IN THE SUPREME COURT OF INDIA

CIVIL APPEALLATE JURISDICTION

CIVIL APPEAL NO.9344 OF 2010
(Arising out of S.L.P. (C) No.23149 of 2009)

Association of Leasing &
Financial Service Companies ...
Appellant (s)

Versus

Union of India and others ...
Respondent(s)

WITH

Civil Appeal No.9345 of 2010 (arising out of S.L.P. (C) No.23805 of 2009)
Civil Appeal No.9346 of 2010 (arising out of S.L.P. (C) No.24704 of 2009)
Civil Appeal No.9347 of 2010 (arising out of S.L.P. (C) No.11672 of 2009)
Civil Appeal No.9348 of 2010 (arising out of S.L.P. (C) No.23161 of 2009))
Civil Appeal Nos.9350-9351 of 2010 (arising out of S.L.P. (C) Nos.27989-27990 of 2009

J U D G M E N T

S.H. KAPADIA, CJI

1. Leave granted.

2. In this batch of Civil Appeals, the controversy pertains to validity of Sections 65(12) and 65(105)(zm) of the Finance Act, 1994 (as amended) insofar as the said provisions seek to levy service tax on leasing and hire purchase. The appellants contend that service tax imposed by Section 66 of the Finance Act, 1994

on the value of taxable services referred to in Section 65(105)(zm) read with Section 65(12) of the Finance Act, 1994 (as amended), insofar as it relates to financial leasing services including equipment leasing and hire purchase is beyond the legislative competence of Parliament by virtue of Article 366(29A) of the Constitution.

Facts in Civil Appeal @ SLP (C) No. 24704 of 2009

3. Appellant is an Association of leasing and financial companies. Finance Act sought to levy service tax on "banking and other financial services". Section 137 of the Finance Act, 2001 substituted Section 65 of the Finance Act, 1994 by a new Section 65 which defined "banking and other financial services". Subsequently, this definition also underwent some changes by way of Section 90 of the Finance Act, 2004 and Section 135 of the Finance Act, 2007. The relevant part of the definition as on date contained in Section 65(12) of the Finance Act, 1994 is as follows:

"65. In this Chapter, unless the context otherwise requires –
(12) "banking and other financial services" means –

(a) the following services provided by a banking company or financial institution including a non-banking financial company or any other body corporate or commercial concern namely: -

(i) financial leasing services including equipment leasing and hire-purchase;"

4. Appellant had filed a writ petition under Article 226 of the

Constitution before the High Court challenging the levy of service tax imposed by Section 65(12)(a)(i). During the pendency of the writ petition, Union of India issued a Notification ST dated 1.3.2006 exempting 90% of the amount repayable under hire-purchase/ equipment leasing agreement(s) from service tax on the ground that the said 90% represented interest income earned by the service provider. According to the appellant, the concept of "service tax" was first introduced by the Finance Act, 1994 which came into force w.e.f. 1.7.1994 under Chapter V. No service tax was levied by the said Act or by its subsequent amendment till 2001. However, vide Finance Act, 2001 service tax was imposed on "banking and other financial services". Vide Section 137(a) of the Finance Act, 2001, Section 65 of the Finance Act, 1994 was replaced by a new Section 65 which defined "banking and other financial services" vide clause (10). By virtue of the said definition under Section 65(10)(i), Parliament has sought to bring within the service tax net, transactions in the nature of financial leasing, equipment leasing and hire-purchase. By Section 65(72), the expression "taxable service" has been defined to mean any service provided to a customer, by a banking company or a financial institution including NBFC, in relation to banking and other financial services [See Section 65(72)(zm)]. Being aggrieved by the inclusion of hire-purchase and leasing

services within the service tax net, the appellant herein challenged the amendment of 2001 as ultra vires the legislative competence of the Parliament. By the impugned judgment, the Madras High Court has dismissed the writ petition, hence, this civil appeal.

Submissions

5. Mr. Arvind P. Datar, learned senior counsel appearing on behalf of the appellant(s), submitted that the effect of Article 366(29A) is to treat six types of transactions as deemed sales so as to enable state legislatures to levy sales tax under Entry 54, List II; that, the Statement of Objects and Reasons to the Constitution (Forty-sixth Amendment) Act makes it clear that all six transactions could have been taxed under Entry 97, List I by Parliament. However, based on the 61st Report of the Law Commission, the Constitution has now conferred exclusive power to the States to levy sales tax by expanding Entry 54, List II by insertion of Article 366(29A). Thus, having characterized constitutionally the subject matter of hire-purchase and leasing as a sale (deemed sale), it is not open to Parliament to tax the same subject matter under Entry 97, List I. Thus, by reason of the Constitution (Forty-sixth Amendment) Act, there exist six transactions as "sales". That, inevitable corollary is that power of taxation of hire-purchase/ leasing, being sales, is exclusively with

the state legislatures. The purpose of the Constitution (Forty-sixth Amendment) Act was to reserve the exclusive competence to tax hire-purchase/ leasing transactions with state legislatures which is clearly seen from the 61st Report of the Law Commission which recommended constitutional amendment. In this connection, learned counsel has placed reliance on the principles laid down by this Court in **Bharat Sanchar Nigam Limited v. Union of India [(2006) 3 SCC 1]**. According to the learned counsel, once by reason of the Constitution (Forty-sixth Amendment) Act the hire-purchase/ leasing is deemed to be a sale, any attempt to levy service tax on the same transaction will amount to a colourable exercise of power. According to the learned counsel, when sales tax is already paid for the transfer of the right to use the goods particularly when such transfer is a deemed sale under Article 366(29A), it is not open to Parliament to impose service tax on the same transaction once again. According to the learned counsel, the impugned judgment of the High Court assumes erroneously that hire-purchase/ leasing transactions include the concept of rendition of service and, thus, the impugned judgment needs to be set aside.

