

Service Tax On Banking Services

The Service Tax on Banking and Financial Services was introduced with effect from 16th July 2001. Its scope, coverage and applicability has been widened in the successive years to include concerns rendering banking services other than the banks and also to bring other services under the Service Tax net. The changes/amendments to the Act were made on:

- 16th August 2002 to cover body corporates
- 1st July 2003 to include proprietorship, partnership and other enterprises providing Forex services.
- 10th September 2004 to

Input Service Distributor to seek registration.

Applicability

Clause (zm) of sub-section 105 of Section 65 of Chapter V of the Finance Act, 1994 sets out the applicability of the Service Tax on Banking services, which states that:

“taxable service means any service provided or to be 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 banking and other financial service”

CBEC Circular of 2002 has excluded ‘Chit Funds’ from the scope of “Banking & Other Financial Services”.

Definition

The applicability clause shall be read in the light of definitions of the terms referred to under the paragraph above. The relevant extract of

Regulation Act, 1949 (10 of 1949); (Section 65 (10))

“Banking Company” has the meaning assigned to it in Clause (a) of Section 45A of the Reserve Bank of India Act, 1934 (2 of 1934) ; (Section 65(11))

“Banking and Other Financial Services” means: -

(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:

- financial leasing services including equipment leasing and hire-purchase;
- credit card services;
- securities and foreign exchange (forex) broking;
- asset management including portfolio management, all forms of fund management, pension fund management, custodial, depository and trust services, but does not include cash management;
- advice and other auxiliary financial services including investment and portfolio research and advice, advice on mergers and acquisitions and advice on corporate restructuring and strategy;

- provision and transfer of information and data processing; and
- other financial services, namely lending ; issue of pay order, demand draft, cheque, letter of credit and bill of exchange; providing bank guarantee, overdraft facility, bill discounting facility, safe deposit locker, safe vaults ; operation of bank accounts;

(b) foreign exchange broking provided by a foreign exchange broker other than those covered under sub-clause (a) ; (Section 65 (12))

“Banking corporate” has the meaning assigned to it in clause (7) of section 2 of the Companies Act, 1956 (1 of 1956) ; (section 65 (14)).

“Financial institution” has the meaning assigned to it in Clause (c) of section 45-I of the Reserve Bank of India Act, 1934 (2 of 1934) ; (Section 65 (45))

The following circulars and notifications were issued by CBEC to clarify on the scope, applicability etc.

- Circular F. No. B.11/1/2002-TRU dated 9th July 2001 – On scope of Banking & Financial services
- Circular 41/4/2002 dated 15th wherein Service rendered by chit funds are excluded from Service Tax net.
- Circular 50/11/2002-ST dated 18th December 2002 on levy of Service Tax on Depository services.
- F. No. B.2/8/2004-TRU dated 10th September on new services

- Notification No. 29/2004 dated 22nd September of exclusion of interest
- Notification No. 13/2004 dated 10th September to exclude service rendered to Government

Registration

Basic Registration: The output service distributor, being the bank, shall seek registration, applying in Form ST-1 to the concerned Superintendent of Central Excise. Moreover, it is mandatory to seek PAN based Service Tax Code as per Circular No. 35/3/2001-CX-4 dated 27th August 2001.

Registration at Branch level of Head Office: Where the bank provides the taxable service from branches/offices located at various places, and has centralised billing system or centralised accounting systems in respect of such service and such centralised billing system or accounting system is located at more than one or more offices or premises, the bank may at its option register such premises or offices from where such centralised billing or accounting systems are located. (Vice Rule 4(2) of the Service Tax rules, 1994)

However, in case where the bank provides the taxable service from branches/offices located at various places, and does not have centralised billing system or centralised accounting systems, as the case may be, the bank shall make separate applications for registration in respect of each such branch/office, to the jurisdictional Superintendent of Central Excise. (Vice Rule 4(3A) of the Service Tax rules, 1994).

It is indeed pertinent to

note that in the era of Core banking solution being adopted by most banks and total computerisation being carried out, single registration would be operationally convenient. This implies that the branches record the Cenvat Credit on input services and communicates to the Controlling office on timely basis.

