

**AUTHORITY FOR ADVANCE RULINGS
(CENTRAL EXCISE, CUSTOMS AND SERVICE TAX)
NEW DELHI**

PRESENT

**Mr Justice P.K. Balasubramanyan (Chairman)
Mr. J. K. Batra (Member)
Mr. J. Khosla (Member)**

The 8th April, 2011

Ruling No. AAR/ ST-1/03/2011

In

Application No. AAR/ST-1/5/2010

Name and address of the applicant	:	RITES Limited, RITES Bhawan No.1, Sector-29, Gurgaon-122001, Haryana
Commissioner concerned	:	Commissioner of Central Excise & Service Tax (LTU), NBCC Plaza, Pushp Vihar, Saket, New Delhi-110 017
Present for the applicant	:	Sh. H.K.Bali, General Manager Sh. Anil Seth, Advocate
Present for the Commissioner	:	Sh. B.K. Singh, JCDR Sh. Sumit Kumar, SDR

R U L I N G

(By Justice P.K. Balasubramanyan)

This is an application by a Public Sector Undertaking under the Ministry of Railways under section 96 C of Chapter V of the Finance Act, 1994. According to the applicant, it provides consultancy services in various facets of transportation like Railways, Highways, Airports, Urban transport, Ropeways etc. in India and abroad. It also provides services of third party inspection, project management and construction supervision. Since it is in the business of providing consultancy services it is being

approached for the leasing of locomotives, coaches and wagons in India. It is also exporting and leasing locomotives and rolling stock abroad.

2. It has approached this Authority for Advance Ruling on the question sought to be raised by it since it proposes to enter into a new business and wants to seek a ruling regarding its liability to pay service tax, if any, on that business. Since there is serious objection on the part of the Commissioner of Service Tax, on the ground that the claim is vague, we set out the activity proposed to be undertaken by the applicant as disclosed in its application.

“Now the company intends to enter into business of providing locomotives, coaches, wagons, etc. under Operating Leasing Agreement in the domestic market. The criteria for that may be company to take locomotives either on operating lease or through outright purchase from Indian railways which in turn may be leased or sub-leased to the prospective clients in India”.

3. While indicating its interpretation of law in Annexure II to the application, the applicant has stated that it proposes to operate on dry lease of its locomotives, coaches and wagons etc. and dry lease is a leasing arrangement of equipment for definite periods with obligation on the lessee to return the leased article on the expiry of the term and pay rent as agreed to during the term of the agreement. This should not be considered a transaction that attracts liability for service-tax. In that context, the applicant has sought a ruling on whether service-tax is leviable while

- (i) operating on dry lease,
- (ii) operating on dry lease in addition to repairs and maintenance of the leased stock,
- (iii) undertaking only repair and maintenance services for the leased stock or
- (iv) entering into two separate contracts with the same client; one for dry lease operating and the other for repair and maintenance.

4. While admitting the application for ruling, this Authority formulated the above questions. We may observe that at the hearing, no claim was raised by the applicant regarding question nos. (ii), (iii) and (iv) and it was acknowledged that a contract for repair and maintenance would attract service-tax, going by the definition of taxable service in clauses (105)(zzg) or (105)(zzzzj) of Section 65 of the Act. The only ruling that was really sought for was regarding the first question as to whether it was exigible to service-tax if it undertakes the activity of operating on dry lease of its locomotives, coaches and wagons etc. The department mainly relied on clause (105)(zm) of Section 65 read with the definition of the banking and financial services in clause (12) of the said Section of the Act to meet the claim and the arguments surrounded the interpretation of that provision.

