Ajay

IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION

CENTRAL EXCISE APPEAL NO.189 OF 2019

Commissioner of CGST & Central Excise .. Appellant
Versus
Shriram Transport Finance Company Ltd. .. Respondent

.....

Mr. Vijay Kantharia with Mr. D.B. Deshmukh, for the Appellant.
Ms. Padmavati Patil a/w. Mr. Kiran Chavan i/by Cen Ex Services for the Respondent.

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CORAM : UJJAL BHUYAN &
MILIND N. JADHAV, JJ.

RESERVED ON : JANUARY 18, 2021.
PRONOUNCED ON : FEBRUARY 12, 2021.

JUDGMENT : (PER : MILIND N. JADHAV, J.)

Heard Mr. Vijay Kantharia along with Mr. D.B. Deshmukh, Advocates for the appellant and Ms. Padmavati Patil along with Mr. Kiran Chavan, Advocates for the respondent.

2. This appeal has been filed by the Commissioner of Central Goods and Services Tax under the provisions of Section 35G of the Central Excise Act, 1994 (briefly referred to as "**the said Act"**) to challenge the order No. A/86601/2018 dated 29.05.2018 passed by the Customs, Excise, & Service Tax Appellate Tribunal (briefly referred to as "**the CESTAT**"), West Zonal Bench, Mumbai in Appeal No. ST/86027/14 arising out of Order-in-Original No. 119-121/STC-1/SKS/13-14 dated 24.12.2013 passed by the Commissioner of Service Tax, Mumbai - I.

3. The appellant has preferred the appeal on the following substantial questions of law:

> "a. Whether the Hon'ble Tribunal was correct in holding that the activity is not taxable prior to 01.03.2006 as there was no mechanism provided for bifurcation of value of service from the interest amount ?
>
> b. Whether the Hon'ble Tribunal was correct in holding that the period prior to 01.03.2006 is not taxable in the absence of mechanism for bifurcation of Service Income as provided in Notification No.4/2006 – ST ?
>
> c. Whether the Hon'ble CESTAT was correct in holding that the period from 01.03.2006 to 31.03.2008 as regular period and imposed penalty u/s 76 when the period from 01.03.2006 to 31.03.2008 is part period of first demand notice ?"

3.1. Today, learned counsel for the appellant has restricted the challenge and modified the substantial question of law as under:-

> "Whether for the period prior to 01.03.2006, service tax is recoverable on entire interest component collected as equated monthly installments on transactions relating to "Financial Leasing Services including equipment leasing and hire-purchase", in absence of any mechanism to bifurcate the processing or management charges"

4. Before we advert to the submissions made by the learned counsel for the parties, it will be apposite to refer to the relevant facts briefly.

4.1. Respondent M/s. Shriram Transport Finance Company Limited i.e. the assessee having centralised registration office at Mumbai is engaged in the activity of providing services of lending, hire purchase, financial leasing of commercial vehicles under the head "Banking and other Financial Services" as defined under the provisions of Section 65(12)(a)(i) of Chapter V of the Finance Act, 1994 (briefly referred to as "**the Finance Act**"). During the course of audit it was noticed that the assessee provided services of hire purchase and financial leasing of commercial vehicles but did not pay service tax on the income

earned on the said services to the department. Total amount of service tax on the income not paid was worked out to Rs.5583.05 lakhs for the period 2003-04 to 2007-08. One of the group company M/s. Shriram Investments Limited was also engaged in similar activities during the period 2003-04 to 2004-05 and had not paid service tax to the tune of Rs.2094.45 lakhs on the income earned by the company. M/s. Shriram Investments Limited was merged with the respondent company w.e.f. 01.04.2005 by virtue of order dated 25.11.2005 passed by this Court in Company Petition No.192 of 2005.

4.2. (i) For the period 2003-04 to 2007-08 combined show cause notice F.No.V/STC/DN.I/GR.II/Audit/STFL/2008 dated 16.10.2008 was issued by the Commissioner of Service Tax, Mumbai demanding service tax of Rs.7678.00 lakhs under proviso to Section 73(1) of the Finance Act along with interest under Section 75 and penalty under Sections 76, 77 and 78 of the said Act;

(ii) For the period 2008-09 show cause notice No. V/STC/DN.I/GR.II/Audit/STFL/2008 dated 06.10.2009 was issued demanding service tax of Rs.53.74 lakhs; and

(iii) For the period 2009-10, show cause notice No. V/STC/DN.II/GR.II/ Audit/STFL/2008 dated 02.08.2010 was issued demanding service tax of Rs.43.26 lakhs.

