

Loans and Investments by  
Companies –Section 186  
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# Inter-corporate loans and investments

## –Section 186-Corresponds to Section 372A of old Act

- Section 186(1) –
- Meaning-“Without prejudice to the provisions contained in this Act”.
- No other provision is affected by what is stated in Section. Qualifying statement protecting operation of another provision.
- No investment beyond two layers of **investment** companies.
- Investment company as defined in Explanation u/s 186(12).

# Restrictions on layering

- Exceptions to layering which will not affect-
- A company from acquiring any other company outside India if such company has investment subsidiaries beyond two layers as per laws in said country.
- Subsidiary company from having any investment subsidiary for meeting requirements of any law.

# Use of “person” in section 186

- **Section 186(2)**
- No loan **direct or indirect** to be provided to
- a) any person or body corporate
- Person excludes individual in employment with company.
- Person-Section 2(31)-IT Act inclusions. Reference to also 2(42)-General Clauses Act.
- No guarantee or security against loan of any person or body corporate and
- Acquisition of any securities by subscription , purchase or otherwise of any other body corporate.
- Ceiling-60% of paid up capital, free reserves and securities premium or 100% of free reserves whichever **higher**.

# Ceiling applicable

- Section 186(3)-Where loans/investments /guarantees provided to other **bodies corporate** exceeds ceiling stated ,previous approval by special resolution in general meeting.
- Use of “ person” in 186(2) rendered infructuous.
- **Proviso**-No requirement of special resolution for loans /investment in WOS **or joint venture.(Section 2(6))**
- **Proviso**-proper disclosure of loans/investments in financial statement as stated in subsection (4).

# Unanimous approval of Board even for investments/loans within limits

- Section 186(4)-Full disclosure of loans ,investments made, guarantees provided, purpose for which loan/guarantee to be used by recipient.
- Section 186(5)-For investments/loans within ceiling ,consent of **all** directors present at the meeting.
- Where loan subsisting with public financial institution , prior consent of Institution to be obtained.

# Institutional approval in certain cases

- **Proviso**-No approval of Institution needed where aggregate of investments/loans does not exceed ceiling **and**
- There is no default in repayment of principal or interest on loans from public institutions.
- No company registered under Section 12 of SEBI Act and covered under class of companies not to make inter corporate loans/ deposits beyond prescribed limits and full disclosure to be made of such loans/deposits.
- Section 12 applicability to Stock Brokers ,RTAs etc.

# No loan on interest free terms

- 186(7)-No provision of loans except at interest rates corresponding to Govt. security of specific tenures.
- Bar on companies which have defaulted in payment of deposits taken prior to the Act over provision of loans/guarantees while defaults subsist.
- Maintenance of Register of loans /guarantees and investments and keeping register open for inspection.



# Exempt Companies

- **Exemption** clause-Section 186(11)
- Exemption from provision except for subsection (1).-
- Loans /guarantee/security /investment by banking/insurance companies /housing finance in ordinary course of business or companies in business of financing industrial enterprises or in providing infrastructural facilities.

# Exemptions

- To investment companies –in respect of investments made only . Lending will come under ceiling.
- To other companies –investments made pursuant to Section 62
- Investments /lending activities by NBFCs under Chapter III-B of RBI Act engaged in business of acquiring securities.

THANK YOU

# Loans to Directors

Ramaswami Kalidas

Practicing Company Secretary

Thane –February,26, 2023

# Loans to directors-Law not prohibitive provision in entirety

- Section 185 in present form applies from 7.5.2018 in substitution of earlier version.
- Present provision “watered down provision” as opposed to original stricter version.
- Section now prohibitory/ restrictive provision as against prohibitory earlier.
- Reduced to “conflict of interest ” provision substantially –Imposes fetters on powers now similar to Section 295.

# Section 185-Introspection

- Originally applied to private companies, Nidhis.
- Effective from 5.6.2015 not applicable to **private company** if:
  - a) No other body corporate has invested in share capital.
  - b) borrowings of company from banks/institutions or body corporates less than twice paid up capital or 50 crores whichever lower.
  - c) No default in repayment of debts at the time transaction made.
- Conditions **aggregative** and not mutually exclusive

# Dilution of provision over previous version of Section 185

- Whether benefit of exemption to private companies applies even under diluted provision.
- Whether MCA circulars are binding in law. Refer Bhagawati Developers v Peerless and Delhi HC decision.
- Exemption issued by Notification under Section 462 –Hence has binding force.
- Non-applicability to Nidhi effective from 5.6.2015 where loan to director or relative is in their capacity of members and there is disclosure of transaction in books.
- No applicability to Govt. company where approval obtained from Ministry or Authority administratively in charge of company.

