Chapter I: Introduction

1.1 Introduction

Depreciation is a method of allocating cost of a tangible asset over its useful life. In every business, apart from current costs, the cost of capital assets employed in the business has to be recouped over the period of productive use of the assets. Therefore, most of the businesses depreciate long term assets for both accounting and tax purposes. Amortisation is paying off debt in regular installments over a period of time. This method measures the consumption of value of intangible asset such as a patent or a copyright. The amortisation and depreciation are often used interchangeably and are similar accounting concepts which are technically not a correct practice because amortisation refers to intangible assets and depreciation refers to tangible assets.

The Income Tax Act, 1961 (Act) provides for depreciation on the assets viz buildings, machinery, plant or furniture, being tangible assets and know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature, being intangible assets acquired on or after the 01 April, 1998.

Paying off of a debt in regular installments or allowance of deduction of capital expenses over a specific period of time (usually over the asset's life) is recorded as amortisation in the financial statements of an entity as a reduction in the carrying value of the intangible asset in the balance sheet and as an expense in the income statement.

The entities like individuals, Firms, Association of Persons, Trusts etc maintain their accounts and claim depreciation as per the Act. However, Companies maintain their accounts as per the Companies Act 1956 but for purpose of Income Tax, they compute and claim the depreciation as per the Act.

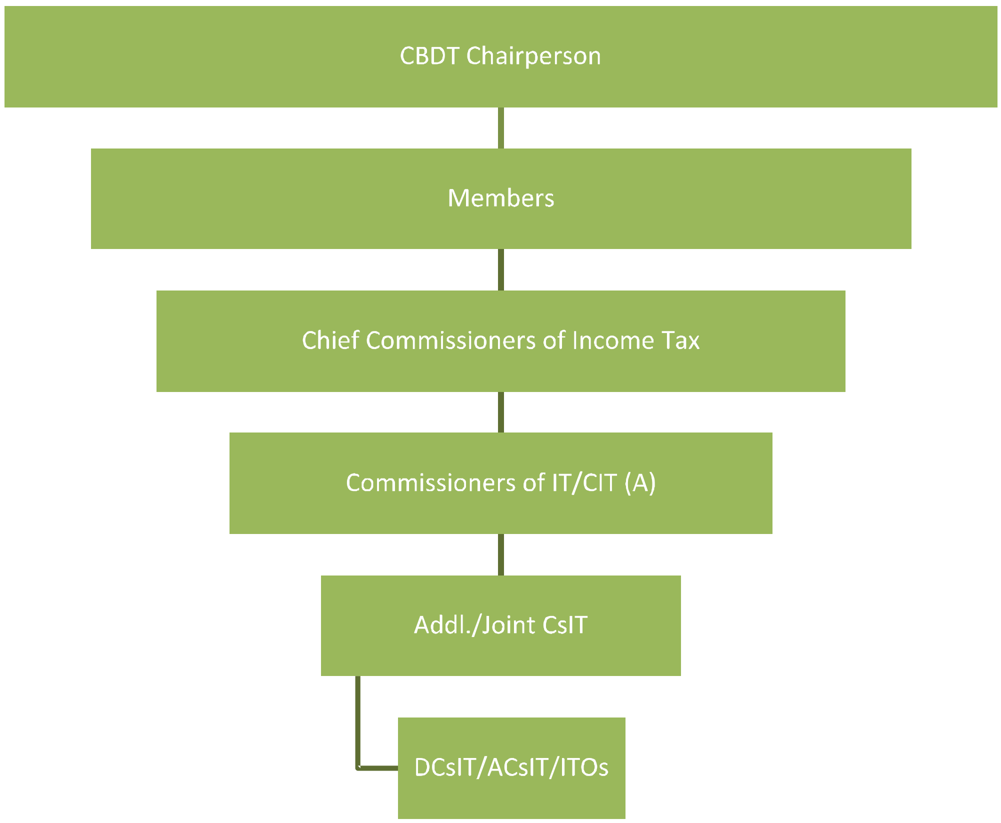
The Act lays down diverse provisions on depreciation and/or amortisation for tax purposes as deduction to an assessee/a company in the course of its business with the intention for promoting economic growth within the country.

1.2 Organizational set up

Central Board of Direct Taxes (CBDT), as a part of Department of Revenue, Ministry of Finance (Ministry), is the apex body charged with administration of Direct Taxes. CBDT is headed by the Chairperson and comprises of six

Members. In addition to their functions and responsibilities, the Chairperson and Members are responsible for exercising supervisory control over field offices of the CBDT, known as Zones. Chief Commissioner of Income Tax (CCIT) heads the field office whose jurisdiction is generally co-terminus with the state. Each CCIT is assisted by CsIT, Additional/Joint CsIT, Deputy CsIT, Assistant CsIT and ITOs.

Graph 1.1: Organogram of CBDT



1.3 Revenue forgone on account of accelerated depreciation

The Receipt Budget of Government of India includes a separate Budget document titled "Statement of Revenue Forgone", which seeks to enlist the revenue impact of tax incentives or tax subsidies being a part of the tax system. The rates of depreciation under the Act differ from those provided under Companies Act. The revenue forgone, inter alia, on account of accelerated depreciation[1] where rate under Act is more than Companies Act, is worked out by first determining the difference between the depreciation/deduction debited to the profits and loss account by the

[1] The word 'accelerated depreciation' has been used in the Receipt Budget of Government of India.

