Controversies

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Issue

When depreciable asset forming part of block of asset is sold and new depreciable asset of the same block is acquired at the Fag end of the financial year and is not put to use whether such asset is includable in the block of asset for the purpose of sec 50.

Whether such new asset will be entitled to depreciation on the ground that such asset is ready for use?

Proposition

Wherever any depreciable asset is purchased during the year, it is not necessary that the new asset should be put to use for such asset to be included in the block of asset for the purpose of Sec 50. It is proposed that there will not be any liability of short term capital gain under section 50 as the new asset goes into the block of asset though the same is not used before the end of the financial year.

It is further proposed that in case of existing business, when a new asset is purchased, then for the purpose of depreciation allowance, if the asset is ready to use, then the claim of depreciation has to be allowed.

View against the proposition

Now, the question arises whether when asset is ready for use, depreciation will be allowed or not. It has been decided in the case of Sri Hanuman Sugar & Industries Ltd. v. CIT 266 ITR 106 (Cal.) that the depreciable asset has to be actually used for the purpose of claiming depreciation and thus it appears that if the asset is ready for use the condition of sec 32 as well as sec 50 is not satisfied and the short term capital gain liability will arises in this case.

It is important to refer to the following decision.

- In Ulka Advertising (P.) Ltd. v. Dy. CIT [2005] 94 ITD 282 (Mum.-trib.) the assessee acquired gas cylinders which were eligible for 100% depreciation in the year of acquisition itself. At the time of acquisition and claim of depreciation, the block asset concept of allowing depreciation was not in vogue. On subsequent sale after 3 years the assessee claimed that the gain is a long term capital gain since the cylinders do not form part of the block of assets at the beginning of the year, in which it was sold. The tribunal held that the definition of block of assets given in section 2(11) and the expression ‘prescribed’ appearing therein is to be construed not only to mean the rate of depreciation prescribed under the income tax rules but also the rate [prescribed under the substantive provisions of the Act [Proviso to section 32(1)(ii), then]. Accordingly, even if the asset is eligible for 100% depreciation in the year of acquisition or use, upon transfer, provisions of section 50 would apply.

- In M. Raghavan v. Asstt. CIT [2004] 266 ITR 145 (Mad.) the Madras High Court gave a decision favouring the revenue. The assessee, a senior advocate sold books whose written down value was reduced to ‘nil’ already in view of section 32(1) of the Act as it stood between 1-4-1984 and 1-4-1996. The assessee realized Rs. 1.25Lakhs. He paid Rs 15,500 as commission to the book seller and claimed the balance Rs. 1,09,500 as not liable to tax as the indexed cost of the asset was more than the sale proceeds. The court held that the objective of introducing sec 50 is to provide a different method of computing capital gains for depreciable assets. It disentitles the owners of the depreciable assets from claiming the benefit of indexation. The value of depreciable assets comes down in the most cases over a period of time although the sale proceeds exceeds the cost of acquisition. If the indexing were to be allowed, it would mean the cost of acquisition as being very much higher than what it actually is to the assessee. If such boosted cost of acquisition is deducted from the amount realized, it would result in negative figure enabling the assessee to claim capital loss. Clearly, it could not have been the intention of the legislature to give multiple benefits to assessee for transferring depreciable assets.

- Finally, it is submitted that if the asset is not used at all then with respect it cannot enter into the block and hence, the depreciation cannot be allowed as well as liability of tax u/s 50 will also arise.

View in favor of the Proposition

Useful reference can be made to the following judicial authorities in support of the propositions that if the asset is acquired though it is not used the same has to be included in the block of asset and hence, short term capital gain liability u/s 50 will not arise. Further when asset is ready to use depreciation has to be allowed.

Section 32 of the Income tax Act says that a depreciable asset owned by the assessee for the purpose of business is eligible for depreciation. The word 'used' will include both passive and active user of the asset. In CIT v. Dalmia Cement Ltd. [1945] 13 ITR 415 (Pat) it was held that the depreciation might be allowed even when machinery was not in use or kept idle.

