Lesson Objectives

- To understand the Concept of Hire Purchase Finance,
- Regulations related to Hire purchase.

Introduction

Hire purchase is a mode of financing the price of the goods to be sold on a future date. In a hire purchase transaction, the goods are let on hire, the purchase price is to be paid in installments and hirer is allowed an option to purchase the goods by paying all the installments. Hire purchase is a method of selling goods. In a hire purchase transaction the goods are let out on hire by a finance company (creditor) to the hire purchase customer (hirer). The buyer is required to pay an agreed amount in periodical installments during a given period. The ownership of the property remains with creditor and passes on to hirer on the payment of the last installment.

A hire purchase agreement is defined in the Hire Purchase Act, 1972 as peculiar kind of transaction in which the goods are let on hire with an option to the hirer to purchase them, with the following stipulations:

a. Payments to be made in installments over a specified period.
b. The possession is delivered to the hirer at the time of entering into the contract.
c. The property in goods passes to the hirer on payment of the last installment.
d. Each installment is treated as hire charges so that if default is made in payment of any installment, the seller becomes entitled to take away the goods, and
e. The hirer/purchase is free to return the goods without being required to pay any further installments falling due after the return.

Features of Hire Purchase Agreement

- Under hire purchase system, the buyer takes possession of goods immediately and agrees to pay the total hire purchase price in installments.
- Each installment is treated as hire charges.
- The ownership of the goods passes from the seller to the buyer on the payment of the last installment.
- In case the buyer makes any default in the payment of any installment the seller has right to repossess the goods from the buyer and forfeit the amount already received treating it as hire charges.
- The hirer has the right to terminate the agreement any time before the property passes. That is, he has the option to return the goods in which case he need not pay installments falling due thereafter. However, he cannot recover the sums already paid as such sums legally represent hire charges on the goods in question.

Hire Purchase v/s Installment Sale

Though both the system of consumer credit are very popular in financing and look similar, there is a clear distinction between the two. In an installment sale, the contract of sale is entered into the goods are delivered and the ownership is transferred to the buyer but the price is paid in specified installments over a period of time.

In hire purchase the hirer can purchase the goods at any time during the term of the agreement and he has the option to return the goods at any time without having to pay rest of the installments. But in installment payment financing there is no such option to the buyer. In installment payment, the ownership of the goods is transferred immediately at the time of entering into the contract. Whereas in hire purchase the ownership is transferred after the payment of last installment or when the hirer exercises his option to buy goods.

Lease Financing v/s Hire Purchase Financing

The two modes of financing differ in the following respect:

<table>
<thead>
<tr>
<th>Ownership</th>
<th>Hire purchase</th>
<th>Lease financing</th>
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</thead>
<tbody>
<tr>
<td>Financer is the owner and owner ship is transferred after payment of last installment.</td>
<td>Financer is the owner, but ownership is never transferred.</td>
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<tr>
<td>Depreciation</td>
<td>Hiner is entitled to claim depreciation benefit.</td>
<td>The lessor is entitled to claim depreciation benefit.</td>
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<tr>
<td>Magnitude</td>
<td>Low</td>
<td>High</td>
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<tr>
<td>Extent</td>
<td>Less than 100% (50-75%)</td>
<td>Up to 100%</td>
</tr>
<tr>
<td>Maintenance</td>
<td>Hiner’s responsibility</td>
<td>Lessor’s responsibility</td>
</tr>
<tr>
<td>Tax benefits</td>
<td>Hiner</td>
<td>Lessor</td>
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Legal Framework

There is no exclusive legislation dealing with hire purchase transaction in India. The Hire purchase Act was passed in 1972. An Amendment bill was introduced in 1989 to amend some of the provisions of the act. However, the act has been enforced so far. The provisions of are not inconsistent with the general law and can be followed as a guideline particularly where no provisions exist in the general laws which, in the absence of any specific law, govern the hire purchase transactions. The act contains provisions for regulating:

1. the format / contents of the hire-purchase agreement
2. warranties and the conditions underlying the hire-purchase agreement,
3. ceiling on hire-purchase charges,
4. rights and obligations of the hirer and the owner.

