

Article



GST on Leasing and Hire-purchase transactions

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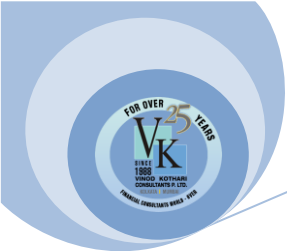
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Introduction

Leasing industry, having a penetration of upwards of 20% of GDP in many countries, is below 1% penetration in India, primarily because of the VAT and service tax levies. In light of this fact, it becomes crucial to see whether the introduction of GST resolves the problem of incremental tax levy in case of lease transactions.

This note takes a quick view on the applicability of GST to lease transactions. The basis for the note is the draft GST law, as of Sept. 2015¹.

Whether a supply of goods or supply of service:

As per the definition of “supply of goods” given in sec. 3, read with Schedule II, a “transfer of title in goods”, or “Any transfer of title in goods under an agreement which stipulates that property in goods *will* pass at a future date upon payment of full consideration as agreed, is a supply of goods” (emphasis supplied).

A lease transaction usually does not by itself result into a transfer of title. A hire purchase transaction contains an option to buy the asset with the hirer – however, the cited definition of “transfer of goods” in Schedule II refers to a transaction positively resulting into a transfer. Therefore, it seems to cover conditional sales, and not hire purchase contracts.

Sec 3 (3) seems to reserve a power with the Central/State government to notify rules on distinction between supply of goods and supply of services; however, these rules have to be subject to sec. 3 (2), which incorporates a reference to the Schedule. From a reading of the Schedule, it appears clearly that since a lease is not a “transfer of goods”, it will be treated as a “supply of services”.

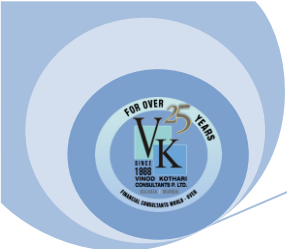
Inter-state character and place of supply:

It is important to determine the inter-state/intra-state nature of the supply. Among other differences, there will be an additional tax applicable in case of inter-state supply of goods. Also, the jurisdiction changes from the SGST/CGST Act to the IGST Act in case of inter-state supplies.

The rules for determination of inter-state/intra-state supplies, in case of goods and services, are different. In case of a supply of goods, the determination is based on whether there is an inter-state movement of goods, and whether the supplier “arranges” for the transportation of the goods. In case of services, the determination is based on the location of the service provider or the service recipient [Sec 14 read with Explanation below sec 15 (2)].

Since our prima facie view is that a lease will be regarded as a supply of services, the following rules are important to determine the location of the service provider [sec 16]:

¹ , available on GSTIndia.com



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- Sub-sections (4) to (13) of sec. 16 lay down 10 types of services [let us call them “Specific Services”] for which the determination of the location will be done as per the specific rules laid in those sub-sections. Of these sub-sections, the only relevant sub-section may be sub-section (10), pertaining to a “financial service”. The expression is not defined in the draft law. However, even if certain types of leases are defined as “financial service”, the conclusion below may not change, because in case of a financial service, the place of the service is the place of the service receiver, as per the records of the service provider.
- For all services other than Specific Services, the question to ask is, whether the service recipient is a registered person, or not.
 - In case of registered service recipient, the place of supply is the location of the recipient.
 - In case of unregistered service recipient, the place of supply is the location of the service provider.

Assuming that most of the lessees under business leases will be registered persons, this brings the following conclusions:

- Leases of business assets – the place of supply will be the location of the service receiver.
- Lease of consumer assets, such as cars, personal use assets, personal solar equipment etc., the place of supply will be the location of the service provider.

Situations of tax on leases:

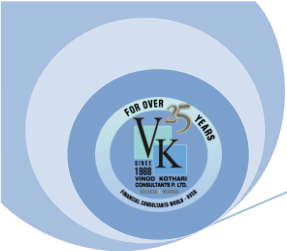
The analysis of the situations below is based on the GST draft law. We have also based the analysis below on the report of the Report of the Task Force on Goods and Services Tax, of 15th Dec 2009, containing a clear recommendation that a consignment/branch transfer will be treated as an inter-state sale².