6. Mr. T.R. Andhyarujina, learned senior counsel appearing on behalf of one of the appellants, submitted that prior to the Constitution (Forty-sixth Amendment) Act, the Parliament had

the legislative competence to levy service tax on a hire-purchase transaction or leasing transaction; except on the sale part in such transaction, which lay in the competence of the States under Entry 54, List II. In this connection, learned counsel placed reliance on the judgment of this Court in **K.L. Johar and Co. v. Deputy Commercial Tax Officer** [(1965) 2 SCR 112]. That, by the Constitution (Forty-sixth Amendment) Act in Article 366(29A)(c) and (d), hire-purchase/ leasing transactions were deemed to be sales and, consequently, the legislative competence in respect of hire part of the transaction was made over to the States. That, the Law Commission in its 61st Report stated that "the other alternative would be to transfer the entire power to the States. This will achieve a merger of the existing power of the States to tax the sale part and the new power to tax the hire part, which will enable state legislatures to provide for a tax on hire purchase price without demarcation". As a consequence of the Constitution (Forty-sixth Amendment) Act, the Parliament's competence to levy a tax on an activity relating to financial leasing services including equipment leasing and hire-purchase is constitutionally truncated by the newly conferred exclusive legislative competence of States over the deemed sales in Article 366(29A)(c) and (d). According to the appellant(s), when Section 65 of the Finance Act imposes a service tax on "value of taxable

services", the value cannot include the elements of transaction of hire-purchase and leasing, which have now been transferred to the exclusive legislative competence of the States. That, although Parliament can levy service tax on the providing of services of hire-purchase and leasing of equipment if the service provider levies a charge by way of management fee, processing fee, documentation charges or administrative fees, the Parliament cannot levy a service tax in respect of the hire part in such transactions in view of the Constitution (Forty-sixth Amendment) Act and, consequently, the Parliament has no legislative competence to levy service tax on the hiring charges in the transaction. The said hiring charges are nothing but interest charges on the finance provided in hiring and leasing and hence the impugned tax cannot extend to tax the interest charged in the transactions. According to the learned counsel, various States have been imposing sales tax/ VAT on the entire transaction of hire-purchase/ leasing including the component of hire charges, interest and other charges. This is done in view of the Constitution (Forty-sixth Amendment) Act. Thus, when sales tax/ VAT is charged by the States on the entire consideration including interest received under the hire-purchase and leasing transactions any tax by Parliament on the same is beyond the competence and residuary power under Entry 97 of List I. Thus,

according to the learned counsel, levy of service tax in respect of the hire part in hire-purchase/ leasing transactions is beyond the competence of the Parliament.

7. Mr. Goolam E. Vahanvati, learned Attorney General for India, submitted that the basic contention advanced on behalf of the appellant(s) is that by reason of introduction of Article 366(29A) by the Constitution (Forty-sixth Amendment) Act, the entire power of taxation in respect of hire-purchase transactions is now vested only in the States under Entry 54 of List II and that the Parliament has no power at all including the power to levy a service tax. According to the Attorney General, the said argument is based on the contents of the 61st Report of the Law Commission, particularly, in relation to the background in which clauses (c) and (d) of Article 366(29A) were recommended. The learned Attorney General invited our attention to the historical background of Article 366(29A) and the 61st Report of the Law Commission in support of his submission that a legal fiction was sought to be inserted in Article 366 in order to give an artificial extension to the definition of sale so as to include the power to levy sales tax even on the hiring part, and this is all that Article 366(29A) intended to do. From that, according to learned Attorney General, one cannot infer that Parliament has divested itself of the power to levy service tax. According to learned

Attorney General, the question of service tax was not even present in the mind of Parliament when the Constitution (Forty-sixth Amendment) Act was enacted and, therefore, reliance on the 61st Report of the Law Commission was completely misconceived. According to learned Attorney General, the reliance placed on Para 44 of the **Bharat Sanchar Nigam Limited** (supra) by the appellant(s) is completely misconceived because that judgment read in entirety recognizes the power of Union of India to levy service tax. The learned Attorney General placed heavy reliance on the judgment of this Court in **All-India Federation of Tax Practitioners v. Union of India [(2007) 7 SCC 527]**. The learned Attorney General drew our attention to the conceptual distinction between a service tax and a tax on hiring transaction. According to him, the business of banking or organizing financial services is an organized activity and service tax is imposed on that activity of financial leasing services provided by a banking company, a non-banking financial company, a body corporate engaged in the business of financial leasing, etc. That, service tax is not imposed on the hiring part of a hire-purchase transaction. According to the learned Attorney General, it is wrong to suggest that the whole "field" is covered by Entry 54 of List II as is sought to be contended on behalf of the appellant(s) because Article 366(29A), by way of a legal fiction, deems a tax on

the delivery of goods on hire purchase to be a sale. To interpret this fiction to mean that even a tax on financial leasing services is a tax on delivery of goods amounts to creating a fiction within a fiction, which is impermissible in law. Therefore, according to the learned Attorney General, there is no question of the impugned levy being a levy of service tax on a hire-purchase transaction. Relying on the doctrine of pith and substance, it was submitted that the substance of the impugned law must be looked at in order to determine whether it is in pith and substance within a particular entry whatever its ancillary effect may be. Applying the said test, it was submitted that imposition of service tax on financial leasing services including equipment leasing and hire purchase does not, in pith and substance, fall within the scope of Entry 54 of List II as extended by Article 366(29A). On the other hand, according to the learned Attorney General, in three decisions of this Court in the case of **T.N. Kalayana Mandapam Association v. Union of India [(2004) 5 SCC 632], Gujarat Ambuja Cements Ltd. v. Union of India [(2005) 4 SCC 214] and All-India Federation of Tax Practitioners (supra)**, it has been held that levy of service tax falls within Entry 97 of List I. For the afore-stated reasons, it was submitted that the impugned levy is within the legislative competence of Parliament with reference to Entry 97 of List I of Seventh Schedule of the

Constitution and, thus, the same is constitutionally valid.

Relevant provisions of the Finance Act, 2001 (as amended)

8. By the Finance Act, 2001, Section 65 of the Finance Act, 1994 stood substituted. For deciding this batch of cases, we are concerned with Section 65(10) read with Section 65(72)(zm), relevant parts whereof are quoted hereinbelow:

> "**65. Definitions**- In this Chapter, unless the context otherwise requires,-
>
> **(10)** "**banking and other financial services**" means, the following services provided by a banking company or a financial institution including a non-banking financial company, namely:-
>
> (i) financial leasing services including equipment leasing and hire-purchase by a body corporate;
>
> **(72)** "**taxable service**" means any service provided,-
>
> **(zm)** to a customer, by a banking company or a financial institution including a non-banking financial company, in relation to banking and other financial services;"

9. The point to be noted is that whereas Section 65(10)/Section 65(12) defines what is "banking and other financial services", Section 65(72)(zm)/Section 65(105)(zm) indicates what is "taxable service". Section 65(12) read with Section 65(105)(zm), as amended, read as under:

"**65. Definitions**.-- In this Chapter, unless the context otherwise requires,--

(12) "**banking and other financial service**" means--

(a) the following services provided by a banking company or a financial institution including a non-banking financial company or any other body corporate, namely:-

(i) financial leasing services including equipment leasing and hire-purchase by a body corporate;

(105) "**taxable service**" means any service provided,--

(zm) to a customer, by a banking company or a financial institution including a non-banking financial company, in relation to banking and other financial services;"

10. We also quote hereinbelow Section 66 of Finance Act, 2001 which deals with charge of service tax and the relevant portion whereof reads as under:

"**66. Charge of service tax**- (1) On and from the date of commencement of this Chapter, there shall be levied a tax (hereinafter referred to as the service tax), at the rate of five per cent. of the value of the taxable services referred to in sub-clauses (a), (b) and (d) of clause (72) of section 65 and collected in such manner as may be prescribed."

