
Service Tax on Interchange fees: Divergent Views by the Supreme Court

A Division Bench of the Hon'ble Supreme Court ("SC") comprising of Justice KM Joseph and Justice S. Ravindra Bhat, in a recent judgment of *Commissioner of GST and Central Excise v. M/s. Citi Bank*¹ held that interchange fee is a taxable service covered by the taxing entry for credit card services and under the negative list. The bench took a split view and delivered two separate judgements. Justice KM Joseph allowed the appeal against the order of the Customs, Excise and Service Tax Appellate Tribunal, South Zonal Bench, Chennai ("the Tribunal") and remanded the matter back to the Tribunal for reconsideration whereas Justice Bhat dismissed the appeal entirely.

Background:

- Interchange fees is the fees collected by a bank providing services against a credit card issued by another bank. The bank issuing the credit card is the issuer bank and the bank providing services against such credit cards is the acquiring bank. The interchange fee gets collected and is sent by the acquiring bank to the issuer bank. The services provided by the acquiring bank are categorized under banking and other financial services.
- Service tax in banking and other financial services (BoFS) was made applicable since 2001. These services also included credit card services. *Vide* Section 65(33)(a) of the Finance Act, 2006 ("the Act"), credit card service was omitted and a separate and new taxable service of credit card was included w.e.f. 01.05.2006.
- Citibank ("the Respondent"), registered with the Service Tax Commissionerate, Chennai was issued four Show Cause Notices questioning the chargeability of service tax on the interchange fees received by the Respondent.
- The main contention of the Respondent was that no service was provided per se for the levy of service tax since the interchange fee is more of an interest earned in the credit transaction with the customer. The Respondent further contended that the acquiring bank had paid the service tax on the interchange fee and thus, if the card-issuing bank pays it again it would lead to double taxation.

¹ Civil Appeal No(s) 8228 of 2019.

- The appeal was filed by the Commissioner of GST and Central Excise (“the Appellant”) against the orders of the Tribunal which set aside the order of the Principal Commissioner Service Tax, Chennai, holding that the Respondent was not liable to pay service tax, penalty and interest on the “interchange fee” received by it.

Observations by Justice KM Joseph:

- The Respondent is an issuing bank providing service for which it receives an interchange fee. Moreover, section 65(33)(a) of the Act is a charging provision, therefore service tax should be levied on the services rendered to the card holders by the issuing bank.
- In the absence of any creditor-debtor relationship between the issuing and acquiring bank, the interchange fee cannot be considered in the nature of interest.
- Service tax may be a value added tax for separate services wherein the tax is paid on each separate service. Hence, the service provided by the issuing bank for which it charged an interchange fee would be liable to the service tax and it would not lead to double taxation.

Observations by Justice S. Ravindra Bhat:

- The service provided by the Respondent as an issuing bank was not to be separated from the service provided by the acquiring bank since it forms a part of a single unified service i.e., of settling transactions. Therefore, the Respondent will not be liable to pay the service tax as it would amount to double taxation.
- Credit card transactions are not transactions in money and hence, they will fall under the definition of service.

VA Comments:

- As this is a split judgment and has a wide ramification upon the banks, a final verdict on the issue of whether interchange fees is taxable in the hands of the issuing bank needs to be settled by a larger bench and the same is awaited thereof. However, the judgment provides necessary yardstick on the structuring of the transaction between issuing bank and the acquiring bank and the retention of the interchange fee component that issuing banks would be well-advised to maintain.

For any further information/ clarification, please feel free to write to:

Mr. Shammi Kapoor, Partner shammi@vaishlaw.com

Mr. Arnab Roy, Principal Associate arnab@vaishlaw.com

Mr. Varennyam Shastri, Associate varennyam@vaishlaw.com

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