

# Good Morning



PRESENTATION ON THE  
SYNOPSIS OF SECTION  
**185,186 AND 187**

- *Hasnain Qaiyumi*

# APPLICABLE PROVISIONS

Loans to Directors

Section 185 of the Companies Act, 2013 read with Companies [\(Meeting of Board and its Power\)](#) Rules, 2014)

Loan and Investment by Company

Section 186 of the Companies Act, 2013 read with Companies [\(Meeting of Board and its Power\)](#) Rules, 2014)

Related Party Transactions

Section 188 of the Companies Act, 2013 read with Companies [\(Meeting of Board and its Power\)](#) Rules, 2014)

1.

# Loans to Directors, etc.

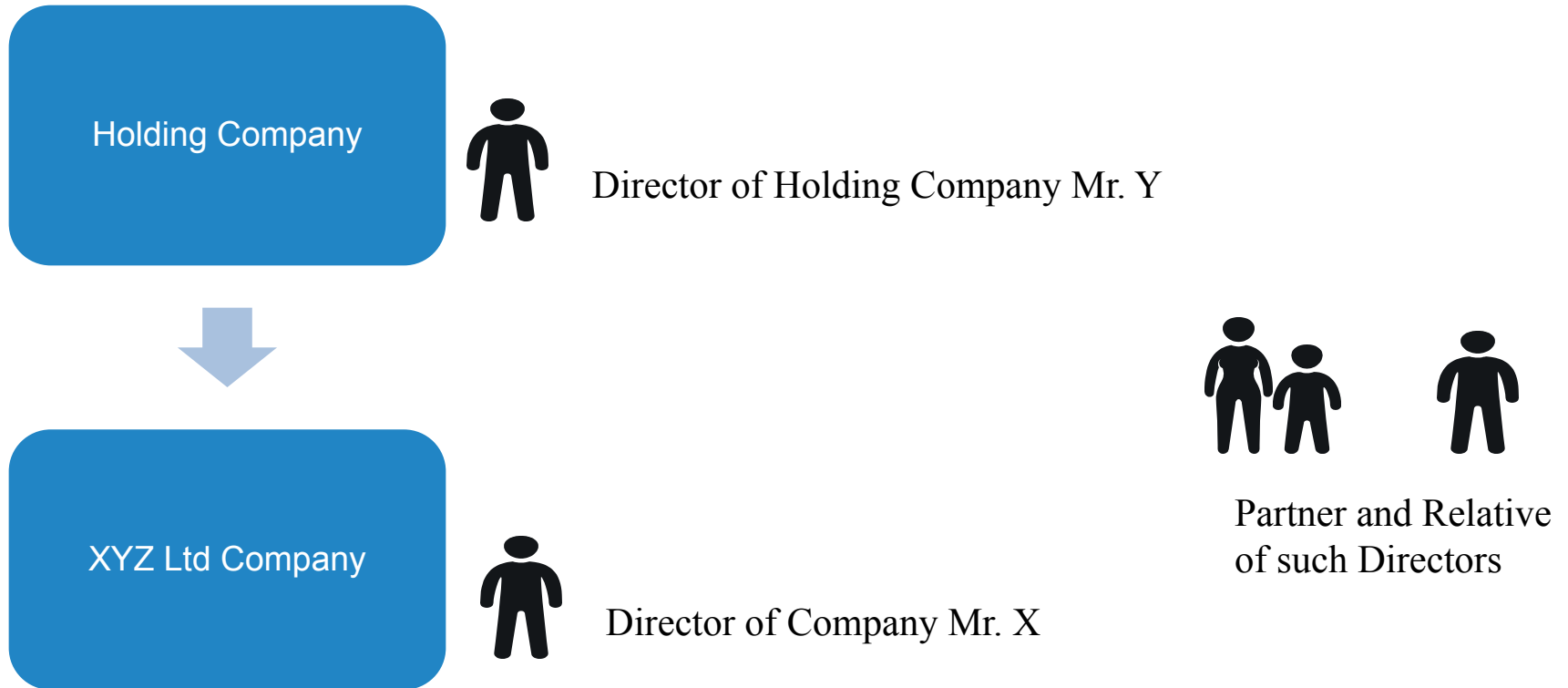
Section 185

# As per Section 185(1) – Puts Prohibition

No company shall, (Negative language)  
**directly** or **indirectly**,

- ❖ Advance any *loan*, including any loan represented by a book debt to, or
- ❖ give any *guarantee* or
- ❖ provide any *security* in connection with any loan taken by,—
  - (a) any director of company, or of a company which is its holding company or any partner or relative of any such director; or
  - (b) any firm in which any such director or relative is a partner.

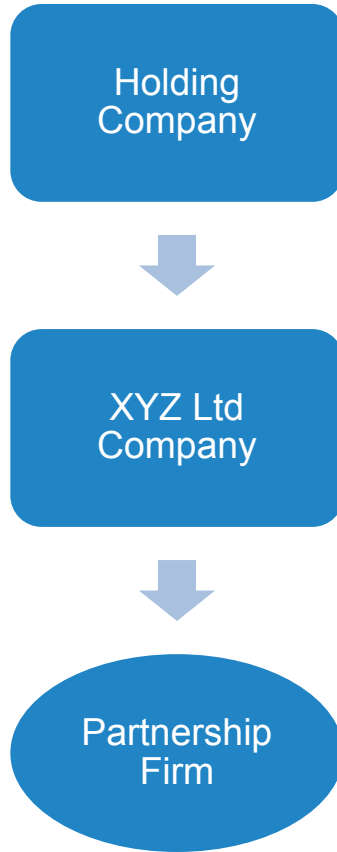
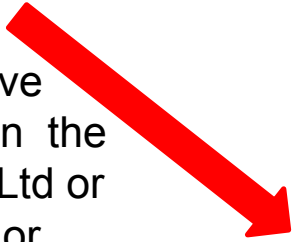
(a) any director of company, or of a company which is its holding company or any partner or relative of any such director;



(b) any firm in which any such director or relative is a partner.



If XYZ Ltd wants to give Loan to the Firm, then the directors of the XYZ Ltd or its Holding company or their Relatives **shall not be** Partner in such Firm



## Section 185(1) prohibits providing of loan or guarantee or security to –

- ❖ Any Director of the Company or
- ❖ Any Relative of such Director or
- ❖ Any Partner of such Director or
- ❖ Any Director of its Holding Company or
- ❖ Any Relative of the Director of its Holding Company or
- ❖ Any Partner of the Director of its Holding Company or
- ❖ Any Firm in which any of the above-mentioned Director is a Partner or