Companies and then allowing depreciation/deduction admissible thereon under the Act and applying tax rates on the sum so worked out.

Revenue forgone figures on account of accelerated depreciation in the Receipt Budget for the years starting from FY 09 to FY 13 are shown in Table 1.1.

Table 1.1: Revenue forgone on account of accelerated depreciation

(₹ in crore)

Financial Year	Total Revenue Forgone	Revenue Forgone on account of Accelerated depreciation	% of Revenue Forgone on account of Accelerated depreciation to total Revenue Forgone
FY 09	1,04,471	21,175	20.27
FY 10	1,18,023	29,308	24.83
FY 11	94,738	33,243	35.09
FY 12	1,01,140	34,320	33.93
FY 13	1,13,466	37,831	33.34
Note: The revenue forgone figures are as per Receipts Budget. For FY 13, figures of revenue forgone are projected.			

The above table indicates that percentage of revenue forgone on account of accelerated depreciation to total revenue forgone ranged between 20.27 to 35.09 *per cent* during FY 09 and FY 13.

1.4 Why we chose the topic

Depreciation/amortisation play a significant role in determining and presenting the financial position and results of operation of an enterprise. In capital intensive sectors, the taxable income becomes negative particularly in the initial period due to sizeable amount of depreciation. Since the revenue forgone on account of accelerated depreciation is more than 30 *per cent* of total revenue forgone during FY 11 to FY 13, we decided to evaluate the system of allowance of depreciation and amortisation as provided in the Income Tax Act, 1961.

Previously, we had reviewed the Scheme of Depreciation Allowance in the year 1991[2]. We had also examined the applicability of provisions relating to depreciation in the year 2004[3]. Therefore, we decided to review the system of allowance of depreciation and amortisation to see whether the deficiencies pointed out earlier still exist.

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[2] C&AG Audit Report No. 5 of 1993 (Para No. 2.01 on the Scheme of Depreciation Allowance)

[3] C&AG Audit Report No. 13 of 2005 (Chapter 2 – Efficiency and effectiveness of administration and implementation of Selected Deductions and Allowances under Income Tax Act)

1.5 Audit objectives

The Performance Audit is intended to focus on whether:

a. the systems and procedures are sufficient and in place to ensure compliance with the provisions of the Act/Rules and instructions issued by CBDT in this regard;

b. adequate internal control mechanism exists for monitoring the allowance of depreciation in general and under special circumstances viz., amalgamation, demerger, reconstruction etc;

c. there are lacunae or ambiguities in the provisions of the Act, if any, in the administration or policy relating to depreciation and amortisation.

1.6 Legal framework

Provisions relating to allowance of depreciation and amortisation are available in Sections 2(11), 32, 43(1), 43(6), 43A, 35D, 35DD, 35DDA and 72A of the Act and are briefly described in **Appendix 1**. Besides, the allowances are also governed by latest judicial pronouncements as well as Circulars/Instructions issued by the CBDT. Appendix I & IA to the Income Tax Rules, 1962, provide for rates of depreciation on different assets, owned and used by the assessee in the course of business.

1.7 Audit scope

The Performance Audit covered assessments completed during the period FY 10 to FY 13 and upto the date of audit. In case of major audit observations, assessment records of previous assessment years (AYs) were also linked wherever found necessary.

1.8 Sample selection

All cases of scrutiny assessments, appeal and rectification cases, except cases where salary was the only source of income and there was no impact of depreciation on income, within the selected units were examined in audit. All circles/wards taken up for regular audit during the period from July to September 2013 were treated as selected units.

1.9 Audit findings

We have checked 87,023 records of the assessees pertaining to the period FY 10 to FY 13 including the period up to the date of audit. Audit findings have been discussed in subsequent Chapters viz; Systemic issues, Allowances of Depreciation and Amortisation and Internal Controls. While making comments on any specific irregularity/ mistake/ lacunae in the Act etc in this Report, relevant Codal provision/ Judicial pronouncement/ Circular/

Instruction have been appropriately mentioned in the beginning of the paragraph.

1.10 Constraints

ITD did not produce all the records requisitioned in audit. **Appendix 2** depicts the status of the non-production of records in different states all over India. Another hindrance in identifying the assessees for examination in audit was the non-maintenance of records of the assessees in company circles availing benefit of depreciation and amortisation as well.

1.11 Acknowledgement

We held an entry conference with CBDT on 04 September 2013 wherein we explained the audit objectives, scope and the main focus of audit examination. The Indian Audit and Accounts Department acknowledges the co-operation of ITD in facilitating the audit by providing the necessary records and information in connection with the conduct of this Performance Audit.

We issued draft Performance Report to the Ministry in April 2014 for their comments. After receipt of Ministry's reply in May 2014, we held exit conference on 29 May 2014 to discuss our findings and recommendations vis-à-vis Ministry's comments. We again issued draft Performance Report in June 2014 containing Ministry's views and audit stand thereon for their further comments. We received further comments from the Ministry in June 2014 which have also been appropriately incorporated in the report together with audit comments thereon.