

FIDC

Finance Industry Development Council

(A Self-Regulatory Organisation for Assets and Loan Financing NBFCs)

101/103, Sunflower, 1st Floor, Rajawadi Road No.2, Ghatkopar (East), Mumbai – 400 077 (India)
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Clarifications sought by Finance Industry Development Council (FIDC) for Implementation under section 285BA(1)(k) of the Income tax Act, 1961 read with Rules 114F to 114H of the Income tax Rules, 1962

1. Whether NBFCs which are not registered with RBI as “deposit-accepting NBFCs” are covered as “depository institution” where they carrying on activities of lending / hire purchase/ leasing, etc., and have issued either bonds /debentures /NCDs, etc. or having borrowing from banks and other financial institutions

Discussion

As per RBI regulations the following are the different types of NBFC registered with RBI:

1. NBFCs holding CoR for accepting Public Deposits
2. Non-Deposit taking Systemically Important (NBFC-ND-SI) companies registered with RBI
3. NBFCs not accepting Public Deposits other than NBFC-ND-SI registered with RBI
4. Non-Banking Financial Companies - Micro Finance Institutions (NBFC-MFIs)
5. Infrastructure Debt Fund (NBFC-IDF) registered with RBI
6. NBFC-Factors registered with RBI
7. Core Investment Companies (CICs) registered with RBI.
8. Asset Finance Companies (NBFC-AFCs) registered with RBI
9. Infrastructure Finance Companies (NBFC-IFCs) registered with RBI
10. NBFC- Peer to Peer (P2P) registered with RBI
11. Asset Reconstruction Companies (ARCs) registered with RBI
12. Investment and Credit Companies (NBFC-ICC) registered with RBI

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As per the Guidance Note updated as of 30 November 2016, the process to be followed is as under

“First, an entity needs to find out whether it is a Reporting Financial Institution. Then, Reporting Financial Institution needs to review their financial accounts by applying due diligence procedures to identify whether any of the financial account is a Reportable Account. If any account is identified as a reportable account, then the Reporting Financial Institution shall report the relevant information in Form 61B in respect of the identified reportable account.”

So first the Entity is required to evaluate whether it is a financial Institution and if a financial institution whether it is a reporting financial institution.

As per the Guidance even if no reportable accounts are maintained Nil reporting is required to be done by the Reporting Financial Institution.

The CBDT Guidance Note dated 30 November 2016 has clarified as under:

“Non-Banking Finance Companies (NBFCs) will be either depository institution or investment entity as per its activities. NBFC which accepts deposit in the course of a banking business or a similar business as mentioned in the definition of depository institution will be considered as Depository Institution and will report accordingly. An NBFC which is working as investment entity will report accordingly.”

The term “Depository Institution” is defined in Explanation (b) to Rule 114F(3) to mean any entity that accepts deposits in the ordinary course of a banking or similar business.

An Entity is considered to be engaged in a “banking or similar business” if, in the ordinary course of its business with customers, it regularly engages in activities such as:

- (a) accepts deposits or other similar investments of funds;
- (b) makes personal, mortgage, industrial, or other loans or provides other extensions of credit;
- (c) purchases, sells, discounts, or negotiates accounts receivable, instalment obligations, notes, drafts, checks, bills of exchange, acceptances, or other evidences of indebtedness;
- (d) issues letters of credit and negotiates drafts drawn thereunder;
- (e) provides trust or fiduciary services;
- (f) finances foreign exchange transactions; or
- (g) enters into, purchases, or disposes of finance leases or leased assets.

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“Depository account” includes any commercial, checking, savings, time, or thrift account, or an account that is evidenced by a certificate of deposit, thrift certificate, investment certificate, certificate of indebtedness, or other similar instrument maintained by a financial institution in the ordinary course of a banking or similar business and also an amount held by an insurance company pursuant to a guaranteed investment contract or similar agreement to pay or credit interest thereon;”

The term 'deposit' is defined under Section 45 I(bb) of the RBI Act, 1934 as under:
'deposit' includes and shall be deemed always to have included any receipt of money by way of deposit or loan or in any other form but does not include:

- (i) amounts raised by way of share capital;*
- (ii) amounts contributed as capital by partners of a firm;*
- (iii) amounts received from a scheduled bank or a co-operative bank or any other banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949;*
- (iv) any amount received from,—*
 - (a) (omitted)*
 - (b) a State Financial Corporation,*
 - (c) any financial institution specified in or under section 6A of the Industrial Development Bank of India Act, 1964, or*
 - (d) any other institution that may be specified by the Bank in this behalf;*
- (v) amounts received in the ordinary course of business, by way of—*
 - (a) security deposit,*
 - (b) dealership deposit,*
 - (c) earnest money,*
 - (d) advance against orders for goods, properties or services,*
- (vi) any amount received from an individual or a firm or an association of individuals not being a body corporate, registered under any enactment relating to money lending which is for the time being in force in any State; and*
- (vii) any amount received by way of subscriptions in respect of a chit.”*

Clarification sought:

We would like to explain the activities of each of categories of NBFCs.

