

NBFCs: Is there a level playing field yet?

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With the Union Budget 2021 around the corner and sweetness of halwa ceremony done, there are few tax demands which have been continuously ignored by the government. One such demand is granting tax parity to NBFCs as with Banks/ financial institutions.

A Non-Banking Financial Company (“NBFC”) is a company incorporated under the provisions of the Companies Act 1956/2013 and is engaged in the business of loans and advances, acquisition of shares/stocks/bonds/debentures/securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business; but does not include any institution whose principal business is that of agricultural activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property. Further, a non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in installments by way of contributions or in any other manner, is also a categorized as an NBFC.¹

A NBFC performs functions or activities which maybe akin to a bank such as lending and making investments. However, unlike banks, a NBFC cannot accept demand deposits or issue cheques. However, in recent times, NBFCs have become a flagbearer in the credit market, in as much as, NBFCs have outperformed banks in new credit deployment. Going by a recent report of CRISIL, NBFCs were projected to reach a share of 19-20% in the credit market.² However, the growing trajectory started taking a downfall beginning somewhere from the second half of 2019 and later worsen by the pandemic. Amidst, the downfall the potential of NBFCs to be a catalyst in growth cannot be ignored.

Even after being pitted as one of the growing sectors, the demands of NBFCs to be treated on the same pedestal as financial institutions/banks from a taxation perspective remains undealt with and has been ignored from time to time. NBFC bodies, every year, before the union budget, propose amendments in the Income-tax Act, 1961 (“Act”) via pre-budget memorandums to bring them on the same footing as banks/financial institutions. Bodies like Federation of Indian Chambers of Commerce and Industry (“FICCI”), in past, have submitted a pre-budget memorandum highlighting the need for extending the benefits to NBFCs.³

Further, Finance Industry Development Council (“FIDC”), a self-regulatory organization for registered NBFCs also proposed to seek parity with banks vis-à-vis the income tax benefits⁴. Some of the common proposals are discussed below:

Exemption from Tax withholding on Interest: Under Section 194A of the Act, any person other than individuals and Hindu undivided families (“HUFs”), making payment of interest, are required to deduct tax at the rate of 10% before remitting such payment. The provision provides exemption to certain institutions like banking Companies, life insurance companies and UTI etc. However, the said benefit is not extended to NBFCs which in result lead to liquidity issues as well as compliance issues. In view of the

¹ <https://www.rbi.org.in/Scripts/FAQView.aspx?Id=92>

² <https://www.financialexpress.com/industry/nbfc-share-in-credit-market-likely-to-reach-20-pct-by-2020/1088529/>

³ <http://www.capitalmarket.com/prebudget/2019-2020/Memorandum/Federation-of-Indian-Chambers-of-Commerce-and-Industry.pdf>

⁴ http://www.fidcindia.com/representations/fidc_15_12_17_pre_budget_memorandum_2018-19.pdf

same, it was time and again, proposed by the bodies that NBFCs. Should be exempt from the provision of Section 194A.

Exemption from Thin Capitalization Norms: Section 94B of the Act, provides limitation in interest deduction to curb base erosion and profit shifting. According to the provisions of Section 94B, interest deduction for an Indian entity is restricted to 30% of its earnings before interest, tax, depreciation and amortization (“**EBITDA**”) in certain situations which are as follows:

- i. Interest or similar expenditure on money borrowed by Indian company is in excess of INR One crore;
- ii. Such an expenditure is deductible while determining taxable income under the head “Profit and gains from business or profession; and
- iii. The expenditure is in respect of a debt from a non-resident Associated Enterprises (**AE**)

Further, proviso to the section covers interest expenditure in respect of debt from non-AEs, where an AE provides an implicit or explicit guarantee.

It is to be noted, that this provision is not applicable on the certain regulated institutions engaged in the business of banking or insurance. It is argued by the bodies that NBFCs are also highly regulated and involved in the similar line of business. Hence, the benefit granted to banks and insurance companies shall also be extended to NBFCs.

At this juncture, it would be pertinent to mention that Government had, in past, constituted a Key Advisory Group (“**KAG**”) on NBFC. The KAG vide its report dated 31.01.2012⁵ recommended certain amendments to the Act which, inter alia, included exemptions from the provision of Section 194A (Tax Deduction at Source on Interest payments), extension of the benefits of Section 43D to the NBFCs etc. However, the proposed recommendations did not see light of the day and were never acted upon.

Amidst, the consistent ignorance of the proposals and recommendations to bring equality in the tax treatment of NBFCs, government has taken a positive step by recognizing the need of parity in the tax treatment vis-à-vis banking companies. Hon’ble Finance Minister Ms. Nirmala Sitharaman in her budget speech dated 05.07.2019, while extending the benefit of Section 43D of the Act to NBFCs, noted the increasingly important role played by NBFCs in India’s financial system and the need to provide greater parity in their tax treatment vis-à-vis scheduled banks.⁶

However, achieving the equality amongst the equals is still a far cry and would take considerable amount of time. It is important for the government to take a note of the demands of NBFCs and provide a level playing field to them as compared to banks and other financial institutions. In these testing pandemic times, it becomes essential for the government to provide tax parity to NBFCs. The parity may lead to more working capital allowance in the hands of these NBFCs. Such NBFCs will further be crucial in supporting the startup ecosystem or schemes like Skill India or Make in India or Atmanirbhar Bharat by providing a continuous flow of credit in the economy.

Disclaimer: The views and opinions expressed in this article are those of the author and does not constitute a legal opinion/advice by Chambers of Jain and Kumar.

⁵ <https://financialservices.gov.in/sites/default/files/Reports%20 NBFCs.pdf>

⁶ <https://www.indiabudget.gov.in/budgetspeech.php>