

GN(A) 7 (Issued 1989)

Guidance Note on Accounting for Depreciation in Companies

Foreword

The subject of accounting for depreciation has always been a matter of crucial importance for the purpose of true and fair determination of the operating results of an entity and the depiction of its financial position through its profit and loss account and the balance sheet, respectively. In the case of companies, some new issues have arisen in this regard because of recent amendments in the relevant provisions of the Companies Act, in particular, delinking of depreciation rates for the purpose of the provisions of the Companies Act from the rates prescribed under the Income-tax Act, 1961, by introduction of new Schedule XIV in the Companies Act. Though Schedule VI to the Companies Act, 1956, requires only a disclosure of depreciation not provided, it is obvious that depreciation has to be provided in all cases so that the accounts give a true and fair view.

With a view to provide an authoritative position of the Institute on the issues arising out of the said amendments in this regard and to consolidate and revise the existing pronouncements on the subject of accounting for depreciation, in particular reference to the companies, issued by the Institute and its various Committees, the Research Committee of the Institute has brought out this Guidance Note on Accounting for Depreciation in Companies.

I hope that this endeavour of the Research Committee will go a long way in providing guidance to the members - in industry as well in practice - in the performance of their day-to-day duties.

New Delhi
September 13, 1989

K.G. Somani
President

Preface

The Council of the Institute and its various Committees had issued, from time to time, various statements/guidance notes on the subject of accounting for depreciation, with particular reference to companies. By virtue of the amendment in Section 350 of the Companies Act, 1956, through the Companies (Amendment) Act, 1988, the rates of depreciation prescribed in Income-tax Act, 1961 and the rules made thereunder are no longer relevant for the purposes of the Companies Act as the aforesaid section now prescribes that the rates of depreciation applicable would be those prescribed in the newly inserted Schedule XIV to the Companies Act. Since the amendment has repercussions, inter alia, on the accounting for depreciation in companies, the Research Committee of the Institute considered it imperative that the erstwhile pronouncements on the subject should be revised and incorporated at one place for the convenience of the users.

This Guidance Note on Accounting for Depreciation in Companies, accordingly, comprehensively deals with various aspects of accounting for depreciation, such as, methods of charging depreciation (including change in the method of providing depreciation), relevant rates of depreciation for the purpose of preparation of accounts of a company with particular reference to Schedule XIV, pro-rata computation of depreciation, depreciation on low value items, charge of depreciation in case of revaluation of assets and other matters arising on account of amendments in the Companies Act, 1956.

I am confident that this guidance note will immensely benefit our members in industry as well as in professional practice in effective discharge of their responsibilities.

New Delhi
September 14, 1989

N. P. Sarda
Chairman
Research Committee

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Guidance Note on Accounting for Depreciation in Companies¹

Introduction

1. The Council of the Institute of Chartered Accountants of India has issued Accounting Standard (AS) 6 on 'Depreciation Accounting'. This Standard lays down general principles of accounting for depreciation applicable to all entities. As such, the Standard is applicable to companies also in all matters where there are no specific requirements under the Companies Act. AS 6 also provides that the statute governing an enterprise may provide the basis for computation of depreciation. In such a situation, the requirements of the statute have to be complied with. Thus, in case of companies, sections 205 and 350 of the Companies Act, 1956, which govern provisions regarding charge of depreciation for the purpose of payment of dividends and computation of managerial remuneration, respectively, provide the basis for computation of depreciation. The Companies (Amendment) Act, 1988, has amended section 350, as a consequence to which rates of depreciation prescribed in Income-tax Act, 1961, and the Rules made thereunder are no more relevant as the aforesaid section now provides that the rates of depreciation applicable would be those prescribed in Schedule XIV, which has been inserted in the Act. This Guidance Note on Accounting for Depreciation in Companies is issued by the Research Committee in the context of the aforesaid sections of the Act as well as the Accounting Standard.

2. The Council of the Institute and its various committees have issued, from time to time, various pronouncements on the subject of accounting for depreciation, in particular reference to the corporate sector, which are listed below:

- (a) Guidance Note on Provision for Depreciation [published in Compendium of Guidance Notes, Vol. 1 (2nd Edition)]
- (b) Statement on Provision for Depreciation in Respect of Extra or

¹ This Guidance Note also applies to various non-corporate entities to the extent it may be relevant though it has been issued specifically for companies.