In view of the above, where a NBFC which is not registered as a Deposit-taking NBFC, has issued debentures, bonds, commercial papers (CPs) or Collateralized Borrowing and Lending Obligation (CBLO), etc. i.e. any instrument evidenced by a certificate of indebtedness, or has borrowing from banks and other financial institutions, then

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whether such NBFC will qualify as a “Depository Institution” and required to carry out compliances under section 285BA read with Rules 114F to 114H.

2. As mentioned at (1) above, if the term “depository account” includes instruments like Debentures, bonds, CPs, CBLO, etc. whether listed debentures/bonds or over the counter exchanged products are outside the purview of the term “depository account”?

CBDT Guidance Note dated 30 November 2016 states that since a large part of the Rules is based on CRS on Automatic Exchange of Information (AEOI), the Financial Institutions (FIs) may refer the CRS and its Commentary to get further understanding of the terms used.

As per OECD guidance Note Para 67, negotiable debt instruments that are traded or held through financial institutions are not financial accounts:

“B. Financial Asset

23. The term “Financial Asset” is used in the definition of the terms “Custodial Institution”, “Investment Entity”, “Custodial Account” and “Excluded Account”. While it does not refer to assets of every kind, it intends to encompass any assets that may be held in an account maintained by a Financial Institution with the exception of a non-debt, direct interest in real property.

24. Within that context, subparagraph A(7) provides that the term “Financial Asset” includes a security (for example, a share of stock in a corporation; partnership or beneficial ownership interest in a widely held or publicly traded partnership or trust; note, bond, debenture, or other evidence of indebtedness), partnership interest, commodity, swap (for example, interest rate swaps, currency swaps, basis swaps, interest rate caps, interest rate floors, commodity swaps, equity swaps, equity index swaps, and similar agreements), Insurance Contract or Annuity Contract, or any interest (including a futures or forward contract or option) in a security, partnership interest, commodity, swap, Insurance Contract, or Annuity Contract. However, the term “Financial Asset” does not include a non-debt, direct interest in real property; or a commodity that is a physical good, such as wheat.”

25. Negotiable debt instruments that are traded on a regulated market or over-the-counter market and distributed and held through Financial Institutions, and shares or units in a real estate investment trust, would generally be considered Financial Assets.

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66. The term “Depository Account”, as defined in subparagraph C(2), includes any commercial, checking, savings, time, or thrift account, or an account that is evidenced by a certificate of deposit, thrift certificate, investment certificate, certificate of indebtedness, or other similar instrument maintained by a Financial Institution in the ordinary course of a banking or similar business. A Depository Account also includes an amount held by an insurance company pursuant to a guaranteed investment contract or similar agreement to pay or credit interest thereon.

67. An account that is evidenced by a passbook would generally be considered a Depository Account. As mentioned in paragraph 25 above, negotiable debt instruments that are traded on a regulated market or over-the-counter market and distributed and held through Financial Institutions would not generally be considered Depository Accounts, but Financial Assets.”

Clarification sought:

Accordingly, it should be clarified that the debentures / bonds, CP, and CBLO which are either listed on the recognized stock exchange or traded through OTC markets and distributed and held in demat accounts through financial institutions should not be considered as depository Accounts.

The due diligence for such securities, bonds, debentures and other instruments traded through the recognized stock exchange / OTC market and / or held in demat account should be the responsibility of the DP or custodians and should not be considered as depository account.

3. In the event, listed instruments such as those discussed at point (2) above are to be reported by the issuer NBFC, there would be duplication of reporting of information related to such listed instrument-holders

Per Rule 114G(1) among other information, the depository institution is required to maintain and report the following information of an accountholder that is a reportable person:

- a. the account balance or value at the end of relevant calendar year or, if the account was closed during such year, immediately before closure (per sub-clause (f)) and

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- b. the total gross amount of interest paid or credited to the account during the relevant calendar year.

