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Finance Industry Development Council

(A Self Regulatory Organisation for NBFCs in India)

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PRE-BUDGET MEMORANDUM FY 2026-27 - ISSUES FOR NBFC SECTOR

1. NEED TO DIVERSIFY FUNDING SOURCES – REFINANCE MECHANISM FOR NBFCs

Present Position/Difficulty: Why the Reform?

Present Position

NBFCs in India have grown to be the 3rd largest in the world after US and UK. NBFCs share in financing of MSMEs has been constantly rising and the sector has shown a impressive double digit growth for the last few years. NBFCs contribute 13.6% to credit-to-GDP ratio (nearly 25% of bank credit) and are critical for financial inclusion. NBFCs have also taken the lead in financing of Green Assets like Electric Vehicles, Solar Rooftops etc. As we work towards achieving the Hon'ble Prime Minister's target of a Viksit Bharat, the demand for credit is bound to increase rapidly.

All these developments clearly indicate the increased demand for funding of NBFCs. More importantly, the sources of funding NBFCs need to be diversified, as has also been stated by RBI in order to reduce overdependence on banks.

Further, MUDRA (Micro Units Development and Refinance Agency) was created for refinancing banks, NBFCs, and MFIs for micro-enterprise lending. However, MUDRA has negligible exposure to NBFCs due to unfavorable refinancing policy and eligibility criteria.

Difficulty

This scenario has resulted in Liquidity Constraints for a Large Number of Small & Medium sized NBFCs and also created Disparity :

• While the big NBFCs have opted for increased foreign borrowings, a large number of small and medium sized NBFCs are raising funds from their larger peers

• This has resulted in increased cost of borrowing for the smaller players which further results in commensurate increase in their lending rates to the small borrowers / MSMEs

• Banks access low-cost refinance from MUDRA, SIDBI, and RBI schemes, while NBFCs funding the same MSME/priority sector borrowers get limited refinance support

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• Priority sector shortfall funds (RIDF, MUDRA deposits) primarily benefit banks

Recommended by the Parliamentary Standing Committee on Finance in their 45th Report dt. June, 2003 (13th Lok Sabha)

• Para 105 of the above said Report states:

"105. The Committee are not satisfied with the reply furnished by the Government. They feel that there is an urgent need for the Government to initiate steps for the healthy and orderly growth of NBFCs along-with proper protection of depositors. To achieve the above goals and to reduce the reliance of NBFCs on investors' deposits, the Committee recommend that the Government should set up a separate refinancing institution for NBFCs on the lines provided to housing finance companies."

Proposed Reform

• 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, priority sector and green initiatives.

• End use of Funds raised through this mechanism may be clearly defined so as to be exclusively used to finance MSMEs, priority sector and green initiatives

• MUDRA Reform: Establish Joint Working Group with MUDRA to redesign refinance policy making it attractive and accessible for NBFCs

Expected Benefits / Outcome

• Cost of Funds Reduction: Lower refinance rates will reduce NBFC lending rates, benefiting MSME and retail borrowers

• Liquidity Enhancement: Provides stable, long-term funding source for NBFCs, especially smaller ones

• Priority Sector Coverage: NBFCs can expand lending to MSMEs, agriculture, and other priority sectors

• Green Financing: Supports government's EV and renewable energy objectives through targeted refinance

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• Financial Inclusion: NBFCs serve semi-urban/rural areas and underbanked segments; refinance support enhances outreach

• Reduced Foreign Dependence: Domestic refinance reduces reliance on foreign borrowings

• Level Playing Field: Provides NBFCs comparable funding access to banks for priority sector lending

This shall promote the Government's agenda on Financial Inclusion leading to "Sabka Saath, Sabka Vikas"

Budgetary Implications

• No additional fund allocation is required

• A part of the total Funds being allocated for the development of MSMEs, Agriculture and Green Initiatives may be carved out to be allocated for Refinancing of NBFCs exclusively for the purpose of financing to these important sectors

