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NAAC ACCREDITED 'A' GRADE



Topic: Profit and Gains from Business and Profession

Course Title: CC 4.1 Ch

Paper: Taxation-1

Unit: 03(A)[Depreciation]

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PROFITS AND GAINS OF BUSINESS AND PROFESSION

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1. What is Depreciation?

Depreciation under the Income Tax Act is a deduction allowed for the decline in the real value of a tangible or intangible asset used by a taxpayer. The Income Tax Department uses the concept of depreciation for the purpose of writing off the cost of an asset over its useful life.

Depreciation is a mandatory deduction and the Act allows the deduction either under straight-line method or written down value (WDV) method. The act calculates the deduction for depreciation under the WDV method except for undertaking engaged in generation or generation and distribution of power. The Act also allows a deduction for additional depreciation in the year of purchase in certain circumstances.

2. Block of Assets u/s 2(11)- Concept

Depreciation is calculated on the WDV of a Block of assets. Block of assets is a group of assets falling within a class of assets comprising of:

- Tangible assets, being building, machinery, plant or furniture,
- Intangible assets, being know how, patents, copyrights, trade-marks, licenses, franchises or any other business or commercial rights of similar nature

3. Conditions for Claiming Depreciation

You can avail deduction for depreciation, only if it satisfies the following conditions.

1. The assets must be owned, wholly or partly, by the assessee.
2. They must be in use for the business or profession of the taxpayer during the previous year. If the assets are not used exclusively for the business, but for other purposes as well, depreciation allowable would be proportionate to the use of business purpose. The Income Tax Officer also has the right to determine the proportionate part of the depreciation under Section 38 of the Act.

If the assets are acquired during the previous year and put to use during the previous year for the assessee's business or profession for a period of less than 180 days, depreciation shall be restricted to 50% of the amount calculated at the prescribed rate.

3. Co-owners can claim depreciation to the extent of the value of the assets owned by each co-owner.
4. Depreciation cannot be claimed on the cost of land.
5. Depreciation is mandatory from A.Y. 2002-03 and shall be allowed or deemed to have been allowed as a deduction irrespective of a claim made by a taxpayer in the profit & loss account.

4. Written Down Value- Meaning

As per Section 32(1) of the IT Act depreciation should be computed at the prescribed percentage on the WDV of the asset, which in turn is calculated with reference to the actual cost of the assets. In the context of computing depreciation, it is important to understand the meaning of the term 'WDV' & 'Actual Cost'.

WDV under the Income Tax Act means:

1. Where the asset is acquired in the previous year, the actual cost of the asset shall be treated as WDV.
2. Where the asset is acquired in earlier year WDV shall be equal to the actual cost incurred less depreciation actually allowed under the Act.

5. Depreciation Allowed

- The allowance for depreciation is calculated under the WDV method except for undertaking engaged in generation or generation and distribution of power. In case of undertakings engaged in generation or generation and distribution of power, such undertaking has an option to claim depreciation on WDV method at the rates provided in New Appendix I – if such option is exercised before the due date of filing the return.

ADDITIONAL DEPRECIATION UNDER SECTION 32(1)(IIA)

Additional depreciation shall be allowed if following conditions are fulfilled by the assessee:

1. Additional depreciation is allowed only on new machinery or plant excluding ships and aircraft which has been purchased and installed after 31-03-2005
2. The assessee shall be engaged in the business of manufacturing and production of any article or thing (computers used for data processing in industrial premises are eligible for additional depreciation). From financial year 2016-17 additional depreciation is also allowed to assessee engaged in business of generation and distribution of power.
3. **Depreciation @ 20% of actual cost of assets is allowed as additional depreciation.**
4. If assessee is engaged in production or manufacturer of any article or thing on or after 1st Apr, 2015 in any notified backward area of Andhra Pradesh, Bihar, Telangana, West Bengal and acquires and installs any new machinery or plant during 1st April, 2015 to 31st March 2020 then additional depreciation is allowed at the rate of 35%.
5. However if the asset is put to use for less than 180 days then additional depreciation will be allowed at half of actual rate .
From financial year 2015-16, if additional depreciation is allowed in year of put to use at half of the rate, then remaining half depreciation is allowed in the succeeding year.
6. **Specific cases in which depreciation is not allowed**
 - Second hand plant and machinery – Plant and machinery which, before installation by assessee, was used whether inside and outside India by any person.
 - Any office appliance or road transport vehicle.
 - Any machinery or plant installed in any office premises or any residential accommodation, including accommodation in the nature of guest house

- Any plant and machinery, the whole of the actual cost of which is allowed as a deduction (whether by way of depreciation or otherwise) in computing income chargeable under the head “Profits and gains of business or profession” of any on previous year.

