

आयकर अपीलीय अधिकरण “ए” न्यायपीठ मुंबई में।
IN THE INCOME TAX APPELLATE TRIBUNAL “A” BENCH, MUMBAI

श्री संजय अरोड़ा, लेखा सदस्य एवं श्री अमित शुक्ला, न्यायिक सदस्य, के समक्ष ।
BEFORE SHRI SANJAY ARORA, AM AND SHRI AMIT SHUKLA, JM

आयकर अपील सं./I.T.A. Nos. 907 & 109/Mum/2013
(निर्धारण वर्ष / Assessment Years: 2008-09 & 2007-08)

ALD Automotive Pvt. Ltd. 13 th Floor, Maker Chamber IV, Nariman Point, Mumbai-400 021	<u>बनाम/</u> Vs.	Dy. CIT, Circle 3(1), Room No. 607, 6 th Floor, Aaykar Bhawan, Mumbai-400 020
स्थायी लेखा सं./जीआइआर सं./PAN/GIR No. AAFCA 0924 K		
(Assessee)	:	(Revenue)

&

आयकर अपील सं./I.T.A. Nos. 2179 & 601/Mum/2013
(निर्धारण वर्ष / Assessment Years: 2008-09 & 2007-08)

Dy. CIT, Circle 3(1), Room No. 607, 6 th Floor, Aaykar Bhawan, Mumbai-400 020	<u>बनाम/</u> Vs.	ALD Automotive Pvt. Ltd. 13 th Floor, Maker Chamber IV, Nariman Point, Mumbai-400 021
स्थायी लेखा सं./जीआइआर सं./PAN/GIR No. AAFCA 0924 K		
(Revenue)	:	(Assessee)

Assessee by	:	Shri Brijmohan P. Agarwal
Revenue by	:	Shri B. B. Rajendra Prasad

सुनवाई की तारीख / Date of Hearing	:	26.4.2016
घोषणा की तारीख / Date of Pronouncement	:	25.7.2016

आदेश / ORDER

Per Sanjay Arora, A. M.:

These are cross appeals, i.e., by the Assessee and the Revenue, for two consecutive years, being assessment years (A.Y.) 2007-08 and 2008-09, u/s. 253 of

the Income Tax Act, 1961 ('the Act' hereinafter), arising out of the orders by the Commissioner of Income Tax (Appeals)-5, Mumbai ('CIT(A)' for short) dated 31.12.2012. The appeals raise two issues, one brought by the assessee and the other by the Revenue, i.e., with regard to:

- a) Depreciation on lease assets; and
- b) Transfer (of a part) of fleet management charges to maintenance accounts

2. The assessee is in the business of providing vehicles of different types on, as stated, operating lease basis, to its' customers. Apart there-from, it provides allied services like repairing, maintaining, insuring, providing drivers, providing relief vehicles and emergency break-down services. Its other activities include distribution and wholesale trading in vehicles. The receipts from the principle activity of leasing and providing allied services are booked under the head of account 'lease rentals' and 'fleet maintenance charges' respectively (refer 'Statement of Facts' before the first appellate authority). The Assessing Officer (A.O.) disallowed the claim for depreciation, which though was allowed by the Id. CIT(A). The second issue is with regard to the revenue generated by way of 'fleet management charges', and *qua* which the assessee is in appeal. We shall take up the two in seriatim.

3. As regards depreciation, which is the subject matter of the Revenue's appeal, the same stood disallowed as the invoices and delivery notes (of the vehicles leased) are also in the name of the party using the vehicle (lessee), whose name appears on the vehicle registration certificate. Clearly, it was this party which is the owner of the vehicle, with the assessee being only a financier. Further, the assessee could produce confirmations as to non claim of depreciation by the lessees only by a few of them. The claim for depreciation was accordingly disallowed. The Id. CIT(A), on perusal of the Master Lease Agreement (MLA) (which though may vary in some respects from customer to customer), as well as the 'operating' lease agreements entered into by the

assessee-company with its customers, opined the lease entered into by the assessee to be an operating lease, so that it, as a lessor, is a real owner of the vehicle leased, with the lessee being allowed only the right to user and concomitant possession. He, accordingly, directed allowance of depreciation, relying on *Mysore Minerals Ltd. vs. CIT* [1999] 239 ITR 775 (SC). Aggrieved, the Revenue is in appeal, raising the following Ground:

‘1. Whether on the facts and circumstances of the case and in law, the Id. CIT(A) was justified in allowing depreciation to the assessee on vehicles given on lease without appreciating the fact that the vehicles were not registered in the name of the assessee and the same were directly delivered to the parties using it and not to the assessee.’

