

# A BRIEF ANALYSIS OF DEPRECIATION IN THE CONTEXT OF TAXATION

Dinesh Goyal,  
Lecturer in Commerce,  
COMMERCE

GSSS KAWI , PANIPAT, INDIA

**Abstract:** Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.<sup>1</sup> There are different method of calculation of depreciation under financial accounting .The methods commonly used are:(a) Straight line method(b) written down value method. The system of claiming depreciation (Section 32(1)(ii)) under income tax act is quite different from financial accounting. Depreciation provision shall apply , whether or not the assessee has claim the deduction in respect of depreciation in computing his total income. This paper will show the analysis of Depreciation in the context of income tax.

**IndexTerms** - Depreciation, lessor, Straight line, written down

**1.Introduction:-** Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life. There are different method of calculation of depreciation under financial accounting .The methods commonly used are:(2)Straight line method(b) written down value method. The system of claiming depreciation (Section 32(1)(ii)) under income tax act is quite different from financial accounting. Depreciation provision shall apply , whether or not the assessee has claim the deduction in respect of depreciation in computing his total income.

**2.General principal regarding depreciation under the income tax act:-** 1. Depreciation available on assets and block of assets. "assets shall mean (i) building, machinery plant or furniture, being tangible assets; (ii) knowhow, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature, being intangible assets , owned wholly or partly by the assessee and used for the purposes of the business or profession. Depreciation shall be allowed on written down value of the block of assets at the prescribed percentage. Block of assets means a group of assets falling within class of assets comprising of : (a) Tangible assets, being building, machinery plant or furniture (b) Intangible assets knowhow, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature In respect of which the same percentage of depreciation is prescribed. 2. Depreciation is allowed only to the owner of asset, however, registered ownership is not necessary .In case of lease ,lessee is entitled to claim depreciation on any superstructure constructed by him on land taken on lease or renovation/extension/improvement of building. Irrespective of accounting treatment prescribed in accounting standard the lessor shall be entitled to claim depreciation a leased asset whether the lease is an operating lease or a financial lease .in case of hire purchase the depreciation on the asset is claimed by the hire purchaser. depreciation on asset partially owned by the assessee shall be allowed to him to the extent of his share in asset. 3. Depreciation can be claimed in respect of any asset only if it is used for the purpose of business o profession.in case only part of asset is used for business or profession depreciation shall be allowed only for that part which is used for the purpose of business or profession. 4. In order to claim depreciation it is mandatory that the asset must be in use during the previous year irrespective of the degree of utilization. If an asset is purchase by the assessee during the previous year and same is put to use for the less than 180 days during the previous year then depreciation will be limited to 50% of the depreciation allowable on such asset as per the rate prescribed in rule 5(1). use for 180 days or more there shall be no such restriction ,depreciation will be allowed in full. The high court held that the rate of depreciation of 60% is available to computers and there is no ground to treat the communication equipment as computer. Hence EPABX and mobile phones are not computers and therefore are not entitled to higher depreciation 60%

**Example:-** Asset is purchased on 1-1-16 for 100000 depreciation is allowable @15% .asset is installed and put to use on 31-12-2016 Assessment year 2016-17.No depreciation shall be allowed since the asset is put to use on 3-12-2016 Assessment year 2017-18.Restriction of 50% applies only in the year in which asset is purchased or acquired.Therefore normal depreciation @15% shall be allowed.Hence depreciation on asset for assessment year 2017-18 15% of 100000=15000.It is mandatory for an assessee to claim depreciation under section 32.Depreciation shall be allowed to the assessee whether or not the assessee has claimed deduction in respect of depreciation in computing his total income .therefore in computing the profits and gains of business or profession for any previous year the deduction of depreciation under section 32 shall be mandatory.Depreciation is allowed when asset is actually put to use. Depreciation is not allowed if the asset is ready for use and is not put to actual use.*The High court confirmed the majority decision of tribunal holding that in this case, the machinery was entitled to depreciation since the business was a going concern and the machinery, being ready for use ,could not be actually put to use due to an extraneous reason namely, raw material paucity.The word "used" in this section(32) may be given a wider meaning and embrace passive as well as active use.*<sup>8</sup>Standby equipment and fire extinguishers can be capitalized if they are ready for use.However such passive use should also be for business purposes

