

# FIDC

## Finance Industry Development Council

*(A body incorporated as a Self Regulatory Organisation for Registered NBFCs - AFCs)*  
101/103, Sunflower, 1<sup>st</sup> Floor, Rajawadi Road No.2, Ghatkopar (East), Mumbai – 400 077 (India)

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July 15, 2014

**Shri Arun Jaitley**  
Finance Minister  
Government of India  
North Block  
**New Delhi - 110 001.**

Hon'ble Finance Minister Sir,

**SUB: POST-BUDGET MEMORANDUM - ISSUES RELATING TO ASSET FINANCING NBFCs**

**Finance Industry Development Council (FIDC)** is a Self Regulatory Organization (SRO) cum Representative Body of all the Asset Financing NBFCs, (NBFC-AFCs) registered with the Reserve Bank of India .

Sir, we take this opportunity to express our sincere thanks to Ministry of Finance for inviting us to present our views/issues during the Pre-Budget Discussion every year.

**We welcome the long-term positive measures taken by your Government in boosting growth for Indian economy and we compliment your goodself that the Union Budget presented on July 10, 2014 is drawing path towards this laudable goal.**

**However, we are giving herein below three issues that may be considered and suitably amended, while passing the Finance Bill in the Parliament.**

### **1. Proposed Amendment to Taxation of Debt oriented Mutual Funds**

#### **Background**

A vibrant and deep corporate and government bond market is essential to a strong economic growth of any country. This helps individuals and institutional investors with lower risk appetite to channelize their investments into safer investment avenues and more importantly gives an alternative to bank deposits. The Government, Corporate Houses as well as Non-Banking Financial institutions tap the debt market and debt mutual funds to broad base and diversify their debt capital raising.

#### **The Budget proposal 2014-2015 and its implications**

The budget 2014-15 has proposed to amend taxation of investments in debt mutual funds by:

- increasing the tax rate on long term capital gains arising from sale of units of debt mutual funds from 10% to 20% and
- increasing the holding period for qualifying for long term capital gains of such units from 12 months to 36 months

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These changes significantly reduce the attraction of debt mutual funds and fixed maturity schemes (“FMP”). This action substantially reduces the flow of funds into the debt markets. The corporate sector and financial intermediaries (NBFC’s in particular) would find it difficult to raise money in the debt market, with the significant reduction in the inflows and would be forced to increase dependence on the banking system. Even the Government will find it difficult to raise resources from the market since FMPs are very large investors in these bonds.

### **Role Played by Mutual Funds**

Mutual Funds are very important players in the Indian Bond and Money Markets. Mutual funds manage more than INR 7 Lakh crore under liquid and debt schemes, invested in corporate debt securities, across the rating spectrum and yield curve.

Mutual Funds hold more than 10% of the total outstanding corporate bonds, and account for at least 35% of all secondary corporate bond market trades, the largest by any category of investors.

MFs also hold more than 75% of total outstanding money market instruments and account for at least 75% of secondary market volumes in this segment. Thus, they help in the process of banking sector disintermediation.

### **Banking system funding and concentration risks**

The Reserve Bank of India has been encouraging financial intermediaries including NBFCs to broad base their debt capital raising, by accessing the mutual funds/FMP market to reduce dependency on the banking system. The amendment in the tax laws as proposed by the budget would adversely affect the efforts of debt issuers to do so.

With huge outflows from these schemes, it is expected MFs will have to liquidate their investments of over Rs. 2 lakh crore, and the burden of this funding will fall on banks. The process of risk diversification from banks to Mutual Funds will be irreversibly reversed, apart from creating huge new strains on the already stretched bank Balance Sheets.

### **Rise in the Cost of Capital**

The massive outflows from Mutual Funds as above post the Budget proposals, and the consequent sell-off in debt investments, will severely impact liquidity in the debt markets. This will have a catastrophic impact of a 150 basis points per annum rise in funding costs of the corporate sector, and also severely restrict the quantum of funding through this route. At a time when corporate balance sheets are already stressed, this will jeopardise the economic recovery process, and the turnaround in the investment cycle will be compromised.

### **Request**

We submit that in the interest of a deeper, more vibrant debt market and in the interest of relatively risk averse investors, the proposed amendment to taxation of debt mutual funds is

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withdrawn and status quo be restored. It is further submitted that any loss of revenue to the exchequer be compared with the benefits of having a strong debt market.

### **2. Difficulties arising out of the proposed amendments in Finance Bill 2014-15 in section 35F and 35L of the Central Excise Act (made applicable to service tax) to small and medium size industries / service providers**

#### **Issue-1**

**Clause 98 of the Finance Bill** seeks to substitute section 35F of the Central Excise Act to provide for deposit of certain percentage of duty demanded or penalty imposed or both before filing an appeal.

Clause 98 is reproduced below:

98..In the Central Excise Act, for section 35F, the following section shall be substituted, namely:—“35F. The Tribunal or the Commissioner (Appeals), as the case may be, shall not entertain any appeal,—

(i) under sub-section (1) of section 35, unless the appellant has deposited seven and a half percent. of the duty demanded or penalty imposed or both, in pursuance of a decision or an order passed by an officer of Central Excise lower in rank than the Commissioner of Central Excise;

(ii) against the decision or order referred to in clause (a) of sub-section (1) of section 35B, unless the appellant has deposited seven and a half per cent. of the duty demanded or penalty imposed or both, in pursuance of the decision or order appealed against;

(iii) against the decision or order referred to in clause (b) of sub-section (1) of section 35B, unless the appellant has deposited ten per cent. of the duty demanded or penalty imposed or both, in pursuance of the decision or order appealed against: Provided that the amount required to be deposited under this section shall not exceed rupees ten crores: Provided further that the provisions of this section shall not apply to the stay applications and appeals pending before any appellate authority prior to the commencement of the Finance (No.2) Act, 2014.

