Submission from FICCI NBFC Committee

Recommendations for Union Budget 2022-23

DIRECT TAX ISSUES AND SUGGESTIONS

1. Amendment to Section 43D – Taxation of Interest income on realization basis in case of Non-Performing loans and Covid 19 moratorium cases.

a. Section 43D of the Income Tax Act, 1961 specifically provides for taxation of interest income from non-performing loans, having regard to prudential guidelines of RBI / NHB, to be taxed on realization basis or credit to Statement of Profit and Loss, whichever is earlier. This provision is applicable to all banks, financial institutions, NBFCs and HFCs.

However, it may be noted that all the HFCs and NBFCs have adopted the Ind AS accounting regime wherein interest income has to be recognized on the net carrying value of Stage 3 loans, in the Statement of Profit and Loss, whether or not the company has received / realized such interest income. This creates an anomaly as the HFCs / NBFCs end up paying tax on such income which is not received / realized from credit impaired accounts since credited to the Statement of Profit and Loss. Further, it defeats the very intent of the introduction of the section in the Income Tax Act, 1961. Hence, a suitable amendment in view of adoption of Ind AS Accounting Standard by HFCs and NBFCs will be much appreciated.

Further, it is highlighted that income recognition in case of such bad or doubtful loans should be aligned with the rules and guidelines issued by RBI / NHB. Rule 6EB defines doubtful asset, non-performing and loss assets in case of public companies regulated by NHB. However, there is inconsistency in the definitions under aforesaid rule when compared to the extant guidelines prescribed by RBI / NHB. Under RBI / NHB guidelines, a loan is classified as non-performing once the instalment receivable is past due 90 days whereas Rule 6EB prescribes 180 days (6 months). This may result into conflict between accounting and taxation of such income and litigations. Accordingly, we recommend that these rules should be aligned by amending Rule 6EB in the spirit of Section 43D and extant guidelines issued by RBI / NHB in this regard.

b. The Covid -19 outbreak had crippled the entire economy as lockdown was initiated throughout the nation. The Reserve bank of India had introduced COVID-19 Regulatory Package dated March 27, 2020 and April 17, 2020, to offer a moratorium on the payment of installments falling due between March 1, 2020 and May 31, 2020 ('moratorium period') to eligible borrowers. The said moratorium was further extended to August 31, 2020. During this period, the assessee HFCs / NBFCs has capitalized the interest income on such loans where moratorium was granted without actual receipt of interest income.

Thus, this will create undue hardships to the assessee HFCs / NBFCs to pay tax on such interest income wherein the actual receipt of the same is not realized.

► ***It is thus suggested that the section 43D be suitably amended to tax interest income from Non-performing loans, classified as Stage 3 loans, of HFCs / NBFCs under Ind AS accounting framework to be taxed solely on receipt basis.***

► ***It is recommended that Rule 6EB shall be suitably amended in line with Extant guidelines issued by RBI / NHB having regard to classification of doubtful, non-performing and loss asset so as to make the rule harmonious with intent of Section 43D.***

► ***Further, interest on loans under moratorium for the moratorium period, as per RBI Covid 19 Regulatory package, shall be charged to tax only on receipt basis.***

2. Taxability of Income on transfer of loans / securitisation transactions under Ind AS

The NBFCs including HFCs have transited to Indian Accounting Standards (converged to IFRS) (Ind AS) from FY 2018-2019. In transfer of loans / Securitisation, the originator of the pool of loans typically accrues the excess interest spread (interest differential over the weighted average interest rate of the pool) over the life of the pool of the loan on time proportion basis. However, under Ind AS, the same needs to get accounted on upfront basis though the same is actually realised over the period of time in future.

It may be noted that income tax shall be applied on real income which is realized in accordance with the contractual arrangement. The upfront booking of income is mere book entry as required by the applicable accounting standard. In effect, the real income in such case is the income that is received over the period of time.

However, it may so happen that basis the accounting entry, the tax department may consider the same as taxable income on upfront basis since credited to the Statement of Profit and Loss. In addition, NBFCs / HFCs are exposed to the risk of penalty proceedings which will lead to litigation on the issue. Further, Reserve Bank of India in its Master direction on Transfer of Loans exposure / Securitisation of Standard Assets issued on September 24, 2021 has directed the NBFCs / HFCs that have adopted Ind AS accounting must deduct such unrealized upfront gains from the owned funds while computing regulatory capital and should be recognized as capital only on realization / receipt.