Compendium of Guidance Notes - Accounting

- Multiple Shift Allowance [Published in Compendium of Statements and Standards on Accounting, 1st Edition]
- (c) Statements on Changes in the Mode of Charging Depreciation in Accounts [Published as an Appendix in the Guide to Company Audit]
 - (d) Guidance Note on Accounting for Depreciation Consequent to Changes in Rates of Depreciation [Published in Compendium of Guidance Notes, Vol. II, 1st Edition]

This Guidance Note comes into effect in respect of accounting periods commencing on or after 1st April, 1989. Accordingly, the above Guidance Notes/Statements stand withdrawn from that date.

Methods of Charging Depreciation

3. Section 205 of the Companies Act, 1956, prescribes the methods of charging depreciation. The relevant extracts thereof are as follows:

“(2)....depreciation shall be provided either-

- (a) to the extent specified in section 350; or
- (b) in respect of each item of depreciable asset, for such an amount as is arrived at by dividing ninety-five percent of the original cost thereof to the company by the specified period in respect of such asset; or
- (c) on any other basis approved by the Central Government which has the effect of writing off by way of depreciation ninety-five percent of the original cost to the company of each such depreciable asset on the expiry of the specified period; or
- (d) as regards any other depreciable asset for which no rate of depreciation has been laid down by this Act or rules made thereunder, on such basis as may be approved by the Central Government by the general order published in the Official Gazette or by any special order in any particular case:

Provided that where depreciation is provided for in the manner laid down in clause (b) or clause (c), then, in the event of the depreciable

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asset being sold, discarded, demolished or destroyed the written down value thereof at the end of the financial year in which the asset is sold, discarded, demolished or destroyed, shall be written off in accordance with the proviso to section 350.

.....

(5) 'Specified period' in respect of any depreciable asset shall mean the number of years at the end of which at least ninety-five per cent of the original cost of the asset to the company will have been provided for by way of depreciation if depreciation were to be calculated in accordance with the provisions of section 350."

.....

4. Note No. 5(i) to Schedule XIV requires that depreciation method(s) used by the company shall be disclosed. Part II of Schedule VI requires that if no provision is made for depreciation, the fact that no provision has been made should be stated and the quantum of arrears of depreciation computed in accordance with section 205(2) of the Act shall be disclosed by way of a note. The Committee is of the view that the company should also disclose the method(s) by which the arrears of depreciation have been computed.

Adoption of different methods for different types of assets

5. A company may adopt more than one method of depreciation. Thus, it is permissible to follow different methods for different types of assets provided the same methods are consistently adopted from year to year in accordance with Section 205(2). Also, units in different geographical locations can follow different methods of depreciation provided the same are consistently followed.

Change in the method of providing depreciation

6. The depreciation method selected should be applied consistently from period to period. A change from one method of providing depreciation to another should be made only if the adoption of the new method is required by statute or for compliance with an accounting standard or if it is considered that the change would result in a more appropriate preparation or presentation of the financial statements of the enterprise. When a change in the method of depreciation is made, depreciation should be recalculated in accordance with the new method from the date of the asset coming into use.

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The deficiency or surplus arising from retrospective recomputation of depreciation in accordance with the new method would be adjusted in the accounts in the year in which the method of depreciation is changed. In case the change in the method results in deficiency in depreciation in respect of past years, the deficiency should be charged to the profit and loss account. In case the change in the method results in surplus, it is recommended that the surplus be initially transferred to the 'Appropriations' part of the profit and loss account and thence to General Reserve through the same part of the profit and loss account. Such a change should be treated as a change in accounting policy and its effects should be quantified and disclosed.

Relevant Rates of Depreciation for the Purpose of Preparation of Accounts of a Company

7. Section 205 of the Companies Act requires that no dividend shall be declared or paid by a company except out of the profits of the company arrived at after providing for depreciation in accordance with the provisions of sub-section 2 of that Section. This sub-section allows the company to provide for depreciation either in the manner specified in Section 350 of the Act or in the alternative manners specified in that sub-section itself. Part II of Schedule VI further provides that if no provision for depreciation is made, the fact that no provision has been made shall be stated and the quantum of arrears of depreciation computed in accordance with Section 205(2) of the Act shall be disclosed by way of a note.

