

## CHAPTER - IV

### THE LEGISLATIVE BACKGROUND OF THE

#### DEPRECIATION PROVISIONS

The finance Act, 1966 made the following changes with effect from 1-4-1966

- i) Insertation of the first provision to Cl (ii) of sub-Section (1).
- ii) Substitution of Cl. (1) of the explainat to clause (iii) to bring it in the line with the amendments in 5,4,3 (1)
- iii) Substitution of 'income of each of such person chargeable under the head "salaries" in seven thousand five hundred rupees or less for drawing a remuneration not exceeding two hundred rupees per mensem in cl. (iv) of sub S (1)

\* The finance (No.2) Act, 1967 effected the following changes with effect from 1.4.1967

- i) Insertion but does not include a transfer in scheme of amalgamation of any asset by the amalgamation company to the amalgamated company where the amalgamated company is an Indian company in cl. (2) of the explanation to cl. (iii) of sub. S (1) after the words for the time being in force.

\* The finance Act 1976 effected the following changes

- i) Substitution of ten thousand for seven thousand five hundred in Cl. (iv) of sub s (1) w.e.f. 1.4.1977.

- ii) Insertation of in item 1 to 24 (both inclusive) in cl. (vi) of sub s (1) before the words ' in the list of the Ninth Schedule 'with effect from 1.4.1976. The finance Act, 1978 substituted 'forty' per cent for twenty percent in cl. (iv) of sub section (1) w.e.f. 1.4.79. The Finance Act 1983 brought about the following changes with effect from 1.4.84.
- i) Substitution of 'five thousand' for seven hundred and fifty' in the first proviso to cl. (ii) of sub-section (1).
- ii) Omission of the words 'but any such sum shall not be deductible in determining the written down value for the purpose of clause (ii) of sub section at the end of clause (iv) of sub - S (1)
- \* The Taxation laws (Amendment and Miscellaneous provisions) Act, 1986 has brought about the following changes to take effect from 1-4-1988.

Where the business or profession of the assessee is carried on in a building not owned by him but in respect of which the assessee holds a lease or other right of occupancy and any capital expenditure is incurred by the assessee for the purpose of the business or profession. On the construction of any structure or doing of any work in or in relation to and by way of renovation or extension of, or improvement to, the building, then the provision of this clause shall apply as if

the said structure or work is a building owned by the assessee.

Section 34 as originally enacted has undergone the following amendments : The finance Act 1965, substituted w.e.f. 1.4.65. The words by holding company to it's subsidiary company or by a subsidiary company to it's holding company.

\* The Finance Act 1986 have been omitted sub section (1) and (2) w.e.f. 1.4.88. These provisions have been deleted in view of the switch-over to the system of allowing depreciation on block of asset.

From the assessment year 1981-82; such particulars have been prescribed by rule 5 A A. Inserted by the Income Tax (first Amendment) Rules 1981 with effect from 1.4.1981.

Transfer of capital asset by holding company for its subsidiary company and vice-verca where a capital assets is transferred by a holding company to it's 100 % subsidiary Indian Company or by 100 % subsidiary company to the holding Indian company.

The depreciation allowed to the transferor company shall also be taken into consideration in determination of the aggregate of all depreciation allowance. The overall effect of S. 34 can't be ignored in any way.

THE AMENDMENTS MADE FROM TIME TO TIME

AMENDMENTS EFFECTIVE FROM THE ASSESSMENT YEAR 1988-89

The Scheme of depreciation has undergone a sea change from the assessment year 1988-89; and it is proposed to summarise the amendments in the provisions of depreciation for the benefit of practitioner's, teachers and tax payer's.

1. Depreciation will hereafter be allowed blockwise and it would not be necessary to maintain account and claim depreciation itemwise.
2. Plant and machinery hitherto eligible for depreciation at rates varying between 15 to 30% will be eligible for depreciation at a higher rate of 33 1/3% plant and machinery eligible at the rate of 40% will be eligible for depreciation at the rate of 50%.
3. Plant and machinery using indigenous know-how as well as those which are used as anti-pollution devices will be eligible for depreciation at the rate of 50%.
4. Some of the energy saving devices and the renewable energy devices will belong to the block where 100% depreciation would be available.
5. A higher rate of depreciation of 20% is prescribed in respect of buildings which are used as hotels or which consists of dwelling units each with a plinth area of 80 square meters or less. Purely temporary erections

such as wooden erections will be entitled to 100% depreciation as at present.

6. Buildings meant for low paid employees of industrial undertakings will be entitled to depreciation at 20% as against the general rate of 5% for residential buildings and 10% for non residential buildings.
7. There will not be allowed any extra shift allowance.
8. Since, ocean going ships will also be included in a block of assets, depreciation will be allowable in respect of such ships not on straight line method as at present but on written down value method.
9. Owing to the introduction of the system of allowing depreciation on block of assets the provisions pertaining to terminal depreciation and balancing charge have lost significances. These provisions have thereof been deleted.
10. Initial depreciation in respect of buildings erected after 31.3.67 is withdrawn.

