* **IN THE HIGH COURT OF DELHI AT NEW DELI**

ITA No. 255/2008

% Reserved on: 14th October, 2009
Pronounced on: 30th October, 2009

Commissioner of Income Tax ... Appellant
through : Mr. Sanjeev Sabharwal, Advocate.

VERSUS

Motor & General Finance Ltd. ... Respondent
through: Mr. O.S. Bajpai, Sr. Advocate with Mr. B.K. Singh, Advocate.

CORAM :-
THE HON'BLE MR. JUSTICE A.K. SIKRI
THE HON'BLE MR. JUSTICE SIDDHARTH MRIDUL

1. Whether Reporters of Local newspapers may be allowed to see the Judgment?
2. To be referred to the Reporter or not?
3. Whether the Judgment should be reported in the Digest?

A.K. SIKRI, J.

For orders, see ITA No.254 of 2008.

(A.K. SIKRI)
JUDGE

(SIDDHARTH MRIDUL)
JUDGE

October 30, 2009/pmc/hp

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Commissioner of Income Tax ... Appellant
through : Mr. Sanjeev Sabharwal, Advocate.

VERSUS

Motor & General Finance Ltd. ... Respondent
through: Mr. O.S. Bajpai, Sr. Advocate with Mr. B.K. Singh, Advocate.

3) **ITA No. 261/2008**

Commissioner of Income Tax ... Appellant
through : Mr. Sanjeev Sabharwal, Advocate.

VERSUS

Motor & General Finance Ltd. ... Respondent
through: Mr. O.S. Bajpai, Sr. Advocate with Mr. B.K. Singh, Advocate.

4) **ITA No. 282/2008**

Commissioner of Income Tax ... Appellant
through : Mr. Sanjeev Sabharwal, Advocate.

through: Mr. O.S. Bajpai, Sr. Advoca
Mr. B.K. Singh, Advocate.

CORAM :-
THE HON'BLE MR. JUSTICE A.K. SIKRI
THE HON'BLE MR. JUSTICE SIDDHARTH MRIDUL

1. Whether Reporters of Local newspapers may be allowed to see the Judgment?
2. To be referred to the Reporter or not?
3. Whether the Judgment should be reported in the Digest? Yes

A.K. SIKRI, J.

1. These appeals relate to assessment years 1995-96 to 1999-2000 in respect of same assessee, *i.e.*, Motor & General Finance Limited. The issues involved are identical. In fact, four appeals relating to these assessment years filed by the assessee as well as the Revenue against the orders of the CIT (A) have been disposed of by the Income Tax Appellate Tribunal (hereinafter referred to as 'the Tribunal') vide its common judgment dated 27.07.2007. It is for this reason all these appeals were heard together. The questions of law on which we heard the arguments are the following:

a) Whether the ITAT was correct in law in holding that the assessee is neither a financial company nor a credit institution in terms of Section 2(5B) of the Interest Tax Act, 1974 and as such was not a taxable entity for the purpose of Interest Tax Act, 1974?

b) Whether the ITAT was correct in law in holding that

under the Interest Tax Act, 1974 only receip business is the criteria and the other parameters as the turnover, capital employment, head-count of persons employed in each line of business activity etc. are not relevant?

c) Whether the order of ITAT is perverse as it has ignored several factual aspects of the decisions relied upon by the CIT(A) in its order?

2. In essence, the controversy is as to whether the assessee is a 'finance company' or a 'credit institution' in terms of Section 2(5B) of the Interest Act, 1974. The assessee company is engaged in the business of hire purchase and leasing activities. It had not been filing return under the Interest Act, 1974 (hereinafter referred to as 'the Act'). A letter dated 22.09.2003 was issued by the Assessing Officer (AO) to the assessee seeking its explanation for non-filing the income tax return for the period in question. In reply, the assessee submitted that it was not liable to file any return. The AO, however, proceeded further by issuing notice to the assessee under Section 10 of the Act on 30.03.2005 for all the four assessment years. Reasons for issuing such a notice, as recorded by the AO, are as under:

"REASON FOR ISSUE OF NOTICE U/S 10 OF THE

As per the provisions of Interest Tax Act, 1974 financ companies means companies engaged in the business of hire purchase transaction or financing such transactions, investment companies, house financing companies engaged in the business of providing finance by making loans advances or otherwise, mutual fund, finance companies or companies which carry on business consisting of one or more of the activities referred to above.

