



Date: 28nd June, 2016

To,
Commissioner of Commercial Tax
Government of Gujarat,
C-5, Rajya Kar Bhavan
Ashram Road
Ahmedabad - 380009
Gujarat

Sub: Representation on reinstating the provision for tax credit in respect of leasing transactions under The Gujarat Vat Act, 2003

Respected Sir,

Asset Finance Association of India (AFAI), an industry body formed with the objective of promoting leasing, factoring and other asset-backed financing entities is an initiative by the Indian Securitisation Foundation (ISF), a non-profit organization incorporated with the cause of promoting capital market instruments in the country. Some of the eminent players of the leasing industry are members to AFAI and are dedicated to the cause of promoting leasing in India. The details of AFAI, its activities and members are provided for in **Annexure I** to this representation.

The purpose of this representation is to humbly request for reinstating input tax credit benefits under The Gujarat Value Added Tax Act, 2003¹ (“Act”) in respect of goods which are provided on right to use basis, as was available under the Act prior to The Gujarat Value Added Tax (Amendment) Act, 2006².

Summary of the Representation

Prior to the amendment to Gujarat Value Added Tax Act, 2003 in 2006, input tax credit was available in respect of purchase of goods provided on right to use basis by the dealer. However post the amendments made by The Gujarat Value Added Tax (Amendment) Act, 2006, the input tax credit was specifically disallowed by making explicit provision in regard to the same. Clause (mmm) was inserted in section 11(5), where input tax credit is specifically denied in case of purchase of goods provided on right to use basis. The same is reproduced below:

(5) Notwithstanding anything contained in this Act, tax credit shall not be allowed for purchases-

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“of the goods for which right to use is transferred for any purpose (whether or not for a specified period), for cash, deferred payment or other valuable considerations”

¹ https://commercialtax.gujarat.gov.in/vatwebsite/download/act/VAT_2005_Eng.pdf

² https://commercialtax.gujarat.gov.in/vatwebsite/download/act/VAT_AMND_2006_Eng.pdf



Therefore we humbly request for reinstating the tax credit benefits under the Act by deleting clause (mmm) from section 11(5) of the Act.

Leasing Industry in India

The Indian leasing industry has witnessed some growth in leasing volumes since 2010 and has seen several new players venture into new asset classes after leasing in India came to a sudden halt in 1996. Leasing has found favor as some of the issues from the past resolved, corporates preferred usage of several assets over ownership, technological obsolescence also created an inclination towards appreciating usage benefits over ownership, leasing facilitated creation of new customer class, as a tool to boost sales for some asset classes and more.

While assessing the performance of the Indian leasing industry, it is noted that the leasing volumes stood at around USD 669 million³ during FY 2014-2015 as opposed to USD 505 million during FY 2013-2014. The leasing industry outlines the upward trajectory motion in terms of growth. The acquisition of capital goods involve high cash outflow, thus importers opt for equipment leasing rather than buying outright. Leasing, as an alternative provides several benefits which are enumerated below:

1. Technological upgradations are suitably met with the lease form of financing. It is easy for companies to replace their worn out or obsolete machines with the leased assets.
2. Hedging of technological obsolescence helps equipment users to avoid the burdens of ownership, one of them being equipment obsolescence. Much of today's equipment incorporates technology that is rapidly changing.
3. Cashflow constraints makes leasing attractive. An outright purchase requires an immediate cash outflow, whereas in case of lease, the cash outflow are spread over years of usage of the asset. Also in case of leased assets, the ownership of the assets is retained by the leasing entity and only the usage of the assets is transferred to the end user. Therefore, in most lease cases, there is no requirement for additional collateral.

The Gujarat Value Added Tax Act, 2003

The Act was passed by the Government of Gujarat in the year 2003 and the Act came into effect in 2005. Thereafter in 2006 an amendment was introduced to the Act which changed the provisions pertaining to availability of input tax credit in case of lease transactions.

The comparative situation prior and post the amendment is enumerated below:

Situation prior to amendment

³ The leasing volumes do not include new leasing business volumes of Indian Railway Finance Corporation a subsidiary of Indian Railways



- a. Section 11 (3)(a) of the Act laid down the provisions in regard to claiming input tax credit in respect of goods purchased and provided on right to use basis. The provisions of section 11 (3)(a) is reproduced as under –

3)(a) Subject to the provisions of this section, tax credit to be claimed under sub-section (1) shall be allowed to a purchasing dealer on his purchase of taxable goods made in the State, which are intended for the purpose of-

(i) sale or re-sale by him in the State;

As per the aforesaid, in order to claim input tax credit as provided under section 11 of the Act the purchasing dealer should have purchased the goods either for further sale or resale by him in the state.