- ***It is recommended that the Act shall be suitably amended to exclude such unrealized upfront gains on Securitisation from taxable income and should be taxed only on realization basis based on real income theory.***

3. Provisions of Section 194IA – TDS on property transactions – Not to apply to SARFAESI sale cases

Section 194IA of the Act was introduced vide Finance Act, 2013 with a view to improved reporting of transactions and taxation of capital gains. It was believed that transactions of immovable properties are usually undervalued and under-reported with the transacting parties refrained from reporting their PAN while entering into such transactions.

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act 2002) allows bank and other financial institutions including Housing finance companies and NBFCs to recover their loans by taking possession/auction of assets which were kept as security by the defaulting borrowers. Under the SARFAESI Act, there is a Central Registry of Securitisation Asset Reconstruction and Security Interest of India (CERSAI) to register security interest created by banks and financial institutions covered under the SARFAESI Act.

Thus, the SARFAESI Act is, in essence, a mechanism wherein the lender company can recover its dues from the defaulting borrower and pass on clear title of the secured property to the new buyer. However, when TDS is deducted from the sale consideration from such SARFAESI sale, the credit of the same is passed on the borrower and the lender company receives less consideration which eventually becomes irrecoverable resulting into loss.

Further, many times, the buyers deduct taxes and report the same in the name of the lender company. Even in these cases, the credit for TDS is not available to the lender company as it is not the transferor of the property and the actual capital gais is assessed in the hands of the defaulting borrower. This results into loss for the lender company.

Lender should be allowed to claim such tax credit, even though the income will be taxed in the hands of the borrower. This will result into recovery of loan to the extent of TDS credit.

► ***Accordingly, we recommend that by way of amendment under Section 194IA, all property sale transactions under SARFAESI shall be exempted from withholding provisions.***

► ***Alternatively, the section can be suitably amended to enforce withholding in the name of the lender company along with permitting the lender company to claim the TDS in its income tax return without considering the capital gains as income.***

4. Practical issues in relation to TDS under Section 206AB

Finance Act 2021 has introduced section 206AB and 206CCA which provides for higher rates for tax for TDS and TCS for a person who has not filed the income tax return in the two preceding years for which the time limit of filing the return u/s 139(1) has expired and the aggregate of TDS and TCS in each of the two years is Rs. 50,000 or more.

Further, to help the taxpayers of TDS and TCS to follow the Compliances of these sections, the IT Department has introduced a new "Compliance Check Functionality for Section 206AB and 206CCA". This new tool enables the tax deductors / collectors to verify the specified person. It is expected that this functionality will ease the compliance burden on taxpayers.

The utility has been provided with bulk upload facility in case the number of records to be checked are voluminous. However, the number of records that can be checked under bulk upload is restricted to 10,000 cases only. Thus, this creates a practical difficulty in case of companies having large shareholder or depositor data base as the details are required to be submitted multiple times.

Further, it is practically impossible for a listed company to validate the return filing status of shareholders while remitting the dividend, which is generally a very short window after the record date. The turnaround time from declaration time to disbursement time is too short to check DTAA, PAN, Residency; 15G/15H etc due to which additional checking of return filing of lakhs of shareholders would not be feasible.

It is therefore requested to reconsider this restriction and provide additional bandwidth, say one lakh records for upload and checking purpose.

► ***Accordingly, we request that the utility must be updated for taking upload and providing results for larger number of records rather than restricting to 10,000 cases only.***

5. Dividend payments to Foreign Institutional Investors / Foreign portfolio investors (FII / FPI)

Dividend payments to FIIs / FPIs I subject to TDS under provisions of Section 196D at 20% rate. The aforesaid section was amended vide Finance Act 2021 to grant benefit of lower rate deduction in case of applicability of relevant Double tax avoidance agreements (DTAA) subject to recipient FII / FPI submitting necessary documents like Form 10F, Tax residency certificate (TRC), no PE declaration etc.

This has casted onerous responsibility on the deductors of collecting and maintaining documents and then applying the correct rate of taxes in these cases. This also becomes a herculean task especially in cases where there large number of FII / FPI shareholders. Also, for the shareholders, they are required to submit the same details to each deductor where they have made investments.

Hence, a repository of such information is highly required for ease of compliance and a common repository of necessary documents to the deductors will ensure consistency of the position across Corporates and avoid multiple submissions by investors. Further, the department can themselves, confirm the applicable rates based on documents submitted by the investors, to provide clarity and avoid future litigations.