In absence of any specific law, the hire purchase transactions are governed by the provisions of the Indian Contract Act and the Sale of Goods Act. In chapter relating to leasing we have discussed the provisions related to Indian Contract Act, here we will discuss the provisions of Sale of Goods Act.
**Sale of Goods Act**

In a contract of hire purchase, the element of sale is inherent as the hirer always has the option to purchase the movable asset by making regular payment of hire charges and the property in the goods passes to him on payment of the last installment. So in this context we will discuss the provisions of Sales of Goods Act, which apply to hire purchase contract.

**Contract of Sale of Goods:** A contract of sales of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price. It includes both an actual sale and an agreement to sell.

**Essential Ingredients of a Sale:** A contract of sale is constituted of following elements:

i. Two parties: namely the buyer and the seller, both competent to contract to effectuate the sale.


iii. Money consideration: price of the goods.

iv. Transfer of ownership: of the general property in goods from the seller to the buyer.


**Sales v/s Bailment:** In a sales, there is a conveyance of property in goods from seller to the buyer for a price and the buyer becomes the owner of goods and can deal with them in the manner he likes. In case of bailment (or leasing) there is a mere transfer of possession of goods from the bailor to the bailee.

**Sales v/s Mortgage, Pledge and Hypothecation:** The essence of contract of a sale is the transfer of general property in the goods. A mortgage is a transfer of interest in the goods from a mortgagor to mortgagee to secure a debt. A pledge is a bailment of goods by one person to another to secure payment of a debt. A hypothecation is an equitable charge on goods without possession, but not amounting to mortgage. The essence and purpose of these contract is to secure a debt. All the three differ from sale, since the ownership in the goods is not transferred which is an essential condition of sale.

**Sale v/s hire purchase:** A hire purchase agreement is a kind of bailment whereby the owner of the goods lets them on hire to another person called hirer, on payment of certain stipulated periodical payments as hire charges or rent. If the hirer makes payments regularly, he gets an option to purchase the goods on making the full payment. Before this option is exercised, the hirer may return the goods without any obligation to pay the balance rent. The hirer is however, under no compulsion to exercise the option and purchase the goods at the end of the agreement period.

A hire purchase contract, therefore, differs from sale in the sense that:

(i) In a hire purchase the possession of the goods is with the hirer while the ownership vests with the original owner.

(ii) There is no agreement to buy but only an option is given to hirer to buy the goods under certain conditions, and

(iii) The ownership in the goods passes to the hirer when he exercises his option by making the full payment.

**Goods:** The subject matter of a contract of sale is the ‘goods’. ‘Goods’ mean every kind of movable property excluding money and auctionable claims. Besides, growing crops, standing trees and other things attached to or forming part of land, also fall in the meaning of goods, provided these are agreed to be severed from land before sale or under the contract of sale. Further, stocks, shares, bonds, goodwill, patent, copyright, trademarks, water, gas, electricity, ships and so on are all regarded as goods.

** Destruction of goods before making of contract:** Where in a contract for sale of specific goods, at the time of making the contract, the goods, without knowledge of the seller, have perished or become so damaged as no longer to answer to their description in the contract, the contract is null and void. This rule, however, does not apply in case of unascertained goods.

** Destruction of Goods after the Agreement to sell but before sale:** Where in an agreement to sell specific goods, if the goods without any fault on the part of the seller, have perished or become so damaged as no longer answer to their description in the agreement, the agreement becomes void, provided the ownership has not passed to the buyer. If the title to the goods has already passed to the buyer he must pay for the goods though the same cannot be delivered.

