

TAX FLASH NEWS

1 October 2021



Depreciation is allowed on the WDV of the block of machinery at the gross value without reducing the waiver of loan

Executive summary

Recently, Pune Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Shapers India Private Limited¹ (the taxpayer) dealt with the issue of eligibility of depreciation on the Written Down Value (WDV) of the block of machinery at the gross value without reducing the waiver of loan therefrom. The Tribunal held that the waiver of loan in the earlier year has no impact either on the actual cost of assets under Section 43(1) or the WDV under Section 43(6) of the Income-tax Act, 1961 (the Act). Accordingly, depreciation should be allowed on the WDV of the block of Machinery at the gross value without reducing the waiver of loan therefrom. Consequently, the disallowance of depreciation was deleted.

Section 2(24)(xviii), introduced from the Assessment Year (AY) 2016-17, will not apply either to AY 2003-04 when the machinery was purchased or to AY 2006-07 when the waiver of loan was received or the year in appeal. Thus Section 2(24)(xviii) does not cover such waiver within the ambit of 'income' for the extant year.

Facts of the case

The taxpayer is engaged in manufacturing molds and plastic molded components. The taxpayer purchased plant & machinery during the financial year ending 31 March 2003. An amount payable with respect to such machinery was waived off on 31 December 2005 (Financial Year 2005-06). The taxpayer written-off such amount in its books of accounts and created capital reserve in that year for equal amount. The taxpayer did not reduce such waiver of loan from the value of block of assets.

The taxpayer claimed depreciation on the depreciated gross value and the amount of depreciation pertaining to the amount of loan waived was INR 6,54,950. The taxpayer claimed that the write back of the capital creditor was made in the AY 2006-07 and it had no relation with the year under consideration. The AO disallowed depreciation claim. Subsequently, the Commissioner of Income-tax (Appeals) [CIT(A)] upheld the order of the AO.

Tribunal's decision

Section 32 is a provision governing the grant of depreciation. It is the 'written down value' of the block that constitutes the bedrock for allowing depreciation and hence it is out of point to claim or allow depreciation on any value other than the WDV of the block.

Ongoing through the provision, it indicates that 'written down value' on and from the AY 1989-90 means the opening WDV of the concerned block of asset as increased by the actual cost of any asset falling within that block purchased and reduced by the sale consideration of the assets sold from the block during the year. Therefore, it indicates that definition of 'written down value' does not encompass any reduction in the value of existing asset in the block except when it is sold.

Going with the definition there was no scope for making any adjustment in the WDV of the block on account of waiver of loan in respect of an asset which was purchased in an earlier year. Once depreciation was to be granted under Section 32 on the WDV of the block of asset, it is vivid that no disallowance of depreciation can be made without first lawfully reducing the WDV of the block.

¹ Shapers India Private Limited v. DCIT (ITA No.2965/PUN/2017) – Taxsutra.com

The Tribunal rejected the contention of the taxpayer that the 'actual cost' of an asset once determined in the year of purchase cannot be altered in a later year and hence even the Explanation 10 cannot be triggered in a later year so as to reduce the actual cost with any amount other than sale proceeds of the assets. A plain and literal reading of Section 43(1) rules out such an interpretation canvassed on behalf of the taxpayer.

Explanation 8 to Section 43(1) provides 'that where any amount is paid or is payable as interest in connection with the acquisition of an asset, so much of such amount as is relatable to any period after such asset is first put to use shall not be included, and shall be deemed never to have been included, in the actual cost of such assets'. A reading of the proviso to Section 36(1)(iii) in juxtaposition to the Explanation 8 to Section 43(1) makes it discernible that any interest paid on capital borrowed for acquisition of an asset till the date such asset is first put to use was not allowable as deduction but is to be treated as a part of its actual cost. Thus, the interpretation suggested by the taxpayer for restricting the modification of the 'actual cost' of an asset only to the year of its purchase does not sound well.

The waiver took place in the year ending 31 March 2006. The AO did not reduce the amount of waiver from the value of block of asset for that year and allowed the gross value of the block to attain finality. The position continued as such in later years as well when the taxpayer kept on claiming depreciation after giving a similar note in the final accounts.

In the year ending 31 March 2011 under consideration, no event activating either Section 43(6) or the opening part of Section 43(1) or the Explanation 10 had happened, which could have disturbed the WDV or the actual cost so as to warrant reduction in the value of block of asset and the consequential depreciation thereon.

The Finance Act, 2015 introduced² clause (xviii) to Section 2(24), with effect from 1 April 2016. Section 2(24)(xviii) is activated in the year when the 'waiver or concession' takes place. It assumes the character of income in the year of its receipt. The point worth noting is that whereas the subsidy or grant or reimbursement received in terms of Explanation 10 to Section 43(1) adjusts the actual cost of asset, any amount of such incentive or reimbursement or waiver etc. which does not fall within the realm of the Explanation 10 assumes the character of income directly in the year of its receipt without disturbing the 'actual cost' or 'written down value' of the block of asset.

² Section 2(24)(xviii) provides that: 'assistance in the form of a subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement (by whatever name called) by the Central Government or a State Government or any authority or body or agency in cash or kind to the taxpayer other than,— (a) the subsidy or grant or reimbursement which is taken into account for determination of the actual cost of the asset in accordance with the provisions of Explanation 10 to clause (1) of section 43; or....' shall constitute income.

