IN THE CUSTOMS, EXCISE AND SERVICE TAX APPELLATE TRIBUNAL
WEST ZONAL BENCH AT MUMBAI
COURT NO.

Appeal No. ST/85743/2014

(Arising out of Order-in-Original No. 03/AC/COMMR/Th-II/ST/2013 dt.29.11.2013 passed by the Commissioner of Central Excise, Thane-II)

M/s. HDFC Bank Ltd. : **Appellant**

VS

Commissioner of Central Excise, Thane-II : **Respondent**

<u>Appearance</u>

Ms. Prajakta Menezes Adv. with
Mr. Arihant Tatel, C.A. i/b Khaitan & Co. for Appellant

Shri M.K. Sarangi, Jt. Commr. (A.R) for respondent

CORAM:

Hon'ble Dr. D.M. Misra, Member (Judicial)
Hon'ble Mr. Sanjiv Srivastava, Member (Technical)

Date of hearing : 16/07/2018
Date of decision : 16/07/2018

ORDER NO. A/87114/2018

Per : **Sanjiv Srivastava,**

The appeal is directed against order in original No 03/AC/COMMR/Th-II/ST/2013 dt. 29.11.2013 of Commissioner Central Excise Mumbai.

2. Appellants are in the business of providing various financial services including those taxable under the category of "Banking and Financial Services (BOFS) and Credit Card Services. Appellants is also providing Cash Credit, Over Draft and Bill Discounting Services to its Customers and charges interest along with administrative expenses in respect of these services. Vide Notification No 29/2004-ST dated 22.09.2004 exemption has been granted in respect of the interest charged on Cash Credit, Over Draft and Bill Discounting Services, while the administrative charges in respect of these services were leviable to service tax. Appellant had had been availing the CENVAT Credit in respect of the input services received by them. However they did not reversed the credit as required in terms of Rule 6 of the CENVAT Credit Rules, 2004, on the ground that as per them the service was not an exempt service as defined under Rule 2(e). A show Cause Notice was issued to the Appellant demanding them to pay/ reverse the CENVAT Credit to tune Rs 193,82,99,055/- for the period from 2008-09, 2009-10 & 2010-11. Interest was also demanded and penalty proposed in respect of the amounts not reversed. Commissioner has adjudicated the matter and confirmed the amount demanded by the show cause notice along with interest at applicable rate. He has also imposed mandatory penalty of the equivalent amount in terms of section 78 of the Finance Act, 1994.Against this order of Commissioner Appellants have preferred this appeal.

3. In their Appeal, Appellants have challenged the order of Commissioner, stating that Cash Credit/ Over Draft (CC/OD) services provided by them are not the exempt services as defined by Rule 2(e) of the CENVAT Credit Rules, 2004. Notification No 29/2004-ST dated 22.09.2004 only exempts that portion of the value from the payment of service tax as is equivalent to the interest charged on this facility. Since on the remaining part service tax is payable/ paid Commissioner has erred by holding that the service provided by them is exempt from payment of service tax. Since factually CC/OD is only partially exempt, rule the proportionate reversal under rule 6 (3A)(c) of the CENVAT Credit Rules, 2004 is not warranted in this case. The reliance placed by the Commissioner on the report of Reserve Bank of India is not correct. In any case the demand is barred by limitation in this case.

4.1 Have heard Ms Prajakta Menezes learned Advocate on the behalf of Appellant and Shri M K Sarangi Learned Authorized Representative on the behalf of Revenue.

4.2 Learned Counsel arguing on the behalf of Appellants submitted that lending service perse is taxable but only part of the value of the lending service to the extent of interest is exempt, thus the service itself cannot be termed as exempted service as defined under Rule 2(e) of CENVAT Credit Rules, 2004. Since CC/OD service provided by them has been exempted only to the extent of the interest recovered, rule 6 of CENVAT Credit Rules, 2004 is not applicable as such in their case and they are not liable to make proportionate reversal of the CENVAT Credit in terms of Rule 6(3A)(c). She relied on the decisions as listed below to support her arguments

i. *GautamSahkari Bank Limited Vs Commissioner of Central Excise Aurangabad [2018 TIOL 1377 CESTAT Mumbai]*
ii. *Vaidyanath Urban Co-operative Bank Limited Vs Commissioner Aurangabad {2014 TIOL 3299 CESTAT MUM]*
iii. *Ambejogal Peoples Co operative Bank Ltd Vs Commissioner Aurangabad [2015 TIOL 2471 CESTAT MUM]*
iv. *Indus Ind Bank vs Commissioner Service Tax Chennai [2010 (18) STR 7834 (T-Chennai) Stay Order.*

