Opinion | Taking a loan from a relative is not that simple

4 min read. Updated: 25 Mar 2019, 08:00 AM IST Gautam Nayak

Certain restrictions apply if you take a loan from friends or relatives

Topics

Personal Loans Unregulated Deposit Schemes Loans from NRIs

Giving a loan to or taking a loan from relatives and close friends is quite common to meet personal and medical emergencies, to tide over temporary shortfalls. Similarly, giving loans to house helps to help them with their personal needs is also quite common. Therefore, a recent news item, which seemed to suggest that accepting personal loans would also be prohibited under the recent Banning of Unregulated Deposit Schemes Ordinance, 2019, created quite a stir among readers. How far is this correct and what are the restrictions under different laws on giving and taking personal loans?

If one looks at the provisions of the recent ordinance, the definition of “deposit" would certainly include personal loans. However, what is banned under the ordinance is not “deposits", but “unregulated deposit schemes". This necessarily implies, as defined in the ordinance, that there is a scheme or arrangement by which deposits are accepted by way of business. What the ordinance seeks to ban is unregulated deposit schemes which are marketed to people, offering certain income or incentives on such deposits. Many investors have been duped by such schemes in the recent past, and the ordinance targets these schemes. The ban certainly does not apply to acceptance of personal loans for personal needs from relatives or friends. Does this, however, mean that, as an individual, you are free to accept loans from friends or relatives? While generally there is no prohibition, certain restrictions do apply, which you need to keep in mind.

The first restriction, contained under the income-tax law, is that you cannot accept a loan exceeding Rs.20,000 in cash or by bearer cheque. The transaction necessarily has to be through an account payee cheque or a bank draft, or by electronic transfer through a bank account. Can you get around this restriction by taking amounts of less than Rs.20,000 at a time? The law has plugged this loophole—the prohibition also applies if the balance of the loan plus the additional amount being borrowed is more than Rs.20,000. For example, if you have taken a loan of Rs.15,000 earlier (maybe even by cheque or electronic transfer) and now intend to borrow another Rs.10,000 in cash, you cannot do so, as the balance would exceed Rs.20,000. Effectively, if the balance of the loan outstanding is already more than Rs.20,000, then there is a total prohibition on acceptance of any more amount in cash.

This prohibition applies to the receiver of the loan. In case of a violation, he is liable to pay a penalty equal to the amount accepted in violation. There is, however, a provision which says that if there is a reasonable cause for such violation, then penalty may not be levied. However, what constitutes a reasonable cause could be a matter of debate, and could lead to litigation. Effectively, you are at the mercy of the tax officer dealing with your case in deciding whether there was a reasonable case or not for the violation—a completely avoidable situation.

There is a similar prohibition on repayment of a loan or deposit, wholly or partially, in cash or bearer cheque, if the balance of the loans or deposits exceeds Rs.20,000. This applies to the total of all loans and deposits made with that person by the lender or depositor. Interestingly, this clause also applies to repayment by a bank. A similar penalty would apply in the event of a violation, but in this case, penalty would be levied on the borrower.

Our exchange control laws also restrict loans between Indian residents and non-resident Indians (NRIs). A resident can accept a rupee loan only from a non-resident Indian or a person of Indian origin, and not any other non-resident, and that too, for a period not exceeding three years, and with interest restricted to a rate of 2% over the bank rate. A resident can give a rupee loan to an NRI relative, but with various restrictions—it has to be interest-free, for a minimum amount of one year and the amount of loan cannot exceed certain limit, among other restrictions.

A resident can take a foreign exchange loan only from his close non-resident relatives, and not other non-residents, subject to various restrictions. The amount of loan cannot exceed $250,000, the loan has to be interest-free, and the loan has to be for at least one year, among other restrictions.
From the above, it can be seen that even for simple things such as personal loans received or given by individuals, there are various restrictions under various laws which one has to be aware of. For businesses, there are more restrictions. Each law has various restrictions, and a person is expected to be aware of all laws. With so many different laws prevalent in India, imagine then, given the “ease" of giving or receiving personal loans, what is the “ease of doing business in India"?

Gautam Nayak is a chartered accountant