FIDC

Finance Industry Development Council

(A Representative Body of NBFCs in India)

101/103, Sunflower, 1st Floor, Rajawadi Road No.2, Ghatkopar (East), Mumbai – 400 077

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20th June, 2024

Smt. Nirmala Sitharaman ji
Minister of Finance
North Block
Government of India
New Delhi 110 001

Hon'ble Finance Minister Madam,

SUB: <u>PRE-BUDGET MEMORANDUM (2024-25) – CONCERNS & SUGGESTIONS FOR AN ENHANCED ROLE OF NON-BANKING FINANCE COMPANIES (NBFCs)</u>

Finance Industry Development Council (FIDC) is a Representative Body of the NBFCs including Housing Finance Companies registered with the Reserve Bank of India. FIDC was formed 20 years ago and is the recognized face of the NBFC sector. Almost all the leading NBFCs and a large number of small and medium sized NBFCs are our members. <u>FIDC is actively working to seek approval from RBI to be the Self-Regulatory Organization (SRO) for the NBFC sector.</u>

On behalf of the Board of Directors and the members of FIDC, I would like to convey our Heartiest Congratulations to you for taking charge as the Finance Minister of India for another term. Having successfully steered the economy out of the most challenging times of Covid to become the fastest growing economy of the world and the 5th largest economy in the world, we are confident that under your guidance and the visionary leadership of our Hon'ble Prime Minister Shri Narendra Modiji, we are destined to not only become the 3rd largest economy but a "Viksit Bharat" by 2047.

<u>Contribution of NBFCs Show a Healthy Growth</u>

We at FIDC are fully committed to ensure an increasing contribution of the NBFC sector in catering to the credit needs of the unbanked and under banked segment of the society.

- India accounts for third largest share of Economic Function 2 (EF2) assets (i.e assets of the entities which are into lending activities akin to NBFCs in India) after the United States and the UK. At individual country level, India has the highest contribution coming from lending entities in its total financial assets of NBFI sector.

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- As of March 2023, NBFCs credit to GDP ratio stood at 12.6 per cent and the sector has grown to become 18.7 per cent of banking sector assets as of March 2023 as compared to 13 per cent ten years ago (March 2013).
- Aggregate lending by NBFCs rose by 20.8 per cent (y-o-y) in September 2023 from 10.8 per cent a year ago.
- Credit growth by NBFCs to the MSME sector was more than three times that of banks.
- For FY23, the RBI's financial inclusion (FI) index stood at 60.1 compared to 43.4 for FY17 and NBFCs have played a significant role in this rise

Key Macro Level Concerns

1.Regulation and Development Must Go Hand in Hand: Need for Regular Engagement of NBFCs with Ministry of Finance and RBI on Periodical Basis:

All the policies framed by the Government and the regulatory framework put in place by the regulator have one common objective which is a healthy development of the sector. In order to achieve this, the basic need is to have a regular engagement on a periodical basis.

Ministry of Finance and RBI do engage with and meet the NBFC sector, but most such engagements are pursuant to concerns / issues on either side. However, with an increasingly important role being played by NBFCs the need is to have a periodical engagement to ensure a two-way flow of informa on and areas of concern. It also enables the policy makers to get first hand market report. In a fast-changing scenario, a structured dialogue on a regular basis is an important need of the hour with the objective to be "proactive" as against being "reactive".

Suggestion:

We therefore request to have such meetings on a periodical (preferably quarterly) basis with senior officials at Dept.of Financial Services (Ministry of Finance) and RBI

2. Harmonization of Regulations of NBFCs with Banks

RBI has harmonized the regulation of NBFCs with that for banks and FIs, especially, the prudential norms on income recognition, asset classification and provisioning. However, this harmonization has only resulted in making the regulations "more stringent". Commensurate harmonization in provisions relating to Recovery and Taxation are still pending for long. Details on these are given in Annexures – A & C.

