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Goods and services tax on leasing transactions: Frequently Asked Questions

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1. Whether a lease is a supply of goods or supply of services?

Section 7 read with Schedule II of the Central Goods and Service Tax Act, 2017 lays down the list of activities that are treated as supply of goods and supply of services.

Clause 1 of Schedule II states that –

1. Transfer

(a) any transfer of the title in goods is a supply of goods;

(b) any transfer of right in goods or of undivided share in goods without the transfer of title thereof, is a supply of services;

(c) any transfer of title in goods under an agreement which stipulates that property in goods shall pass at a future date upon payment of full consideration as agreed, is a supply of goods.

A lease transaction usually does not by itself result into a transfer of title. A hire purchase transaction contains an option to buy the asset with the hirer –however, the cited definition of “transfer of goods” in Schedule II refers to a transaction positively resulting into a transfer. This is clear from use of the expression “property... shall pass”. A mere option to buy does not seem to be captured by the definition above. Therefore, it seems to cover conditional sales, and not hire purchase contracts. On the contrary, in all lease transactions there is a transfer of right to use the asset. Therefore, based on the above understanding it can be concluded that lease transactions shall be treated as “supply of services” for the purpose of GST.

However, if the financial lease involves an automatic transfer of asset after a period of time to the Lessee, the same shall be treated as “supply of goods”.

2. Does GST law make any specific provision for lease transactions?

There are no specific provisions relating to lease of movable properties. However, as per Schedule II, lease of land and building are treated as supply of services under the GST law. Accordingly, even if there is a lease of an immovable property, not being land and buildings, will also be chargeable to GST, as supply of services.

3. What is the ambit of GST in respect of leasing transactions?

The following provides a summary of applicability of GST on leasing transactions, and may be relevant in view of marked difference from the position prevailing before the advent of GST:

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- By type of lease as per accounting standards:
 - Financial lease – yes (however, please see detailed discussion later)
 - Operating lease – yes
- By type of property:
 - Immovable property being land and buildings – yes
 - Immovable property other than land and buildings – yes
 - Movable property – yes
- By type of consumer of the transaction:
 - B2B transactions – yes
 - B2C transactions – yes
 - C2C transactions – may not be “taxable person” or “casual taxable person”
- By cross-border movement
 - Cross-border leases into India – yes (IGST is applicable in case of imports)
 - Cross-border leases out of India – no
 - Leases in course of import or high seas transactions – concept may not remain highly relevant under GST regime – see discussion below.

4. Does the GST law make any distinction between financial lease and operating lease?

As per Schedule II, any transfer of right in goods amounts to supply of services. In case of both, operating leases and financial leases, there is a transfer of right to use to the goods from the Lessor to the Lessee. Therefore, under the GST law, both will be treated in similar way, unless otherwise provided in future.

However, here it is important to understand that the nature of a financial lease is admittedly a financial assistance and is akin to loan transactions. There have been several judicial pronouncements where it has been substantiated that financial leases are akin to loan. In the case of *Association of Leasing and Financial Services Company v/s Union of India*, paragraph 20 and 21 of the judgment clearly brings out the fact that financial leasing and hire purchase transactions are a mode of long term funding. In case of *Asea Brown Baveri Ltd v/s Industrial Finance Corporation of India*, the judgment brings fore the fact that financial lease is nothing but loans in disguise.

Currently, loan transactions, being money for money transactions, are outside the purview of taxable supply (since neither “goods” nor “services” include money). By that argument, since a financial lease is admittedly a monetary transaction, it stands to logic that the interest inherent in financial lease should be exempt. However, currently, the reality is far from the idealistic situation and on absence of any further clarification, financial leases shall continue to be taxed as supply of services or supply of goods based on the actual terms of the transaction.

5. What is the meaning of inter-state lease and what are the rules for determining whether the lease is an inter-state supply or intra-state supply?

A supply which is not intra-state supply is an inter-state supply.



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The meaning of “intra-state supply” comes from section 8 of the Integrated Goods and Service Tax Act, 2017 (IGST Act). As per section 8(2) of the IGST Act, an intra-state supply is where the place of the supply and the location of the supplier are in the same state or union territory. While the rules are different in case of goods, which has been dealt with in sections 10 and 11 of the IGST Act, and services, which has been dealt with in sections 12 and 13 of the IGST Act, in context of leasing transactions, we will be concerned with the rule pertaining to services, since a lease is a supply of service.

