

# TAX FLASH NEWS

18 May 2020

## Principal component of lease rent paid for Set-top Boxes is not allowed as revenue expenditure. However, higher depreciation at 60 per cent is allowed on such Set-top Boxes

Recently, the Chandigarh Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Fastway Transmission (P) Ltd<sup>1</sup> (the taxpayer) held that the arrangement for supply of Set-top Boxes (STBs) was a loan/finance arrangement in the guise of a lease agreement. Therefore, the taxpayer was not entitled to claim the payment of principal component of lease rent as 'revenue expenditure' under Section 37(1) of the Income-tax Act, 1961 (the Act).

However, the taxpayer was entitled to claim higher depreciation on the STBs at 60 per cent. Considering the nature of the equipment, architecture, components, functions and also the average life, STBs would fall under the category of 'computer' for the purpose of determination of rate of depreciation.

### Facts of the case

The taxpayer is engaged in the business of Multi-System Operators and Digital Cable Services (DCS). The DCS services were rendered to the customers through STBs. The taxpayer acts as an intermediate between local cable operators and broadcasters. During the years under consideration<sup>2</sup>, the taxpayer entered into a finance lease agreement with Non-Banking Finance Company (NBFC) for supply of STBs. The lease-term was of 48 months.

The taxpayer was following accounting standard (AS)-19 on 'Leases' prescribed by the Institute of Chartered Accountants of India (ICAI). The taxpayer treated the arrangement with NBFC as a finance lease capitalising the principal component (cost plus custom duty) of the agreed lease rent. The taxpayer debited only the interest in the Profit and Loss account and further treated the assets leased (set top boxes) as fixed assets. However, for the purpose of computation of

income under the provisions of the Act, the transaction was treated as operating lease. Consequently, the principal component of the lease rental was also claimed as deduction along with the interest component.

The Assessing Officer (AO) held that the taxpayer had entered into a finance lease agreement with NBFC and was entitled to claim depreciation on the assets so leased. Accordingly, the AO disallowed the claim of deduction of the principal component of the lease rentals claimed by the taxpayer and allowed depreciation at 15 per cent on the leased assets. The AO rejected the alternate contention of the taxpayer that the STBs would fall within the definition and scope of computers, hence, depreciation on the same should be granted at 60 per cent as provided under the Income-tax Rules, 1962 (the Rules). The Commissioner of Income-tax (Appeals) [CIT(A)] upheld the order of the AO.

### Tribunal's decision

The Act does not recognise or differentiate between different types of lease transactions. As per the provisions of the Act, any expenditure incurred on capital assets cannot be allowed as deduction of expenditure. However, the taxpayer can claim depreciation as prescribed by the rules on the value of such an asset. If such an asset was not owned by the taxpayer, rather, the same has been procured on lease or hire basis to be used solely for business purpose of the taxpayer, the hire charges/lease rental paid for such an asset will be admissible as revenue expenditure under Section 37.

It has been observed that AS-19 has been prescribed by the ICAI to be followed for maintaining the books of accounts by the companies. However, so far as the Act is concerned, the same has no relevance. There is no

<sup>1</sup> Fastway Transmission (P) Ltd v. ACIT (ITA No.140/Chd/2019) – Taxsutra.com

<sup>2</sup> AY 2012-13, AY 2013-14, AY 2014-15, AY 2015-16

provision under the Act differentiating between operating lease and finance lease. As per the provisions of the Act what is to be determined as to whether the agreement/transactions in question is of a lease or a loan or of a hire/purchase. The Supreme Court in the case of Tuticorin Alkali Chemicals and Fertilizers Ltd.<sup>3</sup> has held that normally, the Accounting Standards is accepted but it cannot override the provisions of the Act. Further, the Supreme Court in the case of Kedarnath Jute Manufacturing Co. Ltd.<sup>4</sup> held that whether the taxpayer was fully entitled to a particular deduction or not, would depend upon the provisions of the Act and not on the entries of his books of account.