Valuation

As per Section 67 of the Finance Act, 1994, the value of taxable service in relation to services provided by a banking company or a financial institution including a non-banking financial company or any other body corporate or any other foreign exchange broker shall be the Gross Amount charged by the service provider.

However, Explanation (2) to the above-referred section gives a breather where the service provider levies no separate Service Tax. Accordingly, where the gross amount charged by the service provider is inclusive of Service Tax payable, the value of taxable service shall be such amount as with the addition of tax payable, is equal to the gross amount charged.

For instance, where a bank charges locker rent of Rs. 1000 per year (gross), the break up value shall be Rs. 907 towards locker rent, Rs. 91 towards Service Tax and Rs. 2, being education cess.

Charge of Service Tax, as per Section 66 is 10 per cent. To this education cess of 2 per cent of Service Tax shall be charged.

Exclusions

Certain exclusions from

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This article proposes to give a broad view of the operation of Service Tax on Banking and Other Financial Services. It discusses the applicability of the Act, specific exclusions, registration to be followed for proper compliance, method of valuation and also the Cenvat Credit utilisation. One may observe that except interest income all other income (particularly fee-based) attracts Service Tax. It is indeed imperative that the banks/institutions avail the Cenvat Credit available via various input services/input (including Capital Goods), lest it dents into the bottomline.

include Commercial concerns and defining specifically what ‘Other Financial Services’ mean

- 16th June 2005 requiring

relevant portions of the Act is reproduced below:

“banking” has the meaning assigned to it in clause (b) of Section 5 of the Banking

the levy of the Service Tax has been made in respect of;

1. Charges collected from the Government for collecting taxes & duties are exempt from Service Tax [Notification No.13/2004-st, dated 10-9-2004]

2. Interest income (under section 67 (g)(viii) of the Finance Act, 1994)

3. That portion of (a) services provided by a commercial concern, other than a banking, other company or a Financial Institution, including a NBFC or any other body corporate, in relation to banking and other financial services; and (b) services provided to a customer by a banking company or a FI, including a NBFC, or any other body corporate in relation to banking and other financial services namely lending issues of pay order, demand draft, cheques, letter of credit and bill of exchange; providing bank guarantee, over draft facility, bill discounting facility, safe deposit locker, safe vaults; operation of bank accounts, are exempt from the whole Service Tax which is received by the service provider prior to 10-9-2004 [Not.No.25/2004-ST, dated 10-9-2004].

4. The value of taxable service provided to a customer, by a banking company or a Financial Institution, including NBFC, or any other body commercial concern, in relation to, (a) overdraft facility; (b) cash credit facility; or (c) discounting of bills, bills of exchange or cheques, is exempt, 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, 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. [Not. No. 29/2004-ST, dated 22-9-2004.

Cenvat Credit for Input Services & Capital Goods

Background: Cenvat Credit rules, 2004 were issued on 10th September 2004 in supersession of Cenvat Credit rules, 2002 and Service Tax credit rules, 2002. The Cenvat Credit rules set a framework for availing credit on input services and goods used for providing output services liable for Service Tax.

Definition of the key terms: Sec 2 (k) (ii)- "Input" means all goods, except light diesel oil, high speed diesel oil, motor spirit, commonly known as petrol and motor vehicles, used for providing any output service;

Sec 2 (l)- "Input service" means any service,-

- (i) used by a provider of

Cenvat Credit can be availed for Capital Goods, which are used for providing output services apart from goods listed under Rule 2 (a)(A)(i)

taxable service for providing an output service; and includes services used in relation to setting up, modernisation, renovation or repairs of a factory, premises of provider of output service or an office relating to such factory or premises, advertisement or sales promotion, market research, storage up to the place of removal, procurement of inputs, activities relating to business, such as accounting, auditing financing, recruitment and quality control, coaching and training, computer networking, credit rating, share registry, and security, inward transportation of inputs or capital goods and outwards transportation up to the place of removal;

