

# Lesson 16

## Inter-Corporate Loans, Investments, Guarantees and Security

### LESSON OUTLINE

- Provisions of loan to directors etc.
- Procedures involved in giving loan to directors etc.
- Provisions of loan and investment by company.
- Procedure for Inter-corporate loans and investments
- LESSON ROUND UP
- SELF TEST QUESTION

### LEARNING OBJECTIVES

This lesson explains provisions of the Companies Act, 2013 in relation to loan to directors etc. and loan and investment by company. It also gives a detailed procedure for Inter-Corporate Loans/ Investment/Giving Guarantee/Providing Security. After going through this lesson, you should be able to understand the procedures relating to inter-corporate loans, investments, guarantees and security.

## LOANS AND INVESTMENT BY COMPANY [SECTION 186]

### INTRODUCTION:

The Companies Act, 2013 (Act) has come up with a change in the concept of 'Loan and Investment by Company'. The new Act provides that inter-corporate investments not to be made through more than two layers of investment companies.

The 2013 Act states that companies can make investments only through two layers of investment companies subject to exceptions which includes company incorporated outside India. There are no such restrictions which are currently imposed under the 1956 Act.

Further, the exemption available from the provisions of section 372A of the 1956 Act to private companies as well as loans or investment given or made by a holding company to its subsidiary company are no longer available under the 2013 Act.

In pursuance to the provisions of Section 186(1) of the Act, a Company shall make investment through not more than two layers of investment companies.

'Layer' according to explanation (d) of Section 2(87) of the Act in relation to a holding Company means its subsidiary or subsidiaries.

'Investment Company' means a Company whose principal business is the acquisition of shares, debentures or other securities"

The provisions of Section 186 (1) shall not have effect in the following cases:

- If a company acquires any company which is incorporated outside India and such company has investment subsidiaries beyond two layers as per the laws of such country.
- A subsidiary company from having any investment subsidiary for the purposes of meeting the requirement under any law/ rule/ regulation framed under any law for the time being in force.

### LIMITS FOR LOANS /GUARANTEE/SECURITY/INVESTMENT [SEC-186(2)]

In pursuant to provisions of Section 186(2) of the Act, no company shall directly or indirectly

- give any loan to any person or other body corporate,
- give any guarantee or provide security in connection with a loan to any other body corporate or person and
- acquire by way of subscription, purchase or otherwise, the securities of any other body corporate exceeding 60% of its paid-up share capital plus free reserves plus securities premium account or 100% of its free reserves plus securities premium account, whichever is more.

**Key Notes:** Since Section 186(2)(c) provides for acquisition by way of subscription, purchase or otherwise, the securities of any other body corporate. It is not necessary that the target entity into which investment flows must be a company. It can be any type of body corporate. But it is to be kept in mind that **the intermediary company through which investments are made must have to be a company**. This section mandates a company to make investment only through two layers of investment companies. If ABC Ltd. makes an investment in XYZ Ltd. and further XYZ Ltd. makes an investment in PQR LLP whereas PQR LLP holds shares of SSB Ltd., there is no violation of Section 186 (1) of the Act as there are not more than two layers of investment companies. It is the investor company which shall be held liable in case of any violation of the section; therefore, It is prudent and advisable that the investee company to seek a declaration from the investor company whether the investment

made by the investor is coming from more than two layers up.

### **APPROVAL FROM MEMBERS [SECTION 186(3)]**

Though the Section 186(2) makes restriction as above, Section 186(3), empowers a Company to give loan, guarantee or provide any security or acquisition beyond the limit but subject to prior approval of members by a special resolution passed at a general meeting.

### **DISCLOSURE OF PARTICULARS OF LOAN, GUARANTEE GIVEN AND SECURITY PROVIDED [SECTION 186(4)]**

Section 186(4) of the Act provides that the Company shall disclose following details to the members in the financial statement.

- the full particulars of the loans given, investment made or guarantee given or security provided.
- the purpose for which the loan or guarantee or security is proposed to be utilised by the recipient of the loan or guarantee or security.

The notice of the general meeting for passing resolution shall indicate that

- (a) The limits that will be required in excess of the prescribed limits involved in the proposal;
- (b) The particulars of the body corporate in which the investment is proposed to be made or to which the loan or guarantee or security proposed to be given.
- (c) The purpose of the investment, loan, guarantee or security;
- (d) The source of funding for meeting the proposal; and
- (e) Other details as may be specified.