She further submitted that they had no deliberate intention to either not disclose correct information regarding payment of Service tax liability by utilizing CENVAT Credit, or to evade payment of any tax. The Appellants had filed their ST-3 returns regularly on time disclosing all these transactions and hence extended period of limitation as provided cannot be invoked in the present case. Further since they were under a bonafide belief based on the legal fiction created by law that they were entitled to discharge the reverse charge liability by credit therefore there is no question of delayed or short payment of Service Tax, hence there can be no demand for interest under Section 75. Since the issue under consideration is in respect of interpretation of law, no penalty should have been imposed on them.

4.3 Learned AR arguing on behalf of revenue submitted that the issue involved in the matter has been comprehensively considered by the Kolkata Bench of Tribunal in case of UCO Bank Vs

Commissioner of Service Tax Kolkata [2014 (36) STR 1169 (T-Kol)], and they have held that

> *"A simple reading of the definition of 'exempted services' reveals that it also includes services that are exempt under section 66 of the Finance Act, 1994. In the present case, interest on overdraft facility and cash credit facility are exempted from service tax under section 66 of the Finance Act, 1994 by virtue of Notification No. 29/2004-ST dated September 22, 2004. Therefore, these services would definitely come under the scope of the definition of 'exempted services', hence, the argument of the learned CA that to attract rule 6(3) of the CENVAT Credit Rules, 2004, the entire taxable service, i.e., banking and financial services should be exempted and not few services mentioned under the categories of clause (ix) of the said banking and financial services, is untenable. Thus, the learned Commissioner is right in its approach to include the value of exempted services, namely, overdraft facility and cash credit facility in computing the CENVAT credit attributable to input services used in providing exempted services, as laid down under rule 6(3A)(c) of the CENVAT Credit Rules, 2004."*

In view of the above he argued in the favour of the order and requested to dismiss the appeal.

5. We have considered the submissions made. Issues involved in the Appeal are as follows-

i. Whether the income earned from Cash Credit, Over Draft and Bill Discounting would be regarded as exempted service under Rule 2(e) of CENVAT Credit Rules, 2004;
ii. Whether the Appellant would be required to reverse the CENVAT credit availed in respect of CC/ OD services;
iii. Whether the demand is barred by limitation.
iv. Whether the Interest under section 75 demandable from the Appellants.
v. Whether in facts and circumstances of the case Commissioner was justified in imposing the penalty on Appellants.

6.1 Issue involved is in respect of Cash Credit/ Overdraft facilities offered by the banking/ financial companies. Before the issue is taken up for consideration it is necessary to understand the two products under consideration.

i. Cash Credit Account is the primary method in which Banks lend money against the security of commodities and debt. It runs like a current account except that the money that can be withdrawn from this account is not restricted to the amount deposited in the account. Instead, the account holder is permitted to withdraw a certain sum called "limit" or "credit facility" in excess of the amount deposited in the account. Cash Credits are, in theory, payable on demand. These are, therefore, counter part of demand deposits of the Bank and a proper limit is sanctioned depending on the value of the commodities/debts pledged by the account holder with the Bank.

ii. Overdraft (OD Limit) is also a different kind of bank account where the account holder withdraws more money in excess of the balance available in his Account. Such drawl is allowed against securities including financial instruments like shares, units of mutual funds, surrender value of LIC policy and debentures or even the personal worth of account holder etc.

