



Volume X ♦ Issue IV ♦ Year 2010

## DSK Legal Knowledge Center

### Update on • Tax

#### TAX

#### **SERVICE TAX: ASSOCIATION OF LEASING & FINANCIAL SERVICE COMPANIES**

Recently in the case of Association of Financial Leasing v. Union of India, a three judge bench of the Supreme Court (“**Court**”) on 26.10.2010 decided the issue regarding powers of Central Government to levy service tax on the banking and financial services like financial leasing and hire purchase . The appeal, in the case was filed by an association of leasing and financial companies challenging the constitutional validity of section 65(105) (zm) read with section 65(12) (a) (i) of the Finance Act, 1994 with regard to *‘financial leasing services including equipment leasing and hire purchase’*. It was argued on behalf of the association that levy of service tax on the financial and leasing services is beyond the

legislative competence of the Central Government. The Court rejected the submissions made by the association and upheld the imposition of service tax on such services and held that same is within Central Government’s power.

The association contended that the effect of Article 366(29A), brought about by the 46<sup>th</sup> Amendment, was to treat six types of transactions (mentioned in the provision) as deemed sales so as to enable state legislatures to levy sales tax. Their main contention was that since hire purchase and leasing transactions were specifically characterized as deemed sales under Art.366(29A)(c) and (d) respectively, the Constitution had now **conferred exclusive power** to the states to levy sales tax and therefore service tax could not be imposed on such transaction. The Court rejected this contention.

It held that the purpose behind Article 366(29A) was to merely create a legal fiction for increasing the scope of sales tax. The historical background of the 46<sup>th</sup> Amendment and the 61<sup>st</sup> Law commission report, on the basis of which the 46<sup>th</sup> amendment was enacted, shows that 366(29A) was enacted to merely widen the ambit of sales tax, which was given a very narrow interpretation by earlier judgments like *K. L. Johar and Co. v. Deputy Commercial Tax Officer*, (1965) 2 SCR 112. The exclusion of service tax was never intended by the legislature in fact, service tax levy was not even in the minds of legislature at the time of 46<sup>th</sup> amendment.

The Court held that in the present case, the whole field of transaction was not covered by Entry 54 (which allows levy of sales tax) and that the transaction had service aspect as well. On those service aspects, the centre had a right to levy service tax. The Court held that the financing as an activity or business of NBFCs is different and distinct from operating lease/hire-purchase agreements in the classical sense. The lessor (NBFC) merely finances the equipment/asset which the lessee is free to select, order and take delivery. It accepts the invoice from the vendor (supplier of the equipment) and pays him. The income which the lessor earns is by way of finance/interest he charges in addition to the management fees or documentation charges, etc. It is this

income which constitutes the measure of tax for the purposes of calculating the value of taxable services under section 67 of the Finance Act, 1994. The amount received as principal **is not the consideration** for services rendered and the taxable event is the service which is rendered by the finance company to its customer(s). 'The finance lease' and 'the hire-purchase finance' is thus covered under the expression 'financial leasing services' under section 65(12) of the Finance Act, 1994. Since the tax levied is a tax on the provision of service, its imposition is valid and well within the purview of law. Therefore, the Court held that the power vested with the centre to impose service tax on '*financial leasing services including equipment leasing and hire purchase*' is not unconstitutional.

## **CONCLUSION**

In a transaction there may be some components which constitute 'sale' and some which constitute as 'service'. As long as the necessary ingredients of service are present, mere application of Article 366(29A) would not debar the centre to levy service tax on the service aspect of the transaction.

**DSK Comments:**

The Court while concluding the issue in this case observed that transaction having a component of deemed sale would not be a hurdle for the centre to levy service tax on the very same transaction, if all the ingredients of a service are present. With such an observation Supreme Court has made it ample clear that in all the cases, where there is ambiguity with respect to power to levy different taxes, it has to be seen in each case, if the nature of the activity (sale/service) can be easily bifurcated and that amount can be bifurcated corresponding to such activity. As far as constitutional competence of Central Government is concerned same is well within the purview of the Central Government in light of the test laid down by the Supreme Court.

## DSK Legal Knowledge Center

**Contact Details:** [dsklegal.knowledgecenter@dsklegal.com](mailto:dsklegal.knowledgecenter@dsklegal.com)

### **Mumbai Office**

4<sup>th</sup> Floor, Express Towers,  
Nariman Point,  
Mumbai 400 021  
India  
Tel: (91 - 22) 6658 8000  
Fax: (91 - 22) 6658 8001

### **Delhi Office**

46, Aradhana, Chanakyapuri,  
New Delhi 110 066  
India  
Phone: (91 - 11) 2687 1122; 2687 1133;  
2687 1144  
Fax: (91 - 11) 2687 1155

### **Disclaimer**

The update is intended for your general information only. The information and opinions contained in this document are derived from public sources which we believe to be reliable and accurate but which, without further investigation, cannot be warranted as to their accuracy, completeness or

correctness. It is not intended to be nor should be regarded as legal advice and no one should act on such information without appropriate professional advice. DSK Legal accepts no responsibility for any loss arising from any action taken or not taken by anyone using this material.