

To
The Finance Minister
Hon Shri _____

Subject: -With respect to Service charge/borrowing cost

Sir,

I,Managing Director of.....here in after known as Society. The Society is providing micro credit facilities to its Members. The Society receives service charge/borrowing cost on these micro loans instead of Interest. Although it is a (service charge/borrowing cost) nomenclature being used by the Society for the consideration it receives against loan, but it stands on the same footing as Interest. Even the service charge/borrowing cost being received by the Society is less costly in comparison of Interest.

Under GST regime Interest on Loan is exempted but service charge/borrowing cost is not being considered as a charge/consideration taken on loan. Hence the service charge/borrowing cost taken by the Society is chargeable under GST regime at the rate of 18% like other services. Which is ultimately affecting the micro credits/microfinance beneficiaries by the increase in the cost of loan.

Our request is to bring service charge/borrowing cost on loan in the exemption list like Interest. In support of our stand and argument we are providing a brief write up as annexure attached.

We would be highly thankful on your kind consideration.

Yours faithfully

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(ANNEXURE)

A Note – Why Service charge / Borrowing Cost must be exempted Under GST

Introduction:

Sanghamam is a multi-state credit cooperative society registered under MSCS ACT in 2012. Having its presence in Kerala and Tamilnadu with 7 branches at different locations. It is a credit cooperative society engaged in providing thrift and extending mainly micro loans to its members. Sanghamam is trying to fill the gap of over all national goal of financial inclusion and serving those who are deprived from the financial services. Sanghamam is working on a model; as **“A Cooperative Credit Society is created by members for pooling their funds and creating loanable funds therefrom for addressing their liquidity demands from time to time, mutually sharing the operational cost and owning the benefit and risk of operations.”**

How it works:

Sanghamam is a credit cooperative society registered under MSCS act, it is a member-based institution and provides microfinance facilities to its members. Sanghamam offers mainly two types of activities.

1. Deposits.

Sanghamam takes deposits from its member. These deposit schemes serves the small income earners and provides safekeeping of their small deposits. Sanghamam neither gives any monetary benefit to the depositors for keeping such deposits nor does it charge any fees from members for extending this service.

2. Loans:

Sanghamam gives major portion of the loan-able fund as cash loans/demand loan along with other loan schemes and charges service charge/borrowing cost on such loans. Tenure of such loans is normally 1 year maximum. Beneficiary of this loan services are members of the society. They are mostly from the marginalized and financially excluded/backward section of the society at large. Sanghamam is helping them with microfinance (microloans). Sanghamam is charging borrowing cost/service charge against such loans which is equal to or less than the operational cost of the Society. This cost excludes any kind of profit to the

Society. The borrowing cost includes only the operational cost incurred upon the Society and it does not include the cost of fund or profit to the organization.

Comparison between Interest and Borrowing Cost/Service Charge

Referring the “Report of the Sub-Committee of the **Central Board of Directors of Reserve Bank of India** to Study Issues and Concerns in the MFI Sector” which is widely known as “**Malegam Committee Report**”, the term Interest includes cost of fund, operational cost and profit.

The Malegam Committee was a Sub-Committee of the Board of RBI to study issues and concerns in the microfinance sector and was chaired by Shri Y.H. Malegam – Chairman. The committee report came in January 2011.

While;

Borrowing Cost/Service charge: The borrowing cost/service charge of Sanghamam includes only the operational cost under cash loan head. It does not include the cost of fund, profit to organization etc. The following table shows the comparison between **interest** and **borrowing cost/service charge** -

Sl. No.	Components of Interest (as defined in Malegam Committee Report)	Interest (Its nature in Banks/other financial institutions)	Borrowing cost/service charge (Its nature in Sanghamam)
1	Cost of Fund	In case of Banks/Financial Institutions: - They obtain fund from public in the form of savings, fixed deposits and in return some interest is paid. In some cases they take loan from RBI or from other organization on which they pay interest. It is their cost and a component of	In case of Sanghamam the fund is mobilized from its members in the form of deposits. Neither any amount is given to members on their deposits nor any charge is taken by the Society from members for the maintenance/safe keeping of their deposits. Therefore cost of Fund to Sanghamam is NIL

		calculation of Interest rate.	
2	Operational Cost	In case of Banks/Financial Institutions they incur cost of running their business. This cost is also a component of Interest.	Sanghamam also incurs cost for running office. Which they charge from their members on cash loans/demand loans in terms of Borrowing Cost/Service charge.
3	Profit	In case of Banks/Financial Institutions they add some %age of cost as their profit. Since they have to give dividends to its shareholders, have to make some surplus etc. This is also a component of calculation of Interest rate.	Sanghamam does not add any profit margin. The basics of not adding profit margins is that Sanghamam does not do business with their members but assists them and facilitates in their financial need to develop and grow.
4	Pricing of Interest	Malegam Committee suggested that in Microfinance Institutions there should be a cap of 24% per annum on individual loans.	Sanghamam is charging only 13%, which is near or less to the actual cost of running office.

Interpretation of the words **“Interest”**; **“Borrowing Cost”** or **“Service Charge”**.

Banking Companies and financial institutions which provide loan charge interest as its consideration, while at the same footing, some financial institutions does not use the word “interest”, they uses “borrowing cost” or “service charge”

The question is whether the words “Interest”; “borrowing cost” or “service charge” are same or have different meanings.

It is important to note that “interest”; “borrowing cost” or “service charge” all these are considerations received on Loan. Genetically they are not different; the only difference is of nomenclature.

Therefore, we interpret that “borrowing cost” or “service charge” are also exempted under the GST Act, as “Interest” is.

The point we are making:

We are a credit co-operative society. Our prime activities are accepting deposits and lending money to our members. As lending is a financing activity, we also charge some consideration for lending likewise the banks charge interest. In fact we do not call it interest as terminology but we call it “service charge/borrowing cost/”.

AS PER SCHEDULE OF GST RATES FOR SERVICES AS APPROVED BY GST COUNCIL - Service Tax Exemptions to be continued in GST as decided by GST Council, Sl. No. 8;

Services by way of—

- (i) ***extending deposits, loans or advances in so far as the consideration is represented by way of interest or discount (other than interest involved in credit card services);***

Under notification loan and advances is exempted if it is represented by way of interest (which includes cost of fund, operational cost and profit). The cooperative is also providing loan and only charging the operational cost. GST is exempted on Interest therefore it shall also be exempted on borrowing cost/service charge as well. It will enable Sanghamam to extend more and more financial services to the deprived. The cheaper loan will also be a great benefit to the members of the society.

Thank You.