

Disclaimer

This Presentation aims to tell the General Views, provisions and Laws related to Funding (Loan) options & Interest Savings under Income Tax.

This Presentation may contain references, website links, regulations or other policy materials. This Information provided is only intended to be a general summary. All information in this presentation, including charts, examples and other website references, may be used for any purpose only after Professional advice.

This Presentation is the personal view of Speaker Mr. Daxesh D. Kothari on Funding (Loan) options in the present times and Provisions for deduction of Interest Expenses under Income Tax Law, which should not be relied or acted upon without due Professional advice.

Funding (Loan) options in the present times and Provisions for deduction of Interest Expenses under Income Tax Law



Funding (loan) options in present times

The Present day scenario

- ✓ Banking system flush with funds.
- ✓ Increased competition between Public Sector Banks, Private Banks & NBFCs.
- ✓ Fear of NPA's and its consequences.
- ✓ Monetary policies of RBI not the only mover of interest rates in the economy.

The Present day scenario

Months	RBI Repo Rate	MCLR Rate
Jun. - 2016	6.50%	9.15%
Sep. - 2016	6.50%	9.10%
Dec. - 2016	6.25%	8.90%
Mar. - 2017	6.25%	8.00%
Jun. - 2017	6.00%	8.00%
Sep. - 2017	6.00%	8.00%
Dec. - 2017	6.00%	7.95%

- ✓ **RBI Repo Rate went down by 0.50%. Interest rate in the economy went down by 1.20%.**
- ✓ **Additional 0.70% on account of Demonetization?**

Why lower interest rate is important ?

- ✓ Increased competitions in business.
- ✓ Limited return in investment opportunities.
- ✓ Taking advantage of the competition. Not just sanction of loan, but rates & terms equally or more important.

Strategy of the lenders (Banks & NBFCs)

- ✓ Rollout of teaser rates of interest & terms.
- ✓ Lend only to parties from whom payback (recovery) is visible.
- ✓ Concept of Internal Rate of Return (IRR).
- ✓ Initial charges, recurring charges and prepayment (foreclosure) charges an important revenue stream.

Strategy of the borrowers

- ✓ Financial strength should be on paper to bargain best rates of interest & terms of loan.
- ✓ Outflow on payment of Income Tax can be offset against savings of interest.
- ✓ CIBIL Score – first & foremost important, in the loan evaluation process.

Strategy of the borrowers

Factors which determine the CIBIL score

- ✓ The applicants repayment history.
- ✓ The extent of usage of credit given to the borrower.
- ✓ Tenure of the credit.
- ✓ Number of times new credits applied.
- ✓ Credit mix is viewed positively.

Homework

- ✓ Monitor your credit score.
- ✓ Incorrect information needs to be corrected.

Strategy of the borrowers

- ✓ The need for money can be met by several routes. Select the route which is easy in sanction & cost.
- ✓ The interest paid should be tax deductible from Income Tax.
- ✓ Never to borrow beyond the set norms by giving incorrect information.

Strategy of the borrowers

- ✓ We should have a clear plan for repayment of loan.
- ✓ Property mortgaged should be adequately insured at all times.
- ✓ The person on whose shoulder the responsibility to pay the loan lies, should be insured by a term plan.

Strategy of the borrowers

- ✓ Never borrow & invest in illiquid asset like real estate.

Never borrow and invest. Investment should be only from savings.

- ✓ Never borrow because the loan is available. You will fall in Debt Trap.
- ✓ Never borrow for unrelated diversification or leisure of assets (holiday home) etc.

Strategy of the borrowers

- ✓ Never put money in FD and Debt Funds and borrow structurally. You are facilitating the Banks.
- ✓ If short term borrowed funds are used for long term investment. This will lead to financial stress.
- ✓ Evaluate all the possible option in availing the funding (loan) not just option from the bank we are connected.

Strategy of the borrowers

Basic checklist in sanction letter :

- ✓ Sanctioned loan amount.
- ✓ Terms of disbursement.
- ✓ Interest rate.
- ✓ Interest rate is fixed or floating.
- ✓ Moratorium period.
- ✓ Repayment period.