- ❖ Any Firm in which Relative of the above-mentioned Director is a Partner

# As per Section 185(2) – Puts Restriction

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—

a special resolution is passed by the company in general meeting:

the loans are utilised by the borrowing company for its principal business activities.

"any person in whom any of the director of the company is interested" means—

- (a) any **private company** of which **any such director is a director or member**;
- (b) any **body corporate** at a general meeting of which **not less than 25% of the total voting power** may be exercised or **controlled by any such director, or by two or more such directors, together**; or
- (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**.



# As per Section 185(3) – Can be done freely

Nothing contained in sub-sections (1) and (2) shall apply to—

giving of any loan to a managing or whole-time director

as a part of the conditions of service extended by the company to all its employees

pursuant to any scheme approved by the members by a special resolution

a company which in the **ordinary course of its business** provides loans or gives guarantees or securities for the due repayment of any loan and in respect of such loans an interest is charged at a rate not less than the rate of prevailing yield of one year, three years, five years or ten years Government security closest to the tenor of the loan; or

any loan made **by a holding company to its wholly owned subsidiary** company or any guarantee given or security provided by a holding company in respect of any loan made to its wholly owned subsidiary company *and utilised by the subsidiary company for its principal business activities.*

any guarantee given or security **provided by a holding company** in respect of loan made by any bank or financial institution **to its subsidiary company** *and utilised by the subsidiary company for its principal business activities.*