The Kerala High Court in CIT v. Geo Tech Construction Corporation (2000) 17 DTC 751 (Ker-HC): (2000) 244 ITR 452 (Ker.) discussed the active and passive user of the asset in respect of depreciable claim. There are certain assets which could be put to use only in certain instances. For example, fire extinguishing equipment will be put to use only to put off fire and only when a fire breaks out it will be put to use. However, depreciation will be available as soon as the equipment is ready for use by assessee. Hence, in the above case, the eligibility for depreciation cannot be denied merely on the surmise that the assessee might not have used the asset.

The opening WDV plus acquisition minus the sale value will be the closing WDV of the block and on this depreciation eligibility has to be looked into. Hence, there would be no short term capital gain because of the new asset acquisition despite the fact that it has not been put to use by the assessee. [Oceanic Investments Ltd. v. Asstt. CIT [1997] 57 TTJ (Bom-Trib) 549].

Summation

Sec 50 read as under:

1. Where the full value of consideration received or accruing as a result of the transfer of the asset together with the full value of such consideration received or accruing as a result of the transfer of any other capital asset falling within the block of assets during the previous year, exceeds the aggregate of the following amounts, namely-

   - Expenditure incurred wholly and exclusively in connection with such transfer or transfers;

   - The written down value of the block of assets at the beginning of the previous year;

   - The actual cost of any asset falling within the block of assets acquired during the previous year;

   Such excess shall be deemed to be capital gains arising from the transfer of short term capital assets;

2. Where any block of assets ceases to exist as such, for the reason that all the assets in that block are transferred during the previous year, the cost of acquisition of the block of assets

shall be the written down value of the block of assets at the beginning of the previous year, as increased by the actual cost of any asset falling within that block of assets acquired by the assessee during the previous year and the income received or accruing as a result of such transfer or transfers shall be deemed to be the capital gains arising from the transfer of short term capital assets.

Section 2(11) defines block of assets as a group of assets falling within a class of assets, being buildings, machinery, plant or furniture, in respect of which the same percentage of depreciation is prescribed. Sec 50 refers to a capital assets "forming part of a block of assets in respect of which depreciation has been allowed". This means that the asset which is sold and capital gains relating to which is the subject matter of computation must have been used in a business carried on by the assessee. The requirement of sec 50 (1)(iii) is that the addition to the block of assets must be in respect of an asset falling within that block of assets which means that it should be an asset of same class and bearing same depreciation rate. There is no explicit or express requirement that the new asset should be put to use in any business carried on by the assessee. Hence, it is not necessary that in respect of an addition to the block of assets, it must be put to use and hence no short term capital gain would arise. This view has been taken by the Mumbai Bench of ITAT in the case of Artic V.ACIT 64 TTJ 291.

Mumbai bench of ITAT in the case of Indogem v. ITO [2016] 72 taxmann.com 315 through its order dated 24th August,2016 held that the distinction between possession and occupation has to be kept in mind, which is relevant only for the purpose of determining the question of "use" with regard to claiming depreciation under section 32 of the act, but not for the purpose of acquisition contemplated in sec 50(1)(iii) of the Act dealing with the actual cost of any asset falling within the block of assets acquired during the previous year, and hence liability u/s 50 for short term capital gain will not arise.

In respect of second question i.e. whether if the asset is ready for use but not actually used whether depreciation will be allowed. In this regard it would like to refer to the decisions of Bombay High Court and Karnataka. The Bombay High Court while passing the decision in the case of Dineshkumar Gulabchand Agrawal v. CIT (2004) 267 ITR 769 (Bom), distinguished its earlier decision in case of Whittle Anderson Ltd. by holding that the said decision was rendered in the context of interpretation of the expression "use or used" and subsequent to the said decision there has been an amendment in sec 32 of the Act which provides for the word "used".

Further, the Karnataka High Court has also held that kept ready theory is not workable for depreciation benefit. The machinery and other assets must be actually used to claim depreciation U/s 32 [Dy CIT v. Yellamma Dasappan Hospital (2007) 159 taxmann 58 (Karn)].

In view of the above in my humble opinion when asset is acquired but is not actually used it is possible to claim that the same is includible in the block for the purpose of Sec 50 but depreciation U/s 32 may not be allowed.

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