

Complete text of the judgment on the aforesaid issue argued by APRA & Associates LLP is reproduced below: -

CUSTOMS, EXCISE & SERVICE TAX APPELLATE TRIBUNAL, NEW DELHI

PRINCIPAL BENCH

Service Tax Appeal No. 370 of 2012

[Arising out of Order-in-Original No. 20/Commissioner/2011 dated 13.12.2011
passed by the Commissioner, Central Excise and Service Tax, Large Taxpayer Unit,
Delhi]

Commissioner, Central Excise & Service Tax, Large Taxpayer Unit, Delhi

..... Appellant

VERSUS

**M/s. Power Finance Corporation Urjanidhi, 1, Barakhamba Lane, Connaught
Place, New Delhi**

..... Respondent

APPEARANCE:

Shri Nagendra Yadav and Ravi Kapoor, Authorized Representatives for the
Department

Shri Atul Gupta, Shri Anmol Gupta, Chartered Accountants and Shri Varun Gaba,
Advocate for the Respondent

CORAM:

HON'BLE MR. JUSTICE DILIP GUPTA, PRESIDENT

HON'BLE MR. P.V. SUBBA RAO, MEMBER (TECHNICAL)

FINAL ORDER NO. 50896/2022

DATE OF HEARING: - 09/05/2022

DATE OF DECISION: - 23/09/2022

PER JUSTICE DILIP GUPTA :

This appeal has been filed by the Department to assail the order dated 13.12.2011 passed by the Commissioner, Central Excise and Service Tax, LTU, New Delhi by which the demand proposed in the show cause notice dated 31.01.2011 issued to M/s. Power Finance Corporation has been dropped.

2. The respondent is engaged in providing service under the category of „banking and other financial services“ contemplated under section 65(12) of the Finance Act, 1994, which service became taxable under section 65(105)(zm) of the Finance Act. w.e.f. 16.07.2001. The audit of the service tax records of the respondent for the years 2007-2008 to 2009-2010 was conducted by the officers of Directorate General, Audit. It was noticed that the respondent was providing loans for energy and energy efficiency projects, State Electricity Boards and private parties and even though the respondent had earned Rs. 08,94,64,916/- as premium of interest for restructuring of loans in 2008-2009 and Rs. 06,76,027/- during 2007- 2008 but the respondent treated these amount as interest income and did not pay service tax on it though such charges were leviable to service tax as they were received while providing „banking and other financial services“. Accordingly, a show cause notice dated 31.01.2011 was issued to the respondent proposing a demand of service tax of Rs. 01,11,57,422/- along with interest and applicable penalties. The Commissioner, by order dated 13.12.2011, dropped the whole demand initiated against the respondent. The Department has filed this appeal against the aforesaid order dated 13.12.2011.

3. The issue involved in this appeal is whether the Commissioner was justified in dropping the demand raised against the respondent by treating the premium on interest restructuring of loan as interest on loans which are not leviable to service tax.

4. Shri Nagendra Yadav, authorized representative appearing for the Department made the following submissions:

- (i) The Commissioner erred in considering the contentions of the respondent that the „interest restructuring premium' could not be leviable to service tax because the amount collected upfront i.e. premium is a portion of loss of interest income which the respondent will suffer on the account of swap allowed to the

borrower for the higher rate of interest with the lower rate of interest and that the subject earnings are akin to interest on loans and not towards any charges pertaining to other than interest and that the interest on loans is not subjected to service tax;