11. We also quote hereinbelow Section 67 of Finance Act, 2001 which deals with valuation of taxable services for charging service tax. The relevant portion of Section 67 is quoted herebelow:

"**67. Valuation of taxable services for charging service tax**- For the purposes of this Chapter, the value of any taxable service shall be the gross amount charged by the service provider for such service rendered by him."

12. Since in this batch of cases there is a challenge to the Constitutional validity of the imposition of service tax on hire-purchase/ lease transactions, we are also required to quote hereinbelow Article 366(29A) of the Constitution:

"(29A) "tax on the sale or purchase of goods" includes--

(a) a tax on the transfer, otherwise than in pursuance of a contract, of property in any goods for cash, deferred payment or other valuable consideration;

(b) a tax on the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract;

(c) a tax on the delivery of goods on hire-purchase or any system of payment by installments;

(d) a tax on the 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;

(e) a tax on the supply of goods by any unincorporated association or body of persons to a member thereof for cash, deferred payment or other valuable consideration;

(f) a tax on the supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food

or any other article for human consumption or any drink (whether or not intoxicating), where such supply or service, is for cash, deferred payment or other valuable consideration,

and such transfer, delivery or supply of any goods shall be deemed to be a sale of those goods by the person making the transfer, delivery or supply and a purchase of those goods by the person to whom such transfer, delivery or supply is made;"

13. We also quote hereinbelow Articles 246 and 248 of the Constitution, which read as follows:

"246 - Subject-matter of laws made by Parliament and by the Legislatures of States

(1) Notwithstanding anything in clauses (2) and (3), Parliament has exclusive power to make laws with respect to any of the matters enumerated in List 1 in the Seventh Schedule (in this Constitution referred to as the "Union List").

(2) Notwithstanding anything in clause (3), Parliament and subject to clause (1), the Legislature of any State also, have power to make laws with respect to any of the matters enumerated in List III in the Seventh Schedule (in this Constitution referred to as the "Concurrent List").

(3) Subject to clauses (1) and (2), the Legislature of any State has exclusive power to make laws for such State or any part thereof with respect to any of the matters enumerated in List II in the Seventh Schedule (in this Constitution referred to as the 'State List').

(4) Parliament has power to make laws with respect to any matter for any part of the territory of India not included in a State notwithstanding that such matter is a matter enumerated in the State List.

248 - Residuary powers of legislation

(1) Parliament has exclusive power to make any law with respect to any matter not enumerated in the Concurrent List or State List.

(2) Such power shall include the power of making any law imposing a tax not mentioned in either of those Lists."

14. We are also required to quote Entry 97 of List I, which reads as under:

"**97**. Any other matter not enumerated in List II or List III including any tax not mentioned in either of those Lists."

15. We quote hereinbelow Entry 54 of List II, which reads as under:

"**54**. Taxes on the sale or purchase of goods other than newspapers, subject to the provisions of entry 92A of List I."

Meaning of the words "banking and other financial services" in Section 65(12) of Finance Act, 1994

16. Before dealing with the submissions we need to clarify the concept of "banking and other financial services" which expression finds place in Section 65(12)(a)(i) of the Finance Act,

1994 (as amended).

17. At the outset, it may be noted that the Appellant(s) is a non-banking financial company ["NBFC", for short]. The RBI was constituted under the RBI Act, 1934 ("1934 Act", for short) inter alia to regulate the country's monetary system. It is appointed as a regulator to secure the monetary stability and to operate the credit system of the country. Chapter III-B of the 1934 Act deals with provisions relating to NBFCs and financial institutions. Under Section 45-I(a), "the business of a NBFC" is defined to mean carrying on the business of a financial institution referred to in clause (c) of Section 45-I and includes business of a NBFC. The expression "financial institution" means any non-banking institution which carries on as its business an activity inter alia of financing, whether by way of making loans or advances or otherwise. Thus, Section 45-I(c) treats financing as an activity. Under Section 45-I(f), an NBFC is defined to mean a financial institution which is a company; a non-banking institution which is a company and which as a matter of business receives deposits or which lends in any manner. These activities are regulated by RBI under the 1934 Act. Thus, all NBFCs which carry on these activities as part of their business come within the purview of being financial institutions. Under Section 45-IA, no NBFC shall carry on the business of a non-banking financial institution

without obtaining a certificate of registration from RBI. Under Section 45-JA the RBI is authorized in public interest to issue directions to NBFCs relating to income recognition, accounting standards, deployment of funds etc. and such NBFCs shall be bound to follow the policy so determined. Accordingly, under notification dated 2.1.1998 bearing No. 114, the deposit taking activities of NBFCs was sought to be regulated. Under the said notification, there is classification of NBFCs. Vide Clause 5 it has been clarified that several instances have come to the notice of RBI where NBFCs conducting their business as loan companies claim themselves to be equipment leasing/hire-purchase finance companies with the intention to avail of higher borrowing limits and thus an NBFC having not less than 60% of its assets and deriving not less than 60% of its income from equipment leasing and hire-purchase activities taken together will only be eligible for being classified as equipment leasing company/hire-purchase finance company. The said notification is relied upon only to demonstrate that the classification of loan or investment companies is not only asset and income based but also that certain NBFCs undertake activities of equipment leasing and hire-purchase financing in addition to giving of loans. Under clause (a) of the said Direction, RBI has categorized NBFCs on the basis of the businesses in which they are engaged including

giving of loans, hire-purchase finance and equipment leasing activities [See Taxmann's Statutory Guide to NBFCs page 224].