► ***A central repository of information shall be made available in case of FIIs / FPIs for assistance and proper compliance of the law in relation to TDS compliance.***

6. Increase in threshold for Non deduction of TDS on Interest in case of Fixed deposits with HFCs

Interest income from fixed deposits is subject to withholding taxes at the rate of 10% under section 194A of the Income tax Act, 1961subject to threshold of Rs. 10,000 for non-deduction in case of Banks including Co-operative banks, post offices etc. However, the aforesaid limit is restricted to Rs. 5,000 in case of HFCs and NBFCs.

Finance Act 2018, further, increased the aforesaid threshold to Rs. 50,000 in case of deposits held by Senior citizens.

It may be noted that Fixed deposits accepted by HFCs are subject to NHB regulations and therefore should be on par with the banks, cooperative banks, post offices etc.

► ***It is recommended that the treatment of threshold for Non deduction of TDS on Interest in case of Fixed deposits in case of HFCs shall be at par with Banks, post offices etc.***

7. Exemption of Interest income from Time / Fixed deposits.

Section 80TTA allows deduction upto Rs. 10,000 earned by assessee from savings bank account. A similar provision may be introduced to allow deduction from interest income earned from Time / Fixed Deposits held with banks including Co-operative banks, post offices and deposits with HFCs. This shall further channelize deposits to the banking system and HFCs.

► ***It is recommended to introduce Exemption of Interest income from Time / Fixed deposits with banks and HFCs.***

8. Exemption benefit on interest on deposits including fixed deposits under section 80TTB to be extended to deposits held with HFCs / NBFCs.

Section 80TTB was introduced by Finance Act 2018 to allow deduction upto Rs. 50,000 earned by specified assesses from savings bank account and fixed deposits held with specific entities like Banks including Co-operative banks and Post offices.

However, this benefit is not applicable for interest earned out of deposits held with HFCs and NBFCs.

It may be noted that such Fixed deposits accepted by HFCs / NBFCs are subject to NHB / RBI regulations and therefore should be on par with the banks, cooperative banks, post offices etc.

► ***It is recommended that the exemption benefit on Interest under section 80TTB shall also be made available in case of deposits held with HFCs / NBFCs to bring the treatment at par with Banks, post offices etc.***

9. Exemption from deduction of tax at source on interest income received by NBFCs under Section 194A of the IT Act 1961

As per section 194A of the IT Act, any person making payment of interest is required to deduct tax at source ('TDS'). There are certain exemptions under this section wherein the person making payment to various institutions like banking companies and financial institutions are not required to deduct TDS. Accordingly, any person making payment of interest to Banks is not required to deduct tax.

The NBFC Sector have grown significantly over last decades and has immensely contributed to Government objective of financial inclusion by lending to masses. However, no such

exemption has been provided to NBFCs from the applicability of section 194A. Accordingly, tax is required to be deducted at the rate of 10 percent from interest paid to NBFCs.

Non-applicability of TDS on interest components paid/ payable to Banks put them as a more preferred lender as compared to the NBFCs as computation of interest in every EMI becomes more tedious for the borrower. We proposed that existing TDS exemptions be also extended to NBFC for below stated reasons

1.Level-playing field with Banks

We wish to highlight that like Banks, even NBFCs are regulated by Reserve Bank of India ('RBI') and are mandated to follow RBI guidelines. All deposit accepting NBFCs ('NBFC-D') and all systemically important non-deposit accepting NBFCs (NBFCs-ND-SI) are subject to prudential regulations such as capital adequacy requirements and provisioning norms along with reporting requirements, similar to banks. In-fact over the years, similar to Banks, RBI has been tightening the regulatory framework for NBFCs and has brought convergence in regulation for NBFCs with Banks i.e. registration requirements, higher capital norms, tightened asset classification and provisioning norms, credit concentration norms, enhanced reporting and supervision, corporate governance framework, etc. The RBI recently also introduced Scale-based regulatory guidance for NBFC considering its growth in size, complexity and inter-connectedness within financial sector.

Applying similar corollary, the benefit of the provisions of section 194A should also be extended to NBFCs i.e. the interest income earned by NBFCs should be exempted from any TDS requirement.

2.No Loss to the Revenue

No loss to the Revenue: Tax on the income earned by NBFCs could be paid in the form of 'advance-tax', ensuring no revenue loss to the Government.

3. Administrative hardship

Additionally, given the number of customers deducting TDS for NBFCs at times, the TDS deposited by the customer does not necessary gets reflected on government TDS portal and hence, claim of TDS for NBFCs gets partially rejected. Given the same, the Government should extent the said exemption to NBFCs as well. The TDS exemption will eliminate significant administrative hassles of reconciliations of thousands of TDS deductions at the transaction level.