# As per Section 185(4) – Punishment for Contravention

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

every officer in default of the company

the director or the other person to whom any loan is advanced or guarantee or security is given or provided

Fine of Rs. 500,000 – Rs. 25,00,000

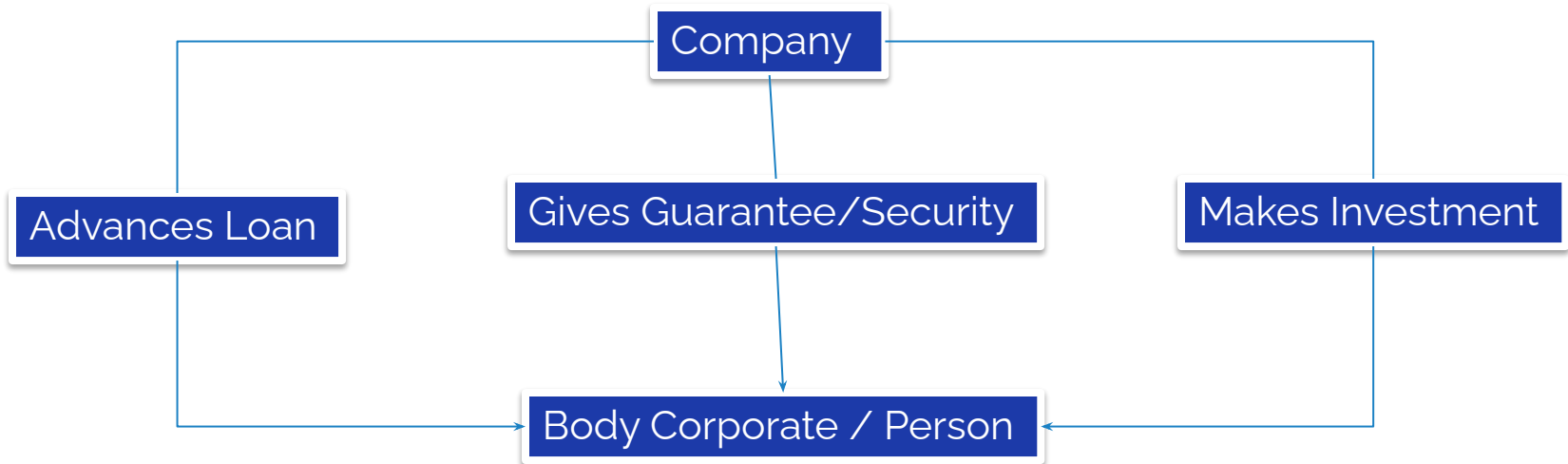
Up to 6 Months Imprisonment

2.

# Loans and Investments by company.

Section 186

# When is Section 186 attracted?



## As per Section 186(1)

Without prejudice to the provisions contained in this Act, a company shall unless otherwise prescribed, make investment through **not more than two layers of investment companies:**

Provided that the provisions of this sub-section shall not affect,—

- (i) a company from acquiring any other company incorporated in a country outside India if such other company has investment subsidiaries beyond two layers as per the laws of such country;
- (ii) a subsidiary company from having any investment subsidiary for the purposes of meeting the requirements under any law or under any rule or regulation framed under any law for the time being in force.

*“investment company” means a company **which is principally engaged in the business** of acquisition of shares, debentures or other securities.*

### **What is the meaning of Principally engaged?**

*A company will be deemed to be principally engaged in the business of acquisition of shares, debentures or other securities, **if its assets in the form of investment in shares, debentures or other securities constitute not less than fifty per cent. of its total assets, or if its income derived from investment business constitutes not less than fifty per cent. as a proportion of its gross income.***

**Invested Assets** = Minimum 50% of Total Assets

**Income from Investment Business** = Minimum 50% of Gross Income.

# Permitted Layer of Investment as per Section 186(1)

- Holding Company
- 1<sup>st</sup> Subsidiary
- 2<sup>nd</sup> Subsidiary
- 3<sup>rd</sup> Subsidiary



Investment up to 2<sup>nd</sup> Subsidiary is allowed

Exemptions –

- (i) a company from acquiring any other company incorporated in a country outside India if such other company has investment subsidiaries beyond two layers as per the laws of such country;
- (ii) a subsidiary company from having any investment subsidiary for the purposes of meeting the requirements under any law or under any rule or regulation framed under any law for the time being in force.

