

# Cash Against Gold: What's the Threshold?



**Wednesday Wisdom**

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## Introduction

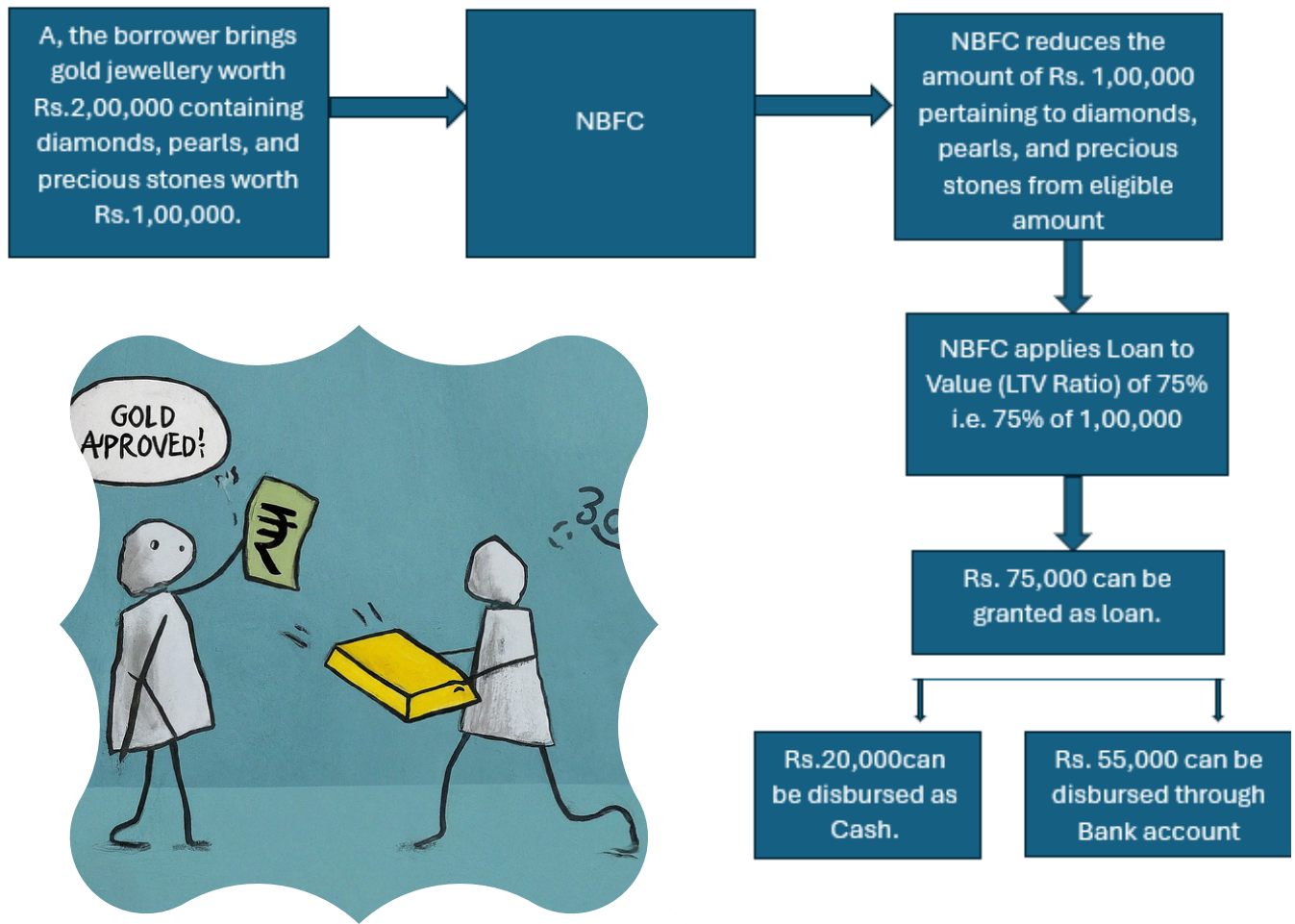
Have you ever been impressed by television advertisements where a person is trading the gold jewellery he owns and getting a big bunch of currency notes in return? While the advertisements are depicting such trading/ transactions to be easy and effortless, the reality is far away from the actual and practical scenario, underneath are hidden fees, exchange rates, safe deposit vault fees and unilateral paperwork crafted by such businesses as if it is their right to forfeit the gold in case of failure of the borrower to repay the loan. It seems that the huge bundle of currency notes we see in such advertisements are actually misleading the audience. The picture is being portrayed one sided. How? Let's delve deeper and know more about it then !

To[1] know more about the related acts and regulations, let's look at the important provision mentioned under the Income Tax Act, 1961 wherein a threshold of Rs. 20,000 has been mandated for such NBFCs while dealing under this cash against gold loan facility being obtained by the borrower for a non-agricultural purpose. Section 269SS of the Income Tax Act, 1961 specifies the mode of taking or accepting certain loans, deposits and specified sum.



