

# TAX FLASH NEWS

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## Service tax update | Banks not liable for payment of service tax under reverse charge on correspondent bank charges – CESTAT, Delhi

Customs, Excise and Service Tax Appellate Tribunal, Delhi (CESTAT) recently observed<sup>1</sup> that as a facilitator to an Indian exporter, Indian bank acts as a mediator between the exporter and the foreign banker representing the foreign importer. In such scenario the Indian banks are not the recipient of the services provided by the foreign bank. Thus, on the charges that are recovered/collected by the foreign bank, Indian bank is not liable to pay service tax under reverse charge.

Further, the CESTAT also held that for the purpose of levy of service tax under the category of 'Banking and Financial services', banking services are required to be provided in India. In the instant case, the foreign bank does not transact banking business in India, accordingly, they would not fall within the definition of a 'banking company' which is the pre-requisite for the levy of service tax under the service category 'Banking and Financial services'.

### Facts of the case

In order to facilitate export transaction, the appellant bank<sup>2</sup> provides services like sending export documents to the importers bank, collection for payment of bill of exchange. For providing these services to the exporter, the appellant bank collects commission/fees on which the service tax liability is also discharged by the appellant bank. Correspondingly, the importer in a foreign country appoints a foreign bank to facilitate the import transaction.

In a scenario where the exporter in India agrees to bear the bank charges levied by the foreign banker of the importer, the charges are deducted by the foreign bank from the amount collected from the importer and the net proceeds are remitted to India.

In the above transaction and in light of the fact that all foreign trade transactions are required to be routed through banking channels, the revenue had alleged that the financial service provided by the foreign bank is in the nature of banking and financial services. These services are provided to the Indian bank (i.e. appellant bank) and thus the appellant is liable to pay service tax on the charges levied by the foreign bank under the reverse charge mechanism.

### CESTAT order

#### The CESTAT made the following observation

- For the purpose of levy of service tax on a taxable service there has to be consideration and such consideration must flow from the service recipient to the service provider and should accrue to the benefit of the service provider. In the instant case, the appellant bank has not paid any consideration to the foreign bank as is clear from the factual position emerging out of the export trade and, therefore the appellant bank cannot be said to be the recipient of the any service by the foreign bank.
- As a general practice, exporters route their export documents through banking channel to ensure safe remittance and also to comply with the RBI guidelines and the FEMA provisions. It is a fact that Indian bankers do not charge to the foreign bankers on behalf of the exporters. The appellant bank plays the role of the mediator between the Indian exporter and the foreign based banker representing the foreign importer as an agent.

In addition to the above observations, CESTAT also relied on the Madras High Court judgement in case of BGR Energy Systems Limited wherein on similar facts the Court had held that foreign banks provide services to the Indian exporters and thus the exporter is liable to pay service tax under the reverse charge mechanism.

<sup>1</sup> TS-643-CESTAT-2020(DEL)-ST

<sup>2</sup> State Bank of Bikaner and Jaipur

Based on the above observation and finding, the CESTAT held that since Indian bank are not the recipient of any services provided by the foreign bank, they are not liable to pay service tax under reverse charge mechanism.

## Our comments

Under the erstwhile regime, the authorities had issued show cause notices to many Banks demanding service tax on such charges payable under reverse charge. Banks had challenged the said demand and the same was an industry issue being disputed at different levels of adjudication or appeal.

After a long drawn battle, while some banks had decided to close the dispute by paying the full tax demand along with appropriate interest and claim the 50% input credit of such tax paid, if available, others opted to discharge the tax liability under the dispute resolution scheme<sup>3</sup> rolled out by the Government and got the waiver of interest and penalty.

Pursuant to the above ruling, there may be a possibility that banks, who had discharged full tax along with interest can evaluate the option of filling an application to claim refund of the tax and interest paid. However, Banks, who had opted for the dispute resolution scheme may not get this opportunity.

Further, it is important to note that the Central Board of Indirect Taxes and Customs (CBIC) had already issued a clarification, under the GST regime, which is contrary to CESTAT's view and provides that the Indian bank receives services from the overseas correspondent bank. Hence, the ratio of above judgment would be relevant for Banks under the GST regime as well.

The above ruling may pave the way to close many service tax and GST open disputes, where Banks are being held liable to pay tax on reverse charge for merely acting as facilitators for import and export transactions.



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<sup>3</sup> Sabka Vishwas (Legacy Dispute Resolution) Scheme, 2019

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