Manual

Value-Added Tax/ Sales-Tax on Lease and Hire Purchase Transactions in India

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Value-added tax and Sales-tax on lease and hire-purchase transactions remains the most gray and the most painful part of leasing business in India. The following is an attempt to answer basic questions on value-added tax/ sales-tax as it relates to lease and hire-purchase transactions. The questions are structured - so for best results, read them sequentially.

A. Generally on the meaning of "sales" and scope of sales-tax law

1. Is VAT and sales-tax the same thing?

Sales-tax, imposed on value-added basis, is VAT. VAT is also nothing but sales-tax. Payment of tax on value added basis means, there is a tax at every stage of sale, but the taxes paid on inputs are deductible against taxes payable on outputs. Value-added tax concept exists in case of central excise, service tax and state sales-tax.

Since the entire country has now adopted the value-added tax system as far as sales-tax is concerned, it is only Central Sales-tax which remains non-value-added tax. Hence, there is a system of concessionalisation of sales from dealers to dealers under CST Act – *see questions below.*

Since VAT is also nothing but sales-tax, references to sales-tax below include references to VAT as well.

2. What is goods and services tax or GST?

Since the classification of sales and services is so difficult in many present-day transactions, and segregation of the two results into non-absorption of input taxes paid in one form against the other, many countries have moved to a comprehensive VAT system where there is a common tax on goods and services. This may also be called GST. India has also been considering moving to GST.

3. What are the various types of financing transactions banks/ NBFCs can enter into in asset financing business? In which of these transactions is sales-tax applicable?

NBFCs may enter into the following transactions:

a. Finance Lease.
b. Hire Purchase.
c. Loan backed by security of the asset financed.
d. Credit Sales
e. Conditional sale.

Sales-tax is applicable in case of financial lease, operating lease as well as hire purchase transactions.

A credit sale is a normal sale of goods –hence, sales-tax is applicable in case of credit sales as well.

Conditional sales might either result into absolute transfer of title, or may just be a device of mortgage of movable property. In case of mortgages, there is no sales-tax. Hence, conditional sales may avoid sales-tax/VAT altogether.

There is no sales-tax on loan of money. See, however, question below on sales-tax in case of sale of repossessed goods.

Assignment of receivables is an assignment of actionable claims and not a sale of goods – hence, question of sales-tax does not arise in case of assignment.

4. When is Sales Tax leviable?

Sales Tax is leviable when goods are sold. Thus there must be " Goods and there must be a "sale".

"Goods" includes all types of movable property. "Sale" means a transfer of property in goods from one person to another for a consideration.

But Sales Tax is leviable only on a person who is a dealer. A casual transaction by a non-dealer is not subject to Sales Tax – for example, if an individual salary earner sells off his personal car, there is no Sales Tax attracted.

However, if sales happen incidental to a business, even if that business does not consist of selling goods, the sales are normally still taxable. For example, if a lender engaged in business of lending repossesses goods pursuant to a default, and then, sells the goods, sales-tax is still applicable.

To summarise, Sales Tax is leviable on sale of goods by a dealer.

5. Is Finance Lease a "Sale" for the purposes of Sales Tax?

In a Finance Lease, NBFCs are the owner of the Goods and the lessee only has the right to use the goods on payment of lease rentals. It is a contract of hiring or bailment. Hence there is no "sale" as there is no transfer of title.

However, there is a transfer of the right to use the goods from us to the lessee. By way of Constitutional Amendment long time back, a transfer of right to use has been deemed to be a sale for sales-tax purposes.

Hence, the transfer of right to use in case of a financial lease is also chargeable to sales-tax.

Against common misnotion, it should be clarified that though a financial lease is admittedly a financial transaction, but it made out to be a transfer of right to use – hence, the rentals, being the consideration for the transfer of right to use, are chargeable to sales-tax. There is no scope for sales-tax purposes to split the rentals into an interest component and a principal component.

6. Is operating Lease a "Sale" for the purposes of Sales Tax?

Prima facie, there is no difference between the legal nature of a financial lease or an operating lease. Hence, both contain a transfer of right to use and hence, both amount to a sale.

7. Is an operating lease, consisting of bunch of services such as maintenance of goods, etc., is also a "sale" for the purposes of Sales Tax?

Sometimes, there are complicated contracts where the distinction between sale and "service" get blurred – leading to questions as to whether it is a sale or a service. Note that service transactions are liable to service tax, not sales-tax. In such cases, what is to be seen is the dominant nature of the transaction – that is, predominantly, have the parties intended providing a service, or simply intended transfer of right to use goods. Detecting such predominant intention may not be easy – subjecting the transaction to controversy.

8. Is a pay-per-use contract a "Sale" for the purposes of Sales Tax?

Subtle distinction has been made between "lease" and "license". License contracts, where there is no passing of control to the actual user, have been regarded as service contracts, not sale contracts. Based on facts, a pay-per-

use contract may be regarded as a license rather than a lease, and hence, may be subject to sales-tax not service tax.

9. Is Hire Purchase a Sale for the purposes of Sales Tax?

Yes, Hire Purchase is a deemed sale of the goods at the time it is delivered to the Hirer by us under the Hire Purchase agreement.

Legally speaking, the goods are sold legally only when after fulfilling all his obligations under the hire purchase agreement the hirer exercises his option to purchase the goods. However, that is the legal sale of the goods. The "sale" for sales-tax purposes takes place at the time of delivery of goods on hire.

