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### **Lessor eligible to claim depreciation on leased vehicles as it is the owner and the user**

The Supreme Court (SC) in the case of I.C.D.S. Ltd.<sup>1</sup> has reversed the Karnataka High Court (HC) decision on the issue of allowing depreciation in the hands of the lessor in a leasing transaction, and reaffirmed the position that in a leasing transaction, it is the lessor (and not the lessee) who is entitled to claim depreciation on the leased assets.

#### **In brief**

I.C.D.S. Ltd. (the assessee), a non-banking finance company is engaged in the business of hire purchase, leasing and real estate, etc. The assessee purchased vehicles from manufacturers by making direct payment and entered into lease

agreements for the vehicles, with its customers. The vehicles were registered in the names of the lessees, as required under the provisions of the Motor Vehicles Act, 1988<sup>2</sup> (MVA).

In its return of income, the assessee claimed depreciation on leased vehicles on the basis that it was the owner of these assets. It also claimed depreciation at a higher rate, (eligible under section 32 of the Income-tax Act, 1961 (the Act) as these vehicles were used in the business of running on hire.

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<sup>1</sup> I.C.D.S. Ltd. v. CIT [TS-8-SC-2013]

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<sup>2</sup> Section 2(30) of the Motor vehicles Act, 1988

## Facts

The assessing officer (AO) held that as the vehicles were registered in the names of the lessees and were used by them, the assessee was not eligible for depreciation under section 32 of the Act as it was neither the 'owner' of the vehicles nor it had 'used' the vehicles for the purposes of business.

The Commissioner of Income-tax (Appeals) (CIT(A)) agreed with the assessee on the eligibility of depreciation but rejected its claim of depreciation at a higher rate. The Income-tax Appellate Tribunal (the Tribunal) ruled the matter in favour of the assessee.

The HC reversed the decision of the Tribunal on the ground that the assessee was only a 'financier' and not the 'owner' of the vehicles. Hence, it was not eligible to claim depreciation.

## Issues before the SC

- Whether the assessee is the owner of the vehicles which are leased out by it.
- Whether the assessee is entitled to the higher rate of depreciation on the said vehicles, on the ground that they were hired out to the assessee's customers.

## Revenue's contentions

- The assessee was not the owner of the vehicles, since they were registered in the names of the lessees.
- The assessee did not use the vehicles in the course of its business.
- Depreciation can be claimed by an assessee only in a case where the assessee is both the owner and user of the asset.

- 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 financier.

## SC Ruling

- Section 32 of the Act requires that the asset must be 'owned, wholly or partly, by the assessee and used for business purposes'. It does not mandate usage of the asset by the assessee itself. As long as the asset is utilised for the purpose of business of the assessee, the requirement of section 32 of the Act will stand satisfied, notwithstanding non-usage of the asset itself by the assessee. In the case of the assessee, since it is a leasing company, the leasing of trucks would be for the purposes of the business.
- In arriving at this conclusion, the SC relied upon the decision in the case of Shaan Finance Pvt. Ltd.<sup>3</sup> where it was clarified that the phrase 'used for the purpose of business' does not necessarily require use of the asset by the assessee itself.
- The following clauses of the lease agreement establish that the assessee was the owner of the vehicles:
  - The assessee was the exclusive owner of the vehicles at all points of time.
  - If the lessee committed a default, the assessee was empowered to repossess the vehicle (and not merely recover money from the customer).
  - At the conclusion of the lease period, the lessee was obliged to return the vehicle to the assessee.

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<sup>3</sup> CIT v. Shaan Finance Pvt.Ltd. [] 3 SCC 605 (SC)

- The assessee had the right to inspect the vehicles at all times.
- With respect to the contention of the revenue department that the vehicle is to be transferred to the lessee at a nominal value at the end of the lease period, the SC held that as long as the assessee has a right to retain the legal title of the vehicle against the rest of the world, it will be the owner of the vehicle in the eyes of the law.
- A lease differs from a hire purchase agreement. In the case of the assessee, these are transactions of 'hire' and hence, will be in the nature of lease transactions.
- The MVA creates a legal fiction of ownership in favor of the lessee only for the purposes of the MVA. Therefore, any definition of the term 'owner' is restricted to that law only and it is not a statement of law on ownership in general.
- The SC also allowed the claim for higher rate of depreciation available to commercial vehicles as the assessee was in the business of leasing vehicles.

## Conclusion

The SC ruling reaffirms the position that, in a leasing transaction, it is the lessor who is the owner of the asset and hence, entitled to depreciation under section 32 of the Act. The SC has also clarified that the legal title of the vehicle for claim of depreciation cannot be determined only by the registration certificate granted under the MVA.

This ruling by the SC will be helpful for assessees engaged in the business of leasing and entitle them to claim depreciation on the leased assets.

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