• Self-Sustaining Model: Refinance is a lending operation, not a grant; principal recoverable with interest

Implementation Modalities/ Financing: Perceived Challenges in Implementation

• A nodal agency for managing this fund and refinancing to NBFCs may be entrusted with this responsibility – DFIs like SIDBI and NABARD may be considered for this role

• Policy Framework: Need to develop comprehensive refinance policy including eligibility criteria, pricing, risk assessment and monitoring mechanisms

Inter-departmental Consultations

• Ministry of Finance - Department of Financial Services (DFS): Primary stakeholder; budgetary allocation and policy direction

• DFS to hold consultations with RBI, SIDBI, NABARD, MUDRA and FIDC

• MUDRA: Joint Working Group to redesign refinance policy and operational framework

Proposed Budget Speech Paragraph

"Furthering the Hon'ble Prime Minister's vision of "Sabka Saath, Sabka Vikas, Sabka Vishwas aur Sabka Prayas", we need to support NBFCs' critical role in financial inclusion and to cater to the growing demand

for credit for MSMEs, Agriculture and Green Assets. We therefore propose to establish a dedicated refinance architecture for NBFCs with strict end use monitoring "

2. REQUEST TO EXEMPT NBFCs FROM TDS ON INTEREST INCOME U/S 194A OF THE INCOME TAX ACT, 1961

Present Position/Difficulty: Why the Reform?

Section 194A mandates 10% TDS on interest payments made to NBFCs by borrowers, while banks, insurance companies, and public financial institutions are specifically exempted. This creates unequal treatment despite both being RBI-regulated lending institutions performing identical lending functions.

Current Impact on NBFCs & MSMEs:

• Impacts Ease of Doing Business:

For MSMEs: Small businesses with low levels of financial literacy and awareness face the compliance burden of proper deduction of TDS and timely depositing the same coupled with timely filing of TDS returns

For NBFCs: Managing borrower accounts which are thousands, and in case of large companies, lakhs in number of retail & corporate/institutional customers spread across the country is too onerous and time-consuming.

Data collected by FIDC from 10 Upper Layer NBFCs shows a total of 3.30 lakh borrowers who are deducting TDS as on 31st March, 2025. This is strictly against the agenda of Ease of Doing business

• Credit Mismatch: When customers don't file TDS returns properly, NBFCs cannot claim credit despite tax being deducted

• Co-lending Complications: In Co-lending arrangements, the borrower is offered a blended rate of interest and he repays one single EMI (including interest). It is practically impossible for the borrower to split the EMI to know the interest being paid to the NBFC and deduct TDS. It is therefore important to bring parity between banks and NBFCs

• There is no additional revenue flowing to the Govt

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• Cash Flow Constraints: Significant working capital blockage, especially for NBFCs operating on thin margins

Recommended by The Parliamentary Standing Committee on Finance in their 45th Report dt. June, 2003 (13th Lok Sabha)

• Para 111 of the above said Report states:

"111. The Committee expect the Ministry of Finance to examine the matter of multiple taxation expeditiously and the genuine concerns of NBFCs should be resolved at the earliest so as to provide level playing field to them vis-à-vis banks."

Proposed Reform

Amend Section 194A of the Income Tax Act to include NBFCs (including HFCs) in the list of exempted entities, at par with banks, insurance companies, and public financial institutions – LEGISLATIVE REFORM

Expected Benefits / Outcome

• *Enhances Ease of Doing Business*: MSMEs and small borrowers shall be saved from the compliance burden of deduction and depositing TDS in time . NBFCs working also gets less complicated

• Level Playing Field: Creates parity between banks and NBFCs performing identical lending functions

• Co-lending Facilitation: Removes practical barriers in co-lending arrangements supporting financial inclusion objectives

• Revenue Efficiency: Single-point tax collection from regulated NBFCs is more efficient than scattered collection from retail borrowers

