

SECTION 184, 185, 186 AND 188 OF COMPANIES ACT, 2013

CA Aleem Lilani
June 2022



**SECTION 184 OF
COMPANIES ACT 2013 -
DISCLOSURE OF INTEREST
BY DIRECTOR**



LOAN TO DIRECTORS

184 (1) - General Disclosure

- Every director shall disclose his concern or interest in any company or companies or bodies corporate, firms, or other association of individuals which shall include the shareholding, at
 - First Meeting of the Board when he participates as a Director and
 - First meeting of the Board in every Financial year or
 - First Meeting of the Board held after there is any change made in any previous disclosure already made by the Director.


184 (2) - Specific Disclosure

- Every director of a company who is in any way, whether directly or indirectly, concerned or interested in a contract or arrangement or proposed contract or arrangement entered into or to be entered into—
 - (a) with a **body corporate** in which such director or such director in association with any other director, **holds more than two per cent. shareholding of that body corporate, or is a promoter, manager, Chief Executive Officer** of that body corporate; or
 - (b) with a **firm or other entity** in which, such director is a partner, owner or member, as the case may be, shall disclose the **nature of his concern or interest** at the meeting of the Board in which the contract or arrangement is discussed and **shall not participate** in such meeting:


DISCLOSURE OF INTEREST




- Form MBP-1 needs to be submitted by the Director for disclosing his interest.



- All such Disclosure is required to keep at the registered office of the Company.
- It is required to be preserved for 8 years from the end of the financial year to which it relates.



- Contract or arrangement entered into by the Company without receiving the disclosure of interest by the Director who is concerned or interested directly or indirectly in the contract or arrangement, then it shall be voidable at the option of the Company.




- If Director of the Company contravenes the provision, then the Director shall be punishable with the imprisonment for a period which may extend to 1 year or with fine which may extend to Rs. 1 Lakh or with both


SOME IMPORTANT POINTS




- Form MBP-1 needs to be submitted by the Director for disclosing his interest.



- All such Disclosure is required to keep at the registered office of the Company.





- Contract or arrangement entered into by the Company without receiving the disclosure of interest by the Director who is concerned or interested directly or indirectly in the contract or arrangement, shall be voidable at the option of the Company.




- If Director of the Company contravenes the provision, then the Director shall be punishable with the imprisonment for a period which may extend to 1 year or with fine which may extend to Rs. 1 Lakh or with both

SOME IMPORTANT POINTS

- 
- 184(2) - Directors should update not only appointment but also relinquishment of their posts

- 
- Company should set this as an agenda point in every Board Meeting
 - Management can also regularly ask for disclosures from each director in writing

- 
- The general notice given by the directors expires at end of each financial year and hence to be given afresh annually

- 
- The purpose is fairness in dealings and not to prohibit any transactions

SECTION - 185 OF COMPANIES ACT 2013 - LOAN TO DIRECTORS



LOAN TO DIRECTORS

185 (1)

- No company shall, directly or indirectly, advance any loan, including loan by a book debt to, or give any guarantee or provide any security in connection with any loan taken by
 - any director of company, or of a company which is its holding company or any partner or relative of any such director; or
 - any firm in which any such director or relative is a partner.

185 (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, the following conditions to be fulfilled:
 - a special resolution is passed by the company in general meeting
 - the loans are utilised by the borrowing company for its principal business activities.

LOAN TO DIRECTOR

Prohibition is exempted in case of following

Loan given to a Managing Director or Whole Time Director when such loan

- Is the part of the conditions of service extended by the company to all its employees or
- 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 in the ordinary course of business, provided interest rate is not less than bank interest rate.

Any loan made guarantee given or security provided by a holding company to its wholly owned subsidiary company, provided use 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, provided use for its principal business activities.

LOAN TO DIRECTORS

Director or to any other person in whom the director is interested will include

- 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 25% of the total voting power may be exercised or controlled by any such director, or by two or more such directors, together

- 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


NON APPLICABILITY OF SECTION - 185

In case of private company -

- In whose share capital no other body corporate has invested any money;
- If the borrowings of such a company from banks or financial institutions or any body corporate is less than twice of its paid up share capital or fifty crore rupees, whichever is lower; and
- Such a company has no default in repayment of such borrowings subsisting at the time of making transactions under this section.

In case of Nidhi Company- Section 185 is not applicable, provided the loan is given to a director or his relative in their capacity as members and such transaction is disclosed in the annual accounts by a note.