18. The Institute of Chartered Accountants of India (ICAI) has also issued AS-19 "Accounting for Leases". It is mandatory in respect of financial leases executed on or after April, 2001. It inter alia provides for capitalization of finance lease assets in the books of the lessee instead of lessor. The lessor [NBFC] is required to show the assets leased only as receivables in its balance sheet instead of as fixed assets. The implication of the above AS-19 for the NBFC prescribed by RBI vide amendments to the 1998 Directions is that all financial leases would now be accounted like hire-purchase transactions [See Manual of NBFCs 9th Edition Page 268]. Similarly, under the RBI Guidelines dealing with accounting for investments, NBFCs having not less than 60% of the total assets in lease and hire purchase and deriving not less than 60% of their total income from such activities can be classified as hire purchase/ equipment leasing companies. All these circulars and guidelines issued by RBI are relied upon only to show that equipment leasing and hire-purchase are activities undertaken as business by NBFCs which are regulated as para banking activities by the RBI under the provisions of the 1934 Act. They are regulated not only to protect depositors but also customers [See Section 45-I(c)(iii)(i)]. The

above activities are financing activities encompassed under Section 45-I(c)(i) which in turn constitutes "rendition of services to its customer(s)" which is the taxable event under Section 65(105)(zm) of the Finance Act, 1994 (as amended). Apart from NBFCs, even banks through their subsidiaries with the approval of RBI can undertake equipment leasing, hire-purchase business and financial services. These are not direct lending activities. However, RBI treats them as services or facilities. The financial facilities are extended by way of equipment leasing or hire-purchase finance subject to approval of RBI [See Taxmann's RBI Instructions for Banking Operations 7th Edition page 224].

19. The significance of the above circulars and guidelines is to show that the activities undertaken by NBFCs of equipment leasing and hire-purchase finance are facilities extended by NBFCs to their customers; that, they are financial services rendered by NBFCs to their customers and that they fall within the meaning of the words "banking and other financial services" which is sought to be brought within the service tax net under Section 66 of the Finance Act, 1994. One more aspect needs to be highlighted. With the application of AS-19, the leased assets are required to be shown as "receivables" and not as fixed assets which further shows that equipment leasing and hire-purchase finance are financial facilities which thereby funds projects

presented by the customers to banks and other financial institutions including NBFCs. Thus, the impugned tax is levied on these services as taxable services. It is not a tax on material or sale. The taxable event is rendition of service. Hence, the impugned tax is different and distinct from tax on sale of goods under Entry 54 List II of the VIIth Schedule to the Constitution.

20. According to Sale of Goods Act by Mulla [6th Edition] a common method of selling goods is by means of an agreement commonly known as a hire-purchase agreement which is more aptly described as a hiring agreement coupled with an option to purchase, i.e., to say that the owner lets out the chattel on hire and undertakes to sell it to the hirer on his making certain number of payments. If that is the real effect of the agreement there is no contract of sale until the hirer has made the required number of payments and he remains a bailee till then. But some so-called hire-purchase agreements are in reality contracts to purchase, the price to be paid by instalments and in those cases the contract is a contract of sale and not of hiring. It depends on the terms of the contract whether it is to be regarded as a contract of hiring or a contract of sale. A hire-purchase agreement partakes of the nature of a contract of bailment with an element of sale added to it. However, if the intention of the financing party in obtaining the hire-purchase and the allied

agreements is to secure the return of the loan advanced to its customer the transaction would be merely a financing transaction. [See page 75]. The point which needs to be re-stated is that the funding activity undertaken by the financing party which could be in the form of loan or equipment leasing or hire-purchase financing, would be exigible to service tax if such activity falls in the category of "banking and other financial services" under Section 65(12) of the Finance Act, 1994. The financial transaction was earlier out of the tax net. In the process there are two different and distinct transactions, viz., the financing transaction and the equipment leasing/hire-purchase transaction. The former is exigible to service tax under Section 66 of Finance Act, 1994 (as amended) whereas the latter would be exigible to local sales tax/VAT. Funding or financing the transaction of equipment leasing and hire-purchase covers two different and distinct transactions. The activity of funding or financing by NBFC who is in the business of financing by giving loans, or equipment leasing or hire-purchase finance falls in the category of financial services rendered by NBFCs to their customers. It is an activity in relation to the hire-purchase or lease transaction. In this connection, as and by way of illustration we need to give an illustration which brings out the distinction between a "finance lease" and "operating lease". A

finance lease transfers all the risks and rewards incidental to ownership, even though the title may or may not be eventually transferred to the lessee. In the case of "finance lease" the lessee could use the asset for its entire economic life and thereby acquires risks and rewards incidental to the ownership of such assets. In substance, finance lease is a financial loan from the lessor to the lessee. On the other hand an operating lease is a lease other than the finance lease. Accounting of a "finance lease" is under AS-19, which as stated above, is mandatory for NBFCs. It is a completely different regime. According to Chitty on Contract, a hire-purchase agreement is a vehicle of instalment credit. It is an agreement under which an owner lets chattels out on hire and further agrees that the hirer may either return the goods and terminate the hiring or elect to purchase the goods when the payments for hire have reached a sum equal to the amount of the purchase price stated in the agreement or upon payment of a stated sum. The essence of the transaction is bailment of goods by the owner to the hirer and the agreement by which the hirer has the option to return the goods at some time or the other [See para 36.242, 36.243]. Further, in the bailment termed "hire" the bailee receives both possession of the chattel and the right to use it in return for remuneration to be paid to the bailor [See para 32.045]. Further, under the head

"equipment leasing", it is explained that it is a form of long-term financing. In a finance lease, it is the lessee who selects the equipment to be supplied by the dealer or the manufacturer, but the lessor [finance company] provides the funds, acquires the title to the equipment and allows the lessee to use it for its expected life. During the period of the lease the risk and rewards of ownership are transferred to the lessee who bears the risks of loss, destruction and depreciation or malfunctioning. The bailment which underlies finance leasing is only a device to provide the finance company with a security interest [its reversionary right]. If the lease is terminated prematurely, the lessor is entitled to recoup its capital investment [less the realizable value of the equipment at the time] and its expected finance charges [less an allowance to reflect the return of the capital] [para 32.057]. In the case of hire-purchase agreement the periodical payments made by the hirer is made up of :

(a) consideration for hire

(b) payment on account of purchase

21. To sum up, NBFCs essentially are loan companies. They basically conduct their business as loan companies. They could be in addition thereto in the business of equipment leasing, hire purchase finance and investment. Because NBFCs are basically loan companies, they are required to show the assets leased as

"receivables" in their balance sheets. That, the activities of hire-purchase finance/equipment leasing undertaken by NBFCs come under the category of "para banking". That, in substance a finance lease, unlike an operating lease, is a financial loan (assistance/facility) by the lessor to the lessee. That, in the bailment termed "hire" the bailee receives both possession of the chattel and the right to use it in return for remuneration. On the other hand, equipment leasing is long term financing which helps the borrower to raise funds without outright payment in the first instance. Here the "interest" element cannot be compared to consideration for lease/hire which is in the nature of remuneration (consideration) for hire. Thus, financing as an activity or business of NBFCs is different and distinct from operating lease/hire-purchase agreements in the classical sense. The elements of the finance lease or loan transaction are quite different from those in equipment leasing/hire-purchase agreements between owner (lessor) and the hirer (lessee). There are two independent transactions and what the impugned tax seeks to do is to tax the financial facilities extended to its customers by the NBFCs under Section 66 of the 1994 Act (as amended) as they come under "banking and other financial services" under Section 65(12) of the said Act. "The finance lease" and "the hire-purchase finance" thus squarely come under

the expression "financial leasing services" in Section 65(12) of the Finance Act, 1994 (as amended).

