

Courts question financing transactions in the garb of operating lease: Substance prevails over form

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In a recent ruling of *CIT vs. The Instalment Supply Ltd*, judgment dated 27th April, 2012¹, New Delhi High Court has looked into the substance of the sale and lease back transaction to deliberate whether the transaction was a financial lease in the garb of operating lease.

Facts of the case:

Instalment supply had purchased parts of computer system from HCL Hewlett Packard Limited (HCL) and leased it back to them. The lessor claimed that he was entitled to 100% depreciation as a lessor and that the cost of each of the items was less than Rs. 5,000/-. The assessing officer held that the transaction was not *bona fide* as the assessee-lessor could not have been interested in acquiring spare parts and leasing them. Moreover, the assets included spare parts of computers, printers, logic cards, adapter cards, power supply, etc and the assessing officer contended that these assets could not function as independent machine. Further the assessee-lessor did not even provide for the details of the spare parts leased back to HCL. The presumption drawn was that HCL in all probability may have used those parts to manufacture computers and further sold them as well. The assessing officer alleged that the transaction was a device to avoid payment of tax.

Income Tax Appellate Tribunal (Tribunal) relying on the case of *CIT vs. Mir Mohammad Ali* (1964) 53 ITR 165 had reversed the findings of the assessing officer, considering force in the submissions of the assessee-lessor in the transaction on the pretext that the assets were owned by the assessee and the agreement captured all necessary conditions to satisfy the case to be a valid lease.

Judgment:

The Hon'ble High Court while evaluating the substance of the transaction looked beyond the terms and conditions of the agreement, its nomenclature and title to evaluate the circumstances surrounding the agreement and the type and nature of the asset ruled in favor of the revenue and against the assessee. While evaluating the substantial question of law, whether the agreement was a mere financing agreement or an operating lease agreement, the Hon'ble Court placed reliance on the earlier Apex Court judgments of *Asea Brown Boveri Limited vs. Industrial Finance Corporation of India and Others*, (2004) 12 SCC 570, *Association of Leasing and Financial Service Companies vs. Union of India*, (2011) 2 SCC 352 and renowned authors on the subject, the Hon'ble Court held that the controversy in the case was not examined and the real issue was not considered by the Tribunal in the right perspective. The Hon'ble Court passed an

¹ <http://itatonline.org/archives/>

order of remand directing the Tribunal to look at the case in fresh light without being influenced by any earlier order and the appeal was disposed of without costs.

Our analysis:

Sale and lease back transactions in the history of lease transactions, have been considered to be the maligned transaction types and has always carried an apparent look of the financial transaction. These kind of transactions that in substance are nothing but pure funding transactions, can be dressed in the name of lease transactions, but would continue to be questioned.

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