4.3. The adjudicating authority i.e. Commissioner of Service Tax, Mumbai - I passed common Order-in-Original No.119-121/STC-I/SKS/13-14 dated 24.12.2013 and held that for the purpose of levy of service tax respondent was treated as defacto owner of

the vehicle and the customer was merely treated as nominal owner of vehicle and accordingly confirmed the demand partially, amounting to Rs.62,81,48,000.00, Rs.5,38,000.00 and Rs.4,33,000.00 respectively for the periods under consideration in the three show cause notices.

4.4. Respondent assessee filed statutory appeal No.ST/86027 of 2014 before the CESTAT, Mumbai. CESTAT, Mumbai by order dated 29.05.2018 partially allowed the appeal and set aside the entire demand for the period prior to 01.03.2006 and confirmed the demand for the subsequent periods along with penalty under Section 76 of the Finance Act. By the impugned order, CESTAT directed recovery of service tax on one tenth interest component of the equated monthly installments (briefly referred to as "**EMI**") received by the respondent assessee as tax liability with consequential penalty under Section 76 of the Finance Act, while setting aside the recovery of tax on interest for the period prior to 01.03.2006.

4.5. Civil Appeal No. 12206 of 2018 has been filed by respondent assessee in the Supreme Court under the provisions of Section 35L of the said Act to challenge the judgment and order of CESTAT dated 29.05.2018 to the extent of recovery of tax on one tenth of the interest component of the EMI from 01.03.2006 and levy of penalty under Section 76 of the Finance Act. This Civil Appeal is pending for decision.

4.6. Appellant has restricted the challenge in the present appeal to the extent of setting aside of the demand of service tax on interest for the period prior to 01.03.2006 on transactions

relating to financing leasing services, including equipment leasing and hire purchase in the absence of any mechanism to bifurcate the processing or management charges as being without authority of law.

5. Mr. Vijay Kantharia, learned counsel appearing for the appellant submitted that respondent is a registered company under the Indian Companies Act, 1956 and is covered under the definition of taxable services under clause 105(zm) of Section 65 of the Finance Act, 1994; it is the duty of respondent to declare value of services provided which it had evaded and avoided; respondent had deliberately suppressed and concealed the value of taxable services provided with intent to evade payment of service tax and had not furnished realised value of the taxable services. He submitted that respondent had earned income for providing of "Banking and other Financial Services" as defined under section 65(12)(a)(i) of Chapter V of the Finance Act, 1994 but failed to declare the correct value of services provided prescribed under section 67 of the said Act for the financial years 2003-04 to 2008-09 and failed to remit the service tax to the government treasury on the taxable value recovered as prescribed under section 68 of the said Act read with rule 6 of the Finance Rules.

5.1. He submitted that respondent is de-jure, de-facto and beneficial owner of the vehicle in respect of hire purchase agreement entered into and only after payment of all equated monthly installments (EMI), the ownership vests with the customer; the title documents of the goods i.e. vehicles are in the custody of the respondent thereby obtaining overwhelming control and entitlement over the vehicles and in fact the customer has factually no ownership at all but is merely a nominal or ostensible owner because the customer is totally deprived of his

right to utilize and ply the vehicle as long as he continues to pay the equated monthly installments; the EMI comprises of the principle component and interest component.

5.2. Attention of the Court was invited to amendment in section 67 w.e.f. 10.09.2004 whereby "interest on loan" is excluded from value for payment of service tax and notification No.29 of 2004 as amended, which provided exemption to interest on overdraft or cash credit facility and emphasis was placed on notification No.4 of 2006 which exempted 90% amount representing interest; this notification gives the methodology of calculating the interest amount, which is the difference between the installments paid towards repayment of the loan amount and the principal amount contained in such installments; this notification pre-supposes that an EMI comprises of the principal amount and the interest amount and government's intention is to give exemption up to 90% of the interest amount only; respondent, in view of the hire purchase agreement received EMI and since part of the EMI comprises of finance charges which is interest amount received, service tax is due and payable on the same.

6. PER-CONTRA, Ms. Padmavati Patil, learned counsel appearing on behalf of respondent at the outset has opposed the appeal on the ground of maintainability and stated that appeal against the impugned order lies to the Supreme Court under the provisions of Section 35L. She submitted that irrespective of the nature of the transaction whether it is a loan transaction or lease finance or hire purchase finance, the respondent being a loan company recovered from the customer EMI comprising of the principal amount and interest. Principal amount is admittedly not liable to service tax. What is liable to service tax is only interest which interest component stands

excluded for the purpose of levy, both in terms of the provisions and rules relating to valuation.

6.1. Respondent has supported the impugned order and asserted that:-

(i) CESTAT, West Zonal Bench, Mumbai has held in the case of Bajaj Auto Finance Ltd. Vs. Commissioner of Central Excise, Pune 2007(7) STR 423 (Tri. Mumbai) that service tax levy is not attracted in respect of hire purchase finance. The decision of CESTAT has been upheld by the Supreme Court as reported in 2008(10) STR 433 (SC). In the light of this, service tax cannot be levied on any amount collected in respect of hire purchase finance.

