FIDC

Finance Industry Development Council

(A body incorporated as a Self Regulatory Organisation for Registered NBFCs - AFCs)

10 January 2011

Shri.Pranab Mukherji
Finance Minister
Government of India
North Block
New Delhi - 110 001.

Hon'ble Finance Minister Sir,

SUB: PRE-BUDGET MEMORANDUM - ISSUES RELATING TO ASSET FINANCING NBFC-AFCs

As you know, Sir, the Asset Financing NBFCs, (NBFC-AFC) registered with Reserve Bank of India and authorized to accept public deposits, have joined hands and formed a **Self Regulatory Organization (SRO)** under the name of **Finance Industry Development Council (FIDC).** FIDC is an All India body and is registered as a Company U/s. 25 of Companies Act, 1956. Our main objective is to work towards bringing discipline amongst our members by enforcing a model code of conduct, represent the views of the industry to the appropriate authorities where necessary and present a unified face of this sector.

Recognising the role played by the NBFCs engaged in asset financing, RBI has given a separate classification for Asset financing NBFCs. Please permit us to refer to our industry as NBFC-AFC for the purpose of this paper.

Sir, you had been good enough to start a pre-budget dialogue with our industry last year when you and your officials gave us a patient hearing to some of our issues. Encouraged by your initiative, we are pleased to submit herewith the issues and concerns of the NBFC-AFCs for your consideration in the forthcoming Union Budget 2011-12.

In recognition of the role played by NBFC-AFCs, we request the Ministry of Finance to treat NBFC-AFCs on a different footing, as part of the mainstream financial sector of the economy and favourably consider the submissions made in this memorandum, some of which are now pending for several years.

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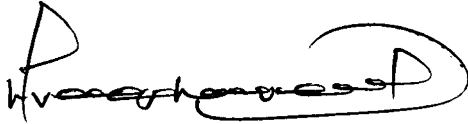
We will be glad to supplement this representation with any additional information that may be required.

We do hope that, like last year, you would give us an opportunity to present our views and concerns to you in person, at a Pre-Budget Meeting, to enable you to consider them in depth and provide suitable redress in your forthcoming presentation of the Union Budget.

We thank you in anticipation of a positive response and look forward to communicating our views to you personally.

Thanking you,

Yours Faithfully,
For **FINANCE INDUSTRY DEVELOPMENT COUNCIL**



T T SRINIVASARAGHAVAN
CHAIRMAN

Encl. As above

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Pre-Budget Memorandum

DIRECT TAX ISSUES

1. TDS on Interest (Sec 194A)

As per Sec 194A of the Act, TDS @10% is required to be deducted on the interest portion of the installment paid to NBFC under loan/finance agreements whereas banking companies, LIC, UTI, public financial institution etc engaged in banking business are exempted from the purview of this Section.

NBFCs carry on the financing business mostly to retail customers who are in unorganized sectors which includes large number of individuals, HUFs and SME sectors. Thus, single point collection of tax by way of advance tax payments from NBFCs would mean greater convenience to the department than collecting tax through large number of such customers from all over the country by way of tax deduction at source.

Apart from this, the distinction in the provision puts NBFCs in a disadvantageous position and creates severe cash flow constraints since NBFCs operate on a very thin spread/ margin on interest which at times is even lesser than the TDS deductible on the gross interest and reduces the effective interest rate of the NBFCs on the loans given. NBFCs are bank- like institutions. Therefore, NBFCs should also get exemption under section 194A.

2. Mode of Repayment of Loan (Sec 269T)

As per Sec 269T of the Act it is obligatory on part of all the persons to repay any loan or deposit only by an Account Payee Cheque or Draft drawn in the name of the person who has made the loan or deposit if the aggregate amount of loan or deposit with interest thereon is Rs. 20,000 or more. However transactions with banking company are exempt from this provision. In our view since the portfolio of the NBFCs is similar to Banks, NBFCs registered with RBI should also be exempt from the applicability of Sec 269T of the Act.

