

Analysis of Service Tax Provisions in Banking Sector



The main purpose of this article is to provide a basic understanding of service tax (including 'swachh bharat cess') implications on various services provided or received, as the case may be, by the bank. In addition, this article will serve as a handy reference tool for members while verifying statutory compliances relating to service tax provisions during various types of bank audits. Read on...

Overview

It would be germane to acquaint with relevant provisions of Chapter V of the Finance Act, 1994 reproduced below so as to prepare a platform for discussion in succeeding paras:

Section 65B (44) of Chapter V of the Finance Act, 1994 defines 'service' as:

"Service means any activity carried out by a person for another for consideration and includes a declared service but it does not include

(a) *An activity which constitutes merely –*

- i. ...
- ii. ...



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- iii. A transaction in Money or Actionable Claim
(b) ...
(c) ...

Explanation 2: For the purpose of this clause, transaction in money shall not include any activity relating to the use of money or its conversion by cash or any other mode, from one currency or denomination, to another form, currency or denomination, for which a separate consideration is charged.

Explanation 3(b): For the purpose of this Chapter, an establishment of a person in the taxable territory, any of his other establishment in a non-taxable territory shall be treated as establishment of distinct persons."

A perusal of *supra* cited provisions reckons that important requirements of 'service' are –

- There should be an 'activity',
- Activity should be carried out by one person for another,
- Activity should be for consideration.

To elucidate the meaning of the term 'activity', reliance can be placed on *Advanced Law Lexicon*, a legal dictionary, which says 'activity' means any *cost incurring operation* within an organisation, which probably includes practically everything that happens. Further, *Para 2.1.1 of CBE&C's 'Taxation of Services : An Education Guide'* states that activity would include an act done, a work done, a deed done, an operation carried out, execution of an act, provision of a facility, etc. It is a term with very wide connotation.

An activity must be done by a person for another for consideration. As per the Indian Contract Act, consideration must be at the *desire* of promisor. Stress shall be laid on the phrase '*desire of promisor*'. The phrase signifies that whether consideration is there or not, it has to be determined as per the desire of the promisor. If an act is done by the promisee as per the desire of the promisor, doing such act as per desire is called as consideration for the promise.

1. Service Tax On Incomes Of The Bank i.e. Taxable Services Rendered By The Bank :

1A) Advances Section

- **Services Covered Under "Any activity carried out by a person for another for consideration":**

Interest on Advances: When bank sanctions a loan, an activity is said to be carried out by bank for which interest would be received. The word 'mere' used in the exclusion a.iii to Section 65B (44) reckons that there should be no profit element

inherent in money transaction i.e. it should be a mere exchange of money. Thus when a bank extends loan to a borrower, this is not a mere exchange of money as interest would be recovered. Therefore, this is a service. Now, determining whether levy of service tax is attracted or not, taxability of service is required to be determined. This Chapter has specified some services in negative list given under Section 66D of the Act on which levy of tax is not attracted. The said service found its place in clause n) to Section 66D reproduced below:

Section 66D (n): "Extending deposits, loans or advances in so far as consideration is represented by way of interest or discount."

Prior to negative list regime, the said service was exempted from levy *via* exemption notification 29/2004 ST dated 22/09/2004. Hence, providing a loan or overdraft facility or a credit limit facility in consideration for payment of interest is covered under negative list and no service tax is applicable on interest income of the bank.

Processing Fees/ Documentation Fees/ CIBIL Charges / Inspection Fee/ Upfront Fee: These charges are recovered for the activity of lending and thus cannot be construed in congruity with interest. To substantiate this, definition of interest given under Section 65B (30) is reproduced, which provide accentuation whether such charges are in the nature of interest or not:

Section 65B(30) : Interest means interest payable in any manner in respect of any moneys borrowed or debt incurred (including a deposit, claim or other similar right or obligation) but does not include

- *any service fee or other charge in respect of the moneys borrowed or debt incurred or* ^[PROCESSING FEES]
- *in respect of any credit facility which has not been utilised.* ^[COMMITMENT FEES]

Hence, processing fee is not interest as defined under Section 65B(30) and service tax is leviable on these charges and on gross amount charged as per Section 67(1)(i).

Commission on Bank Guarantee: These charges are recovered for the activity of giving guarantee and thus, covered under exhaustive part of definition. Hence, service tax is leviable on these charges and on gross amount charged as per Section 67(1)(i).

- **Services Covered Under "Declared Service":**
Commitment Fees: This amount is not recovered for rendering any activity. Therefore, an exhaustive part of this definition does not

cover this. This Chapter has declared some services under Section 66E on which service tax is leviable under Section 66B of the Act. The relevant clause is reproduced below:

Section 66E (e): "agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act."