\* CHANGES MADE BY THE AMENDMENT ACT OF 1988

Earlier, while determining distributable profits for the purposes of declaring dividend, depreciation was required to be provided at the rates specified for the various assets by the Income-Tax Act by virtue of reference there-to to section 350, which in turn was referred to in sub section 2(a) of this section. In this recent years, depreciation rates under the Income Tax Act having undergone steep upward revision, companies were not left with sufficient profits, after providing

for depreciation, to enable declaration of reasonable dividend by them to their shareholders. This section has therefore, been amended by the amendment Act of 1988. This clause seeks to amend section 205 to provide that, in future, depreciation shall be calculated in accordance with the rates specified in schedule XIV to the Act, thus delinking depreciation under the companies Act from that under the Income-Tax Act.

For the purposes of the companies Act, depreciation has how to be calculated in accordance with the rates specified in schedule XIV. The salient features of the Schedule are as under :-

- 1) Assets have been categorised into four categories viz.
  - i) Buildings
  - ii) Plant & Machinery
  - iii) Furniture & fittings
  - iv) Ships.Depreciation rates have been prescribed under two alternative method. The written down value method and straight line method. It is open to a company to adopt any of the said two methods of depreciation and supply appropriate rate of depreciation.
- 2) In respect of plant and machinery two sets of depreciation rates, general rate and special rate have been prescribed, under each of the aforesaid method. General rate is applicable in respect of items of plant and machinery, which are covered by special rates; have been put under four categories and each of the said categories separate rates of depreciation have been laid down.



Likewise, in respect of furniture and fittings, there is a general rate, apart from a special rate for furniture and fittings used in specified businesses and/or for specified purposes.

- 3) Unlike under the Income-tax Act, where there are normal rates of depreciation on w.d.v. method and certain percentage of normal depreciation is reckoned for double or triple shift working the schedule provides for three separate rates for single shift, double shift and triple shift working under each of the aforesaid two methods.
- 4) The rates of depreciation for double shift and triple shift working have been laid down only for assets covered under the head plant and machinery and for any other asset. In regard to items of plant and machinery for which special rates of depreciation have been provided, extra shift depreciation is applicable only to the following.
  - a) Category 'A'
    - i) Recuperative and regenerative glass melting furnaces in case of glass manufacturing concerns.
    - ii) Machinery used in the manufacture of electrical goods for components.
  - b) Category 'B'

Wooden lasts used in the manufacture of shoes in the case of shoe and other leather goods factories.

- 5) Where, during any financial year, any addition has been made to an asset depreciation thereon shall be calculated on a prorate basis from the date of such addition.

6) Depreciation on the basis of rates provided for double or triple shift working shall have to be provided only when the concern has actually so worked during the financial year. In case of concern has not worked on single, double or triple shift. Uniformly throughout the financial year, the calculations for extra depreciation for double or triple shift working is required to be made separately in the proportion which the number of day's for which the concern worked double shift or triple shift as the case may be bears to the normal number of working day's during the year. For this purpose, the normal number of working day's during the year shall be deemed to be

(a) in the case of seasonal factory the number of day's on which the factory actually worked during the year or 180 day's whichever is greater.

(b) in any other case, the number of day's on which the factory actually worked during the year or 240 day's whichever is greater.

7) Disclosure of Depreciation policy :

The depreciation method followed and also the depreciation rates or the useful lives of the assets



as adopted by the company, if they are different from the rates of depreciation specified in Schedule XIV, have to be disclosed in the annual accounts.

- 8) As regards depreciable assets, for which no rate of depreciation has been laid down in the schedule, depreciation is required to be provided on such basis as may be approved by the Central Government.

### 3. SIGNIFICANCE OF THE DEPRECIATIONS PROVISIONS

The effective life of the capital assets employed in business or profession is limited beyond which they are not capable of giving the desired results. By the process of user, the assets depreciate because of wear and tear being the normal incidence of such user.

Depreciation is allowable as a deduction both according to accountancy principles and according to Indian Income Tax Act. For the purpose of determining the true profits in the business sense or under the proper principles of accountancy the wear and tear of the assets utilised by the assessee for the purpose of earning his profits will have to be considered and allowance will have to be made for this wear and tear. The amount of depreciation which is allowed as deduction being the amount lost by depreciation is a capit

loss which must be replaced first to give a true and correct picture of the profits as otherwise there is bound to be distorted picture in the profits in the profits and loss account. Such depreciation being the amount of loss by depreciation to the capital. It should be treated as a charge on the profits.

The allowance can be claimed if the asset in question is shown to be capable of diminishing in value on account of any factor known to the prevailing accounting or commercial practice.

The aggregate of all depreciation allowance under Section 32 (1) or 32 (1A) shall in no case, exceed the actual cost to the assessee of the building, machinery, plant, furniture, structure of work as the case may be upto the A.Y. 1987-88 in terms of S. 34(2) (1) which will stand remitted w.e.f. 1-4-1988 by the Taxation Laws (Amendment and Miscellaneous Provisions) Act, 1986. However, department rebate, development allowance, investment allowance etc., will not be taken into account in arriving at the aggregate depreciation allowance.