

The deduction allowable under this section is only of current repairs but not arrears of repairs for earlier years even though they may still rank for a deduction under section 37(1).

- **Insurance premium:** The deduction allowable in respect of premia paid for insuring the machinery, plant or furniture is subject to the following conditions:
  - ◆ The insurance must be against the risk of damage or destruction of the machinery, plant or furniture.
  - ◆ The assets must be used by the assessee for the purposes of his business or profession during the accounting year.
  - ◆ The premium should have been actually paid (or payable under the mercantile system of accounting).

The premium may even take the form of contribution to a trade association which undertakes to indemnify and insure its members against loss; such premium or contribution would be deductible as an allowance under this section even if a part of it is returnable to the insured in certain circumstances.

It does not matter if the payment of the claim will enure to the benefit of someone other than the owner.

- **Current repairs of capital nature not to be allowed [Explanation to section 31]:** Amount paid on account of current repairs of machinery, plant or furniture shall not include any capital nature expenditure. In other words, current repairs other than of capital nature expenditure is allowed as deduction in the computation of income under the head “profits and gains of business or profession”.
- **Machinery, plant and furniture used partly for business and partly for other purposes:** Where the machinery, plant and furniture are used partly for business and partly for other purposes, only a proportionate part of the expenses attributable to that part of the machinery, plant and furniture used for purposes of business will be allowed as a deduction [Section 38(2)].

### (3) Depreciation [Section 32]

- (1) **Charge of depreciation mandatory:** Section 32 allows a deduction in respect of depreciation resulting from the diminution or exhaustion in the value of certain capital assets.

The *Explanation 5* to this section provides that deduction on account of depreciation shall be made compulsorily, whether or not the assessee has claimed the deduction in computing his total income.

- (2) **Conditions to be satisfied for allowance of depreciation:** The allowance of depreciation which is regulated by Rule 5 of the Income-tax Rules, 1962, is subject to the following conditions which are cumulative in their application.

- (a) **The assets in respect of which depreciation is claimed must belong to either of the following categories, namely:**

- (1) buildings, machinery, plant or furniture, being tangible assets;
  - (2) know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets acquired on or after 1st April, 1998, not being goodwill of a business or profession.
- ❖ The depreciation in the value of any other capital assets cannot be claimed as a deduction from the business income.
  - ❖ No depreciation is allowable on the cost of the land on which the building is erected because the term 'building' refers only to superstructure but not the land on which it has been erected.
  - ❖ The term 'plant' as defined in section 43(3) includes ships, vehicle, books, scientific apparatus and surgical equipments used for the purpose of the business or profession but does not include tea bushes or livestock or buildings or furniture and fittings.
  - ❖ However, the word 'plant' does not include an animal, human body or stock-in-trade. Thus, plant includes all goods and chattels, fixed or movable, which a businessman keeps for employment in his business with some degree of durability.
  - ❖ The expression 'plant' includes part of a plant (e.g., the engine of a vehicle); machinery includes part of machinery and building includes a part of the building.
  - ❖ Similarly, the term 'buildings' includes within its scope roads, bridges, culverts, wells and tubewells.



- (b) The assets should be actually **used** by the assessee **for purposes of his business or profession** during the previous year - The asset must be put to use at any time during the previous year. The amount of depreciation allowance is not proportionate to the period of use during the previous year. If the asset is acquired during the previous year and is not put to use in the same year, then the depreciation shall not be allowed for such asset but the cost of such asset would be added to the block of asset.

**Asset used for less than 180 days** - Where any asset is acquired by the assessee during the previous year and is put to use for the purposes of business or profession for a period of less than 180 days, depreciation shall be allowed **at 50 per cent** of the allowable depreciation according to the percentage prescribed in respect of the block of assets comprising such asset. It is significant to note that this restriction applies only to the year of acquisition and not for subsequent years.

➔ If the assets are not used exclusively for the business of the assessee but for other purposes as well, the depreciation allowable would be a proportionate part of the depreciation allowance to which the assessee would be otherwise entitled. This is provided in section 38.