These charges are recovered for agreeing to do an act. Hence, service tax is leviable on these charges and on gross amount charged as per Section 67(1)(i).

Penal Interest: Emphasising on definition of interest *supra* cited, it can succinctly be construed that penal interest does not fall under the ambit of said definition. Thus, negative list does not cover penal interest. It is a stipulation that if borrower defaults with agreed terms, penal charges would be levied on him. Under the banking transaction, such acts as aforesaid are concomitant and therefore, represents consideration for tolerance of an act which is a declared service under Section 66E (e). At the outset, the amount on which service tax is to be levied is determined in terms of provisions of Section 67 read with Service Tax (Determination of Value) Rules, 2006. The relevant Rule is reproduced below:

Rule 6 of Service Tax (Determination of Value) Rules, 2006: "Transaction value will exclude interest on delayed payment of any consideration for the provision of services or sale of property, whether movable or immovable."

Hence, value for levying service tax on penal interest is nil and therefore no service tax is recovered on it.

- **Services Under "Merely a Transaction in Money":**

Conversion of Foreign Currency to Home Currency: For example, Mr. A is carrying 100\$ and wants to convert it into Indian rupees. He approaches a bank and gets it converted for ₹100*60=₹6000. In this case, this is not a mere transaction in money because conversion rate/merchant rate of bank (1 USD = 60 INR) includes profit element in the form of exchange margin. Hence, this activity is a taxable service which attracts levy of service tax on profit element included in merchant rate in the form of exchange margin. However, bank can calculate service tax either as per Rule 2B of the Service Tax (Determination of Value) Rules, 2006 or as per rates mentioned under Rule 6(7B) of Service Tax Rules, 1994. For further discussion, refer

"Providing a loan or overdraft facility or a credit limit facility in consideration for payment of interest is covered under negative list and no service tax is applicable on interest income of the bank."

explanation 2 to definition of service as discussed in succeeding paras.

Payment of Import Letter of Credit: When bank makes payment under import LC, it will convert INR into USD and therefore, would be a case of conversion of home currency into foreign currency. For further discussion, refer explanation 2 to definition of service as discussed in upcoming para.

- **Services under "Explanation 2 to Definition of Service":**

Payment of Import Letter of Credit: This explanation includes within its ambit an activity of conversion of money from one currency to another currency for which a separate consideration is charged in the form of exchange margin. Further, as per Rule 3 and Rule 8 of Place of Provision of Service Rules, 2012, this service is rendered in taxable territory as location of service receiver is in taxable territory and hence, service tax is leviable thereon. Now as per valuation provisions:

Section 67(1)(i) : "In case where the provision of service is for a consideration in money, gross amount charged by the service provider for such service provided or to be provided by him shall be the value."

Emphasis shall be given to the words "such service" – since gross amount charged by service provider i.e. bank for providing service by way of payment of import letter of credit, the exchange margin is the consideration received in money. But, practically, it is very difficult to ascertain the purchase price of USD which has been sold to the importer for making payment. Hence, we refer to the Section 67(1)(iii) reproduced below:

Section 67(1)(iii) : "In case where the provision of service is for a consideration which is not ascertainable, be the amount as may be determined in the prescribed manner"^[SERVICE TAX (DETERMINATION OF VALUE) RULES, 2006]

In this juncture, provisions of Rule 2B of the Service Tax (Determination of Value) Rules, 2006 are reproduced below which helps to determine value of service:

“The value of service shall be computed as under- Where any one of the currencies is Indian Rupee:

The difference between Buying Rate or Selling Rate, as the case may be and the RBI Reference Rate for that currency at that time, multiplied by units of currency exchanged	<i>Purchase of Forex : Exporter [RBI Rate – Buying Rate]* Units of Forex bought Sale of Forex : Importer [Selling Rate – RBI Rate]* Units of Forex sold</i>
If RBI Reference rate is not available, the value shall be 1% of Gross Amount of Rupees provided/received by the person changing the money	<i>RBI Reference rate is not available 1% of [Indian Rupees exchanged for forex]</i>

....”