Therefore, where the place of the supply and the supplier are located in different states/ union territories, it is an inter-state supply of services. The meaning of place of supply of service has to be derived from section 12(2) of the IGST Act, which states –

(2) The place of supply of services, except the services specified in sub-sections (3) to (14),–

(a) made to a registered person shall be the location of such person;

(b) made to any person other than a registered person shall be,--

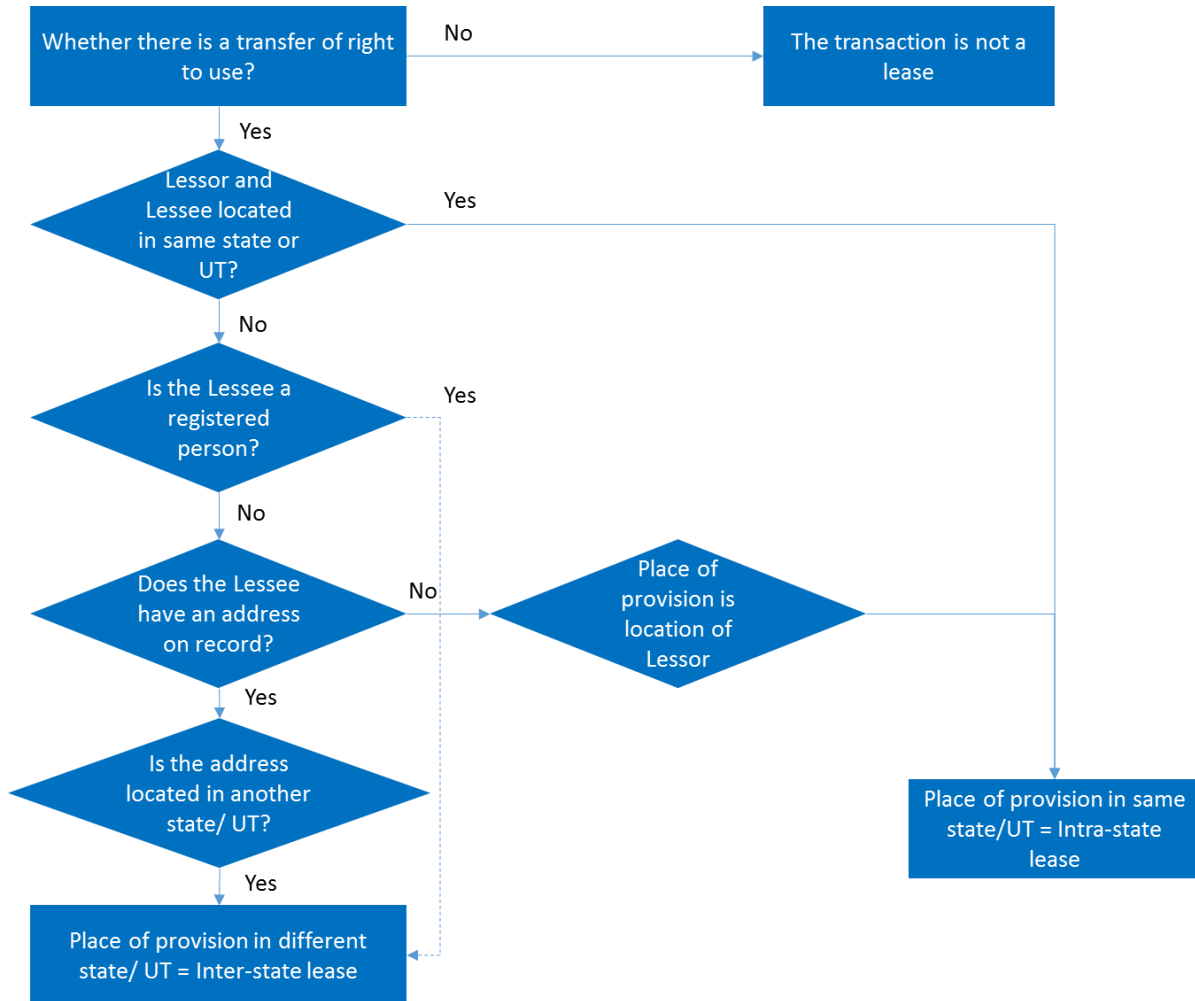
(i) the location of the recipient where the address on record exists; and

(ii) the location of the supplier of services in other cases.

Therefore, the place of supply is where the recipient of the service is located except where the recipient is not a registered person and address on record does not exist; in such cases, the location of the supplier shall be treated as the place of supply of services.

Applying the same logic to lease transactions, the conclusion would be as follows:

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6. How will inter-state lease transactions be charged under GST regime?

Under the GST regime, IGST will be charged on inter-state lease transactions at a rate which shall be notified by the Central Government based on the recommendations of the GST Council.

7. How will intra-state lease transactions be charged under GST regime?

Under the GST regime, intra-state lease transactions shall be subjected to CGST and SGST, the rate of which is yet notified by the Central Government.

8. Is there any implication in terms of tax incidence or tax efficiency on account of the lease being inter-state or intra-state?