• Improved Cash Flow: Releases working capital currently blocked in TDS credits, enabling better credit flow to MSME and retail segments

Budgetary Implications

Revenue Neutral to Positive Impact:

• Current TDS mechanism suffers from significant leakage due to non-filing of returns by retail borrowers

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• NBFCs are regulated entities with mandatory tax compliance, ensuring zero revenue leakage

• Administrative cost savings for tax department in processing and reconciling lakhs of small TDS entries

• Improved NBFC liquidity will enhance lending to productive sectors, potentially increasing overall tax revenue through economic growth

Implementation Modalities/ Financing: Perceived Challenges in Implementation

• Simple legislative amendment to existing exemption list in Section 194A can be done as part of The Finance Bill

Inter-departmental Consultations

• Ministry of Finance - Department of Revenue and Dept of Financial Services

• Reserve Bank of India: May be consulted

• The issue has been long pending for many years despite many representations and discussions with the ministry officials. Latest discussion were held in the meeting convened by Secretary, Dept of Financial Services on 14th May, 2025

• No justifiable reasons have been formally conveyed to us till date

• NBFCs are willing to submit a list of all such borrowers with their PAN etc on a regular basis

Proposed Budget Speech Paragraph

"To enhance Ease of Doing Business, promote financial inclusion and create a level playing field, it is proposed to exempt NBFCs from TDS on interest payments under Section 194A, at par with banks. This will ease the compliance burden on small businesses (MSMEs) and enhance NBFC liquidity, improve credit flow to underserved segments, and strengthen the co-lending ecosystem."

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3. RECOVERY FRAMEWORK – REDUCTION IN THRESHOLD FOR ENFORCING SECURITY UNDER SARFAESI ACT TO 1 LAKH & DRT ACCESS

Present Position/Difficulty: Why the Reform?

SARFAESI Threshold Disparity:

NBFCs can invoke security under the SARFAESI for secured loans with minimum ticket sixe of ₹20 lakhs and above (only NBFCs with asset size of ₹100 crore and above are eligible), while banks can invoke SARFAESI for secured loans of ₹1 lakh and above with no minimum asset size restriction. This creates a 20x higher threshold for NBFCs vs. banks for the same secured lending activity.

Majority of the loans given by NBFCs are less than 20 lakhs and as such the NBFCs are almost denied the direct recovery benefits available under the SARFAESI Act.

DRT Access Gap:

NBFCs have been granted SARFAESI powers but cannot file suits before DRT under Recovery of Debts and Bankruptcy Act, 1993. Banks and financial institutions have access to both SARFAESI and DRT. This creates asymmetric rights - NBFCs can defend in DRT when borrower challenges SARFAESI action but cannot initiate recovery proceedings.

Combined Impact:

• Delayed Resolution: Stressed accounts below ₹20 lakhs take 5+ years to resolve through civil courts vs. 12-18 months under SARFAESI/DRT

• NPA Accumulation: Unable to take timely action on small-ticket defaults, increasing gross NPAs

• Higher Legal Costs: Forced to use expensive, time-consuming civil litigation for retail loans

• Sector Disadvantage: Majority of retail loans in India are below ₹20 lakhs (two-wheelers, consumer durables, small business loans)

• Incomplete Toolkit: NBFCs have limited recovery options despite being secured creditors

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• In the absence of any direct recovery tool like SARFAESI, NBFCs are forced to fall back on indirect tools like filing cheque bouncing cases u/s 138 of The Negotiable Instruments Act, which has increased the burden on the courts

Recommended by The Expert Committee on Micro, Small and Medium Enterprises under the Chairmanship of Sh. U.K. Sinha Setup by RBI – June, 2019

• Para 7.8.2, clause iii of the above said Report states:

"iii. NBFCs are not permitted to enforce action under the SARFAESI Act for loans below ₹1 crore. Since NBFCs will be servicing the loans on behalf of banks, they may be permitted to initiate all recovery measures including SARFAESI for the total loan amount for loans below ₹1 crore." (the threshold at that time was 1 crore which is now 20 lakhs)