NON APPLICABILITY OF SECTION - 185



In case of Government Company- Provided such company obtains approval of the Ministry or Department of the Central Government which is administratively in charge of the company, or as the case may be, the State Government before making any loan or giving any guarantee or providing any security under the section.



Specified International Financial Services Centre
Public and private Companies.

PENALTIES

Sr. No.	Non-Compliance	Category of Person	Penalty
1	Section 185 (4)	Company	Fine of Rs. 5,00,000 to 25,00,000
		Director	Fine of Rs. 5,00,000 to 25,00,000 Imprisonment upto 6 months or both
		Other Person	Fine of Rs. 5,00,000 to 25,00,000 Imprisonment upto 6 months or both

CASE STUDY

Sr. no.	Particulars	Answer
1	Sale of company flat to a director at prevailing market price out of which the director pays 50% immediately and contract to pay the balance amount in 10 equal annual instalments.	cannot be considered as a transaction of loan
2	Making a deposit with the landlord under license agreement for securing a residential accommodation for the managing director of the company	cannot be considered as a transaction of loan.

CASE STUDY

Sr. no.	Particulars	Answer
3	A salary advance of Rs.50000 to employee who is the wife of the managing director of the company	cannot be considered as a transaction of loan
4	Loan to a firm in which the director of the company is a partner	considered as a transaction of loan

CASE STUDY

Sr no.	Particulars	Answer
5	<p>ASP Limited, a listed company secured residential accommodation for the use of its Managing Director by entering into a lease arrangement with the landlord. As per the terms of the agreement, ASP Limited deposited a sum of ₹ 10,00,000 as rental advance with landlord. Referring to the provisions of the Companies Act, 2013, decide whether the said deposit amount be considered as a loan given to the Managing Director.</p>	<p>In accordance with provisions of Sec. 185, amount deposited with the landlord under license agreement for securing a residential accommodation for the managing director of the company cannot be considered as a transaction of loan as it is the company and not the director who has entered into the transaction.</p>


CASE STUDY

Sr no.	Particulars	Answer
6	<p>Mr. X is a director of M/s ABC Ltd. He has approached M/s Housing Finance Co. Ltd. For the purpose of obtaining a loan of Rs. 50 lacs to be used for construction of building his residential house. The loan was sanctioned subject to the condition that M/s ABC Ltd. should provide the guarantee for repayment of loan installments by Mr. X. Advise Mr. X.</p>	<p>Guarantee by Company M/s ABC Ltd. of which Mr. X is a director, for repayment of the loan and interest as per the terms of the proposed agreement is not allowed.</p>

SOME IMPORTANT POINTS



• Section does not prohibit - give but with special resolution




• Challenge lies in interpreting what part of activity should be considered as in the process of business



• We should look at entities ordinary business as a going concern, see past practices



• Supply of goods or property on credit beyond normal terms would tantamount to loan



• Loan given to an employee who becomes a director or relative of a director - prohibition shall not applicable since at the time of giving loan he was not a director

SECTION - 186 OF COMPANIES ACT 2013 - LOAN AND INVESTMENT BY COMPANY



LOAN AND INVESTMENT BY COMPANY

Definition

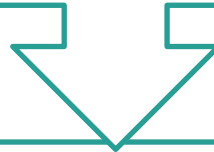
“Investment Company” means a company whose principal business is the acquisition of shares, debentures or other securities and a company will be deemed to be principally engaged in the business of acquisition of shares, debentures or other securities, if its assets in the form of investment in shares, 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.

“Infrastructure facilities” means the facilities specified in Schedule VI

LOAN AND INVESTMENT BY COMPANY

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:



Exception –

- (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.

LOAN AND INVESTMENT BY COMPANY 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 or 100% of its free reserves and securities premium account, whichever is more



For the purposes of this sub-section, the word "**person**" **does not** include any individual who is in the employment of the company

LOAN AND INVESTMENT BY COMPANY

186(3) -

- For providing loan/giving guarantee/security or acquiring security exceeding above limit, a Company need to take prior approval by means of Special Resolution passed at general meeting.
- Exception - Where a loan or guarantee is given or where a security has been provided by a company to its wholly owned subsidiary company or a joint venture company, or acquisition is made by a holding company, by way of subscription, purchase or otherwise of, the securities of its wholly owned subsidiary company, the requirement of this sub-section shall not apply
- Company shall disclose the details of such loans or guarantee or security or acquisition in the financial statement as provided 186 (4)

186 (4) -

- 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 utilised by the recipient of the loan or guarantee or security

LOAN AND INVESTMENT BY COMPANY

186(6)

- No company, which is registered under section 12 (Registration of stock brokers, sub-brokers, share transfer agents, etc.) of the SEBI Act, 1992 and covered under such class or classes of companies as may be prescribed, shall take inter-corporate loan or deposits exceeding the prescribed limit and such company shall furnish in its financial statement the details of the loan or deposits.

