

FIDC

Finance Industry Development Council

(A body incorporated as a Self Regulatory Organisation for Registered NBFCs)

ANNEXURE - II

Indirect Tax Issues

1. Service Tax on Hire Purchase/ Lease Transactions

10% of finance charges/interest component is still subject to Service tax, resulting in Continuation of Disparity with a Simple Loan Transaction

Subsequent to the discussions held with our representatives during the Pre-Budget meeting in February 2006, it was due to your prudent understanding and prompt action that Service tax on the interest component of Lease/HP transactions was given a substantial, though partial, relief.

The relaxation given was to the extent of 90% while 10% of the interest component in a Lease/Hire-Purchase transaction still continues to be subject to levy of service tax whereas the basic objective was to bring parity between a simple loan transaction and a Lease/Hire-Purchase transaction. Levy of service tax @ 12.24%, even on the 10% of interest component makes Lease/Hire-Purchase costlier to the borrower and so economically unfavourable as compared to a loan transaction where 100% of the interest component is exempted from the levy of service tax. This still makes Hire Purchase and Leasing a less competitive instrument, even though these activities are quite popular internationally. If the inequitable service tax element is removed, it will greatly benefit the infrastructure industry by aiding hiring of equipments on a large scale.

We, therefore, request you to kindly exempt the total interest component in a Lease/Hire-Purchase transaction from the levy of service tax so that only the Management fee/Processing charges are subject to the levy, as is the case with a loan transaction.

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Suggestion:

Interest/Finance charges in case of Lease & /Hire Purchase Transactions should be fully exempted from the levy of service tax. As such, service tax in case of lease & hire purchase transactions should be levied only on lease management fee/processing fee/documentation fee.

This would, thus be in tune with the levy of service tax in case of loan transactions where interest component has been totally exempted from the levy of service tax.

2. Treatment of Hire Purchase & Lease Transactions – Multiplicity of Taxes

- (i) As per the 46th Amendment to the Constitution of India, Hire Purchase & Lease Transactions are defined as deemed 'sale' activities. As such, they were subject to sales tax @ 4 to 14% in different states and are now subject to Value Added Tax (VAT) in all the states.
- (ii) Finance Act, 2001 defined Hire Purchase & Lease Transactions as "service" and as such, the interest component in these transactions is subject to service tax @ 12.24%.
- (iii) The Lease Rentals /Hire Purchase transactions are also subject to Tax Deduction at Source (TDS).
- (iv) The Income Tax Department looks at all the Lease Transactions with suspicion. As such, Depreciation benefits to the lessor (who is the owner of the asset) are often denied.



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At various instances, the same transaction is being treated as Sale Transaction, Finance and Service simultaneously. This anomaly and confusion has created enough regulatory problems, which will compound further in future and will be severely detrimental to the interest of every player in the economy.

As a result of multiple taxation, Hire Purchase/Leasing, which has a critical role to play in the Indian economy is being killed by making such transactions economically unviable. This can only nullify the Government's efforts to increase tax revenues from this segment.

On another plane, equally relevant, Hire Purchase finance and Leasing need to be encouraged as a no of court pronouncements have been questioning the financiers'/banks' right of repossession in the case of loan and this has led to resistance among defaulting borrowers to repossession. As against this, courts have recognised the right of repossession in a Hire Purchase and Leasing transaction.

Suggestion:

There is an urgent need to establish clarity on leasing. A clear definition and as such a clear tax treatment of Hire Purchase/leasing needs to be defined without ambiguity.