4. Liquidity Impact

Generally, NBFCs engaged in financing activities operate on a very thin margin on the interest and many of these NBFCs have high cost of operations and low profitability. Deduction of taxes at source (by virtue of section 194A) on the gross interest income earned by such NBFCs puts them in a disadvantageous position as it creates cash flow constraints. Moreover, at times the tax deductible on the gross interest income is much higher than the profitability of the NBFCs ie to utilize the TDS of 10% on gross amount approximately 25% profit margin needs to be earned at the current tax rates. This results into significant refund position to the taxpayers.

5. Large Volumes

NBFCs carry on the financing business mostly with retail customers who could be large in number spread across various geographies and sectors, including unorganized sectors. Due to the large customer base, it becomes almost impossible for NBFCs to regularly follow up with every customer for TDS certificates every quarter (details of which are mandatory for claiming the same in the Income-tax return). Also, practically it is very difficult to collate and collect details from such customers

As stated above, TDS on interest earned by Banks is not applicable under section 194A and tax on the income earned by such banking units are paid in the form of 'advance-tax', ensuring no revenue loss to the Government. On similar corollary, such TDS exemption should be made applicable to NBFC's as well.

The above proposal will also help NBFCs to manage the liquidity crisis, especially in the current times when their profitability is severely impacted on account of Covid-19 lockdown. This will also significantly reduce the compliance burden on the NBFCs' and its customers, while ensuring no loss to the Government Revenue.

► ***It is recommended that as NBFCs are institutions similar to banks the benefit of the provisions of section 194A should also be extended to NBFCs. The interest income earned by NBFCs should be exempted from any TDS requirement.***

Section 194A(3)(iii)(a) be amended as follows:

3) The provisions of sub-section (1) shall not apply—

……..

(*iii*) to such income credited or paid to—

(a) any banking company to which the Banking Regulation Act, 1949 (10 of 1949), applies, or any co-operative society engaged in carrying on the business of banking (including a co-operative land mortgage bank)

New sub-clause (ba) can be added:

(ba) a deposit taking non-banking financial company or a systemically important non-deposit taking non-banking financial company.

OR

The Central Government notifies a non-banking financial company for the purpose of Section 194(5) of the Income tax Act, 1961 and provide that no deduction of tax be made from payment to such person.

10. Restriction on cash receipt in excess of INR 2 lakhs under Section 269ST – Extension of exemption to NBFC to bring parity with Banks

Section 269ST of the IT Act does not permit any person to receive INR 2 lakhs or more:

(a) in aggregate from a person in a day;
(b) in respect of a single transaction; or
(c) in respect of transactions relating to one event or occasion from a person,

otherwise than by an account payee cheque or account payee bank draft or use of electronic clearing system through a bank account.

The above provision does not apply to banks, cooperative banks and post office savings bank. At present, such rigorous provisions are applicable in case of NBFCs.

As NBFC lends to the un-banked populations such agriculture and micro segment, such restriction impacts the business operations. Inclusion of NBFCs akin to Banks, co-operative bank and post-office savings banks will facilitate business operations to a large extent and provide a level playing fields to Banks and NBFC.

Similar amendment to be carried out in Section 269SS and Section 269ST which provides restriction of cash receipts and repayment in respect of loans, deposits and specified sum.

► ***It is recommended that proviso (i) to Section 269ST be amended to exempt NBFC from the purview.***

Section 269ST

Provided that the provisions of this section shall not apply to—

(i) any receipt by—

(a) Government;

(a) any banking company, post office savings bank or co-operative bank

Further inclusion:

or non-banking financial company/ systemically important non deposit taking NBFC;

Similar amendment to be carried out in Section 269SS and Section 269T

11. a. Alignment of Special deduction on provision for bad and doubtful debts between Bank and NBFC – 36(1) (viia) of IT Act

b. One-time accelerated deduction on account of provision for doubtful debts for FY2022-23

Section 36(1)(viia) of the IT Act provides that a bank shall be allowed a deduction of provision of bad and doubtful debts to the extent of 8.5 percent of the total income (computed before making any deduction under this section and Chapter VIA) and 10 percent of aggregate average advances made by rural branches of such bank.

Finance Act, 2016 extended similar benefit to NBFCs and permitted them to deduct provision of bad and doubtful debts to the extent of 5 percent of the total income (computed before making any deduction under this section and Chapter VIA).

Such disparity is unwarranted as the NBFCs are making active contribution to the Indian Government's objective of financial inclusion by providing financial access to the un-banked population in rural areas. Hence, NBFCs having its branches and service centres in rural areas and lending to the rural sector in the form of agricultural loans, equipment finance, etc, should also be equated to lending by rural branches of banks.

