

Decoding the Ordinance on unregulated deposit schemes

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Contrary to initial apprehensions, individuals taking loans from relatives or friends for business or for other personal reasons, will not be affected

The recently-promulgated Banning of Unregulated Deposit Schemes Ordinance 2019 ruffled a few feathers with news reports and legal experts expressing concerns over how the ordinance could hurt individuals who raise quick loans from relatives or friends, and businesses taking loans from unrelated parties and enterprises.

A series of tweets by the Finance Ministry last week, along with specific clarifications issued on individuals borrowing from friends and relatives, have allayed some of the concerns.

We break down the various provisions and exclusions of the ordinance to explain how it will have an impact on individuals and businesses.

The ordinance

The intent of the ordinance is to check illicit deposit/ponzi schemes that hurt small investors.

But the words used to describe some of the exclusions, as laid down in Section 2 (4) of the ordinance, kept individuals and businesses on tenterhooks.

The ordinance states that any deposit scheme under which deposits are accepted or solicited by any deposit-taker by way of business, which is not a regulated deposit scheme, is banned.

Deposit in the ordinance has been defined as “an amount of money received by way of advance or loan in any other form by any deposit-taker with a promise to return whether after a specified period or otherwise either in cash or in kind in the form of a specified service with or without any benefit in the form of interest, bonus, profit or in any other form”.

There are several exclusions in the ordinance on what is not a ‘deposit’. Varying interpretations by legal experts have led to confusion.

Individuals

For instance, while amounts received by an individual by way of loan from his relatives are excluded, under Section 2 (4) (f), there was ambiguity over whether relatives only included immediate family, and not friends and far-off relations.

But the ministry has now clarified that “individuals borrowing or taking loans or money from relatives or friends for marriage or medical emergency or business needs or any other personal reasons have nothing to fear.

Such transactions are not unregulated deposit schemes as defined in Section 2 (17)”.

Also, an individual can receive money from a friend residing abroad, subject, of course, to the provisions of FEMA.

Bottomline: As far as individuals are concerned, they can borrow money from relatives or friends for any purpose – business or personal – as per the ministry’s clarification.

Partnerships

There have been several debates by legal experts, which may need more clarification.

Under Section 2 (4) (e), any amount received by way of contributions towards capital by partners of any partnership firm is excluded from the definition of ‘deposit’, implying that such amounts are allowed and do not attract penal provisions under the ordinance.

Also as per Section 2 (4) (f), amounts received by a firm by way of loan from relatives of any of the partners is excluded from the definition of ‘unregulated deposits’ and is hence, allowed.

But there is uncertainty over the money received from a partner as ‘loan’. Here, the government will have to issue further clarification.

Bottomline: As the current provisions read, there is uncertainty over whether a partnership firm can receive money from its partner which is other than capital contribution. Any amount received from a partner’s friend is not allowed.

Companies

The other concern is whether businesses can take unsecured loans from unrelated entities and parties. But Section 2 (4) (I) excludes amount received for the purpose of business, which clearly implies that businesses can take unsecured loans from unrelated parties and enterprises. The ministry has, however, specifically clarified this point by stating that “small businesses, proprietorships, partnerships, LLPs and SMEs that take unsecured loans from unrelated parties and enterprises are also exempt under Section 2 (4) (I) of the law”.

Bottomline: There is no ban on small businesses receiving loans in the course of or for business purposes.

Published on February 27, 2019

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