Unlike the old CST/VAT regime where CST was not allowed to be set-off, IGST is fully off-settable. Of course, there is a priority order of set off (first IGST, next CGST, finally SGST). However, since the rates for CGST and SGST are likely to be the same, there is no impact on

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account of inter-state versus intra-state supplies. In essence, there is no tax inefficiency in acquiring goods on inter-state basis.

9. How will cross border lease transactions be charged under GST regime?

A cross border lease transaction is a transaction where the Lessor and Lessee are located in two different countries. As per section 12(4) of the IGST Act, where supply of services is imported into the Indian territory, they shall be deemed to in the course of inter-state trade and commerce. Therefore, where the Lessor is located outside India and the Lessee is located in India, the transaction will be subjected to GST under reverse charge mechanism.

However, where the Lessor is located in India and Lessee is located outside India, in such case the place of supply of service shall be outside India and therefore, shall not be subjected to tax under GST law.

10. What is the treatment for leases in course of import or so-called high seas lease transactions?

The concepts of high seas sale or sale in course of import were the product of a system where there was no set off across taxes (CVD/SAD could not have been set off against VAT payable on a local sale). The introduction of GST makes unification of CVD/SAD and VAT. Therefore, the whole concept of high seas sale/sale in course of import, to integrate an import and the first sale made immediately after import, does not remain valid under GST regime.

While, therefore, there will no motive in structuring a high seas sale, there is, however, still a relevance of the concept, as discussed below:

- “India” is defined to include territorial waters [sec 2 (56) of CGST Act]. “Import of goods” is defined [sec 2 (10) of IGST Act] as bringing goods from out of India into India.
- Therefore, if a sale occurs between an overseas supplier (X) to an Indian importer (M1), who sells the goods to another Indian buyer (M2), such that the sale from M1 to M2 happens on high seas basis before the goods have entered territorial waters of India, the sale from X to M1 is sale happening completely outside India, and hence not taxable. The sale/supply from M1 to M2 is taxable as IGST sale.
- The eventual burden on the lessee/buyer may not be different in either case (except in case where the taxable supplier –M1 in this case – is carrying unabsorbed ITC. Therefore, there may not be any strong motivation for structuring high seas transactions any more.

11. What is the taxable base in case of lease transactions?

The value of a taxable supply is the price actually paid or payable for the supply [sec 15 of CGST Act]. Accordingly, lease rentals will be taxable over the period of time over which the same accrue.



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12. What will be the point of taxation for lease transactions?

Tax will be levied on supply of services at the time of supply. As per the provisions of section 12 of the CGST Act, time of supply of services shall be earliest of the following dates:

- (a) the date of issue of invoice by the supplier, if the invoice is issued within the period prescribed under sub-section (2) of section 31 or the date of receipt of payment, whichever is earlier; or
- (b) the date of provision of service, if the invoice is not issued within the period prescribed under sub-section (2) of section 31 or the date of receipt of payment, whichever is earlier; or
- (c) the date on which the recipient shows the receipt of services in his books of account, in a case where the provisions of clause (a) or clause (b) do not apply.

13. In case of those transactions where the lease has commenced, prior to the effective date of GST implementation, will the transaction be subjected to GST? If so, how?

Once the GST is implemented, the taxability of a transaction will be determined based on the time of supply of the lease transaction. As per the provisions of the section 12 of the CGST Act, the time of supply of services shall be earliest of the following dates:

- (a) the date of issue of invoice by the supplier, if the invoice is issued within the period prescribed under sub-section (2) of section 31 or the date of receipt of payment, whichever is earlier; or
- (b) the date of provision of service, if the invoice is not issued within the period prescribed under sub-section (2) of section 31 or the date of receipt of payment, whichever is earlier; or
- (c) the date on which the recipient shows the receipt of services in his books of account, in a case where the provisions of clause (a) or clause (b) do not apply.

Same rule shall apply in case of existing lease transactions as well. In case of lease transactions, invoicing for rentals is done periodically, therefore, in cases where the invoices are raised after the GST implementation and rentals are received thereafter, such shall be taxable to GST.

14. What if the supplier of services already have unutilised input tax credit for the taxes paid for purchase of assets under lease?

The CGST Act allows carry forward of unutilised ITC under previous laws for claiming under GST regime. The rules pertaining to Transitioning states that where a registered person is



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entitled to take credit of ITC, within 60 days from the appointed date, submit form GST TRANS-1 stating the amount of tax or duty to the credit of which the registered person is entitled.

15. What happens to the unutilised ITC where the constitution of the supplier is changed? Will it be transferred to the newly formed entity?

As per section 18(3) of the CGST Act, if the constitution of a registered person changes due to sale, merger, demerger, amalgamation, lease or transfer of the business with the specific provisions for transfer of liabilities, the said registered person shall be allowed to transfer the input tax credit which remains unutilised in his electronic credit ledger to the newly constituted entity.

