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Advance received in Ordinary Course vs. Deposits

Money plays an essential role in every business. Every business requires fund raising and one of the popular forms is borrowings and when borrowings come into picture, the spotlight directly falls on Section 2(31) of the Companies Act, 2013 which is “Deposits”. Deposits is generally returnable, however, sometimes advance received in ordinary course can also be deposits and is regulated under Companies Act, 2013, Banning of Unregulated Deposit Schemes Act, 2019, Maharashtra Protection of Interest of Depositors (in Financial Establishments) Act, 1999, the Reserve Bank of India Act, 1934 and several other statutes. Therefore, it is important to understand this concept of advance received in ordinary course and the regulations around it. We would be discussing about three important statutes, i.e. Companies Act, 2013, Banning of Unregulated Deposit Schemes Act, 2019 and Maharashtra Protection of Interest of Depositors (in Financial Establishments) Act, 1999 in the context of advance received in ordinary course.

What is Deposit?

The term “deposits” is being defined in Companies Act, 2013. “Deposit” includes **any**

receipt of money by way of deposit or loan or in any other form by a Company, but does not include such categories of amount as may be prescribed in consultation with the Reserve Bank of India. Further, Rule 2 (1)(c) of the Companies (Acceptance of Deposits) Rules, 2014, provides an inclusive definition of deposits. It clearly enlists the transactions that would not be considered as deposits.

As per the abovementioned definition, deposit includes receipt of money by way deposit, or loan or in any other form. Now, in general parlance, any transaction in which money is given with the intention to be returned either with or without interest is termed as loan. However, question arises as to how to interpret “in any other form”? Probably, “in any other form” would mean deposits received by whatever name called is the context. Would it mean all such amounts received by a Company in any form apart from loans and deposits which are not covered under exclusions? Or do we need to interpret it in context of loan or deposit only? Here, the words “loans” and “deposits” are specific words whereas “in any other form” are general words. So, by applying principle of

eiusdem generis (meaning: of the same kind or nature), the words “in any other form” may be interpreted as confined to loans and deposits only. Therefore, in context of this explanation, any money received which with an intention to be returned will be termed as deposits, whatever you may call.

Here, a question arises as to whether advance received would be considered as deposits? Advance is not received with an intention to be returned; it is to be appropriated against the relevant identified transactions. In course of carrying out routine business transactions, a Company may receive advance in mutual interest and there is no legal bar in having such transaction. However, many a times, advances are used for camouflaging loans which no regulator likes. Hence, regulators don't give exemptions without conditions. Let us have a look at the deposits definition which contains exclusions with regards to advances, but with certain conditions. The exclusions are reproduced as under:

(xii) **any amount received in the course of, or for the purposes of, the business of the Company-**

It is very important to note that this is a very specific clause and not inclusive.

(a) *as an advance for the supply of **goods** or **provision of services** accounted for **in any manner whatsoever** provided that such advance is appropriated against supply of goods or provision of services within a period of three hundred and sixty -five days from the date of acceptance of such advance: Provided that in case of any advance which is subject matter of any **legal proceedings** before any court of law, the said time limit*

of three hundred and sixty-five days shall not apply:

The highlighted words are very important and need to be understood carefully in order to understand the clause in detail. If we go through the words, the term “goods” is defined under Sale of Goods Act, 1930 and for others we will have to check other statutes, dictionary meaning or in general common parlance.

The sub rule here, clarifies that any amount received in the ordinary course of business as an advance for supply of goods or provision of services, then such amount has to be appropriated against supply of goods or provision of services within 365 days from the date of acceptance of such advance. Else, it would be considered as deposit.

(b) *as advance, accounted for **in any manner whatsoever**, received in connection with consideration for an **immovable property** under an **agreement or arrangement**, provided that such advance is adjusted against such property in accordance with the terms of agreement or arrangement;*

Similarly, immovable property is defined under the General Clauses Act, 1987 and for other words again we will have to check other statutes or dictionary meanings in order to understand and evaluate whether a particular case falls under this clause.