Sec 2 (p)- "output service" means any taxable service provided by the provider of taxable service, to a customer, client, subscriber, policy-holder or any other person, as the case may be, and the expressions 'provider' and 'provided' shall be construed accordingly;

Explanation: For the re-

moval of doubts it is hereby clarified that if a person liable for paying Service Tax does not provide any taxable service or does not manufacture final products, the service for which he is liable to pay Service Tax shall be deemed to be the output service;

Rule 4A of Service Tax Rules, 1994 provides that the service provider has to issue invoice, Bill or Challan with the following particulars. This implies that the bank or such other institution shall obtain invoice from the input service provider, which shall essentially be;

1. Serially numbered
2. Signed by such person or an authorised person
3. The Invoice must necessarily contain the following particulars;
 - The name, address and registration number of the service provider.
 - The name and address of the service receiver.
 - Description, classification and value of taxable service provided or to be provided.
 - The Service Tax payable thereon.

There is an exception for the banking company or a financial institution including a non-banking financial company, or any other body corporate or commercial concern when they issue invoice, bill or challan, it is not compulsory that it contains address of the service provider or be serially numbered. In simple words, even Bank Debit Advice, which contains the name and address of the bank, value of service, amount of Service Tax, name of the service re-

ceiver acceptable and Service Tax Credit can be claimed on the basis of this document.

Utilisation of Cenvat Credit

As per Rule 3 of the Cenvat Credit Rules 2004, a provider of taxable service shall be allowed to take credit of duty paid on-

- i) Any input or capital goods received in the factory of manufacture of final product or premises of the provider of output service on or after the 10th day of September, 2004; and
- ii) Any input service received by the manufacturer of final product or by the provider of output services on or after the 10th day of September, 2004.

And as per Rule 4 (e) of the Cenvat Credit Rules, 2004, the credit may be utilised for the payment of – Service Tax on any output service.

Provided that while paying duty of excise or Service Tax, as the case may be, the Cenvat Credit shall be utilised only to the extent such credit is available on the last day of the month or quarter, as the case may be, for payment of duty or tax relating to that month or the quarter, as the case may be.

Cenvat Credit can be availed for Capital Goods, which are used for providing output service apart from goods listed under Rule 2 (a)(A)(i).

It matters from whom the Capital Goods are bought

It is relevant for the bank/institution as to from whom it buys the capital goods such as Computer/ATM machines/

Air conditioners since any purchase from a person beyond Second Stage dealer would not entitle the bank/institution to claim the Cenvat Credit. The description of persons selling the goods (and issuing invoice) and related terminologies used in the Cenvat Credit rules are presented in the Table A.

Distribution of Input Service amongst various offices

It is indeed possible to distribute input credit of Service Tax though bills of input service are received at Head office or central office despite no taxable service being rendered by these offices. And such Head office or Central office is described as "Input Service Distributor".

Input service Distributor, as per Rule 2(m) of Cenvat Credit Rules, 2004 means; an office of the manufacturer or producer of the final products or provider of the output service, which receives invoices under rule 4A of the Service Tax rules, 1994 towards purchase of input services and issues invoice, bill or, as the case may be, challan, for the purposes of distributing the credit of Service Tax paid on the said services to such manufacturer or producer or provider as the case may be.

Registration of Input Service distributor

Notification No. 27/ 2005 dated 7th June 2005, which has become operational with effect from 16th June 2005 has prescribed that the input service distributor shall make an application to the jurisdictional Superintendent of Central

Table A

Description of the person issuing invoice	Where the equipment is	
	manufactured in India	Imported
Primary person (Author's usage)	Manufacturer	Importer
First stage dealer	One who purchases the goods directly from manufacturer or from the depot of the manufacturer or from the premises of consignment agent (Rule 2 (ij)(i))	One who purchases the goods directly from importer or from the depot of the importer or from the premises of consignment agent (Rule 2 (ij)(ii))
Second Stage dealer	Dealer who purchases	the goods from First Stage dealer
Bank/FI/NBFC/Body corporate	Output service provider	

Indicative list of input services on which Service Tax credit can be availed

The following input services are only an indicative list and the list may be altered to suit the bank's/institution's requirement.