4. We have heard the parties, and perused the material on record.

The basis of the assessee's claim, since allowed by the first appellate authority, is that the lease is a operating lease, so that the risk and reward of ownership are not transferred, and what is granted (to the lessee) is a mere right of user. The registration of the vehicle in the name of the lessee is only for the purposes of the Motor Vehicles Act, 1988. Reliance is placed before us on *I.C.D.S Ltd. vs. CIT* [2013] 350 ITR 527 (SC) and *Mysore Minerals Ltd.* (supra). The ownership clause unequivocally states the intent that the vehicle shall be at all material times the property of the lessor. And, further, that the lessee shall be fully liable and responsible for all the obligations, liabilities and duties as per the Motor Vehicles Act or under any other law or instrument pertaining to the use of the vehicles. One of the indica of a financial lease is that the discounted value of the lease rentals, i.e., over the lease term, covers the cost of the subject matter of (asset under) lease. The lease term in such a case approximates the useful life of the vehicle, with the lessor being generally obliged to transfer the asset to the lessee at a nominal, predetermined value. In the present case, the lease term is not fixed, and is guided by the requirement of the lessee, i.e., the lease term varies from lessee to lessee. Further, along with the principal transaction of

lease, other specified, incidental services may be provided, again, as per the requirement of the lessee. The same are clearly offered as a package, contractually, by way of value-added services, toward providing vehicle (commutation) solutions to the customers. The same though would not detract from ascertaining whether the lease under reference is an operating or a financial lease. The Revenue's concern, as we understand, is that the lessees may not, similarly, claim depreciation, contending the lease to be a financial lease, and toward which, therefore, the AO sought confirmation from the lessees in respect of non-claim of depreciation. This is as, admittedly, it is not the form but the substance (of the transaction) that matters and, further, what is relevant is the beneficial (*de facto*) ownership of the vehicle as against its' titular (*de jure*) ownership, and which, in case of a financial lease, vests with the lessee. Such confirmations could be provided, however, only by a few customers.

The moot question, however, is whether such a claim by the lessee/s, assuming so, valid and, as a corollary, would invalidate the assessee's claim. It is the correct legal position that is relevant, and not the view that the parties may take of their rights in the matter [refer: *CIT v. C. Parakh & Co. (India) Ltd.* [1956] 29 ITR 661 (SC); *Kedarnath Jute Mfg. Co. Ltd. v. CIT* [1971] 82 ITR 363 (SC)]. Notwithstanding, therefore, a claim of depreciation by the lessees/s, i.e., assuming so, there being no estoppel against law, the assessee's claim, where correct, cannot be denied. The proper course with the Revenue is to deny or, as the case may be, withdraw such a claim in the hands of the lessee/s. Rather, as the assessee contends, and which we endorse, claiming depreciation, i.e., as against lease rentals, by the lessee would be disadvantageous for it in-as-much as the latter shall exceed the former. The reason is simple; the lease rentals would include the profit element as well and, thus, be in excess of depreciation, worked out w.r.t. the cost of the asset.

The law being well settled, it is the correctness of the assessee's claim on facts, on which it's claim therefore hinges. By all indica, it is an operating lease, guidance

for which may be had from the Accounting Standard (AS) 19 (by ICAI). The vehicle, at the end of the lease term, is not returned to the customer (lessee), but sold in the market, returning the amount realized in excess of the WDV as profit. The lease term varies and, further, is at the maximum of five years (Clause 9.5 of the MLA/at PB – I), as against the economic lifespan of 8-10 years. We are conscious that the economic life of the vehicle depends also on its' user, and that a period of five years, coupled with extensive user, may exhaust the life of a vehicle and, in any case, with reference to a particular (standard) operating efficiency. Even so, the fact remains that the assessee extends various lease terms to its' clients and, two, a higher term opted by a lessee would necessarily imply a low salvage/sale value, so that the assessee is entitled to recover the principal (along with profit), so that its claim for depreciation – which is a charge toward the capital consumed, would be in any case exigible; the only caveat being that in such a case, i.e., where the depreciation is preferred on the basis of the accounting theory, the same shall have to be on a systematic basis, and not necessarily at the rates as defined under the Act. The insurance premium, though recovered from the lessee (as part of fleet management charges), is the obligation of the lessor, whose name is shown therein as the beneficiary. Confirmation from all major clients also stands furnished before the AO. In our view, therefore, the finding by the Id. CIT(A) of the character of the lease as an operating lease cannot, under the circumstances, be faulted, and the assessee, accordingly, entitled to its claim for depreciation on the leased vehicles. The Revenue's appeal is accordingly dismissed.

5. We, next, take up the assessee's appeal. The assessee's claim is that the repair and maintenance costs are not period costs, but rise gradually with time, while the recovery thereof (which is along with a margin thereon) is made at a uniform rate, i.e., equally over the term of the lease. The higher (than proportionate) amount received in the initial years of the contract is to be regarded as an advance, which is appropriated

to a reserve account. Recognizing revenue thus, is considered by the assessee as in agreement with AS-9 (issued by ICAI). The Revenue considers it as not proper in-as-much as what is received does not carry any concomitant obligation. If the costs incurred, or liable to be incurred, in future, stand to increase, so be it, and which would only imply that the assessee would stand to earn a lower profit (on that account) for that year/s; each year being an independent unit of assessment.