Further, a one-time accelerated deduction only for FY2021-22 will provide liquidity support to NBFCs.

Also, from the perspective of the revenue, such measures are timing difference only as the deduction of provision of bad and doubtful debts claimed under section 36(1)(viia) of the IT Act will be either set-off in the year of write-off or reversal in the year of recovery of such bad & doubtful debts. However, this measure will infuse the required liquidity support to the NBFC.

► ***It is recommended that the existing threshold of deduction of 5 percent of the total income under section 36(1)(viia) applicable to NBFCs should be increased to 8.5 percent and also rural branches of NBFCs be allowed to claim deduction of 10 percent of average rural advances made by rural branches of NBFCs so as to bring it at par with the banks.***

► ***Further, it is recommended that considering severe impact of Covid-19 on NBFC Sector, a one-time accelerated deduction on account of provision for bad and doubtful debts of 15% of total income be provided for FY2022-23.***

The aforementioned measure will provide the much-needed liquidity required for the NBFC sector. Section 36(1)(viia)(d) be amended as follows:

The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in section 28 —

(viia) in respect of any provision for bad and doubtful debts made by:

……

(d) a non-banking financial company, an amount not exceeding five per cent of the total income (computed before making any deduction under this clause and Chapter VI-A)

Amended in Clause (d):

(d) a non-banking financial company, an amount not exceeding *eight and half percent per cent* of the total income (computed before making any deduction under this clause and Chapter VI-A) *and an amount not exceeding ten per cent of the aggregate average advances made by the rural branches of such institutions computed in the prescribed manner*:

Provided that a non-banking financial company is eligible to claim deduction upto fifteen percent of total income for the year ended 31st March, 2023

12. Carry forward of accumulated losses in case of amalgamation or demerger u/s 72A of the IT Act, as applicable for Banks only – to be extended to NBFC

Amalgamation of banking companies is specifically included in section 72A of the IT Act. Hence, carry forward of accumulated business losses and unabsorbed depreciation of amalgamating banking entity can be claimed by the amalgamated banking entity. However, NBFCs have been kept outside the ambit of such provisions.

Given that the Government has actively implemented consolidation exercise in the Banking and Financial Services including the Mega merger of PSU banks and may adopt similar approach for NBFC Sector, it is recommended that provisions of section 72A of the IT Act are extended to NBFCs also to facilitate consolidation initiatives in this sector.

► 72A. (1) Where there has been an amalgamation of—
(b) a banking company referred to in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949) with a specified bank; or

Sub-clause (ba) to be inserted in Section 72A to allow carry forward of accumulated losses in case of amalgamation or demerger to NBFC then, notwithstanding anything contained in any other provision of this Act, the accumulated loss and the unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or, as the case may be, allowance for unabsorbed depreciation of the amalgamated company for the previous year in which the amalgamation was effected, and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly

New sub-clause (ba) can be added:

(ba) *a deposit taking non-banking financial company or a systemically important non-deposit taking non-banking financial company*

13. Applicability of TDS under Section 194 N on cash withdrawal from current account leading to administrative hardship to NBFCs

Section 194 N was introduced in the Budget 2019 which stipulated that any withdrawals from the Current Account for more than 1 crore in a financial year will attract a TDS at 2%. The exemptions to this rule include when the payee is a government body, banks, white-label ATM operator. Large and listed NBFC's principal business is relating to money lending and collections. Such entities having branches across India have significant cash withdrawal requirement for running their day-to-day business. These entities have banking relationships across multiple banks. Currently, the banks deduct the TDS at applicable rates as per Section 194 N.

However, there are no standard practices followed across banks for this process. Banks, sometimes, debit the current account leading to overdrawing of the current account, and also in some cases because the processing of such debits by back-end processing team is done at night, the customer is also not aware of the timing of such debit leading to a shortfall in funds in the bank account. This gets reflected in the CRILIC reports as a default. CRILIC reporting system throws default by any customer in the Current/Loan account. Banks debit the TDS without any prior intimation and not even on a uniform date which results in the Customer not knowing about the debit.

All these results in the customer's account shown as default in CRILIC system and the entities have to spend considerable time and effort in explaining the reason to the regulator and lenders for such transactions. Further, such a non-standardized process followed by the banks leads to administrative inconvenience in terms of accounting.

