

IN THE HIGH COURT OF KERALA AT ERNAKULAM

PRESENT :

THE HONOURABLE MR. JUSTICE C.N.RAMACHANDRAN NAIR
&
THE HONOURABLE MR. JUSTICE T.R.RAMACHANDRAN NAIR

MONDAY, THE 10TH MARCH 2008 / 20TH PHALGUNA 1929

ITA.No. 230 of 2002()

INT. TA.13/CO/2000 of I.T.A.TRIBUNAL,COCHIN BENCH
.....

APPELLANT/RESPONDENT:

THE COMMISSIONER OF INCOMETAX, COCHIN.

BY ADV. SRI.GEORGE K. GEORGE, SC FOR IT
SRI.P.K.R.MENON

RESPONDENTS: APPELLANT

M/S.MUTHOOT LEASING & FINANCE LTD.,
OPP.SARITHA THEATRE, BANERJEE ROAD, COCHIN-18.

BY ADV. SRI.P.BALACHANDRAN (SR.)

THIS INCOME TAX APPEAL HAVING BEEN FINALLY HEARD
ON 10/03/2008, ALONG WITH ITA NO.237/2002 & CONN.
CASES, THE COURT ON THE SAME DAY DELIVERED THE
FOLLOWING:

C.N.RAMACHANDRAN NAIR &
T.R.RAMACHANDRAN NAIR, JJ.

.....
I.T. Appeal Nos.230, 237, 264, 220, 312, 314,
& 269 of 2002, 93, 99, 101, 105, 107 & 111 of 2007,
& O.P. 10041 of 1996
.....

Dated this the 10th day of March, 2008.

JUDGMENT

C.N.Ramachandran Nair, J.

The only question arising in the connected appeals filed by the Revenue against the order of the Income Tax Appellate Tribunal is whether the "finance charges" collected by respondent-companies under hire purchase agreements attract tax under the Interest Tax Act, 1974 as amended by Finance (No.2) Act of 1991. According to the Revenue, "finance charges" collected by the respondents for vehicle financing is nothing but "interest" at flat rate loaded along with loan amount and collected in instalments and therefore, the same is assessable under the Act. The case of the respondents on the other hand is that hire purchase transactions are outside the scope of the Interest Tax Act and so much so, finance charges collected cannot be assessed as interest. We have heard Senior counsel Sri.P.K.R.Menon appearing for the appellant and Senior counsel Sri.P.Balachandran and

other counsel appearing for the respondents.

2. Admittedly respondents being hire purchase finance companies are specifically covered by the definition "credit institution" which are liable to pay interest tax on interest covered by Section 2(7) of the Act. In fact, atleast some of the respondents have paid tax on certain other receipts of interest and consequently have no dispute that they are not assessable under the Act. The short question arising for consideration is whether "finance charges" recovered by them from motor vehicle financing business is interest as defined under Section 2(7) of the Act. For easy reference, "interest" as defined under Section 2(7) is extracted hereunder:

"S.2(7): "Interest" means interest on loans and advances made in India and includes--

(a) commitment charges on unutilised portion of any credit sanctioned for being availed of in India; and

(b) discount on promissory notes and bills of exchange drawn or made in India, but does not include--

(i) interest referred to in sub-section (IB) of Section 42 of the Reserve Bank of India Act, 1934 (2) of 1934);

(ii) discount on treasury bills."

Admittedly the "finance charges" involved in these cases are from

vehicle financing business. Along with "finance charges" recovered in the vehicle financing business, respondents have also claimed exemption on "service charges" recovered in the same business. The Assessing Officer examined the nature of the two receipts and though granted exemption on service charges received, found that the amount received and accounted as "finance charges" is nothing but interest collected at flat rate and therefore, he levied tax on the same. In other words, the finding of the Assessing Officer is that vehicle financing under the so-called hire purchase arrangement is nothing but "loan or advance" made by the respondents and interest accounted under the name finance charges is assessable under the Act. The nature of transaction which is same for all assesseees as found by the Assessing Officer in the assessment of the respondent in I.T.A. 230/2002 is as follows:

"The sanction letter (copy of letter dt.23.10.98 addressed to Shri.Peter Paul filed as specimen) shows that the hirer has given application to the assessee requesting for hire purchase finance of the amount specified therein. The hire purchase agreement (agreement dtd.23.10.98 in the case of Shri.Peter Paul filed as specimen) also shows that the hirer had requested the assessee (owner) for finance for purchase of a new vehicle and the assessee has agreed to finance for the purchase on the terms and conditions stipulated in the hire purchase agreement. It is evident from the above that the assessee has advanced money to the hirer

for the purchase of the vehicle in response to a specific request made by him for finance and the transaction is essentially in the nature of financing transaction. If transactions of this type will not fall within the category of financing transaction it is difficult to conceive which transaction will fall within this category."