During hearing, the Id. AR was queried by the Bench that in that case an appropriation would be equally justified in respect of lease rentals, also charged uniformly, while the capital charge (for depreciation), being on WDV basis, is higher for the initial years. He conceded, would though submit that depreciation is a charge/allowance at the rates provided under the Act, so that the same, irrespective of the assessee's method of accounting in respect thereof, is to be claimed at the statutory prescribed rates. We agree. Further, the assessee's claim is, in our view, unexceptional. *If the expenditure (on repairs) is the basis for the charge raised in its respect*, as it indeed is, calibrating the receipt (by passing adjustment entries in the accounts) to synchronize with the costs likely to be incurred over the contract period, cannot be faulted. We make a statement in definite terms as, if the rendering of the relevant services, incurring the concomitant costs, is not the basis of the charge, what is? It is not the character of the receipt as revenue that is in dispute, but the extent to which it, in the facts and circumstances of the case, can in law be considered as allocable to/arising for a particular year, i.e., considering the year-wise profile of such expenditure, and given that incurring of the cost is itself the basis of the charge. *The amount credited to the reserve account has to be reversed (for each vehicle) over the term of the contract.* The credit to the reserve is stated to be by following the reverse rule of 78, an industry norm. These aspects, however, would require verification. We may restate the issue by way of an example for the sake of better communication thereof. A sum of Rs.1,00,000/- is regarded as liable to be incurred on repairs over the

lease term of (say) five years. Adding 20% thereof (Rs.20,000) as margin, a charge of Rs.1.20 lacs is made by the assessee-lessor, working to an annual charge of Rs.24,000 (i.e., EMI of Rs.2000). The assessee's empirical data suggests that only Rs.8000 (say) is liable to be incurred in the first year, which would carry a concomitant charge of Rs.9,600/-. The excess Rs.14,400/- (Rs.24,000 – Rs.9,600) is transferred to the reserve account. In the latter years, where the normative cost is higher than the average, at Rs.30,000 (say), the shortfall in the proportionate revenue for that year (Rs.36,000), is accounted by write back from the reserve account to that extent (Rs.12,000/-, or Rs.36,000 - Rs.24,000). The entire reserve created in the initial years would thus stand to be reversed in time. Further, the same would therefore stand to be provided and, thus, verified, with reference to each individual contract, i.e., *qua* each vehicle. We further suppose that the costs are also logged vehicle-wise, enabling verification of such 'provision', as well as its reversal, and that the figure of Rs.1 lac and Rs.1.20 lacs (going by our example), being the aggregate cost and the corresponding charge respectively, are based on or approximate the amounts actually obtaining, and is demonstrable. We, accordingly, approve the accounting treatment - which forms the basis for returning income *qua* the said service, in principle. True, the 'excess' amount received in the initial years cannot be called or said to be an advance proper - which could only be so in terms of the contract, and neither the amount appropriated (to the reserve a/c) a 'provision'. Yet, the amount so appropriated can be said as not liable to be recognized as revenue for the year of receipt, considering that the corresponding costs, *which form the basis of the charge*, is yet to be incurred (to that extent). In-as-much as uneven repairs and, therefore, corresponding services, are liable to be rendered over the lease term – as indicated by the corresponding expenditure, the accounting treatment is in consonance with AS-9. The assessee's reliance on the decisions in *Calcutta Co. Ltd. vs. CIT* [1959] 37 ITR 1 (SC) and *Madras Industrial Investment Corporation Ltd. vs. CIT* [1997] 225 ITR 802 (SC),

both advocating the matching principle, is apposite. The AO shall cause necessary verification as indicated above, subject to whose findings of fact we allow the assessee's claim. We may further add that the assessee's plea is acceptable only *qua* such expenditure which is subject to, in the normal course of events, an increase with time, i.e., is age (of the vehicle) related. We say so as we observe several expenses forming part of the fleet management services, viz. providing relief vehicles, drivers, emergency breakdown services, door to door services, etc., and which are essentially period costs, so that all such costs which do not exhibit a pronounced increase with time, i.e., in relation to the age of the corresponding vehicle, would not be subject to such appropriation. The AO's finding shall further include that in respect of reversal of the credit (on the basis of the rule being purportedly followed) as well. Reference to the said rule, we may add, is only toward the assessee following a scientific basis in allocating the revenue over the term of the lease and, accordingly would stand to be examined by the A.O., and the allowance of the assessee's claim by us is subject to his returning positive findings. We decide accordingly.

6. In the result, the assessee's appeals are allowed for statistical purposes, while the Revenue's appeals are dismissed.

Order pronounced in the open court on July 25, 2016

Sd/-
(Amit Shukla)

न्यायिक सदस्य / Judicial Member

मुंबई Mumbai; दिनांक Dated : 25.07.2016

व.नि.स./Roshani, Sr. PS

Sd/-
(Sanjay Arora)

लेखा सदस्य / Accountant Member

आदेश की प्रतिलिपि अग्रेषित/Copy of the Order forwarded to :

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent
3. आयकर आयुक्त(अपील) / The CIT(A)
4. आयकर आयुक्त / CIT - concerned
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, मुंबई / DR, ITAT, Mumbai
6. गार्ड फाईल / Guard File

आदेशानुसार/ BY ORDER,

उप/सहायक पंजीकार (Dy./Asstt. Registrar)

आयकर अपीलीय अधिकरण, मुंबई / ITAT, Mumbai