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Banks may not have to pay service tax for facilitating international trade

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Indian banks will not have to pay goods and services tax (GST) on reverse charge mechanism for facilitating trade for exporters or importers through foreign banks, if a recent ruling by an appellate tribunal is to go by.

In a Rs 110-crore relief to State Bank of Bikaner & Jaipur (SBBJ), now merged with State Bank of India, the Delhi Customs, Excise Service Tax Appellate Tribunal (CESTAT) has ruled that the bank is not liable to pay the erstwhile service tax on a reverse charge mechanism. This is because it was not the recipient of any service rendered by the foreign bank and no consideration was paid by it.

The case may act as a precedent for other service tax and GST cases, where banks may been held liable to pay tax on reverse charge for merely being facilitators for exporters or importers.

To facilitate trade, Indian banks provide services to exporters by sending the export documents to the bank of the importer abroad and collect payment. The role of the Indian bank, SBBJ in this case, is to settle the payment relating to export/import of trade, for which it charges service tax to the exporters. All such foreign trade transactions have to be necessarily routed through normal banking channels as is provided for in the Foreign Exchange Management Regulations.

In a 2017 order, commissioner of central excise and service tax had served SBBJ a demand of Rs 110.84 crore towards service tax. It came with interest and penalty for not paying service tax on foreign bank charges under the reverse charge mechanism for the period between October 2010 and March 2015.

The CESTAT, in its 39-page order, said the bank cannot be said to be the recipient of service for the activities undertaken by the foreign banks situated outside India, the charges for which are deducted at source on the export bill. The appellant bank merely acts on behalf of the Indian exporter and facilitates the service.

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“The appellant bank, therefore, would not be liable to pay service tax under the reverse charge mechanism,” the order said.

The appellate body noted that a similar demand for an earlier period was dropped on two grounds. The foreign bank does not transact the business of banking in India. Therefore, it would not fall in the definition of a banking company, which is a pre-requisite for a service to be covered under ‘banking and other financial services.’ Secondly, the Indian bank does not pay any amount to the foreign bank and, in fact, only plays the role of a mediator between the Indian exporter and the foreign banker, representing the foreign importer. No ‘consideration’ was paid to SBBJ for the transactions.

Ranjeet Mahtani, partner, Dhruva Advisors, said that the principal bench of the tribunal has settled the vexed issue of whether the exporter’s Indian bank is the recipient of services from the correspondent / intermediary foreign bank, which co-assists in settling accounts for an export invoice.

The judgment rendered in SBBJ’s case concludes that the Indian bank does not receive the services, that there is no consideration paid by it. So, it concludes that there can be no obligation for payment of service tax on reverse charge basis. Previously, in BGR Energy’s case, the Madras High Court concluded that the exporter is liable to pay service tax, as it is the recipient of services.

He added that the ratio of this judgment is relevant for taxpayers and banks in the GST regime as well.

The Central Board of Indirect Taxes and Customs (CBIC) had provided a contrary clarification that the Indian bank receives services from the overseas correspondent bank.