Strategy of the borrowers

Basic checklist in sanction letter :

- ✓ Borrower's margin.
- ✓ Upfront & recurring charges.
- ✓ Other obligations like insurance etc..
- ✓ On repayment interest is on reducing basis or not.
- ✓ Any other special terms.
- ✓ Prepayment (foreclosure) terms & cost.

RBI Circular : No foreclosure charge shall be charged to individual borrowers on floating rate loans.

Special Points to be considered in Housing Loan

- ✓ More than one co-borrowers & co-owners of property to claim complete deduction of interest U/s. 24(b).
- ✓ Home loan in form of Overdraft, deposit excess fund & reduce your interest cost significantly.
- ✓ Housing loan at different terms. Loan against property at different terms.
- ✓ Housing loan Top-up can be availed on beneficial terms than LAP.

Special points to considered in Term Loans for Industry

- ✓ Evaluation of possibility for availing interest subsidy & capital subsidy. Subsidy available only if Term Loan is availed.
- ✓ Collateral security is required to be offered.
- ✓ Terms & Conditions of disbursement & advance payments needs to be evaluated.

Special points to be considered in Cash Credit for Industry & Business

- ✓ Cash Credit is linked with stock, Debtors & Creditors. What is the manner in which credit limit calculated needs to be understood before hand.
- ✓ Date of submission of monthly statement & consequences of late submission.
- ✓ Possibility of cash credit without stock statement.
- ✓ Charges payable upfront & recurring on limit sanctioned.

Special points to be considered in LAP (Loan against property)

- ✓ LAP on “House Property” interest deductible U/s. 24(b).
- ✓ Valuation of house property considered for sanction of loan is important to determine the loan amount.
- ✓ Term loan or drop line OD ?
- ✓ LAP against Industrial Property and land – mostly not available.
- ✓ Interest on LAP for general purpose not deductible under Income Tax law.

Points to be considered in Over Draft (OD) against Fixed Deposit (FD)

- ✓ Permanent FD – OD not worthwhile.
- ✓ Interest on OD not deductible against FD interest. Only deductible against income from OD Funds.
- ✓ OD against Debt based Mutual Funds – the best option.

Points to be considered in Over Draft (OD) against Fixed Deposit (FD)

HOW MUTUAL FUND/OVER DRAFT IS BETTER THAN FIXED DEPOSIT/OVER DRAFT ?

Head	Rate		FD				Debt					
LTCG-Debt	20.6%		Gross Return	6.50%			Gross Return	8.50%				
Corporate Tax	30.9%		Deduction in Yield	2.00%			Deduction in Yield	0.60%				
Lending rate	10.0%		Post Tax Yield	4.50%			Post Tax Yield	7.90%				
Rate of Inflation p.a.	5.6%											
Particular	FD Tenure in Days	Years	Rate Of Return FD	Amount Invested	Interest Received	Particular	Tenure Days	Years	Rate Of Return OD	Amount Invested	Interest Paid	Net Interest
Fixed Deposit	1095	3	4.50%	65,00,000	9,33,884	OD	150	0.41	7.50%	65,00,000	2,00,352	7,33,541
Particular	Tenure Days	Years	Rate Of Return	Amount Invested	Interest Received	Particular	Tenure Days	Years	Rate Of Return OD	Amount Invested	Interest Paid	Net Interest
Any Good Debt Product	1095	3	7.90%	65,00,000	1,665,995	OD	150	0.41	9.00%	65,00,000	2,40,411	14,25,584
							Processing Fee					9,750
							Difference - Absolute					6,82,292
							Difference - Per Year					2,27,431

*Mutual funds Investments are subject to Market Risks, read all scheme related documents carefully.

Points to considered in Loan Against Security (Shares & Mutual Funds)

- ✓ Tax Free or Tax efficient income from securities can be in one head (individual).

Borrowings against securities can be in the business entity (company / firm). Interest paid will be tax deductible in the business entity.