(ii) Paragraphs 19.1 and 19.2 of circular No.80/10/2004-ST dated 17.09.2004 issued by the Central Board of Customs and Indirect Taxes (Board) state that "*The interest amount would however remain excluded from the purview of service tax by way of amendment to the provisions relation to valuation (5.67); that all such interests that are in the nature of interest on loans would thus remain excluded from the taxable value*."

(iii) A combined reading of the Board's circular dated 09.07.2001 bearing F.No.11/1/2001-TRU and circular No.80/10/ 2004-ST dated 17.09.2004 clearly would indicate that interest component of the EMI is exempt from service tax even though it forms part of the consideration. The principal component of EMI does not constitute consideration at all.

(iv) In view of the Supreme Court confirming the judgment in the case of Bajaj Auto Finance (*supra*) and Circulars dated 09.07.2001 and 17.09.2004, it follows that :-

a. No part of collection in respect of hire purchase finance is exigible to service tax;

b. In the case of lease finance :-

(i) principle and the interest components of EMI do not attract service tax;

(ii) the management fee/processing and documentation charges if any collected in respect of lease finance may attract levy of service tax; however this is a one time fee only;

(iii) tax liability has been worked out without taking into account the effect of notification No.4/2006-ST dated 01.03.2006 issued under F.No 334/3/2006-TRU which stated that even if service tax is leviable, it has to be recalculated on 10% value (interest) and that too prospectively.

6.2. Respondent assessee has further submitted that :-

(i) service tax has already been paid by the assessee on the management fee / processing and documentation charges collected by the respondent; respondent is registered with Reserve Bank of India (RBI) as a Non Banking Finance Company and its main activities are lending/financing against commercial vehicles; respondent regularly pays service tax on the processing/ document charges collected from its customers; service tax on business auxiliary

income which forms minor part of its total income is also paid regularly;

(ii) being a NBFC company registered with RBI, its major source of income is in the form of interest; its main business is to mobilize / accept deposit / debentures / funds from public / banks /FIs against interest payments and utilize the same for its financial activity and collect interest; the income is only differential interest between interest received on its financing activity and interest paid on its sourcing of fund; and majority of its financing was made only to commercial vehicle owners;

(iii) its financing activity meant lending money to customers to buy commercial vehicles purchased by them and ownership is duly recorded in the customer's name in the RC book, whereas respondent gets endorsement in its name in the RC book as financier to safeguard the claim of loan amount; insurance policy of the vehicle is renewed in the name of hirer only and respondent intimates the lien on the vehicle and obtains necessary endorsement on the insurance policy against the financed amount;

(iv) agreements are executed with the customers for interest rate, repayment schedule and rights and obligations of both parties; nature of agreements are either hire purchase finance / lease finance / loan finance agreements and their income is accounted as finance income in its books of accounts.

6.3. Respondent therefore submitted that in view of the above

submissions and the law settled by the Supreme Court there was no substance in the present appeal and the same be dismissed.

7. Submissions advanced across the bar have been duly considered and also examined the materials on record.

8. Before we advert to adjudicate the issue, we may briefly refer to the relevant statutory provisions.

8.1. At the outset we need to clarify that the expression “banking and other financial services” which finds place in Section 65(12)(a)(i) of the Finance Act, 1994 (as amended). Respondent assessee is a non-banking financial company (briefly referred to as "**NBFC**"). RBI was constituted under the Reserve Bank of India Act, 1934 ("1934 Act", for short), *inter alia,* to regulate the country's monetary system. It is appointed as a regulator to secure the monetary stability and to operate the credit system of the country. Chapter III-B of the 1934 Act deals with provisions relating to NBFCs and financial institutions.

8.2. Under Section 45-I(a), "the business of a NBFC" is defined to mean carrying on the business of a financial institution referred to in clause (c) of Section 45-I and includes business of a NBFC. The expression "financial institution" means any non-banking institution which carries on as its business an activity inter alia of financing, whether by way of making loans or advances or otherwise. Thus, Section 45-I(c) treats financing as an activity. Under Section 45-I(f), an NBFC is defined to mean a financial institution which is a company; a non-banking institution which is a company and which as a matter of business receives deposits

or which lends in any manner. These activities are regulated by RBI under the 1934 Act. Thus, all NBFCs which carry on these activities as part of their business come within the purview of being financial institutions. Under Section 45-IA, no NBFC shall carry on the business of a non-banking financial institution without obtaining a certificate of registration from RBI. Under Section 45-JA the RBI is authorized in public interest to issue directions to NBFCs relating to income recognition, accounting standards, deployment of funds etc. and the NBFCs shall be bound to follow the policy so determined or directions so issued.