Nature and character of service-tax

22. In **All India Federation of Tax Practitioners' case** (supra), this Court explained the concept of service tax and held that service tax is a Value Added Tax ('VAT' for short) which in turn is a destination based consumption tax in the sense that it is levied on commercial activities and it is not a charge on the business but on the consumer. That, service tax is an economic concept based on the *principle of equivalence* in a sense that consumption of goods and consumption of services are similar as they both satisfy human needs. Today with the technological advancement there is a very thin line which divides a "sale" from "service". That, applying the *principle of equivalence*, there is no difference between production or manufacture of saleable goods and production of marketable/saleable services in the form of an activity undertaken by the service provider for consideration, which correspondingly stands consumed by the service receiver. It is this *principle of equivalence* which is inbuilt into the concept of service tax under the Finance Act, 1994. That service tax is, therefore, a tax on an activity. That, service tax is a value added tax. The value addition is on account of the activity which provides value addition, for example, an activity undertaken by a

chartered accountant or a broker is an activity undertaken by him based on his performance and skill. This is from the point of view of the professional. However, from the point of view of his client, the chartered accountant/broker is his service provider. The value addition comes in on account of the activity undertaken by the professional like tax planning, advising, consultation etc. It gives value addition to the goods manufactured or produced or sold. Thus, service tax is imposed every time service is rendered to the customer/client. This is clear from the provisions of Section 65(105)(zm) of the Finance Act, 1994 (as amended). Thus, the taxable event is each exercise/ activity undertaken by the service provider and each time service tax gets attracted. The same view is reiterated broadly in the earlier judgment of this Court in **Godfrey Phillips India Ltd. v. State of U.P. [(2005 (2) SCC 515]** in which a Constitution Bench observed that in the classical sense a tax is composed of two elements : the person, thing or activity on which tax is imposed. Thus, every tax may be levied on an object or on the event of taxation. Service tax is, thus, a tax on activity whereas sales tax is a tax on sale of a thing or goods.

Law as it stood before the Constitution (Forty-sixth Amendment) Act, 1982:

23. The principle that legislative entries must be given the

widest interpretation is subject to the exception that where the entries use legal terms, they must be given their legal meaning. This principle was established in **The State of Madras v. Gannon Dunkerley & Co., (Madras) Ltd.** [(1959) SCR 379] where it was held that in Entry 48 List II, Seventh Schedule of the Government of India Act, 1935, the words "sale of goods" had the same meaning which those words have in the Sale of Goods Act, 1930 ("1930 Act" for short). Thus, a legislature cannot extend its taxing power by defining the words "sale of goods" to cover transactions which did not constitute "sale of goods" within the 1930 Act. Accordingly, it was held in **Gannon Dunkerley's case** that in a building contract there was neither a contract to sell materials used in the construction nor did the property in the materials pass as movables. Accordingly, it was held that the provisions of the Madras General Sales Tax (Amendment) Act, 1947 defining a sale to include "a works contract" were ultra vires. It was held that the exercise of legislative power by the State legislature was an exercise to enlarge that power which would amount to amending Entry 54 of List II by an ordinary law which was impermissible because under that Entry the subject of the legislative power was tax on sale of goods.

24. The word "sale" is a *nomen juris.* It is the name of a consensual contract. The law with regard to chattels is embodied

in the Sale of Goods Act. A contract of sale is different from an agreement to sell and unlike other contracts, operates by itself and without delivery to transfer the property in the goods sold. The word "sale" connotes both a contract and a conveyance or transfer of property. The law relating to building contracts was well-known when **Gannon Dunkerley's case** was decided and under that law the supply of goods as part of the works contract was not a sale. Thus, the essential ingredients of the "sale" are agreement to sell movables for a price and property passing therein pursuant to an agreement. Therefore, to allow subsequent exercise of legislative power to enlarge that power, would be to amend the entry relating to that power in the Constitution by an ordinary law, which is not permissible. The principle of **Gannon Dunkerley's case**, however, has no application to a law enacted by the Parliament imposing sales tax on supply of materials in building contracts since Parliament has power to legislate in respect of Part C States under Article 246(4). It is important to note that such power in the Parliament on the above matter could also be found in Entry 97, List I read with Article 248(2). Entry 97 gives effect to Article 248. Thus, although a sales tax on materials supplied under a building contract is outside Entry 54, List II, as held in **Gannon Dunkerley's case**, Parliament has power to impose such a tax.

[See Constitutional Law of India by H.M. Seervai, pp. 2437]

25. In **K.L. Johar and Co. v. Deputy Commercial Tax Officer** [(1965) 2 SCR 112], this Court held that a hire-purchase agreement had two elements, an element of bail and an element of sale. When all the terms of the said agreement stood satisfied and the option to purchase was exercised, only at that stage sales tax would be exigible; but the legislature would have no power to tax such agreements till that stage was reached. Till that stage, a hire-purchase agreement is not a sale. It is important to note that under **K.L. Johar's** case, bailment termed as "hire" fell within the competence of the Parliament, the tax on sale of goods came within the competence of the State Legislature. Further, delivery which is the essence of bailment was not treated as an essential element of sale as a taxable event and as a result certain consequences as enumerated in the Statement of Objects and Reasons to the Constitution (Forty-sixth Amendment) Act ensued, as highlighted hereinbelow.

