

# Article

## Availability of Input Tax Credit in lease transactions

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### **Analysis of the judgement of Commissioner of Value Added Tax Delhi vs Ms. Carzonrent India P ltd**

In a recent Delhi High Court Ruling of Jan, 2013 of *Commissioner of Value Added Tax Delhi vs. Ms. Carzonrent India P ltd*<sup>1</sup> several issues with regard to input tax credit being available in case of lease transactions were discussed. The leasing company-assessee was into the business of leasing of cars/ motor vehicles. The issues before the Delhi HC were:

- a. Whether the leasing company can claim input tax credit on motor vehicles; and
- b. Whether the Appellate Tribunal – VAT was erred in holding that the leasing company shall avail input credit on proportionate basis.

#### **Relevant Provisions of Law:**

Section 2(zc) of the Delhi VAT Act defines the term 'sale' as:

*“(zc) “sale” with its grammatical variations and cognate expression means any transfer of property in goods by one person to another for cash or for deferred payment or for other valuable consideration (not including a grant or subvention payment made by one government agency or department, whether of the central government or of any state government, to another) and includes-*

*(vi) transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration;”*

Section 9 of the Delhi VAT Act, 2004 provides the conditions with respect to claiming input tax credit by a registered dealer. Relevant extracts are as follows:

*“(1) Subject to sub-section (2) of this section and such conditions, restrictions and limitations as may be prescribed, a dealer who is registered or is required to be registered under this Act shall be entitled to a tax credit in respect of the turnover of purchases occurring during the tax period where the purchase arises in the course of his activities as a dealer and the goods are to be used by him directly or indirectly for the purpose of making –*

- (a) sales which are liable to tax under section 3 of this Act; or*
- (b) sales which are not liable to tax under section 7 of this Act.*

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<sup>1</sup> <http://www.indiankanoon.org/doc/30497316/>



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*(2) No tax credit shall be allowed –*

.....

*(b) for the purchase of non-creditable goods;"*

The Seventh Schedule to the Delhi VAT Act provides a list of ‘non-creditable goods’ which includes:

*“Subject to clauses 2 and 3 of this Schedule, the following goods shall be “noncreditable goods” for the purposes of this Act:*

*(i) All automobiles including commercial vehicles, and two and three wheelers and spares parts for repairs and maintenance and tyres and tubes thereof”*

Clause 2 of the Schedule provides that:

*“Any entry in clause 1 other than item (ii), (xiii), (xiv) and (xv) shall not to be treated as non-creditable goods if the item is purchased by a registered dealer for the purpose of **resale in an unmodified form** or use as raw material for processing or manufacturing of goods, in Delhi, for sale by him in the ordinary course of his business.”*

### HC’s judgment

With regard to availability of input tax credit (ITC), the revenue contended that motor vehicles are non-creditable goods in respect of which no tax credit can be availed as per Section 9(2)(b) read with Seventh Schedule to the Act. The revenue also contended that the leasing activity carried on by the assessee does not qualify as "resale in unmodified form," hence the exception carved out in the seventh schedule did not apply to the leasing company.

The leasing company on the other hand rebutted saying that the definition of sale included transfer of right to use and that ITC would be available in respect of leasing activity carried out by the leasing company/ dealer.

Delhi HC held that there was no difference between normal sale and deemed sale as far as the provisions of section 9 were to be applicable. While section 9(2)(b) disallows ITC for purchase of non-creditable goods as contained in seventh schedule and seventh schedule includes motor vehicles as well, a careful reading of Clause 2 of the Schedule suggests that when the motor vehicles are used for resale in an unmodified form by the registered dealer then ITC will be available. Further, HC held that –

*“The term "resale" has not been defined in the Act. However, common parlance, it means to sell the purchased goods in unmodified form i.e. the contrition in which these goods were at the time of purchase. In a lease transaction, a vehicle*

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*or any other commercial goods after purchase are subjected to „sale“ by way of transfer of right to use and so there can be no doubt that leasing of goods means nothing but "resale" in unmodified form and so goods cannot be treated as non-creditable goods for leasing activity. Thus though nomenclature wise, leased goods (such as vehicles, equipment and computers) are in the nature of capital goods, which are described in the definition of "capital goods", yet these cannot be considered as "capital goods" for the purposes of leasing activity because these goods are not "used" by the applicant in the process of trade or manufacture or works contract, which is an essential condition of the definition. Therefore, for the purposes of leasing under the Act, these goods are "trading goods" so far as the lessor is concerned; and might be termed as "capital goods" in the hands of the lessee in case he uses these goods in the process of trade or manufacture or works contract.*

*A careful perusal of section 105(2) (b) clearly shows that input tax credit has been allowed also the lessee, who acquires transfer of right to use goods, which is nothing but a deemed purchase. Thus it is clear that this Act does not distinguish between a „purchaser“ and a deemed „purchaser“. When it is so, then to distinguish between a „sale“ and a „deemed sale“ would amount to taking a view not warranted by the Act. Further to allow the input tax credit to the lessee by virtue of section 105(2)(b), who is merely holding lawful possession without any title; and to restrict to the leasing company who is normal purchaser of the goods, will lead to unintended consequences.”*

Further the High Court said that eligibility and availment of ITC are not two different concepts under the Act, as the Act nowhere draws such a distinction. The HC finally held that in case of leasing of cars which resulted into transfer of right to use, benefit of ITC will be available. The leasing activity carried out by the assessee does amount to resale and the purchasing dealer's acquisition of motor vehicles, for resale in an unmodified form does not disentitle input tax credit.

The next question before consideration of the court was that whether the leasing company/ assessee could avail input credit only to the proportion of tax paid. The High Court held that:

*“When a dealer, who is involved in leasing business, purchases cars, the point at which credit can be claimed is the tax period when he makes the purchase....The amount of tax - on the purchase so made- can be claimed as a credit, in the turnover which he is obliged to declare to the VAT authorities. That turnover would be the total lease rental received by him, for the corresponding tax period (when the purchase is made by him), as well as any other VATable transaction he may be engaged in. Thus, the question of spreading over his credit, proportionately or otherwise, is unfeasible and in any case not borne out by the VAT Act or the Rules.”*



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### **General principles with regard to ITC from the ruling**

The general principles with regard to ITC that arise from the transaction are:

1. The general proposition of law is that the VAT is applicable on lease rentals, that is, the extent of lease rentals accrued within a period is chargeable to tax.
2. The tax paid on purchase of inputs (input tax), is allowed to be offset against the tax payable on turnover (output tax).
3. Since a transaction of lease is regarded for VAT purposes as a “sale”, the lessor is in the position of a re-seller. Hence, the lessor is liable to pay tax on the lease rentals, but is entitled, subject to specific provisions stated below, to deduct the input tax paid at the time of purchase of the car. The deduction of input tax is allowed on entity-wide basis, in a particular state. Thus, all the input taxes paid in State X will be allowed to be deducted against all the output taxes payable in State X.

*ITC is a state specific issue. States where ITC is denied on transfer of right to use, there shall be not ITC benefit available in such states. One must look at the VAT laws of the respective states to be able to determine whether ITC will be available on transfer of right to use and on that particular asset or not.*