Sl	Input service	Description
1	Advertisement	In respect of bank's products, new branch opening, ATM installation
2	Actuarial	For Gratuity valuation, leave salary provisioning
3	Business auxiliary	Particularly, when the bank outsources its tasks and such unit levies Service tax.
4	Chartered Accountant	For carrying out Statutory, Inspection, Concurrent audit, etc.
5	Company Secretary	Registration of charge, Conducting Search at Registrar of Companies
4	Credit Rating Agency	For sums paid to CRISIL, ICRA etc for market information, industry trends
5	Courier Agency	Despatch of documents
6	Electronic data interchange	Payment to Internet service providers, VPN operators
7	Interior decorator	For office modernisation, unless capitalised.
8	Leased line circuit	To conduct the Core banking solution
9	Manpower recruitment	For hiring staff (Excl. staff who handle investment portfolio since there is no service tax incidence on this)
10	Maintenance & Repair	AMC and Repair of Computers, Servers, Air conditioners, Currency counting machines, ATM equipment (more...)

Excise for registration within a period of thirty days of the commencement of business or the 16th day of June, 2005. This implies that the Registration must be applied for before 15th July 2005.

Manner of distribution and returns to be furnished

As per rule 7 of Cenvat Credit rules, 1994, the input service distributor may distribute the Cenvat Credit in respect of the Service Tax paid on the input service to its manufacturing units or units providing output service, subject to the condition that: -

(a) credit distributed against a document referred to in rule 9 does not exceed the amount of Service Tax paid thereon;

For instance where in a Core Banking Environment, a network connectivity provider would levy Service Tax on the Connectivity Charges. The charges would be payable for connectivity between the branch and Central Server location. And say, Head Office acts as the input service distributor with each branch/office having separate registration, then the aggregate of Service Tax distributed among various branches shall not exceed the total Service Tax levied by the input service provider.

(b) credit of Service Tax attributable to service use in a unit exclusively engaged in manufacture of exempted goods or providing of exempted services shall not be distributed.

Again for instance, the connectivity charges between the Terminal used at Invest-

ments Department and H.O cannot be used for availing credit since the Service Tax incidence does not arise in respect of revenue.

Moreover, the Input Service Distributor shall furnish half-yearly returns, as prescribed under Rule 9(10) of Cenvat Credit Rules, 2004. Such return shall be submitted before the end of the month following the half-year.

Suggestive format of Ser-

Sl	Input service	Description
11	Rent-a-cab scheme	Where the taxis are hired to conduct unit inspection.
12	Security agency	Provided at bank's branches, ATMs
13	Telephone & Telegraph	Use of office telephones, other than those used by investment department
14	Mass list compilation & mailing	Where mass mailing services are used by the bank to publish the products, for example credit card applications, etc
15	Cleaning	Where day-to-day cleaning etc carried out by outside agency other than bank's directly hired staff

INPUT SERVICE TAX DISTRIBUTION
(Sub-rule (2) of rule 4A of the Service Tax rules, 1994)

Issued by	Bank (with complete address)	Document No.	NN			
Recipient	Branch (with complete address)	Date	dd-mm-yyyy			
Name, address of input service provider	Service tax registration no. of the service	Invoice/Bill No. & Date	Service tax as per Invoice/ Bill	Education cess as per Invoice/ Bill	Service Tax as applicable to your office	Education cess as applicable to your office
Total						
Your office is hereby advised to take credit of the Service Tax and cess mentioned above while remitting the Service tax.						

vice Tax credit transfer by input service distributor to the units/branches/offices rendering output services is as shown above:

Conditions for allowing Cenvat Credit

- 1) The Cenvat Credit in respect of inputs may be taken immediately on receipt of the inputs in the factory of the manufacturer or in the premises of the provider of output service:
- 2) (a) The Cenvat Credit in respect of capital goods received in a factory or in the premises of the provider of

output service at any point of time in a given financial year shall be taken only for an amount not exceeding fifty percent of the duty paid on such capital goods in the same financial year:

(b) The balance of Cenvat Credit may be taken in any financial year subsequent to the financial year in which the capital goods were received in the factory of the manufacturer, or in the premises of the provider of output service, if the capital goods are in the possession of the manufacturer of final products, or provider of output service in such

subsequent years.