The logic behind Section 2(24)(xviii) is simple and clear that if the taxpayer has received any subsidy or grant or waiver or concession or reimbursement etc. in respect of an asset, which is otherwise a capital receipt and further that the same cannot be reduced from the actual cost of the asset or the WDV, then it should be subjected to tax as an income of such a year. This provision runs on parity with Section 41(1), which provides for taxation of remission or cessation of a trading liability. One thing which is common to both in Sections 2(24)(xviii) and 41(1) is that the taxability takes place in the year of receipt of waiver or concession and not any other year.

Section 2(24)(xviii) has itself been introduced from the AY 2016-17. As such, it can have no application either to the AY 2003-04 when the machinery was purchased or to the AY 2006-07 when the waiver of loan was received or the year in appeal. The waiver of loan in the earlier year has no impact either on the actual cost under Section 43(1) or the WDV under Section 43(6) for the year under consideration and further Section 2(24)(xviii) also does not envelope such waiver within the ambit of 'income' for the extant year.

Accordingly, depreciation was allowed on the WDV of the block of machinery at the gross value without reducing the waiver of loan therefrom.

Our comments

The Supreme Court in the case of PJ Chemicals Ltd.³ had held that the object of the subsidy was to promote industrial growth in the States and merely because the quantum of the subsidy was calculated as a percentage of the capital investment made by the taxpayer in the assets such as land, building, plant and machinery etc., it cannot be said that the Government met a portion of the cost of the asset directly or indirectly. Accordingly, the taxpayers were held entitled to the depreciation on the actual cost without being reduced by the amount of the subsidy.

Subsequently, the Finance (No. 2) Act, 1998 introduced Explanation 10 to Section 43(1) with effect from 1 April 1999. The Explanation provides that where a portion of the cost of an asset acquired by the taxpayer has been met directly or indirectly by the government or any authority established under any law or by any other person, in the form of a subsidy or grant or reimbursement, then, so much of the cost as is relatable to such subsidy or grant or reimbursement is to be excluded from the actual cost of the asset to the taxpayer.

Considering the Supreme Court decision and Explanation 10 to Section 43(1), the Delhi High Court⁴ held where government has waived off loan granted towards cost of assets, taxpayer's case fell under Section 43(1) and, thus, depreciation on assets was to

³ CIT v. PJ Chemicals Ltd. [1994] 210 ITR 830 (SC)

⁴ Steel Authority of India Ltd v. CIT [2012] 20 taxmann.com 198 (Del)

be disallowed to extent of loan so waived off. The Delhi High Court also observed that Explanation 10 to Section 43(1) was introduced to ensure appropriate computation of actual cost of assets in case subsidy is received. After the introduction of Explanation 10, it is no longer possible to contend that the subsidy given by the Government, by whatever name called, cannot be reduced from the actual cost of the assets in terms of Section 43(1) for the purpose of allowing depreciation. But Explanation 10 does not cover the case of waiver of the loan. It covers only the grant of a subsidy or reimbursement by whatever name called.

In the Delhi High Court's case of Steel Authority of India Ltd, the taxpayer was not falling under Explanation 10, but having regard to the facts of the case, the waiver of the loan amounted to the meeting of a portion of the cost of the assets under the main provisions of Section 43(1). The waiver of the loan was not a mere quantification of a subsidy granted generally for industrial growth. It was granted specifically to the taxpayer and the taxpayer in its books of account reduced the cost of the assets by the amount waived. This reflected a contemporaneous understanding of the purpose of the grant of the loan on the part of the taxpayer.

The Ahmedabad Tribunal in the case of Steelco Gujarat Ltd.⁵ had considered the Explanation 10 and observed that the waiver of loan does not fall into either of the three terms used in the Explanation 10 to Section 43(1) or proviso thereof. Further, there has to be direct nexus of loan with purchase of plant and machinery. In that case, plant and machinery were already existing prior to taking of the loan. Therefore, grant of loan could not be related to the purchase of plant and machinery. Therefore, it could not be inferred that it was given to meet the cost of plant and machinery.

The above observations and Explanation 10 are very important to determine whether the waiver of loan is to be deducted from actual cost of the asset.

The Tribunal in the present case held that the waiver of loan in the earlier year has no impact either on the actual cost of assets under Section 43(1) or the WDV under Section 43(6). Thus there was no requirement for reduction in the value of block of asset and the consequential depreciation thereon.

The Tribunal also observed that Section 2(24)(xviii) has itself been introduced from the AY 2016-17. It was not applicable either to the AY 2003-04 when the machinery was purchased or to the AY 2006-07 when the waiver of loan was received or the year in appeal.

In the definition of the term 'income' clause (xviii) inserted by the Finance Act, 2015 to provide that assistance in the form of subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement by the government or any other authority or body or agency shall be treated as an income. However, if the subsidy or grant or reimbursement is considered in determining the actual cost of assets in accordance with the Explanation 10 to section 43(1), then it will not be treated as an income. It is important to note that while Section 2(24)(xviii) uses the word 'waiver' but corresponding expression is not found in the Explanation 10.



⁵ Steelco Gujarat Ltd. v. ACIT [2009] 33 SOT 437 (Ahd)

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