- b. Section 2(23) of the Act provides the definition of sale. The same has been reproduced as under –

“(23) “sale” means a sale of goods made within the State for cash or deferred payment or other valuable consideration and includes, -

xxx

(d) transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration,

xxx

Transfer of right to use is covered under the definition of sale, so a lease transaction qualifies to be a sale under section 2(23) for the purpose of VAT Act. As the transfer of right to use qualifies the definition of sale, the condition as laid down under section 3(a)(i) for eligibility to claim input tax credit stands satisfied.

- c. Further section 11(5) of the Act which provided for the cases where the input tax credit was explicitly disallowed, had no reference of the lease transaction which meant that a purchasing dealer was entitled to input tax credit on purchase of goods even when the right to use the goods were subsequently transferred.

Hence, prior to amendment of the Act, a dealer was eligible to claim input tax credit in respect of the goods for which right to use was transferred by him.

Changes made by The Gujarat Value Added Tax (Amendment) Act, 2006

The Gujarat value Added Tax (Amendment) Act, 2006, (Amendment Act) has denied input tax credit in case of purchase of goods provided on right to use basis by amending the provisions of section 11(5) of the Act. As mentioned, Section 11(5) of the Act provided for cases where input tax credit was specifically denied. Clause (mmm) has been inserted under section 11(5) by the Amendment Act, which states that input tax credit will not be available



of the goods for which right to use is transferred for any purpose (whether or not for a specified period), for cash, deferred payment or other valuable considerations.

The provisions of section 11(5)(mmm) has been reproduced as under –

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(5) Notwithstanding anything contained in this Act, tax credit shall not be allowed for purchases-

xxx

(mmm) of the goods for which right to use is transferred for any purpose (whether or not for a specified period), for cash, deferred payment or other valuable considerations;

xxx

Hence the amendment specifically mean that input tax credit will not be allowed in respect of purchase of goods provided on right to use basis by the purchasing dealer.

The other definitions relevant to explaining the position in case of availability of input tax credit for assets provided on right to use basis is provided in **Annexure – II** to this representation.

Our Representation

Gujarat is termed as one of the most progressive states in the country. Over the past decade Gujarat has seen rapid economic growth. Driven by massive industrialisation, the state's economy expanded by an average of 10% a year between 2004 and 2012 - above the Indian average of about 8.25%⁴. The economic growth indicators of Gujarat has been impressive with an achievement of average annual growth rate of 10.4%. The Gujarat economy is thriving and the data support the fact that there are robust growth opportunities in Gujarat.

The Gross State Domestic Product (GSDP) at Market prices at constant (2011-12) prices in 2014-15 has been estimated at Rs. 782,820 crore as against Rs. 726,831 crore in 2013-14, registering a growth of 7.7 percent during the year⁵. The Socio Economic Review of Gujarat states the fact that between 02/10/2006 and 31/10/2015, total 3,75,130 MSME Enterprises have been registered with an investment of Rs.1,78,863 crore and employment of 28,31,796. Thus in essence, it seems need for capital expenditure will be on a rise and need for having several financial products to be able to meet the capital expenditures for industries is quintessential to support the demand for capex. Leasing is one of the tools which facilitates use of the fixed assets and also distributes the cash outflows over a period of time. However, the extant provisions in the VAT Act pertaining to input tax credit denial in case of lease transactions makes leasing completely non-lucrative proposition for lessees and lessors in the state.

⁴ <http://www.bbc.com/news/business-27257790>

⁵ [http://financedepartment.gujarat.gov.in/Documents/34%20%20Socio%20Economic%20Review%20\(English\).pdf](http://financedepartment.gujarat.gov.in/Documents/34%20%20Socio%20Economic%20Review%20(English).pdf)



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Outright purchase of assets poses several constraints, a) there is an immediate cash outflow which may not be possible for several business houses considering the tight cashflows business these days work on, b) there is a need for constant technological upgradation that throw the owned asset into redundancy and c) business houses can appreciate the need for usage of the assets more than need for owning the assets. Leasing as a product takes care of these constraints. The cash outflows are spread over the lease tenure. Lease facilitates the lessee to use the asset and pay for the usage with no obligation to own the asset at any point of time. The lease could be terminated in favour of an upgraded asset to ensure that the business is not constrained by the technological obsolescence. Therefore, lease has several merits over outright ownership and/ or acquiring the asset on loan as well.