It can be seen that, practically, the procedure given in Rule 2B is very difficult to follow, as daily record of the purchase and sale of foreign currency in inter-bank market as well as RBI reference rate cannot be easily tallied with foreign currency sold to importer. Hence, a composition scheme has been issued in this respect which leads to easy calculation and control over calculation of service tax on money changing business as given under Rule 6(7B) of the Service Tax Rules, 1994:

Instead of paying service tax at the rate specified under Section 66-B of Chapter V of the Act, the person liable to pay service tax in relation to service of purchase or sale of Foreign Exchange (including Money Changing) shall have the option to pay the following amount:

Gross Amount of Currency Exchanged	ST Payable	Subject to
Upto ₹ 1,00,000	0.14%	Minimum ₹35/-
More than ₹ 1,00,000 upto ₹ 10,00,000	₹140 + 0.07% of the excess over ₹1,00,000	---
More than ₹ 10,00,000	₹770+0.014% of the excess over ₹10,00,000	Maximum of ₹7000/-

Example:

At the time of making payment to exporter, ₹6,00,000 has been debited from the account of borrower (being an amount equivalent to USD 10,000). Now, this would amount to levy of service tax on forex money changing, which will be

computed as under:

Upto ₹ 1,00,000	0.14% of ₹ 1,00,000	₹ 140
From ₹ 1,00,001 to ₹ 6,00,000	0.07% of ₹ 5,00,000	₹ 350
Service Tax		₹ 490
Swachh Bharat Cess	₹ 490/14 x 0.5	₹ 17.50

1B) Deposits Section

a. Savings Account

- Services Covered Under “Any activity carried out by a person for another for consideration”:** **Charges for SMS Alert/DD Commission/ATM Charges/Internet Banking Charges/Ledger Folio Charges:** No doubt, an activity has been rendered by bank for customer for a consideration. Therefore, it is a service. However, in order to determine its taxability, place of provision of service shall be determined. It would be relevant to refer Rule 9 of said rules reproduced below:

Rule 9 of Place of Provision of Service Rules 2012:
“The place of provision shall be the location of the service provider for services provided by a Banking Company / Financial Institution / NBFC to Account Holders^[SAVING ACCOUNT]

Explanation: Service by Banking Co / Financial Institution (including NBFC) to account holder-

“Account” means an account which bears an interest to the depositor [including NR(E) A/c and NR(O) A/cs]

(Rule 2 of POPS Rules, 2012)

On perusal of Rule 9, it can be concisely said that if a service is provided to *saving bank account holders*, location of bank would be the place where service is provided. Therefore, amount charged for services provided by way of SMS alerts/ ATM charges / internet banking charges to saving account holders is leviable to service tax if the bank is located in taxable territory.

- Services Covered Under “Declared Service”:** **Minimum Balance Charges:** These charges are covered under Section 66E(e) as it represents consideration for tolerance of an act and hence, service tax is leviable thereon on gross amount charged as per Section 67(1)(i).

b. Current Account

If any of the above stated charges like ATM charges, minimum balance charges, DD

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commission, etc. are levied in current account, POPS will not fall under Rule 9, it will be covered by Rule 3 of the Place of Provision of Service Rules which will further be determined by Rule 8 and hence, POPS will arise at location of service recipient i.e. location of depositor.

Authors' Interpretation of Rule 9 of Place of Provision of Service Rules, 2012

As the Rule 9 covers in its ambit services provided to account holder as meaning of account has been defined under Rule 2(b) of the said rules, account which bears *interest*. Therefore, place of provision is required to be determined separately if services are provided to *saving account holders* and current account holders because:

- As per Rule 9, location of bank is the place of provision of service whereas,
- As per Rule 3, location of service receiver i.e. location of depositor is the place where service is provided (even if service receiver and service provider both are in taxable territory, then Rule 8 will be applicable and PoPS will arise at location of service receiver only).

Therefore, in case of services rendered to *saving account holders*, PoPS will always arise at location of bank branch:

Location of Bank Branch (SP)	Location of Depositor (SR)	Type of facility availed & income to bank	As per PoPS Rule 9 PoPS = Location of Bank Branch	Whether service tax leviable
Chandigarh	Chandigarh	Service: Demand Draft	Taxable Territory	Yes
Jammu & Kashmir	Chandigarh		Non – Taxable Territory	No
SEZ	Chandigarh	Income:	Taxable Territory	Yes
Chandigarh	Jammu & Kashmir		Taxable Territory	Yes
Chandigarh	SEZ	Commission on DD	Taxable Territory	No*

* As per E/N 12/2013 ST, the taxable services received by a unit located in SEZ and used for the authorised operations, are exempt from service tax.