- 3) The Cenvat Credit in respect of the capital goods shall be allowed to a manufacturer, provider of output service even if he acquires the capital goods on lease, hire purchase or loan agreement, from a financing company.
- 4) The Cenvat Credit in respect of capital goods shall not be allowed in respect of that part of the value of capital goods which represents the amount of duty of such capital goods, which the manufacturer or provider of output service claims as

depreciation under section 32 of the Income-tax Act, 1961 (43 of 1961).

- 5) The Cenvat Credit in respect of input service shall be allowed, on or after the day on which payment is made of the value of input service and Service Tax paid or payable as is indicated in invoice, bill or, as the case may be, challan referred to in rule 9.

Further, as per Rule 9(5), the manufacturer of final products or the provider of output service shall maintain proper records for the receipt, disposal, consumption and inventory of the input and capital goods in which the relevant information regarding the value, duty paid, Cenvat Credit taken and utilised, the person from whom the input or capital goods have been procured is recorded and the burden of proof regarding the admissibility of the Cenvat Credit shall lie upon the manufacturer or provider of output service taking such credit.

Also, Rule 9(6) requires, the manufacturer of final products or the provider of output service shall maintain proper records for the receipt and consumption of the input services in which the relevant information regarding the value, tax paid, Cenvat Credit taken and utilised and the person from whom the input service has been procured is recorded and the burden of proof regarding the admissibility of the Cenvat Credit shall lie upon the manufacturer or provider of output service taking such credit.

Rule 9(8) stipulated that a first stage dealer or a second

stage dealer, as the case may be, shall submit Return within fifteen days from the close of each quarter of a year.

(Banks/institution must ensure that this is being done from its Vendors who supply Computers/peripherals, ATM machines and other goods)

Rule 9(9) – The provider of output service availing Cenvat Credit, shall submit a half-yearly return to the Superintendent of Central Excise, by the end of the month following the particular quarter or half year.

(Applicable for all instances since Cenvat Credit is being availed by the bank/institution)

Rule 9(10) – The input service distributor, shall submit a half yearly Statement, giving the details of credit received and distributed during the said half year to the Superintendent of Central Excise, by the end of the month following the half year.

Payment of Service Tax and submission of returns

Who is liable? As per Section 68 of the Finance Act, 1994, every person providing taxable service to any person shall pay Service Tax at the rate specified under section 66 of the said Act.

As mentioned in para 2.02, it depends whether the Branch/office or the office maintaining centralised billing/accounting system that shall remit the tax.

Payment of tax: The service provider shall pay the tax using TR-6 challan quoting the correct accounting codes,

after taking into account Service Tax/Cenvat Credits available.

Should there be delay in remittance of tax, the same attracts 13 per cent simple interest (Section 74)

As amended by Finance Act, 2005, tax shall be remitted within 5th day of succeeding month in respect of previous month tax recovery.

Accounting Codes to be used for remittance: The following accounting codes shall be used in relation to remittance of tax and other sums.

00440173 – Banking & Other financial services

00440174 – Other receipts representing interest, penalty for delayed payment of Service Tax

00440297 – Education cess

However, it is noted that most banks/entities while remitting the education cess, quote “00440174” and not “00440297”. This may lead to anomalous situation where the Central Excise department would be finding it difficult to match Education cess with Service Tax. This becomes even more pronounced when the department realises that receipt of Interest/Penalty where the same may not have arisen due to timely remittance.

Returns to be submitted: Half yearly returns in Form ST-3 (in triplicate) shall be submitted before 25th October for Half year April 1 to September 30 and before 25th April for the Half year October 1 to March 31 of a financial year. Together with form ST-3, copies of TR-6 challan should be attached. □