# Some perspectives on loans

- Loan-Giving of money with the expectation of repayment usually with interest.
- Essential requirement of loan –the advancement of money upon the understanding of return with or without interest.(Freddie Mehta v UOI(70 Comp Cas. 210).
- Applicability to direct or indirect lending. Lending characterized by fronting of person in indirect loan. Also personal expenses of director borne and not recovered is loan.



# Specific prohibitions

- 185(1)-No loan-directly or indirectly including loan represented by book debt .
- No guarantee or security to be provided for any loan taken by-
- a)director or director of company which is its holding company or any partner or relative of **such** director or
- b)any firm in which any such director or relative is a partner.
- **Such**-In law refers to something already mentioned in preceding part of provision.

# Specific prohibitions on loans , guarantees

- To director of the company
- To the director of Holding co of company
- To any partner of the director
- To any partner of director of holding co of company
- To any relative of the director of the company
- To any relative of director of holding company of company.

# Specific prohibitions

- Any firm in which any director of company is a partner
- Any firm in which director of the holding company of the company is a partner.
- Any firm in which relative of any director of the company is a partner
- Any firm in which any relative of the director of the holding company of the company is a partner.

# When is a loan disguised as book debt

- Includes book debt in the nature of loan.
- Book debt-outstanding sum in ordinary course of business.
- Where book debt takes color of loan it is covered.
- Book debt also includes outstanding on rental of company property due from director.
- Director-expression to be restricted in application to definition in Section 2(34). De jure director and not defacto .
- Prohibition extends over company or holding co of which director of company is director.

# Is letter of comfort a guarantee

- No guarantee or provision of security for loan taken by director or relative.
- Is letter of comfort equivalent to guarantee.
- Language of LOC determinant factor.
- Prohibition of Section 185 over loan to firm of which director or relative is partner.
- Relative-as defined u/s 2(77) and extension thereto.
- Lease or hire purchase arrangement and outstanding not tantamount to loan under Section 185.

# Persons in whom director interested – Explanation

- Advance salary to director in employment deductible unless advance used as subterfuge for loan.
- Section now allows provision of loan /guarantee for loan taken by **any person in whom the director of company is interested** subject to –
  - a)proposal being approved by special resolution.
  - b)loan is used by borrower for its **principal business activities**.
- No definition to term – has to be considered synonymous with ordinary course of business.

# Permissibility under Section 185

- Explanation u/s 185(2).
- Meaning of Explanation in law.
- “Any person in whom any of the director of the company is interested” meaning restrictively used
- a) any private company in which any such director is director or member-Extent of holding not relevant or.
- b) any body corporate at a general meeting of which not less than 25% voting power is exercisable or controlled by **such** director or by two or more directors together or

# Persons in which director interested

- c )Any body corporate , the board , MD or Manager whereof is accustomed to act in accordance with the directors of the board or of any directors or directors of the lending company.
- Clause recognizes concept of *de facto* directors – shadow directors apart from *de jure* .
- Shadow directorship existence circumstantial- to be proved.



# Exceptions under Section 185-Non-applicability

- Exceptions-subsection (3)-
- Loan to MD or WTD as part of conditions of service applicable to all employees or
- Pursuant to any scheme approved at general meeting or .
- Where company provides loan/guarantee in ordinary course of its business on which interest is charged at rates not lower than rates for Govt. security based on tenor or
- Can guarantee/provision of security be gratuitous?

# Exceptions to Section 185

- Loan/guarantee /security by holding company to WOS or
- Any guarantee given or security for loan obtained by Subsidiary from banks or FIs.
- Does it cover guarantee to partly owned subsidiary .?
- Loans to be used for principal business activities of Subsidiary .
- Subsection silent on levy of interest to subsidiary.
- To draw inference from 186(7) which prohibits interest free lending.

- THANK YOU