8. A question may arise as to whether it is obligatory on a company to provide for depreciation only on the basis mentioned in Section 205(2) read with section 350 and Schedule XIV of the Act or whether these bases can be considered as indicating the minimum depreciation which must be provided by the company, insofar as the accounts of the company are concerned and insofar as it is required to exhibit a true and fair view of the state of affairs of the company as on a given date and of the profit or loss for the year.

9. The Committee is of the view that in arriving at the rates at which depreciation should be provided the company must consider the true commercial depreciation, i.e., the rate which is adequate to write off the asset over its normal working life. If the rate so arrived at is higher than the rates prescribed under Schedule XIV, then the company should provide depreciation at such higher rate but if the rate so arrived at is lower than the rate prescribed in Schedule XIV, then the company should provide

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depreciation at the rates prescribed in Schedule XIV, since these represent the minimum rates of depreciation to be provided. Since the determination of commercial life of an asset is a technical matter, the decision of the Board of Directors based on technological evaluation should be accepted by the auditor unless he has reason to believe that such decision results in a charge which does not represent true commercial depreciation. In case a company adopts the higher rates of depreciation as recommended above, the higher depreciation rates/lower lives of the assets must be disclosed as required in Note No. 5 of Schedule XIV to the Companies Act, 1956.

10. This view is supported by the Department of Company Affairs and it has clarified that "the rates as contained in Schedule XIV should be viewed as the minimum rates, and, therefore, a company will not be permitted to charge depreciation at rates lower than those specified in the Schedule in relation to assets purchased after the date of applicability of the Schedule. If, however, on the basis of bona fide technological evaluation, higher rates of depreciation are justified, they may be provided with proper disclosure by way of a note forming part of annual accounts"².

11. The Committee is, however, of the view that in respect of assets existing on the date of Schedule XIV coming into force, and where the company is following the Circular of the Department of Company Affairs bearing No. 1/86, dated 21st May, 1986, whereby depreciation under straight line method was worked out based on depreciation rates in force under Income-tax Act, 1961 and Rules made thereunder at the time of the acquisition of the asset, it would be permissible to the company to follow Circular no. 1/86, dated 21st May, 1986. An appropriate note will be required to be given in this regard.

12. Schedule XIV requires that where the concern has worked extra shift, the multiple or extra shift depreciation will have to be provided on the plant and machinery, wherever applicable. In this regard, various units/ departments/mills/factories should be taken as separate concerns. In cases where depreciation has not been provided in respect of extra or multiple shift allowance, it will be necessary for the auditor to qualify his report accordingly. An example of the qualification is given below:

"Depreciation in respect of extra or multiple shift allowance amounting to rupees has not been provided which is contrary to the

² Circular No. 2/89, dated March 7, 1989 (Annexure I)

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provisions of Schedule XIV to the Companies Act. This has resulted in the profit being overstated by Rs and plant and machinery overstated by Rs.....”.

13. It has been argued that the SLM rates (corresponding to the WDV rates as per Schedule XIV) can be different than those prescribed under Schedule XIV, provided the company continues to determine the rates as provided under Section 205. For instance, against the SLM rate of 11.31% (triple shift rate for general plant and machinery) prescribed in Schedule XIV, a company can charge depreciation at the rate of 10.56%. It may be mentioned that the rate of 11.31% has been determined on the basis of 8 years and 6 months or so of specified period whereas 10.56% is arrived at if 95% of the cost of the asset is divided by 9 years. It is argued that for calculating the SLM rates complete years have to be taken into account whereas the rates under Schedule XIV also take into account fractions of years.

14. The Committee is of the view that a company should provide SLM depreciation at the rates prescribed under Schedule XIV instead of holding the contention that fractions of years can be ignored. This view is supported by Department of Company Affairs, as per its Circular No. 2/89, dated March 7, 1989.

