

Section 185 : Loan To Directors etc.

1. Preambles :

Intent of the Legislature to prevent the directors from abusing their position of trust in respect of:

- Giving loan
- Giving Guarantee
- Provide security

Memorandum Clause:

This clause corresponds to section 295 of the Companies Act 1956 and seek to provide the circumstances and manner in which a company shall advance any loan to any of its directors or to any other person in whom he is interested or give any guarantee or provide any security in connection with any loan taken by him or such other person. The clause also defines the expression “to any other person in whom director is interested. The clause also defines the expression “to any other person in whom director is interested”. The clause also provides for penal provisions for the company and for the directors to whom loan is advanced in case of contravention of sub cause (1).

2. Back ground History and present section at a glance:

Insertion w.e.f 01.04.2014

First Changes taken place on 7th May 2018

Sec 295 of the Companies Act 1956	Sec 185 of the Companies Act 2013 effective today	<u>Our comments</u>
(1) Save as otherwise provided in sub-section (2), no company (hereinafter in this section referred	(1) No company shall, directly or indirectly, advance <u>any loan, including</u>	<u>Prohibitory- Part Loan represented by book debts is also included.</u>

<p>to as" the lending company") <u>without obtaining the previous approval of the Central Government</u> in that behalf shall <u>directly or indirectly,</u>] make any loan to, or give any guarantee or provide any security in connection with a loan made by any other person to, or to any other person by,-</p> <p>(a) any director of the lending company or of a company which is its holding company or any partner or relative of any such director;</p> <p>(b) any firm in which any such director or relative is a partner;</p> <p>(c) any private company of which any such director is a director or member;</p> <p>(d) any body corporate at a general meeting of which not less than twenty- five per cent. of the total voting power may be exercised or controlled by any such director, or by two or more such directors together; or</p> <p>(e) any body corporate, the Board of directors, managing director, managing agent, secretaries and treasurers, or manager whereof is accustomed to act in accordance with the directions or instructions of</p>	<p>any loan represented by a book debt to, or give any guarantee or provide any security in connection with any loan taken by,—</p> <p>(a) any director of company, or of a company which is its holding company or any partner or relative of any such director; or</p> <p>(b) any firm in which any such director or relative is a partner.</p> <p><u>Clause C does not exist- substituted by explanation</u></p> <p><u>Clause (d) does not exist- - substituted by explanation</u></p> <p><u>Clause (e) does not exist</u></p>	<p><u>Auto mode mode effective in place of CG Permission in accordance with the provisions of sub section (2)</u></p> <p><u>Clause (a) and (b) is same to section 295 of old section.</u></p> <p><u>Clause c to e has been substituted by explanation</u></p>
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<p>the Board, or of any director or directors, of the lending company.</p> <p>(2) Sub- section (1) shall not apply to-</p> <p>(a) any loan made, guarantee given or security provided-</p> <p>(i) by a private company unless it is a subsidiary of a public company, or</p> <p>(ii) by a banking company;</p> <p>(b) any loan made-</p> <p>(i) by a holding company to its subsidiary, or</p> <p>(ii) by a company which is the managing agent or secretaries and treasurers of another company to that other company;</p> <p>(c) any guaranty given or security provided-</p> <p>(i) by a holding company in respect of any loan made to its subsidiary, or</p> <p>(ii) by a company which is the managing agent or secretaries and treasurers of another company in respect of any loan made to that other company.]</p>	<p>(2) A company may advance any loan including any loan represented by a book debt, or give any guarantee or provide any security in connection with any loan taken by any person in whom any of the director of the company is interested, subject to the condition that—</p> <p>(a) a special resolution is passed by the company in general meeting:</p> <p>Provided that the explanatory statement to the notice for the relevant general meeting shall disclose the full particulars of the loans given, or guarantee given or security provided and the purpose for which the loan or guarantee or security is proposed to be utilised by the</p>	<p><u>Restrictive Part Under sub Section (2) manner of providing loan has been specified instead of applicability</u></p> <p><u>Permission only for loan/ security/ guarantee to a company with the condition of special resolution + utilization for principal business activity</u></p> <p><u>Same as clause c to e of old section (1) c to e</u></p>
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	<p>recipient of the loan or guarantee or security and any other relevant fact; <u>and</u></p> <p>(b) the loans are <u>utilised by the borrowing company for its principal business activities.</u></p> <p>Explanation.—For the purposes of this sub-section, the expression “any person in whom any of the director of the company is interested” means—</p> <p>(a) any private company of which any such director is a director or member;</p> <p>(b) any body corporate at a general meeting of which not less than twenty-five per cent. of the total voting power may be exercised or controlled by any such director, or by two or more such directors,</p>	<p><u>Exclusion of relatives</u></p>