The interest income chargeable to tax includes interest on loans and advances, commission, charges on unutilized portion of any credit, discount on promissory notes, bills of exchange and interest on debentures, bonds, securities etc. The return of chargeable interest is required to be filed by 31st December of the relevant assessment year.

On perusal of Income tax return of the assessee company for AY 1990-2000, it is observed that the assessee was engaged in financial activities and shown in the P & L for the year, income from net Hire Purchase charges Rs.30,32,80,298/-, Lease charges Rs.40,09,89,489/- and Bill discounting charges Rs.98,31,728/- apart from other income.

The assessee has not filed return of interest Tax for assessment year mentioned above.

In view of the above facts, I have reason to believe that assessee's income coming within the purview of Interest Tax Act, 1974 has escaped assessment for the aforesaid assessment year. Therefore, notices u/s 10 of the Interest Tax Act, 1974 is issued to the assessee for Asstt. Years 1999-2000.

Sd/-
(S P Gupta)
ACIT (OSD)
Ward 16(1) N. Delhi."

3. These reasons were supplied to the assessee. The assessee did not file return even thereafter which led to issuance of reminder

proceedings. The AO refused to do so and also rejec objections of the assessee vide his letter dated 02.03.2006. Thereafter, he proceeded to complete the assessment and passed the assessment orders dated 07.03.2006 under Section 8(3)/10 of the Act. The assessee filed the appeal against this order before the CIT(A). The assessee challenged the validity of notice under Section 10 of the of the Act, which was repelled by the CIT(A). The assessee also contended that it was neither a 'credit institution' nor a 'finance company' in terms of 2(5A) read with Section 2 (5B) of the Act. This contention was also negatived by the CIT (A). However, while dealing with the merits of the addition made by the AO, the CIT (A) deleted the addition on account of hire purchase under Interest Act, 1974.

4. In these circumstances, both the assessee as well as Revenue field appeals before the Tribunal. The Tribunal vide impugned order has held that the assessee is not a taxable entity, as it is not a finance company and consequently, not a credit institution. The deletion on account of hire purchase as decided by the CIT (A) has been maintained. Under these circumstances, these appeals are preferred by the Revenue.

5. We thus proceed to discuss as to whether the case of the assessee

through the relevant provisions of the Act. Since Section a charging Section, we may start with this provision. Section 4(2) reads as under:

> "4(2) Notwithstanding anything contained sub-section (1) but subject to the other provisions of this Act, there shall be charged on every credit institution for every assessment year commencing on and from the 1st day of April, 1992, interest-tax in respect of its chargeable interest of the previous year at the rate of three per cent of such chargeable interest"

6. The charging Section thus stipulates that the interest tax is payable by every credit institution. Credit institution is defined in Section 2(5A) in the following manner:

"2(5A) "credit institution" means, -

> (i) a banking company to which the Banking Regulation Act, 1949 (10 of 1949) applies (including any bank or banking institution referred to in section 51 of that Act);
>
> (ii) a public financial institution as defined in section 4A of the Companies Act, 1956 (1 of 1956);
>
> (iii) a State financial corporation established under section 3 or section 3A or an institution notified under section 46 of the State Financial Corporations Act, 1951 (63 of 1951); and
>
> (iv) any other financial company;"

7. It is a common case of parties that the assessee is not a banking company or a finance institution or a state finance corporation. It is also an accepted position that the assessee can be treated as

company" as mentioned in sub-clause (iv) above. 'I

company' is defined in Section 2 (5B) of the Act in the following manner:

