Article

Nothing can be more specific – GAAR provisions not to hit leasing transactions

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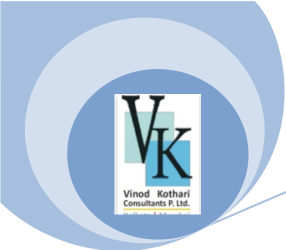


Illustration given on leasing – under the draft guidelines regarding implementation of GAAR in terms of section 101 of the Income Tax Act, 1961.

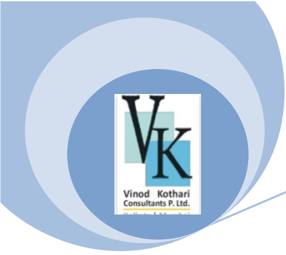
The draft guidelines on GAAR were released today, June 29, 2012. The guidelines are only Draft Guidelines and have been put out for receiving wide-ranging feedback and for discussion purposes only. The guidelines are framed by a Committee constituted by CBDT vide *OM F.NO. 500/111/2009-FTD-1 Dated 27 February, 2012* constituted under the Chairmanship of the Director General of the Income Tax (International Taxation) for formulating the guidelines for proper implementation of GAAR. The guidelines are available at http://www.incometaxindia.gov.in/archive/BreakingNews_GAARRules_28062012.pdf.

Example 6 of the draft guidelines quoted below:

> **"Facts:**
>
> A choice made by a company between leasing an asset and purchasing the same asset. The company would claim deduction for leasing rentals rather than depreciation if it had their own asset. Would the lease rent payment be disallowed as expense under GAAR?
>
> **Interpretation:**
>
> GAAR provisions, would not, prima facie, apply to a decision of leasing (as against purchase of an asset). However, if it is a case of circular leasing, i.e. the taxpayer leases out an asset and through various sub-leases, takes it back on lease, thus creating a tax benefit without any change in economic substance, Revenue would examine the matter for invoking GAAR provisions."

As written in the title of this note – nothing can be more specific than this. A normal leasing transaction, whether operating lease or financial lease, whether have economic substance or not, whether entered into for obtaining tax benefits or not – would not attract the provisions of GAAR u/s 101 of Income Tax Act ("**IT Act**"). Only "Sale and lease back" can be examined and questioned by the Revenue.

It was felt by the Committee that – terms like, "Misuse or abuse", "bona fide purpose" and "lacks commercial substance" may be explained by illustrations. The illustrations stated are, of course only an indicative list and not an exhaustive list.



The given example of leasing – can be treated as equivalent to keeping a Leasing Transaction (except a "Sale and lease back" or a Circular leasing) – under the negative list to which GAAR provisions will not apply.

So, the questions on allowability of depreciation to lessee in case of financial lease, allowability of depreciation to Lessor in case of operating lease, allowability of lease rental as expense, economic substance of leasing of assets by a holding company to its subsidiary company etc. would continue to be governed by the existing provisions of IT Act and the previously decided cases on similar transactions.

It is a well accepted fact (also accepted by the law makers as is illustrated by putting an example on leasing) that so far the tax effect of a lease transaction is concerned, any person who buys the asset will get the same capital allowance.
Further, talking about operating lease and financial lease - the substance of an operating lease is leasing and not financing, and this is established by the accounting standard on lease accounting. And hence, it has to be admitted that an operating lease is not merely a financial arrangement. Irrespective of whom the lessor is, given the depreciation structure, there will be a tax shelter available to the lessor in case of operating lease. If this was to be viewed as a tax avoidance transaction, every lease transaction will become a tax avoidance transaction. Rather every purchase of asset will also become a tax avoidance transaction, as the capital allowance will be available in that case as well.
The given example in the draft guidelines goes well with the true spirit of law and is welcomed by all.