### **APPROVAL OF BOARD AND PUBLIC FINANCIAL INSTITUTION [SECTION 185(5)]**

In pursuant to provisions of Section 186(5) of the Act, every company shall take consent of all the directors present at the board meeting before making any investment, giving loan and guarantee and providing security. In case of company has already taken loan etc., from any Public Financial Institutions, then it is mandatory to take prior approval from such Public Financial Institution.

#### **Exception:**

Provided that prior approval of Public Financial Institution shall not be required where the aggregate loan, investment, guarantee and security proposed is within the limits as specified under section 186(2) and there is no default in repayment of loan instalments or interest thereon to the Public Financial Institution.

### **COMPANIES REGISTERED UNDER SECURITIES EXCHANGE BOARD OF INDIA (SEBI) [SECTION 186(6)]**

Section 186(6) of the Act provides that those Companies which are registered under Section 12 of SEBI Act, 1992 and covered under such class or classes of companies which may be notified by the Central Government in consultation with the Securities and Exchange Board, shall can take inter-corporate loans or deposits exceeding the prescribed limit and shall furnish details of loans or deposit in their financial statements.

### **RATE OF INTEREST ON LOAN [SECTION 186 (7)]**

No loan shall be given under this section 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.

#### **NO LOAN BY DEFAULTER COMPANY [SECTION 186 (8)]**

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.

#### **REGISTER OF LOAN [SECTION 186 (9 and 10)]**

Section 186(9) of the Act mandates every Company to maintain a register which shall contain particulars of loan or guarantee given or security provided or investment made. Every company giving loan or giving guarantee or providing security or making an acquisition of securities shall, from the date of its incorporation, maintain a register in Form MBP 2 and entered therein separately, the particulars of loan and guarantee given, securities provided and acquisitions made as aforesaid.

This register shall be kept at registered office of the company and the register shall be preserved permanently and shall be kept in the custody of company secretary of the company or any person authorized by the Board for the purpose.

The entries in the register (either manual or electronic) shall be authenticated by the company secretary of the company or by any other person authorized by the Board for the purpose.

The extracts of the register may be opened for inspection and copies may be furnished to members who demands for the same on payment of prescribed fee as mentioned in the Articles which shall not exceed ten rupees for each page.

#### **Non-Applicability of section 186:**

The Section 186 (except Sub Section 1) of the Companies Act, 2013 does not apply to the following:

- (a) to a loan made, guarantee given or security provided by a banking company or an insurance company or a housing finance company in the ordinary course of its business or a company engaged in the business of financing of companies or of providing infrastructural facilities;
- (b) to any acquisition—
  - (i) made by a non-banking financial company registered under Chapter IIIB of the Reserve Bank of India Act, 1934 and whose principal business is acquisition of securities:  
Provided that exemption to non-banking financial company shall be in respect of its investment and lending activities;
  - (ii) made by a company whose principal business is the acquisition of securities;
  - (iii) of shares allotted in pursuance of clause (a) of sub-section (1) of section 62.

#### **Penalty for contravention of section 186:**

##### **For Company:**

Every Company which contravenes the provisions of this Section shall be liable to a penalty which shall not be less than Rupees twenty five thousand but which may extend to Rupees five lakhs.

##### **For Officers:**

Every officer of the Company who is default shall be punishable with imprisonment for a term which may extend to two years and fine which shall not be less than Rupees twenty five thousand but which may extend to Rupees One lakh.

**MEANING OF INVESTMENT:** *Investment* for the purposes of section 186(1) would mean as used in section

186(2)(c) of the Act, 2013. Thus the following will be counted as “investments”:

- Subscription or purchase of shares
- Subscription or purchase of share warrants
- Subscription or purchase of debentures bonds or similar debt securities

The following will not be counted as investments:

- Making of **loans or advances**
- Any other financial transactions such as leases, purchase of receivables, or other credit facilities

### **PROCEDURES INVOLVED IN MAKING LOAN, GIVING GUARANTEE AND PROVIDING SECURITY**

Following procedures may be adopted by the company while giving loan to any other body corporate, providing guarantee or security in connection with a loan or acquisition by way of subscription, purchase the securities of any other body corporate.

