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'Interest' of Bank Depositors in Chaos

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Table of Contents

Executive Summary and The Action Plan

A. Objective

1. The interest income generated out of more than 800 million bank deposit accounts in India is of the order of Rs 3.5 lakh crore. This paper looks into issues pertaining to interest application frequency on deposit accounts and tax deduction at source (TDS) methodologies adopted by banks on such interest incomes. In order to address the issues, we undertake an in-depth analysis of the situation with respect to existing regulations, standards and actual practices of the banks. Finally, we provide a structured and implementable roadmap to move towards setting standards that will be to the advantage of the depositors, the government and the banks alike.

B. Present scenario

Interest Application Frequency

2. For Savings Bank (SB) deposits and Term deposits, amounting to Rs 60 lakh crore, Reserve Bank of India (RBI) has allowed banks to pay interest to depositors only at quarterly or longer rests. Most of the banks are paying interest on the SB deposits at an interval of six months. In case of Term deposits, banks are usually paying interest at quarterly intervals.

3. As against deposit products, for loans taken from the banks, the interest is computed monthly. In other words, if a borrower defers payment of interest by two months, the banks charge two months' interest on the delayed interest payment.

TDS on Term deposits

4. The accrued interest on Term deposits enjoys a special status since accrued interest earns further interest, i.e., it cumulates. Thus, the question of when to do TDS on such accrued interest is not only a concern for the banks but also the depositors and for the Government.

5. On interest accrued on Term deposits, TDS has been mandated under the Income Tax Act 1961. Initially the Income Tax Act 1961 and subsequent Finance Act 1987 were relatively clear on what was meant by TDS on accrued interest (for cumulative Term deposits). The TDS was to take effect at the time of credit of interest to the account of the payee or to interest payable account or to suspense account or actual payment in cash, cheque, draft, etc., whichever is earlier. In March 2010, the Government gave banks the freedom to defer TDS realization, on accrued interest, to March 31. Thus the country thinks that the banks have the freedom to qualify the date

of accrued interest annually (for TDS purpose) i.e., only on March 31. This twist of events is seen more as an operational convenience for the banks. However, this has led to disharmony in the TDS procedure followed by banks.

6. In order to comply with the TDS rules, a cumulative Term deposit with a start date of March 3 will have its first interest application on March 31 (an intervening period of less than a quarter or even less than a month). Depending on bank's policy, the subsequent interest applications, for TDS purpose, are either on calendar quarter ends; or anniversary quarter ends; or on September and March ends; or only on March 31.

7. Technically, under cumulative deposit scheme (quarterly compounding), accrued interest at quarter ends should get credited to the deposit account in order to earn further interest on 'principal plus interest', and thus as per Section 194A of the Income Tax Act 1961, TDS on such an accrued interest should take effect. This concept got re-iterated later, in the Finance Act 1987.

8. Additionally, every quarter, the banks while compounding interest, add the accrued interest to the deposit. In other words, an accrued interest remains accrued interest only till the compounding date arrives. Thereafter it becomes part of the deposit. This also gets reflected accordingly in the quarterly balance sheets of the banks where the deposit figure is also declared.

9. Furthermore, where TDS on accrued interest is being done only on March 31, banks may still show the quarterly accrued interest on deposits under their expenditure head every quarter while working out their profit-loss statement for advance tax purpose. There is a question on the banks being formally allowed to show the expenditure on accrued interest under their expenditure head in their quarterly profit-loss account, while at the same time not recognizing the quarterly accrued interest for TDS purpose.

10. In order to study the actual practice adopted for application of TDS on Term deposits by banks, a select set of banks were approached. The study reveals that there is no harmony across banks in their TDS procedures. There are no standards on (i) how and when TDS should be applied, (ii) how interest on the TDS amount is adjusted, and (iii) whether there should be provision for deducting the TDS amount from the customer's SB/Current account. In absence of any standards, the net returns on Term deposits get affected by the different policies adopted by banks.

Interest on Current Account

11. RBI has regulated the interest rate on Current account at 0%. An average of about Rs 6 lakh crore is held under Current account deposits. A very conservative

estimate of the time component of Current account deposits is 50%. This guides us to the fact that about Rs 3 lakh crore held in the Current accounts saves banks' interest liability to the tune of Rs 22,500 crore (at repo rate of 7.5%) or about Rs 12,300 crore (at SB rate of 4.1%).

C. <u>Drawbacks of the present scenario</u>

Interest Application Frequency

12. The current RBI regulations say that interest on deposits should be paid at quarterly or longer rests. The regulation gives banks the freedom to decide, in a non-transparent fashion, the net returns on deposits held by them. On the other hand the existing framework burdens the depositors with the problem of shopping among various banks for the most attractive methodology used in their interest application and computation procedures. The depositor is neither capable to make such comparisons nor aware that such matters affect his return. And depositors' ignorance is a big asset for banks.

13. Consider, on an average, a rate of interest of 4% on SB accounts and 7% on Term deposit accounts. With a daily average of more than Rs 15,50,000 crore parked into SB deposit accounts during 2012-13, the loss to the SB depositors due to interest being paid at six month frequency instead of monthly is nearly Rs 530 crore annually. Similarly, with an average of more than Rs 45,00,000 crore held with banks in form of Term deposits, the loss to the Term depositors due to interest being paid at three month frequency instead of monthly is Rs 1940 crore annually.

14. Though RBI may have set a *rule* on the interest application frequency as quarterly or longer rests, with the introduction of TDS on Term deposit interest income (and for operational ease), many banks, *in violation of the outdated rule*, may have moved away from crediting interest to the account at the end of the quarter from the date of deposit (anniversary quarter) to crediting interest at the end of the calendar quarter, and necessarily on March 31. In other words, there are banks that pay part of the interest before completion of the quarter and still do not discount the same.

TDS on Term deposits

15. For individuals, though the taxation is on the nominal salary income, there is a compensation individuals receive for inflation through dearness allowance or wage indexation. Similarly, while applying taxation on Long Term Capital Gains, the amount is indexed to inflation and only the inflation adjusted capital gains are taxed. However, when it comes to interest incomes from bank deposits, one is already aware that such incomes when seen in real terms are very low or even negative. Moreover, even for the Term deposits- which are high yielding deposits, if one considers using

consumer price index to work out real interest rate, the scenario looks gloomy as the inflation adjusted income is by and large negative. Thus the rationality of taxation on nominal interest incomes is one major point in itself which the government / banks / RBI / depositors should ponder on.

16. Today apart from banks, there are other non-banking and other financial entities which accept deposits. Most of these entities are exempt from TDS prescriptions. This leads to possible leakages in deposits of the banking sector.

17. In the present environment of TDS on Term deposits, there is no aggregation of individual deposit across banks. There is a requirement for every assessee to work out tax (or balance tax) liability on interest income and make such tax payments separately to the government. Such a cumbersome situation and related frictions lead to intentional and unintentional defaults on the payment of full tax on interest incomes. Again, those who have permanent account number (PAN) and are in the 'no tax' bracket (or even when not sure whether they would be in the no tax bracket) have to make efforts to fill Forms 15G/15H or else have TDS invoked and then apply for a refund later. Though the PAN data with banks are well organized, for interest income from banks, currently there is enough scope (i) for leakage of tax, (ii) for unclaimed tax refunds, and (iii) for banks, depositors and the Income Tax department being overburdened to track and do immense paperwork.

18. In case of cumulative Term deposit accounts, the disharmony in the TDS procedure followed by banks on interest accrued, has its impact on net returns. When the banks recover the TDS, they do so as an agent on behalf of the depositors for remitting the same to the Government. Therefore, though it may *prima facie* appear that it is entirely the bank's prerogative to decide when (whether only on March 31), and from which account (whether the SB, Current or Term deposit account) TDS should be recovered, actually it is the depositor who, being the principal, should have the primary right on such matters and options should be accordingly provided by the banks. The banks should not exercise the option of recovering the TDS in such a manner as to put the depositor in a loss position.

Loss Due to Lack of Standards in Interest Payoffs

19. Looking at the impact of disharmony in interest payments on bank deposits, it is noteworthy that in 2012-13 alone,

i) about Rs 2,470 crore of interest income on SB and Term deposits could not be generated due to interest application frequency not being at monthly rests,
ii) Rs 135 - 180 crore of additional interest income for the depositors could not be generated since all banks are not doing TDS on accrued interest annually on March 31 only,

iii) Rs 45 - 60 crore additional revenue to the exchequer was lost due to many banks not doing TDS on accrued interest annually on March 31 only,

iv) Rs 13 - 17 crore had been Axis bank's interest income leakage due to non-adjustment of the interest on the TDS amount,

v) Rs 3.7 - 4.6 crore had been State Bank of India's excess interest payoff due to non-adjustment of the interest on the TDS amount paid on March 31, while capitalising the interest to the principal in the new anniversary quarter (and while paying interest under non-cumulative deposit schemes).

vi) Rs 400 - 500 crore of additional interest income for the depositors could not be generated since banks were not proactive in promoting and educating the depositors on the benefits of TDS from SB/Current accounts in lieu of Term deposit accounts,

vii) Rs 120 - 150 crore additional revenue to the exchequer was lost since banks did not mobilise options from the depositors for doing TDS from SB/Current accounts in lieu of Term deposit accounts,

viii) nothing, of about Rs 12 - 22 thousand crore worth of virtual interest income on Current accounts, could be shared with the depositors, since interest rate is fixed at 0%.

D. Proposed action

20. Broad recommendations based on the study include:

- In order to bring parity across all customers of banks (depositors and borrowers), for deposit accounts RBI should **make interest application frequency as "monthly or shorter rests"**. Since the decision has been already delayed a lot, this should be announced at the earliest and brought into effect latest by April 2014.
- TDS on accrued interest (not paid) to take effect only annually on March 31. All banks to **migrate to the "March 31 only" norm for TDS on accrued interest** by April 2015, if not by April 2014. RBI may consider issuing appropriate guidelines.
- Banks to be formally allowed to show accrued interest on deposits under their expenditure head while working out profit-loss statement during quarter ends and for advance tax purpose. The Institute of Chartered Accountants of India (ICAI) should take necessary action.
- **Banks to necessarily provide the option** to debit the TDS amount, on the accrued interest, from the customer's SB/Current account. Such an option should necessarily be indicated on the account opening application form. RBI may consider instructing banks accordingly.
- Banks to sync the tax bracket information (of the previous year) against PAN from Income Tax Department and execute TDS as per the tax bracket rate. Depositors to have a provision to submit a new form (say, Form W1) instructing the rate of TDS, overruling the tax bracket rate as per database. In view of the

above, Forms 15G/15H may be discontinued. In case PAN is not registered, the 20% rate (or any desirable rate) of TDS to continue when interest paid/accrued during the financial year by the bank exceeds the limits specified. CBDT and banks should coordinate.

- **RBI should not resort to giving freedom to the banks on the accounting standards for deposit accounts.** This would burden depositors to shop around on such aspects even in a transparent environment. The only criteria for comparing banks for deposit accounts should be the nominal interest rate.
- The government must consider working towards an approach paper highlighting the pros and cons of streamlining Tax and TDS on individual's interest income, after indexing for inflation. The government should also study the impact of having all organized non-bank regulated/unregulated financial entities (offering interest income through deposits) brought at par with banks while effecting TDS prescriptions on interest income.
- **Deregulate the Current account interest rates** with a cap. RBI should come out with a discussion paper, on this topic, highlighting the pros and cons of the suggested deregulation.

21. Additional recommendations:

- RBI must consider allocating Depositor Education and Awareness Fund, among other purpose, for educating the depositors on (a) the benefits of deducting the TDS amount from SB/Current accounts in lieu of Term deposit accounts, (b) the correct pension credits into SB accounts, and (c) advantages of seven days Term deposits (over Current accounts) with automatic roll over.
- Banking Codes and Standards Board of India, has framed certain banking codes, which sets minimum standards of banking practices for banks to follow when they are dealing with individual customers. However, it has not yet addressed the 'standards' aspects as dealt in this paper. The Board, in the public interest, should work proactively towards developing and identifying banking standards, enhancing harmony and transparency in the banking practices.

E. Benefits of the proposals

22. Within the present tax laws, this paper shows how procedures can be rationally harmonized in the interest of, not only the depositors but also, the exchequer and the banks.

23. With banks moving to application of interest at **"monthly or shorter rests"**, apart from financial gains to the depositors (to the tune of Rs 2470 crore, annually), it would bring parity across bank depositors and borrowers. This will also remove the requirement of discounting when interests are paid every month to depositors. Furthermore, to address the TDS requirements, such a move would provide operational convenience to banks and eliminate possible violations of RBI guidelines.

24. In addition to the visible gains to the depositors (to the tune of Rs 135 - 180 crore, annually) and the exchequer (to the tune of Rs 45 - 60 crore, annually), having March 31 only for TDS on accrued interest would (i) reduce hassles of excess TDS payments in case of premature closer of cumulative Term deposits; (ii) lead to operational convenience of the banks; (iii) minimize incorrect projections for determining whether aggregate of amounts of interest income credited or paid **'or likely to be credited or paid'** during the financial year by the bank exceeds the limits specified; (iv) minimize float money due to the gap between TDS date and the actual date when the bank transfers the funds to the exchequer (i.e., before 7th of the following month); (v) reduce significant paperwork / computer work for all stakeholders; (vi) provide an opportunity to the banks to utilise such deferred TDS funds during the intermediate period; and (vii) possibly provide some comfort in reducing quarter-end frictional liquidity deficit.

25. Remitting the TDS on Term deposits by debiting any other account (SB/Current) of the customer, the Term deposit remains undisturbed and continues to earn interest on full interest at a relatively higher Term deposit interest rate. When the depositors opt for the same, an additional interest income to the tune of Rs 400 - 500 crore for the depositors and additional revenue to the tune of Rs 120 - 150 crore for the exchequer is generated.