Disallowed

## Section 186(2)

**No company shall directly or indirectly –**

(a) give any loan to any person or other body corporate;

(b) give any guarantee or provide security in connection with a loan to any other body corporate or person; and

(c) acquire by way of subscription, purchase or otherwise, the securities of any other body corporate,

EXCEEDING

60% of its paid-up share capital, free reserves and securities premium account

100% of its free reserves and securities premium account

whichever is more.

unless previously authorised by a special resolution passed in a general meeting

## Section 186(2) – Important observations

- ❖ Loans/Investments/Guarantee/Security is not prohibited but actually restricted to ceiling limit.
- ❖ If Loans/Investments/Guarantee/Security is within the ceiling limit then its allowed.
- ❖ If Loans/Investments/Guarantee/Security is above the ceiling limit then also allowed subject to **Special resolution in the General Meeting.**

## Section 186(3) – Important Proviso – What's allowed Unconditionally

- Holding Company
  - Wholly Owned Subsidiary
  - Joint Venture Company

- Holding Company
  - Wholly Owned Subsidiary

Loans/Investments/Guarantee/Security

Acquisition by way of subscription,  
purchase or otherwise of the securities



## Section 186(5) – Prior approval of Public Financial Institution

Prior approval of Public Financial Institution will be required when -

The Loan of PFI is defaulted by the company

If PFI loan subsists (although not defaulted) but ,  
Present and Proposed  
Loans/Investments/Guarantee/Security  
exceeds the ceiling limit

## Section 186(8) – Default in repayment of deposits

No company which is in default in the repayment of any deposits accepted before or after the commencement of this Act or in payment of interest thereon, shall give any loan or give any guarantee or provide any security or make an acquisition till such default is subsisting.

## Section 186 – Some other Important Conditions

- ❖ Unanimous Board resolution shall be required (all directors present in the meeting shall vote in the favour of the resolution )
- ❖ Interest at which Loan is advanced shall not be less than rate of interest lower than the [prevailing yield](#) of one year, three year, five year or ten year Government Security closest to the tenor of the loan.
- ❖ Full particulars of Loans/Investments/Guarantee/Security shall be disclosed by the company in the Financial statements.
- ❖ All Loans/Investments/Guarantee/Security shall be entered by the company in chronological order within 7 days in register as per form MBP-2, and entry must be made within 7 days in the register maintained as per Form MBP-2
- ❖ Nothing except section 186(1) shall apply to (a) to any Loans/Investments/Guarantee/Security by a banking company, or an insurance company, or a housing finance company in the ordinary course of its business or any investment made by an investment company; Or any investment in shares allotted in right issue or in shares allotted in pursuance of rights issues made by a body corporate or in respect of investment or lending activities, by a non-banking financial company

# Is Section 186 attracted?

| Cases                                                   | Answer | Reason                                                                                                                                                                                                                                                      |
|---------------------------------------------------------|--------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Loan to Director                                        | No     | <b>Section 185 is applicable on the same</b>                                                                                                                                                                                                                |
| Loan to Foreign Company                                 | Yes    | <b>Foreign company is covered under Body corporate</b>                                                                                                                                                                                                      |
| Loan to Employee of the company                         | No     | <b>Employees are not covered under Section 186 as per explanation to section 186(2), unless loan advanced under conditions of service applicable to employees and are also in accordance with the remuneration policy.</b><br>(Clarification issued by MCA) |
| Loan/Guarantee/security to any Body Corporate or Person | Yes    | <b>Covered under scope of Section 186</b>                                                                                                                                                                                                                   |

3.

