



## TRANSFORMATION IN BORROWING POWERS OF DIRECTORS OF THE COMPANY IN RELATION TO AMENDMENTS 2017

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### ABSTRACT

#### Keywords:

The Companies (Amendment) Bill, 2017 passed by Lok Sabha on July 27, 2017, received the assent of Rajya Sabha on December 19, 2017. This amendment is retrospectively applicable to amendatory statutes. Ordinary if an act referred by its title, it shall be considered with reference to the amendment up to date. The external aids on which the interpretation of the new amended article can be relied upon are: a.) The Companies Law Committee Report on February 2016 and b.) 37<sup>th</sup> Report Standing Committee on Finance (2016-17).

Objects of amendments under the Companies (Amendment) Act, 2017 are:

1. addressing difficulties in implementation owing to stringent compliance requirements;
2. facilitating ease of doing business in order to promote growth with employment
3. harmonization with the Accounting Standards, the Securities and Exchange Board of India Act, 1992 and the regulations made, there under, and the Reserve Bank of India Act, 1934 and the regulations made there under;
4. Rectifying omissions and inconsistencies in the Act.

It is in light of this situation that the Companies (Amendment) Act, 2017 seeks to make section 185 less stringent in nature, by proposing that certain transactions be completely prohibited, while others be subject to a special resolution passed at a general meeting, and that the loan be used for the principal business activity by the subsidiary company.

Transactions involving loans, guarantees and securities provided to a director of a company or the director of its holding company, or any partner or relative of such director, and any firm in which the director or his relative is a partner, is prohibited. However, under the proposed amendment, transactions with a private company in which a director of the company providing loans, guarantee or security is also a director or member is allowed subject to a special resolution at the general meeting. Another check and balance mechanism which the section provides is that full disclosures relating to the amount of loan, purposes of

the loan, and other relevant details must be placed before the shareholder

#### LOAN TO DIRECTOR: BROAD OUTLINES OF 2017 AMENDMENTS

After 2017 amendment the provision prohibiting loans to directors or the relative of director as under section 185 was relaxed to a great extent. Companies may give loans to entities in which directors are interested after passing special resolution and adhering to disclosure requirement. Before 2017 amendments this provision of loan to directors has gone to different stages. Briefly, Companies act 1956 was very wide and less strict in comparison to Companies act 2013. Thereafter section 185 of Companies act 2013 proved to be a harsh provision which was tried to be cured by MCA's notification in 2015. But this could not bring the desired changes and hence a overhauling was done to Section 185 of Companies Act 2013 by 2017 amendment.

#### COMPANIES ACT, 1956: SECTION 295

Section 185 on comparison with section 295 of Companies Act 1956, was criticized as being more restrictive in nature. Section 295 of companies act 1956 had only one qualification i.e., prior approval of the Central Government which was subsequently under Companies Act 2013. Moreover, Section 295 had equal applicability on both the loans and deposits. The only requirement for a loan was the understanding that it shall be returned and it may or may not carry interest.

#### COMPANIES ACT 2013: SECTION 185

##### Section 185 of Companies Act 2013 says:

*(1) Save as otherwise provided in this Act, no company shall, directly or indirectly, advance any loan, including any loan represented by a book debt, to any of its directors or to any other person in whom the director is interested or give any guarantee or provide any security in connection with any loan taken by him or such other person: Provided that nothing contained in this sub-section shall apply to—*

*(a) the giving of any loan to a managing or whole-time director—*

(i) as a part of the conditions of service extended by the company to all its employees; or

(ii) pursuant to any scheme approved by the members by a special resolution; or

(b) a company which in the ordinary course of its business provides loans 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 bank rate declared by the Reserve Bank of India.