26. Enabling TDS on interest income as per correct income bracket in which a person lies would (i) eliminate the cumbersome situation and related frictions leading to intentional and unintentional defaults on the payment of full tax on interest incomes; (ii) eliminate the efforts to fill Forms 15G/15H; (iii) minimize undue TDS on interest income and thus reduce applications for tax refunds; (iv) minimize leakage of tax on deposit interest income; (v) minimize unclaimed tax refunds; and (vi) reduce the burden of banks, depositors and the Income Tax department, to track and carryout immense paperwork.

27. An appropriate identification of the real interest income (after adjusting for inflation) would lead to some relief in the current taxation on interest income. This will greatly reduce the tax burden on senior citizens and encourage more deposits to come into the formal banking channel.

28. Ensuring that TDS is prescribed to all organized non-bank entities (offering deposit products) would bring in parity on net interest incomes among parallel deposit taking institutions. It would also level the playing field between banks and non-banks and block the existing leakages in deposits of the banking sector.

F. Concluding remark

29. With the current state of satisfactory computerisation of the banks, the past difficulties on matters related to computations no longer exits. To break the ice and come out of the mindset, one has to first understand the benefits of moving from 'lack of standards' to 'setting of standards' to the advantage of the depositors, the exchequer and the banks alike.

30. There is a need to streamline the TDS procedures which is optimal to the system. RBI should play a role to ensure an equitable recovery of TDS which will not only be beneficial to the depositors, but will satisfy the requirements of the Income-Tax Act and be beneficial for the exchequer too. Thus RBI should mandate under Section 35A of the BR Act, 1949, standards to be followed by banks, to prevent banking practices that are detrimental to the interests of the depositors and the banks.

31. There is a tendency within RBI to thrust responsibilities to the depositors or bank customers when there is a trade-off between bank's administrative convenience and depositors' interest. This appears to suit RBI for its own administrative convenience, leaving the depositors at large. Is it not **too unrealistic for RBI**, to expect (i) the depositors to ask the banks to show their method of computing interest, (ii) the banks to have a comprehensive and easy to understand document for the same, and finally, (iii) the depositors to understand the method and then have the ability to compare banks? RBI needs to come out from such expectations from depositors and recognize the ground level limitations.

32. The divergent practices followed by banks are not breach of any accounting regulation. In fact, while drawing up the profit and loss account and balance sheet the banks have the prerogative to follow their own accounting policies. The ICAI has no powers to interfere with the managements of banks while they select their accounting policies. The only safeguard is that the chartered accountants while examining the profit and loss account and balance sheets can qualify their reports if the accounting policies followed by the management are at variance with the Accounting Standards prescribed by the ICAI. In fact it is the Reserve Bank which should, in the interest of banks, depositors and the exchequer alike, bring in standards on such basic accounting policies.

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Abstract

For Savings Bank (SB) deposits and Term deposits, amounting to Rs 60 lakh crore, though interest is computed on a per annum basis, Reserve Bank of India (RBI) has allowed banks to pay such interests to depositors only at quarterly or longer rests. Most of the banks are paying interest on the SB deposits at an interval of six months. In case of Term deposits, banks are usually paying interest at quarterly intervals.

As against deposit products, for loans taken from the banks, the interest is computed monthly. In other words, if a borrower defers payment of interest by two months, the banks charge two months' interest on the delayed interest payment.

RBI has deregulated rates of interest on Term deposits, SB deposits and loan accounts. However, RBI still regulates the interest application frequency on such products. While doing so, the regulator provides no rationale on why interest application frequencies on deposit accounts are different from those for loan accounts which is to the benefit of the banks and detrimental to the interest of the borrowers and, more so, depositors.

RBI has a responsibility to prevent any bias or lack of standards/transparency in interest application frequency, which is detrimental to the interests of the depositors. In view of Section 35A of the BR Act, 1949, one would like to understand RBI's rationale for deferment of its decision, for over a decade, to bring parity across deposit and loan products offered by banks. Such a delayed decision, by RBI, is at an expense of more than Rs 200 crore of depositors' money every month.

Another issue of significance is the tax deduction at source (TDS) on interest accrued on Term deposit accounts. It is highlighted that there is no harmony in the TDS procedure followed by banks on interest accrued, which has its impact on net returns. Within the present tax laws, this paper shows how procedures can be rationally harmonized in the interest of, not only the depositors but also, the exchequer and the banks.

It is time that RBI comes out with meaningful responses on the vital question of interest application frequency raised as early as April 2007 and later again in 2011. While trying to ensure that the depositors' returns are protected, we initiate a discussion under the premise that banks are for-profit companies and have the privilege of a banking licence for a social (in addition to a commercial) cause. Through this paper we attempt to reiterate the depositor's concerns and highlight the skewed benefits that the bankers may be enjoying at the expense of the depositors. Furthermore, we show how additional interest income to the tune of Rs 600 crore can be generated annually in the country through effecting proper TDS procedures on accrued interest.

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Author's note: In order to stimulate discussions and receive valued comments, the paper is being put in the public domain in form of a Technical Report.

1. Introduction

0. A graduate student approaches a bank and gets an education loan of Rs One lakh at an interest rate of 10% per annum. He intends to re-pay the principal along with interest at the end of one year. Coincidently, he receives Rs One lakh cash award from his college. The student smartly secures his award money by placing it in a Term deposit for one year with the same bank at an interest rate of 10% per annum. This example presumes same rate of interest for the education loan and term deposit for simplicity, though in practice former would always be higher than latter. His loan and his deposit start on the same date. Under the existing accounting practice by banks in India, at the end of one year would the maturity proceeds of his deposit cover the full re-payment of his loan proceeds?

1. Since 2002, banks were mandated to change the interest application frequency from quarterly to monthly for their loans and advances. Due to increase in the interest application frequency, the yield for banks on loans extended by them has increased. However, banks are allowed to pay interest on Savings Bank (SB) deposits and Term deposits only at 'quarterly or longer intervals' resulting in depositors getting relatively less yield on their deposits.

2. As early as July 7, 2011, former Deputy Governor of Reserve Bank of India (RBI), Mrs. Usha Thorat also raised this issue as quoted below

> *"...There is another regulatory issue viz. one relating to the resting period. The current RBI regulations say that interest on deposits should be paid at quarterly or longer rests. The regulations also say that on loans, interest can be charged at monthly rests. But while switching over from quarterly to monthly rests, banks should take care to see that rates did not go up merely on account of switch over. But for all practical purposes, banks can compound and charge interest at monthly rests for loan accounts while for deposit accounts they cannot have less than quarterly rests."*

Mrs. Thorat pointed out that the current asymmetry between the periodicity of interest paid to depositors on their savings account and the interest charged on their loan account needs to be reviewed by regulators in order to address the existing anomaly.

3. The question of RBI's inability, till date, on standardizing the interest application frequency is a concern since it affects the depositors towards getting a fair, transparent, and simple means of comparing banks with respect to interest payable. With the advancement in CBS technology, the bank's computing skills and the capacity of the computer system, as such, is well geared up to handle much more than this simple switchover to monthly interest payoffs from existing quarterly payoffs of interest. More

so, with the 800 million deposit accounts distributed over 80 banks in India, the exercise can hardly be any challenge for the computing capacity of the banks in India. It is important to understand as to why RBI could not bat effectively for the depositors as against possible opposition from the Indian Banks' Association (IBA) when it came to the question of standardizing the interest application frequency to monthly rests across loans and deposits?

4. RBI has a responsibility to prevent any bias or lack of standards/transparency in interest application frequency that is detrimental to the interests of the depositors. In view of Section 35A of the BR Act, 1949, one would like to understand RBI's rationale for deferment of its decision, for over a decade, to bring parity across deposit and loan products offered by banks. Such a delayed decision, by RBI, is at an expense of more than Rs 200 crore[1] of depositors' money every month.

5. Another issue of significance is the tax deduction at source (TDS) on interest accrued on Term deposit accounts. It is highlighted that there is no harmony in the TDS procedure followed by banks on interest accrued, which has its impact on net returns. Within the present tax laws, this paper shows how procedures can be rationally harmonized in the interest of, not only the depositors but also, the exchequer and the banks.

6. It is time that RBI comes out with meaningful responses on the vital question of interest application frequency raised as early as April 2007 (see reference [3]) and later again in 2011. While trying to ensure that the depositors' returns are protected, we initiate a discussion under the premise that banks are for-profit companies and have the privilege of a banking licence for a social (in addition to a commercial) cause. Through this paper we attempt to reiterate the depositor's concerns and highlight the skewed benefits that the bankers may be enjoying at the expense of the depositors. Furthermore, we show how additional interest income to the tune of Rs 600 crore can be generated annually in the country through effecting proper TDS procedures on accrued interest, which is not only in the interest of the depositors but also the exchequer and the banks.

[1] 1 crore = 10 million

2. Interest Application Frequency– Depositors Left at Large

7. By about mid 90's, RBI deregulated interest rates for Term deposits and loan accounts. Later, effective October 25, 2011, RBI also deregulated the interest rates on SB deposits. However, RBI always regulated the interest calculation method on SB deposits which, effective April 1, 2010, was set on a daily product basis.

8. For a given rate of interest, whether it is SB deposits or Term deposits, RBI has given freedom to the banks on how frequently they could pay interest to their depositors. However, this is not the case when it comes to bank loans taken by the same group of people. This difference in methodology, which has been set by RBI, is to the benefit of the banks and detrimental to the interest of the depositors. There appears to be no rationale provided by the regulator on this current scenario.

Loan Accounts: Interest Charged at Monthly Rests

9. During 2002-03, RBI changed the interest application frequency from quarterly to monthly with respect to interest on loans taken by public from the banks. This switchover of interest application frequency to monthly rests from quarterly or longer rests had become necessary to facilitate adoption of 90 days norm for recognition of loan impairment (see reference [7]). By increasing interest application frequency, the yield on the product increases. Thus banks gained while receiving interest (at monthly rests) on the loans extended by them.

10. In view of interest application frequency being monthly on loan accounts, if a borrower defers payment of interest by two months, the banks charge two months' interest on the delayed interest payment. To facilitate adoption of a 90 day norm for loan impairment, the banks could have continued to charge interest quarterly and such quarterly computed interest amount could be discounted monthly. The concept of discounting in interest computation allows interest to be paid before the due date after adjusting for the interest on the pre-payment amount. This leads to an effective reduction in the rate of interest, while making early interest payments. For example, if interest is due at 10% per annum rate after every 3 months, and one insists for the equated interest to be paid every month, it can be paid only after adjusting the 10% rate to a 9.9171% rate (see Appendix A for details). In case of loan accounts, the discounting concept is not seen where one could benefit from interest being calculated for the quarter and paid monthly at a discounted value.

Banks' Banking with RBI: Interest Applied at Monthly Rests

11. During the period 2002-03, RBI also changed the interest application frequency from quarterly to monthly with respect to (i) interests charged on

loans/refinance taken by banks; and (ii) interests paid on eligible cash reserve ratio (CRR) balances held by RBI. Since by increasing the interest application frequency, the yield on the product increases, banks gained while receiving interest (at monthly rests) on CRR balances (that has since been discontinued).

12. Reserve Bank extends refinance facility for Export Credit extended by banks. It also provides a standing liquidity facility to Primary Dealers (PDs). RBI's interest application frequency for such liquidity support to banks / PDs is monthly.

13. On the other hand as part of CRR, banks park a certain portion of their Net Demand and Time Liabilities (NDTL) with RBI. The banks earned interest on eligible CRR balances at monthly frequency. After RBI (Amendment) Act, 2006, the clause that enabled RBI to remunerate reserves was removed and effective March 31, 2007, no interest is paid on reserve balances maintained by banks with RBI. However, prior to this change, the interest payment frequency for CRR balances was monthly.

Deposit Accounts: Why Interest is Applied at Quarterly or Longer Rests?

14. For more than 700 million SB deposits and about 150 million Term deposits, though interest is computed on a per annum basis, RBI has allowed banks to pay such interests to depositors only at quarterly or longer rests. This requirement led banks to credit interest amounts into the SB and Term deposit accounts at periodicity of three months or *more*. Most of the banks are paying interest on the SB deposits at an interval of six months. In case of Term deposits, banks are usually paying interest at quarterly intervals. For Term deposits, the concept of discounting is applied in case of monthly deposit schemes where the interest is calculated for the quarter and paid monthly at discounted value. Such a discounting procedure lowers the return (compared to interest being applied monthly) for senior citizens and pensioners who usually opt for monthly payment of interests on their Term deposits and for whom the monthly interest payment are main source of flows for sustenance.

15. When (i) banks charge interest from its borrowers, on loans extended by them, at monthly rests; when (ii) RBI charges interest from the banks at monthly rests for loans given by it; and when (iii) RBI paid interest (a practice since discontinued) on eligible balances of reserves banks maintained with it at monthly rests, **why** are bank depositors treated differently? In a deregulated interest rate environment, regulating the interest payment to the detriment of the depositors reflects slipshod accounting standards in the banking industry affecting more than 800 million deposit accounts in terms of biased returns. More importantly, it implicitly requires depositors, who usually concentrate on the rate of interest and rarely on interest application frequency, to compare banks on this artificially created and unnecessary ground. It is neither desirable nor feasible for a common depositor to shop for a bank on such aspects to park her/his money which affects the earnings from their savings.

16. Throughout RBI's regulated and deregulated regime of SB / Term deposit interest rates there were lack of standards on interest application frequency leading to annual percentage yield for such accounts being different for different banks. There is no good reason for introducing such flexibility in interest computation standards which, apart from being much involved beyond the capacity of an ordinary depositor, keeps sufficient scope for non-transparency and inconvenience of artificially created comparison requirements.

Interest Application Frequency: Bank Practices Differ

17. Most of the banks are currently paying interest at the rate of 4% per annum for the SB deposit accounts. Keeping aside very few small banks (foreign and urban co-operative banks) which are paying a higher rate, Table 1 below give a list of significant banks paying a higher rate of interest.