> "(5B) "financial company" means a company, other than a company referred to in sub-clause (i), (ii) or (iii) of clause (5A), being -
>
> (i) a hire-purchase finance company, that is to say, a company which carries on, as its principal business, hire-purchase transactions or the financing of such transactions;
>
> (ii) an investment company, that is to say, a company which carries on, as its principal business, the acquisition of shares, stock, bonds, debentures, debenture stock, or securities issued by the Government or a local authority, or other marketable securities of a like nature;
>
> (iii) a housing finance company, that is to say, a company which carries on, as its principal business, the business of financing of acquisition or construction of houses, including acquisition or development of land in connection therewith;
>
> (iv) a loan company, that is to say, a company [not being a company referred to in sub-clauses (i) to (iii)] which carries on, as its principal business, the business of providing finance, whether by making loans or advances or otherwise;
>
> (v) a mutual benefit finance company, that is to say, a company which carries on, as its principal business, the business of acceptance of deposits from its members and which is declared by the Central Government under section 620A of the Companies Act, 1956 (1 of 1956), to be a Nidhi or Mutual Benefit Society;
>
> (va) a residuary non-banking company [other than a financial company referred to in sub-clause (i), (ii), (iii), (iv) or (v)], that is to say, a company which receives any deposit under any scheme or arrangement, by whatever name called, in one lump

(vi) a miscellaneous finance company, that is to say, a company which carries on exclusively, or almost exclusively, two or more classes of business referred to in the preceding sub-clauses;"

8. Again counsel for the parties agreed that applicability of clauses (ii), (iii), (v) and (va) was ruled out. The controversy rested on the applicability of clause (i) and (vi). In fact, it was admitted that hire purchase was not the principal business of the assessee. The submission of the learned counsel for the Revenue, however, was that even when the Tribunal had found that leasing was the principal business, it wrongly excluded the same from consideration on the ground that leasing business was not mentioned in all the Clauses of Section 2 (5B) of Section 2 of the Act. He pointed out that for this purpose, the Tribunal had relied upon its earlier judgment in the case of ***Ms. Rajath Leasing & Finance Ltd.*** Vs. ***JCIT***, (2005) 186 Taxation 169 (Trib.). However, Special Bench of the Tribunal in the case of ***Gujarat Gas Finance Service Ltd.*** Vs. ***Asst. Commissioner of Income Tax,*** (2008) 307 ITR at 370 did not accept the approach of the Tribunal in ***Rajath Leasing & Finance Ltd.*** (supra).

9. The Special Bench did not accept the principle laid down in ***Rajath Leasing & Finance Ltd.*** (supra) that lease business is to be excluded altogether. According to it, distinction had to be drawn between a financial lease and an operating lease. If it is a case of financial lease, then in substance that would not be a loan transaction and would fall in sub-clause (iv) of Section 2(5B), namely, 'a loan company'. It is because of the reason that such a

lease. For this proposition, apart from other judgment Special Bench referred to the majority view of the Apex Court decision in the case of *Sundaram Finanance Limited* v. *State of Kerala,* AIR 1996 SC 1178 wherein the Court held:-

> "30. .....The appellants are carrying on the business of financiers: they are not dealing in motor vehicles. The motor-vehicle purchased by the customer is registered in the name of the customer and remains at all material times so registered in his name. In the letter taken from the customer under which the latter agrees to keep the vehicle insured, it is expressly recited that the vehicle has been given as security for the loan advanced by the appellants. As a security for repayment of the loan, the customer executes a promissory note for the amount paid by the appellants to the dealer of the vehicle. The so-called 'sale letter' is a formal document which is not made effective by registering the vehicle in the name of the appellants and even the insurance of the vehicle was to be effected as if the customer is the owner. Their right to seize the vehicle is merely a licence to ensure compliance with the terms of the hire-purchase agreement... We are accordingly of the view that the intention of the appellants in obtaining the hire-purchase and the allied agreements was to secure the return of loans advanced to their customers, and no real sale of the vehicle was intended by the customer to the appellants. The transactions were merely financing transactions."
>
> 31. The court also cited the following observations of Lord Esher M.R. in the case of *Re Watson* [1890] 25 QBD 27 (page 502 of STC):
>
> > ".....when the transaction is in truth merely a loan transaction, and the lender is to be repaid his loan and to have a security upon the goods, it will be unavailing to cloak the reality of the transaction by a sham purchase and hiring. It will be question of fact in each case whether there is a real