10. There is a concept of "hire-purchase finance". Is sales-tax applicable to such transactions as well?

A so-called hire purchase finance is a case where it is explicit in the contract that the reservation of title by the financier is merely a matter of security. These are commonly referred to as "title retention transactions". A mere title retention transaction is purely a financial transaction – there cannot be a sales-tax in a pure financial transaction.

11. Is sales-tax applicable on lease or sale of immovable property?

Immovable property is not "goods" – hence, transactions in immovable property are outside the purview of sales-tax. These transactions may, however, be subject to ad valorem stamp duty.

B. Classification of sales and jurisdiction

12. What is an inter-state sale and intra-state or local sale?

From sales-tax viewpoint, the classification of sales into inter-state and intra-state sales is very significant. Inter-state sales are liable to tax under the CST Act. Intra-state sales are liable to tax in the state where the sale occurs, that is, the state in which the goods are at the time of the sale.

If a sale is taxable under CST Act, and the entity pays a local tax, that does not absolve the entity from the obligation of paying the proper tax. Likewise, if a sale is taxable in State A, but tax is paid in State B, that does not take away the right of State B to tax it.

Hence, it is very important to understand the proper nature of a sale.

An inter-state sale is either (a) a sale that causes movement of goods from one state to another, or (b) a sale that takes place by endorsement of documents during the movement of goods from one state to another.

Part (a) presupposes that the seller has been involved in the movement of goods from one state to another as a part of the sale transaction. Part (b) is a case of a second sale during the same transit.

13. What is the meaning of "import sale"?

The meaning of import sale is akin to the meaning of an inter-state sale – once again containing two limbs – (a) a sale causing the import of goods into India; and (b) a sale taking place in course of import, that is, before the goods cross the customs frontiers of India.

"Customs frontiers" mean the place where the goods are normally kept prior to their clearance for domestic consumption.

14. What is the significance of inter-state, intra-state and import sale distinction?

As per principles of the Constitution, an import sale is not liable to sales-tax at all. Same holds for an export sale.

An inter-state sale comes under the purview of CST law and there is currently no VAT system in case of CST.

A sale other than import sale, export sale and an inter-state sale comes under local law of the state where the goods are situated at the time of sale. State sales-tax laws follow a VAT system.

Knowing the jurisdiction of the sale is one of the most critical issues in determining the taxability of a sale.

15. Can a lease also be an import lease? What if the lease is an import lease?

All the basic determinants that apply to a normal sale are applicable to leases as well. Thus, if the lease is an import lease, then the lease is not liable to VAT.

16. Can a lease be an inter-state lease? What if a lease is an inter-state lease?

If a lease is an inter-state lease, it is chargeable to tax under the CST Act. CST Act provides for multi-point tax without a VAT benefit – however, it provides for a system of concessionalisation – *discussed below.*

17. What is C form? Can a leasing company issue a C form? Can a lessee issue a C form?

Since CST Act is a multi-point levy, CST Act tries to concessionalise the sales from a dealer to a dealer with a concessional rate of tax. The buyer dealer declares to the seller that the buyer is a dealer, by goods for resale or use in manufacturer – this declaration is given in C form.

As a lease is a sale, hence, a lessor buying goods definitely buys them for re-sale, and therefore, may issue the C form.

The lessee "buys" goods from the lessor – hence, if the lessee is otherwise eligible to issue C form for purchase of the relevant goods, the lessee may issue a C form to the lessor.

18. What is Section 6(2) (b) procedure?

This is a specific benefit in case of two or more sales happening during the same transit. That is, if A sells to B, and B sells to C before taking delivery of the goods, and B redirects the goods to be delivered to C, there is only one delivery – from A to C, but there are two sales. Taxing both these sales would have been cumbersome – hence, CST Act exempts the sale from B to C, provided certain conditions are satisfied. The conditions are:

a. The sale must be a sale under sec. 3 (b), that is, a sale by endorsement of documents.
b. A must furnish to B a declaration in form E-1 (or E-2 in case of more than 2 sales in one transit)
c. C must furnish a declaration to B in C form.

C. Applicability of state tax

19. In which state is the tax payable – the state in which the agreement is signed, or the state in which the leased goods are?

The principles for determination of jurisdiction in case of lease and normal sales are the same. If a sale is not import or export sale, or inter-state sale, then it is localized in the state in which the goods are situated at the time of the sale. Applying the same principle, the place of signing the lease agreement has no relevance. If the lease is not inter-state, the situation of the goods will determine the taxability.

20. If the goods are leased in State A and subsequently move to State B, does that shift the jurisdiction of the transaction?

No. Situs of the goods relevant is as at the time of transfer of right to use, and not thereafter.

21. What is the tax applicable on, in case of a lease?

In case of a lease, the point of sale is the transfer of right to use goods, but the consideration for the sale is the rental. Hence, tax is applicable on the rentals. Several states provide for advance rentals or security deposit also to be taken as a part of the sale price – carefully observe the provisions of the State law.

22. What is the tax applicable on, in case of a hire purchase?

State laws of some States make special provisions in case of hire purchase. These states provide that in case of hire purchase, the entire instalments (sometimes giving the benefit of deduction of interest) are chargeable to tax upfront.

23. Can a leasing company avail of the benefit of set off of tax paid at the time of purchase?

By default, as the lessor is a reseller, there cannot be any objection to the lessor availing of the benefit of set off. However, some states put a specific provision to deny the benefit of set off in case of leased goods.

24. Can the lessee avail of a set off of tax charged on lease rentals?

Unless there are specific provisions to the contrary, the lessee may set off the tax charged by the lessor on lease rentals against his output taxes.