

Cars on Lease: Whether entitled to higher depreciation under IT Rules?

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Introduction:

Leasing companies might have generally hated giving cars on lease, holding car leases to be *bekaar* leases. However, as some of the recent rulings show, depreciation rates on car leases may go as high as 30%, or at least 20%, which might be quite a bounty for leasing companies. This article discusses some recent case law on the point and our opinion.

Provisions of the IT Rules:

As per the Income Tax Rules, depreciation on cars may potentially fall under 3 captions:

- Motor cars, other than those used in a business of running them on hire, acquired or put to use on or after the 1st day of April, 1990: 15%
- Motor buses, motor lorries and motor taxis used in a business of running them on hire: 30%
- General plant and machinery: 20% [15% w.e.f. Assessment Year 2006-07]

The prerequisite of establishing 'end-use':

The settled principle on this point is the ruling in *Commissioner Of Income Tax vs Bansal Credits Limited (2003) 179 CTR Del 23*, against which SLP has been rejected by the Supreme Court. Hence, the ruling delivered in *Bansal Credit's* case may be taken to be the final law on this issue.

As per the ruling in *Bansal Credit's case*, for the purpose of determination of depreciation rates in case of assets on lease, the end-use by the lessee is what is important. This seems logical enough, as after all, the lessor is in the business of letting the lessee use the asset. Hence, the manner of use of the asset is what the lessee actually uses the asset in. If the lessee is using the asset for a business of hire, the car is used in the business of hire.

The Object and Legislative Intent behind affording higher depreciation:

There are several rulings, discussed below, in particular the one by ITAT Kolkata in *Magma Fincorp Ltd.'s* case which has taken an extremely aggressive view and held that any car given on lease is said to be used for a business of hire. However, we are of the view that the objective of providing a higher depreciation rate on assets used in hiring business is that those assets are put

to more wear and tear. It is sheer human instinct that we tend to be more caring for assets that are ours, and less as conserving when it comes to hired assets. Assets run on hire are also subjected to more wear and tear as they are more aggressively used.

Dispensing with the prerequisite of establishing 'end-use':

In the case of *CIT v. M.G.F. India Limited, 2006, 285 ITR 142 Delhi*, a significant judicial leniency was seen in favour of the assessee wherein the Hon'ble Delhi High Court dispensed with the prerequisite of establishing of the 'end-use' of the leased assets by the lessor for making him entitled to higher rate of depreciation on the ground that it would be too burdensome on his part. Hence, if the assessee has used the asset in the business of leasing, the condition put by *Bansal Credit* stands satisfied.

Significance of Ownership and Registration of Vehicle:

However where in substance the assesses are in the business financing and the borrowers are the registered owners then the assesseees are not entitled to claim any depreciation because they are neither the owners of the vehicle nor have they used the vehicle in their profession or business entitling them for depreciation under section 32(1) of the Act, as was the ratio established by the Hon'ble Supreme Court of India in the case of *CIT v. Shaan Finance (P) Ltd. (1998) 231 ITR 308 (SC)*. Further in *CIT v. Manappuram General Finance & Leasing Ltd, (2010) 36 (I) ITCL 122 (Ker-HC)* it was held that where the assessee retained the ownership of the vehicle **with registration in their name** (emphasis ours) but vehicles were either given on lease or given under hire-purchase agreement giving an option to the hirer to purchase it after the payment of lease rentals or hire charges during the agreed period, the assessee would be entitled to higher depreciation. The relevant extract of the case is reproduced below -

“In any case, what is important is not to look at the terminology used in the agreement such as hire-purchase agreement or lease agreement, but it is for the assessing officer to find the true nature and character of the agreement and the arrangement between the financier and the vehicle owners. If it is found to be a loan transaction, then the respondents/assesseees will not be entitled to depreciation much less higher rate claimed by them and allowed by the Tribunal. On the other hand, if the vehicles are purchased by the respondents/assesseees and retained their ownership with registration in their name and the vehicles were either given on lease or given under hire-purchase agreement giving an option to the hirer to purchase it after the payment of lease rentals or hire charges during the agreed period, then the respondents/assesseees will be entitled to depreciation at the higher rate.”