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Suggestion:

Harmonization of Regulations of NBFCs with banks need not be restricted to "tightening" but this must also entail harmonizing benefits enjoyed by banks vis-à-vis NBFCs

3. NBFCs Dependence on Bank Funding

Lately, RBI has voiced their concern on "over dependence" of NBFCs on banks for funding. In this context we would like to highlight the following important facts:

a) Actual Figures may Present a Different Picture

- As per the RBI's Annual Report on Trends and Progress in Banking, as on 30th September, 2024, bank borrowings by NBFCs cons�tuted 37.8% of the total borrowings of NBFCs (excluding Share Capital and Reserves). Borrowings by issuance of Debentures constituted 36.10% and the balance 26.10% are from other sources.

- The RBI figures of bank borrowing by NBFCs include the figures for Government owned NBFCs also, which constitutes a significant portion. Since these are sovereign/quasi-sovereign exposures, these should be excluded from calculation of systemic exposures to the NBFC sector.

b) Overdependence on Banks Must Lead to Diversification and Not Restriction

NBFCs being financial intermediaries need funds to on lend on an ongoing basis. Over the years, various funding sources for NBFCs have been restricted without opening up of any new avenues. This has resulted in liquidity challenges, more so, for a large number of small and medium sized NBFCs who cannot access capital markets.

Suggestion:

Funding sources for NBFCs need to be diversified to check over-dependence on banks. Details are given in Annexure - A

Details of Specific Issues related to

- **Funding & Recovery are given in Annexure – A**
- **Financing of MSMEs are given in Annexure - B and**
- **Taxation are given in Annexure – C.**

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The concerns raised are of prime importance to ensure a healthy growth of NBFCs and enable them to enhance their contribution to the growth of India's economy. We shall be glad to provide any clarification or further information in this regard.

Assuring you of our full cooperation always and thanking you in anticipation

Encl.: Annexures – A, B & C

Thanking you,

Yours Faithfully,

For **FINANCE INDUSTRY DEVELOPMENT COUNCIL**

MAHESH THAKKAR
DIRECTOR GENERAL
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Annexure – A: Diversification of Funding Sources and Tools for Recovery

1. Alternative to Bank Funding – Need for a Refinance Window for NBFCs

Over the years liquidity has been a recurring challenge for NBFCs, especially, large number of small and medium sized NBFCs. Sources of funding like public deposits and External Commercial Borrowings (ECBs) have been restricted. With the recent concerns on the over dependence on banks for funding have further added to the liquidity concerns. There is therefore an urgent need to create a dedicated Refinance window for NBFCs to ensure a smooth and sustainable flow of funds that would also help address the concerns relating to asset liability mismatch. Funds raised through this mechanism may be exclusively used to finance MSMEs and the priority sector.

The Parliamentary Standing Committee on Finance in their 45th Report dt. June, 2003 had also recommended setting up of a Refinance Institution for NBFCs on the lines of National Housing Bank for HFCs.

Suggestion:

DFIs like SIDBI should provide refinance to NBFCs for on-lending to the MSME and the priority sector, with special fund allocation from the Govt. During our interaction, the Management at SIDBI have conveyed their willingness to take up this role.

2. Widening and Deepening of the bond market:

A thriving bond market (especially for bonds rated BBB+ to AA) would help in expanding alternate sources of funding for NBFCs and help reduce dependence on banks. At present the primary as well as the secondary market for corporate bonds is limited largely to AAA and AA+ bonds, and even for such bonds there is no organised market making mechanism and so these bonds tend be largely illiquid.

Suggestion:
We request that a suitable mechanism of market making (perhaps on the lines of the Primary Dealers with suitable modifications) be implemented to assist the corporate sector to access public funds in an organised manner with ready retail liquidity.

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3. Loan Amount Threshold for Enforcing Security Interest under The SARFAESI Act to be Reduced from 20 Lakhs to Rs. 1 Lakh for NBFCs

NBFCs have faced challenges due to this limit being set at Rs. 20 lakhs as it takes abnormally longer time for resolution of stressed account in absence of SARFAESI which goes as high as 5 years which not only increases the number of stressed accounts on NBFCs balance sheet but also increases the legal and litigation cost of NBFCs. This cost gets unnecessarily loaded on the good MSME borrowers which are standard and making timely servicing.

