

FIDC

Finance Industry Development Council

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

ANNEXURE - I

Direct Tax Issues

1. Sec.36 (1) (viia) / 43D Of The Income Tax Act, 1961

Benefits allowed to the banks and housing finance companies, but NBFC-AFCs left out

Under the existing provisions u/s 36(1)(viia) of the Income-Tax Act, a provision for bad and doubtful debts made by banks and financial institutions is allowed as a deduction to the extent of 7.5% from the gross total income. Alternatively, such banks and FIs 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.

NBFC-AFCs are also compulsorily required to make provisions for Non-Performing Assets (NPA's). However, provisions made by NBFC-AFCs in line with such prudential norms fixed by RBI are disallowed by tax authorities when assessing their income tax liabilities. These provisions made against NPAs are in the nature of business expenses incurred wholly and exclusively for business operations by an NBFC-AFC.

Therefore, these provisions should be allowed to be deducted while arriving at the taxable profits of NBFC-AFCs. Any recovery made against these allowed provisions would automatically get taxed later on.

Banks / HFCs / FIs enjoy tax benefit on income deferred as per RBI directives on NPA. NBFC-AFCs are also required to follow these prudential norms as per RBI directives, but they are the only segment of the financial sector denied this tax benefit.



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2. Exemption to NBFC-AFCs from TDS Requirements U/s 194A (3) (iii) of The I.T. Act

Benefit allowed to banks, but NBFC-AFCs left out

As per Section 194A of the Income Tax Act 1961, tax has to be deducted out of the interest payments made by specified borrowers to the lender at the rates in force. The rates vary depending on the constitution of the payee (lender). For the category of domestic companies in which NBFC-AFCs fall, the rate of TDS is presently 22.44% including surcharge of 10% and education cess of 2%. The earnings of NBFCs are far below the TDS. Banking companies, Cooperative societies engaged in banking business, public financial institutions, LIC, UTI, Insurance companies and some other notified institutions are exempted from the purview of this section, implying that if the payment of interest is made to these entities, the borrower is not required to deduct TDS out of the interest payment. This is not available to NBFC-AFCs even though they are in similar lending activities. Consequently, their margins and cash-flow are severely affected.

3. TDS on Financial lease rental payments under Section 194-I of Income Tax Act

Gross lease rental subjected to TDS and not the interest portion alone

Section 194-I of the Income Tax Act deals with TDS on rent payments. The present TDS rate is 22.44% (20% TDS + 10% surcharge + 2% education cess).



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In this section, the definition of 'rent ' has been enlarged to include lease, sub-lease, tenancy or any other agreement or arrangement for use of machinery, plant, equipment etc. besides land and buildings.

NBFC-AFCs operate on very thin margins. On that, if a 20% TDS is applied on gross lease rentals, this will result in negative cash flows. It must be pointed out that unlike renting, leasing is a mode of financing and major portion of lease rentals includes repayment of principal just like a loan repayment. **If TDS is deducted on entire lease rental, it means not only will the TDS be deducted on the interest, but also on the principal amount.** This can spell disaster for the NBFC-AFC sector in India leading to its extinction.

4. Exemption Limit for TDS on Interest Paid on Fixed Deposits Accepted by NBFC-AFCs – Section 194 A

To be Increased from Rs.5,000/- to Rs. 10,000/- as Done for Banks Last Year

By the Finance Act 2007, the exemption limit for tax deduction at source on interest paid by Banks/Co-operative Societies engaged in the business of Banking/Post Office (in respect of certain notified deposits), etc was increased to Rs.10000/-, with effect from 1st June 2007. However, this increase was not extended to interest paid by NBFCs who are also carrying on similar lines of business as banks. It is therefore prayed that this extended limit be also made applicable to NBFCs accepting deposits. It is pertinent to note that in the case of Banks, the limit of Rs.10000/- is computed with reference to the interest credited by each branch.

Prior to this amendment, the said limit was uniform for all entities at Rs.5000/- with the sole exception that it was computed branch-wise for Banks.



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Suggestions:

1. Being subject to all the prudential norms on provisioning and income recognition, under RBI regulations, it is only fair and equitable that the benefits already available to Banks & FIs and HFCs under Sec.36 (1) (viiia) and Sec. 43D of the IT Act be extended to AFCs also.
2. Exemption should be granted from TDS on interest payment to AFCs u/s 194A (3) (iii) of the I.T. Act.
3. Lease and sub-lease should not be included in Section 194-I of Income Tax Act.
4. Exemption Limit for TDS on Interest. other than interest on Securities should be increased to Rs. 10,000/- for AFCs.