Table 1: Savings Bank Deposit Account Interest Rate

Bank Name	**Bank Type**	**Upto Rs. 1 Lakh**	**Above Rs. 1 Lakh**
IndusInd Bank	Private	5.50%	6.00%
Kotak Mahindra Bank	Private	5.50%	6.00%
The Ratnakar Bank	Private	5.50%	6.10% *
YES Bank	Private	6.00%	7.00%
Maharashtra State Co-op. Bank	Urban Co-operative	4.50%	4.50%

* The rate is 7% for above Rs 50 Lakhs

18. In terms of SB deposit interest application frequency, we list few banks and their policy on the same in Appendix B. It is observed that baring Axis Bank and Yes Bank, all major public, private and foreign banks have six- monthly interest payment frequency. Across banks it is also observed that there need not be fixed months when interest on SB accounts are applied.

19. The application of interest at six monthly rests has been more of a legacy. It seeded more from the ease and convenience of interest computation at the pre-computer era. Such a scenario no longer exists since the country today has a satisfactory level of computerization in commercial bank. However, it is seen that because of the existing lax regulation, some banks (e.g., HDFC Bank, effective April 2011) have moved from their earlier quarterly application of interest to half yearly application. Such a move, though beneficial to the banks, is at the cost of their SB depositors.

20. Thus interest application frequency is an area where the depositors are presently getting a raw deal.

Impact of Interest Application Frequency

21. Consider, on an average, a rate of interest of 4% on SB accounts and 7% on Term deposit accounts. With a daily average of more than Rs 15,50,000 crore parked into SB deposit accounts during 2012-13, the loss to the SB depositors due to interest being paid at six month frequency instead of monthly is nearly Rs 530 crore annually. Similarly, with an average of more than Rs 45,00,000 crore held with banks in form of Term deposits, the loss to the Term depositors due to interest being paid at three month frequency instead of monthly is about Rs 1940 crore annually. We highlight the details in Table 2 below. Thus, just because of the RBI mandated compounding periodicity of quarterly or longer rests, for calculating interest, the depositors' yield on their deposits is relatively less. And this, in absolute terms, is 'less' to the tune of Rs 2470 crore in 2012-13.

Table 2: Interest Computation Based on Average Values for 2012-13

(Rs Crore)

		Deposit Type	
		SB	Term
	Principal	15,50,000	45,00,000
	RoI (% per annum)	4	7
Annual Return (AR) from Interests	Simple (AR)	62,000	3,15,000
	Half yearly (AR)	62,620	3,20,512
	Quarlerly (AR)	62,936	3,23,366
	Monthly (AR)	63,149	3,25,305
Effect of Interest Application Frequency	Monthly vs. Half yearly	**529**	4,793
	Monthly vs. Quarterly	213	**1,940**

Note: Principal amounts are average values for 2012-13

Source: Based on references [1], [11] and [12]

Reserve Requirements and Interest Application Frequency

22. In terms of Section 42 (1) of RBI Act, 1934 and Section 24 (2) (B) of BR Act, 1949, RBI, having regard to the needs of securing the monetary stability in the country, prescribes the Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR), respectively, for Scheduled Commercial Banks (SCBs). At present the CRR is prescribed at 4% of a bank's NDTL that banks have to keep as balances with the central bank. Similarly for SLR, presently prescribed at 23% of NDTL, every SCB has to maintain eligible assets in India. (See reference [9] for more details.) Thus, NDTL is the reservable liability of banks, i.e., the liability on which banks should maintain prescribed reserves in form of CRR or SLR assets.

23. **NDTL includes interest accrued on deposits** (See Para 1.7 of reference [9]). On being satisfied at the level of computerization in commercial bank branches, RBI mandated calculation of interest on SB accounts on a daily product basis (effective April 1, 2010). With the current method of interest application on SB deposits on a daily product basis, interest technically accrues on a daily basis. Given the satisfactory level of computerization, the banks are required to include in NDTL, in addition to demand and time deposits, other demand and time liabilities which includes accrued interest. As per extant guidelines of RBI, banks must include accrued interest in their NDTL computed every fortnight. On such NDTL they maintain reserves on lagged basis.

24. In order to safeguard the banking system against defaults or potential defaults, RBI ensured that interest is paid monthly in case of loan accounts for timely identification of non-performing assets and in this process also allowed the banks to apply the interest monthly. Similarly, to safeguard the banking system, liabilities of banks (including interest accrued) are to be identified on a fortnightly basis and reserves be maintained on them. However, in case of interest accrued on deposit, RBI did not find it reasonable to move from 'quarterly or longer rests' to 'monthly or shorter rests' for payment of interest for SB deposits and Term deposits. RBI's insensitivity on such an issue is detrimental to the interests of the depositors.

TDS on Interest Accrued

25. Interest income on Time deposits with banks, under Section 194A of the Finance Act 1995, is subject to TDS as per rates in force. Exemption applies if interest, or aggregate of interest during the financial year, does not exceed Rs 10,000. The bank that is responsible for paying interest on deposits is responsible for deduction of tax at source. This tax is to be deducted, as usual, at the time of credit of interest to the account of payee (i.e. Assessee) or actual payment in cash or by issue of cheque, draft, or any other mode of payment, whichever is earlier. **Even if the amount of interest is credited to any account whether called "interest payable account" or "Suspense Account", or by any other name, in the books of the bank who is paying such income** (i.e. "Payer" of the interest), the provisions of Section 194A apply (see reference [10]).

26. In view of the fact that for macro purpose the banks are required to book the accrued interest on a fortnightly basis (under RBI Act, 1934 and BR Act, 1949), the TDS should also get invoked on at least a monthly basis. Concomitantly, the interest should be paid to the depositor's account on a monthly basis. Such a move of switching interest payments and TDS thereon from "quarterly or longer rests" to "monthly rests" may thus, at a first glance, appear to be a win-win proposition not only to the depositors but also to the exchequer. We dwell upon more on this in Section 4.

27. Finally, though RBI may have set a *rule* on the interest application frequency as quarterly or longer rests, with the introduction of TDS on Term deposit interest income (and for operational ease), many banks, *in violation of the outdated rule*, may have moved away from crediting interest to the account at the end of the quarter from the date of deposit (anniversary quarter) to crediting interest at the end of the calendar quarter. Thus, from operational convenience too, banks should move to interest being paid at monthly or shorter rests. This will also remove the requirement of discounting when interests are paid every month to depositors.

International Practice on Interest Application Frequency

28. Majority of the banks in USA, Canada, UK, France, Germany, Australia and New Zealand, follow the principle of monthly or shorter rests for paying interest to the deposit accounts. The same holds for China, Hong Kong, Taiwan, Japan and Bahrain. In Appendix H we provide the bank details on interest application frequency for some of these countries.

29. In USA, the **Truth in Savings Act** was implemented through the Federal Reserve's Regulation DD, effective June 1993 (see reference [13]). It establishes uniformity in the disclosure of terms and conditions regarding interest and fees when giving out information on or opening a new deposit account. The provisions of the regulation include a requirement that depository institutions disclose an Annual Percentage Yield (APY) for interest-bearing deposit accounts. An APY provides a uniform basis for comparison by indicating, in percentage terms on the basis of one year, how much interest a consumer receives on a deposit account. On passing this law, the US Congress noted that it would help promote economic stability, competition between depository institutions, and allow the consumer to make informed decisions.

3. Non Transparent Deposit Interest Policy

30. The SB deposit account, broadly speaking, has the following features: The interest rate currently is fixed at 4% by majority of the banks, but the return is not fixed. The latter effectively becomes a variable and the net return to the depositors is affected by

i) Interest application frequency (every 3 months or more);
ii) Minimum average monthly/quarterly balance to be maintained for monthly/quarterly fee exemption; and
iii) Service charges on basic transactions carried out in the SB deposit account.

31. Similarly, for a given interest rate and a fixed tenure, the Term deposit returns may vary on account of diverse methods adopted by banks on (a) computation of interest, (b) discounting of the interest, (c) how and when TDS is applied, (d) how interest on the TDS amount is adjusted, (e) whether TDS amount is deducted from the Term deposit account or same customer's SB/Current account.

32. The flexibility provided by RBI on the interest application frequency has resulted in the APY on the deposits being different for different banks. Depositors are not able to make an objective comparison of the deposit rates as interest is credited at quarterly or longer intervals, keeping sufficient scope for variation in yield even if the interest rates are the same.

33. Given the freedom to bankers in the current setup, RBI facilitates a ***'non transparent'*** deregulated interest policy in terms of net return on funds parked under deposit accounts. **In order to enhance transparency, Monetary and Credit Policy 2002-03 proposed dissemination of effective annualised yield on deposits offered by various banks. However, this is neither being followed by banks nor has RBI ensured the implementation of its proposal.**

Biased Interest Trade-off

34. During 2012-13, the country's banking sector had an average of about Rs 15.5 lakh crore parked under SB deposits and about Rs 6 lakh crore held under Current account deposits (see references [1], [11] and [12]). The 1-year Term deposit rates, on an average, hover above the repo rate (the rate at which RBI lends to the banks). Thus considering an average repo rate of 7.5%, the Rs 15.5 lakh crore parked under SB deposits had a potential to fetch interest to the depositors to the tune of Rs 1,07,000 crore in a year. This is so since as per RBI[2], on an average, 92% of the total amount of

[2] Deregulation of Savings Bank Deposit Interest Rate: A Discussion Paper, RBI, April 28, 2011. http://www.rbi.org.in/Scripts/bs_viewcontent.aspx?Id=2344.

SB deposits held by banks always remains with the bank throughout the year[3]. However, at 4.1% average SB interest rate (with some small banks offering more than 4% interest), what is received by the depositors is only Rs 63,500 crore in a year. The prime reason why depositors' money is not receiving more interest is the banking industry's choice to retain a major chunk of the balance Rs 43,500 crore for their profitability and to cross subsidise their expenditures. Banking sector has the freedom to pass any excess cost of funds to their base rate (the minimum lending interest rate decided by banks). RBI's move on deregulation of SB rates is an attempt to let individual banks decide how best they can let go some component of this Rs 43,500 crore to the benefit of the SB depositors (based on their efficient use of cost effective technology to manage such SB deposit accounts).

35. RBI has regulated the interest rate on Current account at 0%. RBI may be aware that a very conservative estimate of the time component[4] of Current account deposits is 50%. This guides us to the fact that about Rs 3 lakh crore held in the Current accounts saves banks' interest liability to the tune of Rs 22,500 crore (at repo rate of 7.5%) or about Rs 12,300 crore (at SB rate of 4.1%) as the system currently provides nothing to the time component of the Current account deposits.

36. Over time, with the advent of information and communications technology and with the core banking system in place, the banking system has evolved where the actual cost to manage 1-year Term deposits vis-à-vis current account and savings account (CASA) deposits for one year, has a difference which is far less than Rs 66,000 crore. Thus, given that the banking sector already has in place RBI mandated *reasonable service charges* (not out of proportion of actual cost to provide the various services related to Current and SB accounts), it appears unjustified to attribute an additional disproportionately high figure of Rs 66,000 crore to manage the minimal free services of Current and SB deposit accounts.

37. The above highlights that there is a need to relax the requirement of 'no interest' on Current account deposits. It is suggested to **deregulate the Current account interest rates** with a cap. Such a cap, to begin with, could be fixed at one-fourth of the SB rate. However, it is desirable that RBI first comes out with a discussion paper, on this topic, highlighting the pros and cons of the suggested deregulation.

Effecting TDS on Interest Income— Nominal Income versus Real Income

38. As a flip side of the discussions on how and when to invoke TDS on Term deposit interest income from banks, it is pertinent to keep some scope to ponder

[3] Also called the time component of the SB deposits and is defined as the average of the minimum balances maintained in each month during the half year period.
[4] One may refer to "Debits to Deposit and Credit Accounts with Scheduled Commercial Banks: 2004-05", Reserve Bank of India Bulletin, November 2006.

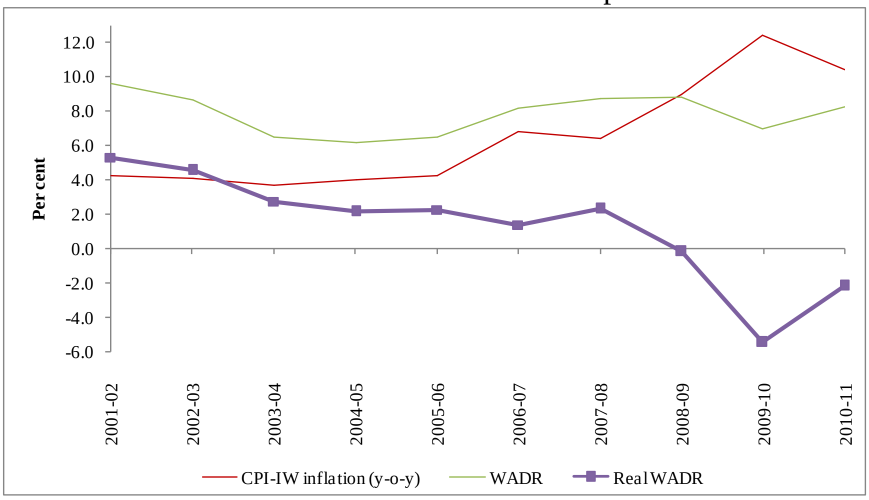
whether there should be TDS at all on Term deposits? Alternatively, should the limit on interest, before TDS is made applicable, undergo a very large quantum jump? A complete analysis of this issue needs a separate paper and thorough research. However, to put forth few points in favour of this proposal, one could argue as follows.

39. For individuals, though the taxation is on the nominal salary income, there is a compensation individuals receive for inflation through dearness allowance (DA) or wage indexation. For such recalibrations, in order to arrive at an appropriately adjusted scale of actual income, the government / institutions / organisations use the consumer price index (CPI) inflation.

