

# **Dealing With Financial Services**

## **(NIPFP- GST Workshop)**

Gautam Bhattacharya

Joint Secretary, Min. of Finance, Government of India

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# Financial Services

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- Major Components

- Banking Companies
- Insurance Companies
- Investments, Pension or Mutual Funds
- Stock, Security, Foreign Exchange broking
- Assets Management & Investment Advisory Companies
- Money Transfer Agencies (VISA, Masters, Western Union)

- Core financial activities are to act as intermediary between savers and borrowers AND to provide liquidity for the all the primary, secondary and the tertiary sector.

# The Importance of the Financial Sector

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- It supports the microeconomic activities.
- It provides various investment options.
- It provides macro-economic stability.
- It is a prerequisite for economic growth and development.
- It affects factors like inflation, flow of funds, price stabilization
- It accounts for about 10% to 25% of the GDP of the developing and developed countries

# Whether This Sector Should be Taxed At All

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- There is a debate whether this sector should be taxed at all. The earlier fiscal experts believed that to the extent the users of this sector are trying to maximize their returns on savings, the value does not belong to a tax base which is essentially consumption based;
- It is also argued that these are essentially intermediate service and they ultimately provide finances for the consumption sector which is anyway going to be taxed
- It is difficult to tax financial services.
- The modern school of fiscal thoughts are that since it is a part of the Gross Domestic Product and also reaches up to the consumption level, there is no reason why it should not be taxed.

# The Different International Practices

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## **EU** ( 6<sup>th</sup> Directives)

- Services such as insurance, credits, deposits, bank guarantees, currency transaction, shares and securities, other core banking activities are **exempt**.
- Any service provided out side the country or to a non-resident within the country is **zero rated**.
- Property management, debt collections, custody services, investment management and other non-core activities can be **taxed**.
- Countries like Germany, France or Belgium allow ‘ **option to pay**’ with a view to allow passing of credit downstream.

# The Different International Practices.

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## **Israel.**

Charges VAT on financial services on a base of total (inputs + wages+ profits) turnover, disallowing both ITC on the input as well as that of the tax paid at the downstream level.

## **Argentina**

Charges heavy VAT (@21% on loans-18% on debit/credit card interests, 10.5% on industrial loans, 0%-interest on hoam loans) to reduce the inflationary pressure.

## **South Africa**

Initially exempted all financial services. But have now imposed tax on all fee based services such as safe deposit services, advisory services.

# The Different International Practices.

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## **Singapore**

Basically taxes the non-core banking services that are fee based or are on commission basis. The credit is allowed to be passed on.

## **New Zealand**

No tax is charged to financial services provided to unregistered persons or end customer. The financial supplies are normally zero rated. On optional / elective basis tax can be paid if the credit needs to be passed down.

## **Australia**

The financial services or auxiliary services are not subjected to GST

# Taxing Financial Services- A Sensitive Issue

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- Ill conceived and ill constructed tax structure can impede economic growth.
- On account of turnover, the sector has substantial revenue potential.
- Financial sector provides vital information about other sector (secrecy and privacy issues).
- It is often difficult to estimate the taxable base.
- Asymmetrical taxation affects financial decisions. With economy opening up, this may cross the national boundary.
- Financial Sector must have a 'neutral tax system' that leaves private investment and financial decisions unaffected.



# Financial Services Currently Taxed in India

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- Asset Management Services (2007)
- ATM Maintenance and management services (2006)
- Banking and other financial services (2001)
- Credit and other card services (2006)
- Credit rating agency services (1998)
- General Insurance Services (1994)
- Insurance Auxiliary services (2001)
- Life Insurance Services (2002)
- Management of ULIP (2008)
- Promotion and management of lotteries (2010)

# Financial Services Currently Taxed in India

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- Processing and clearing house services (2008)
- Recovery agent services (2006)
- Registrar to an issue (2006)
- Share transfer agent service (2006)
- Stock broker service (1994)
- Underwriter services (1998)

# What is not taxed

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- **Interests on loans**
- Return on principals
- Endowment part of an insurance.
- Collection charges of government duties and taxes
- Inter-bank purchases and sale of foreign currency.
- Services provided by RBI

# Challenging Issues Relating to Financial Services

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## (A) VALUATION

- Hire-purchase or financial leasing
- Combined insurance policies
- Fund charges in case of mutual funds
- Lottery service.

(B) Place of supply and exports of financial services-  
problem of jurisdiction

(B) Issue of Double taxation- hire purchase.

(B) Difference between 'debt' and 'loan'.



Thank you





**ADDITIONAL  
INFORMATION**



# Banking Service

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- Banking Services are of two types

## (A) Retail banking

- Basic banking facilities to a large number of small customers
- Account facility
- Money transmission (pay-order, demand drafts etc.)
- Credit-Debit cards
- Safe-keeping
- Deposits
- Loans

# Banking Service

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## (A) Wholesale banking, Investment Banking and Merchant banking

- Specialized banking facilities to a small number of large customers
- Financial leasing
- Merchant banking.
- Securities and forex broking
- Asset or portfolio management
- Corporate investment, financial advice
- Security lending
- Bankers to an issue/ IPO
- Provision and transfer of data processing
- International Banking-LC



# Banking Service

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- What are the amounts that banks receive?
  - Interests on loans
  - Other interests, say on Financial Leasing
  - Discounts on government bonds and trade bills
  - Fees
  - Processing and administrative charges
  - Default charges / Penal interest.