WHITE PAPER - GST IMPACT ON NON-BANKING FINANCE COMPANIES

THE POWER OF BEING UNDERSTOOD

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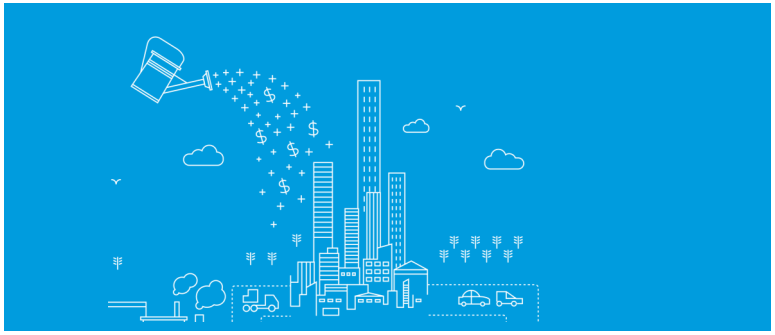
1.0 High Level Impact of GST on NBFCs

- Non-Banking Finance Companies (NBFCs) are companies which are, as per RBI guidelines, allowed to lend money but cannot accept deposits from the public. NBFCs are subject to several guidelines issued by the Reserve Bank of India and are a highly regulated industry.
- Under the erstwhile indirect tax regime, the services provided by NBFCs were mostly exempt. A few services were liable to a centralized service tax, irrespective of the location within India from where the services were provided. Under Goods and Services Tax regime, this aspect has undergone a radical shift and such entities would be required to obtain registration in each state from where they make taxable supplies.
- GST has had an impact on various aspects of business such as billing, information technology systems, compliance and governance frameworks of NBFCs. Given that there are monthly compliances for multiple locations, it is suggested that the process for filing returns is automated.
- It is expected that GST especially in the initial years of implementation may have significant impact on NBFCs. Transitional provisions are in place for migration from service tax to the GST regime and need to be adhered to in line with the intention of the GST legislators.
- One of the major impacts of GST is that there is no cascading effect of taxes. Under service tax regime, NBFCs could not avail credit of Value Added Tax paid on capital goods and certain consumables and these were cost to the company. Under GST regime, these entities may avail credit of input tax paid on supply of goods as well as services.
- Place of supply is a crucial aspect and needs to be considered in line with the provisions of the Integrated GST Act.
- In this whitepaper, we seek to understand the major incomes and expenses of NBFCs and thereafter, the issues faced by the industry.

2.0 Major Income Streams of NBFCs



- Although NBFCs may be engaged in different types of businesses, based on our study of the financial statements of several NBFCs, the following are the major types of income earned by NBFCs and the possible GST impact of the incomes:

Income	Taxable/ Exempt under GST	Rate
Interest Income on advances	Exempt	Nil
Additional Interest Income	May be taxable if it is in nature of penalty	18%
Penalty for delayed payment of loan installments	May be taxable	18%
Processing Fee	Taxable	18%
Foreclosure & Swap Charges	Taxable	18%
Discounting income	Exempt	Nil
Syndication/ Arranger fee	Taxable	18%
Gain on sale of investments	Exempt	Nil
Interest Income from investments	Exempt	Nil
Referral and Commission income (from financial product distribution)	Taxable	18%

- From the above table, we may infer that most of the services offered by NBFCs are falling within 18% or the exempt supply category which attract 'Nil' rate of tax. For taxable supplies such as processing fees, the NBFCs are required to issue a tax invoice compliant with the guidelines of the Central Goods and Services Tax (CGST) Rules, 2017. For exempt supplies, a bill of supply is required to be issued. In certain cases, where both taxable supplies and exempt supplies are done simultaneously, a "Tax invoice cum Bill of Supply" may be issued. Generally, NBFCs issue a statement of account to its customers. The statement of account will need to be modified to be compatible with the CGST Rules, 2017.
- There is a need to bifurcate services provided by NBFCs based on customers. There are different norms for business customers (B2B) and individual non-business customers (B2C).
- For any revisions to income done, a credit note or debit note may be required to be issued which must be referenced to the original invoice.

3.0 Major Inward Supplies of NBFCs

- The major expenses of NBFCs are interest and discount expenses, employee benefit expenses, branch setup and construction costs, infrastructure costs (such as lease rental, call center charges, shared services etc.) and commission expenses, which are paid for distribution of financial products, among various others.
- Interest expended and employee benefit expenses in so far as they relate to payments made in capacity of an employee are outside the purview of GST. Employee reimbursements may fall within the ambit of GST and need to be carefully analyzed by NBFCs. For expenses incurred by employees for hotel stay etc. it may be important for the NBFC to ensure that they quote their GSTIN and name on the bills and not that of employees.
- For inward supplies, NBFCs have the option to avail credit at the flat rate of 50% of all eligible credits on inputs, capital goods as well as input services. Under earlier indirect tax laws, the 50% option was extended to only inputs and input services and in respect of capital goods, there was the possibility to avail the entire credit of excise duties paid against the service tax liability. Generally, at an industry level, NBFCs opt for the option of flat reversal.
- It is pertinent to note that in case of the option of 50% reversal, the option applies only to eligible credits. Ineligible input tax credit such as GST paid on food and beverages, GST paid on certain civil works etc. are not to be considered as part of the pool of eligible input tax credit and on such inward supplies, NBFCs would not get the benefit of 50% reversal. Leasehold improvements and civil work for various branches may not qualify as eligible credits and need to be thoroughly analyzed to avoid loss of input tax credit.

4.0 Some Contentious Issues for NBFCs

- The carry-forward of certain duties of cess under the GST regime such as Krishi Kalyan Cess, Secondary and Higher Education Cess is a litigious topic and may have cash flow impact for NBFCs.
- Place of supply is a potential area of litigation for banks and may result in banks incorrectly considering an inter state supply as an intra state supply. This is important because unlike service tax which was a central levy, GST is a federation of taxes and each state has a stake in the taxes charged by NBFCs for providing their services.
- NBFCs may also receive many subventions and grants from Reserve Bank of India and other government bodies. Taxability of these receipts under GST is an open issue and may require revalidation with industry peers.
- The need for cross charging or distribution of input tax credit may arise for certain common services and for transactions provided by one branch to another. It must be emphasized that for cross charges and distributed credits, the recipient is eligible for 100% of the input tax credit. NBFCs are also not having clarity on which option is beneficial to them and need to analyze the options on parameters such as compliance and monitoring costs, vendor discipline and regulatory clarity.
- Since NBFCs have multi state presence and multiple locations within each state, determining the jurisdictional officer and ensuring that the registrations are up to the mark may result in excess administrative burden for the banks.
- For services provided by Indian branches to foreign branches, issues may arise in respect of chargeability of GST. There is possibility that certain services may be regarded as intermediary services and may not qualify for ‘export of services’.

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