2013 (1) ECS (158) (Tri-Ahd)

IN THE CUSTOMS, EXCISE & SERVICE TAX APPELLATE TRIBUNAL
WEST ZONAL BENCH AT AHMEDABAD

M/s Housing & Development Corporation Ltd. (HUDCO)

Versus

CST Ahmedabad

Appeal No.ST/303/2009

Arising out of: 010 No.STC/01/09/COMMR/AHD/2009, dt.28.4.09 Passed by: Commissioner of Service Tax, Ahmedabad

Appellant:
M/s Housing & Development Corporation Ltd. (HUDCO)

Respondent:
CST Ahmedabad

Represented by:
Shri Jigar Shah, Adv.for Assessee.
Shri S.K. Mall, A.R. for the Revenue.

CORAM:
MR.M.V. RAVINDRAN, HON'BLE MEMBER (JUDICIAL)
MR. B.S.V. MURTHY, HON'BLE MEMBER (TECHNICAL)

Date of Hearing: 08.09. 11
Date of Decision: 25.11.11

ORDER No. A/2057/WZB/AHD/2011, dt. 8.9.11/25.11.11

"It has to be noted that when a borrower makes a prepayment and therefore pays interest separately upto the date of payment, that amount is shown separately as interest and prepayment charges are not collected as interest, but collected as

prepayment charges. Further, even though the borrower has already borrowed the money and the process is over, when prepayment is proposed, borrower is expected to make a request which has to be considered by lender, charges worked out and informed and paid along with principal and interest upto the date of payment. Therefore, there is definitely an element of service involved in considering the request of the borrower for prepayment of loan, fixing of prepayment charges, collection of the same and closure of loan. These activities can be definitely in relation to Banking & other Financial services, which includes lending after 10.09.04. Further, when loans are fore-closed, the situation gives rise to the issue of asset liability mis-match for the lender since lender has to find alternative source for deployment of such funds. Prepayment charges are the charges leviable by a bank/lender to offset the cost of such finding such alternative source for deployment of fund and also intended to make exit difficult for the borrower. This shows that prepayment charges can never be considered to be in the nature of interest." [Para 10]

"When the proposal is made for prepayment of loan or resetting, processing the application is involved. Therefore, there is definitely an element of service in prepayment of loan or resetting of interest. As already discussed earlier, the definition covers any activity in relation to lending." [Para 14]

"Further, in the case of resetting, the relationship between the lender and the borrower does not cease to exist and loan also continues. Therefore, resetting of interest rate can be definitely considered as a service rendered by the appellant in relation to lending and is covered by Service Tax definition." [Para 15]

Per: MR. B.S. V. Murthy:

1. The appellant is registered with the Department under the category of 'Banking and other financial services' and paying Service Tax on the services provided. The assessee is involved in the business of providing finance for housing and urban development. During the course of audit by the Department, it was noticed that the appellant was collecting reset charges from their customers but was not paying Service Tax on the same. It was also observed that the appellant had received the income under the head 'reset' charges and issued receipts to their customers as 'Reset charges' during the financial year 2004-05. It was also observed that during the financial year 2006=07 and 2007-08, the appellant was recovering prepayment charges, on prepayment of part/full loan during the loan period, under the Head 'Additional Interest (prepayment) but were not paying any Service Tax on such charges.

2. A Show Cause Notice was issued for recovering the Service Tax payable on these reset charges and prepayment charges which werecollected under the head 'Additional Interest' by considering the same as taxable value under the category of 'Banking and other

financial services'. The said demand was confirmed by the Commissioner of Service Tax, Ahmedabad against which the appellant has filed the present appeal.