We may discuss the following scenarios:

- Goods are acquired from State A, leased in State A (Scenario A)
- Goods are acquired from State A, leased in State B (Scenario B)
- Goods are imported from out of India, and leased in State X (Scenario C)
- Components of goods are acquired from different states, integrated and leased in State X (Scenario D)
- In course of provision of the leasing service (say, a construction equipment rental business), the goods are moved from one state to another, by the lessor (Scenario E)

Before we get into the discussion, we need to understand that there is a provision for payment of 1% additional tax in case of inter-state supply of goods. Currently, it is provided that this tax will stay for a period of 2 years; however, the government has the right to extend the period. This tax shall not be

² Para 3.20 of the Report



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vatable. This tax may be seen as the proxy for the concessional rate of CST applicable currently. Unlike the current CST, the hassles of production of a C Form etc are completely avoided in the GST law.

Scenario A

- Supplier charges SGST+ CGST at the time of purchase of goods.
- Lessor is liable to pay SGST + CGST on the lease rentals, that is, the value of the services.
- The tax paid on purchase may be fully offset against the tax payable on the services – CGST against CGST and SGST against SGST.
- There is no additional burden due to the lease, except due to the timing of the set off.

Scenario B

- The supplier in State A charges IGST.
- In addition, the supplier charges an additional tax of 1%.
- Lessor is liable to pay SGST + CGST on the lease rentals, that is, the value of the services.
- The IGST paid on purchase may be fully offset against the tax payable on the services, first against CGST, and thereafter, against SGST.
- There is an extra burden due to additional tax, and also due to the timing of the set off.

Scenario C

- The lessor as importer pays IGST to the extent of additional duty. Basic Customs duty is applicable anyways.
- Lessor is liable to pay SGST + CGST on the lease rentals, that is, the value of the services.
- The IGST paid on import may be fully offset against the tax payable on the services, first against CGST, and thereafter, against SGST.
- There is no additional burden due to the lease, except due to the timing of the set off.

Scenario D

- On purchase of each of the components, there is an IGST or CGST+SGST paid, depending on whether the purchase is inter-state or intra-state. An additional tax is also applicable in case of inter-state purchases.
- Lessor is liable to pay SGST + CGST on the lease rentals, that is, the value of the services.
- The IGST/CGST+SGST paid on purchase may be fully offset against the tax payable on the services, IGST to be set off first against CGST and thereafter against SGST, and CGST/SGST against respective taxes.
- There is an extra burden due to additional tax, and also due to the timing of the set off.

Scenario E

- While we will await the text of the law dealing with consignments, in the present case, there is a movement of goods by the lessor for his own business. Entry taxes are getting subsumed into GST. It is difficult to say that the present case is a case of consignment. Apparently, there should be no tax burden in the present case merely due to the movement of the goods.



Summing up the net result of GST:

- Assuming that there is a GST on other financial services as well, the present distortion where loans are not liable to either service tax or sales-tax will get resolved, as there will be a GST on either transaction –whether a lease or a loan.
- Presently, financial lease transactions are charged to both service tax and VAT. As opposed to this, the GST law will have one single tax on all lease transactions.
- Presently, the tax paid on input services cannot be set off against the VAT payable on lease rentals, or vice versa. The GST law by consolidating the two levies results into a cross off-setting of taxes paid on goods or services.
- The present scenario of VAT on lease transactions is unduly complicated because of presence of CST with a need for production of C forms, entry taxes, confusion in the meaning of intra-state and inter-state transactions, etc. GST simplifies the issue substantially. C forms will not be required at all. Entry taxes will not be there. By and large, cascading burden will get eliminated.
- In case of lease transactions for business assets, the service will be deemed to take place at the location of the service recipient – hence, leasing companies will continue to be subjected to payment of GST in various states across the country. However, that is so in case of loans as well, as in case of financial services too, the address of the customer in the records of the service provider is deemed to be the place of the supply.
- Presently, another reason for a substantial distortion in the scenario of lease taxation is the denial of set off, by several states, of input taxes in case of lease transactions. This is also hopefully eliminated in the GST scenario.

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