I-T- Whether when assessee is a leasing and finance company, it gets deprived of depreciation benefits on assets leased out to third parties - NO: SC

By TIOL News Service

NEW DELHI, JAN 16, 2013: THE issues before the Bench are - Whether when the assessee is a leasing and finance company, it gets deprived of depreciation benefits on assets leased out to third parties - Whether for the purpose of claiming depreciation on trucks leased out, it is not necessary for the assessee to use the assets for its own use; Whether when the wording in the Sec 32 emphasises on the ownership of the asset, to decide the question of ownership a reference to Sec 2(30) of the Motor Vehicle Act can be resorted to for verification of registration of vehicle in the name of lessor; Whether Sec 2(30) of the MV Act is a deeming fiction and it cannot be relied upon to decide the question of ownership of the vehicle and Whether when the assets were used for the purpose of business, the assessee is entitled to higher rate of depreciation. And the verdict goes in favour of assessee.

Facts of the case

Assessee is a public limited company, classified by the Reserve Bank of India (RBI) as a non-banking finance company. It is engaged in the business of hire purchase, leasing and real estate etc. The vehicles, on which depreciation was claimed, were stated to have been purchased by the assessee against direct payment to the manufacturers. The assessee, as a part of its business, leased out these vehicles to its customers and thereafter, had no physical affiliation with the vehicles. In fact, lessees were registered as the owners of the vehicles, in the certificate of registration issued under the Motor Vehicles Act, 1988. In its return of income for the relevant assessment years, the assessee claimed, among other heads, depreciation in relation to certain assets, (additions made to the trucks) which had been financed by the assessee but registered in the name of third parties. The assessee also claimed depreciation at a higher rate on the ground that the vehicles were used in the business of running on hire.

The Assessing Officer disallowed claims, both of depreciation and higher rate, on the ground that the assessee's use of these vehicles was only by way of leasing out to others and not as actual user of the vehicles in the business of running them on hire. It had merely financed the purchase of these assets and was neither the owner nor user of these assets. Aggrieved, the assessee preferred appeals to the Commissioner of Income Tax. In so far as the question of depreciation at normal rate was concerned, the Commissioner (Appeals) agreed with the assessee. However, assessee's claim for depreciation at higher rate did not find favour with the Commissioner.

Being dissatisfied, both the assessee and the Revenue carried the matter further in appeal before the Income-tax Appellate Tribunal. The Tribunal agreed with the assessee on both the counts. Relying on the decision of this Court in *Commissioner of Income Tax, Karnataka, Bangalore Vs. Shaan Finance (P) Ltd., Bangalore,* the Tribunal held that the assessee, having used the trucks for the purpose of business, was entitled to a higher rate of depreciation at 50% on the trucks leased out by it.

On appeal, answering both the questions in favour of the revenue, the High Court held that in view of the fact that the vehicles were not registered in the name of the assessee, and that the assessee had only financed the transaction, it could not be held to be the owner of

the vehicles, and thus, was not entitled to claim depreciation in respect of these vehicles. Hence, these appeals by the assessee.

Having heard the parties, the SC held that,

++ depreciation is the monetary equivalent of the wear and tear suffered by a capital asset that is set aside to facilitate its replacement when the asset becomes dysfunctional. In *P.K. Badiani Vs. Commissioner of Income Tax, Bombay*, this Court has observed that allowance for depreciation is to replace the value of an asset to the extent it has depreciated during the period of accounting relevant to the assessment year and as the value has, to that extent, been lost, the corresponding allowance for depreciation takes place;

++ parks in Principles & Practice of Valuation (Fifth Edn., at page 323) states: As for building, depreciation is the measurement of wearing out through consumption, or use, or effluxion of time. Paton has in his Account's Handbook (3rd Edn.) observed that depreciation is an out-of- pocket cost as any other costs. He has further observed-the depreciation charge is merely the periodic operating aspect of fixed asset costs;

++ the provision on depreciation in the Act reads that the asset must be “owned, wholly or partly, by the assessee and used for the purposes of the business”. Therefore, it imposes a twin requirement of ‘ownership’ and ‘usage for business’ for a successful claim under Section 32 of the Act;

++ revenue argued that since the lessees were actually using the vehicles, they were the ones entitled to claim depreciation, and not the assessee. We are not persuaded to agree with the argument. The Section requires that the assessee must use the asset for the “purposes of business”. It does not mandate usage of the asset by the assessee itself. As long as the asset is utilized for the purpose of business of the assessee, the requirement of Section 32 will stand satisfied, notwithstanding non-usage of the asset itself by the assessee. In the present case before us, the assessee is a leasing company which leases out trucks that it purchases. Therefore, on a combined reading of Section 2(13) and Section 2(24) of the Act, the income derived from leasing of the trucks would be business income, or income derived in the course of business, and has been so assessed. Hence, it fulfills the aforesaid second requirement of Section 32 of the Act viz. that the asset must be used in the course of business;