3. The appellant has filed the present appeal on the following grounds:

i) Prepayment charges are not in relation to Banking other financial services and therefore not liable to Service Tax.

ii) Reset charges are not in relation to Banking and otherfinancial services and therefore not liable to Service Tax.

iii) The reset charges/prepayment charges are not the consideration for providing any value addition to the services, therefore not liable to Service Tax.

iv) Reset charges/prepayment charges charged to the customers by the appellant is in the nature of additional interest only and, therefore, not liable to Service Tax.

v) The agreements of lending entered prior to 10.09.2004 by the appellants are not chargeable to Service Tax.

vi) Extended period of limitation cannot be invoked as they are a wholly owned Government company and there cannot be any malafide on their part to evade payment of tax.

4. We have heard both sides and considered the submissions made during the course of hearing and in the written submissions and also have gone through the records.

5. The first submission was that prepayment charges and reset charges are not in relation to 'Banking and other financial services' and therefore not liable to Service Tax at all. Reliance was placed on the decision of European Court of Justice in the case of Societe thermale d'Eugenie-les-Bains Vs Ministere de I'Economie, des- Finances et de I'Industrie. In that case, it was held that when the client exercises cancellation option available to him in respect of hotel services and cancellation charges are retained by hotelier, it cannot be considered as having any direct connection with the supply of any service for consideration and therefore not liable to value added tax. In the case of B.A.Z. Bausystem AG Vs. Finanzamt Munchen Fur Korperschaften [1982] 3 C.M.L.R. 688, it was revealed that where interest/damages plus interest are awarded for breach of contract, interest cannot be included in the taxable amount. In the Master Circular No.96/7/2007-ST, dt.23.8.07, it was clarified that the Service Tax is not liable on account of collection of surcharge for delayed payment of telephone bill. This was submitted to support the view that only those charges which have direct nexus/connection with the provisions of services are to be charged Service Tax. The appellant also relied upon the Circular of the Board No.121/3/2010-ST, dt.26.4.10, to submit that the clarification given that the

detention charges for containers is not chargeable to Service Tax, will be applicable to the issue in this case also. For income tax purpose, reset charges and prepayment charges are treated as interest and the appellant themselves have treated the same as interest. They also relied upon the decision of the Tribunal in the case of Small Industries & Development Bank of India (SIDBI for short) 2011(23) STR 392 (Tri-Del), to support their submission that collection of prepayment charges and reset charges have nothing to do with any service and therefore is not covered under Banking and other financial services. It was also submitted that for the subsequent period, the Commissioner (Appeals) also followed this decision in his order dt.10.08.11. On the other hand, it was submitted on behalf of the Revenue that the decision in the case of SIDBI, would not be applicable since it was rendered when the definition of service itself was different. Further, by referring to the definition as per Finance Act, 1994, it was submitted that any service in relation to lending would attract Service Tax and prepayment charges and reset charges are definitely relatable to lending.

6. When borrower prefers to make prepayment of part/full amount of loan during the loan period, the appellant levies prepayment charges on the amount prepaid. It was submitted that this amount is dependent upon the tenure of loan, differential interest and the interest loss that may have to be borne by the appellant and further balance repayment period etc. According to the appellant, these charges are nothing but additional interest and they treat it as interest income and income tax department also treats it as interest income. In case of finance on fixed interest loan, rate of interest remains fixed for a period of 5 years. But, if the borrowers fulfills certain conditions before expiry of 5 years, the borrower is given an option to opt for floating rate of interest loan. At the time of conversion of fixed rate of interest loan into floating rate interest loan, reset charges are levied. Ld.Counsel for the appellant also explained that these calculations are made on certain parameters. The question that arises whether such charges are includible for the purpose of levy of Service Tax on 'Banking and other financial services'.