- ***The following suggestions may be considered i) Inclusion of large and listed NBFCs in the payee exemption list to Section 194 N being regular advance tax-payers ii) Create a standardized process for all-payer banks to ensure that TDS debits, if any, are not included as part of CRILIC report.***

14. Introduce a separate deduction for home loan repayments

Real estate sector has been severely impacted by current COVID-19 crisis and as a consequent, financial sector (viz Banks and NBFCs) will be directly impacted. This will result in scarcity of demand from potential buyers and impact economy as a whole. The lower interest rate on home loan is an attractive proposition and increase in existing tax deduction for home loans will further boost the sentiments of the housing sector.

Currently, the repayment of principal component of home loans is eligible for tax deduction under Section 80C whereas the repayment of interest component of up to Rs 2 lakh qualifies for tax deduction under Section 24B. However, with multiple investment options, small savings

instruments, insurance policies, pension plans, etc crowding Section 80C, many home loan borrowers remain bereft of availing tax deduction on their entire home loan principal repayments. Similarly, the upper cap on Section 24B becomes inadequate for a large number of home loan borrowers, especially in their initial years of their home loan tenure. Hence, there should be a separate section for home loans repayment with a combined maximum deduction of up to Rs 5 lakh for both principal and interest components. This would boost home buyers' sentiment and thereby, increase demand in the housing industry.

► ***It is recommended that there should be a separate section for home loans repayment with a combined maximum deduction of up to Rs 5 lakh for both principal and interest components.***

INDIRECT TAX ISSUES AND SUGGESTIONS

15. Payment of taxes on net basis and Payment of reverse charge liability through utilization of input tax credit - Section 49(4) read with Section 2(82) of the Central Goods and Services Act, 2017

GST on output supplies made by the companies is required to be discharged on net basis i.e., cash payment being restricted to the liability after offsetting of available input tax credit.

While the above modus operandi is available for GST payable on output supplies, reverse charge GST liability is required to be necessarily discharged in cash and cannot be paid through utilization of input tax credit.

The GST liability under reverse charge is payable in cash, even though companies could avail input tax credit of the GST so paid (on reverse charge supplies) in the same month. This entails obligatory cash outflow for businesses with a corresponding liquid asset being created in parallel.

Further, as input tax credit is an unbridled asset for a business, the said should be freely allowed to be used for payment of all GST liabilities and the embargo on payment of reverse charge liability should be removed for easing financial stress.

► ***It is recommended that legislative changes be carried out in the GST provisions for below suggestion:***

- ***Allowing payment of reverse charge liability on net basis i.e., gross reverse charge liability payable reduced by input tax credit available thereon.***
- ***Allowing payment of reverse charge liability through utilization of input tax credit.***

16. Issuance of credit notes in scenarios of bad debts - Section 34 of CGST Act, 2017

As background, under the currently manifested provisions of the GST law (Section 34 of the CGST Act), credit notes are allowed to be issued by businesses only for specified scenarios inter-alia including sales return, deficiency in service, etc. The said scenarios do not include adjustment of taxes paid in scenarios of full/ partial bad debts; even though adjustment of taxes does not entail any loss to the exchequer per se.

In the current COVID-19 scenario, businesses are apprehensive on receiving customer payments and of renegotiation of prices/ non-payment of dues by some businesses. Where businesses are not allowed to adjust taxes earlier paid on such supplies made by them, the said becomes an

additional burden on them – as they are required to discharge taxes without corresponding recovery from customers.

Herein, it is also worthwhile to note that typically customers would not be able to utilize input tax credit of the GST so charged on the tax invoice on account of non-payment within 180 days of the issuance of invoice. Hence, even in a scenario, where adjustment of GST through issuance of credit notes is allowed, it should not entail any loss to the exchequer per se.

It is also worthwhile to note that globally, most jurisdictions allow an adjustment of taxes in cases of bad debts and the said is imperative during the current times of financial stress.

► ***It is recommended that issuance of credit notes be allowed in scenarios where partial/ full payment is not received from customers***

17. Accept payment of Tax under one major head

Currently, GST is being charged and paid under three different heads - Integrated Goods and Services Tax (IGST), Central Goods and Services Tax (CGST) and State Goods and Services Tax (SGST) or Union Goods and Services Tax (UGST). In case taxpayer makes payment under IGST, it can be utilised for payment of IGST liability first and then against CGST and SGST.

Rather than making payment under different heads, it would be helpful if payment is accepted under one head and then adjusted towards different head while filing returns.

► ***It is recommended to allow payment of tax in cash under one head and adjustment of the same towards actual liability while filing returns.***

18. Adjustment of credit notes while filing GSTR-3B

Credit notes are part and parcel of any business activity. GST law permits adjustment of credit notes while making payment. By adjusting credit notes taxpayer can offset the GST liability for a particular month.