40. Again, for working out the actual income in case of Long Term Capital Gains, there are adjustments done through Cost Inflation Index provided by Central Board of Direct Taxes (CBDT). Using the inflation index, one needs to increase the purchase price of the asset so that it reflects inflation-adjusted true price in the year in which it is sold. The indexation thus helps to counter the effect of inflation on the value of the asset over a period of time.

41. As against the above two scenarios, when it comes to interest incomes from bank deposits, one is already aware that such incomes when seen in real terms are very low or even negative. Moreover, even for the Term deposits- which are high yielding deposits, if one considers using CPI to work out real interest rate, the scenario looks gloomy. The real deposit rates based on CPI (Chart below) have been declining over the last decade and were negative in the recent years. Thus the rationality of taxation on nominal interest incomes is one major point in itself which the government / banks / RBI / depositors should ponder on. Currently, Tax exemption on interest earnings up to Rs 10,000 applies only for SB deposits.

Chart: Real Interest on Term Deposits



WADR: Weighted Average Deposit Rate of Term Deposits
CPI-IW (Base:2001=100): Consumer Price Index for Industrial Workers
Source : RBI - Handbook of Statistics on Indian Economy & Statistical Tables Relating to Banks in India

42. Thus, only the real interest income should be subjected to taxation. In absence of the above, the limit at which TDS is made applicable should be raised to a much higher threshold, say Rs One lakh. This will greatly reduce the tax burden on senior citizens.

Level Playing Field for Effecting TDS

43. Today apart from banks, there are other non-banking and other financial entities which accept deposits. Most of these entities are exempt from TDS prescriptions. This leads to possible leakages in deposits of the banking sector.

44. Thus, in order to bring in a level playing field and discourage flight of deposits away from the formal and regulated banking channel, TDS prescriptions should be made applicable to all organized non-bank regulated/unregulated financial entities (offering interest income through deposits). Such a move would bring in parity on net interest incomes among parallel deposit taking institutions.

4. TDS on Time Deposit Interest Income

45. As on date, in order to comply with the TDS rules, a cumulative Term deposit with a start date of March 3 will have its first interest application on March 31 (an intervening period of less than a quarter or even less than a month). Depending on bank's policy, the subsequent interest applications, for TDS purpose, are either on calendar quarter ends; or anniversary quarter ends; or on September and March ends; or only on March 31.

46. There are ***'non transparent'*** procedures adopted by banks on how TDS is done. When the banks recover the TDS, they do so as an agent on behalf of the depositors for remitting the same to the Government. TDS on accrued interest enjoys a special status, unlike other TDS, since here the interest income earns further interest on a daily basis. Therefore, how best to effect TDS so that it does not put the depositor in a loss position is a concern for all.

47. In case of cumulative Term deposit accounts, how TDS affects interest on accrued interest is considered now. The issue was very briefly highlighted as early as 2002 (see page 19 of reference [2]). In this section we attempt to highlight the disharmony in the TDS procedure followed by banks on interest accrued, which has its impact on net returns.

Post TDS Interest Yield on Cumulative Term Deposit

48. Under Section 194A of the Income Tax Act 1961, the interest incomes on Time deposits are subject to TDS. The manner in which TDS is done has its impact on the net returns of a Term deposit. Subject to existing exemptions, whenever interest is paid to an account, TDS on the interest income is required to take effect. Additionally, even at a time when interest is accrued to the account of payee (i.e. the depositor) TDS will apply. Currently, banks have adopted diverse time frames for qualifying the interest as accrued to the payee's account.

49. Just to illustrate, let us consider that a sum of Rs 40 lakh is placed under a cumulative (re-investment) deposit scheme, with quarterly compounding of interest, for a period of one year at 10% rate of interest. The Term deposit has a start date of May 10, 2013. Depending upon what method of interest computation is adopted by a bank, there may be slight variation in the maturity amount as printed on the deposit certificate (see reference [2]). Following the IBA advocated method for interest computation on Term deposits, the maturity figure on the certificate would be Rs 44,15,252 (an effective annualised percentage yield of 10.38%). Now based on what TDS procedure is adopted by the bank, the net yield would vary. Considering a 10% TDS requirement on

accrued interest, we have the following six scenarios based on how and when TDS is done on the accrued interest and whether or not the TDS amount earns future interest.

i) TDS applied on either "calendar quarters" or "anniversary quarters (in addition to March 31)"

When interest on interest is net of TDS:
Effective, post TDS, interest income **annualised percentage yield = 9.307%**
Total TDS as percentage of Deposit = 1.034%

When interest on interest is ***not*** *net of TDS:*
Effective, post TDS, interest income **annualised percentage yield = 9.343%**
Total TDS as percentage of Deposit = 1.038%

Net Interest Income leakage for the Bank = (9.343 - 9.307)% + (1.038-1.034)% = 0.040% of the deposits where TDS is applied and interest on TDS amount is paid.

ii) TDS applied on "September 30 and March 31"

When interest on interest is net of TDS:
Effective, post TDS, interest income **annualised percentage yield = 9.316%**
Total TDS as percentage of Deposit = 1.035%

When interest on interest is ***not*** *net of TDS:*
Effective, post TDS, interest income **annualised percentage yield = 9.343%**
Total TDS as percentage of Deposit = 1.038%

Net Interest Income leakage for the Bank = (9.343 - 9.316)% + (1.038 – 1.035)% = 0.030% of the deposits where TDS is applied and interest on TDS amount is paid.

iii) TDS applied on "March 31 only"

When interest on interest is net of TDS:
Effective, post TDS, interest income **annualised percentage yield = 9.334%**
Total TDS as percentage of Deposit = 1.037%

When interest on interest is ***not*** *net of TDS:*
Effective, post TDS, interest income **annualised percentage yield = 9.343%**
Total TDS as percentage of Deposit = 1.038%

Net Interest Income leakage for the Bank = (9.343 - 9.334)% + (1.038 – 1.037)% = 0.010% of the deposits where TDS is applied and interest on TDS amount is paid.

50. The procedure used while arriving at the yields involve working out the interest on the TDS amount from the date of TDS till the date of maturity and subtracting the same from the maturity amount. For the detailed workout on the above yields, see Appendix C. We would like to mention that though we have taken a one year deposit (at interest rate of 10% per annum) with a start date of May 10, 2013, to demonstrate the effect of TDS date on accrued interest, the same exercise has been done by taking each possible start dates during the period April 1, 2012 through March

31, 2013. While the results vary to some extent, the overall conclusion remains the same. Furthermore, given that about 74% of the deposits are for tenures one year or more and 33% of the deposits are for tenures two years or more (see Table 4.1 of reference [11]), in cases where deposits are for tenures longer than one year, the values under the above six scenarios would be higher.

Disharmony in TDS application on Interest Income

51. In order to study the actual practice adopted for application of TDS on Term deposits by banks, a select set of banks were approached. The 19 banks selected represent the banking sector in India fairly well. Table 3 provide significant information on: (i) When do the banks accrue interest in the account of the payee, (ii) Whether on the TDS amount (deducted from the account in-between the tenure of the deposit) the bank ceases to pay interest, and (iii) Does the bank give an option to debit the TDS amount from a linked SB/Current account of the depositor.

Table 3: Impact of TDS on Accrued Interest Income from Term Deposits

Impact of TDS on Term Deposits					
S. No.	**Bank Name**	**Bank Type**	**TDS Application (Accrued when?)**	**Interest on Interest Net of TDS**	**Option provided to debit TDS from SB/Current Account**
1	State Bank of India	Public	31st Mar. only	Yes	Yes
2	Bank of Maharashtra	Public	31st Mar. only	Yes	Yes
3	Canara Bank	Public	31st Mar. only~	Yes	No
4	United Bank of India	Public	Sept. end and Mar. end	Yes	No
5	Corporation Bank	Public	Sept. end and Mar. end	Yes	No
6	Bank of Baroda	Public	Sept. end and Mar. end	Yes	No
7	Bank of India	Public	Sept. end and Mar. end	Yes	Yes
8	Union Bank of India	Public	Sept. end and Mar. end	Yes	Yes
9	IDBI Bank	Public	Anniversary Quarter*	Yes	No
10	ICICI Bank	Private	31st Mar. only	Yes	No
11	Axis Bank	Private	Calendar Quarter	No	Yes
12	ING Vysya Bank	Private	Calendar Quarter	Yes	No
13	HDFC Bank	Private	Anniversary Quarter + 31st Mar.	Yes	No**
14	Kotak Mahindra Bank	Private	Anniversary Quarter + 31st Mar.	Yes	No
15	Yes Bank	Private	Anniversary Quarter + 31st Mar.	Yes	No
16	Indusind Bank	Private	Anniversary Quarter + 31st Mar.	Yes	Yes
17	Citibank	Foregin	Anniversary Quarter + 31st Mar.	Yes	No
18	HSBC	Foregin	Anniversary Quarter + 31st Mar.	Yes^	Yes
19	Standard Chartered	Foregin	Anniversary Quarter + 31st Mar.	Yes	Yes

~ Before April 2012, the Application was Quarterly
* Does not additionally apply TDS on March 31. However, the bank provides an option for Calendar Quarter TDS application
** The bank likely to provide the Option in due course of time.
^ Before September 2011, the answer was No

TDS on Accrued Interest Annually on March 31 only— Benefits

52. It is observed that a significant number of banks still resort to showing accrual of interest, into the Term deposit account, more than once in a year. There has been a lot of confusion, since the introduction of TDS on interest income, on how to account for the virtual interest income which takes place due to quarterly compounding in cumulative deposit accounts. Theoretically and technically, under quarterly

compounding, accrued interest at quarter ends should get credited to the deposit account in order to earn further interest on 'principal plus interest', and thus as per Section 194A of the Income Tax Act 1961, TDS on such an accrued interest should take effect. This concept got re-iterated later, in the Finance Act 1987. The accrued interest (not paid) on Time deposits enjoys a special status since accrued interest earns further interest, i.e., it cumulates. Thus, the question of when to do TDS on such accrued interest is not only a concern for the banks but also the depositors and for the Government. Now, through Government's facilitation of deferment in TDS realization (see Appendix D), the banks have the freedom to qualify the date of accrued interest annually on March 31 only. This twist of events is seen more as an operational convenience for the banks. However, what we highlight now is that the move of effecting TDS on accrued interest annually on March 31 only, is not only beneficial to banks but also the depositors, the Government and thus, all stakeholders in the country.

53. The move creates a potential, for the government, to earn additional tax on additional interest income. Moving from TDS every quarter to TDS only on March 31, the additional TDS is of the order of 0.0031*0.4 = 0.0012% of the deposit amount (see Appendix C). Similarly, while moving from TDS every six months to TDS only on March 31, this additional TDS is of the order of 0.0020*0.4 = 0.0008% of the deposit amount. Here, we assume that 40% of interest income are of the accrued nature and subjected to TDS[5]. Furthermore, currently less than 30% of the banks' accrued interests are subjected to TDS annually on March 31 only rather than every three/six months (in addition to March 31). Thus, in absolute terms, moving the 70% of the banks' accrued interest income that is still subjected to TDS at every quarter or every six months to TDS annually on March 31 only, the exchequer would gain to the tune of (45,00,000*0.7*{0.0012*10+0.0008*5}/1500 =) Rs 34 crore. Here, based on the sample banks, we have taken the ratio of banks doing TDS every three months vis-a-vis every six months as 10:5. Again, if one considers (i) TDS at the 20% rate in the absence of permanent account number (PAN) and (ii) TDS at the 30.9% rate on NRO deposits (which is about Rs 55,000 crore), these tax revenues would increase. Furthermore, considering that most of these interest incomes would fall in the 30% bracket, the exchequer could gain as high as Rs 100 crore by just asking the banks to do TDS on accrued interest only on March 31.

[5] Based on the percentage distribution of Term deposits of banks according to size of deposits (see Table 1.29 of reference [12]), it is observed that about 87% (62%) of the Total deposit amount arises out of deposits having sizes of Rs one lakh (15 lakh) or more. One could expect majority of such deposits falling under the TDS net. After accounting for the four scenarios (i) Forms 15G/15H provided, (ii) deposits are under non-cumulative (monthly or quarterly payoff) schemes, (iii) deposits of Government Sector (which is 15% of the Total deposits (see Table 4.2 of reference [11]), and (iv) deposits under FCNR and NRE accounts (which is 7% of the Total deposits (see Table 33 of reference [14]), a conservative estimate of the deposit amount accruing interest under the cumulative deposit scheme and is being subject to TDS is 40% of the Total deposit amount.

54. The additional interest income generated by the depositors' funds parked under Term deposits would be of the order of Rs 300 crore if all those banks that are still doing TDS on accrued interest at every quarter ends or every six months move to doing TDS annually on March 31 only. This follows from Appendix C on noting that the additional effective yield is (9.334-9.307)% = 0.0276% if TDS is done annually on March 31 only instead of quarter ends. Similarly, the additional effective yield is (9.334-9.316)% = 0.0182% if TDS is done annually on March 31 only instead of every six months. Thus for Rs 45 lakh crore of Term deposits, (after accounting for the 40% of the interest income that are of the accrued nature and eligible for TDS, and after considering that only 70% of the accrued interest are subjected to TDS every three/six months rather than March 31 only,) in absolute terms the additional interest is (45,00,000*0.4*0.7*{0.0276*10+0.0182*5}/1500 =) Rs 308 crore.

55. As indicated, the above computations are based on a rate of interest of 10% per annum and furthermore the deposit runs for one year with a start date of May 10, 2013. In order to arrive at more general results, the exercise was done for 12 scenarios, i.e., with start date as 10^{th} of each of the 12 months (April 2012 through March 2013). An average rate of interest of 9% per annum is taken since 43% of the deposit amounts are earning a rate of interest of 9% or more (see Table 1.28 of reference [12]). By not moving towards effecting TDS on accrued interest annually on March 31 only, the income losses (for the exchequer and the depositors) in each of the 12 scenarios are presented in Appendix E. It follows that during 2012-13, on an average, the loss to the exchequer is about Rs 60 crore and that for the depositor is Rs 180 crore. In order to arrive at an interval estimate, considering that only 30% (instead of 40%) of the interest income are of the accrued nature and eligible for TDS, on an average, the loss to the exchequer is about Rs 45 crore and that for the depositor is Rs 135 crore.