8.3. Accordingly, under notification dated 02.01.1998 bearing No. 114, the deposit taking activities of NBFCs was sought to be regulated. Under the said notification, there is classification of NBFCs. Vide Clause 5 it has been clarified that several instances have come to the notice of RBI where NBFCs conducting their business as loan companies claim themselves to be equipment leasing/hire-purchase finance companies with the intention to avail of higher borrowing limits and thus an NBFC having not less than 60% of its assets and deriving not less than 60% of its income from equipment leasing and hire-purchase activities taken together would only be eligible for being classified as equipment leasing company/hire-purchase finance company. The said notification has been referred to only to demonstrate that the classification of loan or investment companies is not only asset and income based but also that certain NBFCs undertake activities of equipment leasing and hire-purchase financing in addition to giving of loans. Under clause (a) of the said Direction, RBI has categorized NBFCs on the basis of the businesses in which they are engaged including giving of loans,

hire-purchase finance and equipment leasing activities [See Taxmann's Statutory Guide to NBFCs page 224].

8.4. The Institute of Chartered Accountants of India (ICAI) has also issued AS-19 "Accounting for Leases". It is mandatory in respect of financial leases executed on or after April, 2001. It *inter alia* provides for capitalization of finance lease assets in the books of the lessee instead of lessor. The lessor [NBFC] is required to show the assets leased only as receivables in its balance sheet instead of as fixed assets. The implication of the above AS-19 for the NBFC prescribed by RBI vide amendments to the 1998 directions is that all financial leases would now be accounted like hire-purchase transactions. [See Manual of NBFCs 9th Edition; Page 268]. Similarly, under the RBI guidelines dealing with accounting for investments, NBFCs having not less than 60% of the total assets in lease and hire purchase and deriving not less than 60% of their total income from such activities can be classified as hire purchase/ equipment leasing companies.

8.5. All these circulars and guidelines issued by RBI are referred to only to show that equipment leasing and hire- purchase are activities undertaken as business by NBFCs which are regulated as para banking activities by the RBI under the provisions of the 1934 Act. They are regulated not only to protect depositors but also the customers [See Section 45-I(c) (iii) (i)]. The above activities are financing activities encompassed under Section 45-I(c)(i) which in turn constitutes "rendition of services to its customer(s)" which is the taxable event under Section 65 (105) (zm) of the Finance Act, 1994 (as amended). Apart from NBFCs, even banks through their subsidiaries with the approval of RBI can undertake equipment leasing, hire-purchase business and

financial services. These are not direct lending activities. However, RBI treats them as services or facilities. The financial facilities are extended by way of equipment leasing or hire-purchase finance subject to approval of RBI [See Taxmann's RBI Instructions for Banking Operations 7th Edition; page 224].

8.6. The significance of the above circulars and guidelines is to show that the activities undertaken by NBFCs of equipment leasing and hire-purchase finance are facilities extended by NBFCs to their customers; that, they are financial services rendered by NBFCs to their customers and that they fall within the meaning of the words "banking and other financial services" which is sought to be brought within the service tax net under Section 66 of the Finance Act, 1994.

8.7. One more aspect needs to be highlighted. With the application of AS-19, the leased assets are required to be shown as "receivables" and not as fixed assets which further shows that equipment leasing and hire-purchase finance are financial facilities which thereby funds projects presented by the customers to banks and other financial institutions including NBFCs. Thus, the impugned tax is levied on these services as taxable services. It is not a tax on material or sale. The taxable event is rendition of service. Hence, the impugned tax is different and distinct from tax on sale of goods under Entry 54 List II of the VIIth Schedule to the Constitution.

8.8. By the Finance Act, 2001, Section 65 of the Finance Act, 1994 stood substituted. We are concerned with Section 65(10) read with Section 65(72)(zm), relevant parts whereof are quoted hereinbelow :

> *"65. Definitions : In this Chapter, unless the context otherwise requires,-*
> *(10) "banking and other financial services" means, the following services provided by a banking company or a financial institution including a non-banking financial company, namely:-*
>
> *(i) financial leasing services including equipment leasing and hire-purchase by a body corporate;*
>
> *(72) "taxable service" means any service provided,-*
>
> *(zm) to a customer, by a banking company or a financial institution including a non-banking financial company, in relation to banking and other financial services;*"

8.9. Section 65(10) defines what is "banking and other financial services", Section 65(105)(zm) (as amended) indicates what is "taxable service". Section 65(10) read with Section 65(105)(zm), as amended, reads as under:

> *"65. Definitions.-- In this Chapter, unless the context otherwise requires,--*
>
> *(10) "banking and other financial service" 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, namely:-*
>
> *(i) financial leasing services including equipment leasing and hire-purchase by a body corporate;*
>
> *(105) "taxable service" means any service provided,--*
>
> *(zm) to a customer, by a banking company or a financial institution including a non-banking financial company, in relation to banking and other financial services;"*

8.10. Section 66 of the Finance Act, 2001 deals with charge of service tax, the relevant portion whereof reads as under :

> *"66. Charge of service tax- (1) On and from the date of commencement of this Chapter, there shall be levied a tax (hereinafter referred to as the service tax), at the rate of five per cent of the value of the taxable services*

referred to in sub-clauses (a), (b) and (d) of clause (72) of Section 65 and collected in such manner as may be prescribed."