> the goods are hired, the case is not within the Bills of Sale Act. The document itself must be looked at as part of the evidence; but it is only part, and the court must look at the other facts, and ascertain the actual truth of the case."

The Supreme Court in the case of ***Asea Brown Boveri Ltd.*** **v.** ***Industrial Finance Corporation of India,*** [2005] 126 Comp Cas 332 (SC) has also drawn a distinction between a normal lease and a financial lease. It was held that in case of financial lease, it is the lessee who, for all practical purposes, is the owner of the asset and not a lessor. After posing the question as to whether the agreement between the parties was a financial lease or not, the Court explained what term 'financial lease' would mean and for this purpose referred to the dictionary and books as is clear from the following:-

> (i) Dictionary of Accounting & Finance by Rule Brockington (Pitman Publishing, *Universal Book Trader 1996*, at page 136):
>
> > "A finance lease is one where the lessee uses the asset for substantially the whole of its useful life and the lease payments are calculated to cover the full cost together with interest charges. *It is thus a disguised way of purchasing the asset with the help of a loan,* SSAP 23 required that assets held under a finance lease be treated on the balance sheet in the same way, *as if they had been purchased and a loan had been taken out to enable this."* (emphasis[1] supplied)
>
> (ii) *Lease Financing & Hire Purchase* by Dr. J.C. Verma (4th Edn., 1999):

of long-term debt financing. In financial lease, leasing company buys the equipment and lease out to the use of a person known as the lessee, it is a full pay out lease involving obligatory payment by the lessee to the lessor that exceeds the purchase price of the leased property and finance cost.

Financial lease has been defined by international accounting standards committee as a lease that transfers substantially all the risks and rewards incident to ownership of an asset. Title may or may not eventually be transferred. *Lessor is only a financier and is not interested in the assets.* This is the reason that financial lease is known as full pay out lease where contract is irrevocable for the primary lease period and the rentals payable during which period are supposed to be adequate to recover the total Investment in the asset made by the lessor."

(iii) *Lease Financing & Hire Purchase* by Vinod Kothari (2nd Edn., 198):

"A financial lease is a contract involving payment over an obligatory period of specified sums sufficient in total to amortise the capital outlay of the lessor and give some profit.

An operating lease is any other type of lease that is to say, where the asset is not wholly amortised during the non-cancellable period, if any, of the lease and where the lessor does not rely for his profit on the rentals in the non-cancellable period."

After considering the aforesaid definitions of lease finance, the Supreme Court observed that following are the features of the financial lease.

"1. The asset is use-specific and is selected for the lease specifically. Usually, the lessee is allowed to select it himself.

2. The risks and rewards incident to ownership are passed on to the lessee. The lessor only remains the legal owner of the asset.

3. Therefore, the lessee bears the risk of obsolescence.

4. The lessor is interested in his rentals and not in

5. The lease period usually coincides with economic life of the asset and may be broken i primary and secondary period.

6. The lessor enters into the transaction only as a financier. He does not bear the casts of repairs, maintenance or operation.

7. The lessor is typically a financial institution and cannot render specialized service in connection with the asset.

8. The lease is usually full pay out, that is, the single lease repays the cost of the asset together with the interest."