26. It is in view of the above problems, that the Constitution (Forty-sixth Amendment) Act, 1982 came to be enacted. The 61st Report of the Law Commission begins with the genesis. One of the points referred to in the Law Commission's Report related to the restricted scope for the levy of sales tax by State Governments

in respect of works-contract and hire-purchase transactions. In the report it has been stated vide paras 1.6 & 1.7 at page 10 "since the expression 'sale of goods' in Entry 54 of State List has the same meaning as in Sale of Goods Act, a hire-purchase agreement is not a sale, as no property passes in such a transaction until the option to purchase is exercised and the other terms of the agreement are fulfilled. Similarly, in a building contract, which is indivisible, there is no sale of goods. It is contract of works. Similarly, a transaction between an hotelier and a resident customer is one of 'service' and is not taxable as 'sale of goods'; if there is a consolidated charge for boarding and lodging". That, **Gannon Dunkerley's case** is an example of composite contracts, involving supply of goods and services. It is in this background that we have considered the question whether the power to tax indivisible contracts of works should be conferred on the States. It is in the above background that the Law Commission in fact observes "Supreme Court with respect appears to have adopted an unusually restricted interpretation of the word "sale"". It is true that the word "sale" is not defined in the Constitution but is well recognized canon of construction that the words used in the three legislative Lists should receive the widest interpretation and not to the narrow definition of the word "sale" contained in the Sale of Goods Act for the purpose of

interpreting that expression in Entry 54, List II. That is the principal juridical ground on which we have expressed our preference for the transfer of power to tax such contracts to the State Legislatures. That, the Commission would prefer restoration of the power to State legislature [See pages 19 and 20]. Thus, to restore the power to levy sales tax on such contracts, the Commission suggested the third out of the three below-mentioned alternatives:

(i) amending State List Entry 54;

(ii) adding a fresh Entry in the State List;

(iii) inserting in Article 366 a wide definition of "sale" so as to include works contract.

27. It is the third alternative that brought in Article 366(29A) vide the Constitution (Forty-sixth Amendment) Act, 1982 (page 21). Even in the context of hire-purchase contracts the same alternative is opted for by the Commission. However, two observations of the Commission may be noticed. The first is in para 25, page 32. It reads as follows:

> "The effect of the judgment in K.L. Johar's case is to reduce the tax base on which sales tax is payable. A tax on hire-purchase without sale can be levied on the full value of the hire-purchase transaction by the Union under the residuary power – entry 97 of Union List."

28. To the same effect is the observation of the Commission

at page 37:

> "The power to tax hire-purchase within the State also vests in the Union under Union List, entry 97."

29. Thus, before the Constitution (Forty-sixth Amendment) Act, hire-purchase transaction could have been taxed by Union under Entry 97, List I but as a matter of policy Parliament brought in Article 366 (29A) as recommended by the Commission. The point to be noted is that reliance on the report [though it helps our above reasoning on some of the aspects] placed by the appellant (s) only shows that service tax was not in the mind of Parliament when the Constitution (Forty-sixth Amendment) Act stood enacted. It was not even in the mind of the Law Commission. That, as stated above, only on the principal juridical ground that the word "sale" in Entry 54, List II should have been read widely, the Commission suggested that Article 366 be amended so that power to tax such contracts remains with the State Legislature as originally intended. In fact at page 20, the Commission states "before the judgment of the Supreme Court in Gannon Dunkerley's case, the word "sale" was usually regarded as including works contract and works contract was regarded as falling in Entry 54, List II and that taxes were in fact being levied and recovered by the States".

Scope of Article 366(29A)

30. If one examines Article 366(29A) carefully, one finds that clause (29A) provides for an inclusive definition and has two limbs. The first limb says that the tax on sale or purchase of goods includes a tax on transactions specified in sub-clauses (a) to (f). The second limb provides that such transfer, delivery or supply of goods referred to in the first limb shall be deemed to be a sale of those goods by the person making the transfer, delivery or supply and purchase of those goods by the person to whom such transfer, delivery or supply is made. Now, in **K.L. Johar's case**, this Court held that the States can tax hire-purchase transactions resulting in sale but only to the extent to which tax is levied on the sale price. This led the Parliament to say, in the Statement of Objects and Reasons to the Constitution (Forty-sixth Amendment) Act, "though practically the purchaser in a hire-purchase transaction gets the goods on the date of entering into the hire-purchase contract, it has been held by the Supreme Court in **K.L. Johar's case** that there is a sale only when the purchaser exercises the option to purchase which is at a later date and therefore only the depreciated value of the goods involved in such transaction at the time the option is exercised becomes assessable to sales tax which position has resulted in avoidance of tax in various ways." Thus, we find from the Statement of Objects and Reasons that the concept of "deemed

sale" is brought in by the Constitution (Forty-sixth Amendment) Act only in the context of imposition of sales tax and that the words "transfer, delivery or supply" of goods is referred to in the second limb of Article 366(29A) to broaden the tax base and that as indicated in the Report of Law Commission prior to the judgment of this Court in **Gannon Dunkerley's case**, works contract was always taxed by the States as part of the word "sale" in Entry 48/54 of List II. The object behind enactment of Article 366(29A) is to tax the composite price so that the full value of the hire-purchase price is taxed and to avoid the judgment in **K.L. Johar's case** whose implication was to narrow the tax base resulting in seepage of sales tax revenue. It is in that sense "splitting" of the contract needs to be understood. Thus, it cannot be said that Parliament divested itself of the power to levy service tax vide enactment of the Constitution (Forty-sixth Amendment) Act. Even in the Report of the Law Commission, it has been observed that "if a hire-purchase transaction results in a sale, sales-tax is undoubtedly leviable by the States. No doubt, it is difficult to determine the "sale price" for the purpose of the sales tax law but this has no bearing on the question of legislative competence" (page 26). Thus, reliance placed by the appellant(s) on the expression "splitting up" in **K.L. Johar's case** is misconceived because the "splitting up" referred to in **K.L.**

Johar's case was, as stated above, in regard to valuation and not in regard to legislative competence.

Whether the State Legislature has the exclusive competence to levy tax on "financial leasing services" under Entry 54, List II?

31. On behalf of the appellant(s) it was submitted that the State Legislature has the exclusive competence to levy a tax on hire-purchase and financial leasing by reason of Entry 54, List II read with Article 366(29A). It was submitted that, as held by this Court in the case of **Bharat Sanchar Nigam Limited** (supra) [vide para 44], splitting was permissible under Article 366(29A) only in two cases indicated in sub-clauses (b) and (f) and that in no other service (including hire-purchase).