8.11. Section 67 of the Finance Act, 2001 deals with valuation of taxable services for charging service tax. The relevant portion of Section 67 is quoted herebelow:

"67. Valuation of taxable services for charging service tax-For the purposes of this Chapter, the value of any taxable service shall be the gross amount charged by the service provider for such service rendered by him."

9. In the backdrop of the above statutory provisions, we find that respondent is engaged in the business of lease and equipment finalizing which is squarely covered by the definition of 'banking and other financial service' in Section 65(12) of the Finance Act. It is well settled position that hire purchase is a loan by which the hirer obtains goods from a seller and the banking and financial institution finances the purchase of goods with the title firmly rest with the hirer and the financing institution being vested with the right to acquire possession of the said goods in the event of default in payment of contracted amount / equated monthly installments. A contract for hire purchase is substantially different from that of an operating lease. Therefore, taxability of the service is not in question. Every consideration for the taxable service is leviable in accordance with the charging section unless excluded by the charging section which is Section 66 of the Finance Act read with Section 65(105)(zm) and Section 65(12) thereof. In computing the value of taxable service mandated by Section 67 of the Finance Act, the law provides exclusion either by explanation or by rules. It is that exclusion that has been claimed by the respondent as its statutory right which is disputed by the Revenue. In the present case consideration for the taxable service rendered by the respondent is received as EMI which is thereafter assigned as principal and interest. The Apex Court has held that there are three components

that make up consideration for hire purchase, namely, principal, processing / management charges and interest with taxability devolving on the later two.

10. Respondent is in the business of hire purchase and financing lease of commercial vehicles; its main business concerns pre-owned commercial vehicles; the service of financial leasing or hire purchase is part of "Banking and other Financial Services" as defined under Section 65(12) of the Finance Act and taxable from 16.07.2001. The issue under consideration, therefore, in the present case is whether the activity of the respondent is covered in the definition of taxable service of "Banking and other Financial Services" or otherwise.

11. Order-in-Original has held that the respondent is the owner of the motor vehicles though registration of a customer's name as owner under the Motor Vehicles Act, 1988 is stated in the records of the Transport Department and the registration of the name of respondent is shown as Hypothecatee in the R.C. Book. Registration of a person's name as owner in the records of the Transport Department and the R.C. Book should be confined only for the purpose of discharging the liabilities, obligations and duties imposed under the Motor Vehicles Act and the Rules framed thereunder and for no other purpose.

12. However the decision of the Apex Court in the case of ***Association of Leasing and Financial Service Companies Vs. Union of India***[1] is relevant. In this case the Apex Court has ousted the challenge to the vires of the levy of service tax on financial lease and hire purchase activity such as the respondent engages in. The decision in the above case makes it unambiguously clear that barring operating lease alone which is considered to be entirely a sale, consideration for

1 2001 (20) STR 417 (SC)

all other lease and hire purchase transactions are squarely liable to tax except on principal amount recovered.

12.1. The relevant findings in paragraph Nos.20 and 21 in the judgment in Association of Leasing and Financial Service Companies (*supra*) are extracted as under :-

> *"20. …….. A hire-purchase agreement partakes of the nature of a contract of bailment with an element of sale added to it. However, if the intention of the financing party in obtaining the hire-purchase and the allied agreements is to secure the return of the loan advanced to its customer the transaction would be merely a financing transaction. [See page 75]. The point which needs to be re-stated is that the funding activity undertaken by the financing party which could be in the form of loan or equipment leasing or hire-purchase financing, would be exigible to service tax if such activity falls in the category of "banking and other financial services" under Section 65(12) of the Finance Act, 1994. The financial transaction was earlier out of the tax net. In the process there are two different and distinct transactions, viz., the financing transaction and the equipment leasing/hire-purchase transaction. The former is exigible to service tax under Section 66 of Finance ct, 1994 (as amended) whereas the latter would be exigible to local sales tax/VAT. Funding or financing the transaction of equipment leasing and hire-purchase covers two different and distinct transactions. The activity of funding or financing by NBFC who is in the business of financing by giving loans, or equipment leasing or hire-purchase finance falls in the category of financial services rendered by NBFCs to their customers. It is an activity in relation to the hire-purchase or lease transaction. In this connection, as and by way of illustration we need to give an illustration which brings out the distinction between a "finance lease" and "operating lease". A finance lease transfers all the risks and rewards incidental to ownership, even though the title may or may not be eventually transferred to the lessee. In the case of "finance lease" the lessee could use the asset for its entire economic life and thereby acquires risks and rewards incidental to the ownership of such assets. In substance, finance lease is a financial loan from the lessor to the lessee. On the other hand an operating lease is a lease other than the finance lease. Accounting of a "finance lease" is under AS-19, which as stated above, is mandatory for NBFCs. It is a completely different regime. According to Chitty on Contract, a hire-purchase agreement is a vehicle of instalment credit. It is an agreement under which an owner lets chattels out on hire*