Finally, their Lordships expressed their opinion at p. 520 of the report as under:

"10. In our opinion, financial lease is a transaction current in the commercial world, the primary purpose whereof is the financing of the purchase by the financier. The purchase of assets or equipments or machinery is by the borrower. For all practical purposes, the borrower becomes the owner of the property inasmuch as it is the borrower who chooses the property to be purchased, takes delivery enjoys the use of occupation of the property, bears the wear and tear, maintains and operates the machinery/equipment; undertakes indemnity and agrees to bear the risk of loss or damage, if any. He is the one who gets the property insured. He remains liable for payment of taxes and other charges and indemnity. He cannot recover from the lessor, any of the abovementioned expenses. The period of lease extends over and covers the entire life of the property for which it may remain useful, divided either into one term or divided into two terms with clause for renewal. In either case, the lease is non-cancellable."

10. The Special Benches observed that it is necessary to establish that the company carries on a business of the interest specified in various sub-clauses (except sub-clause (va) "as its principal

almost exclusively. Normally, therefore, it should be taken a company receiving deposits is covered by this sub-clause, but if it is read with the other sub-clauses, particularly sub-clause (vi), i.e., a miscellaneous finance company which carries on either exclusively or almost exclusively two or more classes of businesses referred to in the preceding sub-clauses which include sub-clause (va) as well, it gives an impression that unless the company referred to in sub-clause (va) receives any deposit under any scheme or arrangement as a business activity, it would not be a financial company. To put it negatively, if the assessee had another business which is its principal business the provisions of the Interest-tax Act would not apply.

11. In that case, the assessee company therein had 53% of the total income from leasing. It also took into consideration the break-up of assets and percentage thereof against total assets and found that there also lease assets have its largest share of assets, *i.e.*, 42% of the total assets. The Tribunal thereafter noted the contention of the counsel for the assessee on this negative aspect and the demand of the learned counsel to prove that the leasing was its main and principal business, which is not in the enumerated business. Therefore, the Act has no application to the assessee. Following arguments was raised by the learned

> "In the case before us as is evident from the compositic of income as well as from the Reserve Bank of India clarification, principal business is that of leasing and none other."

12. The Tribunal observed that on the application of negative test, the principal business may not be lease business as income from the said business and assets thereof were less than 50%. However, the Tribunal was of the opinion that to judge as to whether the assessee is a business company or not, application of positive test was required, *viz.*, whether it was carrying on as its principal business in either of the sub-clause (i) to (v) or a business as understood in sub-clause (va) or exclusively or almost exclusively in two or more businesses as required by sub-clause (vi) of Section 2 (5B) of the Act. It found that none of the businesses of the assessee in that case was having a share more than 50%.

13. Following aspects surface on the reading of the aforesaid judgment:-

i) While considering what constitutes 'principal business' as mentioned in sub-clause (i) to (v) of Section 2(5B) of the Act, will depend upon the facts and circumstances of each case. The income from a particular business is not the sole

income, earning during the relevant year would a relevant.

ii) The negative test applied in ***Rajath Leasing & Finance Ltd.*** (supra) is not the correct test whether the assessee is a finance company or not, is to be determined by applying positive test, namely, whether it is carrying on its principle business in either of the sub-clauses (i) to (v) or a business understood in sub-clause (5A) or exclusively or almost exclusively on any two or more businesses referred to in earlier sub-clauses as required by sub-clause (vi) of Section 2(5B) of the Act.

iii) Lease business is not *per se* excluded from consideration. Distinction is to be drawn between a financial lease and an operating lease. In case a particular lease is a financial lease, then in substance it is a loan transaction and would fall in sub-clause (iv), i.e., 'a loan company'.

iv) A distinction is to be drawn between lease agreement (whether financial lease or operating lease and hire-purchase agreement). A case of hire-purchase business would fall in sub-clause (i) whereas financial lease would fall in sub-clause (iv) in their respective categories. The next question would be as to whether the hire-purchase or financial lease business is the principle business or not

v) For application of sub-clause (vi) the hire-purchase business falling under sub-clause (i) and sub-clause (iv) can be clubbed together for determining as to whether the assessee carries on exclusively or almost exclusively the said two businesses.