Applicability of the rates prescribed in Schedule XIV to assets existing on the date on which Schedule XIV came into force.

15. Applicability of the rates prescribed in Schedule XIV to existing assets would depend upon whether the company has been charging depreciation on its assets as per the written down value method or the straight line method.

16. Where a company has been following the written down value method of depreciation in respect of its assets, the WDV rates prescribed in Schedule XIV should be applied to the written down value as at the end of the previous financial year as per the books of the company.

17. Where a company has been following the straight line basis of depreciation in respect of its assets the position prevailing at present is discussed hereunder.

18. In January, 1985, the Department of Company Affairs issued a circular No. 1/85 dated 10.1.1985 (enclosed as Annexure II). In this Circular, the Government recognised the need for recalculating the specified period

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consequent to changes in the income-tax rates. For determining depreciation consequent upon changes in the income-tax rates it recommended the following method:

- (i) As far as recomputation of specified period is concerned, the specified period be recomputed by applying to the original cost, the revised rate of depreciation as prescribed under Income-tax Rules.
- (ii) As far as charge of depreciation is concerned, depreciation be charged by allocating the written down value as per books over the remaining part of the recomputed specified period.

19. The Department of Company Affairs issued another Circular (No. 1/86 dated 21st May, 1986, enclosed as Annexure III) wherein it re-examined its earlier Circular of 1985. The Department accordingly expressed its view that "once the 'specified period' was determined at the time of purchase of an asset in accordance with the procedure laid down under Section 205(5) read with Section 350 of the Companies Act with reference to the rates of depreciation under the Income-tax Act at that time and the amount of depreciation fixed under Section 205(2)(b) of the Companies Act, the same need not be changed subsequently consequent on changes in the rates of depreciation in the Income-tax Act." The Circular further stated that it was therefore "open to the companies to provide for depreciation under clause (b) of Section 205(2) of the Companies Act on the basis of rates of depreciation prescribed under Income-tax Act and in force at the time of acquisition/purchase of the asset."

20. In its Circular No. 2/89 dated March 7, 1989, the Department has reiterated that the companies which follow Circular No. 1/86 "may, therefore, continue to charge depreciation at the old SLM rates in respect of the already acquired assets against which depreciation has been provided in earlier years on SLM basis."

21. The Committee is of the view that where a company is following the straight line method of depreciation in respect of its assets existing on the date of Schedule XIV coming into force, it would be permissible to apply the relevant SLM rates prescribed in the said Schedule on the original cost of the assets from the year of the change of rates.

22. The Committee is accordingly of the view that where a company has been following straight line method of depreciation in respect of its assets

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existing on the date of Schedule XIV coming into force, the following alternative bases may be adopted for computing the depreciation charge:

- (a) Where a company follows the manner of charging depreciation recommended by the Department of Company Affairs in its Circular No. 1/85, it has to change its depreciation rates as follows:
 - (i) the specified period should be recomputed by applying to the original cost, the revised rate as prescribed in Schedule XIV;
 - (ii) depreciation charge should be calculated by allocating the unamortised value as per the books of account over the remaining part of the recomputed specified period.
- (b) A company which follows the Circular No. 1/86, can continue to charge depreciation on straight line basis at old rates in respect of assets existing on the date on which the new provisions relating to depreciation came into force.
- (c) SLM rates prescribed in Schedule XIV can be straightaway applied to the original cost of all the assets including the existing assets from the year of change of the rates.

23. A company which changes the rates of depreciation should make an appropriate disclosure in its accounts pertaining to the year in which the change is made.

Pro-rata Depreciation

24. Note no.4 in Schedule XIV to the Companies Act, 1956, prescribes that “where, during any financial year, any addition has been made to any asset, or where any asset has been sold, discarded, demolished or destroyed, the depreciation on such assets shall be calculated on a *pro rata* basis from the date of such addition or, as the case may be, up to the date on which such asset has been sold, discarded, demolished or destroyed”. The Committee is of the view that a company may group additions and disposals in appropriate time period(s), e.g., 15 days, a month, a quarter etc., for the purpose of charging *pro rata* depreciation in respect of additions and disposals of its assets keeping in view the materiality of the amounts involved.