- ✓ Margin, Rate of Interest, Term Loan / Overdraft, Quantum of facility are important aspects for consideration.

Foreign Exchange Funding (Loan)

- ✓ Borrowing can be made in Forex for local fund requirements.
- ✓ INR emerging as a strong currency than ever before.
- ✓ Hedging of Forex exposure possible at a cost.
- ✓ Total cost of Forex fund.
LIBOR + Margin + Hedging cost

Project finance some important aspects

- ✓ Work on realistic figures in Project Report. If not achieved can impact future borrowing & interest rates.
- ✓ Legal format of the project important – sole Proprietorship, Partnership, LLP, Pvt. Ltd.
- ✓ Promoters need to arrange for 100% collateral of loan availed.

Bill Discounting

- ✓ Sales made to standard parties can be encashed immediately after deduction of interest cost of the credit period.
- ✓ Otherwise than the above, Cash Credit on this bills could have been available only partially after deduction of margin.
- ✓ Effective way to address working capital requirements.

Some loans with relaxed features

- Doctors Loan.
- Education Loan.
- Loans to Trusts.
 - ✓ Longer moratorium period.
 - ✓ Longer repayment period.
 - ✓ No collateral securities required.
 - ✓ Rebate on regular interest payment.

Private Equity Funding

- ✓ PE a financial partner in the business.
- ✓ Supports in the growth of business.
- ✓ Promoters & the PE investors makes the business valuable.
- ✓ PE investor exists from the company – unlocks the value.

Pre – requisites :

- ✓ Business with good potential of growth.
- ✓ Top quality of management of the company.
- ✓ Transparent operations and accounts.

Venture Capital Funding

- ✓ There is an Entrepreneur & a bright business idea.
- ✓ Venture capitalist funds that idea to start the venture.
- ✓ The venture flourishes.
- ✓ The venture becomes valuable.
- ✓ The venture capitalist exists – unlocking of value.

Pre – requisites

- ✓ Idea is a game changer idea.
- ✓ Entrepreneur has to put his blood & sweat in the venture.
- ✓ Transparent operations and accounts.

Funding through SME Listing

- ✓ Float an IPO of a SME Co. and raise equity capital.
- ✓ Unlocking of the enterprise value enabling company & promoters to avail funding on that basis.
- ✓ Tax efficient funding. STCG – 15%. LTCG – NIL.
- ✓ Encourages growth of the company at all times to come, by participation of investors on SME platform & thereafter main board.

Restriction on Inter Corporate loans

- ✓ Restriction under Section 73 of the Companies Act in respect of loans / advances received.
- ✓ Restriction under Section 185 of the Companies Act in respect of loans / advances given.
- ✓ Loan to share holders (holding more than 10% equity of the company) is treated as deemed dividend.

Merger & Acquisition and realignment of business in present scenario

- ✓ We have a legacy of SME styled business.
- ✓ GST dis-incentive or no more incentive for SME.
- ✓ Merge smaller business and make bigger & efficient business.
- ✓ M & A can be within the group or outside.

Effectively converting Pvt. Ltd. Co. to LLP or Partnership Firm

- ✓ Taxation in the company.

25% / 30% + 15% (20% Dividend distribution Tax) = 40%

- ✓ Pvt. Ltd. can be converted to LLP without capital gain tax only if turnover in any of the last 3 years does not exceeds Rs. 60 lakh.
- ✓ Slow down the Pvt. Co., transfer major assets and let the company be a asset investment company. Activate the LLP in business.

Stressed loans & business restructuring

Signs of stress :

- ✓ Mismatch in cash flow requirement and receipt of payment from the clients.
- ✓ More time and energy spent on managing loans, less on business growth.
- ✓ Unable to source supplies on usual credit terms.

Stressed loans & business restructuring

Solutions of stress :

- ✓ Bridge loans.
- ✓ Capital infusion + Strategic Partners.
- ✓ Close down uneconomical activities.
- ✓ Asset Sale.
- ✓ Outsourcing of some activities.

