

To,
Mr. P. Chidambaram
Finance Minister,
Government of India,
North Block,
New Delhi – 110 001

Hon'ble Finance Minister Sir,

**REG: SERVICE TAX ON LEASE & HIRE PURCHASE TRANSACTIONS
SHOULD BE AT PAR WITH SERVICE TAX ON LOAN TRANSACTIONS**

The Non-Banking Finance Companies (NBFCs), spread all over the country, and registered with Reserve Bank of India and authorized to accept public deposits, have joined hands and formed a **Self Regulatory Organization (SRO)** under the name of Finance Industry Development Council (FIDC). FIDC is **registered** as a Company U/ s. 25 of Companies Act, 1956. Our main objective is to work towards bringing discipline amongst our members by enforcing a model code of conduct, besides presenting a unified face of this sector.

1. Service Tax levied on Processing Charges and Interest/ Finance Charges in case of Lease & Hire Purchase Transactions

Union Budget 2001 (Finance Act, 2001) levied Service Tax on Financial Leasing Services, including Equipment Leasing & Hire Purchase Transactions. CBEC F.No. B.11/ 1/ 2001-TRU dt. July 09,2001 issued by Joint Secretary, TRU, Ministry of Finance laid down the instructions for this levy. As per Annexure –VII (para 2.1.3) (copy enclosed) of this circular, service tax in case of financial Lease & Hire Purchase Transactions has been levied on:

- i) The Lease Management Fee/ Processing Fee/ Documentation Charges (recovered at the time of entering into the agreement) and
- ii) On the Finance/ Interest Charges (recovered in monthly installments)

2. Service tax proposed to be levied on Processing Charges in case of Loan Transactions (Interest is exempted from the levy)

Union Budget 2004 (Finance Bill 2004) has proposed to levy service tax on the processing fee/ documentation fee in case of Loan Transactions. However, the interest component has been clearly exempted from the levy of service tax.

3. Service Tax on Interest/ Finance Charges in case of Lease/ Hire Purchase Transactions is unjustified.

a) Nature of Lease & Hire Purchase Transactions

Lease and Hire Purchase transactions are in substance deemed “sale” transactions as per the 46th Amendment to the Constitution of India. The lease rentals / hire purchase installments are the sale proceeds (for the concerned asset) received on monthly basis over a period of few years.

b) Components of lease & Hire Purchase Transactions

An asset given under Hire Purchase/ Lease Transaction has three financial components:

- i) Cost of the Asset (Principal)
- ii) Interest at a pre-determined rate – since the cost of the asset is recovered over a period of few years
- iii) Lease Management fee/ Service Charges/ Processing Charges/ Document Charges

The Hirer/ Lessee (User) to whom the asset is given pays back in monthly (or any other such frequency as may be agreed) installments called Hire Purchase/ Lease Rentals over a mutually agreed period of time. These Hire Purchase/ Lease Rentals consist of both the principal (cost of the asset) and the interest element.

Lease Management Fee/ Service Charges/ Processing Charges/ Document Charges is a upfront charge recovered at the time of signing the agreement and ranges from 0% to 3% of the total amount.

c) Interest Component includes our Borrowing Cost and Operational Cost

The above said interest component in a lease rental/ hire purchase installment is our income. However, it has to be kept in mind that this interest component charged by us from the hirer/ lessee includes our cost of borrowing from banks and public in the form of Fixed Deposits. In addition to this, there are operational costs and delinquencies in the form of making provisions for non-performing assets as per RBI guidelines.

4. **Our Request**

Interest/ Finance charges in case of Lease & / Hire Purchase Transactions should be 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 shall be in tune with the levy of service tax in case of loan transactions where interest component has been clearly exempted from the levy of service tax.

Let us keep the lines of communication open.

We look forward to an **immediate positive response** and are confident that we are in the process of a **long and beneficial relationship**.

Thanking you,

Yours faithfully,

For **FINANCE INDUSTRY DEVELOPMENT COUNCIL**

MAHESH THAKKAR
DIRECTOR GENERAL