

Need to reduce the stress on stressed Assets for Banking Sector

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Banking sector has outperformed or rather maintained consistency during and post pandemic, thereby playing a pivotal role in bringing back the economy on track. However, deterioration of certain asset class has been considered a larger economic risk for the Indian banking space, rolling back the attention to the so called 'Stressed Assets'. Looking at the current valuations and quick turnaround appetite, stressed assets can in fact provide an opportunity for long term players for investing in operational and good quality underlying assets to expand their base in a cost- effective manner.

From a Bank's point of view, "Stressed Assets" are loan exposures that are classified as Non-performing Assets ('NPAs') or Special Mention Account ('SMAs').

RBI has categorized namely three types of Stressed Assets viz. Sub-standard Assets, Doubtful Assets and lastly Loss Assets.

Banks accept various kinds of collateral while advancing loans. In case such loans turn into NPAs, Banks are forced to liquidate the collaterals in order to recover their capital against such loan outstanding. In majority of cases wherein Stressed Asset resolution is done by liquidation of collaterals, the Banks lose money. The main reason for this is that the process is time bound as mandated by various regulatory tenets prescribed by the RBI. Accordingly, an appropriate price discovery for disposal of such collaterals is rarely achieved. In most of the cases, the Banks are forced to take a haircut even on the principal amount of loan outstanding, while the entire projected interest income is a write off. This gets further burdened by certain provisions under the tax laws which the Banks need to adhere to.

For instance, under section 43CA of the Income tax Act, 1961 ('the Act'), there are prescribed methods for arriving at the value of consideration for "transfer of assets, other than capital assets, in certain cases, whether it is a business assets or capital asset". The difference between Stamp Duty Value and Cost of Acquisition of property is charged as Short Term/ Long Term Capital Gains based on the period of holding of such assets. These provisions are applicable in case Stamp Duty Value exceeds 110% of the sale consideration.

Typically, in case of the Banks, since the liquidation exercise is stipulated as per statutory timelines, Banks mostly end up disposing the assets at a price which is far lower than the commercial price/stamp duty valuation. Also, from practical experience, it is observed that stamp duty valuation rates in most

circles exceeds commercial prices prevailing therein as they follow ready reckoner rates prescribed by local state laws. This eventually compels the Banks to pay taxes on notional profits to comply with RBI regulations of time bound sale. Though the aforesaid section was introduced to prevent tax evasion on transfer of assets by cash exchanges for consideration settlement, it becomes burdensome to apply in the situation discussed above with respect to Banks.

An amendment should be made by way of providing for an exemption from application of section 43CA of the Act from the above discussed situations. Alternatively, in such cases, the valuation report which is received from a reputed valuer may be considered to be the fair market value of such land/building.

Another section which also needs attention is section 194IA of the Act, which casts an obligation on the Banks for tax withholding while buying an immovable property.

Section 194 IA of the Act provides that any person buying an immovable property from a resident seller shall withhold tax @ of 1% from the sales consideration or the stamp duty value of such property, whichever is higher. The tax shall be withheld if the amount of sales consideration or stamp duty value is INR 5 million or more.

Again, in this situation, the tax withholding is done on higher amount for cases where the stamp duty value is considered. Thereby, the net cash inflow in the hands of the Bank is reduced.

Hence, it is expected that a specific exemption is announced in the forthcoming Budget to exclude such transactions entered by the banks from the ambit of section 194 IA of the Act. The rationale is that Banking industry is strictly regulated, details of all such collateral disposals are available with all Banks, and these auction sale transactions are executed as per other statutes and under the purview of RBI.

One more aspect worth taking care of is about the definition of 'consideration' under the aforesaid provisions. Section 43CA of the Act contains the special provision for computation of the full value of consideration in case of transfer of immovable property. These provisions do not define 'consideration'.

On the other hand, Explanation (aa) to Section 194-IA of the Act provides that the "consideration for transfer of any immovable property" shall include all charges of the nature of club membership fee, car parking fee, electricity or water fee, maintenance fee, advance fee or any other charges of similar nature, which are incidental to the transfer of immovable property. For the purpose of tax withholding under section 194-IA of the Act, the 'consideration' as referred to above is compared with the stamp duty value, and not the consideration before including the charges incidental to transfer.

In other words, 'consideration' for section 194-IA and section 43CA of the Act differ when one buys directly from the builder. In the matter of resale flats, perhaps, 'consideration' for both section 50C and section 194 IA of the Act will align in most cases.

Thus, it is recommended that a common definition of 'consideration' is provided for all sections viz. 43CA, 50C, and 194 IA of the Act by bringing in the required amendments. There is a need to bring parity in the provisions making an overall impact rather than in piece-meal.

In the context of applicability of section 194R of the Act on the Banking sector, there were anomalies on certain transactions when the provisions were introduced. Subsequently, the Government issued clarifications to remove a few ambiguities and moved them out of the ambit of the aforesaid provisions in respect of those transactions.

This Budget being tagged as one of the most expected populous Budget of all times, it is expected that the Government will make all the classes and masses happy with plethora of announcements and clarifications.