Provisions for deduction of Interest Expenses under Income Tax Law

Interest paid, claimed as Business Expense Sec 36(i) (iii)

- ✓ Interest paid in respect of borrowed capital used for the purpose of business or profession.
- ✓ Interest on capital borrowed on acquiring capital asset, allowed as a revenue expenditure only when such asset is put to use.
- ✓ Interest paid where dominant purpose is not for earning of income, deduction is not allowable.

Interest bearing funds used to give interest free loans

- ✓ If interest free loans are given "commercial expediency" has to be established.
- ✓ If there is clear nexus between interest bearing funds and business income or commercial expediency then interest free loans granted from other funds would not impact deductibility of such interest.

Maximum rate of interest deductible under Income Tax Act

- ✓ Interest paid to family members U/s 40A (2b) needs to be justified as per the facts of the case.
- ✓ Interest @ 18% p.a. held reasonable is one case.

Interest @ 12% p.a. only held reasonable in some other case.

Interest paid on “House Property” Section 24(b)

- ✓ Interest paid to acquire a “house property” deductible against its rental income to any extent.
- ✓ Maximum loss allowable under the head, not to exceed Rs. 2 lakh. Balance loss can be carried forward.
- ✓ Loan can be from any lender, not necessary institutional.

Interest paid deductible against incomes from other sources – Section 57(iii)

- ✓ Any expenditure incurred wholly and exclusively to earn such income is deductible.
- ✓ Amounts borrowed, then invested, then income received therefrom. Interest paid on such borrowed amounts can be claimed as deduction from said incomes.

Interest paid to earn tax free income – Section 14(A)

- ✓ Expenditure incurred to earn tax free incomes is not deductible.
- ✓ Interest expenditure to earn tax free incomes like Dividends, LTCG on shares, Agricultural Income – not deductible.



**Our elders always
told us
“Save money
&
Don't borrow
money”**

Question

Who is the biggest
spender in the world
&

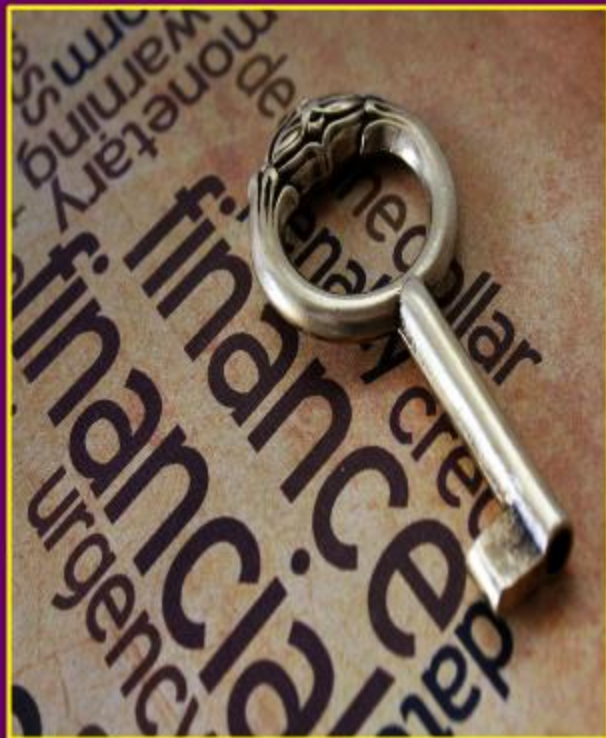
who is the biggest
borrower in the world ?



Question

Which economy is considered as one of the biggest & strongest economy of the world ?

Currency of which country is one of the most respected ?



Question

**Who is the biggest spender
in the world
&
who is the biggest
borrower in the world ?**

Answer

USA

Question

**Which economy is considered
as one of the biggest &
strongest economy of the
world ?**

**Currency of which country is
one of the most respected?**

Answer

USA

Hence the message,

**Borrowing is not a bad
idea, but how we
borrow and what we
do with the borrowed
funds is all that
matters.**

A request...

- 😊 Personalised Question & Answer session is downstairs with Tea / Coffee.
- 😊 Please submit your feedback form.

Thank you...



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