7. Before we proceed further, it would be appropriate to reproduce the definition of 'Banking and other financial services' as it- existed prior to 10.09.04 and after 10.09.04. The definition as it existed prior to 10.09.04 was reproduced in the order of the Tribunal in the case of SIDBI and the same is reproduced as under:

"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, namely:

(i) financial leasing services including equipment leasing and hire purchase by a body corporate;

(ii) credit card services;

(iii) merchant banking services;

(iv) securities and foreign exchange (forex) broking;

(v) asset management including portfolio management, all forms of fund management, pension fund management, custodial depository and trust services, but does not include cash management;
(vi) advisory and other auxiliary financial services including investment and portfolio research and advice, advice on mergers and acquisition and advice on corporate restructuring and strategy; and
(vii) provision and transfer of information and data processing:

8. This definition of 'Banking and other financial services' was amended by Finance Act, 2004 and the present definition as amended reads as under:

"banking and 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:-
(i) financial leasing services including equipment leasing and hire purchase;
(ii) credit card services;
(iii) merchant banking services;
(iv) securities and foreign exchange (forex) broking;
(v) asset management including portfolio management, all forms of fund management, pension fund management, custodial, depository and trust services, but does not include cash management;
(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; and
(vii) provision and transfer of information and data processing; and

(viii) 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 discountingfacility, safe deposit locker, safe vaults, operation of bank accounts;

(b) foreign exchange broking provided by a foreign exchange broker other than those covered under subclause (a);

From the above, it can be seen that sub-clause (viii) and clause (b) marked bold were added in the 2004 Budget thus expanding the scope of services. "

9. A taxable service is defined under Section 65(105) (zm) of Finance Act, 1994 and is as under:

"Taxable service means any service provided or to be provided to any person by a banking or a financial institution including non-banking financial company or any other body corporate or commercial concern, in relation to banking and other financial service."

10. The definitions produced as above, would show that all the services related to lending form part of the taxable service. Therefore, the question is whether the prepayment charges and charges levied for resetting the interest rate form a part of the lending process or not. If the amounts collected are in the nature of interest, no Service Tax is leviable since there is no Service Tax on the interest, but only on the activity of lending. The appellants have contended that such charges are nothing but interest and are treated as interest. The question to our mind is not whether how the appellants are treating it or income tax department is treating. it, but the question is whether the activity of collecting prepayment charges and reset charges in respect of a borrower can be called as service in relation to lending. When a borrower opts for prepayment of loan, as submitted by the appellants themselves, the tenure of the loan, reason for the prepayment, track record of the borrower in servicing loan, the interest rate existing at the time of lending and at the time of closure, and the loss to the lender because of prepayment are taken into account. Admittedly, the prepayment charges vary from borrower to borrower, according to the appellant themselves. Further, it is collected for premature closure of the loan and it is not the interest factor that is taken into account. It has to be noted that when a borrower makes a prepayment and therefore pays interest separately upto the date of payment, that amount is shown separately as interest and prepayment charges are not collected as interest, but collected as prepayment charges. Further, even though the borrower has already borrowed the money and the process is over, when prepayment is proposed, borrower is expected to make a request which has to be considered by lender, charges worked out and informed and paid along with principal and interest upto the date of payment. Therefore, there is definitely an element of service involved in considering the request of the borrower for prepayment of loan, fixing of prepayment charges, collection of the same and closure of loan. These activities can be definitely in relation to Banking & other Financial services, which includes lending after 10.09.04. Further, when loans are fore-closed, the situation gives rise to the issue of asset liability mis-match for the lender since lender has to find alternative source for deployment of such funds. Prepayment charges are the charges leviable by a bank/lender to offset the cost of such finding such alternative source for deployment of fund and also intended to make exit difficult for the borrower. This shows that prepayment charges can never be considered to be in the nature of interest.

11. The appellants relied upon the judgment of Tribunal in the case of SIDBI, wherein the Tribunal had held that the activity of foreclosure of the loan cannot be treated as Banking & other Financial Service.