Adjustment of credit notes and its disclosure is allowed while filing GSTR-1 return. However, in case there is NIL liability or negative liability due to adjustment credit notes, disclosure of the same is not allowed while filing GSTR-3B return. This is leading to reconciliation issues between GSTR-1 & GSTR-3B.

► ***It is recommended to provide functionality for disclosure and adjustment of credit notes while filing GSTR-3B***

POLICY ISSUES AND SUGGESTIONS

19. Arbitration Clause under Emergency Credit Line Guarantee Scheme

Under the FAQs of Emergency Credit Line Guarantee Scheme, the FAQ No 83 on 'when would legal action be considered as initiated in case an account turns NPA' clearly states the below:

"Mere issue of recall notice shall not be construed as initiation of legal action. Legal action shall be considered as initiated upon filing of application in Lok Adalat/Civil Court/ Revenue State Authority/DRT or after action pursuant to the notice issued under Section 13(4) of SARFAESI Act, 2002 or after admission of application under NCLT or commencement of arbitration proceedings or such other action as may be decided by NCGTC from time to time."

However, as per a recent notification by National Credit Guarantee Trustee Co. Ltd. (NCGTC) dated August 11, 2021, an additional FAQ has been added. According to latest addition by way of FAQ 161:

Arbitration proceedings are not considered as legal action for recovery of dues. NCTGC has without any valid justification or assigning any reason struck off the legal remedy option available to Banks and NBFCs of commencement of arbitration proceedings under the FAQ 83.

It is requested that the words "Arbitration proceedings are not considered as legal action for recovery of dues" should be done away with. Also, the option of Arbitration under the head "Legal Action Taken" should be immediately activated on the website of NCGTC for the Application process for interim payment.

It is pertinent to point out that claims of MLIs less than Rs 20 lacs are not being entertained in DRT and such claim necessarily go through Arbitration route for its claim adjudication. Therefore, disallowance of Arbitration proceeding (as one of the measures for legal actions), will complicate the process of interim and final claim submission for the MLIs. **Hence, it is requested that provisions of FAQ 83 should continue to remain applicable.**

20. Alignment of single counterparty exposure limit for banks' exposure to Gold Loan NBFCs with that of other NBFCs

The present limit of bank finance ie. 7.5% of capital funds of banks to Gold Loan NBFCs was fixed in 2012 at a time when there was no regulation in place specifically for this sector. Now, 8 years have passed and the industry has grown responsibly over these years. To harmonize 'single counterparty exposure limit' for bank's exposure to 'single NBFCs' with that of 'general single counterparty exposure limit', RBI, in September 2019 increased the bank's exposure limit to a 'single NBFC' to 20% of Tier-I capital of the bank as against 7.5% for Gold Loan NBFCs.

As with the growth in the asset base, borrowing requirements of Gold Loan NBFCs have increased and despite the fact that industry players have diversified their sources of funding, the bank funding contributes a major source of funding for them.

It may be noted that bank's exposure opportunity to Glod Loan NBFCs is limited on account of the above exposure ceiling. It is to be noted that most banks keep their respective ceiling slightly lower than the RBI ceiling limit further reducing the credit flow to the sector.

The problem is also getting aggravated because of the merger of PSU banks. Due to the merger of PSU banks, exposure to Gold Loan NBFCs by the merged entity tends to be larger when combined and hence appetite for further increase in exposure becomes limited which was hitherto getting spread over several banks.

- ***It is recommended to align the single counterparty exposure limit for banks' exposure to Gold Loan NBFCs with that of other NBFCs i.e. at 20 percent of Tier I capital of the bank to enhance credit flow to the sector as well as harmonization of single counterparty exposure limit.***

21. Issuance of Udyam Certificate to MSMEs

Individuals to be exempted from Udyam registration requirement.

Subsequent to the issue of the circular permitting on-lending to NBFCs, RBI issued a fresh circular RBI/2020-21/10 FIDD.MSME & NFS.BC.No. 3/06.02. 31/2020-21 dated July 2, 2020 notifying new criteria for classifying the enterprises as Micro, Small and Medium Enterprises. The New PSL criterion requires Udyam to be obtained for MSME borrowers. However, the process of registration has been extremely slow largely due to practical issues being faced in the registration process. Udyam registration portal requires Aadhar linkage with verification through OTP process to the linked mobile. Most of the MSME individual borrowers have prepaid mobile account and they tend to change their mobile number frequently. Aadhar Verification for Udyam certificate is not being possible till mobile number are linked and updated which can only be done by UIDAI centres. As it is practically difficult to obtain the Udyam registration for individual customers, we request for exempting the individuals for Udyam registration requirement.