6.2 The definition of Banking and Financial Services (BOFS) as per section 65(12) of the Finance Act, 1994, at the relevant time is reproduced below:

(a) the following services provided by a banking company or a 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;
Explanation.—For the purposes of this item, 'financial leasing' means a lease transaction where—

- *(i) contract for lease is entered into between two parties for leasing of a specific asset;*
- *(ii) such contract is for use and occupation of the asset by the lessee;*
- *(iii) the lease payment is calculated so as to cover the full cost of the asset together with the interest charges; and*
- *(iv) the lessee is entitled to own, or has the option to own, the asset at the end of the lease period after making the lease payment.*

(ii) omitted;
(iii) merchant banking services;
(iv) securities and foreign exchange (forex) broking, and purchase or sale of foreign currency, including money changing;
(v) asset management including portfolio management, all forms of fund management, pension fund management, custodial, depository and trust services;
(vi) advisory and other auxiliary financial services including investment and portfolio research and advice, advice on mergers and acquisitions and advice on corporate restructuring and strategy;
(vii) provision and transfer of information and data processing; and
(viii) banker to an issue services; and
(ix) other financial services, namely, lending, issue of pay order, demand draft, cheque, letter of credit and bill of exchange, transfer of money including telegraphic transfer, mail transfer and electronic transfer, providing bank guarantee, overdraft facility, bill discounting facility, safe deposit locker, safe vaults, operation of bank accounts;
(b) foreign exchange broking and purchase or sale of foreign currency, including money changing provided by a foreign exchange broker or an authorised dealer in foreign exchange or an authorised money changer, other than those covered under sub-clause (a).
Explanation.—For the purposes of this clause, it is hereby declared that 'purchase or sale of foreign currency, including money changing' includes purchase or sale of foreign currency, whether or not the consideration for such purchase or sale, as the case may be, is specified separately."

6.2 From the perusal of the above definition it is quite evident that Banking and Financial Services, as defined comprises of a basket of various services provided by the Banking or Financial Company to its customers. Thus from the very definition it is very clear that the intention of the legislature, is not to treat the entire gamut of services provided by a banking/ financial Company en-block as a whole, or else the definition would have been simply *"all the services provided by a banking/ financial company to its customer."* By listing the various aspects and services provided by such banking/ financial company separately the intention of legislature is quite clear that each and every activity has to be treated separately for the purpose of levy of Service Tax and also for the purpose of exemption.

7.1 From the text of the definition specifically at clause (ix), it is clear that the Cash Credit/ Overdraft facilities provided by the bank/ financial company to its customers is taxable service. Notification No 29/2004-ST dated September 22, 2004, which provides exemption in relation to these services is reproduced below:

"In exercise of the powers conferred by sub-section (1) of section 93 of the Finance Act, 1994 (32 of 1994), the Central Government, being satisfied that it is necessary in the public interest so to do, hereby exempts so much of the value of taxable service provided to a customer, by a banking company or a financial institution including a non-banking financial company, or any other body corporate or commercial concern, in relation to,-

(a) overdraft facility;

(b) cash credit facility; or

(c) discounting of bills, bills of exchange or cheques,

as is equivalent to the amount of interest on such overdraft, cash credit or, as the case may be, discount, from the service tax leviable thereon under section 66 of the said Act, subject to the condition that the said interest amount is shown separately in an invoice, a bill or, as the case may be, a challan issued for this purpose."

7.2 From plain reading of the exemption notification it is quite evident that the said exemption notification do not exempt the Banking and Financial Services as such but only is in respect of one limb of the said service i.e. overdraft facility, cash credit facility and discounting of bills, bills of exchange or cheques. Further what has been exempted is equivalent to the amount of interest on such overdraft, cash credit or, as the case may be, discount. Appellants have argued that in respect of these services apart from the interest, there are certain administrative fees also charged from their customer which is liable to service tax as this exemption notification grants exemption only in respect of the interest charged and not the administrative fees. Hence these services are not exempt services as they are only partially exempted to the extent of the interest received by them for providing these services.

7.3 Reserve Bank of India (RBI) has issued a Master Circular UBD.BPD (PCB) MC. No. 5 / 13.05.000 / 2009-10 dated July 1, 2009, in respect of Management of Advances. Relevant extracts from the Circular, for the present controversy are reproduced below:

"1. BACKGROUND

1.1 In the context of rapid growth of primary (urban) co-op. banks (UCBs), qualitative aspects of lending, such as adequacy of lending to meet credit requirements of their borrowers and effective supervision and monitoring of advances have assumed considerable importance. Previously working capital finance provided by the banks to trade and industry was regulated by the Reserve Bank of India through a series of guidelines / instructions issued. There were various quantitative and qualitative restrictions on bank's lending. The banks were also expected to ensure conformity with the basic financial disciplines prescribed by the RBI from time to time under Credit Authorisation Scheme (CAS).