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	<p>together; or</p> <p>(c) any body corporate, the Board of directors, managing director or manager, whereof is accustomed to act in accordance with the directions or instructions of the Board, or of any director or directors, of the lending company.</p> <p>(3) Nothing contained in sub-sections (1) and (2) shall apply to—</p> <p>(a) the giving of any loan to a managing or whole-time director—</p> <p>(i) <u>as a part of the conditions of service extended by the company to all its employees; or</u></p> <p>(ii) pursuant to any <u>scheme approved by the members by</u></p>	<p><u>Automatic permission</u> + <u>Notification dated 5th June 2015</u></p> <ul style="list-style-type: none"> - Government Company- approval - Private Company- condition - Nidhi company – to director or relative in the capacity as member- disclosure in annual accounts
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<p>(3) Where any loan made, guarantee given or security provided by a lending company and outstanding at the commencement of this Act could not have been made, given or provided, without the previous approval of the Central Government, if this section had then been in force, the lending company shall, within six months from the commencement of this Act or such further time not exceeding six months as the Central Government may grant for that purpose,</p> <p>either obtain the approval of the Central Government to the trans- action or enforce the repayment of the loan made, or in connection with which the guarantee was given or the security was provided, notwithstanding any agreement to the contrary.</p>	<p><u>a special resolution</u>; or</p> <p>(b) a company which in the <u>ordinary course of its business</u> provides loans or gives guarantees or securities for the due repayment of any loan and in respect of such loans an interest is <u>charged at a rate not less than the rate of prevailing yield of one year, three year, five year or ten year Government security closest to the tenor of the loan</u>; or</p> <p>(c) any loan made by a <u>holding company to its wholly owned subsidiary company</u> or any guarantee given or security provided by a holding company in respect of any loan made to its wholly owned subsidiary company; or</p>	<p><u>6.291%</u> <u>6.598%</u> <u>7.048%</u></p> <p><u>Loan / Guarantee/ Security (third party)</u></p>
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<p>(4) Every person who is knowingly a party to any contravention of sub-section (1) or (3), including in particular any person to whom the loan is made or who has taken the loan in respect of which the guarantee is given or the security is provided, shall be punishable either with fine which may extend to five thousand rupees or with simple imprisonment for a term which may extend to six months:</p>	<p>(d) any <u>guarantee</u> given or <u>security</u> <u>provided by a holding company in respect of loan made by any bank or financial institution to its subsidiary company</u>:</p> <p>Provided that the loans made under clauses (c) and (d) are utilised by the subsidiary company for its principal business activities.</p> <p>(4) If any loan is advanced or a guarantee or security is given or provided or utilised in contravention of the provisions of this section, the company shall be punishable with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees, and the director or the other person to whom any loan is advanced or guarantee or security is given or</p>	<p><u>(Guarantee/ Security in respect of loan from bank/ FI</u></p> <p><u>Condition of utilization</u></p>
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<p>Provided that where any such loan, or any loan in connection with which any such guarantee or security has been given or provided by the lending company, has been repaid in full, no punishment by way of imprisonment shall be imposed under this sub-section; and where the loan has been repaid in part, the maximum punishment which may be imposed under this sub-section by way of imprisonment shall be proportionately reduced.</p> <p>(5) All persons who are knowingly parties to any contravention of sub-section (1) or (3) shall be liable, jointly and severally, to the lending company for the repayment of the loan or for making good the sum which the lending company may have been called upon the pay in virtue of the guarantee given or the security provided by such company.</p>	<p>provided in connection with any loan taken by him or the other person, shall be punishable with imprisonment which may extend to six months or with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees, or with both.</p> <p><u>NA</u></p>	<p>No such clause exists in respect of personal liability</p> <p>No Such clause exists</p>
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<p>(6) No officer of the lending company or of the borrowing body corporate shall be punishable under sub- section (4) or shall incur the liability referred to in sub- section (5) in respect of any loan made, guarantee given or security provided after the 1st day of April 1956] in contravention of clause (d) or (e) of sub- section (1), unless at the time when the loan was made, the guarantee was given or the security was provided by the lending company, he knew or had express notice that that clause was being contravened thereby.</p>	<p><u>NIL</u></p>	
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Exemption to Government, Private and Nidhi companies vide notification GSR 464 (E)dated 5th June 2015