Depreciation would be allowable to the owner even in respect of assets which are actually worked or utilized by another person e.g., a lessee or licensee. The deduction on account of depreciation would be allowed under this section to the owner who has let on hire his building, machinery, plant or furniture provided that letting out of such assets is the business of the assessee. In other cases where the letting out of such assets does not constitute the business of the assessee, the deduction on account of depreciation would still be allowable under section 57(ii).

**Use includes passive use in certain circumstances:** One of the conditions for claim of depreciation is that the asset must be “used for the purpose of business or profession”. Depreciation is allowed when asset is actually put to use and not ready to use. However, in certain circumstances, Courts have held that, an asset can be said to be in use even when it is “kept ready for use”.

**For example,** stand by equipment and fire extinguishers can be capitalized if they are ‘ready for use’.

Likewise, machinery spares which can be used only in connection with an item of tangible fixed asset and their use is expected to be irregular, has to be capitalised.

Hence, in such cases, the term “use” embraces both active use and passive use. However, such passive use should also be for business purposes.

- (c) **The assessee must own the assets, wholly or partly** – Depreciation is allowed only to the owner of the asset. If the assessee has taken an asset on lease, he, being the lessee, cannot avail depreciation in respect of such asset. On the other hands, the lessor will be entitled to depreciation on such asset as he is the owner.

➔ However, in this connection, students may note that the *Explanation 1* to section 32 provides that 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 purposes of the business or profession or the construction of any structure or doing of any work by way of renovation, extension or improvement to the building, then depreciation will be allowed as if the said structure or work is a building owned by the assessee.

Depreciation is allowable not only in respect of assets “wholly” owned by the assessee but also in respect of assets “partly” owned by him and used for the purposes of his business or profession.

- (3) **Computation of Depreciation Allowance:** Depreciation allowance will be calculated on the following basis:

- (i) **Power generation undertakings:** In the case of assets of an undertaking engaged in generation or generation and distribution of power, such percentage on the actual cost to the assessee as prescribed by Rule 5(1A).

**Rule 5(1A)** - As per this rule, the depreciation on the abovementioned assets shall be calculated at the percentage of the actual cost at rates specified in Appendix IA of these rules. However, the aggregate depreciation allowed in respect of any asset for different assessment years shall not exceed the actual cost of the asset. It is further provided that such an undertaking as mentioned above has the option of being allowed depreciation on the written down value of such block of assets as are used for its business at rates specified in Appendix I to these rules.

However, such option must be exercised before the due date for furnishing return under section 139(1) for the assessment year relevant to the previous year in which it begins to generate power.



It is further provided that any such option once exercised shall be final and shall apply to all subsequent assessment years.

- (ii) **Block of assets:** In the case of any block of assets, at such percentage of the written down value of the block, as may be prescribed by Rule 5(1).

**Block of Assets:** A “block of assets” is defined in section 2(11), as a group of assets falling within a class of assets comprising—

- (a) tangible assets, being buildings, machinery, plant or furniture;
- (b) intangible assets, being know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature, not being goodwill of a business or profession,

in respect of which the same percentage of depreciation is prescribed.

Block of asset simply means “same class of assets with same rate of depreciation”.

**Know-how** - In this context, ‘know-how’ means any industrial information or technique likely to assist in the manufacture or processing of goods or in the working of a mine, oil-well or other sources of mineral deposits (including searching for discovery or testing of deposits for the winning of access thereto).

- (iii) **Additional depreciation on Plant & Machinery [Section 32(1)(ia)]:** Additional depreciation is allowed on any new machinery or plant (other than ships and aircraft) acquired and installed after 31.3.2005 by an assessee engaged in the business of manufacture or production of any article or thing or in the business of generation or transmission or distribution of power at the rate of 20% of the actual cost of such machinery or plant.

**Asset put to use for less than 180 days:** As per second proviso to section 32(1)(ii), 50% of additional depreciation to be allowed, where the plant and machinery is put to use for less than 180 days during the previous year in which such asset is acquired.