The RBI has vide its notification dated November 12, 2021 implemented a key change of recognising delinquencies on a daily basis instead of on a monthly basis, irrespective of the loan size. This would have a significant impact on the level of systemic NPAs reported by the NBFCs. The recognition norms are thus harmonised across banks and NBFCs. Provision of speedier and effective recovery mechanism in the form of SARFAESI Act is critical to manage this additional burden.

It may be relevant to mention here that the average size of loans sanctioned by NBFCs is far lower at about Rs 5 lakhs, implying that most of the customers of NBFCs are out of the present threshold of Rs 20 lakhs. This effectively places the NBFCs at a disadvantage by preventing NBFCs from usage of a legally valid recovery tool available to banks, creating a piquant situation that in respect of the same customer a bank may resort to the provisions of the SARFAESI Act, while an NBFC cannot. There would be another dichotomy in the case of co-lending and it is not clear as to whether the participating bank can invoke the SARFAESI Act for its own share but the partner NBFC is not permitted to do so.

NBFCs are also subject to a fair practice code and other safeguards to prevent misuse of such provisions to harass customers. NBFC ombudsmen have also been appointed to address any customer grievance in this matter, thus minimising risk of recalcitration.

Suggestion:
In view of the above submissions, the said threshold should be reduced from Rs. 20 lakhs to Rs. 1 lakh in order to bring NBFCs at par with HFCs, Banks, SFBs and other financial institutions. The same was also recommended by the Expert Committee on MSMEs setup by RBI under the Chairmanship of Sh. U.K. Sinha.

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Annexure – B: Financing of MSMEs by NBFCs

1. NBFCs Registration under The Factoring Regulation Act – Request for Harmonisation of Regulations with the Factoring (Amendment) Act, 2021

We invite a kind reference to Paragraph 5 (ii) of the Statement of Objects and Reasons of Factoring (Amendment) Act, 2021, which reads as under:
"(ii) amend section 3 to widen the scope of financiers and to permit other nonbanking finance companies also to undertake factoring business and participate on the Trade Receivables Discounting System platform for discounting the invoices of micro, small and medium enterprises;"

The essence of objects and reasons for the amendments to the Factoring Act, in our bona fide opinion, was to widen the number of financiers and to permit other NBFCs, in whatever proportion of their assets and income to do factoring business, except that the assignment of receivables has to be registered through and on the TReDS platform (under payment system) However, as per RBI Notification No. DOR.FIN.080/CGM(JPS)– 2022 dated January 14, 2022 the eligible NBFCs (classified as Investment and Credit companies – NBFCs-ICC and whose principal business is lending) need to seek fresh registration with RBI for undertaking factoring business. Thus, they have to carry dual registration – both as an NBFC (ICC) and an NBFC (Factor).

Apparently, the prescriptions regarding requirements of separate registration as NBFC (Factor), except for the purpose of eligibility to participate on the TReDS platform are incongruent and inconsistent with the Factoring Regulation (Amendment) Act, 2021.

Suggestion:

(1) For the existing registered NBFCs, factoring should be subsumed by the classification of NBFC (ICC) meaning thereby that the separate classification of NBFC (Factor) should be done away with.
(2) In such cases, all the registered NBFCs may be authorized to commence or carry on the business of factoring under the Factoring Regulation Act by registering itself on TReDS platform. The Certificate of Registration held by the applicant NBFC may also be considered as the certificate of registration under the provisions of Section 3 of The Factoring Regulation Act.

2. NBFCs Should be Allowed to Offer Credit on UPI and Avail Overdraft Facility from UPI: A Move in Line with RBIs Payments vision of 2025

With the Reserve Bank of India allowing pre-approved credit lines to be extended by banks on the UPI network, consumers can seamlessly access and transact with their pre-approved credit lines through their UPI accounts, providing enormous convenience and instant access to credit. However, currently credit on UPI both through credit cards and pre-approved credit lines have been reserved for banks and NBFCs have not been allowed to access the UPI payments platform to provide the same facility to its customers.