25. Where the financial year of a company is more/less than 12 months, a question may arise as to whether the rates of depreciation prescribed in Schedule XIV are to be applied proportionately to the duration of the financial year of the company or the said rates are to be applied as flat rates irrespective of the duration of the financial year. It may be argued that since section 205 and 350 of the Companies Act, 1956, are in relation to the financial year, the rates prescribed in Schedule XIV are applicable in respect of the financial year of the company, irrespective of its duration. The Committee is, however, of the opinion that in view of the true and fair consideration of preparation of accounts, the rates of depreciation as per Schedule XIV should be applied proportionately taking into consideration the duration of the financial year.

Depreciation on Low Value Items³

26. Prior to the enforcement of the Companies (Amendment) Act, 1988, many companies used to follow the practice of writing off low value items in the year of acquisition, since such a write off was permitted under the Income-tax Act. The limit for such a write off was Rs. 5,000/-. Schedule XIV is, however, silent on this aspect. The Committee is of the view that the concept of materiality should be kept in mind while deciding the amounts to be written off in this regard. For instance, in small companies, the total write off on this basis may be a substantial figure, it may not, therefore, be proper to charge 100% depreciation on low value items. However, in large companies, where the value of assets is very high, it may be proper to charge 100% depreciation on low value items keeping in view the concept of materiality. The Committee recommends that the accounting policy followed by the company in this regard should be disclosed appropriately in the accounts.

Computation of Managerial Remuneration — Whether SLM Rates given in Schedule can be used

27. The Department of Company Affairs, as per its circular no. 3\19\88-CL. V, dated April 13, 1989, has stated that “For the purpose of determining net profits of any financial year the amount of depreciation required to be

³ This paragraph stands superseded by the 'Guidance Note on Some Important Issues Arising from the Amendments to Schedule XIV to the Companies Act, 1956', issued in August 1994.

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deducted in pursuance of clause (k) of sub-section (4) of Section 349 read with Section 350 shall be the amount calculated as per the written down value method at the rate specified in Schedule XIV, on the assets as shown by the books of the Company at the end of the relevant financial year". The Committee is of the opinion that the language of Section 350 as it stands at present, does not permit the use of the Straight Line Method. The aforesaid section makes reference to 'written-down value of the assets' indicating thereby that for the purposes of computation of managerial remuneration, only the WDV method can be used as the SLM rates, by definition, are applicable only to the original cost of the assets and not to the WDV of the assets.

Charging of Depreciation in Case of Revaluation of Assets

28. A question may arise, as to whether the additional depreciation provision required in consequence of revaluation of fixed assets can be adjusted against "Revaluation Reserve" which is created by a company by transferring the difference between the revalued figure and the book value of the fixed assets. Depreciation is required to be provided with reference to the total value of the fixed assets as appearing in the accounts after revaluation. However, for certain statutory purposes e.g., dividends, managerial remuneration etc., only depreciation relating to the historical cost of the fixed assets is to be provided out of the current profits of the company. In the circumstance, the additional depreciation relating to revaluation may be adjusted against "Revaluation Reserve" by transfer to Profit and Loss Account. In other words, as per the requirements of Part II of Schedule VI to the Companies Act, the company will have to provide the depreciation on the total book value of the fixed assets (including the increased amount as a result of revaluation) in the Profit and Loss Account of the relevant period, and thereafter the company can transfer an amount equivalent to the additional depreciation from the Revaluation Reserve. Such transfer from Revaluation Reserve should be shown in the Profit and Loss Account separately and an appropriate note by way of disclosure would be desirable. Such a disclosure would appear to be in consonance with the requirement of Part I of Schedule VI to the Companies Act, prescribing disclosure of write-up in the value of fixed asset for the first five years after revaluation.

29. If a company has transferred the difference between the revalued figure and the book value of fixed assets to the "Revaluation Reserve" and

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has charged the additional depreciation related thereto to its Profit and Loss Account, it is possible to transfer an amount equivalent to accumulated additional depreciation from the Revaluation Reserve to the Profit and Loss Account or to the General Reserve provided suitable disclosure is made in the accounts as recommended in this guidance note.

