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Employer-Employee Loans and the National Credit Act



What is the effect of Employer-Employee Loans as per the new National Credit Act (NCA) threshold? Is it at arm's length or not?

In a previous blog insert we discussed the new zero registration threshold applicable to credit providers, as well as *the consequences of non-compliance with the National Credit Act (NCA)*. We highlighted that persons involved in any credit lending activities, which fall within the ambit of the NCA, must register as credit providers with the National Credit Regulator (NCR), regardless of the value of the credit agreements.

We now focus on the effect of the new threshold for businesses, particularly where an employer enters into various types of loan transactions with his/her employees.

One should always bear in mind that the NCA, subject to certain exceptions, applies to all credit agreements:

- concluded, or having effect, within South Africa; and
- which were entered into by parties *dealing at arm's length*.

Which agreements qualify as “credit agreements” for purposes of the NCA?

In terms of the NCA, an agreement qualifies as a *credit agreement* in terms of the NCA, *among others*, if:

- a payment obligation is deferred (postponed); and
- a **charge, fee or interest** is payable to the credit provider.

When are parties dealing at arm's length?

The NCA provides that parties are dealing at arm's length when they are **independent** of each other and strive to obtain the highest possible **advantage** from the transaction.

It has been argued that loans advanced in the context of an employment relationship are not concluded at arm's length and, therefore, should not qualify as a credit agreement in terms of the NCA.

However, the NCA does not make provision for any exemptions in respect of an employer providing his/her employees with loans where a **charge, fee or interest** has been levied and, accordingly, the levying of any **charge, fee or interest**, regardless of whether it is nominal or linked to prime, will render the agreement a *credit agreement in terms of the NCA*.

Employer-employee loan agreements:

Employer-employee loan agreements usually provide for **nominal interest** to be paid by an employee to the employer on the principal debt over a specified period of time, thereby:

- deferring the payment of the loan; and
- levying interest on the deferred payment.

Types of employer-employee loans:

The following are examples of the most common types of employer-employee loan agreements entered into:

- Salary advances;
- Traditional loans; and
- Employee share ownership schemes.

The NCA is applicable, now what?

The NCA will automatically become applicable to the employer-employee loan transaction where a **charge, fee or interest** has been levied, and subsequently, an employer will be required to:

- register as a credit provider with the NCR; and
- comply with various onerous provisions of the NCA, such as:
 - conducting credit assessments (in order to avoid extending reckless credit); and
 - providing pre-agreement disclosures (this sets out all relevant information pertaining to the transaction to enable the employee as credit consumer to make an informed decision in respect of accepting the loan).

Is an employer really striving to obtain the best possible advantage from an employer-employee loan?

It is accepted that an employer does not strive to obtain the best possible advantage when providing an employee with a loan **free of charge, fee or interest**, as this is not to the benefit of the employer. For this very reason, the transaction will not be deemed to be concluded at arm's length and will therefore fall outside the ambit of the NCA.

On the other hand, it will be presumed that an employer is striving to obtain some sort of advantage from a transaction when he/she levies a **charge, fee or interest** (regardless of whether the rate of interest is nominal or linked to prime) on a loan extended to an employee.

Arguably, an employer-employee loan subject to a nominal interest rate should not fall within the ambit of the NCA, as the employer does not benefit from the loan; **however**, the NCR and the courts are of the view that any **charge, fee or interest** applied to a transaction will render the loan subject to the NCA.

What about the upliftment of employees by means of employee share ownership schemes?

Given that an employer is uplifting his/her employees by offering an employee share ownership scheme in terms of which interest-bearing loans are made available to enable employees to purchase shares in the holding or subsidiary company, the court will view the transaction as a credit agreement in terms of the NCA.

This position was confirmed by the recent Supreme Court of Appeal (SCA) judgment in *Vesagie No & others v Erwee No & another* (734/2013) [2014] ZASCA 121 (19 September 2014) (“the Vesagie case”), which saw the SCA confirming that an agreement for the sale of shares, which was subject to deferred payment and the levying of interest, was *void ab initio* as the seller of the shares was not a registered credit provider in terms of the NCA.

The SCA’s judgment in the Vesagie case therefore serves as a warning to employers intending to enter into any type of loan agreement with employees, not only for the purchase of shares, as the simple act of levying interest on the deferred payments will unintentionally result in the agreement being **null and void ab initio**.

Consequently, the NCA will automatically become applicable to any employer-employee loan agreement where a **charge, fee or interest** has been levied, as the transaction will be deemed to be at arm’s length despite it having been entered into during the course and scope of an employment relationship.

Conclusion:

It is clear that the NCR and the courts have adopted a strict interpretation of the NCA and, as such, are likely to deem any employer-employee loan agreement that is subject to a **charge, fee or interest** as falling within the ambit of the NCA. The Vesagie case serves as a stark reminder that even a small matter of levying interest can lead to dire consequences for all parties to the transaction.

Employers should, therefore, exercise caution when levying a **charge, fee or interest** on loans extended to employees so as not to open the proverbial can of worms. Employer-employee loans should therefore be structured in such a manner as to minimise the risk of being catapulted into the NCA's arena of application.

Caution should, however, be exercised if interest is not levied on an employer-employee loan as the South African Revenue Services may come knocking; therefore a Tax Directive should be requested by parties considering such an arrangement in order to safeguard against any unexpected taxes and potential penalties.

About the Author: Montenique Hayward is a BCom (Law) [2011], LLB [2013] and LLM [2017] graduate from the University of Pretoria. During her LLM studies, she specialised in Consumer Protection and was, subsequently, awarded the JUTA award for the highest mark obtained at the end of her LLM. She was also admitted as an attorney of the High Court in 2015 and practiced as such before joining our team in 2017 as a Corporate Legal Advisor.

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