1.2 However, consistent with the policy of liberalisation and financial sector reforms, several indirect measures to regulate bank credit such as exposure norms for lending to individual / group borrowers, prudential norms for income recognition, asset classification and provisioning for advances, capital adequacy ratios, etc. were introduced by RBI and greater operational freedom has been provided to banks in dispensation of credit.

1.3 Banks are expected to lay down, through their boards, transparent policies and guidelines for credit dispensation, in respect of each broad category of economic activity, keeping in view the credit exposure norms and various other guidelines issued by the Reserve Bank of India from time to time. Some of the currently applicable guidelines are detailed in the following paragraphs.

1.4 Banks are now operating in a fairly deregulated environment and are required to determine their own interest rates on deposits (other than saving account) and interest rates on their advances. The interest rates on banks' investments in government and other permissible securities are also market related. Intense competition for business, involving both the assets and liabilities, together with increasing volatility in the domestic interest rates as well as foreign exchange rates, has brought pressure on the management of banks to maintain an optimal balance between spreads, profitability and long-term viability. The unscientific and ad-hoc pricing of deposits in the context of competition, and alternative avenues for the borrowers, results in inefficient deployment of resources. At the same time, imprudent liquidity management can put banks' earnings and reputation at great risk. These pressures call for a comprehensive approach towards management of banks' balance sheets and not just ad hoc action. The managements of UCBs have to base their business decisions on sound risk management systems with the ultimate objective of protecting the interest of depositors and stakeholders. It is, therefore, important that UCBs scrupulously follow the Asset-Liability Management (ALM) guidelines issued by the Reserve Bank of India.

4. CREDIT ADMINISTRATION

4.1 Rate of interest

4.1.1 UCBs are permitted to determine their lending rates taking into account their cost of funds, transaction costs etc with the approval of their Board. However, banks are advised to ensure that the interest rates charged by them are transparent and known to all customers. Banks are also required to publish the minimum and maximum interest rates charged on advances and display the information in every branch.

4.1.2. It may however be appreciated that though interest rates have been deregulated, rates of interest beyond a certain level may be seen to be usurious and can neither be sustainable nor be conforming to normal banking practice.

4.1.3. Boards of banks are, therefore, advised to lay out appropriate internal principles and procedures so that usurious interest, including processing and other charges, *are not levied by them on loans and advances. In laying down such principles and procedures in respect of small value loans, particularly, personal loans and such other loans of similar nature, banks may take into account, inter-alia, the following broad guidelines:*

(i) An appropriate prior-approval process should be prescribed for sanctioning such loans, which should take into account, among others, the cash flows of the prospective borrower.

(ii) *Interest rates charged by banks, inter-alia, should incorporate risk premium as considered reasonable and justified having regard to the internal rating of the borrower. Further, in considering the question of risk, the presence or absence of security and the value thereof should be taken into account.*

(iii) *The total cost to the borrower, including interest and all other charges levied on a loan, should be justifiable having regard to the total cost incurred by the bank in extending the loan, which is sought to be defrayed and the extent of return that could be reasonably expected from the transaction*

(iv) *In the case of loans to borrowers under priority sector, no penal interest should be charged for loans up to Rs.25,000. Penal interest may be levied for reasons such as default in repayment, non-submission of financial statements, etc. However, the policy on penal interest should be governed by well-accepted principles of transparency, fairness, incentive to service the debt and due regard to genuine difficulties of customers.*

(v) *Banks should ensure that the total interest debited to an account should not exceed the principal amount in respect of short term advances granted to small and marginal farmers. The small and marginal farmers for the purpose shall include those with land holding of 5 acres and less.*

(vi) *An appropriate ceiling may be fixed on the interest, including processing and other charges that could be levied on such loans, which may be suitably publicised."*

7.4 From the above mentioned Master Circular issued by RBI, it is quite evident that banks are free to determine their own interest rate after taking into account all the administrative expenses and the cost of advancing the loans, cash credit or overdraft facility. However all the purpose of the customer, or the bank financial institution all the recoveries made against such facilities would be classified under the category of interest. It is not the case after deregulation of the Banking and Financial services that the interest rates are externally dictated, but are to be determined by the banks themselves **taking into account their cost of funds, transaction costs etc** (Para 4.1 of the Master Circular). Thus the claim of the Appellant in respect of administrative fees etc., charged by them separately in respect of the CC/ OD services appear to be contrary to the said Master Circular.