- 1. Government Companies- With the approval of ministry of central government which is administratively in charge**
- 2. Private company**

- In whose share capital no other body corporate has invested any money
 - Borrowing from Bank and FI or body corporate is < twice of its paid up share capital or 50 crore , whichever is lower and
 - Has no default in repayment of such borrowings subsisting at the time of making transaction under this section
3. Nidhi company- director or his relative in their capacity of member and such transaction is disclosed in annual accounts

3. Terms Used in section

- i. Loan : Not defined
 - According to Black Law dictionary:“ Loan means a lending advance of money with absolute promise to repay”
 - The essential requirement of loan is the advance of money (some article) upon the understanding that it shall be returned and it may or may not carry interest- DrFrdieArdeshir Mehta vs. Union Of India (1991) 70 Comp. Cas. 210 (Bom)

- ii. Company 2(20) – means incorporated under this act or previous act
- iii. Director- sec 2(34)- means appointed to the board of company
- iv. Holding Company: 2 (46)
- v. Subsidiary company 2(87)
- vi. Relatives: 2(77) with reference to a person
 - Members of HUF
 - Spouse
 - Prescribed –
 - Father, Mother, son, brother and sister including step --- relative ,
 - Daughter
 - Spouse of son, daughter
- vii. Principal business/ ordinary course of business- not defined but according to Stroud Judicial Dictionary of Words and Phrases – Seventh Edition – Volume-2

“Whether a transaction has taken place “in ordinary course of business” was a matter to be determined objectively by reference to business practices in commercial world, the ordinary operational activities of a business as a going concern, the past practices of a company and its dealing with creditors.”

viii. Body corporate:- sec 2 (11)- includes company incorporated outside India but does not include

- Co-operative society Registered under law relating to Co-operatives
- Notified other body corporate

Attention is invited: LLP is body corporate in terms of sec 2(1)(d) of LLP Act

ix. Board of directors- sec 2(10)

x. Managing director: 2(54)

xi. Manager- : 2(53)

xii. Paid Up Capital : 2(64) – aggregate amount of money credited as paid up capital as is equivalent to the amount received as paid up in respect of shares of company but does not include any other amount

xiii. Free Reserves : 2(43) : Means reserves as per last audited balance sheet – available for distribution of dividend excluding unrealized gain/ revaluation of assets/ notional gain etc or change in carrying amount of assets o liabilities recognized in equity including surplus of P&L on account of measurement of the assets / liability at fair value

xiv. Private Limited company 2(68) – means having minimum capital as may be prescribed and which by its article

- Restrict the right to transfer its share
- Except in case of OPC, limits the number of its member to two hundred (joint holder treated single member)
- - exclusion – person who are under employment and previous employee
- Prohibits to public to subscribe for any securities

4. Compliance:

Sec 186 :

(1) Without prejudice to the provisions contained in this Act- Permissible Investment in two layers

(2) Ceiling of investment : directly and Indirectly : in respect of – Overall Composite Limit

- Loan
- Guarantee or providing security
- Acquire/ Purchases/ subscription- Securities

Higher of :

60% of Paid up share Capital + Free Reserves+ Security Premium

Or

100% Free Reserves+ Security Premium

Note : Loan to employees will not be considered for ceiling computation

- (3) If exceeds the limit- Special resolution is required in GM – Exception: Loan/ Guarantee/ Security to wholly subsidiary or acquisition by holding company of wholly subsidiary company/ Joint venture
- (4) Full disclosure of Investment/ Loan/ Security/ Guarantee in financial statements with purpose of utilisation
- (5) 100% consent of directors present in meeting + Permission from FI if the condition of loan- not required if investment/ loans etc is within limit of 60% or 100% as the case may be and there is no default in repayment of instalment of loan and interest
- (6) Restriction on acceptance of inter corporate loan and deposits from the prescribe limit : The company is registered u/s 12 of SEBI Act and covered under prescribed class
- (7) Rate of Interest not Lower than the prevailing yield of one year, three year, five year or ten year Government Security closest to the tenor of the loan.
- (8) Restriction of loans/ Guarantee/ Security/ Investment if default in repayment of deposits till such default subsists
- (9) Maintenance of Register
- (10) Place of Keeping register if Registered office
- (11) Provisions not apply to investment company, Banking Company, housing company etc whose ordinary course of activity/ object for that purpose
- (12) Power to make rules to Government
- (13) Penalty : Company : 25000 subject to max 5.00 Lakhs and officer : punishment extended period of 2 years + fine 25000 which may be extended to Rs. 1.00 Lakhs