And, in case of services rendered to *current account holders*, PoPS will always arise at location of depositor:

Location of Bank Branch (SP)	Location of Depositor (SR)	Type of facility availed & income to bank	As per PoPS Rule 3 PoPS = Location of Depositor	Whether service tax leviable
Chandigarh	Chandigarh	Service : Demand Draft	Taxable Territory	Yes
Jammu & Kashmir	Chandigarh		Taxable Territory	Yes
SEZ	Chandigarh	Income: Commission on DD	Taxable Territory	Yes
Chandigarh	Jammu & Kashmir		Taxable Territory*	Yes*
Chandigarh	SEZ		Taxable Territory	No**

* As per explanation 3(b) to the definition of service: “For the purpose of this Chapter, an establishment of a person in the Taxable Territory any of his other establishment in a Non-Taxable Territory shall be treated as establishment of Distinct Persons.” So, Jammu & Kashmir branch is deemed to be separate person in terms of explanation 3(b) of Section 65B (44). Now, in personal view of the author, for instance, if a depositor of State Bank of India approaches to Oriental Bank of Commerce for DD, then for Oriental Bank of Commerce it is not a service rendered to depositor having an interest bearing account. The place of provision of service is determined as per Rule 3 of said rules but since the location of service receiver is not known to the Oriental Bank of Commerce, then place of provision of service will be location of service provider by virtue of Rule 3 of provision of Service Rules, 2012. Therefore, applying the same principles, in this case, it will be deemed that bank is providing services to depositor having an account with distinct person and location of service receiver is not known to the bank and therefore, place of provision of service will be location of service provider

by virtue of Rule 3 and hence attracts levy of service tax.

** As per E/N 12/2013 ST, the taxable services received by a unit located in SEZ and used for the authorised operations, are exempt from service tax.

And, in case of services rendered to NR(E) / NR(O) Account Holders, PoPS will always arise at location of bank branch :

Location of Bank Branch (SP)	Location of Depositor (SR)	Type of facility availed & income to bank	As per PoPS Rule 9 PoPS = Location of Bank Branch	Whether service tax leviable
Chandigarh	USA	Demand Draft	Taxable Territory	Yes

Had Rule 2(b) of PoPS Rules, 2012 not included NR(E)/NR(O) Account within in the meaning of word account covered under Rule 9, then services rendered by bank to these account holders would come under the purview of Rule 3 and thus will become exempt from levy of service tax. But as this type of account has been included in the definition of “account”, services rendered by bank to these depositors would attract levy of service tax.

Cheque Dishonour Charges: It also represents consideration for tolerance of an act. As per discussion regarding POPS done above, POPS of this declared service will also be determined in the same manner i.e. (Rule 9)[saving a/c] or (Rule 3 – Rule 8) [current a/c, loan a/c] i.e. location of the service provider or location of bank branch, as the case may be.

2. Expenses Of The Bank i.e. Taxable Services Received By The Bank :

2A) Deposit Section

Interest Paid on Saving Bank Account : There is no implication of service tax payment on bank as this type of service is specifically excluded from the purview of service tax by inserting a provision in Section 66D of the Chapter V [Section 66D(n) as explained in the preceding clauses.

2B) Full Reverse Charge Applicability

Search Report Fee/ Legal Opinion Fee – Paid to Lawyer: This is taxable service rendered by lawyer and as per POPS Rules, 2012 – Rule 3 and Rule 8, place of provision of service will be location of service receiver. Hence, service tax is leviable on these charges. But as per Notification Number 30/2012, this service is covered under full reverse charge.

Notification Number 30/2012 ST:

Description of Service			% of ST payable by SP	% of ST payable by SR
In respect of services provided or agreed to be provided			Nil	100%
By Individual Advocate or Firm of advocate	By way of legal service	To any Business entity located in taxable territory		

Also, exemption notification 25/2012 does not exclude it from purview of service tax levability.

Exemption Notification Number 25/2012 (Entry

Number 6):

Services provided by an individual as an advocate or a partnership firm of advocates by way of legal services to... any person other than a business entity.

Section 65B(17): Business Entity means any person ordinarily carrying out any activity relating to industry, commerce or any other business or profession.

Hence, when bank avails legal services from an advocate/ partnership firm of advocates:

- Notification no. 30/2012: Reverse charge is applicable.
- Exemption notification 25/2012 is not applicable (as services are provided to business entity).
- Bank is required to pay service tax on the amount of bill under full reverse charge mechanism.

Now consider a case when **bill of the advocate is in the name of borrower:** In this case, bank will be considered as *pure agent* in terms of Rule 5(2) of Service Tax (Determination of Value) Rules, 2006 and such value will be excluded from value of services and therefore, there will be no service tax applicability on bank under reverse charge mechanism. For instance, if advocate bill is received for ₹10,000 then following treatment shall be done by the bank:

- Bank shall recover ₹10,000 from client as advocate fee. Further, in terms of Rule 5(2) of Service Tax (Determination of Value) Rules, 2006, this value is **excluded from valuation** of service and therefore it does not attract service tax liability under reverse charge mechanism on the bank.