56. In addition to the visible gains to the depositors and the exchequer, having March 31 only for TDS on accrued interest would (i) reduce hassles of excess TDS payments in case of premature closer of cumulative Term deposits; (ii) lead to operational convenience of the banks; and (iii) minimize float money due to the gap between TDS date and the actual date when the bank transfers the funds to the exchequer (i.e., before 7^{th} of the following month).

57. In view of Section 194A of the Income Tax Act, 1961, TDS has to take effect whenever the aggregate of amounts of interest income credited or paid **'or likely to be credited or paid'** during the financial year by the bank exceeds the limits specified (currently Rs 10,000). In view of the clause **'or likely to be credited or paid'**, banks have adopted their own policies on how to interpret it and accordingly, banks have set different algorithms to check whether or not the aggregate of amounts of interest income credited or paid 'or likely to be credited or paid' during the financial year exceeds the limits specified. In other words, there prevails a disharmony on this basic issue as well, which has its impact on net returns. Just to illustrate, HDFC Bank and

Axis Bank (to name a few), ignoring projected interest income, invokes TDS only when the actual aggregate of current and past amounts of interest income in the financial year breaches Rs 10,000. On the contrary Kotak Mahindra Bank and HSBC (again, to name a few) after having evolved algorithms based on projected figures, invokes TDS even when the actual aggregate of current and past amounts of interest income in the financial year hasn't breached Rs 10,000. Such a policy of the bank may lead to situations where the actual interest turns out to be less than the projected interest income (of Rs 10,000 or more). Switching to 'March 31 only' for TDS on accrued interest would minimize incorrect projections.

58. A possible concern for the government, in switching to 'March 31 only' for TDS on accrued interest, could be decline in continuous flow of revenues for its day to day expenses. However, considering that TDS amount of about Rs 10,000 crore on accrued interest is withdrawn and paid out of the Term deposits annually, and the fact that persistently high government cash balances are being maintained with RBI keeping the liquidity deficit beyond the Reserve Bank's comfort zone[6], it may sound more meaningful for the economy to switch to the 'March 31 only' norm and thus (i) generate additional income / revenue for the depositors / exchequer, (ii) reduce significant paperwork / computer work for all stakeholders, (iii) provide an opportunity to the banks to utilise such deferred TDS funds during the intermediate period, and (iv) possibly provide some comfort in reducing quarter-end frictional liquidity deficit[7].

59. Finally, where TDS on accrued interest is being done only on March 31, banks may still show the quarterly accrued interest on deposits under their expenditure head every quarter while working out their profit-loss statement for advance tax purpose. There is a question on the banks being formally allowed to show the expenditure on accrued interest under their expenditure head in their quarterly profit-loss account, while at the same time not recognizing the quarterly accrued interest for TDS purpose.

Impact of TDS— Banks Paying Interest on Nonexistent Funds

60. There are few banks that **do not** cease to pay interest on the TDS amount once it takes effect in-between the tenure of the deposit. Based on a one year deposit with start date of May 10, 2013 (RoI = 10% per annum), this amounts to **Net Interest Income leakage for the Bank to the tune of, as high as, 0.040% of the deposits where TDS is applied.** For Axis Bank, the Total Term deposits are of the order of Rs 1.35 lakh crore (See Table B1 of reference [12]). Thus, considering that 40% of this amount is being exposed to Net Interest Income leakage, this works out to about (1.35*0.4*0.040/100 =) Rs 22 crore. Now, considering a rate of interest of 9% per annum, in general (see Appendix E), the Net Interest Income leakage for Axis Bank

[6] See reference [1] and Appendix I for more details.
[7] During quarter-end when tax payment flows out of the bank deposits into Government account, the liquidity situation becomes tight causing a frictional liquidity pressure on the system.

alone is about Rs 17.4 crore annually. Axis Bank has indicated (see Appendix J) that the interest reinvested is gross of TDS recovery for only Term deposits with a value less than Rs 5 crore. For Term deposits worth more than Rs 5 crore, the bank compound interest post TDS recovery. Accordingly, we find it appropriate to provide an interval estimate of the bank's losses due to not having universally adopted a more rational procedure of adjusting for the interest on the TDS. Referring to Table 1.29 of reference [12], one could reasonably consider that some 20% to 30% of the bank's Term deposits contribute towards deposits having sizes more than Rs 5 crore. Since we have already accounted for most of such deposits while taking the 40% measure for amounts exposed to Net Interest Income leakage, by adjusting for an additional 10% of the bank's Term deposit amounts would lead us to a figure of (17.4*0.3/0.4 =) Rs 13.1 crore. Thus, *prima facie* the Net Interest Income leakage for Axis Bank alone is in the range of Rs 13.1 - 17.4 crore annually.

61. It appears banks have embraced one among the various methods for adjusting the interest on the depleted deposit caused by TDS on accrued interest. There are situations where bank's policy on this is guided more by the CBS software application rather than the bank's policy guiding the CBS. Even when interest on interest is being worked out net of TDS, we find many banks overpaying net interest (i) by not appropriately *discounting* a part of the interest amount when TDS on accrued interest takes effect before end of a full quarter and (ii) by not appropriately working out the exact interest post TDS (at several intermediate periods).

62. It is observed that many banks have adopted paying part of the interest (without discounting) before it is due just to accommodate the TDS requirement. This appears to be in violation of the RBI's current guideline that interest should be paid at quarterly or longer rests. Specifically, in the anniversary quarter-end (in which March 31 gets captured), many banks (e.g. HDFC Bank, Bank of Maharashtra, Standard Chartered Bank, Citibank and State Bank of India (SBI)) do not adjust for the interest on the TDS amount paid on March 31, while capitalising the interest to the principal in the new quarter. As against this, there are banks that do make the adjustments correctly (e.g. HSBC, ICICI Bank and Kotak Mahindra Bank).

63. We now illustrate the case of non-adjustment of the interest on the TDS amount in the quarter that has March 31 in-between. Workout-1 of Table 4 demonstrates the situation. To overcome the lacuna, through Workout-2 of Table 4 we suggest a modified method where an adjustment is made on April 1, 2013 to the intermediate principal by an amount equal to the TDS amount.

Table 4: Illustration of TDS (March 31 only) on Interest Income from a Term Deposit

Workout-1

Deposit Amount (Rs)	9,00,000
Original Tenor	12 Months
RoI	8%
Start Date	10-Sep-12
Maturity date	10-Sep-13

Incomplete adjustment of interest due to TDS on March 31

Tax deducted @ 10%

FD AMT	START DATE	END DATE	QUARTER / DAYS	RATE OF INTEREST	GROSS INTEREST	TDS AMT	NET INTEREST
900000	10-Sep-12	9-Dec-12	1Q	8.00%	18000		
918000	10-Dec-12	9-Mar-13	2Q	8.00%	18360		
936360	10-Mar-13	31-Mar-13	22	8.00%	4478		
				Accrued interest as on March 31st 2013	**40838**	**4,084**	**36,754**
936360	1-Apr-13	9-Jun-13	70	8.00%	14249		
951003	10-Jun-13	9-Sep-13	4Q	8.00%	19020		
				Accrued interest as on Sep. 10th 2013	**33269**	**3,327**	**29,942**
				Total Interest paid on Sep. 10th 2013	**74107**	**7,411**	**66,697**

Workout-2

Deposit Amount (Rs)	9,00,000
Original Tenor	12 Months
RoI	8%
Start Date	10-Sep-12
Maturity date	10-Sep-13

Correct adjustment of interest due to TDS on March 31

Tax deducted @ 10%

FD AMT	START DATE	END DATE	QUARTER / DAYS	RATE OF INTEREST	GROSS INTEREST	TDS AMT	NET INTEREST
900000	10-Sep-12	9-Dec-12	1Q	8.00%	18000		
918000	10-Dec-12	9-Mar-13	2Q	8.00%	18360		
936360	10-Mar-13	31-Mar-13	22	8.00%	4478		
				Accrued interest as on March 31st 2013	**40838**	**4,084**	**36,754**
932276	1-Apr-13	9-Jun-13	70	8.00%	14187		
950941	10-Jun-13	9-Sep-13	4Q	8.00%	19019		
				Accrued interest as on Sep. 10th 2013	**33206**	**3,321**	**29,885**
				Total Interest paid on Sep. 10th 2013	**74044**	**7,404**	**66,639**

64. Finally, just to demonstrate the effect of non-adjustment of the interest on the TDS amount paid on March 31, while capitalising the interest to the principal in the new anniversary quarter (and while paying interest under non-cumulative deposit schemes), we consider SBI alone. As per SBI's balance sheet (Schedule 5 – Other Liabilities and Provisions) as on March 31, 2013, the interest accrued is Rs 13,333 crore. Since SBI is crediting interest to the SB accounts in June and December ends, there is a component of accrued interest due to SB deposits. And this component is Rs 4100 crore (taking Rs 4.1 lakh crore as SB deposits of SBI). Thus primarily, Rs 9,200 crore is the accrued interest due to Term deposits and borrowings. Factoring out accrued interest due to borrowings and other situations where TDS is not taking effect, a conservative estimate is that only 40% to 50% of such interest accrued is getting affected to non-adjustment of the interest on the TDS amount paid on March 31, while capitalising the interest to the principal in the new anniversary quarter (and while paying interest under non-cumulative deposit schemes). Thus, on Rs 3,700 - 4,600 crore there is a 10% TDS, amounting to Rs 370 - 460 crore. Now, on an average, there would be an excess interest payment on this amount for a period of 45 days (during the intermediate period before the anniversary quarter ends). This would lead to (taking interest rate of 8% per annum) an **excess interest payoff of Rs 3.7 - 4.6 crore by SBI**. Again, this excess interest

payoff of Rs 3.7 - 4.6 crore would have a multiplier effect (in case of cumulative deposits at every further anniversary quarter ends), before the deposits finally mature.

TDS on Interest Income Recovered from CASA Deposits

65. Regarding banks giving an option to debit the TDS amount from a linked SB/Current account of the depositor, less than 40% of the banks appear to provide the option. However, based on actual branch visits of these banks, it is observed that (except for HSBC) neither is the option indicated on the application form for opening Term deposit account (or any other published documents meant for the depositor), nor is the branch staff aware of the feasibility of offering the option of debiting the SB/Current account instead of the parent Term deposit account.

66. The issue of TDS on Term deposits has a history. When, in 1995, the government first introduced TDS on interest from Term deposits, banks were in a difficult situation since it amounted to iterative withdrawal of some component of the Term deposit's interest as tax. This lead to some complications involved in arriving at the maturity amount. There were no readily available customized computer packages to execute it effectively.

67. As a first step, the IBA deliberated on the issue based on its interaction with CBDT. Accordingly, IBA advised the banks (see Appendix F) that they may remit the tax amount deducted at source on a Term deposit (say earning 9% per annum interest) by debiting any other account (SB/Current) of the customer without disturbing the Term deposit. This way, the Term deposit continues to earn interest on full interest at a relatively higher Term deposit interest rate. IBA correctly expressed that this is in the interest of the depositors with no difference to the exchequer. In fact, such a proposal is not only gainful to millions of depositors but also to the exchequer. IBA had advised the banks that they should, in the interest of their depositors, educate every depositor of the option for paying the TDS amount on Term deposits separately out of their SB or Current account.

68. With time, computer packages got customized, **but not the provision to provide option to the depositors**. Now that the banks have the computer technology for providing this option, the question that needs to be addressed is:

> *Would a bank allow a customer to debit the TDS amount from his Savings/Current account or is it a unilateral decision of the bank to necessarily pull out the TDS amount from the depositor's high yielding Term deposit?*

69. As on date IBA and RBI have, by not bringing out any guideline, implicitly indicated that the prerogative lies only with the banks to allow or not to allow a customer to pay the TDS amount from the customer's SB/Current account. Even though RBI is fully aware that such an option is beneficial to the depositors (and also, as per

IBA, beneficial to the banks), RBI has allowed the banks to reserve the right to provide or not to provide the option. And if for a bank the procedure is not convenient, resulting in the bank's not providing the option, RBI has no consideration for the depositors. In this connection, IBA gives a rationale as to why option need not be provided for by the banks and I quote,

> *"...the depositor should insist for option. If a particular bank does not provide for the same at the time of opening the account, which is not in the interest of the customer, in the present context of liberalization, banks may lose its client. The RBI also cannot insist for a uniform pattern to be followed by all banks in the present competitive/liberalized environment."*

70. However, in a situation where effectively none of the banks are transparent in providing the option (with less than 40% of the banks providing the option that too in letter but not in spirit), the assertion of IBA does not hold. Thus, the vital question that RBI needs to address is ***'to what extent would the banks be allowed by RBI to gain convenience at the cost of achieving feasible optimal procedures keeping in mind the interests of the depositors?'***

71. In 2012-13, about Rs 3.2 lakh crore interest was paid on Term deposits. Considering that 40% of this amount is accrued interest that is being exposed to TDS (at the 10% TDS rate), a total of about Rs 12,800 crore is withdrawn and paid out of the Term deposits as TDS while the Term deposit is still running. Had an option been provided by the banks and the depositors educated to opt for the same, **an additional interest income to the depositors would have been about Rs 512 crore.** (Here the differential is obtained by taking average Term deposit interest rate of 8% per annum and SB deposit rate of 4% per annum.) As a bonus, this would also lead **the exchequer generating an additional revenue of about Rs 154 crore** (say, at 30% tax rate), on the additional interest income. A similar argument, based on considering that 30% of Rs 3.2 lakh is accrued interest that is being exposed to TDS, would lead to Rs 384 crore as the additional interest income to the depositors and Rs 115 crore as the additional revenue generated by the exchequer.