"The methods of fixation of the initial payment, i.e., margin money, determination of finance charges and determination of hire purchase price followed by the assessee also clearly show that the hire purchase transactions entered in to by it are in substance financial transactions. The margin money is the cost of the asset as reduced by the hire purchase finance sanctioned to the hirer at his request. It has no relation to the cost of the asset. If a hirer seeks 90% of the cost of the asset as hire purchase finance, margin money will be the balance 10% only. For the same asset if a hirer is sanctioned 75% of the cost as hire purchase finance the margin money will be 25% only. This shows that the hire purchase advance is a loan, pure and simple granted by the assessee according to the needs of the hirer. Similarly finance charges are also calculated at a flat rate of 11% per annum on the net amount financed and this is nothing but calculation of interest @ 11% p.a. at flat rate for the period of hire purchase. The hire purchase price is also fixed by adding the finance charges to the net amount financed. The hire purchase price so fixed is payable in equal monthly instalments over a number of years. It is clear from the above that the finance charges collected by the assessee actually represents interest on the amount advanced by it to the so-called hirer."

(emphasis supplied)

From the above it is clear that though the transaction is styled as hire purchase agreement, it is actually financing for purchase of a vehicle.

The crucial difference between hire purchase agreement and

arrangement in these cases is that while in the hire purchase arrangement the financier remains the owner of the goods and the hirer has only an option to purchase the goods after payment of the hire purchase instalments, in these cases the borrower is the purchaser and registered owner of the vehicle and the respondents-companies have only a licence to repossess the vehicle on default. Even though none of the authorities including the Tribunal has not considered the provisions of the Motor Vehicles Act, 1988 pertaining to financing of vehicle purchase, we feel it would be useful to refer to the provisions of the said Act for understanding the nature of transaction between the respondents and the vehicle owners. Section 51(1) of the Motor Vehicles Act mandates that the registering authority shall enter in the certificate of registration of the vehicle, about the hire purchase agreement. Clause (3) provides for cancellation of the hire purchase liability entered in the certificate of registration on production of proof of termination of the agreement. Similarly, clause (4) provides for transfer of ownership of the vehicle subject to hire purchase agreement only with the consent of the finance company. Ultimately, clause (5) authorises the finance company to take over possession of the vehicle subject to hire purchase agreement and thereafter they can apply for

change of registration in their name. Therefore, the business of the respondents reflected in the order of the Assessing Officer is consistent with the above statutory provision of the Motor Vehicles Act which only provide for endorsement of hypothecation in the RC book and registration of the vehicle is in the name of the borrower. Now the question to be considered is whether on these facts, the transaction between the respondents and the borrowers is a case of loan or a hire purchase agreement. The Assessing Officer has already found and respondents cannot controvert the fact that flat rate of interest for the whole loan period is loaded to the loan amount and the hire charges collected in instalments include such interest loaded to the loan amount advanced by the finance company. Besides endorsement of hypothecation in the RC book of the vehicle, the respondents take promissory notes, cheques etc., from the borrowers towards security. The Supreme Court has considered the distinction between hire purchase arrangement and loan transaction in the following words in the decision in SUNDARAM FINANCE LTD. V. STATE OF KERALA reported in AIR 1966 SC 1178:

"..... If there is a bona fide and completed sale of goods, evidenced by documents, anterior to and independent of a subsequent and distinct hiring to the

vendor, the transaction may not be regarded as a loan transaction, even though the reason for which it was entered into was to raise money. If the real transaction is a loan of money secured by a right of seizure of the goods, the property ostensibly passes under the documents embodying the transaction, but subject to the terms of the hiring agreement, which become part of the buyer's title, and confer a licence to the seizure. When a person desiring to purchase goods and is not having sufficient money on hand borrows the amount needed from a third person and pays it over to the vendor, the transaction between the customer and the lender will unquestionably be a loan transaction. The real character of the transaction would not be altered if the lender himself is the owner of the goods and the owner accepts the promise of the purchaser to pay the price or the balance remaining due against delivery of the goods. But a hire-purchase agreement is a more complex transaction. The owner under the hire-purchase agreement enters into a transaction of hiring out goods on the terms and conditions set out in the agreement, and the option to purchase exercisable by the customer on payment of all the instalments of hire arises when the instalments are paid and not before. In such a hire-purchase agreement there is no agreement to buy goods, the hirer being under no legal obligation to buy, has an option either to return the goods or to become its owner by payment in full of the stipulated hire and the price for exercising the option. This class of hire-purchase agreement must be distinguished from transaction in which the customer is the owner of the goods and with a view to finance his purchase he enters into an agreement which is in the form of a hire-purchase agreement with the financier, but in substance evidence a loan transaction, subject to hiring agreement under which the lender is given the licence to seize the goods."