and further agrees that the hirer may either return the goods and terminate the hiring or elect to purchase the goods when the payments for hire have reached a sum equal to the amount of the purchase price stated in the agreement or upon payment of a stated sum. The essence of the transaction is bailment of goods by the owner to the hirer and the agreement by which the hirer has the option to return the goods at some time or the other [See para 36.242, 36.243]. Further, in the bailment termed "hire" the bailee receives both possession of the chattel and the right to use it in return for remuneration to be paid to the bailor [See para 32.045]. Further, under the head "equipment leasing", it is explained that it is a form of long-term financing. In a finance lease, it is the lessee who selects the equipment to be supplied by the dealer or the manufacturer, but the lessor [finance company] provides the funds, acquires the title to the equipment and allows the lessee to use it for its expected life. During the period of the lease the risk and rewards of ownership are transferred to the lessee who bears the risks of loss, destruction and depreciation or malfunctioning. The bailment which underlies finance leasing is only a device to provide the finance company with a security interest [its reversionary right]. If the lease is terminated prematurely, the lessor is entitled to recoup its capital investment [less the realizable value of the equipment at the time] and its expected finance charges [less an allowance to reflect the return of the capital] [para 32.057]. In the case of hire-purchase agreement the periodical payments made by the hirer is made up of :

(a) consideration for hire
(b) payment on account of purchase

21. To sum up, NBFCs essentially are loan companies. They basically conduct their business as loan companies. They could be in addition thereto in the business of equipment leasing, hire purchase finance and investment. Because NBFCs are basically loan companies, they are required to show the assets leased as "receivables" in their balance sheets. That, the activities of hire- purchase finance/ equipment leasing undertaken by NBFCs come under the category of "para banking". That, in substance a finance lease, unlike an operating lease, is a financial loan (assistance/facility) by the lessor to the lessee. That, in the bailment termed "hire" the bailee receives both possession of the chattel and the right to use it in return for remuneration. 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)."

12.2. The Apex Court has further concluded the question of law raised by the appellant in paragraph Nos.37 and 39 of the said judgment which are extracted as under :-

"37. Applying the above decisions to the present case, on examination of the impugned legislation in its entirety, we are of the view that the impugned levy relates to or is with respect to the particular topic of "banking and other financial services" which includes within it one of the several enumerated services, viz., financial leasing services. These include long time financing by banks and other financial institutions (including NBFCs). These are services rendered to their customers which comes within the meaning of the expression "taxable services" as defined in Section 65(105) (zm). The taxable event under the impugned law is the rendition of service. he impugned tax is not on material or sale. It is on activity/ service rendered by the service provider to its customer. Equipment Leasing/ Hire-Purchase finance are long term financing activities undertaken as their business by NBFCs. As far as the taxable value in case of financial leasing including equipment leasing and hire-purchase is concerned, the amount received as principal is not the consideration for services rendered. Such amount is credited to the capital account of the lessor/ hire-purchase service provider. It is the interest/ finance charge which is treated as income or revenue and which is credited to the revenue account. Such interest or finance charges together with the lease management fee/ processing fee/ documentation charges are treated as considerations for the services rendered and accordingly they constitute the value of taxable services on which service tax is made payable. In fact, the Government has given exemption from payment of service tax to financial leasing services including equipment leasing and hire-purchase on that portion of taxable value comprising of 90% of the amount representing as interest, i.e., the difference between the instalment paid towards repayment of the lease amount and the principal amount in such instalments paid (See Notification No. 4/2006 - Service Tax dated 1.3.2006). In other words, service tax is leviable

only on 10% of the interest portion. (See also Circular F.No. B.11/1/2001-TRU dated 9.7.2001 in which it has been clarified that service tax, in the case of financial leasing including equipment leasing and hire-purchase, will be leviable only on the lease management fees/ processing fees/ documentation charges recovered at the time of entering into the agreement and on the finance/ interest charges recovered in equated monthly instalments and not on the principal amount). Merely because for valuation purposes inter alia "finance/ interest charges" are taken into account and merely because service tax is imposed on financial services with reference to "hiring/ interest" charges, the impugned tax does not cease to be service tax and nor does it become tax on hire- purchase/ leasing transactions under Article 366(29A) read with Entry 54, List II. Thus, while State Legislature is competent to impose tax on "sale" by legislation relatable to Entry 54 of List II of Seventh Schedule, tax on the aspect of the "services", vendor not being relatable to any entry in the State List, would be within the legislative competence of the Parliament under Article 248 read with Entry 97 of List I of Seventh Schedule to the Constitution.