This clause refers to advance received against construction or real estate projects. The point to be ascertained here would be that there has to be an agreement or arrangement in place and the advance received has to be appropriated only against the immovable property in the books of the Company. There is no limit of 365 days applicable here.

(c) *as security deposit for the performance of the contract for supply of goods or provision of services;*

Security deposit is money that is received as a proof of intent and may be used to pay damages. So, any money received as security deposit for the performance of contract pertaining to supply of goods or provision of services is exempted from definition of deposits.

(d) *as advance received under long term projects for supply of capital goods except those covered under item (b) above:*

In general parlance, any projects which takes development time of more than 3 years is considered as long-term project. Capital goods is defined under revised GST Law. This may include research projects, manufacturing projects, etc. So, any amount received under long term projects other than against immovable properties, shall not be treated as deposits.

(e) *as an advance towards consideration for providing future services in the form of a warranty or maintenance contract as per written agreement or arrangement, if the period for providing such services does not exceed the period prevalent as per common business practice or five years, from the date of acceptance of such service whichever is less;*

There is a specific condition mentioned in this sub-rule. The period for providing future services shall not be in the form of a warranty or maintenance contract shall be as per common business practice or for five years, from the date of acceptance of such service whichever is less. In case, if the period exceeds five years, it would be treated as

deposit. For example, if a car manufacturing Company receives money and gives a warranty of 10 years on cars, whether it would be able to claim this exemption?

(f) *as an advance received and as allowed by any sectoral regulator or in accordance with directions of Central or State Government;*

Sectoral regulators in India include SEBI, IRDAI, RBI. So, any advance received and as allowed by sectoral regulators if mentioned under their laws, shall be exempted. A point to note here is that sectoral regulations/laws have to be referred to while ascertaining this subrule.

(g) *as an advance for subscription towards publication, whether in print or in electronic to be adjusted against receipt of such publications;*

Any amount received as an advance for subscription of publications viz., newspaper/magazine/media subscriptions shall be appropriated against such subscriptions only.

The clauses (e), (f) and (g) have been inserted as an amendment to the deposit rules with effect from 29th June, 2016. It is further stated that, if the amount received under items (a), (b) and (d) above becomes refundable (with or without interest) due to the reasons that the company accepting the money does not have necessary permission or approval, wherever required, to deal in the goods or properties or services for which the money is taken, then whether the amount received shall be deemed to be a deposit is a question to be evaluated. Also, the amount shall be deemed to be deposits on the expiry of fifteen days from the date they become due for refund. Thus, the all above conditions have to be fulfilled in order to claim exemption from deposits.

Out of the above, clause (a) has a limit of number of years and other clauses do not have limit on number of years. Also, clause (a) above is a general clause and rest all other clauses are specific clauses. So, if multiple clauses are applicable to a certain transaction, then most relevant specific clause should be considered since in general vs. specific, specific will always prevail over general.

Advances in nature of loans

The Companies (Auditor's Report) Order, 2020 (CARO) also provides a mention of the term "advances in nature of loans". CARO is about loan given and not received. Even though it speaks about advance under asset side of the balance sheet, but the terminologies or parameters mentioned therein, can be used for borrowings as well.

Guidance Note on CARO 2020 published by the Institute of Chartered Accountants of India, throws some light on this term. It has been stated that whether advance is in the nature of loan would depend on circumstances in each case. If there is a normal advance received in ordinary course, would not be an advance in nature of loan. However, if an advance is given-

- (a) for an amount which is far in excess of the value of an order or
- (b) for a period, which is far in excess of the period for which such advances are usually extended as per the normal trade practice,

then such an advance may be in nature of a loan to the extent of such excess. A useful guide in this case would be to consider the period required for execution of the order. If the period required for execution of the order is more than usual trade practice, then such advance would be said to be in the

nature of loan unless there is any evidence to the contrary. Also, a stipulation regarding interest may normally be an indication that the advance is in the nature of loan, but this is not conclusive evidence.