Considering the fact that the Upper Layer NBFCs are now subjected to regulations akin to banks, it is imperative that NBFCs are also permitted to carry out certain activities which are so far only being restricted to banks. The Reserve Bank of India (RBI) can impose strict guidelines to ensure that NBFCs maintain high standards of data security and customer protection, mitigating potential risks.

a) NBFCs to Offer Credit on UPI

Allowing NBFCs to have membership of the UPI network can significantly benefit the financial ecosystem by promoting financial inclusion, enhancing competition and innovation, expanding the digital payments landscape, leveraging a broader customer base, improving access to credit, ensuring regulatory compliance, supporting governmental digital initiatives, and increasing efficiency in payment services

i) Financial Inclusion - Enhancing transactional volumes and Reach:

NBFCs often serve customers in rural and semi urban areas where banks have limited reach. By integrating with UPI, NBFCs can provide these underserved populations with access to digital payment services, fostering greater financial inclusion. The volume of transactions being generated currently through credit on UPI platform has been minimal so far owing to the difficulty faced by ecosystem players in efficiently utilising this channel of distribution.
It is therefore imperative to allow private players to use this platform as they are usually the drivers of 'small credit' on a massive scale. Allowing NBFCs will also allow more partnerships and co-lending in this space.

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ii) Customer centricity and reduced transaction costs:

Including NBFCs in the UPI network would increase competition in the financial services sector which could lead to better services and lower transaction costs.

iii) Expansion of Digital Payments Ecosystem:

The inclusion of NBFCs would expand the digital payments ecosystem which would play an important role for achieving the goals of a cashless economy. With more players in the UPI network, the adoption of digital payments can accelerate, reaching a broader segment of the population.

iv) Improved Credit Access:

NBFCs often provide credit facilities to individuals and small businesses that do not have access to traditional banking services. By being part of the UPI network, NBFCs can offer integrated payment and credit solutions, making it easier for customers to access loans and repay them digitally.

v) Efficiency in Payment Services:

NBFCs, through their technological adoption and focus on customer-centric services, can bring efficiencies to payment services. Their inclusion can lead to faster and more efficient payment processing, benefiting consumers and businesses alike.

vi) Building robust underwriting models:

Leveraging UPI data can help build robust underwriting models using transition parameters such as declines due to insufficient funds, merchant type, geographical location of customer, etc. to minutely assess a borrower's creditworthiness.

b) <u>NBFCs Availing Overdraft Facility from UPI</u>

Furthermore, NBFCs should be allowed to avail of overdraft facility from UPI primarily due to the following reasons:

i) Enhanced Liquidity for NBFCs and Strengthening Cash Flow Management:

ii) Diversified liability mix and reduced dependence on traditional funding sources:

OD facilities can provide an alternative to traditional funding sources such as bank loans or equity financing. This diversification of funding options can reduce the financial vulnerabilities of NBFCs and allow them to respond more dynamically to market needs.

Suggestion:
- NBFCs should be allowed to have full membership of UPI and Offer Credit
- NBFCs should be allowed to avail overdraft facilities from UPI

3. NBFCs Should be Included as Member Lending Institution (MLI) under the Credit Enhancement Guarantee Scheme for Scheduled Castes

NBFCs being key players in financing small borrowers, MSMEs are covered under the Credit Guarantee Scheme for MSMEs by CGTMSE. However, NBFCs are not included as Member Lending Ins tu on (MLI) under the Credit Enhancement Guarantee Scheme for Scheduled Castes (CEGSSC) for financing of entrepreneurs belonging to scheduled castes, which was announced in the Union Budget 2014-15 under the social sector initiatives of Ministry of Social Justice & Empowerment, Govt of India. IFCI Ltd. is the nodal agency for the scheme.

Suggestion:
NBFCs, duly registered with RBI must be included in the list of Member Lending Institutions (MLI) under the CEGSSC scheme.