Role Of auditors:

	<p><u>AS- 18- Related Party Transactions: Disclosure</u></p> <ul style="list-style-type: none">• <u>Name and nature of related party relationship required to be disclosed</u>
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	<p><u>whether transaction taken place or not</u></p> <ul style="list-style-type: none"> • <u>In case of transaction:</u> <ul style="list-style-type: none"> ✓ <u>Name of related party</u> ✓ <u>Relationship</u> ✓ <u>Nature of transaction</u> ✓ <u>Volume</u> ✓ <u>Any other element to understand transaction</u> ✓ <u>Outstanding balance</u> ✓ <u>Amount written off etc.</u>
<p><u>CARO -2020</u></p>	<p><u>Schedule-III of Companies Act 2013</u></p>
<p>Clause -3 whether during the year the company has made investments in, provided any guarantee or security or granted any loans or advances in the nature of loans, secured or unsecured, to companies, firms, Limited Liability Partnerships or any other parties, if so,-</p> <p>a) whether during the year the company has provided loans or provided advances in the nature of loans, or stood guarantee, or provided security to any other entity [not applicable to companies whose principal business is to give loans], if so, indicate-</p> <p>A. the aggregate amount during the year, and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security to subsidiaries, joint ventures and associates;</p> <p>B. the aggregate amount during the year, and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security to parties other than subsidiaries, joint ventures and associates</p> <p>b) whether the investments made, guarantees provided, security given and the terms and conditions of the grant of all loans and advances in the nature of loans and guarantees</p>	

<p>provided are not prejudicial to the company's interest;</p> <p>c) in respect of loans and advances in the nature of loans whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are regular</p> <p>d) if the amount is overdue, state the total amount overdue for more than ninety days, and whether reasonable steps have been taken by the company for recovery of the principal and interest</p> <p>e) whether any loan or advance in the nature of loan granted which has fallen due during the year, has been renewed or extended or fresh loans granted to settle the over dues of existing loans given to the same parties, if so, specify the aggregate amount of such dues renewed or extended or settled by fresh loans and the percentage of the aggregate to the total loans or advances in the nature of loans granted during the year [not applicable to companies whose principal business is to give loans</p> <p>f) whether the company has granted any loans or advances in the nature of loans either repayable on demand or without specifying any terms or period of repayment, if so, specify the aggregate amount, percentage thereof to the total loans granted, aggregate amount of loans granted to Promoters, related parties as defined in clause (76) of section 2 of the Companies Act, 2013;</p>							
<p><u>Clause : 4: Reporting on Compliance of sec 185 and 186</u></p> <p>in respect of loans, investments, guarantees, and security, whether provisions of sections 185 and 186 of the Companies Act have been complied with, if not, provide the details thereof</p>	<p>Additional Disclosure requirement in respect of Loans are granted to promoters, Directors, KMP & other related Parties in respect of Loan repayable on demand & without specifying terms or period of repayment.</p> <table border="1" data-bbox="803 1669 1339 1906"> <thead> <tr> <th data-bbox="803 1669 1039 1732">Type of Borrower</th> <th data-bbox="1039 1669 1209 1732">Outstanding Amount</th> <th data-bbox="1209 1669 1339 1906">% of Total Loans & Advances in the nature of Loan</th> </tr> </thead> <tbody> <tr> <td data-bbox="803 1732 1039 1906"></td> <td data-bbox="1039 1732 1209 1906"></td> <td data-bbox="1209 1732 1339 1906"></td> </tr> </tbody> </table>	Type of Borrower	Outstanding Amount	% of Total Loans & Advances in the nature of Loan			
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	Promoter Sec 2(69)		
	Director		
	KMP Sec 2(51) - CEO, MD Sec 2(53) – by virtue of Article/Agreement or resolution passing GM or by Board of Director entrusted with Substantial power of management, Manager Sec 2(53) – Under the control & director of Board of directors & who manages the whole or substantial affairs, CS, WTD, CFO or other person not more than 1 level below WTD whose is in employment		
	Related Party Sec 2(77) – Individual, self, spouse, Member of HUF + specified persons under rule		

Note: The above brief synopsis on the amendments is prepared keeping in view of the small and medium companies. In case of any material/ provisions not covered, the detailed provisions of the Companies Act 2013 is required to be referred.

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