The input tax credit disallowance, becomes a sunk cost and therefore puts leasing out of preference reducing prospective lessees to either purchase or avail loan facility. A sine-quo-non to a flourishing economy is availability of various financial products and how developed financial products are.

Considering Gujarat government's vision and policy initiatives, the input tax credit denial is not helping the cause of growth and development in the state. It is, infact, working on cross purposes.

Similar input tax credit denial was inserted by the Maharashtra government in case of lease of passenger vehicles in the year 2013. However, this position was over-turned in the recent state Budget where the input tax credit was reinstated after recognising the criticality of survival of leasing in the segment. The amendment in the Maharashtra Vat Act reinstating input xax credit on passenger motor vehicles is briefly provided in **Annexure – III** to this representation for reference.

Similar to the Maharashtra government, we urge your goodself to consider the merits of leasing and facilitate the environment for leasing as a product to grow by doing away with the input tax credit disallowance in case of leases; thereby giving a level playing field with the other states as well.

As AFAI is dedicated to the cause of contributing to the development of the asset backed funding sector in particular, in the event of any further clarification needed, we would be happy to provide the same.

For *Asset Finance Association of India*

Sd/-

(Nidhi Bothra)



Annexure - I

The Asset Finance Association of India is an initiative by the Indian Securitisation Foundation to bring together the stakeholders of the asset finance sector in India. The organisation is intended to promote, help, develop, protect, encourage and secure, in India, general interest of various forms of asset backed funding by acting as industry association, to organize industry events, forums, discussions to promote research, generally to take care of the interest of trade, industry and commerce, stakeholders, participants and investors in asset finance and generally to act in the best interest of the Indian asset finance sector. Primarily, the asset finance activities to be catered to by the Association include leasing, factoring, trades in receivables, etc.

The Association aims at bringing industry players on a common platform – to join their thoughts, and to provide a voice to their thoughts. The Association aims at providing a strong platform of advocacy for asset finance industry.

Some of the functions of the organisation include:

- **Advocacy:** making representation to various authorities from time to time on matters concerning the following –
 - a. Leasing
 - b. Factoring
 - c. Receivable Financing
 - d. Other forms of asset backed finance.
- **Industry forums and networking:** holding periodic conventions and educational courses.
- **Development of industry standards:** framing self-regulatory standards on disclosures, reporting, servicing reporting, DOs and DONTs for various forms of asset finance.
- **Information exchange:** on matters of common interest, collateral performance etc.

AFAI Executive Committee Members

1. Ms. Simi Thapar

Ms. Simi Thapar is a Head - Equipment Leasing and Financing Solutions - Corporate Finance at Tata Capital. Simi has 25 Years Work Experience in Financial Services across diverse industries and diverse asset and product categories. Ground experience in new business initiative, product development and in devising strategy for organic and inorganic growth of business.



2. Mr. Gautam Munish

Mr. Gautam Munish, currently serving Hewlett Packard financial services as regional sales director is a seasoned finance professional with 20 years of diverse work experience across Asset, Liability and Investment products. He has extensive experience in building and managing business from ground up, with exposure to detailed competitive landscape analysis, compliance and regulatory adherence and evangelizing the merits of a differentiated approach to market.

3. Mr. Sunil Badala

Mr. Sunil Badala is a partner with the financial services tax practice of the Indian Firm of KPMG. He specializes both in domestic corporate tax and international tax and entry and exit strategies for multinationals and large domestic companies investing into/ outside India. He has a total of about 18 years of experience, including 14 years with the India Firm and has extensive experience in International and Domestic taxation, Inbound Entry Strategies for Multinationals and Outbound Structuring Strategies for large domestic companies.

4. Mr. Shrirang Tambe

Mr. Shrirang Tambe founder and CEO of ORIGA Leasing one of the first FinTech asset leasing companies for high growth oriented companies with philosophy of access to finance. His expertise lies in advising and nurturing growth oriented companies across financial and strategic areas.