7.5 In Reserve Bank of India Report dated 28 September, 2000 of the Working Group on Discounting of Bills by Banks, Para 3.4.2.1 following has been stated-

"Considering the fact that the banks are now permitted to offer tenor linked PLRs, and have the freedom to determine the rate of interest on bill finance, without linkage to PLR, conscious efforts are to be made by banks as well as trade and industry, to move over to a three-tier interest rate structure, corresponding to the style of credit (loans / bills / cash credit), for financing working capital. Pricing of each such component and its mix in the overall loan portfolio of the bank would depend upon individual bank's resource mix and transaction cost, the prevalent competitive market rates as well as the bank's own targeted maturity mix of its asset portfolio. ***Bill Discounting, being advantageous from the banker's point of view, can carry interest at a lower rate than the loan, whilst interest rate on loan component of working capital may be charged according to the tenor of the loan; Cash Credit may carry a higher interest rate in keeping with the international practice, where overdraft, which serves more or less an identical purpose as cash credit, attracts higher interest rate.*** *Still the banks have to contend with the transaction charges for handling the bills, which, if too high, may dissuade clients to opt for loan or cash credit in preference to bills."*

Thus from the above observations, it is quite evident that the actual consideration for the CC/ OD services is only higher interest rate and nothing else

7.6 Since the entire consideration received against the CC/ OD services is in nature of interest, the said services provided by them to their customer are exempt from payment of service tax under

Notification No 29/2004-ST dated 22nd September 2004. In terms of Rule 2(e) of the CENVAT Credit Rules, 2004, exempt services have been defined as to *"means taxable services which are exempt from the whole of the service tax leviable thereon, and includes services on which no service tax is leviable under section 66 of the Finance Act;".* Since in respect of these services the entire consideration received from the customer is exempt from payment of service tax these services would definitely be covered by the definition of exempt service as provided by this rule.

7.7 Courts have often employed the doctrine of pith and substance to understand the true nature of any entry in legal instrument. Applying the same doctrine for ascertain the true nature of exemption provided by the said notification, we are of the view that interest is not only the major component but is the only component for providing the said CC/ OD services. What so ever minor amounts appellants may have charged towards the administrative fees etc., will not in fact change the nature of exemption provided to the said services. Further even appellant cannot claimed that these services were being provided by them for a consideration of administrative fees. Even the customer while opting or selecting for the such facilities being provided by the banking, financial or even non-financial companies is ever much concerned about these charges whereas he is mostly concerned about the interest charges that he is required to pay as consideration for availing these services. Thus by exempting the value equivalent to interest recovered for providing these services, in fact, in pith and substance exemption has been granted to the services of CC/ OD provided by Banking and Financial Companies.

8.1 Rule 6 of the CENVAT Credit rules at the relevant period provided as follows:

"***6. Obligation of manufacturer of dutiable and exempted goods and provider of taxable and exempted services.***—
(1) and (2) . . .
(3) Notwithstanding anything contained in sub-rules (1) and (2), the manufacturer of goods or the provider of output service, opting not to maintain separate accounts, shall follow either of the following options, as applicable to him, namely:—

> *(i) the manufacturer of goods shall pay an amount equal to 10 per cent. of value of the exempted goods and the provider of output service shall pay an amount equal to eight per cent. of value of the exempted services; or*
>
> *(ii)the manufacturer of goods or the provider of output service shall pay an amount equivalent to the CENVAT credit attributable to inputs and input services used in, or in relation to, the manufacture of exempted goods or for provision of exempted services subject to the conditions and procedure specified in sub-rule (3A).*

Explanation I.—If the manufacturer of goods or the provider of output service, avails any of the option under this sub-rule, he shall exercise such option for all exempted goods manufactured by him or, as the case may be, all exempted services provided by him, and such option shall not be withdrawn during the remaining part of the financial year.
Explanation II.—For removal of doubt, it is hereby clarified that the credit shall not be allowed on inputs and input services used exclusively for the manufacture of exempted goods or provision of exempted service.
(3A) For determination and payment of amount payable under clause (ii) of sub-rule (3), the manufacturer of goods or the provider of output service shall follow the following procedure and conditions, namely:—
(a) and (b) . . .
(c) the manufacturer of goods or the provider of output service, shall determine finally the amount of CENVAT credit attributable to exempted goods and exempted services for the whole financial year in the following manner, namely:—
(i) and (ii) . . .