Further, third proviso to section 32(1)(ii) also provides that the balance 50% of the additional depreciation on new plant or machinery acquired and used for less than 180 days which has not been allowed in the year of acquisition and installation of such plant or machinery, shall be allowed in the immediately succeeding previous year.

*In case of an individual, HUF, AoP (other than a co-operative society) or BoI or an artificial juridical person, additional depreciation is not allowable under the default tax regime under section 115BAC. Additional depreciation would be allowable only if such person has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A) and pays tax as per the optional tax regime under the regular provisions of the Act.*

*In case of companies and co-operative societies, additional depreciation would not be allowable if they opt for the special provisions u/s 115BAA/115BAB and section 115BAD/115BAE, respectively. In other words, additional depreciation would be allowable only if companies and co-operative societies pay tax under the normal provisions of the Act.*

#### **Plant and Machinery not qualifying for additional depreciation**

Such additional depreciation will not be available in respect of:

- (i) any machinery or plant which, before its installation by the assessee, was used within or outside India by any other person (second hand machinery); or
- (ii) any machinery or plant installed in office premises, residential accommodation, or in any guest house; or
- (iii) office appliances or road transport vehicles; or
- (iv) any machinery or plant, the whole or part of the actual cost of which is allowed as a deduction (whether 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.

**Note:** Additional depreciation is not allowed to power generation undertakings opting Appendix 1A of Rule 5 i.e., depreciation calculated as a percentage on the actual cost to the assessee.

**Eligibility for grant of additional depreciation under section 32(1)(iia) in the case of an assessee engaged in printing or printing and publishing [Circular No. 15/2016, dated 19-5-2016]**

An assessee, engaged in the business of manufacture or production of an article or thing, is eligible to claim additional depreciation under section 32(1)(iia) in addition to the normal depreciation under section 32(1).



The CBDT has, vide this Circular, clarified that the business of printing or printing and publishing amounts to manufacture or production of an article or thing and is, therefore, eligible for additional depreciation under section 32(1)(iia).

- (iv) **Terminal depreciation:** In case of a power concern as covered under clause (i) above, if any asset is sold, discarded, demolished or otherwise destroyed in the previous year (other than the previous year in which it is first brought into use) the depreciation amount will be the amount by which the moneys payable in respect of such building, machinery, plant or furniture, together with the amount of scrap value, if any, falls short of the written down value thereof. The depreciation will be available only if the deficiency is actually written off in the books of the assessee.

**Example:** Mahapower Ltd. purchased an asset on 20.7.2019. The actual cost of the asset was ₹ 100 lakhs. Mahapower Ltd. claimed depreciation @5% on the actual cost of the asset. WDV of the asset as on 1.4.2023 is ₹ 80 lakhs. On 15.5.2023, Mahapower Ltd. sold the asset for ₹ 55 lakhs. Deduction allowed as terminal depreciation u/s 32(1)(ii) for P.Y. 2023-24 is ₹ 25 lakhs (₹ 80 lakhs - ₹ 55 lakhs) provided the deficiency of ₹ 25 lakhs is actually written off in the books of Mahapower Ltd.

#### Meaning of certain terms

Term	Meaning
<b>Moneys payable</b>	In respect of any building, machinery, plant or furniture includes — (a) any insurance, salvage or compensation moneys payable in respect thereof; (b) where the building, machinery, plant or furniture is sold, the price for which it is sold.,
<b>Sold</b>	Includes a transfer by way of exchange or a compulsory acquisition under any law for the time being in force. However, it does not include a transfer, in a scheme of amalgamation, of any asset by the amalgamating company to the amalgamated company where the amalgamated company is an Indian company or a transfer of any asset by a banking company to a banking institution in a scheme of amalgamation of such banking company with the banking institution, sanctioned and brought into force by the Central Government.



**Clarification regarding treatment of expenditure incurred on purchase of participating interest by the Oil Exploration and Production (E&P) Companies [Circular No. 20/2019, dated 19.08.2019]**

Over the life cycle of an Oil & Gas block, Oil Exploration and Production (E&P) companies generally buy ('Farm in') and sell ('Farm out') their participating interests (PI) in the 'Production Sharing Agreement' (PSC). 'Farm-in' expenditure is incurred when an entity in this line of business acquires a PI from another entity(s) in oil/gas block(s) and becomes part of the PSC entered into with the Central Government.