In respect of existing block of assets, if there are purchases or sales, the **written down value** shall be computed under the following steps:

Step-I: Find out the written down value of the block of assets as at the beginning of the relevant previous year

Step-II: Add: Actual cost of asset/assets falling within the block acquired during the year

Step-III: Deduct money payable in respect of any asset falling within that block, which is sold or discarded or demolished or destroyed during that previous year together with the amount of scrap value, if any

The balance (if positive) is the written down value of the block of assets at the end of the previous year on which depreciation for the current previous year shall be allowed at the prescribed rate.

- Written down value , short term capital gains or loss on transfer of depreciable assets-picture at a glance:*

Situation	Result
When Block exists:	
(i) Step-I+ Step-II+ cost of transfer > Step-III	Balance is WDV for the year
(ii) Step-I+ Step-II+ cost of transfer < Step-III	Balance is short term capital gains
When Block does not exist:	
(i) Step-I+ Step-II+ cost of transfer > Step-III	Balance is short term capital loss
(ii) Step-I+ Step-II+ cost of transfer < Step-III	Balance is short term capital gains

Practical Problem on Depreciation:1

From the following particulars, compute admissible depreciation and capital gain/loss for the previous year relevant to the assessment year 2020-21:

Written down value of Building A &B as on 1.04.2018(Depreciation rate 10%) Rs 2,50,000/-

Cost of Building C purchased on November,15,2019 (depreciation rate 10%) Rs 3,00,000/-.

- (i) If all buildings are (A,B&C) are sold for Rs 6,00,000/-
- (ii) If all Buildings (A&B) are sold for Rs5,00,000/-
- (iii) If all Buildings are sold for Rs 50,000/-

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Solution:

Particulars	CASE-I (Rs)	CASE-II(Rs)	CASE-III(Rs)
<u>Block of Assets comprising Building(Rate of Depreciation @10%)</u>			
WDV as on 1.4.2019	2,50,000	2,50,000	2,50,000
Add: Building C purchased on 15.11.2019	(+) <u>3,00,000</u>	(+) <u>3,00,000</u>	(+) <u>3,00,000</u>
	5,50,000	5,50,000	5,50,000
Less: Sale during the year	(-) <u>6,00,000</u>	(-) <u>5,00,000</u>	(-) <u>50,000</u>
Written down value as on 31.3.2020	Nil	50,000	5,00,000
Depreciation for the previous year[see note]	<u>Nil</u>	<u>2,500</u>	<u>35,000</u>
Short term capital gain	50,000	Nil	Nil
Short term capital loss	Nil	Nil	Nil

Note: In situation of CASE-II, the entire WDV consists of Building C , which is used for less than 180 days during the previous year. Hence, depreciation is charged at half the eligible rate, i.e 5%. In CASE-II, the written down value comprising the cost of the new building is charged @5%, while the excess of the new Building is charged at full rate i.e 10%.

Practical Problem: 2

CHEMCO LTD engaged to manufacture of chemicals and furnishes the following particulars relating to manufacturing unit at Haldia for the year ended on 31.3.2020.

	Rs
WDV of machinery on 01.04.2019	10,00,000/-
New machinery purchased on 01.08.2019	10,00,000/-
New machinery purchased on 01.01.2020	4,00,000/-

Machinery sold on 15.01.2020 1,00,000

All assets were put to use immediately, Rate of depreciation on machinery is 15%. Rate of additional depreciation is 20%.

Compute depreciation allowable to CHEMCO LTD and the WDV of block of assets as on 31.03.2020.

CU B.Com (Hons) -2019-Adapted

Computation of depreciation allowance allowable to Chemco Ltd for the year 2020-21

Particulars	Rs	Rs
WDV of machinery as on 1.4.2019	10,00,000/-	
Add: New machinery purchased on 01.08.2019	10,00,000/-	
Add: New machinery purchased on 01.01.2020	<u>4,00,000/-</u>	
Total	24,00,000/-	
Less: Sale Proceeds of machinery	<u>1,00,000/-</u>	
WDV of machinery as on 31.03.2020		<u>23,00,000/-</u>
Depreciation :		
On plants purchased on 01.01.2020 (being used for less than 180 days during the previous year):		
[Rs 4,00,000 × $\frac{15}{100} \times \frac{1}{2}$]	30,000/-	
On the balance Rs[23,00,000-4,00,000]@15%	<u>2,85,000/-</u>	3,15,000/-
Additional Depreciation:		
On Rs 10,00,000 @20%	2,00,000/-	
On Rs 4,00,000 @10% [half of the eligible rate as it is used for less than 180 days during the previous year]	<u>40,000/-</u>	<u>2,40,000/-</u>
Total depreciation		<u>5,55,000</u>