



Compliances with Companies Act, 2013 by Private Limited Companies with respect to loans to directors – Part VI

Companies advancing loans or providing securities for loans taken by Directors has always been a very complex subject. This is particularly so for private companies which are most often run by promoter directors. Some private companies are closely held family concerns where the family members are directors and it is quite common for the companies to advance loans to such directors. This was exempted under the previous Companies Act entirely, so private companies could freely provide loans to their directors. Since 12th September 2013, this is no longer possible.

This write up seeks to provide an overview of the prohibition contained in Section 185 of the Companies Act, 2013.

Loans to Directors etc. under Section 185

Under Section 185 of the new Companies Act, there is a total prohibition of such transactions altogether, because the new Companies Act does not prescribe any prior sanction or approval for the purpose. Section 185 of the Companies Act, 2013 provides that *no company shall, directly or indirectly, advance any loan to any director or any other person in whom the director is interested, or give any guarantee or provide any security in connection with a loan taken by any other person in whom the director is interested*. The restriction is also applicable to private companies.

As per Section 295 of the old Companies Act, loans advanced or securities provided to the Directors required prior approval of the Central Government. In fact the previous companies act, exempted private companies from the restrictions for advancing such loans or security to their directors, however the new Companies Act has done away with such exemption.

Any other person in whom the director is interested

The expression ‘any other person in whom the director is interested’ has been described to mean:

- Any director of the lending company, or of a company which is its holding company or any partner or relative of any such director;
- Any firm where a director or relative is partner;
- Any private company of which any such director is a director or member;
- Any body corporate at a general meeting of which not less than twenty five percent of the total voting power may be exercised or controlled by any such director, or by two or more such directors, together or;
- 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.

Relative

The term ‘relative’ as defined under the Companies Act includes:

- a) other members of a Hindu Undivided Family;
- b) spouse;
- c) father (including step father);
- d) mother (including step mother);
- e) son (including step son);



- f) son's wife;
- g) daughter;
- h) daughter's husband;
- i) brother (including step brother); and
- j) sister (including step sister).

This list may be expanded or contracted by the Central Government from time to time.

Permitted lending activities vis-à-vis directors

The following exemptions have been provided i.e. the transactions described hereinbelow, do not fall within the purview of Section 185 of the new Companies Act:

- A. Loans to managing directors or whole time directors are permitted, *provided that*
 - o such loans are advanced as part of the conditions of service extended by the company to all its employees, for instance, by way of a housing loan scheme, education loan scheme, etc.; or
 - o when such loan is pursuant to any scheme approved by the members by a special resolution.
- B. Companies who in their ordinary course of business provide loans or give guarantee for due repayment of loans are exempt from Section 185, *provided that* such loans provided by the company are charged with interest at a rate not less than the bank rate declared by RBI.
- C. Any loan made or security provided by a holding company to its wholly owned subsidiary company in respect of any loan made to its wholly owned subsidiary company *provided that such loans are utilised by the subsidiary company for its principal business activities.*
- D. Any guarantee given or security provided by a holding company in respect of any loan made by any bank or financial institution to its subsidiary company *provided that such loans are utilised by the subsidiary company for its principal business activities.*

Under the previous Companies Act, banking companies were expressly excluded. That exception is now covered under item B above.

Consequences of non-compliance with Section 185

A penalty of not less than five lakh rupees, which may extend to twenty five lakhs can be levied on a company which advances any loans or provides any security in contravention of this section. Whereas the director or the person to whom such loan or security is provided is punishable with imprisonment which may extend to six months or fine which shall be not less than five lakh rupees and maybe extended to twenty five lakh rupees or both.

Under the previous Companies Act, penalty and imprisonment could be avoided by repaying the unauthorised loan, however no such redemption provisions are prescribed under the new Companies Act. The penalty prescribed under the new Companies Act, is much higher than the penalty previously prescribed and does not offer the offending company / director any respite on account of repayment of such loans.