32. For answering the above, we need to keep in mind the doctrine of "pith and substance" and the rule of interpretation of legislative entries. These have to be applied to what is stated hereinabove in the earlier part of our judgment in which we have dealt with the concept of "banking and other financial services" and the nature and character of "service tax" as a tax on activities. We may reiterate that Equipment Leasing and Hire-Purchase Finance are activities of long term financing and they fall within the ambit of "banking and other financial services". As stated above, a financial lease is a lease that transfers

substantially all risks and rewards incident to ownership. In the said lease, the lessor (NBFC) merely **finances** the equipment/ asset which the lessee is free to select, order, take delivery and maintain. The lessor (NBFC) arranges the funding. It accepts the invoice from the vendor (supplier) and pays him. The income which the lessor earns is by way of finance/ interest charges in addition to the management fees or documentation charges, etc. It is this income which constitutes the measure of tax for the purposes of calculating the value of taxable services under Section 67 of the Finance Act, 1994. Thus, a financial lease would come within "financial leasing services" in terms of Section 65(12)(a)(i). There are different types of financial leases, namely, a tax-based financial lease, a leverage lease and an operating lease. In the present case, there is no adjudication of the matter. The appellant(s) approached the High Court directly without proper adjudication by the competent authority under the Finance Act, 1994. Even in the matter of allocation between the principal and finance/ interest charges, adjudication under the Act was warranted which has not been done. One must also bear in mind that Article 366(29A) is essentially sales tax specific. It was brought in to expand the tax base which stood narrowed down because of certain judgments of this Court. That is the reason for bringing in the concept of "deemed sale" under which

tax could be imposed on mere "delivery" on hire-purchase [See clause (c)] which expression is also there in the second limb of the said article.

33. To begin we would like to quote hereinbelow from the judgment of this Court the relevant observations in the case of **The Second Gift Tax Officer, Mangalore v. D.H. Hazareth [AIR 1970 SC 999]** on the doctrine of pith and substance:

> "The sovereignty of Parliament and the Legislatures is a sovereignty of enumerated entries, but within the ambit of an entry, the exercise of power is as plenary as any Legislature can possess, subject, of course, to the limitations arising from the fundamental rights. The entries themselves do not follow any logical classification or dichotomy. As was said in State of Rajasthan v. S. Chawla (1959) Supp 1 SCR 904 = (AIR 1959 SC 544) the entries in the Lists must be regarded as enumeratio simplex of broad categories. Since they are likely to overlap occasionally, it is usual to examine the pith and substance of legislation with a view to determining to which entry they can be substantially related, a slight connection with another entry in another List notwithstanding. Therefore, to find out whether a piece of legislation falls within any entry, its true nature and character must be in respect to that particular entry. The entries must of course receive a large and liberal interpretation because the few words of the entry are intended to confer vast and plenary powers. If, however, no entry in any of the three Lists covers it, then it must be regarded as a matter not enumerated in any of the three Lists. Then it belongs exclusively to Parliament under entry 97 of the Union List as a topic of legislation."

34. We also quote hereinbelow the relevant observations in the case of **M/s Ujagar Prints (II) v. Union of India [(1989) 3**

SCC 488]:

> "Entries to the legislative lists, it must be recalled, are not sources of the legislative power but are merely topics or fields of legislation and must receive a liberal construction inspired by a broad and generous spirit and not in a narrow pedantic sense. The expression "with respect to" in Article 246 brings in the doctrine of "Pith and Substance" in the understanding of the exertion of the legislative power and wherever the question of legislative competence is raised the test is whether the legislation, looked at as a whole, is substantially 'with respect to' the particular topic of legislation. If the legislation has a substantial and not merely a remote connection with the entry, the matter may well be taken to be legislation on the topic."

35. On the interpretation of legislative entries the law is well-settled by the judgment of this Court in the case of **M/s. International Tourist Corporation v. State of Haryana [AIR 1981 SC 774]** in the following terms:

> "…Before exclusive legislative competence can be claimed for Parliament by resort to the residuary power, the legislative incompetence of the State legislative must be clearly established. Entry 97 itself is specific that a matter can be brought under that entry only if it is not enumerated in List II or List III and in the case of a tax if it is not mentioned in either of those Lists. In a Federal Constitution like ours where there is a division of legislative subjects but the residuary power is vested in Parliament, such residuary power cannot be so expansively interpreted as to whittle down the power of the State Legislature. That might affect and jeopardise the very federal principle. The federal nature of the Constitution demands that an interpretation which would allow the exercise of legislative power by Parliament pursuant to the residuary powers vested in it to trench upon State legislation and which would thereby destroy or belittle State autonomy must be rejected . . ."

36. Now coming to the main point whether the whole field is covered by Entry 54 and that the levy of service tax is incompetent, it is important to note the language of Entry 97, List I and Article 248 except for the word "other" in Entry 97. This is because when one reads Entry 97 of List I with Article 246(1) it confers exclusive power first, to make laws in respect of matters specified in Entries 1 to 96 in List I and, secondly, it confers the residuary power of making laws by Entry 97. Article 248 does not provide for any express powers of Parliament but only for its residuary power. Article 248 adds nothing to the power conferred by Article 246(1) read with Entry 97, List I. In the context of an exhaustive enumeration of subjects of legislation what does the conferment of residuary power mean? Entry 97, List I which confers residuary powers on Parliament provides "any other matter not enumerated in List II and List III including any tax not mentioned in either of those lists". The word "other" is important. It means "any subject of legislation other than the subject mentioned in Entries 1-96". Lastly, we must keep in mind a clear distinction between the subject and measure of tax. [See **Goodricke Group Ltd. v. State of West Bengal, (1995) Suppl 1 SCC 707]**

37. Applying the above decisions to the present case, on examination of the impugned legislation in its entirety, we are of

the view that the impugned levy relates to or is with respect to the particular topic of "banking and other financial services" which includes within it one of the several enumerated services, viz., financial leasing services. These include long time financing by banks and other financial institutions (including NBFCs). These are services rendered to their customers which comes within the meaning of the expression "taxable services" as defined in Section 65(105)(zm). The taxable event under the impugned law is the rendition of service. The impugned tax is not on material or sale. It is on activity/ service rendered by the service provider to its customer. Equipment Leasing/ Hire-Purchase finance are long term financing activities undertaken as their business by NBFCs. As far as the taxable value in case of financial leasing including equipment leasing and hire-purchase is concerned, the amount received as principal is not the consideration for services rendered. Such amount is credited to the capital account of the lessor/ hire-purchase service provider. It is the interest/ finance charge which is treated as income or revenue and which is credited to the revenue account. Such interest or finance charges together with the lease management fee/ processing fee/ documentation charges are treated as considerations for the services rendered and accordingly they constitute the value of taxable services on which service tax is

made payable. In fact, the Government has given exemption from payment of service tax to financial leasing services including equipment leasing and hire-purchase on that portion of taxable value comprising of 90% of the amount representing as interest, i.e., the difference between the instalment paid towards repayment of the lease amount and the principal amount in such instalments paid (See Notification No. 4/2006 – Service Tax dated 1.3.2006). In other words, service tax is leviable only on 10% of the interest portion. (See also Circular F.No. B.11/1/2001-TRU dated 9.7.2001 in which it has been clarified that service tax, in the case of financial leasing including equipment leasing and hire-purchase, will be leviable only on the lease management fees/ processing fees/ documentation charges recovered at the time of entering into the agreement and on the finance/ interest charges recovered in equated monthly instalments and not on the principal amount). Merely because for valuation purposes inter alia "finance/ interest charges" are taken into account and merely because service tax is imposed on financial services with reference to "hiring/ interest" charges, the impugned tax does not cease to be service tax and nor does it become tax on hire-purchase/ leasing transactions under Article 366(29A) read with Entry 54, List II. Thus, while State Legislature is competent to impose tax on "sale" by legislation relatable to Entry 54 of List II

of Seventh Schedule, tax on the aspect of the "services", vendor not being relatable to any entry in the State List, would be within the legislative competence of the Parliament under Article 248 read with Entry 97 of List I of Seventh Schedule to the Constitution.