Explanation.- For the purposes of this section “duty demanded” shall include,—

(i) amount determined under section 11D;

(ii) amount of erroneous Cenvat credit taken;

(iii) amount payable under rule 6 of the Cenvat Credit Rules, 2001 or the Cenvat Credit Rules, 2002 or the Cenvat Credit Rules, 2004.

To Note:

As per the existing provisions contained in section 35F of the Central Excise Act (which has been extended to service tax also), the person desirous of appealing against a decision or order shall, pending the appeal, deposit with the adjudicating authority the duty demanded or the penalty levied. However, there is a proviso to section 35F which gives power to the Appellate Authorities to dispense with such pre-deposit of duty or penalty demanded if the

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Appellate Authority is of the opinion that if such pre-deposit would cause undue hardships to such persons.

### **The adverse effect of the proposed amendment affecting ordinary business men in the small and medium size category and non-profit organizations are:**

The power of the Appellate Authority to waive the pre-deposit of duty demanded in case of financial hardships of the appellant is taken away, resulting forced pre-deposit of duty at the percentage fixed in the finance bill (7.5% of the duty in the case of first appeal or 10% of the duty in the case of second appeal). In the case of small and medium size industry/service provider or non-profit organizations rendering services for the social benefit etc. will be forced to pre-deposit the duty whether they have finance or not and wait for an indefinite period of 8 to 10 years to get a decision from the Tribunal (CESTAT) considering the pendency of cases at Tribunal which is reported at about 1,00,000 cases pending at various benches of the Tribunal in India.

#### **Solution:**

While retaining the provisions introduced in the bill for mandatory pre-deposit of 7.5% / 10 % as the case may be, the discretionary power of the Appellate Authority to waive the pre-deposit amount in the case of financial difficulties of the Appellant should also be continued. This provision is lacking in the proposed amendment.

#### **Issue- 2**

**Clause 99 of the Bill** seeks to insert a new sub-section (2) in section 35L of the Central Excise Act so as to clarify that determination of disputes relating to taxability or excisability is covered under the expression “determination of any question having a relation to rate of duty”

Clause 99 is reproduced below:

99. In the Central Excise Act, section 35L shall be numbered as sub-section (1) thereof, and after sub-section (1) as so numbered, the following sub-section shall be inserted, namely:—

“(2) For the purposes of this Chapter, the determination of any question having a relation to the rate of duty shall include the determination of taxability or excisability of goods for the purpose of assessment.

### **The adverse effect of the proposed amendment affecting ordinary business men in the small and medium size category and non-profit organizations are:**

The adverse effect of the above amendment is that if there is a dispute between the Central Excise Department and person rendering the service (in the case of service tax)/ or manufacturer (Central Excise), for settling the dispute after Tribunal, the matter has to be taken to Supreme Court. As per the existing provisions in section 35(F) in the case of dispute involving **rate of duty** and valuation an appeal from Tribunal goes to Supreme Court directly. The amendment has been introduced as a clarification to “rate of duty” to include determination of disputes relating to taxability or excisability. In short, to decide a service is

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taxable or not the jurisdictional High Court has no power. All disputes start with question of taxability at lower level, denying jurisdiction to High courts will not only delay the process of judicial decision but also will bring financial difficulties for small and medium sized service industries, individuals rendering the service and non-profit/ charitable organizations rendering the service due to the high cost of litigation in taking the case to Supreme Court and will not be affordable to those categories. Therefore the jurisdictional High Courts should be given power to deal with such cases within a limit fixed by the Government, so that the interest of small scale service providers and non-profit /charitable organizations . The proposed bill if enacted will definitely adversely affect large number of tax payers in the lower income brackets.

### **3. RECOVERY MECHANISM – COVERAGE UNDER THE SARFAESI ACT**

We reiterate our demand that inspite of the fact that NBFCs are today regulated almost at par with banks, they have been denied the benefit of any defined recovery mechanisms which are available not only to banks but also non bank entities like Housing Finance Companies.

Recently, RBI has issued a “Framework for Revitalizing of Distressed Assets in the Economy” in order to check the growing menace of NPAs. This framework is equally applicable to banks and Systemically Important NBFCs (NBFC – ND- SI) and has recommended coverage of these NBFCs under the SARFAESI Act.

**Since the new framework has already been enforced, coverage of Systemically Important NBFCs under SARFAESI Act needs to be given priority. Moreover, in addition to banks and Financial Institutions, specified Housing Finance Companies have also been notified under the Act.**

***Sir, we shall be glad to supplement this representation with any additional information that may be required.***

***We thank you in anticipation of a positive response and assure you of our full co-operation always.***

Thanking you,

Yours Faithfully,

For FINANCE INDUSTRY DEVELOPMENT COUNCIL

**MAHESH THAKKAR**  
**Director General**