In classic case, Hon'ble Supreme Court Reports, *K. C. Gajapati Narayan Deo and Other vs. the State of Orissa*, dated 29th May, 1953, it was stated that the whole doctrine of colourable legislation is based upon the maxim that you cannot do indirectly what you cannot do directly. Thus, it is implied that if you cannot accept deposits when eligible, you cannot accept deposits by mere pretence. In fact, this would amount to fraud. Thus, if an advance received, after investigation by auditors, appears to be in the nature of loan, it would be termed as deposits only and here 365 days period will not be of any relevance and none of the exclusions under the definition of deposits under Section 2(c) (xii) would become applicable.

However, is there any defence, if such advance is not in the nature of loan and is actually an advance and goes beyond 365 days? As mentioned in the explanation above, the clauses (e), (f) and (g) under rule 2(1)(c) of the Companies (Acceptance of Deposit) Rules, 2014, pertaining to advance received against warranty, allowed by sectoral regulators and against subscriptions towards publication were inserted vide an amendment notified on 29th June, 2016. Now, since the said clauses were inserted later, an interesting thought to ponder over here is that what would happen to the advances received against warranty provided for more than 5 years or for newspaper subscriptions from the commencement of these rules till the aforesaid amendment became effective? Whether it would be treated as deposit then? Or should a stand be taken as to any amount received by way of deposit,

loan or in any other form, since it is not returnable, be considered as advance only and not deposit? What view should be taken for jewellers who accept advances or hospitality companies who provide holidays on timeshare basis and accept advances, but do not provide services within 365 days? A view can be taken that provision of services or appropriating the advances against such services is sufficient compliance and that it does not fall under the nature of deposits. However, this is a point which is yet to be tested in judicial processes.

Evaluation mechanism

When there are conditions, there also needs to be a control mechanism. The Institute of Chartered Accountants of India, in their publication viz., Guidance Note on Audit of

Debtors, Loans and Advances, have listed down certain valuation techniques. Following is few of the techniques with respect to loans and advances:

1. There should be proper systems
2. There should be proper documentation
3. Documents to be kept in safe custody
4. Periodical reviews to be conducted
5. Non-compliance cases to be highlighted

The guidance note also provides a mention of verification that the auditor is required to do and the representations that is required to be submitted by the Company.

Thus, these are asset side transactions, but it can be relevant for liability side transactions too.

BUDS Act, 2019

As discussed earlier, deposit is regulated at multiple levels under various laws. One recent law that is applicable all over India is the

Banning of Unregulated Deposit Schemes Act, 2019 (BUDS). This Act came into force on 21st February, 2019. The definition of deposits under BUDS is again an inclusive definition and refers to **an amount of money received by way of an advance or loan or 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 or in the form of a specified service, with or without any benefit in the form of interest, bonus, profit or in any other form.** If we compare this definition with definition of deposit given under the Companies Act, 2013, there is a huge difference as this definition is broader as it refers to money received by way of advance, loan or any other form by the deposit taker. This Act is applicable to every entity and not restricted only to a Company. The definition under Companies Act, 2013 mentioned by way of deposit, loan and in any other form and BUDS clearly mentions the word “advance”. Further, this definition in itself has words such as with a promise to return the money, after a specified period, either in cash or in kind or in form of a specified service, with or without any benefit. Thus, this definition also appears to be wider as it involves cash or kind or for any specified services.

The above definition also has few exclusions. Exclusions pertaining to advance are reproduced as below:

- (1) ***an amount received in the course of, or for the purpose of, business and bearing a genuine connection to such business including—***
 - (i) ***payment, advance or part payment for the supply or hire of goods or provision of services and is repayable in the event the goods or services are not in fact sold, hired or otherwise provided;***

- (ii) **advance received in connection with consideration of an immovable property under an agreement or arrangement** subject to the condition that such advance is **adjusted against such immovable property** as specified in terms of the agreement or arrangement;
- (iii) **security or dealership deposited for the performance of the contract** for supply of goods or provision of services; or
- (iv) **an advance under the long-term projects** for supply of capital goods except those specified in item (ii):

This clause is again inclusive like the definition of deposits under BUDS and hence there are no conditions. This gets validated from Section 41 of BUDS Act, 2019 which mentions that the provisions of this Act shall not apply to any deposits taken in the ordinary course of business.