**Document of Title to goods:** A document of title to goods is one which entitles and enables its rightful holder to deal with the goods represented by it, as if he were the owner. It is used in the ordinary course of business as proof of ownership, possession or control of goods, e.g. cash memo, bill of lading, dock warrant, warehouse keeper's or wharfinger's certificate, lorry receipt, railway receipt and delivery order.

**Price:** The price means the money consideration for transfer of property in goods from the seller to the buyer. The price may be ascertained in any of the following modes:

i. The price may be expressly stated in the contract.

ii. The price may be left to be fixed in manner provided in the contract.

iii. Where the price is neither expressed in the contract nor there is any provision for its determination, it may be ascertained by the course of dealings between the parties.

iv. It may be a ‘reasonable price’.

v. It may be agreed to be fixed by ‘third party valuation’.

The most usual mode is however, by expressly providing price in the contract.

**EM or security deposit:** In certain contract the buyer pays an amount in advance as earnest money deposit or as a security deposit, for the due performance on his part of the contract. Though the amount of earnest money is adjustable towards the price of the goods, it differs from the price in the sense that while payment towards the prices is recoverable, EM is liable to be forfeited if the buyer fails to perform his part and the contract goes off.

**Doctrine of Caveat Emptor (Let the Buyer Beware):** If the buyer relies on his own skill and judgment and takes the risk of the suitability of the goods for his purpose, it is no part of the seller’s obligation to caution the buyer of the defects in the
goods or to give to the buyer an article suitable for his purpose. If the buyer relies on his own skill and judgment and the goods turn out to be defective, he cannot hold the seller responsible for the same. This is known as the ‘doctrine of caveat emptor’ or ‘let the buyer beware’. This applies to all sale contracts invariably, except in following cases:

a. When the buyer makes known to the seller the particular purpose for which he requires the goods and relies on the seller's skill and judgment.

b. When the goods are sold by description by a manufacturer or seller who deals in goods of that description, the seller is bound to deliver the goods of merchantable quality.

c. When the purpose for which the goods are purchased is implied from the conduct of the parties or from the nature or description of the goods, the condition of quality or fitness for that particular purpose is annexed by the usage of trade.

d. When the seller either fraudulently misrepresents or actively conceals the latent defects.

Transfer of Property in Goods: The property in goods is said to be transferred from the seller to the buyer when the latter acquires the proprietary rights over the goods and the obligations linked thereto. The transfer of property in goods is the essence of a contract of sale.

The moment when the property in goods passes from the seller to the buyer is significant from the point that risks associated with the goods follow the ownership, irrespective of the delivery. If the goods are damaged or destroyed, the loss is borne by the person who is the owner of the goods at the time of damage or destruction. The two essential requirements for transfer of property in the goods are

a. Goods must be ascertained and

b. The parties must intend to pass the property in the goods.

Performance of a sale contract: Performance of a sale contract implies, as regards the seller to deliver the goods, and as regards the buyer to accept the delivery and make payment for them, in accordance with the terms of the contract. Unless there is a contract to the contrary, delivery of the goods and payment of the price are concurrent conditions and are to be performed simultaneously.

Delivery of goods: ‘Delivery’ means ‘voluntary transfer of possession of goods from one person to another’. Delivery may be (a) actual (b) symbolic or (c) constructive.

Delivery is said to be actual when the goods are handed over physically. A symbolic delivery takes place where the goods are bulky and incapable of actual delivery e.g. a car is delivered by handing over the keys to the buyer. A constructive delivery is a delivery by attornment which takes place when the person in possession of the goods acknowledges that he holds the goods on behalf and at the disposal of the other person.

Acceptance of Delivery: The buyer is said to have accepted the goods, when he signifies his assent that he has received the goods under, and in performance of the contract of sale. A buyer cannot reject the goods after he has accepted them. A buyer is deemed to have accepted the goods, when:

a. He intimates to the seller, his acceptance or

b. He retains the goods, beyond a reasonable time, without intimating to the seller that he has rejected them or

c. He does any act in relation to the goods which is consistent with the ownership of the seller.