++ the assessee did use the vehicles in the course of its leasing business. In our opinion, the fact that the trucks themselves were not used by the assessee is irrelevant for the purpose of the section;

++ we may now advert to the first requirement i.e. the issue of ownership. No depreciation allowance is granted in respect of any capital expenditure which the assessee may be obliged to incur on the property of others. Therefore, the entire case hinges on the question of ownership; if the assessee is the owner of the vehicles, then he will be entitled to the claim on depreciation, otherwise, not;

++ a scrutiny of the material facts at hand raises a presumption of ownership in favour of the assessee. The vehicle, along with its keys, was delivered to the assessee upon which, the lease agreement was entered into by the assessee with the customer. The Revenue’s objection to the claim of the assessee is founded on the lease agreement. It argued that at the end of the lease period, the ownership of the vehicle is transferred to the lessee at a

nominal value not exceeding 1% of the original cost of the vehicle, making the assessee in effect a financer;

++ however we are not persuaded to agree with the Revenue. As long as the assessee has a right to retain the legal title of the vehicle against the rest of the world, it would be the owner of the vehicle in the eyes of law. A scrutiny of the sale agreement cannot be the basis of raising question against the ownership of the vehicle. The clues qua ownership lie in the lease agreement itself, which clearly point in favour of the assessee;

++ the only hindrance to the claim of the assessee, which is also the lynchpin of the case of the Revenue, is Section 2(30) of the MV Act. The general opening words of the Section say that the owner of a motor vehicle is the one in whose name it is registered, which, in the present case, is the lessee. The subsequent specific statement on leasing agreements states that in respect of a vehicle given on lease, the lessee who is in possession shall be the owner. The Revenue thus, argued that in case of ownership of vehicles, the test of ownership is the registration and certification. Since the certificates were in the name of the lessee, they would be the legal owners of the vehicles and the ones entitled to claim depreciation. Therefore, the general and specific statements on ownership construe ownership in favour of the lessee, and hence, are in favour of the Revenue;

++ we do not find merit in the Revenue's argument for more than one reason: (i) Section 2(30) is a deeming provision that creates a legal fiction of ownership in favour of lessee only for the purpose of the MV Act. It defines ownership for the subsequent provisions of the MV Act, not for the purpose of law in general. It serves more as a guide to what terms in the MV Act mean. Therefore, if the MV Act at any point uses the term owner in any Section, it means the one in whose name the vehicle is registered and in the case of a lease agreement, the lessee. That is all. It is not a statement of law on ownership in general. Perhaps, the repository of a general statement of law on ownership may be the Sale of Goods Act; (ii) Section 2(30) of the MV Act must be read in consonance with sub-sections (4) and (5) of Section 51 of the MV Act;

++ the MV Act mandates that during the period of lease, the vehicle be registered, in the certificate of registration, in the name of the lessee and, on conclusion of the lease period, the vehicle be registered in the name of lessor as owner. The Section leaves no choice to the lessor but to allow the vehicle to be registered in the name of the lessee. Thus, no inference can be drawn from the registration certificate as to ownership of the legal title of the vehicle; and (iii) if the lessee was in fact the owner, he would have claimed depreciation on the vehicles, which, as specifically recorded in the order of the Appellate Tribunal, was not done. It would be a strange situation to have no claim of depreciation in case of a particular depreciable asset due to a vacuum of ownership. As afore- noted, the entire lease rent received by the assessee is assessed as business income in its hands and the entire lease rent paid by the lessee has been treated as deductible revenue expenditure in the hands of the lessee. This reaffirms the position that the assessee is in fact the owner of the vehicle, in so far as Section 32 of the Act is concerned;

++ there was some controversy regarding the invoices issued by the manufacturer – whether they were issued in the name of the lessee or the lessor. For the view we have taken above, we deem it unnecessary to go into the said question as it is of no consequence to our final opinion on the main issue. From a perusal of the lease agreement and other related factors, as discussed above, we are satisfied of the assessee's ownership of the trucks in question;

++ therefore, in the facts of the present case, we hold that the lessor i.e. the assessee is the owner of the vehicles. As the owner, it used the assets in the course of its business, satisfying both requirements of Section 32 of the Act and hence, is entitled to claim depreciation in respect of additions made to the trucks, which were leased out;

++ with regard to the claim of the assessee for a higher rate of depreciation, the import of the same term “purposes of business”, used in the second proviso to Section 32(1) of the Act gains significance. We are of the view that the interpretation of these words would not be any different from that which we ascribed to them earlier, under Section 32 (1) of the Act. Therefore, the assessee fulfills even the requirements for a claim of a higher rate of depreciation, and hence is entitled to the same.