3.Increase in the Limit of Sec 40A(3)

Payment made otherwise then by account payee cheque/ draft exceeding Rs.20,000/- in a day to a person, is now totally disallowed.

Having regard to growth, inflation, volume of transaction, economic development threshold limit should be increased to Rs. 1 Lac. It is suggested that the Threshold limit u/s 40A(3) should be increased to Rs.1 Lacs & disallowance shall be restricted to 20%.

4.Tax benefits for Income deferral u/s.43D of the Income Tax Act

Section 43D of the Income Tax Act recognises the principle of taxing income on sticky advances only in the year in which they are received. This benefit is already available to Banks, Financial Institutions and State Financial Corporations. This benefit has also been extended to Housing Finance Companies by the Finance Act, 1999.

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In accordance with the directions issued by the RBI, NBFCs follow prudential norms and like the above institutions are required to defer income in respect of their non-performing accounts. Since the directions are mandatory in nature, NBFCs have to adhere to the said directions in preparing their accounts. However, the income tax authorities do not recognise these directions and tax such deferment of income on accrual basis. It is but appropriate that the Income tax authorities accept this principle of income deferral in the case of NBFCs also, who are the only segment of the financial sector denied this tax benefit. It is, therefore, suggested that Sec.43D of the Income Tax Act be extended to include in its scope NBFCs registered with RBI, as in the case of other institutions.

5.Allowability of Provision for Non-performing Assets (NPAs) u/s.36(1)(viia) of the Income Tax Act

NBFCs are now subject to directions of RBI as regards income recognition and provisioning norms. Accordingly, NBFCs are also compulsorily required to make provisions for NPAs.

Under the existing provisions u/s.36(1)(viia) in the Income tax Act, provisions for bad and doubtful debts made by banks are allowed as a deduction to the extent of 7.5% from the gross total income and 10% of aggregate average rural advances made by them. Alternatively, such banks have been given an option to claim a deduction in respect of any provision made for assets classified by the RBI as doubtful assets or loss assets to the extent of 10% (increased from 5%) of such assets. However, the benefits u/s.36(1)(viia) are not available to NBFCs. It is appropriate, in all fairness, that the provision for NPAs made by NBFCs registered with RBI be allowed as deduction u/s.36(1)(viia) of the Income tax Act.

6. Declaration in Form 15G/15H r.w. Section 206AA

A new section 206AA has been introduced in the Income Tax Act which has come into effect from 1.4.2010. Under the Section, furnishing of PAN has been made mandatory for all categories of payments. The mandatory quoting of PAN has been extended to cover payment of interest without tax deduction even for those persons who provide the declaration forms in Form 15G/15H.

We would like to highlight that the declaration in Form 15G/15H are given by those persons who have income below the taxable threshold limits and hence need not have PAN. Further, the details of depositors giving such declarations in Form 15G/15H are being furnished in the TDS Returns filed electronically every quarter and such declaration forms are also submitted to the relevant authority as prescribed under the Income Tax Act.

To remove the genuine hardship that will be faced by senior citizens/other small depositors, it is suggested that Sub-section 2 of Section 206AA be removed to enable the depositors to furnish declaration forms 15G/15H without providing PAN.

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7. Introduction / Increase in the threshold limit where TDS is required to be deducted

"NBFC-AFCs issue secured non-convertible debentures to retail investors (individuals) in order to raise funds. In the case of unlisted debentures TDS is to be effected from one rupee of interest paid without any threshold limit. This is very harsh on the individuals who invest their small savings in these secured debentures. It is, therefore, suggested that clause (v) of proviso to S. 193 be amended, as under:

The words ", being debentures listed on a recognised stock exchange in India in accordance with the Securities Contracts (Regulation) Act, 1956 (42 of 1956), and any rules made there under," be deleted.

