

Proposals on Depreciation

"The corporate income-tax rate, the surcharge thereon and the rates of depreciation are interlinked. Any reform would have to address all three elements. The international best practice is to provide for depreciation at rates that would enable the investor to replace the asset before its economic life ends. In India, in addition to the depreciation rates, an initial depreciation is allowed to encourage new investments. A number of profit making companies continue to pay low tax, even if well within the law, by taking advantage of liberal depreciation rates and of exemptions and incentives. Moreover, the current depreciation rates lean towards employing capital rather than labour." With these observations the Finance Minister has made significant changes in depreciation. There are wide ranging views about these changes. This article deals with these aspects.

— H Padamchand Khincha

Clause 8 of Finance Act, 2005 seeks to substitute the existing clause (iia) of section (1) of section 32 of the Income tax Act. Clause 8 reads as follows:

"in the case of any new machinery or plant (other than ships and aircraft) which has been acquired and installed after the 31st day of March 2005 by an assessee engaged in the business of manufacture or production of any article or thing, a further sum equal to twenty per cent of the actual cost of such machinery or plant shall be allowed as deduction under clause (ii)". (emphasis supplied)

Finance Minister's Speech (para 168) while presenting the Budget for the year 2005-06 has also emphasised the same. Para 168 reads as follows:

"As a further measure of relief, I propose to remove the requirement of 10 per cent increase in installed capacity for availing of the benefit of initial depreciation".

The clause provides for additional depreciation in case of

new machinery or plant (other than ships and aircraft) acquired and installed after the 31st March 2005. To claim benefit under this sub clause, the assessee should be engaged in the business of manufacture or production of any article or thing. The additional depreciation is equal to twenty per cent of the actual cost of machinery or plant acquired and installed. Further the clause mandates that the additional depreciation shall be allowed as deduction under clause (ii). The proviso provides that no deduction shall be allowed in respect of:

- (1) machinery or plant which is, before installation by assessee; used within or outside India by any other person;
- (2) machinery or plant installed in office premises or residential accommodation;
- (3) office appliances or road transport vehicles;
- (4) machinery or plant, where whole of actual cost is allowed as deduction from business income in any one previous year.

Earlier, first proviso to clause (iia) provided for some additional conditions to be fulfilled for claiming the benefit of additional depreciation. The additional depreciation was allowed to:

- (a) a new industrial undertaking being established during any previous year. Such undertaking should begin to manufacture or produce any article or thing on or after the 1st day of April 2002; or
- (b) an undertaking existing before 1st day of April 2002 and during any previous year. It achieves substantial expansion by way of increase in installed capacity by not less than twenty five per cent. Twenty five per cent was substituted by ten per cent by Finance Act, 2004 wef 01-04-2005.

However, these both conditions have been omitted in clause (8) of Finance Act, 2005. Thus, now an assessee can claim additional deduction even if there is no new industrial undertaking or substantial expansion. It is enough that assessee is engaged in the business of manufacture or production of article or thing. Thus, if an assessee

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purchases plant or machinery for his existing business, he can claim the additional depreciation under clause (iiia).

Some issues/points that arise from the proposed amendment are as follows:

- 1.1 The amendment applies to new plant and machinery. The proviso to the section states that second hand imported machinery will not be regarded as new plant and machinery. This is unlike what is provided for in many other sections.
- 1.2 In the earlier section, it had been provided that an industrial undertaking established by reconstruction or splitting up of an existing undertaking would not be eligible for additional depreciation. Such restrictions have not been incorporated in the new provisions. The eligible condition is the acquisition of new plant and machinery and its utilisation in manufacture or production. That the undertaking in which such machinery is deployed was formed by reconstruction or splitting would be no bar to the claim of additional depreciation.
- 2.1 The following plant and machinery will not qualify for additional depreciation:
 - (a) plant and machinery installed in office premises;
 - (b) plant and machinery installed in residential accommodation including a guest house;
 - (c) office appliances;
 - (d) road transport vehicles;
 - (e) plant and machinery, the whole of the actual cost of which is allowed as a deduction in computing the income under the head

“profits and gains of business or profession” in any one previous year.

