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# SC delivers split verdict on applicability of service tax on credit card interchange fees

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**Summary**

The Division Bench of the Supreme Court has delivered a divergent view on the issue of applicability of service tax on interchange fee for credit card transaction charged by the card-issuing bank. Justice Joseph opined that the interchange fee is received for the service rendered by the card-issuing bank, hence shall be liable to service tax. Justice Bhat opined that the services rendered by the issuing bank and the acquiring bank cannot be segregated and need to be considered as a single unified service to the merchant establishment. The service element provided by the issuing bank in the credit card transaction at the merchant establishment is, therefore, not subject to service tax as it is incorporated in the service by the acquiring bank as one service provided to the merchant establishment.

## Facts of the case

- The assessee[1] is a bank registered under service tax for providing services under the category of Banking and other financial services, business auxiliary services, charge card and other card payment services, manpower recruitment or supply services, among other services.
- A Show Cause Notice was issued proposing to levy service tax on interchange fee charged by the assessee to its credit card customers in gross billed amount along with interest and penalty.
- The assessee contended that it is not performing any service to render it exigible to service tax on the interchange service. Further, the interchange fee has already been subjected to service tax at the hands of the acquiring bank.
- The matter was adjudicated and the demand of service tax was confirmed against the appellant, along with interest and various penalties were imposed. Against the said order, the appellant filed appeal before the Tribunal. The Tribunal set aside the Final Orders, by which the Principal Commissioner Service Tax, Chennai, found the assessee liable to pay service tax, penalty and interest on the amount of the interchange fee received by it.
- The Revenue filed a Special Leave Petition before the SC against the said order of the Tribunal.

## SC observations and ruling[2]:

### A. Observations and opinion of Justice Joseph:

- The credit card system is fundamentally based on the issuing bank, undertaking a risk. Essentially, the funds of the issuing bank are used to affect the payment. Though the cardholder pays the money to the bank, the issuing bank undertakes certain risk to settle the amount. In the whole credit card transaction mechanism, the issuing bank indeed performs services in relation to the settlement of the amount transacted through the card[3].
- The term 'service provider' includes both the issuing bank and the acquiring bank and the gross amount to be charged will be on separate services provided by each. Therefore, there could not be a gross amount by adding the value of two distinct services by two different service providers.
- The assessee, as an issuing bank, provided service for which it got paid an interchange fee. Therefore, such fee is eligible for levy of service tax.
- There was no creditor-debtor relationship between the assessee (issuing bank) and the

[1] M/s Citibank N.A.
[2] Order dated 9 December 2021
[3] In terms of Section 65(33a)(iv) of the Finance Act, 1994

Card Associations, or acquiring bank or the merchant. Therefore, the interchange fee cannot be described as compensation fixed by the parties for use or forbearance of the borrowed money and cannot be in nature of interest.

- The role of the issuing bank is indispensable in the credit card transaction. The active role that it plays and the risk that it takes in settling the amount, constitutes rendering service and not merely transaction in money.
- The appeal by Revenue is allowed and the matter shall be remanded back to Tribunal.

### B. Observations and opinion of Justice Bhat:

- The role of the issuing bank in the service provided by the acquiring bank to the merchant establishment is a part of a single unified service and it cannot be broken up into its components and classified as separate services for classification.
- The issuing bank's role is subsumed into the service of the acquiring bank for which the gross consideration is received from the merchant establishment. The service element provided by the issuing bank in the credit card transaction at the merchant establishment is, therefore, not subject to service tax as it is incorporated in the service by the acquiring bank as one service provided to the merchant establishment**.**
- The amount received by the issuing bank as interchange income or fee is not towards interest.
- The credit card transactions cannot be considered as transactions in money and cannot be excluded from the definition of service.
- When the service is characterised to be a single unified service, wherein service tax is collected from/remitted by the acquiring bank on the value (whole MDR which includes the interchange fee that is retained by the issuing bank) taxable for the single service rendered by both the acquiring and issuing bank, the assessee cannot be called upon to pay the service tax again as this would result in double taxation.
- With regards to the Revenue's allegation of wilful suppression, there was no merit given that this was not the allegation or scope of the notice issued.
- The present case does not warrant remand to the Tribunal and this dispute should stand finally concluded at this stage. Therefore, appeal by Revenue ought to be dismissed.

**Our comments**

Considering the divergence in the opinion of the Division Bench, the matter is likely to attain finality only at the larger bench of the Apex Court. Accordingly, it will be interesting to wait and watch the verdict of the larger bench. Thus, the taxpayers will have to wait until the matter attains finality.

Interestingly, under the GST regime, on a similar issue, the Maharashtra Authority for Advance Ruling (AAR)[4] had pronounced that interchange fee earned by the issuing bank forms an integral part of supply of service of acquiring bank to the merchant establishment, and, therefore, should not be taxed again with GST.

[4] The Mobile Wallet Pvt. Ltd.

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