- (ii) It is not disputed that the respondent allowed the interest restructuring of loan after 3 years on payment of a 'premium' for the entire remaining period of loan, whereby the borrower is allowed to swap the higher rate of interest with the lower rate of interest. Thus, the respondent is facilitating the already existing borrower to take the advantage of the prevailing new low interest rate, if any, and thereby bringing down the borrower's cost of borrowing the loan. Moreover, the 'interest restructuring premium' amount charged by the respondent from the borrowers was the consideration for the said taxable service provided by the respondent to its clients and such interest restructuring premium amount was the value of the taxable service provided by the respondent. These earnings of the respondent are liable to be considered as the value for the purpose of levy and liability of service tax;
- (iii) The 'interest restructuring premium' amount charged by the respondent is neither in relation to the loan amount lent to borrowers nor is it in relation to time elapsed or time to elapse for the repayment or the discharge of the loan amount. Thus, the 'interest restructuring premium' amount is not at all akin to the 'interest' as charged upon a loan;
- (iv) The 'interest restructuring premium' amount charged by the respondent is in lieu of the „suffering' undergone by it and, therefore, a consideration received for the service provided to the borrowers by the respondent. This clearly establishes that the 'interest restructuring premium' amount charged by the respondent is the value of service provided to the borrowers. The method of quantification of the 'interest restructuring premium' amount charged does not make it akin to 'interest' on a loan. It was only a 'factoring-in' of loss to the service provider respondent while estimating the amount of consideration as value of the service provided in respect of the interest restructuring allowed in relation

to the loan lent to the borrower; and

- (v) The Commissioner failed to appreciate that the 'interest restructuring facility', whereby the borrower is allowed to swap the higher rate of interest with the lower rate of interest is a facility provided to the borrower to take the advantage of the prevailing low interest rate, if any, and thereby bringing down cost of borrowing the loan.

5. Shri Atul Gupta, learned chartered accountant, appearing for the respondent, however, supported the impugned order and made the following submissions:

- (i) Interest restructuring charges are outside the ambit of 'banking and other financial services';
- (ii) Premium received towards interest restructuring are in nature of interest;
- (iii) Even if it is considered, as is the case of the Department, that the premium on interest restricting of loan is same as fore/pre-closure charges, the issue has been decided by the Larger Bench of the Tribunal in **Commissioner of Service Tax, Chennai vs. Repco Home Finance Ltd**, holding that it would not be leviable to service tax under 'banking and other financial services'; and
- (iv) The respondent was under a bonafide belief that the activity carried on by it is not taxable and this belief of the respondent stands confirmed as the demand has been dropped by the Commissioner. In such circumstance, there was no intention to evade payment of tax and so the extended period of limitation could not have been invoked.

6. The submissions advanced by the learned authorized representative appearing for the Department and the learned chartered accountant for the respondent have been considered.

7. In order to provide the benefit of lower interest rate in future as against the prevailing rate to the borrowers, an option is given to the borrowers for interest restructuring of loan though the other terms of the contract remain unchanged. As per the guidelines of the respondent, loans disbursed by it would be eligible for

interest restructuring of loan subject to the stipulation that a loan which has been restructured for 3 years, shall be considered for further restructuring after 3 years on the payment of 50% of premium for the entire remaining period of loan.

8. It has to be examined whether restructuring premium charged by respondent falls under 'lending' and, accordingly, leviable to service tax under 'banking and other financial services'.

9. 'Banking and other financial services' has been defined under section 65(12) of the Finance Act and the relevant portion is reproduced below:

“banking and other financial services” means-

(a) the following services provided by a banking company or a financial institution including a nonbanking financial company or any other body corporate or commercial concern, namely:

(i) *****

(ii) *****

(iii) *****

(iv) *****

(v) *****

(vii) *****

(viii) *****

(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, over draft 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 purpose of this clause, it is hereby declare that “purchase or sale of foreign currency, including money exchanging” includes purchase or sale of foreign currency, whether or not a consideration for such purchase or sale, as the case may be, is specified separately. [Section 65(12)]”

10. This service is made taxable under section 65(105)(zm) of the Finance Act and the said section is reproduced below:

“Section 65(105)(zm)

(a) Taxable service means any service provided or to be provided to any person, by a banking company or a financial institution including a non-banking financial company, or anybody corporate or commercial concern in relation to banking and other financial services.”

11. The contention of the Department is that restructuring premium charged by the respondent falls under „lending“ and, accordingly, would be leviable to service tax under „banking and other financial services“. According to the Department, the interest restructuring premium amount charged by the respondent from the borrower is a consideration for the taxable service provided by the respondent. This is for the reason that the interest restructuring premium amount is not in relation to the loan amount and would, therefore, not be akin to interest.