1. It is to be kept in mind that a company can give any loan or give any guarantee or provide security and acquire securities of any Body corporate through Board resolution up to 60% of its paid up capital, free reserves and security premium account or 100% of its free reserves and security premium whichever is more.
2. On the basis of aforesaid conditions and requirements of the company meeting of Board of Directors is to be convened after giving proper notice and proposals of giving loan or giving guarantee or providing security etc. are to be discussed.
3. No investment shall be made or loan or guarantee or security given by the company unless the resolution sanctioning it is passed at a meeting of the Board with the consent of all the directors present at the meeting.

For specimen of Board resolution, please refer Annexure-II and III given at the end of this chapter.

4. It is to be checked whether there is any existing loan from any public financial institution, If so, prior approval of that public financial institution is also required for any subsequent loan from any other source. However, prior approval of Public Financial Institution shall not be required where the aggregate loan, investment, guarantee and security proposed is within the limits as specified under section 186(2) and there is no default in repayment of loan or interest thereon to the Public Financials Institution.
5. After deciding the source of fund and quantum of requirement, the Board may authorize one of the directors of the company or any other person to apply for the concerned public financial institutions for approval.
6. Arrange to convene a general meeting of shareholders after giving proper notice and to pass special resolution therein, where the giving of any loan or guarantee or providing any security or the acquisition exceeds the limits specified i.e 60% of its paid up capital, free reserves and security premium account or 100% of its reserves and security premium whichever is more.

For specimen of special resolution, please refer Annexure-IV given at the end of this chapter.

7. File the copy of special resolution in Form No. MGT-14 along with the fee as provided in Companies (Registration of offices and fees) Rules, 2014 with the Registrar within 30 days of passing the resolution. Necessary documents are required to be attached as per the requirements of the form.
8. Registers are to be maintained in Form MBP-2 by every company giving loan or giving guarantee or providing security or making an acquisition shall, from the date of its registration and the particulars of loan and guarantee given, securities provided and acquisition are to be entered therein.

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9. Entries in the register shall be made chronologically in respect of each such transaction of making such loan or giving guarantee or providing security or making acquisition.
10. It is to be ensured 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.
11. The company shall disclose to the members in the financial statement the full particulars of the loans given, investment made or guarantee given or security provided and the purpose for which the loan or guarantee or security is proposed to be utilized by the recipient of the loan or guarantee or security.
12. Scrutinize the repayment history of the company with regards to repayment of any deposits or interest thereon. No company which is in default in the repayment of any deposits or in payment of interest thereon shall give any loan or give any guarantee or provide any security or make any investment through acquisition of another company till such default is subsisting.

## ANNEXURES

### ANNEXURE-I

#### **SPECIMEN OF BOARD RESOLUTION TO PROVIDE CORPORATE GUARANTEE FOR AND ON BEHALF OF A SUBSIDIARY COMPANY SEEKING WORKING CAPITAL LOAN FROM ANY BANK.**

“RESOLVED THAT in consideration of the STATE BANK OF PATIALA (SBP) having agreed to advance working capital facilities with an overall credit limit of Rs.50,00,00,000/- (Rupees Fifty Crore only) (hereinafter referred to as “the credit facilities”) in the manner and on the terms and conditions contained in the sanction letter no..... dated .....to M/s ABC Pvt. Ltd., a company incorporated under companies Act, 2013 having registered office at B-123, Safdarjung Enclave, New Delhi-110029 (hereinafter referred to as the borrower”), one of the subsidiaries of M/s XYZ Ltd. (the Company) and the company do execute a corporate guarantee guaranteeing the repayment of the credit facilities along with interest in favour of SBP for and on behalf of M/s ABC Pvt. Ltd., the subsidiary company.

FURTHER RESOLVED THAT the Board of Directors of the company consider and declare the following:

1. That the terms and conditions for providing corporate guarantee as annexed to the sanction letter no.....dated....communicated by the Bank to M/s ABC Pvt. Ltd. be and is hereby accepted as these are not prejudice to the interest of the company.
2. The Board considered that the corporate guarantee is for an amount of Rs. 50 crore being approved for tenure of 5 years subject to renewal by the Bank.
3. The Board confirm that the guarantee provided is not prejudicial to the interest of the company.
4. The Board further considered receiving counter guarantee from M/s ABC Pvt. Ltd. in favour of the company M/s XYZ Ltd. to protect the interest of the company.