# Related Party Transactions

Section 188

# Meaning of Related Party

(76) —related party, with reference to a company, means—

(i) a director or his relative;

(ii) a key managerial personnel or his relative;

(iii) a firm, in which a director, manager or his relative is a partner;

(iv) a private company in which a director or manager is a member or director;

(v) a public company in which a director or manager is a director or holds along with his relatives, more than two per cent. of its paid-up share capital;

*(vi) any body corporate whose Board of Directors, managing director or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager;*

*(vii) any person on whose advice, directions or instructions a director or manager is accustomed to act;*

**Provided that nothing in sub-clauses (vi) and (vii) shall apply to the advice, directions or instructions given in a professional capacity;**

(viii) any company which is—

(A) a holding, subsidiary or an associate company of such company; or

(B) a subsidiary of a holding company to which it is also a subsidiary;

(ix) such other person as may be prescribed;

# Synopsis of Section 188

Except with the [consent of the Board of Directors](#) given by a resolution at a meeting of the Board and subject to such conditions [as may be prescribed](#), no company shall enter into any contract or arrangement with a related party with respect to—

- (a) sale, purchase or supply of any goods or materials;
- (b) selling or otherwise disposing of, or buying, property of any kind;
- (c) leasing of property of any kind;
- (d) availing or rendering of any services;
- (e) appointment of any agent for purchase or sale of goods, materials, services or property;
- (f) such related party's appointment to any office or place of profit in the company, its subsidiary company or associate company; and
- (g) underwriting the subscription of any securities or derivatives thereof, of the company;

Clarification by MCA

section 188 requires that no member of the company shall vote on a special resolution to approve the contract or arrangement (referred to in the first proviso),

if such a member is a related party. It is clarified that 'related party' referred to in the second proviso has to be construed with reference only to the contract or arrangement for which the said special resolution is being passed.

Thus, the term 'related party' in the above context refers only to such related party as may be a related party in the context of the contract or arrangement for which the said special resolution is being passed.

# Specified Ordinary Resolution under section 188

## Transactions

## When OR required?

sale, purchase or supply of any goods or material, directly or through appointment of agent

More than 10% of turnover of company OR 100 crore (Lower)

selling or otherwise disposing of or buying property of any kind, directly or through appointment of agent

More than 10% of turnover of company OR 100 crore (Lower)

leasing of property any kind

More than 10% of Networth or turnover of company OR 100 crore (Lower)

availling or rendering of any services, directly or through appointment of agent

More than 10% of turnover of company OR 50 crore (Lower)

remuneration for underwriting the subscription of any securities or derivatives

More than 1% of net worth

appointment to any office or place of profit in the company, its subsidiary company or associate company

Monthly Remuneration exceeds 250,000 Rs.

**office or place of profit” means any office or place—**

(i) where such office or place is held by a director, if the director holding it receives from the company anything by way of remuneration over and above the remuneration to which he is entitled as director, by way of salary, fee, commission, perquisites, any rent-free accommodation, or otherwise;

(ii) where such office or place is held by an individual other than a director or by any firm, private company or other body corporate, if the individual, firm, private company or body corporate holding it receives from the company anything by way of remuneration, salary, fee, commission, perquisites, any rent-free accommodation, or otherwise;

**“arm’s length transaction”** means a transaction between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest.



## When BR/OR not required

- ❖ If transaction is in ordinary course and arms length price
- ❖ Government company having RPT with another Government company
- ❖ Holding company having RPT with another Holding company
- ❖ If more than or equal to 90% Related party are relatives of promoters
- ❖ Unlisted Government company having transaction with any other person after **obtaining approval from concerned ministry (Other than Government company)**

## Consequences when BR/OR not passed

- ❖ Contract voidable at option of the Board
- ❖ Directors shall indemnify the loss
- ❖ Directors are disqualified for 5 years
- ❖ Directors in default shall vacate office



- ▷ *If we desire respect for the law, we must first make the law respectable.*
  - ▷ *Louis D. Brandeis*



Thank – you.