[1] The article reflects the general work of the authors and the views expressed are personal. No reader should act on any statement contained herein without seeking detailed professional advice

Let's look at the flowchart below to understand better



Further vide a notification dated March 09, 2017<sup>[2]</sup> regarding disbursement of loan amount in cash by NBFCs, the threshold of Rs. 20,000 as specified under the Income Tax Act, 1961 was emphasized again.

In other words, it can be stated that for gold loan transactions exceeding the Rs. 20,000 threshold, it is imperative that the funds be transferred to the borrower's bank account rather than disbursed in cash, aligning with regulatory guidelines and ensuring transparency in financial transactions.

- **Lending Guidelines:<sup>[3]</sup>**

Now let's see a few conditions based on which an NBFC is allowed to grant a loan against gold. While all the below mentioned conditions are a prerequisite for the NBFCs to grant a loan against gold, it is pertinent to note that one of the instructions specifies how an advertisement related to gold loan shall not be misleading.

[2] RBI notification on disbursement of loan amount in cash, March 9th, 2017

[3] Section 39 of RBI Master Direction dated September 1, 2016 (updated as on August 29, 2023)

NBFCs shall ensure that a Board approved policy for lending against the gold is in place which includes:

- i. Adequate steps for KYC guidelines.
- ii. Proper assaying procedure.
- iii. Internal system to satisfy ownership of the gold jewellery.
- iv. Adequate system for storing the gold jewellery in safe custody and maintaining such systems from time to time.
- v. The gold jewellery accepted as collateral to be appropriately insured.
- vi. Systems and procedures to be put in place for dealing with fraud including separation of duties of mobilization, execution, and approval.

Moving ahead with another important aspect of repayment by the borrower in such gold loan transactions. The repayment of such loans can be made in various ways such as EMI based, bullet repayment, partial repayment, foreclosure etc. Such repayment options shall be exercised as per the agreement signed between the NBFC and the borrower.

However, a question arises as to what will happen in an unfortunate event if the borrower fails to repay the loan. In such cases, these NBFCs may auction the gold jewellery subject to fulfilling the conditions mentioned under the master direction issued by RBI[4].

- **Auction Guidelines:**

1. The loan agreement shall also disclose details regarding auction procedure.
2. Transparent auction procedure in case of non-repayment with adequate prior notice to the borrower. There shall be no conflict of interest and the auction process must ensure that there is an arm's length relationship in all transactions during the auction including with group companies and related entities.
3. The auction shall be announced to the public by issue of advertisements in at least two newspapers, one in vernacular and another in national daily newspaper.
4. As a policy, the applicable NBFCs themselves shall not participate in the auctions held.
5. Gold pledged shall be auctioned only through auctioneers approved by the Board.
6. The auction shall be conducted in the same town or taluka in which the branch that has extended the loan is located.
7. NBFCs shall disclose in their annual reports the details of the auctions conducted during the financial year including the number of loan accounts, outstanding amounts, value fetched and whether any of its sister concerns participated in the auction.

It shall be mandatory on the part of the NBFCs to provide full details of the value fetched in the auction and the outstanding dues adjusted and any amount over and above the loan outstanding shall be payable to the borrower.

[4] Section 27 (4) and section 39 of RBI Master Direction dated September 2016 (updated as on August 29, 2023)

- **Other Instructions:**

1. NBFCs financing against the collateral of gold must insist on a copy of the PAN Card of the borrower for all transactions above Rs. 5 lakhs.
2. Documentation across all branches must be standardized.
3. NBFCs shall not issue misleading advertisements like claiming the availability of loans in a matter of 2-3 minutes.

While all the above mentioned are the conditions mandated by law, some NBFCs are going above and beyond their limits just to gain benefit by providing the gold loan facility. These entities are bending rules in a way to extract maximum benefit by offering the gold loans. Sadly, the borrowers often find themselves trapped which ultimately results into rather a loss than a benefit for the borrower.



**Let's understand this through an illustration:**

A, the borrower goes to XYZ, an NBFC for availing gold loan by giving gold jewellery and after all the verification of gold and other procedures, XYZ and A executes an agreement. However, the cash against the gold which the NBFCs pay to A, exceeds the mandated threshold of Rs. 20,000. Now, XYZ plays smart by compelling A to sign an indemnity bond stating that the income tax liability that may arise out of such transaction shall be solely and completely borne by A. After A signing this indemnity bond, XYZ gives the cash to A. By doing so, XYZ sheds off the responsibility from its shoulder and burdens A unnecessarily.

## CONCLUSION:

Although the gold loan provides a convenient and accessible way for the borrowers in need of immediate financial relief, both the NBFC and the borrower shall be attentive and cautious while actually utilizing such options. It is important for the NBFCs to follow the mandates, be in the boundaries and protect the interest of its borrowers. The NBFCs, by maintaining transparency, can build trust and credibility and foster good relations with its borrowers while offering a service that may help its borrowers to stand on their own feet in difficult times. Borrowers need to be aware about the fine prints that are provided along with loan documentation.

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