NCDs are privately placed and are generally listed and held by the accountholders in Demat form. The FI obtains the list of NCD Holders as on last day of the calendar year / date of redemption and also list of NCD holders as on the interest record dates. The information of the account holders is obtained from Central Depository Services Limited (CDSL) & National Securities Depository Limited (NSDL). The details of interest paid and balance are obtained from the Registrar and Transfer Agents (RTAs).

The year-end balance / balance before closure and gross interest paid to the accountholder is also reported by the Custodial Institution as the NCDs are held in demat form.

Thus same information will be reported by multiple FIs.

Clarification sought:

- i) It is requested that necessary clarification may be issued for a suitable framework in order to avoid duplication of reporting.
- ii) In case of CPs, the interest payment and redemption is carried out through Issuing and Paying Agent (IPA). The issuing financial institution has no knowledge of the persons who in turn hold the CPs and bonds. Hence the account holder in case of CPs / bonds is considered as the IPA itself. Generally the IPA is a Banking company and accordingly no reporting is required to be done as the banking company is a reporting financial institution having Global Intermediary Identification Number (GIIN).

Though technically the persons holding the bonds are the accountholders but since their information is not known, and since the financial institutions deal with the issuing and paying agent, it is considered as their accountholder. Thus a suitable clarification may be issued in this regard.

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4. Are Core Investment Companies –Investment Entities or they are Non-Financial entities

Core Investment Companies may not satisfy the definition of investment entity and so should be a non-financial entity.

An investment entity includes an Entity whose primary income is from business of investing, reinvesting, or trading in financial assets **and such entity is managed** by another entity that is a depository institution, a custodial institution, an investment entity or a specified insurance company and also the gross income of the entity from such business activities is more than 50% of the entities gross income over a three year period.

Generally Core Investment Companies are not managed by another Entity and so should not be Investment Entity.

However, the CBDT Guidance Note dated 30 November 2016 has clarified as under:

“Non-Banking Finance Companies (NBFCs) will be either depository institution or investment entity as per its activities. NBFC which accepts deposit in the course of a banking business or a similar business as mentioned in the definition of depository institution will be considered as Depository Institution and will report accordingly. An NBFC which is working as investment entity will report accordingly.”

None of the categories of NBFC should come within the purview of Investment Entity as defined – kindly confirm.

5. Asset Reconstruction Companies (ARC) should not be a financial Institution under FATCA / CRS

Similarly ARC should not fit within the definition of depository Institution nor should fit within the definition of Investment Entity and so ARC should not be a Financial Institution and should be a Non- Financial Entity. Kindly confirm

6. Non-reporting Financial Institution

Most of the NBFC are catering to local population in the remote areas and so should fit within the definition of Non-Reporting Financial Institutions. It is extremely difficult to

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ensure FATCA / CRS self-certification is collected from the rural areas specifically from entities in rural areas, as the awareness is less.

Non-reporting financial institution category should be continued.

7. Reporting based on TDS rate/ flagging as non-resident

Many RFIs have identified reportable accounts based on “TDS Rate” or “Non-resident” flag in the system, which indicated TDS rate applied for non-residents.

However, in the absence of self-certification from such account holders and details like country of tax residence, TIN, address, the RFIs have not been able to report such accounts.

Clarification sought:

The RFIs seeks clarification on whether the account is required to be blocked or how the reporting should be done

8. Joint Accounts

Generally joint accounts are maintained by depositor holders for the ease of operation of the account and also for smooth succession of the account on the demise of one of the account holder. As per the Income-tax Act, the first holder should be the beneficial owner of the deposit and the interest income and offer to tax the interest received.

In case the second holder is a non-resident, does full value of the deposit account to be reported to the second holder who is not entitled to receive the deposit amount or the interest thereon.

9. Change in the status of Tax residence of Account holder

There are instances that the tax residence of the deposit holders may have changed during the year and the same may not have been captured in the system. Tracking the change of circumstances is extremely difficult. Some mechanism should be developed whereby the account holders change of circumstances is linked to the bank account of the depositor

Sometime the change in circumstances is known only at the time of maturity of the deposit. Does the RFI require amending the earlier filings of Form 61B?

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We shall be glad to supplement this memorandum with any additional information / clarification that may be required.

Thanking you,

Yours Faithfully,

For **FINANCE INDUSTRY DEVELOPMENT COUNCIL**

MAHESH THAKKAR
DIRECTOR GENERAL