



UNDERSTANDING USURY

By Herman S. Chatrath

In California, usury laws cap interest rates on a loan or forbearance of money, creating significant risks for both lenders and borrowers who violate these limits. Lenders can face loan invalidation, penalty payments, and potential criminal charges, while borrowers who understand these laws can identify illegal lending practices, demand refunds of excess interest, and avoid predatory loans that could trap them in unsustainable debt cycles. This article explores California's usury laws and their consequences whether you're extending or receiving credit.

California's Usury Laws

California usury laws are codified in Article XV, Section 1 of the California Constitution. For non-exempt lenders, they cap interest rates on a "loan" or "forbearance of money" at 10% per year for consumer loans (for personal, family or household use), and the greater of 10% per annum or the federal discount rate plus 5% (currently making the cap between 10–12%) for non-consumer loans. These laws are designed to protect borrowers from predatory lending while allowing regulated financial institutions to operate under federal and state banking regulations rather than constitutional interest rate limits.

Who is Subject to Usury Laws

California's usury laws apply to all loans unless a specific exemption applies. Usury restrictions apply to private lenders, such as individuals or businesses that are not in the regular business of lending. That means if you loan money to a friend or invest in a promissory note without a license, you're likely subject to California's usury limits.

Common Usury Exemptions

California's usury laws do not apply to loans made by banks, credit unions, licensed finance lenders, or to real estate loans arranged by licensed brokers and secured by property (Civil Code § 1916.1). Business loans of \$300,000 or more to corporations or LLCs may also be exempt.

Usury laws also don't apply to bona fide credit sales or legitimate service charges. For example, a higher price on an installment sale (a time-price differential) or reasonable fees for underwriting or administrative services are generally not treated as interest. However, if a "service charge" is simply a disguised way to increase the loan's return—such as a percentage-based fee without any real service—it may be recharacterized as interest and trigger usury violations. Not all business loans are exempt. The structure and documentation matter, and loans that don't clearly meet a statutory or constitutional exemption remain subject to California's interest rate limits.

What Happens If You Violate California's Usury Laws?

Violating California's usury laws can result in serious penalties. Lenders who charge unlawful interest may have to forfeit all interest collected, and borrowers may be entitled to up to triple the amount paid. In some cases, courts may declare the loan void and unenforceable, leaving the lender unable to recover even the principal. Criminal charges are possible for willful violations under Penal Code §§ 639–639a, and punitive damages may apply if the conduct is found to be fraudulent or oppressive.

The California Department of Financial Protection and Innovation (DFPI) oversees licensed lenders and can take enforcement action against those who violate lending laws. While licensed entities may be exempt from constitutional usury limits, unlicensed or predatory lenders remain fully subject to them.

For businesses selling goods or providing services, California law recognizes the time-price differential doctrine. This distinction, recognized by courts such as in *Southwest Concrete Products v. Gosh Construction Corp.* (1990) 51 Cal.3d 701, allows businesses to charge a service charge on late payments without being subject to usury restrictions, so long as the transaction is a bona fide sale rather than a disguised loan.

Whether you're an investor offering bridge loans or a business seeking capital, properly structuring the transaction is critical to avoid unintentionally violating California's usury laws. The rules—and their exemptions—are complex, technical, and often counterintuitive. For borrowers, understanding whether a loan is subject to usury limits can impact enforceability and potential remedies. For lenders, failure to comply can lead to severe penalties. Given the risks on both sides, careful planning and legal review are essential.

The transactions department at Coleman & Horowitz, LLP represents clients in business entity formation, corporate governance, dissolution and winding up of business entities, mergers and acquisitions, stock sales, asset purchase agreements, business and succession planning and general counsel to business entities. If you have any questions about this article or our services, contact the author, Herman S. Chatrath, or Michael P. Dowling, head of the transactions department, at (559) 248-4820 or (800) 891-8362 or hchatrath@ch-law.com or mdowling@ch-law.com.

© Coleman & Horowitz, LLP, 2025

About the Author:



Herman S. Chatrath is an attorney in Coleman & Horowitz's Fresno and Visalia offices, where he represents companies and their owners in business, real estate, and construction transactions and wills, trusts and estate planning matters. A graduate of Loyola Law School, Herman brings a strong background in commercial real estate, having managed large portfolios of apartment and office buildings, as well as overseeing non-performing loans for a private real estate company with assets over \$4 billion. He can be reached at (559) 248-4820 or hchatrath@ch-law.com.

About the Firm:

Established in 1994, Coleman & Horowitz, LLP is a state-wide law firm focused on delivering responsive and value-driven service and preventive law. The Firm represents businesses and their owners in matters involving transactions, litigation, agriculture & environmental regulation and litigation, intellectual property, real estate, estate planning and probate. Attorneys at the firm also serve as mediators, arbitrators, and discovery referees.

The Firm has been recognized as a "Preeminent Law Firm" by Martindale Hubbell, a "Go-To" Law Firm (Corporate Counsel) and listed in the Chambers California Spotlight for commercial litigation (Fresno). From six offices in California, and the Firm's membership in Primerus, a national and international society of highly rated law firms (www.primerus.com), the Firm has helped individuals and businesses solve their most difficult legal problems. For more information, see www.ch-law.com and www.Primerus.com.

DISCLAIMER: This article is intended to provide the reader with general information regarding current legal issues. It is not to be construed as specific legal advice or as a substitute for the need to seek competent legal advice on specific legal matters. This publication is not meant to serve as a solicitation of business. To the extent that this may be considered as advertising, then it is expressly identified as such.

IRS CIRCULAR 230 DISCLOSURE: To ensure compliance with the requirements imposed by the IRS, we inform you that any U.S. federal tax advice contained in this article is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.