72. Just to add rigour, we would like to emphasise that the additional income would be higher when one adjusts for the proportion of TDS amounts paid out of Current accounts, earning interest at 0% per annum rate, as against 4% per annum for SB accounts. Thus the overall estimates provided here are quite conservative.

73. When the banks recover the TDS, they do so as an agent on behalf of the depositors for remitting the same to the Government. Therefore, though it may *prima facie* appear that it is entirely the bank's prerogative to decide which account to tap to recover the TDS (whether the SB, Current or Term deposit account), actually it is the depositor who, being the principal, should have the primary right to decide from which of his accounts such TDS amounts should be recovered. The banks, it appears, should

not exercise the option of recovering the TDS in such a manner as to put the depositor in a loss position. Thus, it is only RBI who can play a role to ensure an equitable recovery of TDS which will not only be beneficial to the depositors, but will satisfy the requirements of the Income-Tax Act and be beneficial for the exchequer too. Thus RBI should mandate under Section 35A of the BR Act, 1949, standards to be followed by banks, to prevent banking practices that are detrimental to the interests of the depositors and the banks.

Reforms Inevitable to Minimize Chaos

74. Though some banks are doing TDS on the accrued interest on a half yearly basis or only on March 31, it is gathered that for the purpose of bank's quarterly balance sheet, the accrued interest parked in the provisioning or interest payable account (for macro-monitoring only) is used for arriving at the bank's quarter-end profit-loss and the bank's tax liability.

75. Additionally, every anniversary/calendar quarter, the banks while compounding interest, add the accrued interest to the deposit. In other words, an accrued interest remains accrued interest only till the compounding date arrives. Thereafter it becomes part of the deposit. This also gets reflected accordingly in the quarterly balance sheets of the banks where the deposit figure is also declared.

76. The divergent practices followed by banks are not breach of any accounting regulation. In fact, while drawing up the profit and loss account and balance sheet the banks have the prerogative to follow their own accounting policies. The Institute of Chartered Accountants of India (ICAI) has no powers to interfere with the managements of banks while they select their accounting policies. The only safeguard is that the chartered accountants while examining the profit and loss account and balance sheets can qualify their reports if the accounting policies followed by the management are at variance with the Accounting Standards prescribed by the ICAI. In fact it is the Reserve Bank which should, in the interest of banks, depositors and the exchequer alike, bring in standards on such basic accounting policies.

77. Currently, TDS under Section 194A generates revenue of the order of Rs 15,000 crore annually. The Income Tax Department of India through its continuous research endeavors to formulate progressive tax policies and make compliance easy. In this process, it has adopted technology as an enabler for improved service delivery.

78. In the present environment of TDS on Term deposits, there is no aggregation of individual deposit across banks. There is a requirement for every assessee to work out tax (or balance tax) liability on interest income and make such tax payments separately to the government. Such a cumbersome situation and related frictions lead to intentional and unintentional defaults on the payment of full tax on interest incomes.

Again, those who have PAN and are in the 'no tax' bracket (or even when not sure whether they would be in the no tax bracket) have to make efforts to fill Forms 15G/15H or else have TDS invoked and then apply for a refund later. Though the PAN data with banks are well organized, for interest income from banks, currently there is enough scope (i) for leakage of tax, (ii) for unclaimed tax refunds, and (iii) for banks, depositors and the Income Tax department being overburdened to track and do immense paperwork. The Income Tax department could look for ways to circumvent the not-so-straight-forward compliance procedure.

79. This raises a question on the possibility of enabling deduction of tax at source on Term deposit / SB deposit interest income as per correct income bracket in which a person lies. With the current satisfactory level of computerization in banks and the Income Tax Department alike, it may be appropriate to set a roadmap for the banks to query tax bracket information (of the previous year) against PAN from Income Tax Department and execute TDS as per the tax bracket rate. Depositors should have a provision to submit a new form (say, Form W1) instructing the rate of TDS, overruling the tax bracket rate as per database. This would eliminate the requirement of Forms 15G/15H. In case PAN is not registered, the 20% rate (or any desirable rate) of TDS to continue when interest paid/accrued during the financial year by the bank exceeds the limits specified. It may be desirable to deliberate on the PAN related confidentiality issues and bank's responsibility in such matters under existing laws. There are pros and cons to the proposal and if the pros dominate the cons, in the interest of the depositors, tax payers, banks and the exchequer, it may be worthwhile for the Government to work towards it.

Need for Financial Education and Accounting Standards

80. Pursuant to the enactment of The Banking Laws (Amendment) Act, 2012, under Section 26A of the BR Act, 1949, RBI is empowered to establish a Depositor Education and Awareness Fund (DEAF), that will be credited with the balances from accounts that have not been operated upon / claimed for a period of ten years or more. DEAF will be earmarked for promotion of depositors' interest and for such other purposes considered necessary for the promotion of depositors' interests. Accordingly, the Fund, among other purpose, could also be utilised for educating depositors on

(a) the benefits of deducting the TDS amount from SB/Current accounts in lieu of Term deposit accounts,

(b) the correct pension credits into SB accounts,

(c) advantages of seven days Term deposits (over Current accounts) with automatic roll over,

(d) advantages of moving to banks who do not put any penalty for premature withdrawal and make it worthwhile for depositors to go in for the maximum rate, and

(e) advantage of shifting to banks which offer higher rates on SB deposits.

81. Banking Codes and Standards Board of India (BCSBI), since its inception in 2006, has brought out certain codes of Bank's commitment, which sets minimum standards of banking practices for banks to follow when they are dealing with individual customers. However, it has not yet addressed the 'standards' aspects as dealt in this paper. The Board should also, as its name suggests, work proactively towards identifying banking standards, for the good of the banking system. It is suggested that BCSBI develops and identifies good banking standards to enhance harmony and transparency in the banking practices.

5. Closing Remarks and Recommendations

82. This paper addresses issues pertaining to interest application frequency and TDS methodologies adopted by banks that have been left unattended for quite some time.

83. On interest application frequency, the current RBI regulations say that interest on deposits should be paid at quarterly or longer rests. While for loan accounts banks can levy interest at monthly rests, for deposit accounts they cannot pay at less than quarterly rest. The regulation gives banks the freedom to decide, in a non-transparent fashion, the net returns on deposits held by them. On the other hand the existing framework burdens the depositors with the problem of shopping among various banks for the most attractive methodology used in their interest application and computation procedures. The depositor is neither capable to make such comparisons nor aware that such matters affect his return. And depositors' ignorance is a big asset for banks.

84. With the current state of satisfactory computerisation of the banks, the past difficulties on matters related to computations no longer exit. To break the ice and come out of the mindset, one has to first understand the benefits of moving from 'lack of standards' to 'setting of standards' to the advantage of the depositors, the exchequer and the banks alike.

85. For individuals, though the taxation is on the nominal salary income, there is a compensation individuals receive for inflation through DA or wage indexation. Similarly, while applying taxation on Long Term Capital Gains, the amount is indexed to inflation and only the inflation adjusted capital gains are taxed. However, when it comes to interest incomes from bank deposits, one is already aware that such incomes when seen in real terms are very low or even negative. Moreover, even for the Term deposits- which are high yielding deposits, if one considers using CPI to work out real interest rate, the scenario looks gloomy as the inflation adjusted income is by and large negative. Thus, only the real interest income should be subjected to taxation. In absence of the above, the limit at which TDS is made applicable should be raised to a much higher threshold, say Rs One lakh. This will greatly reduce the tax burden on senior citizens.

86. Today apart from banks, there are other non-banking and other financial entities which accept deposits. Most of these entities are exempt from TDS prescriptions. This leads to possible leakages in deposits of the banking sector. Thus, in order to bring in a level playing field and discourage flight of deposits away from the formal and regulated banking channel, TDS prescriptions should be made applicable to all organized non-bank regulated/unregulated financial entities (offering interest income

through deposits). Such a move would bring in parity on net interest incomes among parallel deposit taking institutions.

87. As on date, there is no harmony on TDS procedure on Term deposits held in banks. There are lack of standards on (i) how and when TDS should be applied, (ii) how interest on the TDS amount is adjusted, and (iii) whether there should be provision for deducting the TDS amount from the customer's SB/Current account.

88. One needs to ensure that a proper system is put in place through a proactive look into the (lack of) accounting standards relating to such a micro issue having macro implications. It is time attempts are made to standardize the procedures, which has its impact on net returns. If within the present tax laws, procedures can be rationally harmonized which is not only in the interest of the depositors but also the exchequer and the banks, why should RBI not invoke Section 35A of the BR Act, 1949 to issue appropriate guidelines? Additionally, given that TDS on interest income from Term deposits is being executed by the organized banking sector and the electronic process is also automated, there is much scope to implement the correct TDS amount based on correct income bracket of the payee.

89. There is a tendency within RBI to thrust responsibilities to the depositors or bank customers when there is a trade-off between bank's administrative convenience and depositors' interests. This appears to suit RBI for its own administrative convenience, leaving the depositors at large. Is it not **too unrealistic for RBI**, to expect (i) the depositors to ask the banks to show their method of computing interest, (ii) the banks to have a comprehensive and easy to understand document for the same, and finally, (iii) the depositors to understand the method and then have the ability to compare banks? RBI needs to come out from such expectations from depositors and recognize the ground level limitations.

90. Looking at the impact of disharmony in interest payments on bank deposits, it is noteworthy that in 2012-13 alone,

i) about Rs 2,470 crore of interest income on SB and Term deposits could not be generated due to interest application frequency not being at monthly rests,
ii) Rs 135 - 180 crore of additional interest income for the depositors could not be generated since all banks are not doing TDS on accrued interest annually on March 31 only,
iii) Rs 45 - 60 crore additional revenue to the exchequer was lost due to many banks not doing TDS on accrued interest annually on March 31 only,
iv) Rs 13 - 17 crore had been Axis bank's interest income leakage due to non-adjustment of the interest on the TDS amount,
v) Rs 3.7 - 4.6 crore had been SBI's excess interest payoff due to non-adjustment of the interest on the TDS amount paid on March 31, while capitalising the

interest to the principal in the new anniversary quarter (and while paying interest under non-cumulative deposit schemes).

vi) Rs 400 - 500 crore of additional interest income for the depositors could not be generated since banks were not proactive in promoting and educating the depositors on the benefits of TDS from SB/Current accounts in lieu of Term deposit accounts,

vii) Rs 120 - 150 crore additional revenue to the exchequer was lost since banks did not mobilise options from the depositors for doing TDS from SB/Current accounts in lieu of Term deposit accounts,

viii) nothing, of about Rs 12 - 22 thousand crore worth of virtual interest income on Current accounts, could be shared with the depositors, since interest rate is fixed at 0%.

91. One major concern of the banks, and correctly so, is the cost implication for modification of their CBS applications. The tweaking that would be required are:

i) In the term deposit creation module provide for a linked SB/Current account number from where TDS would take effect.

ii) Whenever the linked account cannot provide for the full funds required for TDS, the Term deposit account should substitute the linked account.

iii) Accrued interest to be credited into the deposit account annually on March 31 only and TDS executed.

iv) Interest application frequency to be increased to monthly or shorter rests.

v) Pay accrued interest into the SB account every month end.

vi) Algorithm for paying interest to be standardized, e.g., for a Term deposit with start date May 10, 2013 and end date May 10, 2014, we could follow a routine as illustrated/proposed in Appendix G.

92. The CBS servicing cost to make such tweaks would vary from bank to bank. However, based on discussion with banks, an impressionistic assessment of an average cost per bank would be in the range of Rs 30-100 lakh. In other words for the banking industry in totality it may cost about Rs 50-60 crore to bring in the standards. This would be a one time investment to embrace meaningful standards for deposit accounts.

93. Broad recommendations based on the study include:

- In order to bring parity across all customers of banks (depositors and borrowers), for deposit accounts RBI should **make interest application frequency as "monthly or shorter rests"**. Since the decision has been already delayed a lot, this should be announced at the earliest and brought into effect latest by April 2014.
- TDS on accrued interest (not paid) to take effect only annually on March 31. All banks to **migrate to the "March 31 only" norm for TDS on accrued interest** by April 2015, if not by April 2014. RBI may consider issuing appropriate guidelines.

- Banks to be formally allowed to show accrued interest on deposits under their expenditure head while working out profit-loss statement during quarter ends and for advance tax purpose. The ICAI should take necessary action.
- **Banks to necessarily provide the option** to debit the TDS amount, on the accrued interest, from the customer's SB/Current account. Such an option should necessarily be indicated on the account opening application form. RBI may consider instructing banks accordingly.
- Banks to sync the tax bracket information (of the previous year) against PAN from Income Tax Department and execute TDS as per the tax bracket rate. Depositors to have a provision to submit a new form (say, Form W1) instructing the rate of TDS, overruling the tax bracket rate as per database. In view of the above, Forms 15G/15H may be discontinued. In case PAN is not registered, the 20% rate (or any desirable rate) of TDS to continue when interest paid/accrued during the financial year by the bank exceeds the limits specified. CBDT and banks should coordinate.
- **RBI should not resort to giving freedom to the banks on the accounting standards for deposit accounts.** This would burden depositors to shop around on such aspects even in a transparent environment. The only criteria for comparing banks for deposit accounts should be the nominal interest rate.
- The government must consider working towards an approach paper highlighting the pros and cons of streamlining Tax and TDS on individual's interest income, after indexing for inflation. The government should also study the impact of having all organized non-bank regulated/unregulated financial entities (offering interest income through deposits) brought at par with banks while effecting TDS prescriptions on interest income.
- **Deregulate the Current account interest rates** with a cap. RBI should come out with a discussion paper, on this topic, highlighting the pros and cons of the suggested deregulation.