4. Credit Guarantee Scheme for NBFCs for Financing MSMEs – Need to Relax Profitability Criteria for New NBFCs

The Credit Guarantee Scheme of CGTMSE for NBFCs for financing MSMEs was recently modified on 19th May 2023 vide Circular Number CGTMSE/44/37 (Circular). This is leading to exclusion of several NBFCs from CGTMSE cover and impede flow of credit to MSEs. The revised criteria for NBFCs as per Circular are as below:

Should have completed one full fiscal year of operations and reported profit - for NBFCs with vintage upto 3 years	Should have reported profit in at least 2 years out of the last 3 years of audited financial statements – for NBFCs with vintage more than 3 years

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We submit that criteria prescribed for profitability is quite tough. Further, a NBFC which is highly capitalized and which has robust credit operations may not necessarily have profitability due to following factors:
(a) Higher expenditure for technology, employees, branch expansion,
(b) Expenditure for new product expansion,
(c) Support of patient capital which has long term view for growth & is sure of profitability.

Suggestion:
We request that:
- profitability criteria be tweaked from 3 years hurdle period to 5 years and
- opportunity be allowed to the deserving NBFCs to be considered as MLI through an exception route.

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Annexure – C: Taxation

1. Levy of GST on Co-lending by Banks & NBFCs

Lately, DGGI has been investigating banks and NBFCs to determine whether there has been any GST evasion in the co-lending business model adopted by these entities. This has come as a big shock which has the potential to derail the co-lending model. In this regard, to clarify the business model and tax liabilities, we would like to submit the following for your kind consideration:

1. Co-lending Model Introduced and prescribed by Reserve Bank of India

The concept of co-lending *per se* was introduced by Reserve Bank of India as "co-origination of loans by banks and NBFCs for lending to priority sector" in para 3 of the statement of RBI on developmental and regulatory policies of the third bi-monthly monetary policy statement 2018-19 dated 01.08.2018. Subsequently, RBI issued a circular on "Co-origination of Loans by Banks and NBFCs for Lending to the Priority Sector" dated 21.09.2018 and "Co-Lending by Banks and NBFCs to the Priority Sector" dated 05.11.2020 respectively.

The objective of the Co-Lending Model was to address the growing credit demands in sectors such as agriculture, micro, small, and medium enterprises (MSMEs), and housing, which are crucial for economic development. By allowing banks and NBFCs to collaborate, the RBI aimed to make loans more affordable to the end-borrowers. The key benefit of the Co-Lending model was to provide a competitive edge for credit in the priority sector. It proposed to leverage the lower cost of funds from banks and the wider reach of NBFCs to offer loans at competitive rates to borrowers. It is noteworthy to mention here that the importance of co-lending was also emphasized in EASE 4.0 Reform announced by our Hon'ble Finance Minister acknowledging the fact that the delivery of credit to the last mile priority sector borrowers may be effectively achieved through the Co-lending Model.

The essential idea behind these delegated norms prescribed by the RBI is that the funds of the banks are channelled to the customers in priority sectors by using the reach of the NBFCs. The same is quoted from the RBI circular on Co-lending dt. 05.11.2020:
"*The primary focus of the revised scheme, rechristened as "Co-Lending Model" (CLM), is to improve the flow of credit to the unserved and underserved sector of the economy and make available funds to the ultimate beneficiary at an affordable cost, considering the lower cost of funds from banks and greater reach of the NBFCs.*"

It is pertinent to note that RBI has clearly acknowledged and spelt the key strengths of banks being "the availability of lost cost funds" and that of NBFCs being "greater reach". Thus, it is an implicit acceptance of the fact that NBFCs cost of funds is higher than that for banks which results in higher lending rates of NBFCs as compared to banks.

2. Options to Structure Co-lending Model

The Co-lending Model provides for the following options to structure the co-lending arrangement between banks and NBFCs:

i) Option- A: Co-origination of Loans

Under the first option, both banks and NBFCs may jointly contribute to the loan's exposure at the time of disbursement. This mechanism involved ex-ante due diligence, ensuring that both lenders jointly assessed the loan before disbursement. This in industry parlance is called as Option A – Co Origination Model.

The model entails joint contribution of credit at the facility level, by both the bank and NBFC (typically in the ratio of 80:20). It essentially involves sharing of risks and rewards between the bank and the NBFC for ensuring appropriate alignment of respective business objectives, as per the mutually agreed upon contracts. Based on the respective interest rates and proportion of risk sharing, a single blended interest rate is offered to the ultimate borrower.