Further, the monetary limit of Rs.2,500/- was revised long back in 1989 which may also be revised to Rs.25000/-being the limit suggested for S. 194A – interest other than interest on Securities. "

Further, Having regard to growth, inflation, volume of transaction, economic development threshold limit where the TDS is required to be deducted should be increased.

(Amount in Rs.)

Section	Nature	Present Limit	Suggested Limit
194A	TDS on Interest	5,000(for others) /10000(for banks)	25,000
194H	TDS on Commission	25,000	50,000
194J	TDS on Professional Fees	30,000	50,000

8. Depreciation in respect of Construction Equipment registered under Motor Vehicles Act

The I.T. Act allows depreciation at the rate of 100% in case of certain equipment meant for pollution control, solid waste control, mineral oil concerns, mines and quarries, energy saving devices and renewable energy devices. The Act also allows high rate of depreciation to motorcars, buses, motor lorries and taxies used in a business of running them on hire.

Construction equipment, which contribute immensely to infrastructure development, are not given this benefit of higher depreciation rate.

In our view, Construction equipment which are used in the infrastructure development should be extended this benefit of higher depreciation rate.

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INDIRECT TAX ISSUES

1.Extension of Cenvat Credit Rule to other Services Also

In terms of Service Tax credit currently there are 16 Services which fall under Rule 6(5) of Cenvat Credit Rules whereby one is able to take credit to the extent of 100% if the same is in connection with both taxable and non taxable services. For other services, the same falls under Rule 6(3) of Cenvat Credit Rules where one is able to claim credit either on a ratio of Taxable vs Non Taxable Services generated (duly certified) or by paying a pre-fixed percentage (8 %) of value of total turnover.Our view is that the Credit of Rule 6(5) should not be restricted to the 16 Services alone, instead 100% Credit should be given for any services that results in generation of Output Services since service is not a commodity where one is able to identify unit wise as to what results in generation of Taxable and Non Taxable products separately. So it is proposed that application of Rule 6(5) of Cenvat Credit should be extended to any services that results in generation of service both Taxable and Non Taxable Services. In terms of availing Credit one to one correlation should also be avoided as in certain cases expenses have very close nexus with the generation of Taxable Services yet as the same are falling under Rule 6(3) we have no other option but to avail Cenvat Credit on proportionate basis. So the distinction between Rule 6(3) and Rule 6(5) is to be avoided. The input credit should be seamless.

2. Service Tax on Hire Purchase/Lease Transactions

Service Tax is imposed on Hire Purchase and Finance Leasing transactions. Both these transactions have been defined as "sale" transactions. Constitutionally any transaction can either be a "Sale" or a "Service", but cannot be both. Service tax is imposed on the interest component of Hire Purchase /Finance Lease transactions. Also in addition, VAT is also levied on the installment amounts in most of the states. Such dual taxation on transaction of lease and hire purchase is impacting the profitability and sustainability of finance industry. After receiving lot of representations from the industry, Government on this matter in March 2006 came out with abatement to the extent of 90% of the interest component. In terms of small retail customers, who depend on lease and hire purchase for their finance needs, taxing these products would bring undue financial hardship on them. In our view, levy of service tax is unjustified, when VAT is levied on the total installment amount. Thus, even a partial levy i.e. incidence of a service tax on 10% of the interest component should be withdrawn. Lease and Hire Purchase transactions should be considered as 'Deemed Sale' and subject only to VAT not Service Tax.

3.Assessment/ Audit under Service Tax

Currently an assessee apart from the Self Assessment procedure, in respect of Returns under Service Tax Rules may be further subject to Scrutiny by Divisional Superintendent, followed by Departmental Excise Audit (EA 2000 Audit) and Central Excise Revenue Audit (CERA) for the same transactions. So as an Assessee apart from Self Assessment procedure is subject to attending different queries from different service authorities under the statutory power vested in them by the Finance Act, 1994. This is consuming lots of productive time and manpower.

We require a single window approach whereby an assessee is answerable to queries from a single statutory body and in one go.

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