

## HIRE-PURCHASE AGREEMENTS

(I). Preliminary.- Hire-purchase agreements have acquired special importance in the developing economy of the country. What does hire-purchase agreement connote ? By a contract of hire-purchase is meant a contract which in addition to terms of hire, provides that on payment of the rent for a certain period, or for a certain number of times, or on the payment of a certain sum after such payment of rent, or at some time during the hiring, the property in the goods hired shall (or may) pass from the owner to the hirer. [Periar's Law of Hire and Hire-Purchase 2<sup>nd</sup> Ed., p.2]. In effect hire-purchase agreement is a contract of bailment and is governed by the provisions of Chapter IX of the India Contract Act, 1872. This agreement is with an option to purchase though it is sometimes used in a wider sense to include agreements where there is an irrevocable agreement to buy in instalments are paid. A hire-purchase agreement thus creates a bailment, but is a bailment plus an option to purchase. The transaction is composed of the element of both the law of hire and sale, it would be clearly wrong to assimilate it to a hypothecation of moveable property .[V. Dakshinamurthi Mudaliar v. General & Credit Corporation (India) Ltd., AIR 1960 Mad. 328, 330].

The transaction partakes of a contract or bailment with an element of sale added to it. In such an agreement, the owner of the goods lets them on hire for periodic payments by the hirer upon an agreement that when a certain number

of payments by the hirer upon an agreement that when a certain number of payments have been completed, the absolute property in the goods will pass to the hirer, but so that the hirer may return the goods at any time without any obligation to pay any balance of rent accruing after return; until the conditions have been fulfilled, the property remains with the owner. In this agreement the hirer is not bound to purchase the thing hired, he has an option, he may or may not purchase. But in either case, if there is an obligation to buy, or an option to buy, the goods delivered to the hirer by the owners on the terms that the hirer on payment of a premium as also of a number of instalments shall enjoy the use of the goods, which ultimately may become his property, the transaction amounts to one of hire-purchase, even though the title to the goods has remained with the owner and shall not pass to the hirer until certain event has happened, namely that all the stipulated instalments have been paid, or that the hirer has exercised his option to finalise the purchase on payment of a sum nominal or otherwise. [Instalment Supply (P) Ltd. v. Union of India, AIR 1962 SC 53, 58; Sundaram Finance Ltd. v. State of Kerala, AIR 1966 SC 1178].

(ii) Hire-Purchase agreement not sale.-It has to be remembered that a hire-purchase agreement is not a sale even if it contains a stipulation in the form of option of the hirer to purchase the article hired. Even where the price for sale is to be paid in instalments later, the property in the goods passes as soon as the sale is made. This follows from the definition of sale in section 4 of the Sale of Goods Act, 1930 (as distinguished from an agreement to sell) which

requires that the seller transfers the property in the goods to the buyer for price. The essence of sale is that the property is transferred from the seller to the buyers for a price whether paid at once or paid later in instalments. On the other hand, a hire-purchase agreement as its very name implies, has two aspects. There is first an aspect of bailment of the goods subjected to the hire-purchase agreement, and there is next an element of sale which fructifies when the option to purchase, which is usually a term of hire-purchase agreements, is exercised by the intending purchaser. Thus the intending purchaser is known as the hirer so long as the option to purchase is not exercised, and the essence of the hire-purchase agreement properly so called is that the property in the goods does not pass at the time of the agreement but remains in the intending seller, and only passes later when the option is exercised by the intending purchaser. The distinguished feature of a typical hire-purchase agreement is made but only passes when the option is finally exercised after complying with all the terms of the agreement. [K.L. Johar & Co. v. Dy CTO, AIR 1955 SC 1082,1088].

The position of the owner of goods under a hire-purchase agreement is that of a person who has made an irrevocable offer to sell but no obligation to buy. [Helby v. Mathews, (1895) AC 471 ; Lee v. Butler, (1893) 2 Q.B. 318]. The essence of the hire-purchase agreement is that the hirer is not bound to purchase. [Dalpat Rai v. Manohar Lal & Sons, AIR 1974 Raj. 61]. A hire-purchase agreement has two elements ; (i) element of bailment, and (ii)

element of sale, in the sense that it contemplates an eventual sale. The element of sale fructifies when the option is exercised by the intending purchaser after fulfilling the terms of the agreement. When all the terms of the agreement are satisfied and the option to purchase is exercised, a sale takes place of the goods which till then had been hired. [K.L.Johar & Co. v. Dy. CTO, AIR 1965 SC 1082, 1090].

(iii) Duty of hirer.-According to section 151 of the Contract Act, 1872, the hirer is bound to take as much care of the goods hired to him as a man of ordinary prudence would under similar circumstances take of his own goods of the same bulk, quality and value as the goods hired. Under Section 152 of the Contract Act, the hirer in the absence of any special contract is not responsible for the loss, destruction or deterioration of the thing hired, if he has taken such care. Accordingly, the parties may provide by stipulation in that behalf that the hirer will be liable for any loss or damage to the goods arising from any cause whatever.

(iv) Parties .-Normally , there are two parties to the hire-purchase agreement, viz., the owner and the hirer. However, sometimes a financier, for example in case of motor vehicles, is also brought in as a necessary party who purchase the vehicle from the owner and lets the same on hire to the hirer on instalments

and in such case, a guarantor is also required to be supplied by the hirer to secure fulfilment of the obligations imposed on the hirer under the agreement.