12. We have considered the decision of the Tribunal in the case of SIDBI. In that case, the demand for Service Tax was made on the amount collected for prepayment of direct loan from the customer. In that case also, as in the present case, it was submitted by the appellant that foreclosure of loan is a case of ending service and foreclosure charges are basically in lieu of interest loss and to prevent the customer from indiscriminately seeking foreclosure. While considering the issue, Tribunal took note of the definition of Banking & other Financial Services as existed prior to amendment only. After reproducing the definition, the Tribunal has observed that "the authorities below

have not indicated as to which category of the definition, the activity of foreclosure falls under. Foreclosure is an ending of loan already given and cannot be treated as a service to the customer of loan and hence the same cannot be treated as rendering any services by the financial institution. We agree with the ld.Advocate that it is a case of withdrawing services rendered at the request of customer and the foreclosure premium is a kind of compensation for possible loss of expected revenue, on the loan amount returned by the customer. The most important aspect to be taken note of is the fact that during the relevant time, the services provided in relation to lending were not taxable. Therefore, the Tribunal had no occasion to consider whether the service was in relation to lending. The appellants contended that the Tribunal had considered the issue and come to the conclusion that the activity of foreclosure is amounting to withdrawal of the service and not providing any service at all and therefore, the decision of the Tribunal in the case of SIDBI would be still applicable even though the definition was different. At this stage, we have to take note of the fact that in the case of SIDBI, the Department had not even indicated as to which part of the definition, the activity of foreclosure falls under. The observations of the Tribunal in the order start with this sentence. There was no discussion as to the nature of payment, method adopted, how it is covered under the definition and why it is taxable. When the definition itself did not cover the lending activity itself, the question as to whether the prepayment of loan is a part of service or not, was not considered and could not have been considered. The observations of the Tribunal have to be considered in the context in which they were made and in line with which provisions they were made and it is also to be taken note that the decision is in the light of the submissions made by both sides. In this connection, we find it appropriate to take note of the decisions cited by the Id.Authorised representative appearing for the Department and listed below, to support his submission that the facts of the decision relied upon have to be shown, and the ratio of the case is what is decided therein in the facts of the case and not what logically can be deducted from the same.

i) Collr.of CCE, Calcutta Vs Alnoori Tobacco Products 2004 (170) ELT 135 (SC)
ii) CCE Bangalore Vs Srikumar Agencies 2008 (232) ELT 577 (SC)
iii) Sneh Enterprises Vs CC New Delhi 2006 (202) ELT 7 (SC)

13. We find that these decisions support the submissions. We have already seen that in the case of SIDBI, the facts were not discussed in detail, statutory provisions were different and the submissions were different.

14. The two decisions of the European Court cited by the Id.Counsel are not appropriate since they do not really relate to Banking & other Financial Services. Further without comparing statutory provisions, it will not be appropriate to rely upon the decision of the European Court, for Indian cases. The appellants also relied upon the decision of Hon'ble High Court of Madras in the case of Edupuganti Pitchayya & Ors Vs Gonuguntla Venkata Ranga Row, dt.20.10.43. In that case, Hon'ble High Court took a view that out of the amount collected over and above the principal is in the nature of interest and it denotes consideration of or otherwise in respect of loan or retention by one party of some of money or other property belonging to another. This was submitted to support the view

that prepayment charges and reset charges are nothing but interest. In this case, prepayment/reset charges are not in the nature of interest at all but is in the nature of charge for early closure of loan/resetting of loan and is relatable to lending since it either closes the loan or charges the terms and hence it cannot be equated with interest at all. It has to be noted that in the case of prepayment, interest is collected separately till the date of prepayment. It is also not necessary that when a loan is prepaid or reset, the lender suffers. In fact, foreclosure by prepayment and reset are relatable to lending and if an application for processing a loan application is chargeable to Service Tax and processing fee charged for foreclosure/prepayment of loan or reset of interest would also be chargeable. In fact, we are unable to see what is the difference between the liability of Service Tax in respect of application of a loan where the processing fee is charged which is independent of loan and over and above the interest, when we see here also it is over and above the interest. The processing fee is charged for considering the various aspects such as credit worthiness of the borrower repaying capacity of the borrower, period of loan vis-a-vis repaying capacity of the borrower, quality of assets of the borrower etc. When the proposal is made for prepayment of loan or resetting, processing the application is involved. Therefore, there is definitely an element of service in prepayment of loan or resetting of interest. As already discussed earlier, the definition covers any activity in relation to lending.