Recommended by The Parliamentary Standing Committee on Finance in their 45th Report dt. June, 2003 (13th Lok Sabha)

• Para 102 of the above said Report states:

"102. The Committee find that there is no effective mechanism in vogue for ensuring recovery of dues of NBFCs. They are of the opinion that the lack of any such mechanism is scuttling the growth of this sector. They feel that unless they (NBFCs) recover their dues speedily and effectively, they will continue to make defaults in respect of repayment to their depositors. They are given to understand that similar provisions exist in the National Housing Bank Act in respect of Housing Finance Companies. Hence, they recommend that the Government should take expeditious steps to extend the provision of both the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 and Recovery of Debt Due to Banks and Financial Institutions Act, 1993, to the NBFCs."

<u>Proposed Reform</u>

Two-Part Reform:

i. SARFAESI Amendment: Reduce SARFAESI threshold for NBFCs to ₹1 lakh (at par with banks) and reduce/eliminate minimum asset size requirement to ₹25-50 crore to cover more regulated NBFCs

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ii. DRT Access: Amend Recovery of Debts and Bankruptcy Act, 1993 to grant NBFCs access to file debt recovery suits before DRT, completing the recovery framework at par with banks

Expected Benefits / Outcome

• Shall provide NBFCs the much-needed direct recovery tool

• NPA Reduction: Timely action on defaults will reduce gross NPA levels across NBFC sector

• Cost Efficiency: Significant reduction in legal and collection costs

• Financial Inclusion Support: NBFCs can continue serving underbanked segments without fear of recovery paralysis

• Complete Toolkit: Access to both SARFAESI and DRT provides comprehensive recovery framework matching banking sector

• Borrower Discipline: Improved recovery mechanisms will encourage timely repayment behavior

• Shall significantly reduce the number of cheque bouncing cases filed by NBFCs u/s 138 of The Negotiable Instruments Act

Budgetary Implications

Positive Long-term Impact:

• No Direct Revenue Impact:

Implementation Modalities/ Financing: Perceived Challenges in Implementation

Moderate Challenges - Manageable with Planning:

• Reduction in the Threshold limit to 1 lakh under SARFAESI Act requires a mere Notification an no legislative amendment is required

• For DRT access Legislative Amendment to the Recovery of Debts and Bankruptcy Act, 1993

• DRT Capacity: May require strengthening DRT infrastructure to handle increased case load; phased implementation recommended

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Inter-departmental Consultations

• Ministry of Finance - Department of Financial Services: Primary stakeholder for both SARFAESI and DRT amendments

• Ministry of Law & Justice - Legislative Department: For drafting amendments to both Acts

• Reserve Bank of India: Regulatory framework alignment and notification issuance

• Department of Revenue - DRT Administration: Infrastructure planning and capacity assessment

• NITI Aayog: Alignment with financial inclusion and credit growth objectives

Proposed Budget Speech Paragraph

"To strengthen the recovery framework for NBFCs, it is proposed to reduce the threshold to ₹1 lakh for enforcing security under The SARFAESI Act and also grant DRT access, at par with banks. This will accelerate NPA resolution, reduce legal costs, and support continued credit flow to retail and MSME sectors."

4. REQUEST TO ISSUE PENDING NOTIFICATION ON EXEMPTING NBFCs FROM SECTION 94B AS AMENDED BY FINANCE ACT,2023

Present Position/Difficulty: Why the Reform?

Section 94B restricts interest deduction to lower of: (a) interest paid to foreign associated enterprises (AE), or (b) 30% of EBITDA. Banking and insurance companies are explicitly exempted under Section 94B(3). Finance Act 2023 amended Section 94B to empower Central Government to notify "such class of non-banking financial companies" for exemption. However, the notification is still pending (18+ months since amendment).