The rate of interest charged by the NBFC vis-à-vis the rate of interest charged by the bank is always higher in such co-lending business models. We would like to clarify that the rate of interest charged by NBFCs is higher than that of banks because the borrowing cost of NBFCs is also higher than that of banks. Further, the major source of funding for NBFCs is banks thereby adding an additional layer of intermediation which ultimately manifests in higher lending rates being charged by NBFCs.

The higher rate of interest has no other significance and does not serve as a consideration in any way for any activity offered by the NBFC.

It must be noted that both the banks and NBFCs are bound by the RBI Master Circular on Fair Practice Code - guidelines relating to customer service and fair practices code and the obligations enjoined upon the banks and NBFCs therein - shall be applicable mutatis mutandis in respect of loans given under the arrangement in terms of the rate of interest that they are allowed to charge.

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All the NBFCs have been following the relevant RBI guidelines in fixing their share of interest and there has been no practice of unduly high rate of interest being charged from the customer. To successfully process, hand over and recover such loans, a fee is charged from the customer (borrower) under different names – processing fee, service fee, servicer fee, escrow management fee, documentation fee, out-of-pocket fees etc. Such fee, if any collected, by whatever name it is called, is definitely subject to the levy of GST as per the existing model and this fee may or may not be shared between the bank and the NBFC. It is reiterated that the tax liability on such share of the fee, by whatever name it is called, which accrues to the bank/NBFC is duly discharged under the GST law as required.

ii) Option-B: Co-lending

The second option allowed banks to structure the co-lending arrangement as a post disbursal takeover of the bank's share in the loan on a back-to-back basis. This approach streamlined the operational process, particularly in cases where banks had longer approval times. The same is expected to be akin to direct assignment model and subject to compliance with Master Direction – Reserve Bank of India (Transfer of Loan Exposures) Directions, 2021 issued by RBI vide its notification dated September 24, 2021. As per RBI Guidelines except the Minimum Holding Period (MHP) Guidelines Banks & NBFCs have to follow the guidelines of this circular and it is a Direct Assignment of receivables by NBFC to Bank. The co-lending arrangements under the second option i.e., akin to Direct Assignment model, the process followed is as under:

a. Both the co-lenders agree on defined credit parameters on which the loans will be originated, an NBFC sources the borrower ("Sourcing NBFC") as per such predefined parameters and the Bank shall be the acquiring co-lender.

b. It is agreed that post disbursement of the loan the Bank shall take over 80% of the share in the loan and 20% shall be retained by the Sourcing NBFC.

c. Post acquisition of the loan, escrow mechanism is set up for collecting the repayments received from the borrower and the same is distributed amongst the co-lenders as per the pre-agreed ratio,

d. Further, the interest from the co-lending business will be shared in a predefined ratio. Taking a numerical example - say, the co-lenders charge a blended rate of interest of 16% to the customer wherein Bank shall be entitled to receive 10% on its share and the excess interest i.e. 6% received from the customer on bank's share shall be retained by the Sourcing NBFC. Further

Sourcing NBFC shall also be entitled to receive the interest component at the blended rate of interest on its share in the loan i.e. 16% on 20% in this example.

e. Apart from the interest income received from the customers and shared between the parties in the pre-agreed ratio, neither party shall remunerate the other party in any other manner whatsoever.

f. Sourcing NBFC continues to be the single point of interface for the customers as it continues to be the primary counter party for the borrower. Sourcing NBFC does not provide any new or additional service to the Bank and continue to perform its role as lender to the borrower except that since 80% of the receivables get assigned to the Bank, the interest and principal portion of the proportional loan is appropriated by the Bank from the Escrow Account.

g. While as per the co-lending arrangement agreed with the bank in line with the Co-lending Model, Sourcing NBFC acts as customer interface on behalf of the bank, it is pertinent to note that, it doesn't in any manner dilute the rights of the bank as a lender against the borrower and allows it to step into the shoes of Sourcing NBFC to ensure that the customer servicing or recovery actions as undertaken by it also.