94. Additional recommendations:

- RBI must consider allocating Depositor Education and Awareness Fund, among other purpose, for educating the depositors on (a) the benefits of deducting the TDS amount from SB/Current accounts in lieu of Term deposit accounts, (b) the correct pension credits into SB accounts, and (c) advantages of seven days Term deposits (over Current accounts) with automatic roll over.
- Banking Codes and Standards Board of India, has framed certain banking codes, which sets minimum standards of banking practices for banks to follow when they are dealing with individual customers. However, it has not yet addressed the 'standards' aspects as dealt in this paper. The Board, in the public interest, should work proactively towards developing and identifying banking standards, enhancing harmony and transparency in the banking practices.

95. During early June 2013, a draft of this paper was circulated among few researchers, banks, regulators and other professional bodies for receiving comments and inputs. Each financial institution's top management was contacted and reverts obtained based on such communications. In Appendix J we have listed bodies / organizations contacted and itemized the responses wherever received.

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Appendix A

Discounting of Interest while Paying Monthly but Applied Quarterly

For paying the equated Monthly interest, one needs to find the unknown equated Monthly interest by equating the Quarterly interest to the sum of 3 months' Monthly interest (in additional to the interest on the Monthly interest). Let P be the principal amount and r the per annum rate of interest. Furthermore, let the unknown equated Monthly interest be *x*. Then,

Quarterly interest $= P(r/400)$

3 months' equated Monthly interest plus "interest on interest" $= x\{(1+r/1200)^2 + (1+r/1200) + 1\}$

Therefore,

Equated Monthly interest $= x = P(r/400)/\ \{(1+r/1200)^2 + (1+r/1200) + 1\}$

Illustration:

Principal (P)	1000
RoI (% p.a.) (r)	12
Interest Application Frequency	3 months

Interest paid at the end of 3 months = Q =	**P*r/400 =**	30	**effective Annual RoI = 400*Q/P =**	**12**
Equated Interest Amount when paid every month = *x* =	**P(r/400)/{(1+r/1200)^2+(1+r/1200)+1} =**	9.9007	**effective Annual RoI = 400*A/P =**	**11.8808**
Sum of 3 months' monthly Interest = A =	**3*x =**	29.7020		

Appendix B

Savings Deposit Interest Application Frequency		
Bank Name	**Bank Type**	**Interest Application Frequency (month)**
State Bank of India	Public	6
Indian Bank	Public	6
Andhra Bank	Public	6
Canara Bank	Public	6
Indian Overseas bank	Public	6
United Bank of India	Public	6
Allahabad Bank	Public	6
Bank of Baroda	Public	6
Bank of India	Public	6
Bank of Maharashtra	Public	6
Central Bank of India	Public	6
Corporation Bank	Public	6
Punjab National Bank	Public	6
Syndicate Bank	Public	6
UCO Bank	Public	6
Union Bank of India	Public	6
HDFC Bank	Private	6
ICICI Bank	Private	6
Axis Bank	Private	3
Yes Bank	Private	3
South Indian Bank	Private	6
Indusind Bank	Private	6
IDBI Bank	Private	6
Kotak Mahindra Bank	Private	6
Citi Bank	Foregin	6
HSBC	Foregin	6
Standard Chatered Bank	Foregin	6

Appendix C

CASE: Calander Quarter (TDS)			
Principal	100		
RoI (% p.a.)	10		
Maturity amt. for One year deposit	110.381	yield = 10.38%	
Start Date	10-May-13		
No. of days till June 30, 2013 (from May 10, 2013)	52		
No. of days till Sep. 30, 2013 (from Aug. 10, 2013)	52		
No. of days till Dec. 31, 2013 (from Nov. 10, 2013)	52	TDS (with Interest at Maturity)	Period for Interest on TDS
No. of days till Mar. 31, 2014 (from Feb. 10, 2014)	50		
Accrued Interest on 30th June	1.425		
TDS	0.142	0.155	3Q + 39D
Accrued Interest on 30th Sept.	2.536		
TDS	0.254	0.269	2Q + 39D
Accrued Interest on 31st Dec.	2.599		
TDS	0.260	0.269	1Q +39D
Accrued Interest on 31st Mar.	2.605		
TDS	0.260	0.263	39D
No. of days till May 9, 2014 (from April 1, 2014)	39		
Interim amount on 10th May 2014	110.341		
Interest on 10th May 2014	10.341		
Balance interest accrued and paid on 10th May 2014	1.177		
TDS	0.118		yield
Net amount paid at Maturity	109.307		9.307
9.307 % effective yield	Net TDS yield to Govt. =	1.034	10.341
TDS not subject to interest			
Interim amount on 10th May 2014	110.381		
Interest on 10th May 2014	10.381		
Balance interest accrued and paid on 10th May 2014	1.217		
TDS	0.122		yield
Net amount paid at Maturity	109.343		9.343
9.343 % effective yield	Net TDS yield to Govt. =	1.038	10.381

CASE: Anniversary Quarter (TDS)			
Principal	100		
RoI (% p.a.)	10		
Maturity amt. for One year deposit	110.381	yield = 10.38%	
Start Date	10-May-13		
No. of days till Mar. 31, 2014 (from Feb. 10, 2014)	50		
		TDS (with Interest at Maturity)	Period for Interest on TDS
Accrued Interest on 10th Aug.	2.500		
TDS	0.250	0.269	3Q
Accrued Interest on 10th Nov.	2.563		
TDS	0.256	0.269	2Q
Accrued Interest on 10th Feb.	2.627		
TDS	0.263	0.269	1Q
Accrued Interest on 31st Mar.	1.475		
TDS	0.148	0.149	39D
No. of days till May 9, 2014 (from April 1, 2014)	39		
Interim amount on 10th May 2014	110.341		
Interest on 10th May 2014	10.341		
Balance interest accrued and paid on 10th May 2014	1.177		
TDS	0.118		yield
Net amount paid at Maturity	109.307		9.307
9.307 % effective yield	Net TDS yield to Govt. =	1.034	10.341
TDS not subject to interest			
Interim amount on 10th May 2014	110.381		
Interest on 10th May 2014	10.381		
Balance interest accrued and paid on 10th May 2014	1.217		
TDS	0.122		yield
Net amount paid at Maturity	109.343		9.343
9.343 % effective yield	Net TDS yield to Govt. =	1.038	10.381

CASE: Sept. and Mar. (TDS)			
Principal	100		
RoI (% p.a.)	10		
Maturity amt. for One year deposit	110.381	yield = 10.38%	
Start Date	10-May-13		
No. of days till Sept. 30, 2013 (from Aug. 10, 2013)	52	TDS (with Interest at Maturity)	Period for Interest on TDS
No. of days till Mar. 31, 2014 (from Feb. 10, 2014)	50		
Accrued Interest on 30th Sept.	3.960		
TDS	0.396	0.421	2Q + 39D
Accrued Interest on 31st Mar.	5.204		
TDS	0.520	0.526	39D
No. of days till May 9, 2014 (from April 1, 2014)	39		
Interim amount on 10th May 2014	110.351		
Interest on 10th May 2014	10.351		
Balance interest accrued and paid on 10th May 2014	1.187		
TDS	0.119		yield
Net amount paid at Maturity	109.316		9.316
9.316 % effective yield	Net TDS yield to Govt. =	1.035	10.351
TDS not subject to interest			
Interim amount on 10th May 2014	110.381		
Interest on 10th May 2014	10.381		
Balance interest accrued and paid on 10th May 2014	1.217		
TDS	0.122		yield
Net amount paid at Maturity	109.343		9.343
9.343 % effective yield	Net TDS yield to Govt. =	1.038	10.381

CASE: Only Mar. (TDS)			
Principal	100		
RoI (% p.a.)	10		
Maturity amt. for One year deposit	110.381	yield = 10.38%	
Start Date	10-May-13		
No. of days till Mar. 31, 2014 (from Feb. 10, 2014)	50	TDS (with Interest at Maturity)	Period for Interest on TDS
Accrued Interest on 30th Sept.	0.000		
TDS	0.000	0.000	2Q + 39D
Accrued Interest on 31st Mar.	9.164		
TDS	0.916	0.926	39D
No. of days till May 9, 2014 (from April 1, 2014)	39		
Interim amount on 10th May 2014	110.371		
Interest on 10th May 2014	10.371		
Balance interest accrued and paid on 10th May 2014	1.207		
TDS	0.121		yield
Net amount paid at Maturity	109.334		9.334
9.334 % effective yield	Net TDS yield to Govt. =	1.037	10.371
TDS not subject to interest			
Interim amount on 10th May 2014	110.381		
Interest on 10th May 2014	10.381		
Balance interest accrued and paid on 10th May 2014	1.217		
TDS	0.122		yield
Net amount paid at Maturity	109.343		9.343
9.343 % effective yield	Net TDS yield to Govt. =	1.038	10.381

Appendix D

CIRCULAR NO- 03/2010.

F.No.275/66/2007-IT (B)
Government of India
Ministry of Finance
Department of Revenue
Central Board of Direct Taxes

……

New Delhi, the 2nd March, 2010.

Sub: **Tax Deduction at Source on payment of interest on time deposits under Section 194A of the Income Tax Act, 1961 by banks following Core-Branch Banking Solutions (CBS) software** – reg.

…..

As per provisions of section 194A of the Income Tax Act 1961, income tax has to be deducted at source at the time of credit of interest income to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, at the rates in force if such interest amount exceeds specified limit. Further, Explanation to section 194A states that "*for the purpose of this section, where any income by way of interest as aforesaid is credited to any account, whether called 'Interest payable account' or 'Suspense Account' or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee and the provisions of this section shall apply accordingly*".

2. Representations have been received from Indian Banks Association (IBA) seeking clarification regarding deduction of tax at source from payment of interest on time deposits by banks using Core-Branch Banking Solutions (CBS) software. In case of banks using CBS software, interest payable on time deposits is calculated generally on daily basis or monthly basis and is swept & parked accordingly in the provisioning account for the purposes of macro-monitoring only. However, constructive credit is given to the depositor's / payee's account either at the end of the financial year or at periodic intervals as per practice of the bank or as per the depositor's / payee's requirement or on maturity or on encashment of time deposits; whichever is earlier.

3. The matter has been considered by the Board. Explanation to section 194A was introduced with effect from 1.4.1987 by the Finance Act, 1987 to plug the loophole of avoiding deduction of tax at source by crediting interest in the books of accounts under accounting heads 'interest payable account' or 'suspense account' instead of to the depositor's / payee's account. Therefore, the

Page **1** of **2**

Explanation is not meant to apply in cases of banks where credit is made to provisioning account on daily/monthly basis for the purposes of macro monitoring only by the use of CBS software.

4. In view of the above position, it is clarified that since no constructive credit to the depositor's / payee's account takes place while calculating interest on time deposits on daily or monthly basis in the CBS software used by banks, tax need not be deducted at source on such provisioning of interest by banks for the purposes of macro monitoring only. In such cases, tax shall be deducted at source on accrual of interest at the end of financial year or at periodic intervals as per practice of the bank or as per the depositor's / payee's requirement or on maturity or on encashment of time deposits; whichever event takes place earlier; whenever the aggregate of amounts of interest income credited or paid or likely to be credited or paid during the financial year by the banks exceeds the limits specified in section 194A.

Hindi version to follow.

(Ansuman Pattnaik)
Director (Budget)

Copy to:-

1. All Chief Commissioners and Director Generals of Income Tax.
2. All CIT (TDS).
3. The Chairman, Members and other offices in CBDT of the rank of Under Secretary and above.
4. DIT (TDS), DIT (Recovery), DIT (System), DIT (DOMS), DIT (Vigilance) and DIT (IT).
5. 100 copies to DIT (PR, PP & OL) for printing in the quarterly tax bulletin and for circulation as per their usual mailing list.
6. The Comptroller and Auditor General of India (40 copies).
7. Guard File.

(Ansuman Pattnaik)
Director (Budget)

Appendix E

Overall Gains on Effecting TDS on Accrued Interest Annually on March 31 Only

RoI = 9% per annum (Rs Crore)

Start Date	Maturity Date	Additional TDS	Additional Interest Income
10-Apr-12	10-Apr-13	33.4	300.7
10-May-12	10-May-13	27.6	248.6
10-Jun-12	10-Jun-13	21.7	195.7
10-Jul-12	10-Jul-13	16.9	152.3
10-Aug-12	10-Aug-13	14.1	126.5
10-Sep-12	10-Sep-13	11.0	99.2
10-Oct-12	10-Oct-13	9.9	89.0
10-Nov-12	10-Nov-13	13.0	117.2
10-Dec-12	10-Dec-13	15.6	140.4
10-Jan-13	10-Jan-14	19.6	176.3
10-Feb-13	10-Feb-14	25.6	230.8
10-Mar-13	10-Mar-14	30.5	274.4
Average for 2012-13		19.9	179.3

Impact of TDS on Axis Bank's Estimated Losses

RoI = 9% per annum (Rs Crore)

Start Date	Maturity Date	Axis Bank's Loss
10-Apr-12	10-Apr-13	17.2
10-May-12	10-May-13	17.6
10-Jun-12	10-Jun-13	17.5
10-Jul-12	10-Jul-13	17.2
10-Aug-12	10-Aug-13	17.7
10-Sep-12	10-Sep-13	17.6
10-Oct-12	10-Oct-13	17.2
10-Nov-12	10-Nov-13	17.7
10-Dec-12	10-Dec-13	17.5
10-Jan-13	10-Jan-14	17.2
10-Feb-13	10-Feb-14	17.7
10-Mar-13	10-Mar-14	17.3
Average for 2012-13		17.4

Appendix F

भारतीय बैंक संघ

INDIAN BANKS' ASSOCIATION

स्टेडियम हाउस, छठी मंजिल, खण्ड 3, वीर नरीमन मार्ग, मुंबई 400 020.
Stadium House, 6th Floor, Block 3, Veer Nariman Road, Bombay 400 020.
दूरभाष Phone : 2855150 (स्टेडियम हाउस Stadium House) / 2182288 (वि.व्या.के. W.T.C.)
तार : बैंकसलिंक Gram : BANKSLINK • टेलेक्स Telex : 011-85146/82373 फैक्स Fax : 2835638/2184222

No.OPR.C/10-42(4)/9
28th February 1996

Chief Executives of All Member Banks

Dear Sirs,

FINANCE ACT, 1995: TAX DEDUCTION AT SOURCE (TDS) BY BANKS ON INTEREST <u>ON TIME DEPOSITS – REINVESTMENT PLAN</u>

Group of a few bankers of the IBA deliberated on approach to the subject issue. It has been viewed that banks can offer the following options to the depositor :

(1) The amount of tax to be deducted on the interest accruing on reinvestment deposit for the financial year could be debited to the running (SB/CA) account of the depositor, if the option is given by the depositor. In this process, the depositor is assured of getting the maturity value already quoted in the deposit receipt. This option is beneficial to the bank as well as the depositor. It would be worthwhile to get maximum number of options from the depositors.