22. Extension of PSL classification for NBFC loans every six months by RBI with a 5% cap

RBI announced Extension of facility of Priority Sector Lending- Banks' lending to NBFCs for on-lending wherein the facility of bank lending to NBFCs (other than MFIs) for on-lending was allowed to be classified as PSL up to September 30, 2021. As announced in the 'Statement on Developmental and Regulatory Policies' dated October 8, 2021, the facility has been extended till March 31, 2022 keeping in view the increased traction observed in delivering credit to the underserved/unserved segments of the economy.

Loans disbursed under the on-lending model will continue to be classified under Priority Sector till the date of repayment/maturity whichever is earlier.

Our request is to continue the PSL classification to banks for on lending to NBFCs, which will enable retail NBFCs to deliver credit to the undeserved/unserved segments at an reasonable cost as a permanent facility and increase limit for the bank from 5% to 10%.

23. Issuance of Credit Cards by NBFCs

RBI Regulations permit NBFCs also to issue Credit Cards directly. Gold Loan NBFCs have more than 300 lakh customers at any given point in time who have availed the gold loan on the security of household used gold jewellery.

Permission may be granted to "Large NBFCs- SI" predominantly engaged in lending against Gold Jewellery to issue Credit Cards on the security of the gold ornaments pledged by borrowers with a limit not exceeding the Loan to Value stipulated by RBI. The borrowers who opt for the card will enjoy the benefit of having to pay interest only on the day they start using the credit cards at POS machines and thereby save on the interest expense.

24. Lowering the loan limit for applicability of SARFAESI Act from Rs 20 lakh to Rs 1 lakh

The government has reviewed and lowered the eligibility for NBFCs for applicability of SARFAESI Act i.e. Asset Size of NBFC from Rs. 500 Crore to Rs. 100 Crore and Loan Amount from Rs. 50 lakhs

to Rs. 20 lakhs. While it is a step in the right direction, however, this threshold of Loan Amount of Rs. 20 lakhs should be further reduced to Rs. 1 lakh.

25. Centralised liquidity support for PTCs

The investor base for PTCs (both ABS and more so for RMBS) is limited and the market is largely driven by the banks as investors (primarily to meet their PSL requirements). One of the reasons for low participation from different classes of investors (mutual funds, insurance companies, etc) is lack of development of secondary markets for PTCs. This makes investments in PTCs illiquid. This not only makes pricing inefficient for PTCs but also severely impacts the very appetite for PTCs. This has following major impacts:

- Concentration for credit risk within banks/ NBFCs.
- Inefficient pricing for PTCs
- Lower participation from investors other than banks

To promote development of securitization market (PTCs), liquidity of PTCs (i.e., option to sell in secondary market) is very critical. Besides reducing illiquidity premium for PTCs, this will also help in diversification of credit risk away from banks / NBFCs through better participation from other investors.

One suggestion to improve liquidity of PTCs, is to have assured liquidity facility (to purchase PTCs in secondary market) from a central agency. Since the intended objective is to provide assured secondary market liquidity for PTCs, due care has to be taken to ensure that this facility does not otherwise serves are a mitigate for credit risk. We suggest as under:

Our suggestion:

- The central agency should be mandated to provide assured liquidity (centralized liquidity support) for PTCs by way of purchase of PTCs in the secondary market. This central agency could be NHB, SIDBI, NABARD or any other entity created with mandate to development PTCs market. This will also address some of the tenor related concerns of the investors for assets with longer maturity e.g., RMBS.
- The facility should continue to be available for PTCs subject to following conditions:
    - PTCs are rated by an external credit rating agency registered with SEBI.
    - Securitization transaction is carried out under SEBI Regulation and / or RBI Regulations
    - The PTCs is rated minimum at same level (as initially rated) at the time when secondary market transaction pursuant to this facility is proposed. If PTCs are rated at lower level (than original rating) at the time of secondary purchase under this facility, the facility shall not be available till the credit rating is upgraded to minimum of original rating.
    - The facility should be available only after a cooling period (say [1] year for ABS and [2] years for RMBS) from the date of securitization for the facility unless specifically allowed by the relevant regulator.
    - The facility should be available at pre-defined time intervals (quarterly / half yearly) till expiry of mutually agreed period for each transaction.
    - The PTCs should be rated at minimum of [BBB]
- The interest rate for the facility may be decided upfront and may be linked to an external benchmark.
- The central agency may also have flexibility to offer the PTCs so acquired in the market.