Current Disparity and Impact:

• Banks enjoy blanket exemption regardless of ownership structure, while NBFCs performing identical money-lending business remain subject to restrictions

• Interest is 60-70% of total costs for NBFCs; borrowing is integral to operations, not tax avoidance

• Affects NBFCs with foreign parents, PE investors, or requiring foreign capital for growth

• Creates competitive disadvantage vs. banks in identical borrowing situations

• Example: NBFC paying ₹40 crore interest to foreign AE with ₹80 crore EBITDA faces ₹16 crore disallowance (only ₹24 crore deductible vs. ₹40 crore paid)

Proposed Reform

Issue notification under Section 94B(3) of The Income Tax Act, 1961 exempting all RBI-registered NBFCs (at minimum, all systemically important NBFCs and those with asset size above ₹100 crore) from thin capitalization rules, at par with banks.

Expected Benefits / Outcome

• Functional Parity: Recognizes that NBFCs, like banks, are in the business of lending and borrowing is their core operational requirement

• Foreign Investment Facilitation: Encourages foreign capital into NBFC sector, supporting infrastructure and priority sector financing

• Infrastructure Financing: Particularly benefits infrastructure finance and large-ticket NBFCs requiring substantial foreign funding

• Competitive Neutrality: Eliminates artificial tax disadvantage faced by NBFCs compared to banks

• Fulfills the objective of Finance Act 2023 amendment

Budgetary Implications

Limited Revenue Impact with Long-term Gains:

• Direct Impact: Estimated interest disallowances of ₹500-1000 crore annually across NBFC sector will become allowable deductions

• Sectoral Growth: Enhanced foreign capital inflows will support NBFC growth, leading to increased corporate tax collections in medium term

• Infrastructure Development: NBFCs play critical role in infrastructure financing; exemption will accelerate capital formation

• Phased Implementation: Can be implemented for systemically important NBFCs first, followed by broader coverage

Implementation Modalities/ Financing: Perceived Challenges in Implementation

Minimal Challenges - Enabling Provision Already Exists:

• Legislative Framework: Finance Act 2023 already provides enabling provision; only notification required

• Classification: Clear criteria needed for eligible NBFCs (e.g., RBI registration, asset size threshold, systemic importance)

• Verification: RBI registration database provides ready verification mechanism

• Precedent: Similar exemption for banks and insurance companies provides implementation template

Inter-departmental Consultations

• Ministry of Finance - Department of Revenue (Tax Policy & Legislation Division): For issuing notification

• Reserve Bank of India: For classification criteria and concurrence on functional equivalence

• Department of Financial Services: Policy coordination

Proposed Budget Speech Paragraph

"To facilitate foreign investment in NBFCs and support infrastructure financing, it is proposed to exempt RBI-registered NBFCs from thin capitalization norms, at par with banks. This fulfills Finance Act 2023's legislative intent."

5. REQUEST TO AMEND SECTION 80TTB TO EXTEND DEDUCTION BENEFITS TO SENIOR CITIZEN DEPOSITS WITH NBFCs

Present Position/Difficulty: Why the Reform?

Section 80TTB allows senior citizens deduction up to ₹50,000 on interest from deposits with banks, co-operative banks, and post offices. NBFC deposits are excluded from this benefit despite NBFCs being RBI-regulated entities accepting public deposits under similar regulatory framework.

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Current Disparity and Impact:

• Senior citizens avoid NBFC deposits due to lack of tax benefit, affecting NBFC deposit mobilization

• NBFCs must offer higher interest rates to compensate for lost tax benefit, increasing funding costs

• Creates discrimination between regulated financial intermediaries (banks vs NBFCs)

• NBFCs accepting public deposits follow stringent RBI norms similar to banks

Proposed Reform

Amend Section 80TTB of The Income Tax Act, 1961 to extend the ₹50,000 deduction benefit to include interest from deposits with RBI-registered NBFCs authorized to accept public deposits.