15. Even though, we have not discussed the charges levied for resetting the loan in detail, the principle underlining reset of interest and prepayment of loan are same. The Revenue has a better case in respect of reset charges since the issue is not at all covered by the decision of the Tribunal in the case of SIDBI as far as resetting charges are concerned. Further, in the case of resetting, the relationship between the lender and the borrower does not cease to exist and loan also continues. Therefore, resetting of interest rate can be definitely considered as a service rendered by the appellant in relation to lending and is covered by Service Tax definition. It was submitted by the appellant that resetting charges were not being collected by them after 2004-2005. However, it was submitted by the ld.A.R. appearing for the Department that in the financial year 2005-06, 2006-07, 2007-08, the appellant had changed the head of income from resetting charges to additional interest. We find that this submission was not made before the original adjudicating authority and further we also find that in Para 5 wherein the Service Tax liability has been worked out in the table, in the first year, it has been shown as reset charges whereas in the year 2005-06, it has been shown as additional interest charges. In the year 2006-07 and 2007-08, it has been specifically indicated as additional interest (prepayment). This gives an impression that contrary to the submission made by the Id.A.R. appearing for the Department, the Department's contention was that in the year after 2005-06, the appellant did not collect any reset charges. In any case, in view of the conclusion that we have reached that the service tax is payable on reset charges as well as prepayment charges, we consider that it is not necessary for us to go into this aspect.

16. The next question that arises is whether the demand can be sustained for more than normal limitation period. In this case, the show cause notice was issued on 22.10.08 and

the period covered by the show cause notice is 10.9.04 to 31.3.08. Before we go into the limitation aspect, certain other points which were raised are also considered.

17.1 The appellant has contended that Service Tax is a value added tax. Service Tax may be charged when there is a value addition in the services provided by the service provider. Since the customers do not get any value addition in the services provided by charging reset charges/prepayment charges, Service Tax is not payable.

17.2 Charges collected for restructuring of loans and prepayment of loans is a way of value addition. The very fact that the cost that the customer has to pay for the facilities of prepayment/reset, is named as prepayment "charge" and reset "charge", immediately conveys that the same is in the nature of fee in lieu of some service/facility. The cost of the service for the customers increases or decreases with the increase or decrease of these charges. Thus, the reset charges and prepayment charges can be considered as the cost incurred by the borrower towards value added services like restructuring of the loan and prepayment of loan. Hence, the same charges are liable for Service Tax.

18.1 Reset charges/prepayment charges charged to the customers by the appellant is in the nature of additional interest only and therefore not liable to Service Tax.

18.2 The appellant has contended that the said charges are calculated taking into consideration the rate of interest and loan amount. Thus, they are in the nature of additional interest and not liable to service tax.

18.3 It has already been discussed that the prepayment charges arethe charges for allowing the facility of prepayment of loan. Similarly, reset charges are the charges levied by the appellant for restructuring the interest rate. The method of calculating the charges has no bearing on the nature of service provided. Just because the charges have been calculated based on the outstanding loan amount and the interest rate prevalent at that time will not change the head of income from service charges to interest.

18.4 Interest is nothing but the time-compensation for somebody's money being retained by 'somebody else. The longer the period of retention, the higher will be the interest amount. In this background, the prepayment charges can never be considered to be in the. nature of interest as prepayment only means payment before time. This should ideally result in refund of interest and not the demand for more interest because the borrowed money is being paid back before time.

19.1 The agreements of lending entered prior to 10.9.04 by theappellants are not chargeable to Service Tax.

19.2 Appellant has contended that in the clarification issued by theBoard vide Letter F.No.B.11/1/2001-TRU, dt.9.7.01, it has been held that the Service Tax would not be applicable. on hirepurchase agreements entered prior. to imposition of levy. In their

case, all charges have been collected in respect of lending arrangement which has been entered into prior to 10.9.04, when the lending services were made taxable.