(emphasis supplied)

Now what is to be considered is whether the transaction between the respondents and the applicants who purchased the vehicles with the finance given by the respondents is really a hire purchase under the Act. The Tribunal heavily relied on the provisions of the Hire Purchase Act 1972 and took the view that transaction of hire purchase is not "loan or advance" as defined under Section 2(7) of the Act. On going through the Tribunal's orders, we find that what weighed with them is the option under the hire purchase agreement to the borrowers to purchase the vehicle. However, we notice that option given to the borrower to purchase vehicle for rupee one in the hire purchase agreement is an empty formality in this case because vehicle purchased is registered in the name of the borrower and respondents have only a licence to repossess the vehicle on default. In order to get ownership, respondents have to apply for change of registration in their name under the provisions of the Motor Vehicles Act abovereferred. Besides this, we have already noticed the salient features of the so-called hire purchase agreement, whereunder the loan amount is recovered in instalments along with flat rate of interest charged for loan period and loaded to the instalments. Respondents have taken cheques, promissory notes, etc. towards security for the loan, in addition to

hypothecation noticed in the RC book. It is clear from the terms of transaction that the vehicle financing covered by so-called hire purchase agreements is only in the nature of loan and contrary to hire-purchases conceived under the Hire Purchase Act, respondents have only a licence to repossess the vehicle and get the vehicle registered in their name and that too under orders of Registering Authority under the Motor Vehicles Act after default is committed by the hire purchasers. We are of the view that the Tribunal mis-directed itself and reached a wrong conclusion only because of their failure to appreciate the facts pertaining to transaction properly and without reference to the provisions of the Motor Vehicles Act which deal with ownership, hypothecation, etc. on vehicles. Respondents have heavily relied on Circular No. 760 dated 13.1.1998 issued by CBDT wherein they have stated that genuine hire purchase transactions are not covered by the Interest Tax Act. However, we notice that the very same CBDT in circular No. 738 dated 25.3.1996 have earlier clarified that interest recovered under hire purchase agreement falls under Section 2(7) of the Interest Tax Act. Even in the circular relied on by the respondents what the CBDT has said is that each and every transaction should be considered on merits and exclusion is provided only on hire charges

and not on interest. Applying the principle laid down by the Supreme Court in SUNDARAM FINANCE LTD.'s case, we already found that the transaction is a genuine loan transaction, though it is styled as a hire purchase arrangement. Another instruction relied on by the respondents is instruction No. 1425 in E.No. 275/90/80 IT (B) dated 18.11.1981 issued by the CBDT with reference to Section 194A of the I.T. Act which provides for deduction of tax at source on interest income. What is stated in this is that no deduction should be made at the time of payment of hire purchase instalment. We do not know how this circular prohibiting deduction of tax at source on hire purchase instalment of which interest is only an element can apply to the facts of this case. Moreover, it is to be noted that hire purchase companies are squarely covered by definition of "credit institutions" under the Act and are liable to pay tax on charge of interest on loans and advances. It is immaterial whether a loan or advance is called hire purchase agreement or not. On the other hand, what is to be considered is whether the transaction involved is really a loan or advance and if the transaction is found so, then the interest earned on the same is taxable under the Interest Tax Act. Besides the decision of the Supreme Court in SUNDARAM FINANCE LTD.'s case, the other decision relied on by

the assessee is that of the Punjab and Haryana High Court in DEEP HIRE PURCHASE V. COMMR. OF INTEREST TAX, 274 I.T.R. 69.

We notice that this is a case where Punjab and Haryana High Court had only confirmed the order of the Tribunal remanding the matter to the assessing officer with an observation that interest on financing only attracts tax under Section 2(7) of the Act. However, the question whether motor vehicle financing of the kind carried on by the respondents which is the issue in this case attract tax under the Act or not was not raised or decided by that Court. Similarly another decision relied on by the respondent is that of the Madras High Court in COMMR. OF INCOME TAX V. HARITA FINANCE LTD. 283 I.T.R. 370 (Mad.) also does not deal with the nature of transaction involved in this case. On the other hand, the Court has only held that Tribunal's findings on facts are binding and conclusive and there is no scope for interference in Reference Case. However, in this case revenue had specifically canvassed against the findings of the Tribunal contrary to the concurrent findings entered by the assessing authority and the first appellate authority based on documents and with reference to specific hire purchase agreements entered into between the respondents and their parties. After going through the facts pertaining to transactions

extracted above, we find no justification for the Tribunal to come to the findings different from that of the two lower authorities. Besides this we have already noticed that the exercise of option provided in the agreement relied on by the Tribunal is contrary to the real deal and against the provisions of the Motor Vehicles Act because of registration of vehicles by the borrowers in their own names. The Tribunal's findings are based on wrong assumption of facts and they have decided the matter without even referring to the provisions of the Motor Vehicles Act which comprehensively deal with all transactions in motor vehicles. We, therefore, allow the appeals by reversing the order of the Tribunal and restoring the assessments confirmed in first appeals.

The O.P. No.10041/1996 stands dismissed.

C.N.RAMACHANDRAN NAIR
Judge

T.R.RAMACHANDRAN NAIR
Judge

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