For the purpose of deciding whether a particular transaction is a lease or not, the question of intentions of the parties is to be determined and the intention has to be inferred from the circumstances of each case. As per the facts of the present case, the transaction in question may be either of a lease or of a loan or a Hire Purchase agreement.

On reference to various terms of the lease deed, it has been observed that the only role of the lessor in the arrangement was to finance the transaction of purchase of equipment, with the lessee selecting the equipment to be supplied by the dealer, using it for its expected economic life, paying back the entire cost of the equipment over the lease tenure and exercising all rights of ownership over the asset. It also bears the risks of losses, damages, etc. associated with the ownership of the asset and no option to the lessee to terminate the lease and return the asset before the end of the lease term. Thus, it was neither a lease, nor a hire purchase agreement, but a loan/finance arrangement between the parties.

Therefore, the taxpayer was only eligible to claim interest paid as part of the said lease rentals as expenditure under Section 36(1)(iii). The taxpayer was not entitled to claim the principal component of alleged lease rent paid as 'revenue expenditure' under Section 37(1). However, the taxpayer was entitled to claim depreciation on the said assets purchased from borrowed capital.

### ***Applicability of higher rate of depreciation***

The AO has allowed the depreciation at 15 per cent, whereas, the contention of the taxpayer was that STBs were classifiable under the head 'Computers including Computer Software' and were eligible for depreciation at 60 per cent. The taxpayer contended that a STB was not only in itself a computer but also was part and parcel of a larger computer system from which it gets the signals, decode the audio-video signals and pass on to the television.

Various courts while adjudicating on the issue of allowability of rate of depreciation have interpreted 'computer and computer software' as a 'computer system' which includes the other associated equipment attached with the CPU such as monitor, mouse, key board, printer, scanner etc. as these equipment/devices though, in themselves will not be doing the function of computer but they are required to be attached with the computers and cannot be operated independently. The life span of these devices attached to the CPU goes with that of the computer. In the modern era of fast evolution in technology sector, the technological devices based on computer programming and software are being replaced or required to be replaced in a very short span of time with their new and improved versions with enhanced capabilities and performance features etc. due to revolutionary developments in this sector.

It is not only the primary function that may be the sole criteria for deciding whether the STBs will be eligible for depreciation as applicable to the computers or not, rather the overall facts and circumstances such as the architectural design, nature of its components, the economic life of the STBs and their functions both primary and other functions, that are the deciding factors.

Considering the nature of the equipment, their architecture, their components, their functions and also their average life, STBs would fall under the category of 'computer' for the purpose of determination of rate of depreciation.

### **Our comments**

The issue with respect to the claim of lease rental for supply of STBs as revenue expenditure under Section 37 vis-à-vis eligibility of higher depreciation on STBs has been a subject matter of debate before the Courts.

The Cochin Tribunal in the case of Kerala Communicators Cable Ltd.<sup>5</sup> held that the expenditure incurred for acquisition of STBs was capital in nature since it was incurred for securing tangible assets on which the taxpayer collected annual maintenance charges. The acquisition brought into existence a new asset, and the taxpayer obtained a new advantage. Further, the Tribunal held that without any proof of STBs being energy saving devices, they have to be considered as 'plant and machinery' entitled for depreciation at 15 per cent and not at 80 per cent.

The Tribunal in the present case has held that the arrangement made by the taxpayer was a loan/finance arrangement in the guise of a lease agreement. Accordingly, the taxpayer was not entitled to claim the payment of principal component of lease rent as revenue expenditure under Section 37(1). However, the taxpayer was entitled to claim higher depreciation on the STBs at 60 per cent.

<sup>3</sup> Tuticorin Alkali Chemicals and Fertilizers Ltd. v. CIT [1997] 93 Taxman 502 (SC)

<sup>4</sup> Kedarnath Jute Manufacturing Co. Ltd v. CIT [1971] 83 ITR 363 (SC)

<sup>5</sup> ACIT v. Kerala Communicators Cable Ltd (ITA No. 271/Coch/2018)

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