The difference between the blended rate of interest charged from the borrower and interest paid to the banks/ financial institutions on the co-lent loans is known as the "Excess interest spread". This merely represents the interest on the NBFCs' share in the co-lending model and is certainly not in the nature and spirit of any charge or fee. This excess interest spread is an "interest income" which is subject to the levy of income tax and is in no manner (by nature and spirit) a fee or a charge and is therefore not subject to the levy of GST.
Additionally, we would also like to bring it to your notice that, for GST to be applicable, there usually needs to be a supply of goods or services. In a joint operation like the co-lending arrangement, where both entities are co-lenders working together to provide credit, there is no traditional supply of services from one party to another. The Sourcing NBFC and Bank are merely entering into a joint operation, and there are no common assets, common instrumentalities or common resources. There is no aggregation at all, to lead to formation of an entity each party brings into the arrangement its own segregated assets and segregates the revenues on back-to-back basis, at the source itself. In this Co-lending Model, the Sourcing NBFC and the bank/other NBFC participate as co-lenders in a joint operation. The primary objective of this joint operation is to serve the customer by providing credit.
Importantly, no specific service is being provided by one co-lender to the other within this arrangement. Instead, they collectively provide credit to the borrower and the interest rate

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differential is a reflection of their respective roles and risks within this joint operation. Accordingly, the excess interest charged by the NBFC in the context of the co-lending arrangement should not be considered a servicing fee subject to GST.

Suggestion:
Based on the facts explained above, we hereby request you to kindly issue a circular clarifying that the higher rate of interest charged by a NBFC (under Option-A) or the excess rate of interest retained by NBFC (under Option-B) in Co-lending arrangements are purely in the nature of interest on loan and are not a consideration for any service, and thus are not subject to the levy of GST.

2. TDS On Interest (Section 194A) – Request for Exemption

As per section 194A of the Act, any person making payment of interest is required to deduct tax at source ('TDS') @ of 10%. There are certain exemptions given under this section wherein the person making payment to various institutions like Banking Company, Life Insurance Companies and UTI etc., is not required to deduct TDS. Accordingly, any person making payment of interest to Banks is not required to deduct tax.
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. This creates severe cash flow constraints since NBFCs operate on a thin spread/ margin on interest which at times is even lesser than the TDS on the gross interest. Further, due to enormous transactions running into thousands, NBFCs have to face severe administrative hardship.

RBI has allowed banks and NBFCs to engage in Co-Lending to the priority sector. As per this, a single borrower may be co-funded by bank and a NBFC in a pre-determined ratio. Both bank and NBFC may price the loan independently. However, the borrower shall be offered a single blended rate of interest. All the repayments made by the borrower (including the interest) by way of EMIs shall be made to an escrow account from where the amounts shall be credited to the bank and NBFC in respective proportion. In such a scenario, the borrower shall not be in a position to split the EMI and determine the exact interest component of the NBFC portion and hence TDS deduction shall be practically impossible. It is therefore important to bring both bank and NBFC at par on the TDS provisions.

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Suggestion:
There is an urgent need to exempt NBFCs from TDS Deduction u/s 194A in order to ensure harmonization and remove the ambiguity in Co-lending. The same may be done by way of a Notification to be issued u/s 194A (3)(iii)(f)

3. Request for Extension of Validity of 194LC and 194LD of Income tax Act, 1961 Giving of Withholding tax to be charged @5%

Extension u/s 194LC for lower Withholding tax of 5%
U/s 194LC withholding tax was applicable at 5% on offshore borrowings through ECB loans / Bonds till June 30, 2023. The same was not extended in the recent amendment bill. Request you to extend the lower withholding tax to 5% as compared to current taxation as per DTAA for loans or 9% for bonds if listed in IFSC.
Foreign currency borrowings have been prominent source for Indian borrowers in recent years. Since the increase in the withholding tax would make these borrowings costlier and unviable.

Suggestion:
We request you to provide extension to 5% Withholding Tax for all the ECB loans and bonds.