RESOLVED FURTHER THAT the draft of the Guarantee Agreement received from SBP along with its sanction letter no.....dated..... (Copies whereof duly authenticated by the chairman of the Board have been circulated to the members of the Board) be and is hereby approved and the Mr. MD, Managing Director of the company be and is hereby authorised to accept on behalf of the company with such modification therein as may be acceptable to SBP.

RESOLVED FURTHER THAT the common seal of the company be affixed to the guarantee agreement (with such modifications as may be agreed) in the presence of Mr. MD, Managing Director who shall sign the same in token thereof, and Mr. ED, Executive Director who shall counter sign the same in token thereof.

FURTHER RESOLVED THAT an undertaking to that effect that the company is willing to provide its corporate guarantee and execution of the necessary guarantee agreement for the above said purposes be furnished to

SBP by Mr. MD, Managing Director and/or Mr. ED, Executive Director for and on behalf of the company for providing corporate guarantee.

RESOLVED FURTHER THAT, a copy of the foregoing resolution duly certified as a true copy be submitted to the Bank under signature of any one of the director of the company and the Bank do act upon the same.”

*ANNEXURE-II*

**SPECIMEN OF BOARD RESOLUTION TO INVEST COMPANY’S FUNDS IN SHARES/DEBENTURES/  
BONDS OF ANOTHER COMPANY**

“RESOLVED THAT pursuant to the provisions of Section 186 of the Companies Act, 2013, the unanimous consent of all the directors present at the meeting is be and is hereby given that the company to invest a sum not exceeding Rs. 50,00,00,000/- (Rupees Fifty Crore only) in the equity shares of M/s ABC Ltd.

RESOLVED FURTHER THAT Mr. MD, Managing Director of the company be and is hereby authorised to sign the share application form(s) and/or transfer deeds, as may be required and other necessary documents relating thereto.”

*ANNEXURE-III*

**SPECIMEN OF BOARD RESOLUTION TO ACQUIRE SHARES OF ANOTHER COMPANY**

“RESOLVED THAT pursuant to Section 186 of the Companies Act, 2013, the consent of the Board of Directors of the company be and is hereby accorded to make investments of Rs. 50,00,00,000/- (Rupees Fifty Crore only) for acquisition of 5,00,000 equity shares of Rs.100/- each fully paid up in M/s XYZ Ltd. from various existing shareholders of M/s XYZ Ltd.

RESOLVED FURTHER THAT Mr. MD, Managing Director of the company be and is hereby authorised to make payment of consideration to the transferors and to do all such necessary act as may be necessary for this act.”

*ANNEXURE-IV*

**SPECIMEN OF SPECIAL RESOLUTION TO GIVE AUTHORITY TO BOARD OF DIRECTORS TO MAKE  
INVESTMENT IN EXCESS OF THE PRESCRIBED LIMIT.**

“RESOLVED THAT pursuant to the provisions of Section 186 of the Act and other applicable provisions, if any, the consent of the members of the company be and is hereby granted to make investments of a sum not exceeding Rs. 100 Crore by way of subscription and/or purchase of equity shares of M/s XYZ Ltd., notwithstanding that such investment or such investment together with the company’s existing investment in all other body corporate shall be in excess of the limits prescribed under section 186 of the Act.

RESOLVED FURTHER THAT the Board of directors of the company be and is hereby authorized to do all such acts, deeds, matters and things as, in its absolute discretion, may be considered necessary, expedient or desirable and to settle any question or doubt that may arise in relation thereto in order to give effect to the foregoing resolution or otherwise considered by the Board of directors to be in the interest of the company.”

**Explanatory Statement**

As on date the aggregate amount of the investments in shares/debentures, loans and guarantee(s)/security(ies) made, given, or provided by the company to other bodies corporate are within the limits provided in Section 186 of the Companies Act, 2013. Since the Board wants to invest in excess of the prescribed limit specified in Section 186 of the Act, approval of the shareholders of the company is required.

The Board of Directors in its meeting held on \_\_\_\_\_ decided to recommend the special resolution as set out in the notice for approval of the shareholders.

None of the directors save and except Mr. X and Mr. Y are concerned or interested in this resolution.