30. The Revaluation Reserve is not available for payment of dividends. This view is also supported by the Companies (Declaration of Dividend out of Reserves) Rules, 1975. Similarly, accumulated losses or arrears of depreciation should not be set off against Revaluation Reserve. However, the Revaluation Reserve can be utilised for adjustment of the additional depreciation on the increased amount due to revaluation from year to year or on the retirement of the relevant fixed assets (as discussed in paragraphs 28 and 29 above respectively).

31. The revaluation of fixed assets is normally done in order to bring into books the replacement cost of such assets. This is a healthy trend as it recognises the importance of retaining sufficient funds through additional depreciation in the business for replacement of fixed assets. As such, it will be prudent not to charge the additional depreciation against revaluation reserve, though the charge of additional depreciation against Revaluation Reserve is not prohibited as discussed in paragraphs 28 and 29 above. The practice of not charging the additional depreciation against Revaluation Reserve would also give a more realistic appraisal of the company's operations in an inflationary situation.

Annexure I

**Circular No. 2/89
No. 1/17/87-CL.V**

**Government of India
Ministry of Industry
Department of Company Affairs
Shastri Bhavan, 5th Floor, 'A' Wing
Dr. R. P. Road
New Delhi-1, the 7.3.1989**

To

All Chambers of Commerce & Industry.

Subject: Clarification on the provisions relating to depreciation under the Companies Act, 1956, as amended by the Companies (Amendment) Act, 1988.

Dear Sirs,

This Department has been receiving queries from different quarters on the subject mentioned above, from time to time, and, accordingly, the following clarifications are issued:

(1) *Date on which the new provisions relating to depreciation become effective:*

The Companies (Amendment) Act, 1988 specifically provides that Schedule XIV shall be deemed to have come into force on 2-4-1987. The amended provisions of Section 205 and 350 of the Act have come into force on 15-6-1988 by virtue of the notification issued by this Department. A question, therefore, arises whether depreciation can be charged on assets on the basis of the rates provided in Schedule XIV for accounting year ending between 2nd April, 1987 and 14th June, 1988.

In view of the intention of the legislature behind the amendments in Sections 205 and 350 of the Act, the amended provisions have come into force w.e.f. 2-4-1987.

(2) *Recomputation of specified period:*

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It is stated that in 1986, the Department had issued a circular stating that specified period once determined may not be recomputed. Accordingly, the Department had advised the companies that it was open for them not to recompute the specified period even when there is change in the rates of depreciation later on (as against the position of the Department's earlier circular of 1985 on the subject). It is argued that as far as the existing assets are concerned, the companies can follow either of the two circulars. An option under the 1986 circular would thus be available to the companies as at present not recomputing the specified period where the Straight Line Method is used. In other words, where a company decides to follow the 1986 circular, assets on which SLM depreciation was being charged can continue to be depreciated at old SLM rates.

In view of this Department's Circular No. 1 of 1986 (No. 1/1/86-CL.V), dated 21.5.1986, specified period once determined may not be recomputed. The companies which follow this circular may, therefore, continue to charge depreciation at the old SLM rates in respect of the already acquired assets against which depreciation has been provided in earlier years on SLM basis.

(3) Can higher rates of depreciation be charged?

It is stated that Schedule XIV clearly states that a company should disclose depreciation rates if they are different from the principal rates specified in Schedule. On this basis, it is suggested that a company can charge depreciation at rates which are lower or higher than those specified in Schedule XIV.

It may be clarified that the rates as contained in Schedule XIV should be viewed as the minimum rates, and, therefore, a company shall not be permitted to charge depreciation at rates lower than those specified in the Schedule in relation to assets purchased after the date of applicability of the Schedule. However, if on the basis of a bonafide technological evaluation, higher rates of depreciation are justified, they may be provided with proper disclosure by way of a note forming part of annual accounts.

(4) Can SLM rates be different than those specified under Schedule XIV?

