L&S UPDATE

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GST

Cenvat credit of services of DICGC availed by banks, available: CESTAT Larger Bench

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all Law.

The Larger Bench of the Customs Excise and Service Tax Appellate Tribunal (**“CESTAT”**) has held that service received by the banks from Deposit Insurance and Credit Guarantee Corporation (**“DICGC”**) qualify as ‘input service’ and accordingly Cenvat credit of such services can be availed by the banks.

ISSUE IN BRIEF

All banks in India are mandatorily required to insure their deposits with DICGC, a subsidiary of the Reserve Bank of India (**"RBI"**). DICGC protects small depositors in the event of bank failure by insuring the deposits up to INR 1,00,000 per depositor (now amended to INR 5,00,000). The banks availed Cenvat credit of the service tax charged by DICGC on the insurance premium paid.

LITIGATION BACKGROUND

The CESTAT Mumbai in the case of *ICICI Bank* had held that Cenvat credit of DICGC services was not eligible. The order was reserved on October 8, 2018 and the decision was rendered on February 12, 2019. However, CESTAT Delhi in the case of *State Bank of Bikaner* by its Order dated January 11, 2019 held that the Cenvat credit of DICGC insurance services was eligible as input service and Cenvat credit was available.

The decision of CESTAT Delhi was not brought to the notice of Division Bench at Mumbai before its Order was passed.

Subsequently, in the case of *State Bank of Patiala*, the Chandigarh CESTAT observed that since contrary views have been taken by CESTAT Mumbai and CESTAT Delhi, the issue needs to be referred to a Larger Bench.

ARGUMENTS BY THE APPELLANTS, i.e. BANKS

- DICGC insurance service was covered under main part of the definition of 'input service' and was also mentioned in the 'inclusive portion'.

- The activity of accepting deposits was integrally connected to the lending activities of the bank under which service tax was discharged under the category of Banking and Other Financial Services on various incomes.

- As per the *Banking Regulation Act, 1949* and *Deposit Insurance and Credit Guarantee Corporation Act, 1961*, a bank is statutorily required to insure the deposits. Therefore, it is a statutorily obligation without which the bank cannot function at all.

- Banks are engaged in “accepting” deposits and not “extending” deposits and so Section 66D(n) of the *Finance Act, 1994* would not be applicable.

- Even if it is assumed that some part of the deposit was not used for provision of output services, Cenvat credit cannot be denied as 50% of the total Cenvat credit was already reversed in view of Rule 6(3B) of the Cenvat Credit Rules, 2004.

ARGUMENTS BY THE REVENUE

- Since no consideration was charged by the bank in relation to acceptance of deposits, it was only a transaction in money and therefore was outside the scope of service tax under Section 66D(n) of the *Finance Act*.

- For any service to be qualified as input service, it should be consumed or used for providing taxable output services. The input service should have direct nexus with the output service.

- DICGC Insurance is aimed at protecting the interest of the depositors against the failure of the bank and does not provide any protection to the bank.

THE LARGER BENCH DECISION

- The basic activity of a banking company, as contemplated under the *Deposit Insurance and Credit Guarantee Corporation Act, 1961* or the *Banking Regulation Act, 1949* is to mobilise resources received by the banks in the form of deposits from the public for lending or investment.

- The acceptance of deposits is not only a pre-requisite for lending but is also necessary for the banks since the entire activity undertaken by the bank begins with the acceptance of deposits, without which the subsequent activities of lending or investment cannot be undertaken.

- It is mandatory for all banks who have obtained a licence from the RBI under Section 22 of the *Banking Regulation Act, 1949* to register themselves with the DICGC. If a banking company fails to pay the premium amount to DICGC, it won't be able to retain its registration, which may ultimately also lead to the cancellation of the licence granted to the banking company by the RBI.

- The Bench relied on the Karnataka High Court decision in the case of *PNB Metlife India Insurance Co. Ltd.*, where the High Court had held that the re-insurance service received by the company was a statutory requirement as per the *Insurance Act 1938* and therefore it has to be considered as having nexus with output service and therefore would qualify as 'input service'. The bench also noted the decision of CESTAT Hyderabad in the case of *Shriram Life Insurance Company Ltd.* where it held that the investment activity undertaken by the company was a statutory obligation to carry out life insurance business and therefore the activity was an integral part of life insurance service and Cenvat credit was eligible.

- The insurance service received by the banks from the DICGC is not only mandatory but was also commercially expedient. **The service rendered by the DICGC to the banks would fall in the main part of the definition of 'input service' and such Cenvat credit would be eligible.**

- As per Section 66D(n), the activity of services by way of **extending deposits**, loans or advances is under negative list. The activity of **accepting** deposits would be an activity where the banks receive deposits from the customers in the form of savings account, recurring deposits for which the banks pay interest to the customers. Therefore, accepting deposits does not come within Section 66D(n).

- The assessable deposits on which the premium is calculated, not only includes deposits such as savings, fixed, current, recurring, etc., but also includes certain balances appearing in the account of the banks such as credit balances in cash credit accounts, guarantees, bills purchased, etc. Therefore, the contention of the Revenue that insurance premium was paid only on the deposits of the customers was incorrect.

- As per Rule 6(3B) of the Cenvat Credit Rules, the banks were required to reverse 50% of the Cenvat credit availed. This rule was introduced with the view to disallow the credit of input services attributable to interest income earned by banking companies. Therefore, when such reversal was done by the banks, banks were entitled for credit of the entire amount of service tax paid on input service having nexus with the provision of output service.

IMPLICATIONS

- The aforesaid decision has affirmed the proposition that services which are statutorily required to be availed, without which the operations could not be carried out, would form an integral part of the output service and thus would qualify as input service.

- Further, the decision has also clarified that once Rule 6(3B) of Cenvat Credit Rules, 2004 has been followed by the banks, then all such services having some nexus with output service would qualify as input service and it is irrelevant for the banks to identify as to which part of the input service was used for providing taxable service and which part was used for exempt service.

- This decision has provided great relief to banking sector and will have a precedential value in the Goods and Services Tax regime as well.

[*South Indian Bank* v. *Commissioner* - Interim Order Nos. 13 - 31 / 2020, dated March 20, 2020, CESTAT Larger Bench]

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