Expected Benefits / Outcome

• Senior Citizen Welfare: Provides senior citizens with additional investment avenues offering competitive returns

• NBFC Liquidity: Enhances deposit mobilization capability of NBFCs at reasonable costs

• Level Playing Field: Removes artificial distinction between bank and NBFC deposits for tax purposes

• Market Competition: Healthy competition benefits depositors through better rates and services

• Financial Inclusion: Supports diversification of savings options for senior citizens

Budgetary Implications

Marginal Revenue Impact:

• Limited Scope: Only applies to NBFCs authorized to accept public deposits (relatively small universe – only around 50 NBFCs)

• Estimated Public Deposits: NBFC public deposits approximately ₹25,000-30,000 crore vs. bank deposits of ₹180 lakh crore

Implementation Modalities/ Financing: Perceived Challenges in Implementation

No Significant Challenges:

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• Simple Amendment: Add RBI-registered deposit-taking NBFCs to list of eligible institutions in Section 80TTB

• Clear Identification: RBI maintains register of NBFCs authorized to accept public deposits; no ambiguity

• Existing Framework: Same deduction mechanism already in place for bank deposits; no new systems needed

Inter-departmental Consultations

• Ministry of Finance - Department of Revenue (Tax Policy Division): Primary stakeholder for amendment

• Reserve Bank of India: Confirmation of list of eligible deposit-taking NBFCs

• Department of Financial Services: Policy alignment on deposit mobilization

Proposed Budget Speech Paragraph

"To benefit senior citizens and promote financial inclusion, it is proposed to extend income deduction benefits to deposits with RBI-registered NBFCs. This provides our senior citizens with additional safe investment options while supporting the NBFC sector."

6. REQUEST TO NOTIFY NBFCs AS FINANCIAL INSTITUTION FOR THE PURPOSE OF CLAIMING DEDUCTION UNDER SECTION 80E OF THE INCOME TAX ACT

Present Position/Difficulty: Why the Reform?

Currently, interest paid by borrowers on education loans availed by them from any financial institution qualifies for deduction under Section 80E of The Income Tax Act.

Further, sub section (3) clause (b) defines financial Institution as:

“financial institution" means a banking company to which the Banking Regulation Act, 1949 (10 of 1949) applies (including any bank or banking institution referred to in section 51 of that Act); or any other financial institution which the Central Government may, by notification in the Official Gazette, specify in this behalf;

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Besides all banks, currently only one NBFC has been notified for the purposes of Section 80E of the Act. Thus, as on date, education loans granted only by banks and that particular NBFC qualify for deduction under Section 80E of the Act.

This creates a discrimination as the borrowers may be willing to borrow from anywhere basis their convenience but they may not be eligible to claim deduction for interest paid by them under section 80E of the Act.

Proposed Reform

All NBFCs registered with RBI and which give education loans, must be notified as "financial institution" under Section 80E (3) (b) of The Income Tax Act, 1961.

Expected Benefits / Outcome

Increase in the eligible financial institutions with the inclusion of all NBFCs providing education loan may lead to healthy competition and customers may benefit from competitive interest rates on education loan. Further, it will foster growth and development of education loan segment of the market.

Budgetary Implications

Since, only the scope of income deduction is being widened there shall be a Negligible Revenue Impact.

Implementation Modalities/ Financing: Perceived Challenges in Implementation

Only a Notification to be issued as explained above

Inter-departmental Consultations

• Ministry of Finance - Department of Revenue (Tax Policy Division): Primary stakeholder for amendment, Department of Financial Services

• Reserve Bank of India: Confirmation of list of eligible deposit-taking NBFCs

• Ministry of Education

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Proposed Budget Speech Paragraph

"In order to make higher education more affordable, it is proposed to widen the scope of income deduction available towards interest paid on education loans. For this, it is proposed to extend the income deduction on loans taken from all RBI registered NBFCs which give education loans "

For **FINANCE INDUSTRY DEVELOPMENT COUNCIL**

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