5. Considering that the Ruling turns on the interpretation of section 65(12) of the Act, we think it proper to set down the said provision thereunder:

65. Definitions

In this Chapter, unless the context otherwise requires,-

(1) to (11) xx xx xx xx xx xx

(12) “banking and other financial services” means –

(a) the following services provided by a banking company or a financial institution including a non-banking financial company or any other body corporate or commercial concern namely:-

- (i) financial leasing services including equipment leasing and hire-purchase;
Explanation: For the purposes of this item, “financial leasing” means a lease transaction where –
 - (i) contract for lease is entered into between two parties for leasing of a specific asset;
 - (ii) such contract is for use an occupation of the asset by the lessee;
 - (iii) the lease payment is calculated so as to cover the full cost of the asset together with the interest charges; and
 - (iv) the lessee is entitled to own, or has the option to own, the asset at the end of the lease period after making the lease payment;

(ii) xx xx xx

(iii) merchant banking services,

- (iv) securities and foreign exchange (forex) broking, and purchase or sale of foreign currency, including money changing;]
 - (v) asset management including portfolio management, all forms of fund management, pension fund management, custodial, depository and trust services;
 - (vi) advisory and other auxiliary financial services including investment and portfolio research and advice, advice on mergers and acquisitions and advice on corporate restructuring and strategy;
 - (vii) provision and transfer of information and data processing; and
 - (viii) banker to an issue services; and
 - (ix) other financial services, namely, lending; issue of pay order, deemed draft, cheque, letter of credit and bill of exchange; transfer of money including telegraphic transfer, mail transfer and electronic transfer; providing bank guarantee, overdraft facility, bill discounting facility, safe deposit locker, safe vaults; operation of bank accounts;
- (b) foreign exchange broking and purchase or sale of foreign currency, including money changing provided by a foreign exchange broker or an authorized dealer in foreign exchange or an authorized money changer, other than those covered under sub-clause (a).

Explanation : For the purposes of this clause, it is hereby declared that “purchase or sale of foreign currency, including money changing” includes purchase or sale of foreign currency, whether or not the consideration for such purchase or sale, as the case may be, is specified separately

6. At the outset, the Departmental Representative submitted that adequate facts have not been pleaded by the applicant to justify the rendering of a ruling by this Authority. He pointed out with reference to an earlier ruling by this Authority in Paradise International [(2009) 234 ELT 370 (AAR)] that without production of the lease deed proposed to be entered into by the applicant, no satisfactory ruling can be given by this Authority. He pointed out that the terms of the proposed lease are not even set out in the application. There is not even an indication of the duration of the lease. The answer to the question would also depend upon the nature of the actual transaction that is proposed to be entered into and the vague facts set out in the application would not justify rendering a ruling thereon. We find some force in this submission, but at the same time as explained before us on behalf of the applicant, what the applicant proposes to undertake is the grant of a lease of its equipments for a short period on rent without providing any other service and leaving the equipment in the possession and

control of the lessee and the ruling is sought on such a transaction. It was also pointed out that the applicant has granted wet leases in contradistinction to the transaction involved herein and that it is not questioning its liability to pay service-tax for wet leases since that transaction would include the providing of men and material and repairs for the locomotives etc. leased out. In fact, a copy of a wet lease entered into by the applicant was produced before us to show the difference between that activity and the activity of mere leasing of locomotives, coaches and wagons as now proposed to be undertaken. We have earlier admitted the application with a view to give a ruling on this question and since at the argument it was made clear to us that the applicant would be purchasing or hiring these equipments and would merely be letting them out to the proposed lessee, for a short term on a rent to be paid for use of the equipment without providing any other services to the lessee, we think that it would be proper to give a ruling on that question on the basis of the submissions made regarding the nature of the transaction. We make it clear here itself that if the applicant were to depart from what is set out before us as the proposed activity which is the leasing of its equipments for a short period on rent without providing any other service and without having any control over the equipment, this ruling will have no application. We also make it clear that once a lease is entered into and the transaction is reduced to writing, it would be open to the authority concerned to scrutinize the transaction with reference to whether the assets to be leased are capitalized in the accounts of the lessor, the proportion the rent for the lease bears to the cost of the equipment and the term or period of the lease in relation to the life of the equipment leased and so on to determine the taxability as indicated in the decision of the Supreme Court in Association of Leasing and Financial Services Company v. UOI [2010 (20) STR 417]. On this premise we proceed to give a ruling on the question posed.