14. We are in agreement with the aforesaid approach taken by the Special Bench in ***Gujarat Gas Finance Service Ltd.*** (supra) requiring that for the purpose of applicability of sub-clause (v), i.e., to determine whether the company carrying lease business would be covered as loan company or not, distinction will have to be drawn between a financial lease and an operating lease and financial lease would be relevant for the applicability of sub-clause (iv) as that would fall in the category of a loan company.

15. Learned counsel for the respondent assessee also agreed with the aforesaid principles which would be applicable in the instant case. In view thereof, we may straightway observe that reliance by the Tribunal on its earlier judgment in the case of ***Rajath Leasing & Finance Ltd.*** (supra) and on that basis concluding that lease business *per se* is not covered by Section 2(5B) of the Act would not be correct. On this aspect ***Rajath Leasing & Finance Ltd.*** (supra) does not lay down correct law. As pointed

business in question is that of financial leasing or operational leasing. In the event it is a financial lease, the case can be covered under sub-clause (iv).

16. However, matter has not been examined from this angle by any of the authorities below. Though there is some indication in the order of the AO inasmuch as the AO has observed that the assessee was claiming higher rate of depreciation, the AO also referred to two judgments of this Court in ***CIT*** **v.** ***Suidu Trade Links Ltd.***, 2003 Taxman 302 (Delhi) and ***CIT*** **v.** ***Madan and Co.***, 128 Taxman 116 = 254 ITR 445. But, apart from referring to these two cases, there is no discussion specifically on the two kinds of leases and it appears that that did not even occur to any of the authorities. It is, therefore, necessary to undertake this exercise and to determine as to whether the lease business of the assess falls in the category of operational lease or financial lease. Reason is simple. If it is financial lease and gets covered under sub-clause (iv), then the assessee can be termed as 'credit institution'. It is clear from the following table showing income of the assessee from different activities:-

	31.3.95		31-3-96		31-3-98		31-3-99	
Income	Amount	% of total income	Amount	% of total income	Amount	% of total income	Amount	% of total income
Lease Charges	408685186	46.68	43846347	45.23	582922013	47.40	400989489	49.33

charges								
Other income	121206462	13.84	92050814	9.50	269127363	21.88	987787	
Total	875529620	100	969397927	100	122989593	100	812880253	100

17. For this, matter will have to be referred back to the AO as it is the AO who can, on the basis of material produced before him, can come to the conclusion as to whether the lease agreements entered into by the assessee with the lessee are financial leases or operational leases or both and in that case how much charges are to be apportioned as income from financial lease and how much is to be assigned as income from the operational lease. We may point out at this stage that Mr. Bajpai, learned senior counsel for the assessee, had pleaded that the assessee was engaged in operating lease business only and not the financial lease business and made a fervent plea that there is no necessity to refer back the matter to AO. However, in the absence of complete material before us, it would not be possible to undertake this exercise. In any case, this Court cannot assume the function of fact finding authority and it would be opposite if AO deals with such an aspect in the first instance. We, therefore, answer the questions as under:-

b) This question is decided in the negative, i.e., in favour of the Revenue and against the assessee.

a) & c) Since the ITAT did not apply the correct

Leasing & Finance Ltd. (supra), decision Tribunal is set aside. At the same time, it is not possible to conclusively determine, in these proceedings, as to whether the assessee company is a financial company or a credit institution or not. For this purpose matter is remitted back to the AO for fresh determination keeping in view correct criteria as stated in this order.

18. As a consequence, ITAT's order is set aside. No costs.

(A.K. SIKRI)
JUDGE

(SIDDHARTH MRIDUL)
JUDGE

October 30, 2009.
pmc/hp

- for directions on office note.