Depreciation on Motor cars Vs Income tax

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Come the month of March and the talk invariably centers around ways by which income tax can be saved or reduced before the close of the financial year. And if, you are carrying on a business or profession one of the major instruments of reducing taxes is to claim depreciation on the purchase of your new vehicle.

How does this actually work? It is important to understand that any expenditure incurred for the purpose of the business is allowed as a deduction from your business profits; as such, expenditure incurred on vehicle used in the business viz fuel expenses, repairs & maintenance expenditure, vehicle insurance are allowed as deductions for the said purpose. Besides in computing income from business one of the most important items of allowances is the allowance for depreciation, provided by Section 32 of the Income Tax Act.

What is depreciation? Depreciation is a non-cash expense which results from the reduction/diminution in the value of certain capital assets including cars etc. This deduction towards depreciation is very essential to arrive at the Income from Business/profession of the taxpayer and also to amortize the capital cost of the amount invested in business assets like factory building, machinery, plant, furniture, cars etc. The purpose of allowing depreciation is to provide in the course of time for replacement of asset which is allowed to be depreciated over a period of time.

To claim depreciation on vehicles following conditions have to be fulfilled:

- You must be the owner of the motor car.
- The car must be actually used by the owner for the purpose of his or her business or profession.
- The car must be used during the financial year.

Therefore in case you want to claim depreciation on new car before 31st March 2012 you need to ensure that the invoice of the new car is in your name or the name of the entity in which you want to purchase the car, the car needs to be registered with RTO office before 31st March 2012, since in Goa you cannot put the vehicle on the road without registering with the RTO and you need to have sufficient proof in terms of petrol bills etc in order to establish that the vehicle was use for your business or profession before 31st March 2012. It is always advisable to maintain a log book for your vehicle to establish extent of use of your car for business purposes vis-à-vis for personal use. To the extent that the vehicle is used for personal purposes depreciation could be proportionately disallowed by tax authorities.

The rate of depreciation for motor car is 15% while the rate of depreciation for motor buses, motor lorries and motor taxes used in the business of running them on hire is 30%. However if the car is purchased during the financial year and is used for the Business or Profession for less than 180 days i.e. purchased after 2nd October (3rd Oct in case of Financial Year 2011-12 since it is a leap year), depreciation shall be allowed at 50 percent of the allowable depreciation i.e. 1/2 of 15% ….7.5%.

However for the following financial year and thereafter the depreciation allowed will be 15% of the Written Down Value.

For eg: Motor car purchased on 1st March 2012 ` 10,00,000

Less: Depreciation for Financial Year 2011-12 is 7.5%
(1/2 of 15%) of ` 10 lacs
Written down value as on 31.3.12
Depreciation for FY 2012-13 (15% on ` 9,25,000/-)
WDV 31.03.13

- 75,000
- 9,25,000
- 1,38,750
- 7,86,250

If the tax payer or tax entity is in the 30% tax bracket i.e. partnership firms, companies and individuals whose annual taxable income exceeds ` 8 lacs, the saving in tax on account of depreciation in the above example would be as follows:

For FY 2011-12  Depreciation ` 75,000/-  Tax saved ` 22,500/-  
For FY 2012-13  Depreciation ` 1,38,750/-  Tax saved ` 41,625/-

Furthermore, incase if one has taken a loan for purchase of the vehicle then the interest on loan would be allowable as business expenditure.

It is to be noted that if one has opted for presumptive taxation scheme u/s 44AD of the Income Tax Act where you have the option of declaring your income at the rate of 8% of the gross receipts for turnover upto ` 60 lacs, then the benefit of depreciation on cars or other capital assets is presumed to have been claimed.

The benefit of depreciation of cars is only available in case you are carrying on a business or profession and not if you have only salary income.

In conclusion, buying a motor car before 31.03.12 just for the sake of saving taxes is not the right option. However in case you were anyway planning to buy a new vehicle now or in the coming 5-6 months, then preopening that decision to March would give you the benefits of saving tax for the Financial Year 2011-12.