38. …….

39. ……. As stated above, what is challenged in this case is the service tax imposed by Section 66 of the Finance Act, 1994 (as amended) on the value of taxable services referred to in Section 65(105)(zm) read with Section 65(12) of the said Act, insofar as it relates to financial leasing services including equipment leasing and hire-purchase as beyond the legislative competence of Parliament by virtue of Article 366(29A) of the Constitution. In short, legislative competence of the Parliament to impose service tax on financial leasing services including equipment leasing and hire-purchase is the subject matter of challenge. Legislative competence was not the issue before this Court in the Bharat Sanchar Nigam Limited's case. In that case, the principal question which arose for determination was in respect of the nature of the transaction by which mobile phone connections are enjoyed. The question was whether such connections constituted a sale or a service or both. If it was a sale then the States were legislatively competent to levy sales tax on the transaction under Entry 54, List II of the Seventh Schedule to the Constitution. If it was service then the Central Government alone had the legislative competence to levy service tax under Entry 97, List I and if the nature of the transaction partook of the character of both sale and service, then the moot question would be whether both the legislative authorities could levy their separate taxes together or only one of them. It was held that the subject transaction was a service and, thus, the Parliament had legislative competence to levy service tax under Entry 97,

List I. In para 88 of the said judgment, this Court observed that "No one denies the legislative competence of the States to levy sales tax on sales provided that the necessary concomitants of a sale are present in the transaction and the sale is distinctly discernible in the transaction. This does not however allow the State to entrench upon the Union List and tax services by including the cost of such service in the value of the goods". The principle of law in para 88 squarely applies to the present case. As stated above, we are concerned with "financial leasing services" which are sought to be taxed under Section 65(12)(a)(i). The taxable event is indicated in Section 65(105)(zm). As stated above, the impugned provision operates qua an activity of funding/ financing of equipment/ asset under equipment leasing under which a lessee is free to select, order, take delivery and maintain the asset. The lessor (NBFC) arranges the finances. It accepts the invoice from the vendor (supplier) and pays him. Thus, the lessor (NBFC) renders financial services to its customer(s) and what is taxed under the impugned provision is the income, by way of finance/ interest charges in addition to management fees/ documentation charges, which is earned by the financier (lessor). The taxable event is the service which is rendered by the finance company to its customer(s). The value of taxable service under Section 67 is income by way of interest/finance charges (measure of tax) which is not determinative of the character of the levy. Thus, Section 67 of the Finance Act, 1994 seeks to tax financial services rendered by the appellant(s) with reference to the income which the appellant(s) earns by way of interest/ finance charges In the circumstances and for the reasons given hereinabove, the question of splitting up of transactions, as contended on behalf of the appellant(s), does not arise. As held hereinabove, equipment leasing and hire-purchase finance constitute long term financing activity. Such an activity was not the subject matter of the discussion in the Bharat Sanchar Nigam Limited's case. The service tax in the present case is neither on the material nor on sale. It is on the activity of financing/funding of equipment/ asset within the meaning of the words "financial leasing services" in Section 65(12)(a)(i).”

12.3. While relying on the above decision and the decisions of the Apex Court in the case of ***Commissioner of Central Excise & Service Tax, New Delhi Vs. M/s. Lease Plan India Ltd.*** (final order No.50113-20116/2018 dated 10th January 2018 in Appeal No. ST/51947-51950/2014) and ***Commissioner of Income Tax Vs. Sirpur Paper Mills***[2], and applying the ratio to the facts of the

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present case CESTAT has correctly concluded in paragraph Nos.13 and 15 to 18 of the impugned order which is extracted as under :-