**3.Additional Depreciation(32(1)(ia)):-**In the case of any new machinery or plant other than ships and aircraft which has been acquired and installed by the assessee engaged in the business of manufacture or production of any article or thing or on the business of generation ,transmission or distribution of power a further sum equal to 20% of the actual cost of such machinery or plant shall be allowed as deduction under section 32(1)(ii).Provided that where an assessee sets up an undertaking or enterprise for manufacture or production of any article or thing on or after the 1<sup>st</sup>day of April 2015 in any backward area notified by the central government in this behalf, in the state of Andhara Pradesh or in the state of Bihar or in the state of Telangana or in the state of west Bengal and acquires and installs any new machinery or plant (other than ships and aircraft) for the purpose of the said undertaking or enterprise during the period beginning on the 1<sup>st</sup> day of April 2015 and ending before the 1<sup>st</sup> day of April 2020 in the said backward area, then the provisions of clause (ia) shall have effect as if for the word twenty present the word thirty five percent had been substituted.Provided further that no deduction shall be allowed in respect of -(a)any machinery or plant which before installation by the assessee was used either within or outside india by any other person or (b) any machinery or plant installed in any office premises or any residential accommodation including accommodation in the nature of guest house or(c) any office appliances or road transport vehicles or(d) any machinery or plant the whole of the actual cost of which is allowed as a deduction (by way of depreciation or otherwise)in computing the income chargeable under the head profits and gains of business or profession of any one previous year.Provides also that where an assets referred to in clause (ia) or the first proviso to clause (ia) as the case may be is acquired by the assessee during the previous year and is put to use for the purpose of business for a period of less than 180 days in that previous year and the additional depreciation in respect of such asset is restricted to 50% of amount calculated at the percentage prescribed for an asset under clause (ia) for that previous year then the deduction for the balance 50% of the amount calculated at the percentage prescribed for such asset under clause (ia) shall be allowed in the immediately succeeding previous year in respect of such asset.

#### 4. Illustration:-

New machinery installed on 1-5-2016	84
New windmill purchased and installed on 18-6-2016	22
Item purchased after 30 November 2016	
Lorries for transporting goods to sales depot	3
Fork lift trucks used inside factory	4
Computers installed in office premises	1
Computer installed in factory	2
New imported machinery	12
The new imported machinery arrived an Chennai port on 30-3-2017 and was installed on 3-4-2-17	
All other item were installed during the year ended 31-3-2017.	

The company was newly started during the year. Calculation of depreciation available under section 32 of the income tax act 1961 in respect of plant and machinery purchased by company which is engaged in the manufacture of textile fabrics during the year ended 31-3-2017

1	Block 1 (Plant and Machinery@15%)		
	Used for 180 days or more		
	New machinery	84	
	Normal depreciation @15%		12.6
	Additional depreciation @20%		16.8
	Used for less than 180 days		
	Lorries for transporting goods to sale depot	3	
	Fork lift trucks	4	
	total	7	
	Normal depreciation @15%		0.525
	Additional depreciation @20%		0.4
	Total allowable depreciation		30.325
	WDV excluding machinery of 12 installed on 3-4-17		60.675
2	Block 2 (Computers @60%)		
	Used for 180 days or more	-	
	Used for less than 180 days		
	Computer installed in office premises	1	
	Computer installed in factory	2	
	Total	3	
	Normal depreciation @30%		0.9
	Additional depreciation @10% on computer installed in factory		0.2
	Total depreciation		1.1
	WDV ON 31-3-17		1.9
3	Block 3 (Plant and machinery@80%)		
	Used for 180 days or more		
	Windmill purchased and installed on 18-6-2016	22	
	Used for less than 180 days	-	
	Normal depreciation @80%		17.6
	Additional depreciation @ 20%		4.4
			22
	WDV of the block as on 31-3-17		NIL

Determination of Actual cost in special cases:-

Explanation to sec 43 (1)	Mode of acquisition	Actual cost
1	Assets acquired for scientific research subsequently brought in to business use	Actual cost less deduction availed under section 35

2	Assets acquired by way of gift or inheritance	Actual cost to the previous owner minus depreciation actually to him
3	Assets acquired at higher price from any other person using the asset for his business or profession with a view to claim depreciation on enhanced cost and reduce tax liability	Actual cost to be determined by the assessing officer with prior approval of joint commissioner
4A	Assets acquired by an assessee from another person who had claimed depreciation on such asset and the asset is leased back to such other person	The written down value of the asset to transferor at the time of transfer to the assessee .
5	Building used for private purpose subsequently brought in to business use	The cost of purchase or construction of the building as reduced by the notional depreciation calculated up to the year of bringing the asset to business use at the depreciation rate applicable to that year
6 and 2 to section 43 (6)	Assets transferred by a holding company to its subsidiary co. or by subsidiary co. to its holding company if the following two conditions are satisfied (i) share of the subsidiary co. should be wholly owned by the holding co. or its nominees (ii) The transferee company should be an Indian company	WDV to the transferor company will be adopted as the actual cost to the transferee company
7 and Exp 2 to section 43 (6)	Transfer of assets in a scheme of amalgamation by amalgamating company to amalgamated company	WDV to amalgamating company will be adopted as the actual cost to the amalgamated company
7A	Assets transferred by a demerged company to the resulting Indian company	Actual cost shall be the WDV in the hands of the demerged company
8	Assets acquired out of borrowed fund	Interest on loan borrowed relating to period after the asset is first put to use shall never form part of actual cost

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