The intent behind the drafting of section 185 of the 2013 Act was to prevent the misappropriation of funds by directors who hold a fiduciary relationship with the company. This resulted in the section being very stringent, and not in line with the rest of the 2013 Act, which relaxes norms and seeks to improve the ease of doing business in India. Moreover, the words "Save as otherwise provided in this Act", in the beginning of section 185 created an ambiguity. This would mean that if any other section of the Companies Act, 2013 allows the giving of loan to the person covered in this section 185, then it will be permitted. Thus, this defeated the purpose of section 185 in itself.

#### **MINISTRY OF CORPORATE AFFAIR NOTIFICATION IN 2015**

The Ministry of Corporate Affairs (MCA) exempted private companies from section 185 subject to three conditions. First, there should be no investment in the concerned company from any other body corporate; secondly, the company should not have any borrowings from banks, financial institutions and other body corporate equal to or more than twice its paid up share capital, or rupees 50 crores, whichever is lower; and finally, that there should be no subsisting default at the time of making such transaction, and that the company should have the capability to pay off the loan. While this notification did provide a temporary relief of sorts for private companies, the three conditions which were required to be met in this notification provided for quite a high threshold. Although an exemption was indeed carved out for private companies, this notification does not really relax the norms.

#### **COMPANIES (AMENDMENT) ACT 2017**

One of the significant amendments brought was the amendments with respect to the loans to directors. A completely new section 185 is proposed. Some of the key changes are:

##### **Complete Restrictions**

Section 185 (1) went through complete overhauling. It was amended as:

*No company shall, 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.

Hence, it imposed a complete restriction on providing loan, guarantee or security in connection with loan to any director, director of the holding company or any partner or relative of any such director or any firm in which any such director or relative is a partner.

##### No safeguard under Section 186:

Moreover, in the new sub section that the word 'save as otherwise provided in the act' has been omitted. Therefore we cannot take any more the safeguard of section 186 to give any loan or advances to any concern where any director(s) of the company is interested.

##### **Loan can be advanced:**

Under the regime of the Amended section 185 loan to any person concern where any director in interested became more stringent and can be given only for the purpose of the principal business of the borrowed company and not for any other purpose and the approval of the members of the lender company need to be taken by way of special resolution and after giving full disclosure in the notice of the general meeting.

Section 185(2) after 2017 amendment reads as,

(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.

(a) a special resolution is passed by the company in general meeting: 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 recipient of the loan or guarantee or security and any other relevant fact; and

(b) The loans are utilised by the borrowing company for its principal business activities.

##### Special Resolution:

Loan to following parties is allowed subject to special resolution of shareholders and certain other prescribed conditions

(i) any private company of which any such director is a director or member;

(ii) anybody 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

(iii) anybody 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 Currently transactions with aforesaid categories is prohibited.

### Loans in ordinary course of Business

Current exemption provided under section 185(1) continues to remain except that when 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 year, five year or ten year Government security closest to the tenor of the loan.

### **Penalty:**

It is also proposed to penalize defaulting officer in the company along with the company and director or the other person to whom any loan is advanced or guarantee or security is given. The amended section 185 has extended the penal provisions to an officer of the company, which has been defined in section 2 (59) to include any director, manager or key managerial personnel or any person in accordance with whose directions or instructions the Board of Directors or any one or more of the directors is or are accustomed to act. Therefore, the ambit of the penal provision has been widely extended.

Thus, 2017 amendments are also in line with the ease of doing business in India, being somewhat more liberal in nature. The Amendment Act further bifurcates the regulatory framework into two categories: the first contemplating certain transactions which are prohibited and another consisting of transactions which may be permitted, subject to approval of the shareholders by way of a special resolution passed at a general meeting.

### **CONCLUSION**

2017 Amendment is partly prohibitive and partly restrictive by nature. It seeks to arrive at a middle ground, between both section 295 of the erstwhile 1956 Act, and section 185 of the 2013 Act. The amendment also strikes a fair balance by granting the final say to shareholders, and also mandates that full disclosures must be made to them before a loan is sanctioned. This amendment relaxes the norms to a certain extent, and will be beneficial especially to the private sector.

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