The Government of India (GoI) offers exploration and development rights through global bidding for specified blocks in various rounds under the New Exploration and Licensing Policy (NELP), Hydrocarbon Exploration & Licensing Policy (HELP), Open Acreage Licensing Policy (OALP) etc. by signing the Production Sharing Contracts (PSC's) with the Oil & Gas companies. The successful Oil & Gas Companies are granted license to explore, develop and carry out production operations in Oil & Gas blocks and in India under a PSC with the GoI. Typically, owing to the large investments required and the risks involved, multiple E&P companies execute the PSC with the GoI in which each member has its agreed and defined PI.

It is common international practice for the upstream companies to buy (farm-in) and sale (farm-out) their PI in the PSC or similar contracts with the Government and thereby to share risk, bring new and niche expertise and technologies. In such transactions, PI are treated as interests in rights, licences and obligation under the PSC. Such farm-in purchase price is accounted as an asset as per guidance note issued by the Institute of Chartered Accountants of India. International accounting rules for Oil & Gas followed in Australia, Indonesia, UK etc. also require that such acquisition cost to be capitalized and depreciated. A perusal of the Model PSC's {as per the website of the Director General of Hydrocarbon (DGH)} indicates that participating interests are share in rights and obligation to explore, exploit and sell petroleum under the PSC along with related licences, permits etc. A few of the case-laws on this issue also support treatment of acquisition rights in a PSC as Intangible asset.

In this regard, it is relevant to mention that earlier vide Notification No. G.S.R. 117(E) dated 08.03.1996, in exercise of its powers under section 293A of the Act, Central Government had laid down that the persons with whom it enters into agreement for the association or participation in any business consisting of the prospecting for or extraction or production of mineral oils on or after the 1st day of April, 1992 -

- a) shall not be assessed on the income as association of persons or body of individuals consisting of such persons; but
- b) each of the persons referred to above be assessed in respect of his or its share of income, as the case may be, in the same status in which the person enters into the agreement with the Central Government.



*Thus, as persons participating in an E&P contract are assessed individually in respect of their share of income, the sum expended on acquisition of whole or part of such 'Participating Interest' in an E&P contract where such acquisition is approved by the Government of India, represents the amount paid to acquire the underlying share (expressed as a percentage) being interests in rights, licences and obligations under the E&P contract.*

*In view of the above legal position, it is hereby clarified as under:-*

- i. amount paid for acquiring the 'Participating Interest' shall not be treated either as cost for acquiring the share in partnership or investment for acquisition of a member's interest in an association of persons or body of individuals, rather it would be treated as an amount paid to acquire the underlying assets; and*
- ii. the amount paid for acquiring the 'Participating Interest', after reducing component of cost attributable to tangible assets for purposes of section 32(1)(i), would be treated as an 'intangible asset' (being a business or commercial right akin to a licence), eligible for claim of depreciation for purposes of section 32(1)(ii).*

- (4) **Rates of depreciation:** All assets have been divided into four main categories and rates of depreciation as prescribed by Rule 5(1) are given below:

PART A TANGIBLE ASSETS		
I	Buildings	
Block 1.	Buildings which are used mainly for residential purposes except hotels and boarding houses	5%
Block 2.	Buildings which are not used mainly for residential purposes and not covered by Block (1) above and (3) below	10%
Block 3.	Buildings acquired on or after 1st September, 2002 for installing machinery and plant forming part of water supply project or water treatment system and which is put to use for the purpose of business of providing infrastructure facilities	40%
Block 4.	Purely temporary erections such as wooden structures	40%
II	Furniture and Fittings	
Block 1.	Furniture and fittings including electrical fittings ["Electrical fittings" include electrical wiring, switches, sockets, other fittings and fans, etc.]	10%
III	Plant & Machinery	
Block 1.	Motor cars other than those used in a business of running them on hire, acquired during the period from 23.8.2019 to 31.3.2020 and put to use on or before 31.3.2020	30%