(iii) the amount attributable to input services used in or in relation to manufacture of exempted goods [and their clearance up to the place of removal] or provision of exempted services = (M/N) multiplied by P, where (M) denotes total value of exempted services provided plus the total value of exempted goods manufactured and removed during the financial year, (N) denotes total value of (output) and exempted services provided, and total value of dutiable and exempted goods manufactured and removed, during the financial year, and 1(P) denotes total CENVAT credit taken on input services during the financial year;"

8.2 Since we have held that the CC/ OD services provided by the appellant are exempt from payment of service tax to the extent of interest recovered, the view of Commissioner in including the quantum of interest recovered against the provision of said services for determination of the amount to be reversed in term of Rule 6(3A)(c) of the CENVAT Credit Rules, 2004 cannot be faulted with.

8.3. The view expressed by us is in line with decision of the Kolkata Bench of Tribunal in case of UCO Bank Vs Commissioner of Service Tax Kolkata [2014 (36) STR 1169 (T-Kol)].

8.4 In their submissions Appellants have placed reliance on the decisions referred in para 4.2. However we find that none of these decisions have considered the scheme of CC/ OD vis a vis the exemption notification No 29/2004-ST. These decisions have gone on the bare reading of the said exemption notification to hold that the said exemption notification are only partially exempting the said services, even without determining the non-exempted part of the said services which in our view distinguishes the said decisions from the decision rendered in case of UCO Bank. Further since these decisions have not considered the decision earlier rendered in case of UCO Bank, these decisions are sub-silento and cannot be followed.

9. It is further argued that since all these facts were disclosed by the appellant in their ST-3 returns, therefore, the demand of the CENVAT credit is barred by limitation. It is difficult at this stage, to ascertain whether all the facts in relation to these services and all facts including availment of CENVAT credit and its reversal as per rule 6(3A)(c) of the CENVAT Credit Rules, 2004 were disclosed is a question of fact which cannot be ascertained by us at this moment. Commissioner has also not recorded a specific finding in this regard in his order. In the interest of justice, therefore, the appellant be allowed a fair chance to present these evidences and be subjected to scrutiny/verification by the Department. Accordingly, we set aside the confirmation of demand of CENVAT credit and imposition of penalty and remand the case for redetermination of the liability, if any, only after determination of the issue on limitation.

10. Since we have upheld the order of Commissioner on the merit of issue and are remanding the matter for re-determination of issue on limitation, we have no hesitation in holding that interest under section 75 shall be recoverable on the amounts finally determined. Penalty also needs to be re-determined after determining the issue on limitation.

11. Thus we answer the questions framed in para 5, as follow:

i	Whether the income earned from Cash Credit, Over Draft and Bill Discounting would be regarded as exempted service under Rule 2(e) of CENVAT Credit Rules, 2004;	Yes.
ii	Whether the Appellant would be required to reverse the CENVAT credit availed in respect of CC/ OD services;	Yes
iii	Whether the demand is barred by limitation.	To be reconsidered
iv	Whether the Interest under section 75 demandable from the Appellants.	Yes but to be re-determined
v	Whether in facts and circumstances of the case Commissioner was justified in imposing the penalty on Appellants.	Yes but to be re-determined

12. Appeal filed is accordingly allowed by remand to adjudicating authority to consider the matter only on the ground of limitation and re-determine the amount of CENVAT Credit to be reversed under Rule 6(3A)(c) along with the interest under Section 75 and penalties to be imposed.

(Operative portion of the order pronounced in court)

(Dr. D.M. Misra)
Member (Judicial)

(Sanjiv Srivastava)
Member (Technical)

SM.