19.3 In the case of lease or hire purchase arrangements, Service Tax is leviable on lease management fee/processing fee/documentation .charges (recovered at the time of entering into agreement) and on the finance/interest charges (recovered in equated monthly instalments). The clarification was given in respect of finance/interest charges which was recovered in equated monthly instalments after the date of agreement since other charges are recovered at the time of agreement itself. The logic behind the clarification is that since interest is already decided at the time of agreement but collected subsequently in the form of equated monthly instalments, the date of agreement would be considered as the date of rendering service though charges are recovered subsequently. In the case of lending services, the charges for prepayment and reset are levied only if the borrower chooses to prepay his loan or restructure his loan. The service comes into being only when the borrower opts for either of them. Thus, the clarification issued by the Board in the case of lease or hire purchase agreements cannot be applied to the issue at hand.

20. It was submitted on behalf of the appellant that the appellant is wholly owned Government Company and therefore there cannot be malafide intention on their part to evade payment of Service Tax. Revenue relied upon the decision of the Tribunal in the case of Bharat Petro Corporation Ltd Vs CCE Nasik 2009 (242) ELT 358 (Tri-Mum), wherein the Tribunal upheld the submission that BPCL is a Government owned company had suppressed the fact and therefore, just because it is wholly owned Govt. company, it cannot be said that bonafide can be presumed. He also submitted that blind belief cannot be a ground for non-payment of taxes. In this case, we find that the appellants have treated the amount of prepayment charges as additional interest and reset charges as additional interest from 2005-2006. It was also submitted that Income Tax Department has accepted such treatment given by them. The fact remains that after definition of lending was amended, and the service tax definition included in the activity in relation to lending for liability to Service Tax, appellant should have intimated the fact to the Department and checked up whether such collection of amount in relation to lending would be liable to tax or not. It is settled law that Government company is not a Government and it has to be taken note that even Government departments make the payments for the services received from another department. Telecommunication department used to provide telecommunication services to other departments and other departments paid for the telecom services rendered and even for the services rendered by Railways, Postal and other departments, payments are made. Therefore, the fact that the appellant is a wholly owned government company, does not mean that they need not have to follow the law of land or take it lightly and plead ignorance of law or being a wholly a government company, seek differential treatment. The fact remains that the appellant was required to declare the income received once the law was amended and they were required to seek clarification, if there was doubt. Even if they felt that the activity did not attract Service Tax, ST-3 returns should have been filed/or Department addressed intimating that these services are not liable to tax. In this case, the submission

made by the Id.A.R. that plea of bonafide has to be considered in the light of decision of the Tribunal in the case of SPIE CAPAG S.A. Vs CCE Mumbai 2009 (243) ELT 50 (Tri-Mum), is appropriate. In that case, while dealing with the plea of bonafide belief, the Tribunal observed that "the least that was expected of the appellant to discharge the plea of bonafide belief was to make enquiries from Central Excise authorities or some reputed legal firm regarding dutiability of items manufactured by it." Therefore, we find ourselves in agreement with the submissions that the appellant could not have interpreted the law according to their understanding without taking sufficient care for their interpretation, is correct. In the absence of any evidence to show that the appellant had intimated the Department or had obtained legal opinion, invocation of extended period on the ground of suppression of facts has to be upheld.

21. Therefore, the demand for extended period for Service Tax and interest thereon has to be upheld.

22. An alternative submission was made that the provisions of Section 80 are invocable in this case. According to Section 80 of Finance Act, 1994, "provision of Section 76, 77 or 78, no penalty shallbe imposable on the assessee for any failure referred to any such provision, if the assessee prove that there was a reasonable cause for the said failure." We consider that the appellant being a wholly owned government company and the fact that they did not pay Service Tax only on prepayment charges and reset charges and also in view of the fact that accounting treatment given to these items as additional interest has been accepted by the Income Tax department, in our opinion, would be sufficient for invoking provisions of Section 80 of Finance Act, 1994. Accordingly, while upholding the demand of Service Tax and interest, penalties, imposed under various Sections of Finance Act, 1994 are set aside.

(Pronounced in Court on 24.11.11)