Further, it is also clarified in the explanation to this clause that for Company, deposits shall have same meaning as assigned to it under the Companies Act, 2013 and in respect of a Non-Banking Financial Company (NBFC) registered under the Reserve Bank of India Act, 1934, the term deposits shall have the same meaning under the said Act. Thus, this Act is more relevant for non-corporate entities.

MPID Act, 1999

The Maharashtra Protection of Interest of Depositors (in Financial Establishments) Act, 1999 (MPID) came into force on 29th April, 1999. It is applicable for the State of Maharashtra only. There are similar Acts for other States viz., Tamil Nadu, Pondicherry, Andhra Pradesh, etc. The term deposit is

defined in MPID as any receipt of money or valuable commodity by a financial establishment to be returned after a specified period or otherwise, either in cash or kind or in the form of specified service with or without any benefit in the form of interest, bonus, profit or in any other form. This definition is an inclusive definition too and consists of few exclusions. There is a mention of amounts received in ordinary course of business by way of advance against order for goods or services. Financial Establishment is being separately defined to include any person accepting deposit under any scheme or arrangement or in any other manner but does not include a corporation, banking Company or a co-operative society owned or controlled by Government.

A landmark case of the year 2022 may be referred here to understand the definition better. In hon'ble Supreme Court case pertaining to the *State of Maharashtra vs. 63 Moon technologies Limited*, National Spot Exchange Limited (NSEL) was an electronic trading platform which facilitated transactions between buyers and sellers. The question was whether consideration which was not paid to the sellers by NSEL, due to suspension of its trading, was a deposit. It was held that the MPID Act defines deposit in broad terms. Further, according to the definition, the return may be either in money, commodity or service, and it is not necessary that the commodity or the money must be returned in the same form. The definition includes the receipt of money and the return of a commodity, or even the receipt of a commodity and a return in the form of a service. Further, hon'ble Supreme Court also highlighted that Section 2(c) states that the return may be with or without any benefit in the form of interest, bonus, profit or in any other form. The definition does not stipulate that there must be an added benefit,

rather that the added benefit is irrelevant for the purpose of the definition. For the purpose of Section 2(c), the receipt of the commodity or money must be retained by itself. The definition does not provide any such embargo. Rather, the definition is broadly worded to include even the possession of the commodities for a limited purpose. Hon'ble Supreme Court by quoting several judgements also settled constitutional validity of MPID Act.

This judgement will impact lots of business activities as the definition of deposit under MPID increases the scope wider and will require careful studying. The definition of deposits under BUDS is also wider however, the exemptions had narrowed the scope. But, the scope of deposit under MPID does not appear so.

Consequences

Under Companies Act, 2013, the consequences for non-compliance, in addition to the amount of deposit are fine which shall not be less than one crore rupees or twice the amount of deposit accepted by the Company, whichever is lower but which may extend to ten crore rupees. Further, every officer of the company who is in default shall be punishable with imprisonment which may extend to seven years and with fine which shall not be less than twenty-five lakh rupees but which may extend to two crore rupees

Provided that if it is proved that the officer of the company who is in default, has contravened such provisions knowingly or wilfully with the intention to deceive the company or its shareholders or depositors or

creditors or tax authorities, he shall be liable for action under section 447 (Punishment for Fraud).

Under BUDS, the consequence for non-compliance is where an offence under this Act has been committed by a deposit taker other than an individual, every person who, at the time the offence was committed, was in charge of, and was responsible to, the deposit taker for the conduct of its business, as well as the deposit taker, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly.

Under MPID, any financial establishment, which fraudulently defaults any repayment of deposit on maturity along with any benefit in the form of interest, bonus, profit or in any other form as promised or fraudulently fails to render service as assured against the deposit, then every person including the promoter, partner, director, manager or any other person or an employee responsible for the management of or conducting of the business or affairs of such financial establishment shall, on conviction, be punished with imprisonment for a term which may extend to six years and with fine which may extend to one lakh rupees such Financial Establishment also shall be liable for a fine which may extend to one lakh of rupees.

Conclusion

One needs comprehensive understanding of these subjects so that he does not attract any trouble and need to take very well studied, updated and wise approach while dealing with advances in ordinary course of business.

