currency loan.
- The adjustment shall be made to the actual cost of asset as defined u/s 43(1); or capital expenditure referred in section 35(1)(iv); or cost of acquisition as per section 48 except section 50.
- The increase/decrease in liability at the time of payment has to be adjusted from actual cost of the asset. {Actual cost less depreciation allowed till date}

1.5 Section 43(6): written down value of depreciable asset

(i)	Block value as on the first day of previous year	XXX
(ii)	**Add**: Actual cost of asset acquired during the previous year	XXX
(iii)	**Less**: Asset sold (money received or receivable)	(XX)

(iv) Block value as on the last day of previous year (restricted to either zero or positive value) XXX

- The term asset sold indicates actual money in terms of cash, cheque, draft realised and not any other mode or benefit which can be converted into money.
- **No depreciation is admissible when**
  - (i) The written down value of block of asset is reduced to zero though the block of assets exist on the last day of previous year.(value zero due to claim of full depreciation in the PY **(or)**
  - (ii) If block of assets ceases to exist on last day of previous year **(or)**
  - (iii) If the entire block have been transferred and the block of asset is empty on the last day of PY.
  - ➔ **Provision Illustration:** Opening WDV on 01.04.2014 ` 400,000 consist of asset A. Asset acquired during the year ` 650,000. Assets sold during the year ` 15,50,000.

    The block of asset **ceases to exist** on the last day of the PY, **hence no depreciation is admissible**. {(` 400,000 + ` 650,000) - (` 10,50,000)}. Even asset sold at ` 15,50,000, restricted to opening WDV+ acquisition cost). The difference between ` 15,50,000 – ` 10,50,000 is treated as short term capital gain u/s 50.
  - ➔ **Provision Illustration:** opening WDV 01.04.2014 ` 400,000 consist of asset A & B. Asset C acquired during the year ` 650,000. An asset A is sold during the year ` 15,50,000.

    The WDV of block of asset is reduced to zero through the block of assets exist on the last day of previous year due to the **block of asset is empty** on the last day of PY, hence no depreciation is admissible. {(` 400,000 + ` 650,000) - (` 10,50,000)}. Even asset sold at ` 15,50,000, restricted to opening WDV+ acquisition cost). The difference between ` 15,50,000 – ` 10,50,000 is treated as short term capital gain u/s 50.
  - ➔ **Provision Illustration:** opening WDV 01.04.2014 ` 400,000 consist of asset A & B. Asset C acquired during the year ` 650,000. The entire block of asset destroyed by fire and received insurance compensation ` 245,000 only.

    The block of asset **ceases to exist** on the last day of the PY, **hence no depreciation is admissible**. {(` 400,000 + ` 650,000) - (` 2,45,000)}. No depreciation is available even balance is positive because of block of asset cease to exist. The difference between ` 2,45,000 – ` 10,50,000 is treated as short term capital loss u/s 50. As per section 45(1A) the capital gain is taxable in the year of receipt of insurance compensation.
- **Depreciation in case change of ownership**
  - ✓ Find out the amount of depreciation for the whole year assuming no such amalgamation, succession or demerger taken place.
  - ✓ Amount of depreciation shall be apportioned between amalgamating and amalgamated company in the ratio of number of days the assets are used.
- The written down value of the asset falling within that block of assets at the beginning of the previous year u/s 43(6) has to be adjusted by the amount for which the asset is actually sold. But fair market value is considered in case of scrap of an asset. **{(In re Cable Corporation of India Ltd.)(2011)(Bom)}**
- Where once asset was part of block of asset and depreciation was granted on the block, it cannot be denied in subsequent year on ground that one of asset was not used by assessee in some of the years; user of assets has to apply upon block as a whole instead of an individual asset. **{(In re unitex products ltd)(2008)(Mum)}**

1.6 32(1) (iia): Additional depreciation – An overview

- Conditions to be satisfied.
  - (i) Eligible assessee:
    - ➔ Assessee engaged in manufacture or production of any article or thing; (or)
    - ➔ Assessee engaged in the business of generation (or) generation and distribution of power.
  - (ii) New plant and machinery (other than ships and aircraft) should be **acquired and installed** on or after 01.04.2005 and exclusively used for the purpose of business.
  - (iii) Additional depreciation shall be available at **20% of actual cost** of new plant and machinery

acquired and installed on or after 01.04.2005

(iv) Additional depreciation only in the **year of an asset put to use** in the factory. (i.e. if plant such as air conditioner is installed and put to use in office, not eligible for additional depreciation.)

(v) Additional depreciation **is not allowed** in respect of second hand machinery & office appliances.

(v) When an asset is put to use for less than 180 days, then 50% of the eligible additional depreciation is allowed as deduction.

(vi) If plant and machinery is eligible for 100% depreciation in the first year of put to use, then no additional depreciation is eligible on such asset. **Ex**: air pollution control equipment.

- ❖ In order to claim the benefit of additional depreciation u/s 32(1) (iia), what is required to be satisfied is that the **new** plant or machinery should have been **acquired and installed after** March 31, 2005. Assessee manufacturing textile goods eligible for additional depreciation on the setting up of wind mills for generation of power. The provision does not state that the setting up of a new machinery or plant should have any operational connectivity to the article or thing that is already being manufactured by the assessee.

1.7 Unabsorbed depreciation – An overview

- ❖ Section 32 depreciation allowance is allowed as deduction during the relevant previous year.
- ❖ In case of inadequacy of profit, remaining balance of depreciation allowance is deductible from other heads of income except salary head for the same assessment year.
- ❖ The balance still remain, shall be carried forward for unlimited period to the subsequent assessment year by the same assessee.
- ❖ In subsequent year it shall be set off under other heads of income except salary head by following the order of priority; **(a)** current year depreciation; **(b)** brought forward business loss; **(c)** unabsorbed depreciation.
- ❖ Continuity of business is not relevant factor for carry forward and set off.

1.8 Section 32AC: Investment in new Plant and Machinery (Amended - Fin. Act, 2014)

- ❖ **A company engaged** in the business of manufacture or production of any article or thing (**and)**
- ❖ New plant or machinery **acquired and installed on or after 01.04.0213 but before 01.04.2015 (and)** invest a sum of more than ` 100 crore in this period.
- ❖ *New plant or machinery **acquired and installed on or after 01.04.2015 but before 01.04.2017 (and)** invest a sum of more than ` 25 crore **for any assessment year. (Fin. Act, 2014 w.e.f. 01.04.2015)***
- ❖ An investment allowance at **15% of the aggregate amount of actual cost** of investment during this period is allowed as deduction.
- ❖ The investment allowance of 15% is **in addition to** the depreciation and additional depreciation allowable u/s 32(1). Further the investment allowance would **not be reduced** to arrive at the written down value of new plant and machinery.
- ❖ "New Plant and machinery" **does not include**
  - (a) Any plant and machinery which before its installation by the assessee **was used** either within or outside India by any other person
  - (b) Any plant or machinery **installed in** any office premises or any residential accommodation including accommodation in the nature of a guest house.
  - (c) Any **office appliances** including computer or computer software
  - (d) Any vehicle or ship or aircraft
  - (e) Any plant or machinery, the whole of **actual cost** of which is allowed as deduction in computing the income chargeable under the head "PGBP" of any previous year.
- ❖ If the new asset acquired and installed is **sold or transferred**, except by amalgamation or demerger, **within a period 5 years** from the date of installation, the amount of deduction shall be deemed to be the income of the assessee under the head "PGBP".
- ❖ In case of amalgamation or demerger, **benefit of amortization** is allowed to amalgamated or resulting company for the remaining period.