7. The applicant is admittedly not in banking business or in the business of rendering any financial services. The departmental representative argued that going by the definition of 'banking and other financial services' in section 65(12) of the Finance Act, any transaction entered into by a body corporate or a commercial concern for equipment leasing would also come within financial leasing services and if so, clearly

there was a liability for payment of service tax on such activity. It is pointed out that the definition is wide and it takes in any service provided by a financial company or financial institution including a non-banking financial company or any other body corporate or commercial concern viz. financial leasing services including equipment leasing and hire purchase. The argument is that “financial leasing services” has an expansive definition since it includes equipment leasing and hire purchase as indicated by the Explanation and hence a commercial undertaking engaged in equipment leasing will come within the purview of Section 65(12). It is submitted that equipment leasing means ‘leasing of any equipment’ and if a body corporate or commercial concern were to undertake that activity, that activity will be exigible to service-tax. On behalf of the applicant it was submitted that ‘equipment leasing’ and ‘hire-purchase’ being included in financial leasing services have to be transactions where the equipment is intended to be ultimately owned by the lessee and where the payment or tendering of instalments by the lessee is to cover the price of the equipment and ultimately, the lessee gets title to the equipment itself or gets the right to purchase the equipment. The transaction that the applicant seeks to undertake, does not contemplate transfer of the subject matter of the lease to the lessee at any point of time, the term of the lease fixed has no correlation to the life or period of utility of the equipment and the rent payable would not make up any part of the cost of the acquisition of the equipment by the applicant and the equipment would always remain as that of the applicant.

8. The definition speaks of ‘financial leasing service’ including equipment lease or hire purchase. Financial leasing is indicated as meaning a lease transaction where four elements have to cumulatively exist including the payment of the lease amount being calculated as to cover the full cost of the asset together with the interest charges and the lessee being entitled to own the leased asset at the end of the period after making the lease payment. A contract of hire purchase is explained in Halsbury’s Law of England, Vol.2 paragraph 1852 thus:

“(A) contract of hire purchase or more accurately the contract of hire with an option of purchase is one under which the owner of goods lets them out on hire

and undertakes to sell them to, or agrees that they shall become the property of the hirer, conditionally on his making a certain number of payments”.

Thus, a transaction of hire purchase contemplates the payment of the value of the equipment by the hirer and transfer of title to the hirer at the end of the transaction. In fact, it is said that generally in a transaction of equipment lease or hire purchase, it is the hirer who identifies the equipment to be leased/purchased and determines the value to be paid and all that the lessor has to do is to pay the money for the equipment and negotiate with the hirer to pay rental or instalments to be fixed for use of the equipment taking note of the price paid by the lessor and the interest on the investment made by him. The term of the lease (or the period) is also generally chosen by the lessee. (See page 15, *Equipment Leasing Partnerships by Cudworth*). Therefore, when clause (12) of Section 65 dealing with ‘banking and other financial services’ takes in financial leasing services including ‘equipment leasing’ and ‘hire purchase’; the natural way of understanding the transactions of equipment leasing and ‘hire purchase’ is as transactions analogous to ‘financial leasing services’, in the definition of which they are included. Actually, hire purchase even otherwise falls under that category. That the context would justify such an interpretation is supported by the following passage at page 460 (11th Edition 2008) in *‘Principles of Statutory Interpretation’ by Justice G.P. Singh*:

“It is, however, quite often that the object or the subject matter or the collocation or speaking briefly the context has the effect of restricting the normal wide meaning of general words, “for words and particularly general words cannot be read in isolation; their colour and content are derived from their context”. “ It is a recognized principle of construction,” observed KAPUR, J. “that general words and phrases, however, wide and comprehensive they may be, in their literal sense must usually be construed as being limited to the actual object of the Act.” It may in the same context be said that it is a sound rule of construction to confine the general provisions of a statute to the statute itself.”

9. In this context, understanding the scope of definition contained in Section 65(12) of Chapter V of Finance Act, 1994 it appears to be logical to understand the expression 'equipment leasing' as having an element of financing like a 'hire purchase' or a 'financial leasing service' and it cannot be understood as taking in a mere leasing of an equipment for a short duration unrelated to the life and cost of the equipment and without the intention of giving the lessee the option to purchase the equipment on the expiry of the term or on fulfilling its obligation to pay the hire charges (which takes in the value of the equipment itself) in instalments in terms of the transaction.