It is stated that SLM rates (corresponding to the WDV rates as per Schedule XIV) can be different than those prescribed under Schedule XIV provided a company continues to determine the rates as provided under Section 205. Thus, against the SLM rates prescribed under Schedule XIV of 11.31% (triple shift rate for general plant and machinery), a company can

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charge depreciation at the rate of 10.56%. It may be mentioned that the rate of 11.31% has been determined on the basis of 8 years and 6 months or so of specified period whereas if 95% is divided by 9 years, the corresponding SLM rate comes to 10.56%. The argument is that for calculating the SLM rates complete years have to be taken into account whereas the rates under Schedule XIV also take into account fractions of years.

It is clarified that a company must necessarily provide SLM depreciation on the rates prescribed under Schedule XIV and the interpretation that fractions of years cannot be taken into account is not correct.

Yours faithfully,

U. P. Mathur
Director

Annexure II

**Circular No. 1/85
No. 1/1/85 CL.V No. 15/50/84-CL.VI**

**Government of India,
Ministry of Industry and Company Affairs,
Department of Company Affairs, New Delhi-1,
dated 10.1.1985**

To

All the Chambers of Commerce

Subject: Determination of Depreciation under Section 205(2)(b) of the Companies Act, 1956 consequent upon changes in the Income-tax Rates introduced by Finance Act, 1983.

Dear Sirs,

I am directed to say that during the year 1983, the rates of depreciation under Income-tax Act have been changed on some of the assets. As the depreciation provision in the annual accounts of the Companies Act, 1956 is related to the rates of depreciation as provided in the Income-tax Act, any change in the rates under Income-tax Act affects the provision of depreciation in the annual accounts of the companies. As a result, this Department has received several queries/representations from companies enquiring as to what procedure they should adopt for charging depreciation on straight line method on the assets purchased earlier to the change in the rates of depreciation as provided in the Income-tax Act.

2. This issue has been examined in this Department and it has been decided that under sub-section (5) of Section 205, "specified period" for providing depreciation on straight line method under clause (b) of sub-section (2) of Section 205 has to be recalculated on the basis of the revised rates under Income-tax Act. The companies which adopt the straight line method of depreciation should provide for the depreciation in their annual accounts on the following basis:

- (a) No. of years for which asset has already been depreciated, before the change in depreciation rate.

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Say, 'A' years

- (b) Specified period calculated at revised rates by which 95% of the original cost of asset would have depreciated on written down value method at revised rates.

Say, 'B' years

- (c) Written down value of the asset in the books at the beginning of the year in which rates have been changed under I.T. Act.

Say, Rs. 'X'

- (d) 5% of the original cost.

Say, Rs. 'Y'

- (e) Fixed installments of depreciation to be provided each year after the rate has been changed shall be calculated as per the formula.

$$\frac{X-Y}{B-A}$$

If 'A' is greater than 'B', then the amount (X-Y) may be provided for as depreciation in the year in which rates are changed.

3. You are requested to bring the above views of the Department to the notice of your member companies for their information and guidance.

Sooraj Kapoor
(Joint Director)

Annexure III

**(Circular No. 1/86)
No. 1/1/86-CL.V No. 15(50) 84-CL.VI**

**Government of India,
Ministry of Industry,
Department of Company Affairs,
Shastri Bhavan, 5th Floor, 'A' Wing
New Delhi, the 21-5-1986**

To

All Chambers of Commerce etc.

Subject: Determination of depreciation under Section 205 (2)(b) of the Companies Act, 1956 consequent upon changes in Income-tax Rates introduced by Finance Act, 1983.

Dear Sirs,

I am directed to refer to this Department's Circular of even number dated 10.1.1985 on the above subject and to say that the question of providing depreciation under straight line method and the calculation of specified period, as suggested in the Circular referred to above, has been re-examined. On reconsideration, the Department is of the view that once "Specified period" is determined at the time of purchase of an asset in accordance with the procedure laid down under section 205(5) read with section 350 of the Companies Act with reference to rates of depreciation under Income-tax Act at that time and amount of depreciation fixed under section 205(2)(b) of the Companies Act, the same need not be changed subsequently consequent on changes in the rates of depreciation under Income-tax Act. It is, therefore, open to the Companies to provide for depreciation under clause (b) of Section 205(2) of the Companies Act on the basis of rates of depreciation prescribed under the Income-tax Act and in force at the time of acquisition/purchase of the asset.

B. Bhavani Sankar
Joint Director (Accounts)