Hire Purchase Agreement
A hire purchase agreement is in many ways similar to a lease agreement, in so far as the terms and conditions are concerned. The important clauses in a hire purchase agreement are:

1. Nature of Agreement: Stating the nature, term and commencement of the agreement.

2. Delivery of Equipment: The place and time of delivery and the hirer’s liability to bear delivery charges.

3. Location: The place where the equipment shall be kept during the period of hire.

4. Inspection: That the hirer has examined the equipment and is satisfied with it.

5. Repairs: The hirer to obtain at his cost, insurance on the equipment and to hand over the insurance policies to the owner.

6. Alteration: The hirer not to make any alterations, additions and so on to the equipment, without prior consent of the owner.

7. Termination: The events or acts of hirer that would constitute a default eligible to terminate the agreement.

8. Risk: of loss and damages to be borne by the hirer.

9. Registration and fees: The hirer to comply with the relevant laws, obtain registration and bear all requisite fees.

10. Indemnity clause: The clause as per Contract Act, to indemnify the lender.

11. Stamp duty: Clause specifying the stamp duty liability to be borne by the hirer.


13. Schedule of hire charges.
The agreement is usually accompanied by a promissory note signed by the hirer for the full amount payable under the agreement including the interest and finance charges.

So far we discussed the legal aspect, let’s now discuss the taxation aspect of the hire purchase agreement.

Taxation Aspects
The taxation aspects of hire purchase transaction can be divided into three parts (a) Income Tax, (b) Sales Tax and (c) Interest Tax.

Income Tax Aspect
Hire purchase, as a financing alternative, offers tax benefits both to the hire-vendor (hire purchase finance company) and the hirer.

Income tax assessment of the hire purchase or hirer: The hirer is entitled to (i) The tax shield on depreciation calculated with reference to the cash purchase price and (ii) the tax shield
on the finance charges. Even though the hirer is not the owner he gets the benefit of depreciation on the cash price of the asset/ equipment. Also he can claim finance charges (difference of hire purchase price and cash price) as expenses. If the agreement provides for the option of purchasing the goods as any time or of returning the same before the total amount is paid, no deduction of tax at source is to be made from the consideration of hire paid to the owner.

**Income tax assessment of the Owner or financer:** The consideration for hire/ hire charges / income received by the hire vendor / financer is liable to tax under the head profits and gains of business and profession where hire purchase constitute the business (mainstream activity) of the assessee, otherwise as income from other sources. The hire income from house property is generally taxed as income from house property. Normal deduction (except depreciation) are allowed while computing the taxable income.

**Sales Tax Aspect**
The salient features of sales tax pertaining to hire purchase transactions after the Constitution (Forty Sixth Amendment) Act, 1982, are as discussed in following points:

a. **Hire purchase as Sale:** Hire purchase, though not sale in the true sense, is deemed to be sale. Such transactions as per se are liable to sales tax. Full tax is payable irrespective of whether the owner gets the full price of the goods or not.

b. **Delivery v/s Transfer of property:** A hire purchase deal is regarded as a sale immediately the goods are delivered and not on the transfer of the title to the goods. The quantum of sales tax is the sales price, thus the sales tax is charged on the whole amount payable by the hirer to the owner. The sales tax on a hire purchase sale is levied in the state where the hire purchase agreement is executed.

c. **Rate of tax:** The rate of sales tax on hire purchase deals vary from state to state. There is, as a matter of fact, no uniformity even regarding the goods to be taxed. If the rates undergo a change during the currency of a hire purchase agreement, the rate in force on the date of the delivery of the goods to the hirer is applicable.

**Interest Tax**
The hire purchase finance companies, like other credit / finance companies, have to pay interest tax under the Interest Tax Act, 1974. According to this Act, interest tax is payable on the total amount of interest earned less bad debts in the previous year at a rate of 2 percent. The tax is treated as a tax deductible expense for the purpose of computing the taxable income under the Income Tax.