12. The contention raised on behalf of the respondent is that interest restructuring charges would be outside the ambit of „banking and other financial services“ for the reason that the term „lending“ means depositing of money or property with the expectation that the same will be returned, while in the case of „interest restructuring“, the borrower is allowed to swap the higher rate of interest with the lower rate of interest. The premium which the respondent receives for interest restructuring of loan is for the loss of interest which the respondent will suffer on account of lowering of the rate of interest on the loan granted to the borrower. By providing interest restructuring facility, the respondent agrees to forgo its future income by way of 8 ST/370/2012 interest and gets only a portion that interest in advance in the year in which interest restructuring is done.

13. As an example, if rate of interest (say 9%) is agreed upon between the respondent and the customer taking loan. However, in future, as per market

prevailing rates, such rate of interest may be lower (say 6%). Accordingly, in order to get the benefit of reduced rate of interest applicable on its loan, the customer approaches the respondent as per the proposal for interest restructuring. The respondent, in order to cover up some part of its losses (50%) due to reduction in interest rate, calculate the interest adjustment as per the formulae prescribed by the Reserve Bank of India and after receiving the same from the customer, agrees to restructure its applicable rate of interest to a lower rate (6%).

14. The relevant excerpts of Guidelines of the Reserve Bank of India (2008) in relation to interest restructuring are as follows:

"Norms relating to Infrastructure loan

20. (1) Applicability

(i) **These norms shall be applicable to restructuring and/or rescheduling and/or renegotiation of the terms of agreement relating to infrastructure loan**, as defined in paragraph 2(1)(viii) of these Directions which is fully or partly secured standard and sub-standard asset and to the loan, which is subjected to restructuring and/or rescheduling and/or renegotiation of terms.

(ii) *****

(2) Restructuring, reschedulement or renegotiation of terms of infrastructure loan

The non-banking financial companies may, not more than once, restructure or reschedule or renegotiate the terms of infrastructure loan agreement as per the policy framework laid down by the Board of Directors of the company under the following stages:

(5) Adjustment of interest

Where rescheduling or renegotiation or restructuring involves a reduction in the rate of interest, the interest adjustment shall be computed by taking the difference between the rate of interest as currently applicable to infrastructure loan (as adjusted for the risk rating applicable to the borrower) and the

reduced rate and aggregating the present value (discounted at the rate currently applicable to infrastructure loan, adjusted for risk enhancement) of the future interest payable so stipulated in the restructuring or rescheduling or renegotiation proposal."

(Emphasis supplied)

15. The above extract shows the method of computation of interest adjustment' is nothing but the difference between the interest computed on higher rate of interest (say, 9%) and that computed on lower rate of interest (say, 6%) and such difference (including future installments) discounted to Net Present Value.

16. This above computation has been explained by the respondent with the help of an example to understand how this 'interest adjustment' is computed and what it denotes. It is as follows:

“Illustration: Say Respondent sanctioned a loan to Mr. A of Rs. 1,20,000/- on 01 April 2021 payable till 31 March 2027 in 6 equal annual installments of Rs. 20,000 each along with Interest rate of 9%. Mr. A paid the three installments till 31 March 2024 as below –

Date	Principal outstanding	Principal repaid	Rate of Interest p.a.	Period (Year)	Interest	Aggregate instalment
01-Apr-21	1,20,000.00	-	9%	-	-	-
31-Mar-22	1,20,000.00	20000	9%	1	10800	30800
31-Mar-23	1,00,000.00	20000	9%	1	9000	29000
31-Mar-24	80,000.00	20000	9%	1	7200	27200

Now, on 01 April 2024, Mr. A, as per the proposal, approached the Respondent to lower the applicable rate of Interest at 6% which is the prevailing market rate of Interest. For the same, Respondent charged from Mr. A a 'premium/interest adjustment' which is nothing but future loss of Interest of the Respondent computed as Net Present Value and charged from Mr. A today. The computation thereof is given below –