Rules regarding taxies:

However, the 30% depreciation rate is applicable in case of “taxis”. The word “taxi” has a definitive meaning. Not every car running on hire is a taxi. The rulings that have taken place in the past on the issue are partly in context of lorries – hence, the meaning of the word “motor taxi” has not come for precise discussion. Therefore, in our opinion, the common man's

understanding of the word “taxi” should be applicable. Hence the residual depreciation rate of 20%, applicable to general plant and machinery, will be applicable in such cases.

The operative word being “business of running them on hire”:

In yet another case of the *Commissioner of Income-Tax and The Deputy Commissioner of Income-Tax vs Bpl Sanyo Finance Pvt. Ltd.* on 20 February, 2006, it was held that 20 per cent is the depreciation allowable in respect of the motor cars other than those used in the business of running them on hire. Whereas, 40 per cent is the depreciation allowed in respect of motor buses, lorries and taxis used in a business of running them on hire. **The stress is on "running them on hire"**. Here the use may be for its business, but not "business of hiring vehicles". In other words, if the assessee uses the vehicles for its "own use" or for its business other than the "business of running the vehicles on hire" then 20 per cent is the depreciation allowable, whereas if the assessee uses them in its "business of running them on hire" the depreciation allowable is 40 per cent. It is immaterial whether the vehicles are hired to sister concern or to a third party or to a total stranger.

A landmark judicial interpretation of the expression ‘Motor Cars’:

All these judgments have been discussing the eligibility of higher rate of depreciation in case of Motor buses, motor lorries and motor taxis and not about motor cars.

Although the word ‘car’ or ‘motor car’ has not been used or defined anywhere in the Income Tax Act or in the Rules made thereunder, however recently in a judgment delivered in the case of *Magma Fincorp Ltd. vs. Assistant Commissioner of Income-tax [2010] 128 TTJ 715(KOL.)*, it was held that the assessee is entitled to higher rate of depreciation as per Appendix I, Income Tax Rules, 1961 Entry III(3)(ii) in respect of **motor cars** used in the business of running them on hire. The reasoning for coming to the above conclusion by the Tribunal may be emphasized by reproducing the relevant extract of the judgment below:

“it is evident that the assessee is entitled to normal rate of depreciation i.e., 15 per cent on the motor cars other than those used in the business of running them on hire. Thus in respect of motor cars which are used in the business of running them on hire the assessee is out of the depreciation table. As per Entry No. (3)(ii) the depreciation is allowable on the motor taxis used in the business of running them on hire. The contention of the Revenue is that the assessee would fall in this category only if motor taxis are used in the business of running them on hire and not motor cars. We are unable to accept the above contention of the Revenue because if the contention of the Revenue is accepted then if the assessee used the motor cars in the business of running them on hire the assessee would not be entitled to depreciation on such motor cars because Entry No. 111(2) excludes motor cars used in the business of running them on hire. If as per Revenue the assessee is to be excluded from Entry No. (3)(ii) also then he will not be entitled to any depreciation, which can never be the intention of the legislature. It was explained by the learned counsel that the motorcar used in the business of running them on hire is in common parlance referred to as motor taxi. This contention of the learned counsel seems plausible.”

Conclusion:

Thus the Ld. Tribunal, following the decision of the Hon'ble Calcutta High Court in the case of *Agarwal Finance Co. Pvt. Ltd. vs Commissioner Income Tax, W.B. – I* <http://www.indiankanoon.org/doc/336254/>, held that when the motor cars are used in the business of running them on hire the assessee would be entitled to higher rate of depreciation as per Entry No. III (3)(ii). This particular judgment delivered by the Ld. ITAT, Kolkata will have a far reaching effect since it tends to transform the entire meaning and interpretation of the expression 'motor cars' hitherto adopted by the judiciary.