10. Section 65(12) of the Act defines banking and other financial services. The intention manifested is to deal with financial services. Whether it is financial services rendered by a banking institution or by a non-banking institution, those will fall under the definition. Originally, in addition to a banking company or a financial institution including a non-banking financial company, any other body corporate rendering such a service was also included. With a view to rope in other commercial concerns undertaking the business of rendering financial services, the definition was amended to include them. The services remained banking and other financial services. Financial services included financial leasing services and that included equipment leasing and hire purchase. We think that the thrust of the definition was always on financing as a service, whatever form it took and whoever undertook it. It is, therefore, easier to understand the expression 'equipment leasing' as a leasing involving financing with a view to enable the lessee to acquire title to the equipment at the end, and that, that alone is covered by the definition and not a lease of an equipment simplicitor.

11. The departmental representative relied upon the decision of the Supreme Court in ¹Association of Leasing and Financial Service Companies. Vs. Union of India, to contend that the Supreme Court has understood the expression 'equipment lease' occurring in Section 65(12) of the Act, as leasing of equipment and this decision concludes the question. It is not possible to agree with this submission. For, running

¹ 2010 (20) STR 417 (SC)

through the decision of the Supreme Court is the concept that financing is involved in the transactions being dealt with by that Court in the decision. In fact, it has been observed:

“on the other hand, equipment leasing is long term financing which helps the borrower to raise funds without outright payment in the first instance. Here the “interest” element cannot be compared to consideration for lease/hire which is in the nature of remuneration (consideration) for hire. Thus, financing as an activity or business of NBFCs is different and distinct from operating lease/hire-purchase agreements in the classical sense. The elements of the finance lease or loan transaction are quite different from those in equipment leasing/hire purchase agreements between owner (lessor) and the hirer (lessee). There are two independent transactions and what the impugned tax seeks to do is to tax the financial facilities extended to its customers by the NBFCs under Section 66 of the 1994 Act (as amended) as they come under “banking and other financial services” under Section 65(12) of the said Act. “The finance lease” and “the hire purchase finance” thus squarely come under the expression “financial leasing services” in Section 65(12) of the Finance Act, 1994 (as amended).”

12. What we understand from the above, is that unless financing is involved, the leasing of equipment would not come within the purview of Section 65(12) of the Act.

13. Here, we have a case where the equipment is purchased or taken on lease by the applicant. It is proposed to be granted on a lease for a short term (in fact, on behalf of the petitioner it is submitted that it was proposed to grant a lease for two years only). The lease amount or rent is to bear only a small proportion to the cost of the equipment. The term of the lease has no correlation with the life of the equipment which on the expiry of the short term, would revert to the control of the applicant. The subject matter of the lease was to be in the possession and effective control of the lessee during the term of the lease. There was no intention to convey the title to the equipment to the lessee on the expiry of the term or to confer on the lessee an option

to purchase the equipment. It appears to be a simple case of hiring of locomotives, coaches/wagons for a short duration on a rent to be paid by the lessee who was entitled to have the equipment under its control and risk during the term of the lease. Such a transaction cannot come within the purview of 'financial leasing services' contained in Section 65(12) of the Act.

14. Since exclusive possession and effective control of the equipment is to be transferred to the lessee during the term of the lease, Section 65(105)(zzzzj) cannot also be attracted.

15. We, therefore, rule that the proposed leasing of the locomotives coaches/wagons by the applicant for a short duration to a lessee on a rent, the term or rent bearing no correlation to either the life of the equipment or the cost of the equipment, would not be exigible to service-tax under the Finance Act, 1994 on the basis of the definition in Section 65(12) of the Act. This ruling is, however, subject to our observations in paragraph 6 above.

16. Since it was conceded on behalf of the applicant that the other transactions projected in the application attracted service-tax, we are not specifically ruling on those transactions as indicated earlier.

17. Accordingly, the ruling is given and pronounced on this day, the 8th of April, 2011.

Sd/-
(J.K.Batra)
Member

Sd/-
(P.K.Balasubramanyan)
Chairman

Sd/-
(J.Khosla)
Member