- 2.2 Similar provisions as above were existent in many other sections. Eg: Sections 32A, 32AB etc.
- 2.3 Plant and machinery may be tangible or intangible. Eg: Know how may be plant and machinery *Scientific Engineering House Pvt Ltd Vs CIT reported in 157 ITR 86 SC*. But keeping in view, the aspect of acquisition and installation; it may be difficult to secure a deduction for know how, and other intangible assets although they are effectively employed in the activity of manufacture or production.
- 3.1 The plant and machinery should be acquired and installed after the 31st day of March 2005.
- 3.2 If the plant is acquired in one year but installed in another year, a question arises whether the additional depreciation will be available at all? If so, in which year should it be available? It would appear that deduction in such circumstances should be available. Further, it should be available in the year of installation, as out of the two events, installation happens latter; thereby subsuming the earlier act of acquisition.
- 3.3 Also, clause 8 lays emphasis on the words “acquired and installed” and not the words “used”. Thus in a case where an assessee acquires and installs but does not put to use the machinery or plant before the end of relevant previous year, he should still be able to claim the additional deduction under clause (iiia) of section 32(1).
- 4.1 The deduction is available to an assessee engaged in the manufacture or production of an article or thing. The eligible assessee could be an individual or firm or company. The eligible assessee could be resident or non-resident.
- 4.2 Unlike other sections (section 80HHC or erstwhile 10A), machinery employed in a processing activity, not amounting to a manufacture will not be entitled to additional depreciation.
- 4.3 The assessee must be engaged in the business of manufacture or production. The eligible machinery however need not be utilised in that manufacture or production. It may be installed elsewhere eg: in the processing activity.
- 4.4 Power industry would not be eligible for this benefit as a separate sub-section governs its depreciation claim.
- 4.5 Whether a software industry is entitled to deduction would depend upon whether it satisfies the aspect of manufacture or production and further, whether software is an article or thing. It is possible to argue that both the tests would be satisfied. The following are some other sections and case laws in support of above proposition.
 - ☞ The definition of the term “industrial undertaking” in section 10(15) very specifically refers to the activity of manufacture of software. In other words, in the definition, the creation of computer software is equated to manufacture.
 - ☞ The definition in the erstwhile section 10A provided that the creation of computer programs amounted to both manufacture as well as production of an article or thing.
 - ☞ The Karnataka High Court in

the case of *CIT Vs Datacons Private Limited* reported in 155 ITR 66, on the aspect of whether conversion of data furnished by the customers into balance sheet, stock account etc, amounted to processing of goods held in favour of the assessee. While so holding the High Court held that the activity carried on by the assessee would fall within the concept of processing of goods, if not also manufacture of goods. (emphasis supplied).

☞ The Karnataka High Court had relied upon the Gujarat High Court decision in *CIT Vs Ajay Printery Private Limited* 58 ITR 811 wherein the High Court, in the context of section 23A of the Indian Income-tax Act of 1922, held that the printing of balance sheet, profit and loss account, dividend warrants, share certificate amounted to manufacture of goods.

☞ The Guwahati High Court very recently in the case of *CIT Vs Technotive Eastern Private Limited* 255 ITR 253 held that the activity of computer documentation services amounted to manufacture for the purpose of claim of deduction under section 80HH and 80I.

4.6 The Supreme Court's decision in *N C Budharaja's case* 204 ITR 413 may be referred to for a good discussion on the aspect of article or thing.

5.1 The deduction shall be equal to 20% of the actual cost of the machinery or plant.

5.2 The additional depreciation is to be calculated not with reference to the quantum of normal depreciation; but with reference to the actual cost of the machinery.

5.3 There is no specific mention or

limitation of the section that such depreciation would be available only for one year being the year in which the installation is complete. Literally reading (although this surely is not the intention), the additional depreciation may be claimed for each subsequent year.

5.4 The deduction is with reference to the actual cost of the asset and not the actual cost of the asset to the assessee. In other words subsidies and grants received by an assessee may not be reduced while quantifying this deduction.

5.5 If the machinery acquisition is funded through a loan in foreign currency and devaluation of currency were to happen in a subsequent year, the quantum of devaluation may not impact the actual cost of quantifying additional depreciation. It may be noted that section 43A permits the change in actual cost only when there is an actual outgo of money and in the year which such payment is made.

6.1 The new bus-clause viz (iiia) provides that additional depreciation shall be allowed under sub-clause (ii). Thus, there is no independent deduction under sub-clause (iiia).

6.2 Though the deduction would

be allowed under sub-clause (ii), the rate of additional depreciation will not alter the classification of block of assets. Eg: An asset falling in the 15% block will continue to remain in the same block and would not move into the 35% block (15+20).

6.3 The allowance of depreciation under sub-clause (ii) may be subject to the restriction of 180 days of lesser. In the event of asset is used for less than 180 days, the additional depreciation may be restricted to half the allowable quantum. In such a situation; the balance may lapse and may not be available for set-off in the subsequent year. ■

International Conference on 'eChallenges & Focus 2005'

The Dubai Chapter of The Institute of Chartered Accountants of India is organizing the above International Conference on 17-18th March 2005 at Le Meridien Hotel (Airport Hotel), Dubai. Hon'ble Shekha Lubna al Qassimi, Minister of Economy and Planning, Government of UAE has been invited to inaugurate the Conference. The Conference will also be addressed by Mr. Ahmad Kajoor, Under-Secretary IT & Planning, Ministry of Labour, Govt. of UAE and the Consul General of India, besides the President and Vice-President of the Institute.

Registration charges for Non-members of Dubai Chapter of ICAI is US\$200.00. Members attending the program will be granted eight CPE hours.

For Stay and Visa arrangements, members are requested to contact at +97142945335 or +971505879361(mob). They can also and can mail at horizont@emirates.net.ae. For enrolments/enquiry/clarifications, please write at icai@dubai-internetcity.net

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