Date	Principal Outstanding	Principal Repaid	Present Rate of Interest p.a.	Present Interest	Revised Rate of Interest p.a.	Revised Interest	Difference	Discount Rate	Discounting Factor	Discounted Interest
				(A)		(B)	(A-B)			
01-Apr-24	60,000	-	9%	-	6%	-	-	6%	-	-
31-Mar-25	60,000	20,000	9%	5,400.00	6%	3,600.00	1,800.00	6%	0.943396	1,698.11
31-Mar-26	40,000	20,000	9%	3,600.00	6%	2,400.00	1,200.00	6%	0.889996	1,068.00
31-Mar-27	20,000	20,000	9%	1,800.00	6%	1,200.00	600.00	6%	0.839619	503.77
Total				10,800.00		7,200.00	3,600.00			3,269.88
50% of Discounted Interest collected as Premium from Mr. A on account of Interest Restructuring										1,634.94

*Discounting Factor is derived by the following formulae - $[1/(1+r)^n]$

17. It can be seen from the illustration above, that respondent was to receive total interest of Rs. 10,800 in next 3 years at the original interest rate of 9% as agreed upon but due to lowering down the interest rate to 6%, respondent will now receive Rs. 07,200 at 6% rate of interest in next 3 years. Therefore, to compensate for the loss of interest that is going to be caused to the respondent for reduction in rate of interest due to interest restructuring, respondent computed net present value of such loss (which comes out to Rs. 03,269.88/-) and collected 50% of the same as premium for interest restructuring while remaining 50% is the benefit gained by the customer due to interest restructuring.

18. Thus, premium so charged by the respondent from its customers due to interest restructuring is nothing but net present value of loss of interest that will be caused to the respondent.

19. It is, therefore, not possible to accept the contention of the Department that restructuring premium charged by the respondent would fall under 'lending' and would be subjected to levy of service tax under 'banking and other financial services'.

20. The Department has also contended that the premium paid on interest restructuring is in the form of foreclosure and, therefore, would be subjected to levy of service tax under 'banking and other financial institutions'.

21. Though, this is disputed by the respondent but even if it assumed that it is in the nature of a foreclosure charges, it cannot be subjected to levy of service tax in view of the decision of the Larger Bench of the Tribunal in **Repco Home Finance Ltd.** The relevant observations are reproduced below:

“44. It, therefore, clearly follows that foreclosure charges are recovered as compensation for disruption of a service and not towards “lending” services. In fact, the amount for processing charges and documentation charges or like charges are subjected to service tax because they are essential for the activity of lending and are treated as activities “in relation to lending”. Foreclosure is anti-thesis to lending and, therefore, cannot be construed to be “in relation to lending”. The phrase “in relation to lending” cannot be so stretched so as to bring within its ambit even activities which terminate the activity. In *Standard Chartered Bank v. Commissioner of Service Tax, Mumbai-I* [2015 (40) S.T.R. 104 (Tri. - LB)], it was emphasised that this phrase should not be given a very wide meaning.

45. These foreclosure charges should not be viewed as „alternative mode of performance“ of the contract because they arise upon repudiation of specified terms of contract and are intended to compensate the injured party banks and non-banking financial companies. This is because ‘alternative mode of performance’ still contemplates performance, whereas foreclosure is an express repudiation of the contractual terms giving rise to the levy of foreclosure charges.

46. Thus, merely because the clause relating to damage is featuring in a contract, it would be incorrect to conclude that the party has been given an option to violate the contract. Hence, to treat eventuality of foreclosure as an optional performance is incorrect. The contract cannot be understood to be providing an option to the parties to either perform or not perform/violate.”

22. Even otherwise, the extended period of limitation could not have been invoked in the facts and circumstances of the case. The respondent believed that the activity carried on by it was not taxable and the belief of the respondent stands justified by the order of the Commissioner dropping the charges. It also needs to be noted that the respondent had duly disclosed and recorded the information in its books of account. It cannot, therefore, be alleged that it had concealed or suppressed information with an intent to evade payment of service tax.

23. The impugned order dated 13.12.2011 passed by the Commissioner, therefore, does not call for any interference in this appeal. The appeal is, accordingly, dismissed.