(2) If the depositor is not opting for (1) above, bank has to effect the TDS from the accrued interest credited to the reinvestment deposit for the financial year. Further compounding of the post-TDS deposit balance has to be done on case to case basis, in which case maturity value marked initially would have to be ignored.

Yours faithfully,

(B R K KAMATH)
EXECUTIVE – BANKING OPERATIONS

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Appendix G

Algorithm for Paying Interest for a Term Deposit (Interest compounded monthly)

with a principal P1 and a start date May 10, interest worked out till June 9, say i1;
with Int1 = i1, interest worked out on (P1+Int1) from June 10 to July 9, say i2;
with Int2 = Int1 + i2, interest worked out on (P1+Int2) from July 10 to Aug. 9, say i3;
...
with Int9 = Int8 + i9, interest worked out on (P1+Int9) from Feb. 10 to Mar. 9, say i10;
with Int10 = Int9 + i10, interest worked out on (P1+Int10) from Feb. 10 to Mar. 31, say i11;
with Int11 = Int10 + i11, identify TDS amount as x% of Int11, say T1;
let P2=P1-T1;
with revised principal P2, interest worked out on (P2+Int11) from Apr. 1 to Apr. 9, say i12;
with Int12 = Int11 + i12, interest worked out on (P2+Int12) from Apr. 10 to May 9, say i13;
with Int13 = Int12 + i13, identify TDS amount as x% of (Int13-Int11), say T2;
maturity proceeds = Int13 + P2 – T2.

Principal = P1
Gross Interest = Int13
TDS = T1 + T2
Net Interest = Int13 – (T1 + T2)
Maturity Proceeds = P1 + Int13 – (T1 + T2) = Int13 + P2 – T2

Appendix H

Banks Worldwide and Interest Application Frequency

Country	Bank	Account type	Interest calculated	Payment frequency	Link
USA	Bank of america	ragular saving	daily	monthly	https://www.bankofamerica.com/deposits/savings/regular-savings-account.go
USA	Chase	Chase plus saving	monthly	monthly	https://www.chase.com/index.jsp?pg_name=ccpmapp/individuals/savings/page/chase-plus-savings-rates
USA	wellsfargo	saving	daily	monthly	https://www.wellsfargo.com/savings_cds/way2save
USA	centralpacific	saving	daily	monthly	https://www.centralpacificbank.com/Personal/Products/Savings.aspx
USA	NBT Bankcorp	saving	daily	quarterly/monthly	http://www.nbtbank.com/home/personal-banking/savings/Savings-Accounts/personal-savings.html
USA	Americafirst	saving		monthly	https://www.americafirst.com/rates/savings-rates.cfm?rateGroup=1
Canada	BMO bank of monetral	saving		daily	http://www.bmo.com/home/personal/banking/bank-accounts/premium-rate-savings
Canada	CIBC	saving	daily	monthly	https://www.cibc.com/ca/chequing-savings/premium-growth-acct.html
Canada	Desjardins	saving		monthly	http://www.desjardins.com/en/particuliers/produits_services/comptes-services-relies/comptes/epargne-stable.j
UK	HSBC	saving		monthly	http://www.hsbc.co.uk/1/2/savings-accounts/regular-savings-accounts
UK	halifax	saving		monthly	http://www.halifax.co.uk/savings/accounts/regular-saver/
UK	Natwest	saving	monthly	monthly	http://www.natwest.com/personal/savings.ashx
Australia	Bank of Melbourne	saving		monthly	http://www.bankofmelbourne.com.au/personal/bank-accounts/savings-accounts/incentive-saver
Australia	HSBC	saving	monthly	monthly	http://www.hsbc.com.au/1/2/personal/savings/high-interest
Australia	BOQ	saving	daily	monthly	http://www.boq.com.au/personal_everyday_bonus.htm
FRANCE	Credit mutual	saving		fortnight	https://www.creditmutuel.fr/cmcee/en/bank/personal/savings-investments/index.html
FRANCE	many banks in france	saving		fortnight	http://www.french-property.com/guides/france/finance-taxation/banking/savings/regulated-savings-accounts/
GERMANY	ABN amro	saving		monthly/depends	https://www.abnamro.nl/en/personal/savings/spaarrente.html
GERMANY	Allied Irish Bank	saving		monthly/depends	http://www.aib.ie/personal/savings/aib-saver-account
CHINA	bank of china	saving		monthly/depends	http://www.boc.cn/en/pbservice/pb1/200806/t20080626_1323990.html
CHINA	bank of comm	saving		weekly	http://www.bankcomm.com/BankCommSite/en/detail.jsp?id=1214188802100&type=CMS.STD&category=ROOT
New Zealand	HSBC	saving	daily	monthly	http://www.hsbc.co.nz/1/2/personal/savings-and-transactional-accounts/savings-cheque-account
HONGKONG	hang seng	saving		monthly	http://bank.hangseng.com/1/2/rates/interest-rates
Bahrain	HSBC	saving	daily	monthly	http://www.us.hsbc.com/1/2/home/personal-banking
Saudi Arabia	riyad bank	saving	daily	depends	http://www.riyadbank.com/English/PersonalBanking/SavingsAccount.html

Appendix I

Monetary and Liquidity Conditions

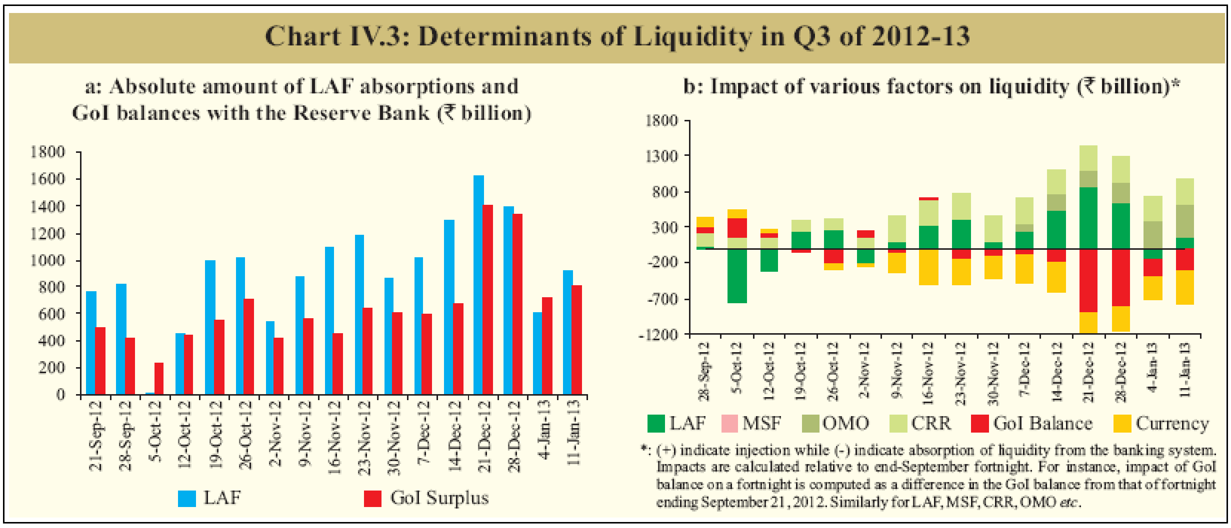

Chart IV.3: Determinants of Liquidity in Q3 of 2012-13

Source: Macroeconomic and Monetary Developments - Third Quarter Review 2012-13. RBI, January 28, 2013.
http://rbidocs.rbi.org.in/rdocs/Publications/PDFs/00MTQ250113F.pdf

Appendix J

Comments from Stakeholders

Some inputs, on the study, received from institutions are listed below.

Axis Bank

- First of all, I would like to thank you for sharing this wonderful piece of research with us! This paper is very enriching in the way it sees through the interest calculation for both Saving as well as the Term deposit accounts.
- Your research paper is very well argued, and was very interesting and insightful.
- The paper points out that Banks make significant money due to arbitrage between interest application frequency on loans (typically 1 month) and deposits (typically 3 months or more). Having said this, this arbitrage is not intended by the Bank, but exists primarily due to operational reasons of managing the NPAs of the Banks very actively, because of which interest on loans have to be mandatorily calculated on a monthly basis. There is a huge variance in the ticket size of the term deposits, the average being a few thousands, and retail loans, the average being a few lacs. This means that, on a similar size portfolio, we have much larger costs of servicing of term deposits, compared to costs for retail assets. These costs as well as the risk pricing have to be factored in, while pricing the asset products. Therefore, effectively the Bank does not gain from the arbitrage.
- On the point of TDS, your point is very valid and helpful. We will relook at the methodology at our Bank for TDS payment to the government, in view of your argument.
- After going through this paper, we are reviewing the way the Bank calculates the interest on the Term deposits. Presently, the interest reinvested is gross of TDS recovery for only Term Deposits with a value less than Rs 5 crore. For Term Deposits worth more than Rs 5 crore, interest is compounded post TDS recovery. We are most probably going to change the way we calculate interest for even Term Deposits worth less than Rs 5 crore.

State Bank of India (SBI)

- The study raises an issue wherein it is found that there is no rationale on why interest application frequencies on deposit accounts (quarterly or longer rests) are different from those on loan accounts (monthly), which is beneficial to banks and detrimental to customers. It also throws light on significance of TDS on interest accrued on term deposits. The study highlights that there is no harmony in TDS procedure followed by Banks which has its impact on net returns.

- On the issue "Interest application frequency", SBI is compounding quarterly for Time Deposits, Half Yearly for Savings Bank Deposits. Monthly compounding for loans (except Agricultural loans).
- On the issue "banks applying TDS on accrual interest on either 'calendar quarters' or 'anniversary quarters' (in addition to last day of financial year)", SBI recover TDS on Anniversary Quarters as well as last day of financial year.
- With regards to the issue "the recovery of TDS on accrued interest should be shifted to from Calendar quarters/ Anniversary Quarters to last day of financial year. Due to compounding effect the customers will get the more interest, Bank will have more balances in Deposit head and the government will get more TDS on March 31", SBI considers that this may be true, but the time value of money for the Government of India has not been taken. The amount of TDS received by the government may look higher in absolute terms but it may be less when we apply time value of money.
- Though, as per Income Tax Act 1961, TDS is to be effected on the interest income earned or likely to be earned for the financial year if it exceeds certain sum (presently Rs. 10000/-) per customer per Bank, SBI is deducting TDS whenever the interest earned and accrued of a customer reaches Rs.10000/- in financial year.
- As per RBI's current guidelines Interest on Deposits should be paid at quarterly or longer rests. SBI is not adjusting the TDS, which was paid to GOI as TDS (similar practice being followed by many other Banks). Whenever we recover the TDS on particular TDR/STDR, we debit TDS from accrued interest of particular account and pay to GOI as TDS. Even though we parted the money to GOI to the extent of TDS on behalf of customer by reducing his accrued interest to that extent we are still paying interest on his principal amount since we are not reducing said TDS from principal.
- On the question of deduction of TDS from CA/SB instead of same Deposit account, SBI deducts the TDS from deposit account itself.
- With regards to the issue "most of the banks deducts TDS from the deposit itself. Since the customer is the owner of the money, he/she should have the option to pay the TDS either from SB/CA or deposit itself. (So that he/she will get more benefit from higher interest paid on deposit)", SBI considers that in the majority of cases, SB/CA may not have sufficient balance on the transaction day to pay TDS.

<u>All India Bank Depositors' Association (AIBDA)</u>

- The paper is very well argued, well researched and very insightful. It is intuitively putting through the arguments and clarifies issues affecting vast depositors of our country.
- We, at AIBDA fully endorse the views on various fault-lines and lack of harmony in the existing policies and practices of banks relating to interest application frequency and tax deduction at source on interest income on bank deposits. There

are also serious issues about practices relating to service charges levied on bank depositors.

- We sincerely hope that the RBI and Ministry of Finance will give serious considerations to the issues and suggestions made in this paper. Having so said, we also wish to point out that

  • The AIBDA has also been pursuing the issue of interest application frequency with the RBI. However, RBI has not been able to respond to us on the issue in a concrete fashion.

  • The protection of depositors "real rate of return" against the scourge of high inflation is of primary concern to almost all depositors. AIBDA has already made a strong case with the RBI for initiating the concept of "inflation indexed term-deposit scheme" to protect small depositors and senior citizens. This could be a useful alternative to existing non-productive [zero or negative "real" interest rate earning] term deposits. AIBDA believes that to lure Indian middle-class savers from purchase of gold, it is imperative to formulate and implement inflation-indexed term deposit scheme offering interest rates which are equivalent of inflation measured in CPI terms plus 3% per annum.

  • In a country with 9% of the population being senior citizens (age 60 or more), it is important that tax related paperwork is minimized for them. Significant number of senior citizens falls below income tax bracket and most of them live on interest income on their deposits with banks. Such people may not have the skills, capacity or tenacity to comply with the complex paper works either for exemption of TDS or claim of tax refunds.

- Once again congratulations for yet another excellent research paper from you.

Other Organizations

Few of the other organizations from whom the responses are still awaited are Bank of Maharashtra, HSBC, ICICI Bank, HDFC Bank, IBA, BCSBI, ICAI, CBDT, Department of Financial Services and RBI.