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## Interest Free Loan falls under the purview of Financial Debt

### Introduction

The Hon'ble Supreme Court on 26th July 2021 delivered a very important judgement in the case of *M/s. Orator Marketing Pvt. Ltd. Vs. M/s. Samtex Desinz Pvt. Ltd.* [\(2021\) ibclaw.in 68 SC](#), interpreting the definition of financial debt u/s 5(8) of the Insolvency and Bankruptcy Code, 2016 "IBC". The Supreme Court held that the definition of financial debt u/s 5(8) does not exclude interest free advances/loans as it was of the view that while interpreting the meaning of a certain provision in a statute, the same cannot be read in isolation. The statute has to be read as a whole.

### Factual Matrix and Timeline

In the present case M/s. Samtex Desinz Pvt. Ltd. hereinafter "Samtex" (Respondent) received a term loan of Rs. 1.60 crores advanced from M/s. Sameer Sales Pvt. Ltd. "Sameer" (Original Lender) to meet its working capital requirements. Sameer later assigned the outstanding loan of Rs. 1.56 Crores to M/s. Orator Marketing Pvt. Ltd. "OMPL" (Appellant). This amount was repayable in two years from the date of Agreement i.e., on or after 1st February, 2020 upon demand by the lender. Subsequently, there was default in payment of debt of Rs. 1,56,89,740/- on the part of Samtex, pursuant to which OMPL filed a petition u/s 7 of the IBC for initiating Corporate Insolvency Resolution Process "CIRP" before National Company Law Tribunal "NCLT", Delhi bench.

However, NCLT rejected the petition and subsequently held that OMPL does not qualify as a financial creditor u/s 5(7), IBC because the debt in question is not financial debt u/s 5(8), IBC. The same was affirmed by the Hon'ble National

Company Law Appellate Tribunal “NCLAT”, Delhi wherein it noted that a term loan advanced without an interest does not fall within the ambit of financial debt.

In contrary, the Hon’ble Supreme Court was of the view that the definition of financial debt cannot be read in isolation. It further noted that Section 5(8) defines financial debt to mean “a debt along with interest *if any* which is disbursed against the consideration for time value of money and includes money borrowed against the payment of interest, as per Section 5(8) (a) of the IBC. However, The NCLT and NCLAT have overlooked the words “*if any*” while interpreting the definition of financial debt u/s 5(8) of IBC.

## **Issue- whether interest free loan falls under the ambit of s 5(8) of IBC, 2016**

For a debt to qualify as financial debt u/s 5(8) of IBC, the two essential requirements that ought to be met are (a) there must be a debt along with interest, if any, and (b) the debt must be disbursed against consideration for time value of money.<sup>[i]</sup>

## **The take of NCLT and NCLAT on the issue**

Both NCLT and NCLAT rejected the application of OMPL on the grounds that the debt is not financial in nature and subsequently, it does not qualify as a financial creditor u/s 5(7) of IBC. NCLAT in its judgement took into consideration the loan agreement signed between the parties which stated that the loan is advanced without any interest and thus it falls outside the purview of financial debt.

It also rejected the contention put forth by OMPL that the development of the business of Samtex was enough consideration for time value of money. The court noted that the term “time value of money” has to be a consideration for the Financial Creditor and how a Corporate Debtor will use the money cannot be the consideration for time value of money for the Financial Creditor.

## **Supreme Court’s Decision**

The Hon’ble Supreme Court set aside the judgement and order of NCLAT which affirmed the order of NCLT and dismissed the appeal. The Court noted that the aforesaid judgements were patently flawed because both the NCLT and NCLAT misconstrued the definition of ‘financial debt’ by reading the same in isolation and out of context.

The Supreme Court held that the definition of financial debt in Section 5(8) of IBC does not expressly exclude an interest free loan. Financial debt would have to be construed to include interest free loans advanced to finance the business operations of a corporate body.

## **Analysis and Observations**

### ***(i) Legislative intent and Interpretation of the Code***

The Hon’ble Supreme Court draws attention to the judgement of *Poppatlal Shah v State of Madras* which states that in order to interpret any statutory provision, one must look into the legislative intent of the statute. The intention of the statute has to be found in the words used by the legislature itself and in case of any doubt, the object and purpose of

the statute or the reason and spirit behind it shall be taken into account.

The Court held that the definition of 'financial debt' in Section 5(8) of the IBC cannot be read in isolation and other relevant provisions must also be taken into consideration which includes the definition of claim, corporate debtor, creditor, debt, default, financial creditor as also the provisions, inter alia, of Sections 6 and 7 of the IBC because the statute has to be read as a whole.

### **(ii) Ambit of financial debt u/s 5(8)**

Section 5(8) defines financial debt to mean *"a debt alongwith interest, **if any**, which is disbursed against the consideration for the time value of money and **includes** money borrowed against the payment of interest."* The definition of financial debt includes the components of sub-clauses (a) to (i) of the said Section.

The Supreme Court noted that the NCLT and NCLAT while pronouncing the judgements did not take into account the words *"if any"* mentioned in the above definition. These words/phrases cannot be skipped while interpreting the definition as it adds meaning to it. Thus, the Hon'ble Court held that the words *"if any"* used in the definition denote that a loan extended without any interest is not excluded and it would also qualify as a financial debt within the meaning of Section 5(8) and hence, if there is no interest payable on the loan, only the outstanding principal would qualify as a financial debt.

The Court further relied on the judgments of Dilworth v Commissioner of Stamps and State of Bombay v Hospital Mazdoor Sabha wherein it was held that when a definition incorporates the word "include" which is very generally used in interpretation clauses in order to enlarge the meaning of the definition, then such words or phrases used must be construed as comprehending. Thus, while dealing with such an inclusive interpretation, a restrictive interpretation should not be given to the words of wider denotation.

Both NCLT and NCLAT also failed to notice clause (f) of Section 5(8), in terms whereof 'financial debt' includes any amount raised under any other transaction, having the commercial effect of borrowing. The Supreme Court noted that a term loan meeting the financial requirements of a Corporate Debtor for its operation has the commercial effect of borrowing therefore, should not be excluded from the purview of a financial debt. The Court also stated that where the word is defined to include something, the definition is prima facie extensive. Thus, making the interest free debt disbursed against consideration for time value of money.

## **Conclusion and way forward**

This case clears the position of law with regards to interest free loans and classifies them under the purview of financial debt. In addition, the Court read the definition of financial debt u/s 5(8) with clause (f) for establishing that the term loan advanced was disbursed against consideration for time value of money in order to promote the business operations of Samtex making the debt financial in nature. The Court also took into account the importance of words/phrases mentioned in a definition of a statute and held that any provision of a statute should not be read in isolation rather the statute must be read as a whole.

## **Reference**

[1] *Dr BVS Laxmi v Geometrix Laser Solutions Pvt Ltd* 2017 SCC OnLine NCLT 458.

