Depreciation: All You Need to Know

The following essay will explain the meaning of depreciation and all the terms around it through a list and contrast the surrounding terms with the main concept of depreciation.

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The following Article will explain the meaning of ‘depreciation’ and all the terms around it through a list and contrast the surrounding terms with the main concept of ‘depreciation.’

- **Depreciation**

Depreciation is the total value of wear and tear or obsolescence of an asset. In other words, it is the decline in the value of an asset due to consumption, obsolescence and wear and tear. **Section 32** of the Income Tax Act provides for the same. Income Tax law has its own Depreciation Rates.

**Conditions to Claim Depreciation**

1. The assessee should own the asset wholly or partly.

2. The asset should be used only for the business or profession of the assessee. In case the asset is not exclusively used for the above purpose, the depreciation allowable will be proportionate to the use of business purpose.

3. Co-owners can claim depreciation only to the extent of the value of the asset each co-owner owns.

4. There is no depreciation allowed on the cost of land.

5. To claim depreciation, the minimum duration is six months.

6. There is depreciation on intangible assets such as Intellectual Property Rights as well since there is a “value” associated to them.
Methods to Calculate Depreciation

1. Straight Line Method
Total value of asset = Rs. 100
Expected life of asset = 10 years
∴ Depreciation = 100/10
= Rs.10 per year

2. Written Down Value Method
Value of Asset = Rs. 100
Depreciation (2018) = - 10
Value in 2019 = Rs. 100 - 10
= Rs.90
Depreciation in 2019 = - 9
Value in 2020 = Rs. 90 - 9
= Rs.81

• **Accelerated Depreciation**

This method of depreciation allows depreciation to be claimed at an increased rate in the earlier years of the asset’s life.
To provide an incentive for manufacturing, the Income Tax Department allows additional depreciation of certain items such as plant and machinery during the year of purchase. Under this method, since depreciation allowed is higher, the income becomes less, which consequently, reduces the income tax liability on an assessee.
Under Section 32(1) (iia) of the Income Tax Act, this additional depreciation of 20% is available in the first year of purchase in addition to the normal depreciation.

Only depreciation allowed under Section 32 of the Income Tax Act.

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Based on the New Amendment, this is available to assesses in the Power Transmission Business.
- **Investment Allowance**

A tax incentive which is offered to business so that capital investment is encouraged is called an ‘investment allowance.’ It is also called a ‘Development Rebate.’ Under this method certain specified percentages of capital costs, including depreciation, can be deducted from taxable income. This helps lower the tax liability.

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<tr>
<th>Depreciation</th>
<th>Investment Allowance</th>
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<td>Under Section 32AC of the Income Tax Act, this provides an incentive to encourage investment in plant or machinery.</td>
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Only depreciation allowed under Section 32 of the Income Tax Act.

The benefit of this is available to any assessee.

- **Amortization of preliminary expenses**

Pursuant to S. 35 D of the Income Tax Act, wherever an Indian Company or a non-corporate resident assessee incurs any expenses when they commence a business or extend an existing undertaking, then a deduction is allowed with respect to such preliminary expenses.
Examples of Preliminary Expenses that can be Amortized

1. Charges incurred for registering the company with the Registrar of Companies
2. Underwriting commission, brokerage etc.
3. Any other expenses as prescribed and not deductible under any other section

Extent of Deduction allowed

Deduction will be the lower of actual expense incurred or:

1. 5% of the cost of a project
2. 5% of the Capital employed
3. The amount so calculated shall be allowed as a deduction equally over a period of 5 years.

- **Provisions for set off and carry forward of losses**

Set off refers to adjusting one’s losses against the profit of that financial year. We can carry forward our losses to the next Assessment year if there are no adequate profits subject to the conditions stated in the Act.

**Income losses Intra-head Set off – Section 70 of the Income Tax Act**

Under this, if the assessee has incurred a loss, then he can adjust it from any other source of income under the same head. It is called intra-head adjustment.

This cannot be done where there is speculative business loss, long-term capital loss, Income from losses from owning and maintaining horse races, income losses of specified business.

**Income losses Inter-head Set off – Section 71 of the Income Tax Act**

Under this, if the assessee has incurred a loss under one head of income and has income under the other head of income, then the assessee can adjust the loss of one head against the income of the other head.
This can be done for the House Property Income Losses and Non-Speculative Business Losses.

Income Losses Carry Forward

It may so happen that even after making the above adjustments, some income losses remain unadjusted. Such unadjusted losses are ‘carried forward’ to next year for adjustment against subsequent year income.

This can be done for House Property Income Losses under Section 71B, Non Speculative Business Losses under Section 72, Speculative Business Losses under Section 73, Specified Business Loss under Section 73A or by carrying forward capital gain income losses for immediately 8 assessment years after the loss was incurred.