

# Article

## Loans and Advances: An overview of related provisions in the Companies Bill, 2012

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## *Article*

The Companies Bill, 2012 (“Bill”) as approved by the Lok Sabha on December 18, 2012 has brought about drastic amendments with respect to provisions relating to loans and investments to be made by the companies in comparison to the provisions of the present Act i.e. Companies Act, 1956 (“Act”).

### **1. LOAN TO DIRECTORS [CLAUSE 185]**

#### **1.1. *NO LOAN TO DIRECTORS***

The Bill has completely ruled out the possibility of giving any loan (including a loan representing a book debt), a guarantee or a security, either directly or indirectly, to any director or to any other person in whom the director is interested [Clause 185]. This provision is contrary to the provision of the present Act which only imposes a pre- condition of taking approval from the Central Government before giving such loan, guarantee or security. However, the phrase ‘any other person in whom the director is interested’ remains the same to include the related persons as specified in the present Act.

#### **1.2. *EXEMPTIONS***

In accordance with the regulatory provisions of the Bill, loan can be provided only if falls under the exempted categories. The exemptions provided under the Bill differ from those specified under Section 295 of the Act and include the following:

- a) Giving loan to a managing director or a whole-time director-
  - i. As a part of conditions of service applicable to all employees; or
  - ii. Pursuant to a scheme approved by the members by passing a special resolution.
- b) A company providing loan, guarantee or security for the repayment of the loan in the ordinary course of business and charging interest at the prevailing bank rate.

#### **1.3. *PENALTY***

The Bill provides for severe penalty in case of non-compliance of the provisions of this Clause on loans to directors. Any loan made, guarantee or security given in contravention of the said clause will lead to following consequences:

- a) The company shall be punishable with a fine of not less than rupees five lakhs, which may however extend to rupees twenty-five lakhs; and



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- b) The director or the other person as prohibited under this section, who receives the loan or to whom the guarantee and security is provided, shall be punishable with imprisonment which may extend to six months or with fine of not less than rupees five lakhs, which may however extend to rupees twenty-five lakhs.

## **2. LOANS AND INVESTMENTS BY COMPANY [CLAUSE 186]**

### **2.1. APPLICABILITY**

Clause 186 of the Bill restricts the investments to be made by a company through more than two layers of investment companies with the following exemptions:

- a) 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;
- b) a subsidiary company from having any investment subsidiary for the purpose of meeting the requirements under any law or under any rule or regulation framed under any law for the time being in force.

Pertinent to note that the Clause 186 is no more a provision covering only inter-corporate loans, investments and guarantees like Section 372A of the Act. Now the Bill has extended its hand to all loans and investments made by a company to *any other person* also. In other words, all loans, investments and guarantees made or issued by a company, whether to another body corporate or to any other person, will be regulated by a single provision of Clause 186 and all compliances under the said clause including those relating to interest rates and entry in registers need to be met before extending such loans or investments.

Inclusion of all loans and investments to any person within the prescribed limit will surely create problems to the companies.

### **2.2. LIMITS**

The limit of making such loans and investments is same as compared to the limit provided by Section 372A of the Act. However, the Act earlier provided the meaning of 'free reserves' by way of an explanation to the Section 372A which included free reserves and securities premium. Now the Clause 186 includes the securities premium in the section itself.

### **2.3. INTEREST ON LOAN**

Sub-clause 7 of Clause 186 of the Bill provides that no loan shall be given at a 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.

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Earlier, in the Act, the interest rate was given a bench mark of prevailing interest rate of RBI.

### **2.4. EXEMPTIONS**

The Bill provides exemption to a banking company, insurance company, a housing finance company, companies in business of financing of companies or providing infrastructural facilities. Further, following acquisitions have also been kept out of the purview of the Clause:

- a) Acquisitions made by a registered NBFC whose principal business is acquisition;
- b) Acquisitions made by a company whose principal business is acquisition of securities;
- c) Acquisition of shares allotted to existing shareholders in pursuance of Clause 62(1)(a) of the Bill.

Interestingly, unlike in the Act, the loans and investments made in wholly owned subsidiaries have not been given exemptions under the Bill. This would mean that even the loan or guarantee given of investments made in wholly owned subsidiaries will also be regulated by the said Clause under the new Bill and all investments/loans etc will be considered for counting the ceiling under this Clause.

### **2.5. PENALTY**

The punishment for acting in contravention of the said Clause shall be:

- a) For the company- a fine of not less than rupees twenty-five thousand, which may extend to rupees five lakhs;
- b) For every officer in default: imprisonment for a term extending to two years and fine not less than rupees twenty-five thousand which may extend to rupees one lakh.

As compared to the existing lenient penal provisions in the Act, the Bill seems to have taken a very strict view on violation of the clause and has provided a non compoundable penalty for directors and officers in default<sup>1</sup> and heavy monetary penalty on the defaulting companies.

### **3. INVESTMENTS MADE BY COMPANY IN ITS OWN NAME [CLAUSE 187]**

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<sup>1</sup> Bill includes the company secretary, whole time directors, CEO and CFO also in the definition of 'Officer in Default'

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The provisions with respect to investments made by a company in its own name as provided by Clause 187 are more or less similar and not much change has been brought about in this regard. However, the exemption provided to investments made by a company whose principal business consists of buying and selling of shares and securities has been withdrawn under the provisions of the Bill.

The penalty imposed as a consequence of contravening the provisions of the said clause is as follows:

- a) The company shall be punishable with a fine of rupees twenty-five thousand which may extend to rupees five lakhs; and
- b) Every officer in default shall be punishable with imprisonment for a term which may extend to six months or a fine of rupees twenty five thousand which may extend to rupees one lakh, or both.

## **Conclusion**

The Bill has incorporated stringent provisions with regard to loans and investment to be made by a company. Loans to directors or corporates in which they have interest have totally been prohibited except if given as policy of company applicable to all employees or can be given to MD or WTD if approved by members by way of a special resolution. Investments and loans made to or security or guarantee issued to even a wholly owned subsidiary will not be reckoned for the purpose of Clause 186 (similar to Section 372A of the Act). The Bill along with the rigid provisions has also provided rigorous penalties for violation of the clauses. One has to be very cautious and careful to comply with the rigid provisions of the Bill.