5. Ms. Nidhi Bothra

Ms. Bothra is a consultant on leasing, asset backed lending, securitisation, structured finance and corporate finance and is Executive Vice President in Vinod Kothari Consultants (P) Ltd. Ms. Bothra has conducted various corporate training workshops on leasing, and has handled several consulting assignments on leasing in different markets. Nidhi has analysed state of leasing industry in several countries and writes the report on the state of leasing industry in India for several years now.

6. Mr. Dipankar Sen

A MBA graduate with specialisation in finance, He has over 20 years of experience in leasing and financial services and today heads the leasing portfolio for Orix in India. His experience has been in both fund based and fee based activities where he has managed the SME, Corporate and PSU segments for their leasing requirements in equipments. Under the leasing portfolio in Orix, he today manages the vehicle leasing business where company offers solutions in both dry and wet leases.



Annexure – II

DEFINITIONS

Capital Goods [Section 2(5)]

“capital goods” means plant and machinery (other than second hand plant and machinery) meant for use in manufacture in taxable goods and accounted as capital assets in the books of accounts⁶.

Dealer [Section 2(10)]

“dealer” means any person who, for the purpose of or consequential to his engagement in or, in connection with or incidental to or in the course of his business buys, sells, manufactures, makes supplies or distributes goods, directly or otherwise, whether for cash or deferred payment, or for commission, remuneration or otherwise and includes, -

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(h) any person who transfers the *right to use* any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration;

Sale [Section 2(23)]

“sale” means a sale of goods made within the State for cash or deferred payment or other valuable consideration and includes, -

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(d) transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration,

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but does not include a mortgage, hypothecation, charge or pledge; and the words “sell”, “buy” and “purchase” with all their grammatical variations and cognate expressions shall be construed accordingly

Sale Price [Section 2(24)]

‘Sale price’ means the amount of valuable consideration paid or payable to a dealer or received or receivable by a dealer for any sale of goods made including the amount of duties levied or leviable under the Central Excise Tariff Act, 1985 or the Customs Act, 1962 and any sum charged for anything done by the dealer in respect of the goods at the time of or before delivery thereof, and includes, in relation to -

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(ii) the transfer of the right to use any goods for any purpose, whether or not for a specified period.

⁶ Substituted vide Gujarat Value Added Tax (Amendment) Act, 2006.



INCIDENCE AND LEVY OF TAX

Tax Credit [Section 11]

The provisions relating to tax credit have been provided under section 11 of the Gujarat Vat Act 2005. The same has been reproduced as under –

As per section 11 (1)(a) -

“(1) (a) A registered dealer who has purchased the taxable goods (hereinafter referred to as the “purchasing dealer”) shall be entitled to claim tax credit equal to the amount of,-

- i. tax collected from the purchasing dealer by a registered dealer from whom he has purchased such goods or the tax payable by the purchasing dealer to a registered dealer who has sold such goods to him during the tax period⁷, or;
- ii. tax paid by him during the tax period under sub-section (1) or (2) of section 9 or
- iii. tax paid by the purchasing dealer under the Gujarat Tax on Entry of Specified Goods into Local Areas Act, 2001⁸.

Section 11 (3)(a) lays down the situations under which a registered dealer will be eligible to claim tax credit. The provisions of section 11 (3)(a) has been reproduced as under –

“3 (a) Subject to the provisions of this section, tax credit to be claimed under sub-section (1) shall be allowed to a purchasing dealer on his purchase of taxable goods made in the State, which are intended for the purpose of –

- i. sale or re-sale by him in the State;
- ii. sale in the course of inter-State trade and commerce ;
- iii. branch transfer or consignment of taxable goods to other States (subject to the provision of Sub-clause (b) below);
- iv. sales in the course of export out of the territory of India;
- v. sales to export oriented units of the units in Special Economic Zones for sale in the in the course of export out of the territory of India;
- vi. use as raw material in the manufacture of taxable goods intended for (i) to (v) above or in the packing of the goods so manufactured.
- vii. use as capital goods meant for use in manufacturer of taxable goods intended for (i) to (vi) above subject to the condition that such capital goods are purchased after the appointed day⁹.

⁷ Substituted vide Gujarat Value Added Tax (Amendment) Act, 2006.