16. What happens to the unutilised ITC if the supplier enters into a business combination?

Section 18(3) also covers change due to business combinations like mergers, demergers and amalgamations as well. Therefore, even in case of business combinations, the newly constituted entity will be able to claim unutilised ITC.

17. In what ways can a bank/ financial institution engaged in leasing business claim ITC?

The CGST Act allows banks and financial institutions to claim ITC in either of the two ways:

- a. They shall be eligible to claim ITC to the extent of 50% of the eligible ITC on inputs, capital goods and input services in that month and the rest shall lapse; or
- b. Where the registered person is engaged in the partly into taxable supplies and partly into exempted supplies, the whole of ITC, to the extent it is attributable to taxable supplies, can be claimed.

Once a bank/ financial institution decide to opt for one of the above methods for claiming ITC, it will not be able to withdraw the option during the remaining part of the financial year.

As we discussed earlier in this write up that the leases are taxable supplies and loans are exempted supplies under GST, therefore, a bank/financial institution engaged in leasing business will have both taxable as well as exempted supplies. Their choice of the method of claiming ITC will depend on the proportion of the taxable and exempted supplies and the proportion of the ITC attributable to each of the two supplies.

In addition to the above, the banks/ financial institutions can also explore the following options:

- a. Creating two separate business verticals –
 - i. One for leasing activities and the other for other activities.
 - ii. Both these verticals can get separate registrations under GST law. Each of the verticals will be treated as separate registered person.
 - iii. Exercise the option of claiming ITC to the extent it is attributable to taxable supplies for the leasing vertical;

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- iv. Exercise the option of claiming 50% of eligible ITC for other than leasing vertical.
- b. Creating a separate business entity for leasing activities –
 - i. One entity will carry out leasing activities and the other entity will carry out other activities.
 - ii. Both these entities will get separate registrations under GST law.
 - iii. Exercise the option of claiming ITC to the extent it is attributable to taxable supplies for the leasing entity;
 - iv. Exercise the option of claiming 50% of eligible ITC for other than leasing entity.

18. Can a supplier claim credit for taxes paid under earlier law, which was not eligible for ITC?

Only unutilised ITC under earlier laws can be claimed under GST law. Therefore, if the taxes paid under earlier were not eligible for ITC, the same shall not be available for credit under the GST law.

19. Under the VAT laws, some of states allowed the tax payers to claim ITC on a staggered manner. Can such registered persons claim ITC at one go under the GST regime or do they have to claim it on a staggered manner even under the new law?

In our view the benefit will be available at one go. However, we will need to check the rules of the respective states.

20. How will processing fees on lease transactions be charged under GST regime?

CGST Act defines service as –

*(102) “services” means anything other than goods, money and securities but includes **activities relating to the use of money** or its conversion by cash or by any other mode, from one form, currency or denomination, to another form, currency or denomination for which a separate consideration is charged;*

Processing fees is charged to process the applications for financial transactions or lease transactions, therefore, there are charged towards activities relating to use of money and are covered under the law as supply of services.

21. How will the sale of repossessed assets be charged under GST?

Sale of repossessed goods will be treated as supply of goods under the GST law and therefore will be taxed accordingly.



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22. What will be the scenario in case of car leases (a) for the leasing entity; (b) for the lessee?

Currently in India, there are two models of taking car on lease. First, where car is taken on lease by the ultimate user of the car and second, where the car is taken on lease by corporate houses and are used by the employees of such corporate houses. Let us understand the taxability of the car leases from the point of view of the lessor and the lessee.

From the point of view of Lessor

- a. The lease shall be treated as supply of service and shall be taxed accordingly.
- b. ITC on motor vehicles can be claimed only where they are used:
 - (i) for making the following taxable supplies, namely:—
 - (A) further supply of such vehicles or conveyances ; or
 - (B) transportation of passengers; or
 - (C) imparting training on driving, flying, navigating such vehicles or conveyances;
 - (ii) for transportation of goods;

In the present case the Lessor uses the car for further supply of such conveyance, therefore, shall be eligible to claim ITC.

From the point of view of Lessee

- a. The lease shall be treated as supply of service and shall be taxed accordingly.
- b. Since the tax is paid on the lease of motor vehicles and that the motor vehicles is not utilised for any of the stated activities, the lessee shall not be eligible to claim ITC on the tax paid.

23. Can leasing be regarded as a separate business vertical within a non-banking financial entity?

In our view, yes, in view of the definition of “business vertical” in sec. 2 (18), there is a strong case for treating operating leasing as a separate business vertical. There is a regulatory distinction between leasing and lending. The risks and returns are different. However, in case of financial lease, we are of the view that it may be difficult to regard the same as a separate business vertical.