(v).- Clauses.-In drafting a hire-purchase agreement, care should be taken to draft the following important clause in the agreement properly ;

(a) No obligation to buy.-The agreement of hire-purchase should not amount to an agreement to buy but it should only give the hirer an option to purchase because where a person under an agreement to buy obtains the possession of the goods and the hirer under the hire-purchase agreement so obtains the possession, he would be able to give title to any one who takes the goods on sale or pledge from him without notice of the hire purchase agreement [See section 30 (2) of the Sales of Goods Act, 1930 and thereby the hirer would be able to defeat the intention of the owner. Where, however, the agreement is not an agreement to buy but it merely give an option to the hirer to buy on the fulfillment of certain conditions, the hirer cannot give a valid title to any one. [Roopchand Jankidas v. National Bank, 46 Cal. 342].

(b) Property in goods not to pass.-A hire-purchase agreement must contain an express stipulation that the property in the goods shall not pass of the hirer until all instalments have been paid.

© Minimum payment clause.-A hire-purchase agreement may be terminated either by the owner or hirer and the hirer may return the article to the owner after terminating the agreement. But since the articles are subject to usual wear and tear on account of user, it is usual to insert a “minimum payment” clause in the agreement in order to provide for depreciation of the article taken under the hire-purchase agreement. Such a clause provides that in the event of the agreement being determined by the owner or the hirer, the hirer shall be liable to pay 50% of the total price after deduction of the instalments already paid by the hirer.

(d) Seizure clause.-It is also usual to incorporate a clause in the hire-purchase agreement empowering the owner to seize the article hired in the event of the hirer committing a breach of any terms thereof, particularly the non-payment of monthly hire.

(vi) Claim of financier to prevail over the state.-Where under a hire-purchase agreement, the financier, i.e., the owner lets on hire a motor vehicle to the hirer, clause 4 of the agreement states that, on default by the hirer, the owner can seize, remove and retake possession of the vehicle and sue for all the instalments due and for damage for breach of the agreement and for all the costs of retaking of possession of the said vehicle and all costs occasioned by the hirer's default. Clause 6 would show that, only upon the hirer paying the entire amounts due under the agreement, the said vehicle shall become the

sole and absolute property of the hirer. In regard to the registration of the vehicle shall become the sole and absolute property of the hirer. In regard to the registration of the vehicle, though it is in hirer's name, clause 8 of the agreement states that the owners-meaning the financing company agree to permit the hirer to have the registration of the vehicle in his name provided that the hirer shall transfer the registration in the name of the owners whenever required to do so by them and especially when the hirer commits breach of any of the conditions of the agreement. In the light of these clauses in the agreement and in the event of the financier seizing the vehicle on default on the hirer in payment of the instalments, the claims of the financier would prevail over that of the State. Where a person has got a prior secured right over the property, the State's claim will not prevail. In the Income-tax Act, there is no substantive provision for superseding or overriding the claims or rights of a secured creditor. Schedule II mentioned in section 222 of the I.T. Act, 1961, which contains statutory rules in accordance with which the modes of recovery mentioned in that section have to be exercised, relates to procedure only and does not deal with substantive rights. [Sundaram Finance Ltd. v. RTO, (1979) 117 ITR 334 (Ker)].

(vii) Allowability of depreciation of hired article.-The Board has issued the following circular containing instructions regarding depreciation allowance on plant and machinery acquired under hire-purchase agreement.

“The following instructions are issued for dealing with case in which an asset is being acquired under or on what is known as hire-purchase agreement:-

- (i) In every case of payment purporting to be for hire-purchase, production of the agreement under which the payment is made should be insisted on.
- (ii) Where the effect of an agreement is that the ownership of the subject is at once transferred to the lessee( e.g. where the lessor obtains a right to sue for arrear of instalments but no right to recovery of the asset) the transaction should be regarded as one of purchase by instalments and no deduction in respect of “hire” should be made. Depreciation should be allowed to the lessee on the entire purchase price as per the agreement.
- (iii) Where the terms of the agreement provide that the equipment shall eventually become the property of the hirer or confer on the hirer an option to purchase the equipment, the transaction should be regarded as one of hire-purchase. In such case the periodical payments made by the hirer should not for tax purposes be regarded as made up of-
  - (a) consideration for hire, to be allowed as a deduction in the assessment ;
  - and

- (b) payment on account of purchase, to be treated as capital outlay, depreciation being allowed to the lessee on the initial value(i.e., the amount for which the hired subject would have been sold for cash at the date of the agreement).”

The allowance to be made in respect of hire should be the difference between the aggregate amount of the periodical payments under the agreement and the initial value(as described above), the amount of this allowance being spread evenly over the term of agreement. If, however, the agreement was terminated either by outright purchase of the equipment or its return to the owner, the deduction should cease as from the date of the termination.

An assessee claiming this deduction should be asked to furnish a certificate from the vendor or other satisfactory evidence of the initial value (as described above). Where no certificate or satisfactory evidence is forthcoming, the initial value should be arrived at by computing the present value of the amount payable under the agreement at an appropriate rate per centum. In doubtful case the fact should be reported to the Board”.

[Circular No.9 of 1943, R. Dis. No. 27(4) IT/43, dated 23<sup>rd</sup> March, 1943].

- (viii) Registration.-Registration of a hire-purchase agreement is not compulsory.
- (ix) Stamp duty.-The hire-purchase agreement requires a stamp of only Re. 1 like an ordinary agreement.
- (x) Model Forms