> *"13. It is now well settled in law that hire purchase is but a loan: that the hirer obtains goods from a seller and the banking and financial institution finances the purchase of goods with the title firmly resting with the hirer and the institution vested with right to acquire possession of the goods, through judicial intervention, in the event of non-payment of contracted amount. This differs substantially from operating lease. Therefore, the taxability of the service is not in question. The decisions of the Tribunal that have held otherwise did not have the benefit of wisdom of the judgment of the Hon'ble Supreme Court in re Association of Leasing and Financial Service Company and are, therefore, per incuriam.*
>
> *15. The issue is whether that statutory exclusion can be denied. We hold that no statutory exclusion can be denied. However, we take note that with the inclusion of financial and equipment leasing in the definition of the activity in relation to which taxability arises, it was the decision of the Hon'ble Supreme ourt in re Association of Leasing and Financial Services Companies that settled the transactions, such as that of the appellant, within the scope of coverage as loans instead.*
>
> *16. The consideration for the taxable service rendered by appellant is received as equated monthly installment which is then assigned by appellant as principal and interest. It has been held by the Hon'ble Supreme Court that there are three components that make up consideration for hire purchase – principal, processing / management charges and interest – with taxability devolving on the letter two. Decisions of the Tribunal have excluded the scope of collection from the last. It is, therefore, clear that only processing / management fees can be subjected to tax.*
>
> *17. The claim of appellant is that such charges as are subjected to tax have already suffered the burden; the ostensible base for this claim is the compliance on the processing fee collected upfront. Interest is an all-encompassing expression used in the banking industry to describe the recompense for lending money besides the recovery of principal along with interest or at some agreed upon point in time. This interest must, to meet the commercial objective of profit, pay for the cost of funds deposited with the financial institution and other overheads. To the extent that the bank or institution is solely in the business of lending, such expenses are a charge on the income and interest earned is only that.*

> *18. However, while conferring the mantle of lending on hire purchase and leases, other loan operating leases, the Hon'ble Supreme Court in re Association of Leasing and Financial Services added another factor of income, viz., processing or management fee, to interest and principal and held it liable to tax. The judgment also distinguished these loans from normal bank loans by reference to banking companies undertaking such leases or hire-purchase through subsidiaries and by the categorization of non-banking financial companies, in accordance with instructions of Reserve Bank of India, as leasing or hire-purchase entities on the basis of prescribed parameters. There is, therefore, a distinction between the interest earned by a bank and the disaggregation of equated monthly installments earned by a financial institution engaged in financial leasing and hire-purchase."*

12.4. Explanation 1 to section 67 of the Finance Act prior to 18.04.2006 contained a specific exclusion vide sub clause (viii) excluding interest on loans. Though section 67 was substituted by Finance Act 2006 w.e.f. 18.04.2006, the corresponding Service Tax Determination of Value Rules 2006 vide rule 6(2)(iv) again excluded interest on loan from the purview of valuation of taxable services However, the Board vide circular No.80/10/2004-ST dated 17.09.2004 clarified that interest on loan would stand excluded. Respondent has been discharging service tax regularly on processing charges and also filing returns regularly. Respondent gives loan to its customers / borrowers for the purpose of hire purchase agreement for purchasing the vehicles and this lending is in the nature of a loan. Since it is in the nature of loan consequently interest on loans stands excluded from the value of taxable services. Board circular dated 09.07.2001 referred to by the appellant in fact supports the case of the respondent. In view of the settled law and in exercise of the legislative and rule making power once parliament has excluded interest on loans from the purview of taxable service, it is not open to the authority to hold that the

exemption notifications would not apply. Further in view of the decision of the Apex Court in the case of Association of Leasing and Financial Service Companies and Bajaj Auto Finance Ltd. (*supra*) re-affirming the legal position that the respondent is not liable to pay service tax in respect of the interest on loan advanced as the same stands excluded from the purview of the taxable services, we find no reason to interfere with the impugned order.

13. In view of the above discussions, we hold that CESTAT was correct in holding that for the period prior to 01.03.2006 interest on loan is not taxable in the absence of mechanism for bifurcation of service. Therefore, recovery of service tax on interest for the period to 01.03.2006 is without authority of law as there is a presumption of attributing the entire amount to interest in the absence of any mechanism to isolate the processing or management cost even if that were collected by way of equated monthly installments.

14. Therefore, on a thorough consideration of the matter, we are of the view that CESTAT has returned a clear finding that hire purchase is but loan and that hirer obtains goods from the seller and the banking and financial institution finalised the purchase of the goods with the title firmly resting with the hirer with the financial institution vested with the right to acquire possession of the goods through judicial intervention.

15. The appellant has not been able to show any illegality or perversity in the aforesaid findings rendered by the CESTAT.

16. Under these circumstances, we find no error or infirmity in the view taken by the CESTAT *qua* the ground raised by the appellant. No

question of law, much less any substantial question of law as pleaded by the appellant arises from the order of the CESTAT.

17. Since we have decided the appeal on merit, it is considered not necessary to delve into the preliminary objection raised by the respondent.

18. Consequently, the appeal is dismissed. However, there shall be no order as to cost.

[MILIND N. JADHAV, J.] **[UJJAL BHUYAN, J.]**