In case the **bill of the advocate is in the name of bank**, then bank cannot claim itself to be the pure

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agent of borrower and service tax is required to be paid by the bank under reverse charge mechanism. For instance, if advocate bill is received for ₹10,000 then following treatment shall be done by the bank:

- Bank is a service receiver and therefore should book liability under reverse charge mechanism.
- Further, bank shall recover ₹10,000 from client as advocate fee and for client, bank is service provider and therefore, such debit shall also attract levy of service tax and swachh bharat cess. This means that bank should recover Rs. 11,450 from the client.
- Service tax shall be paid by bank as under:
 - ₹1400 – for being a service provider
 - ₹1400 – for being a service receiver, under reverse charge mechanism. Doing so, bank should avail CENVAT credit of ₹1400 also.
- Swachh Bharat Cess shall be paid by bank as under
 - ₹50 – for being a service provider
 - ₹50 – for being a service receiver, under reverse charge mechanism. However, CENVAT credit of swachh bharat cess is not available.

2C) Partial Reverse Charge Applicability

Payment of Security Services (₹25000): This is taxable service rendered by security agency/company/firm to the bank and as per POPS Rules, 2012 – Rule 3 and Rule 8, Place of provision of service will be location of service receiver i.e. location of the bank branch. Since, location of bank falls in the taxable territory, service tax is leviable on these charges. But as per Notification Number 30/2012, this service is covered under reverse charge.

“Thus, if the service provider is either an individual (sole proprietorship firm) or HUF or partnership firm (including LLP) or AoP, then security services provided to the bank will come under the purview of reverse charge. Hence, bank shall pay 100% of the service tax on the value of services levied in the bill. However, if security services are provided by a company, then it will not come under reverse charge. In such cases, bank shall pay service tax levied on the bill to service provider.”

Thus, if the service provider is either an individual (sole proprietorship firm) or HUF or partnership firm (including LLP) or AoP, then security services provided to the bank will come under the purview of reverse charge. Hence, bank shall pay 100% of the service tax on the value of services levied in the bill.

However, if security services are provided by a company, then it will not come under reverse charge. In such cases, bank shall pay service tax levied on the bill to service provider.

Thus, an auditor must check the status of service provider, to determine the applicability of reverse charge. Also, it should be noted that service tax under reverse charge is attracted only if control lies with the branch/head office itself.

3. Debatable Issue

Interest On Delay In Payment Of Credit Provided By Way Of Credit Card: There are two views on this:

Judicial View: Interest on delayed payment of credit provided by way of credit card is on *delay in making payment for use of money. Prima-facie*

N/N 30/2012		Reverse Charge	
In respect of the services provided or agreed to be provided			
By HUF or Individual Partnership Firm (whether registered or not) AoP Located in taxable territory		To Business Entity registered as Body Corporate Located in the taxable territory	
Description of service		% of ST Payable by SP	% of ST Payable by SR
Entry No. 9	Service by way of <ul style="list-style-type: none">Supply of manpower for any purposeSecurity services	Nil	100%

“On perusal of Rule 9, it can be concisely said that if a service is provided to saving bank account holders, location of bank would be the place where service is provided. Therefore, amount charged for services provided by way of SMS alerts/ ATM charges / internet banking charges to saving account holders is leviable to service tax if the bank is located in taxable territory.”

interest on credit card dues partakes the character of “interest on loan” and, therefore, it shall not form part of value of credit card related services. [*Canara Bank vs. Commissioner of Central Excise & Customs (LTU)* – 2013 – Tribunal Bangalore Bench]

CBEC View: CBEC vide its *Taxation Of Services : An Education Guide* on page number 46 in para 4.14.10 regarding Section 66D(n) mentioned that this interest is on *delay in making payment for services*

provided and hence, these exorbitant charges has no relationship with the prevailing interest. Thus, these are in the nature of consideration for the services rendered for using the convenience of using the services by way of credit card and hence, taxable.

Author’s View: *Prima-facie* judicial view appears to be correct view, as “interest” will fall under Section 66D(n), even if rate is exorbitant. Hence, service tax is not *leviable* on such interest.

To Conclude

Service tax has a very wide coverage in our fast growing economy. An auditor shall keep a bird eye view on the nature of each and every type of service charge levied by bank and shall analyse service tax implications on it. In this article, our stress is only to bring a great learning opportunity among professionals and make available for them a handy tool to refer statutory implications on mostly all types of service charges being levied by banking industry today. ■

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