⁸ Inserted vide Gujarat Value Added Tax (Amendment) Act, 2006.

⁹ Inserted vide Gujarat Value Added Tax (Amendment) Act, 2006.



Provided that if purchases are used partially for the purposes specified in this sub-section, the tax credit shall be allowed proportionate to the extent they are used for the purposes specified in this sub-section”.

Since transfer of right to use is regarded as a sale, the dealer was earlier eligible to claim tax credit in respect of the items whose right to use has been transferred by him.

However as per amendment by the Gujarat Value Added Tax (Amendment) Act 2006, in the provisions of section 11, tax credit stands denied in respect of goods for which right to use is

transferred for any purpose for cash, deferred payment or other valuable considerations. The same has been effected by inserting clause (mmm) in sub-section (5) of section 11 of the VAT Act. The amendment has been reproduced as under –

(5) Notwithstanding anything contained in this Act, tax credit shall not be allowed for purchases-

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(mmm) of the goods for which right to use is transferred for any purpose (whether or not for a specified period), for cash, deferred payment or other valuable considerations;



Annexure – III

In the erstwhile Maharashtra Vat Rules, 2005¹⁰ under Rule 54(a) set-off was admissible to the claimant who was engaged in the business of transferring the right to use of “motor vehicles (not being goods vehicles)”

As per the Notification no. STR- 1506/CR-38/Taxation-1¹¹ dated 8th September, 2006 the words “not being good vehicles” was substituted by the word “passenger vehicles” for better understanding.

However, as per the Notification no. VAT 1513/CR 61/Taxation.-1¹² dated 21st May 2013 whereby set-off which was admissible on transfer of right to use the vehicle was removed with effect from 1st May, 2013 and thereby the set-off was allowed to dealer who was in the business of hiring of vehicles.

This notification caused a dent in the leasing market involved in the transfer of use of the passenger vehicles and as such a reinstatement of this notification was urgently required. This issue was dealt in the Maharashtra Budget 2016-17 and as per Para 6 of Part II of the Maharashtra Budget¹³ speech for FY 2016-17 made on 18th March, 2016 made changes to set-off rules, which provided for restoring the ITC benefit in case of lease of passenger motor vehicles

The text from the budget can be read as follows:

"Passenger motor vehicles are not eligible for set-off even if leased. I now propose that set-off on passenger motor vehicles will be available to the extent of output tax on lease of such vehicles."

Accordingly, Rule 53 of Maharashtra Value Added Tax Rules, 2005¹⁴ has been amended and a new sub-rule (11) had been inserted with effect from 1st April, 2016.

The said sub-rule is reproduced below:

“(11) (a) If the claimant dealer is engaged in the business of transferring the right to use (whether or not for a specified period) for any purpose, of passenger motor vehicles, then he shall be entitled to claim set-off of tax paid on the purchase of such motor vehicles only to the extent of tax payable on such transfer of right to use;

¹⁰ Read more at: http://www.raoemmar.com/assets/4e330a92-92d1-4a6e-987e-2e3493a042e0/files/docs/VAT/Maharashtra/maharashtra_vat_rules_2005.pdf

¹¹ Read more at: <http://www.steasys.com/Notification/CR38%20080906%20AMEND%20RULE.pdf>

¹² Read more at:

http://mahavat.gov.in/Mahavat/MyFold/DOWNLOADS/NOTIFICATIONS/KNOW_NOTIFI_MVAT/KNOW_NOTIFI_MVAT_06_03_13_5_37_22PM.pdf

¹³ Read more at: https://www.maharashtra.gov.in/PDF/Budget_2016_English_Part_II.pdf

¹⁴ Read more at:

http://www.mahavat.gov.in/Mahavat/MyFold/DOWNLOADS/NOTIFICATIONS/KNOW_NOTIFI_MVAT/KNOW_NOTIFI_MVAT_04_06_16_11_36_20AM.pdf



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(b) the set off as determined under clause (a) in respect of the such vehicles shall be claimed in the period in which such right to use has been transferred by the claimant dealer.”

Therefore, as per the above amendment the dealer can now set-off the tax paid on the purchase of passenger motor vehicles to the extent of tax paid on the lease rental of such passenger motor vehicle. Hence, the above amendment has brought a cheer in the leasing industry dealing in the passenger motor vehicles sector in Maharashtra.