38. According to Mr. Arvind Datar and Mr. K. Parasaran, learned counsel appearing on behalf of some of the appellants, once the subject matter of hire-purchase and leasing is constitutionally characterized as a sale (deemed sale) by the Constitution (Forty-sixth Amendment) Act, the said subject matter can be taxed only under Entry 54, List II and it cannot be taxed under Entry 97, List I. According to the learned counsel, the object behind enactment of the Constitution (Forty-sixth Amendment) Act was to reserve the exclusive competence to tax hire-purchase transactions with the State Legislature and exclude the Parliament from the legislative sphere. In support of the above contentions, learned counsel placed reliance on para 44 of the judgment of this Court in the case of **Bharat Sanchar Nigam Limited** (supra), the relevant portion of which is quoted hereinbelow:

> "44. Of all the different kinds of composite transactions, the drafters of the Forty-Sixth Amendment chose three specifications, a works contract, a hire-purchase contract and a catering contract to bring them within the fiction of a deemed sale. Of these three, the

first and third involve a kind of service and sale at the same time."

39. Emphasizing the underlined words, the learned counsel contended that a hire-purchase does not involve a sale and service at the same time and, therefore, service tax cannot be levied on the interest/ finance charges which is sought to be done in the present case. In our view, the judgment in **Bharat Sanchar Nigam Limited's case** has no application to the present case. As stated above, what is challenged in this case is the service tax imposed by Section 66 of the Finance Act, 1994 (as amended) on the value of taxable services referred to in Section 65(105)(zm) read with Section 65(12) of the said Act, insofar as it relates to *financial leasing services* including equipment leasing and hire-purchase as beyond the legislative competence of Parliament by virtue of Article 366(29A) of the Constitution. In short, legislative competence of the Parliament to impose service tax on financial leasing services including equipment leasing and hire-purchase is the subject matter of challenge. Legislative competence was not the issue before this Court in the **Bharat Sanchar Nigam Limited's case**. In that case, the principal question which arose for determination was in respect of the nature of the transaction by which mobile phone connections are enjoyed. The question was whether such connections constituted

a sale or a service or both. If it was a sale then the States were legislatively competent to levy sales tax on the transaction under Entry 54, List II of the Seventh Schedule to the Constitution. If it was service then the Central Government alone had the legislative competence to levy service tax under Entry 97, List I and if the nature of the transaction partook of the character of both sale and service, then the moot question would be whether both the legislative authorities could levy their separate taxes together or only one of them. It was held that the subject transaction was a service and, thus, the Parliament had legislative competence to levy service tax under Entry 97, List I. In para 88 of the said judgment, this Court observed that "No one denies the legislative competence of the States to levy sales tax on sales provided that the necessary concomitants of a sale are present in the transaction and the sale is distinctly discernible in the transaction. This does not however allow the State to entrench upon the Union List and tax services by including the cost of such service in the value of the goods". The principle of law in para 88 squarely applies to the present case. As stated above, we are concerned with "financial leasing services" which are sought to be taxed under Section 65(12)(a)(i). The taxable event is indicated in Section 65(105)(zm). As stated above, the impugned provision operates qua an activity of funding/

financing of equipment/ asset under equipment leasing under which a lessee is free to select, order, take delivery and maintain the asset. The lessor (NBFC) arranges the finances. It accepts the invoice from the vendor (supplier) and pays him. Thus, the lessor (NBFC) renders financial services to its customer(s) and what is taxed under the impugned provision is the income, by way of finance/ interest charges in addition to management fees/ documentation charges, which is earned by the financier (lessor). The taxable event is the service which is rendered by the finance company to its customer(s). The value of taxable service under Section 67 is income by way of interest/finance charges (measure of tax) which is not determinative of the character of the levy. Thus, Section 67 of the Finance Act, 1994 seeks to tax financial services rendered by the appellant(s) with reference to the income which the appellant(s) earns by way of interest/ finance charges. In the circumstances and for the reasons given hereinabove, the question of splitting up of transactions, as contended on behalf of the appellant(s), does not arise. As held hereinabove, equipment leasing and hire-purchase finance constitute long term financing activity. Such an activity was not the subject matter of the discussion in the **Bharat Sanchar Nigam Limited's case**. The service tax in the present case is neither on the material nor on sale. It is on the activity of financing/funding of equipment/

asset within the meaning of the words "financial leasing services" in Section 65(12)(a)(i). Lastly, we may state that this Court has on three different occasions upheld the levy of service with reference to Entry 97 of List I in the face of challenges to the competence of the Parliament based on the entries in List II and on all the three occasions, this Court has held that the levy of service tax falls within Entry 97 of List I. The decisions are in the case of **T.N. Kalayana Mandapam Association (supra), Gujarat Ambuja Cements Ltd. (supra) and All-India Federation of Tax Practitioners (supra)**.

Conclusion

40. As stated above, the appellant(s) had moved the High Court in the writ petition challenging the validity of Section 66 of the Finance Act, 1994 on the value of taxable services referred to in Section 65(105)(zm) read with Section 65(12)(a)(i) without exhausting the statutory remedy. The contracts entered into by the appellant(s) with its customers were not vetted. There has been no adjudication under the Act in most of these cases and, therefore, we hereby direct the competent authority under the Finance Act, 1994 to decide the matter in accordance with the law laid down. Subject to above, for the afore-stated reasons, we hold that the service tax imposed by Section 66 of the Finance Act, 1994 (as amended) on the value of taxable services referred

to in Section 65(105)(zm) read with Section 65(12) of the said Act, insofar as it relates to financial leasing services including equipment leasing and hire-purchase is within the legislative competence of the Parliament under Entry 97, List I of the Seventh Schedule to the Constitution. Accordingly, the appeals are dismissed with no order as to costs.

.....CJI
(S. H. Kapadia)

.....J.
(K.S. Radhakrishnan)

.....J.
(Swatanter Kumar)

New Delhi;
October 26, 2010