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.

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

186 (9)

- Every company giving loan or giving a guarantee or providing security or making an acquisition under this section shall keep a register which shall contain such particulars and shall be maintained in such manner as may be prescribed.

LOAN AND INVESTMENT BY COMPANY

186 (10)

The register referred to in sub-section (9) shall be kept at the registered office of the company and -

Shall be open to inspection at such office;
and

Extracts may be taken therefrom by any member, and copies thereof may be furnished to any member of the company on payment of such fees as may be prescribed.

LOAN AND INVESTMENT BY COMPANY

186 (11)

- Nothing contained in this section, except sub-section (1), shall apply—
- to any loan made, any guarantee given or any security provided or any investment made by a banking company, or an insurance company, or a housing finance company in the ordinary course of its business, or a company established with the object of and engaged in the business of financing industrial enterprises, or of providing infrastructural facilities;
- to any investment—
 - made by an investment company;
 - made in shares allotted in pursuance of clause (a) of sub-section (1) of section 62 or in shares allotted in pursuance of rights issues made by a body corporate;
 - made, in respect of investment or lending activities, by a non-banking financial company registered under Chapter III-B of the Reserve Bank of India Act, 1934 and whose principal business is acquisition of securities

186 (12)

- The Central Government may make rules for the purposes of this section

LOAN AND INVESTMENT BY COMPANY

Exceptions/ Modifications/ Adaptations

In case of Government Company - Section 186 shall not apply to :-

a Government company engaged in defence production;

a Government company, other than a listed company, in case such company obtains approval of the Ministry or Department of the Central Government which is administratively in charge of the company, or, as the case may be, the State Government before making any loan or giving any guarantee or providing any security or making any investment under the section.

LOAN AND INVESTMENT BY COMPANY

Exceptions/ Modifications/ Adaptations

Specified IFSC Public Company & Private Company

1. The Board can exercise powers under sub-section (5) by means of resolutions passed at meetings of the Board of Directors or through resolutions passed by circulation
2. Sub-sections (2) and (3) of section 186 shall not apply if a company passes a resolution either at meeting of the Board of Directors or by circulation.
3. Sub-section (1) of section 186 shall not apply.


Section 8 Company

1. Provided that nothing contained in sub-section (7) shall apply to a company in which 26% or more of the paid-up share capital is held by the Central Government or one or more State Governments or both, in respect of loans provided by such company for funding Industrial Research and Development projects in furtherance objects as stated in its memorandum of association.

PENALTIES

Sr. No.	Non-Compliance	Category of Person	Penalty
1	Section 186 (13)	Company	Fine of Rs. 25,000 to 5,00,000
		Every other officer responsible	Fine of Rs. 25,000 to 1,00,000 Imprisonment upto 2 years or both

SOME IMPORTANT POINTS

- 
- A Company in default in repayment of deposits cannot give till default is subsisting
 - Disbursement exceeding limit is to be previously authorized
 - Postal Ballot can be done

SECTION - 188 OF COMPANIES ACT 2013 - RELATED PARTY TRANSACTIONS



Transaction with Related Parties governed by:

Companies Act, 2013 and Rules made thereunder

SEBI (LODR) Regulations, 2015

Accounting Standard

AS 18

IND AS 24

Definition of related party under the Companies Act, 2013

Section 2(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;
- 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*

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

* For the purposes of sub-clause (ix) of clause (76) of section 2 of the Act, a director or key managerial personnel of the holding company or his relative with reference to a company shall be deemed to be a related party.

Definition of related party under the Companies Act, 2013

‘Relative’ with reference to any person, means any one who is related to another, if—

- (i) they are members of a Hindu Undivided Family;
- (ii) they are husband and wife; or
- (iii) one person is related to the other in such manner as may be prescribed;

Rules prescribed under Companies (Specification of definitions details) Rules, 2014

A person shall be deemed to be the relative of another, if he or she is related to another in the following manner, namely:-

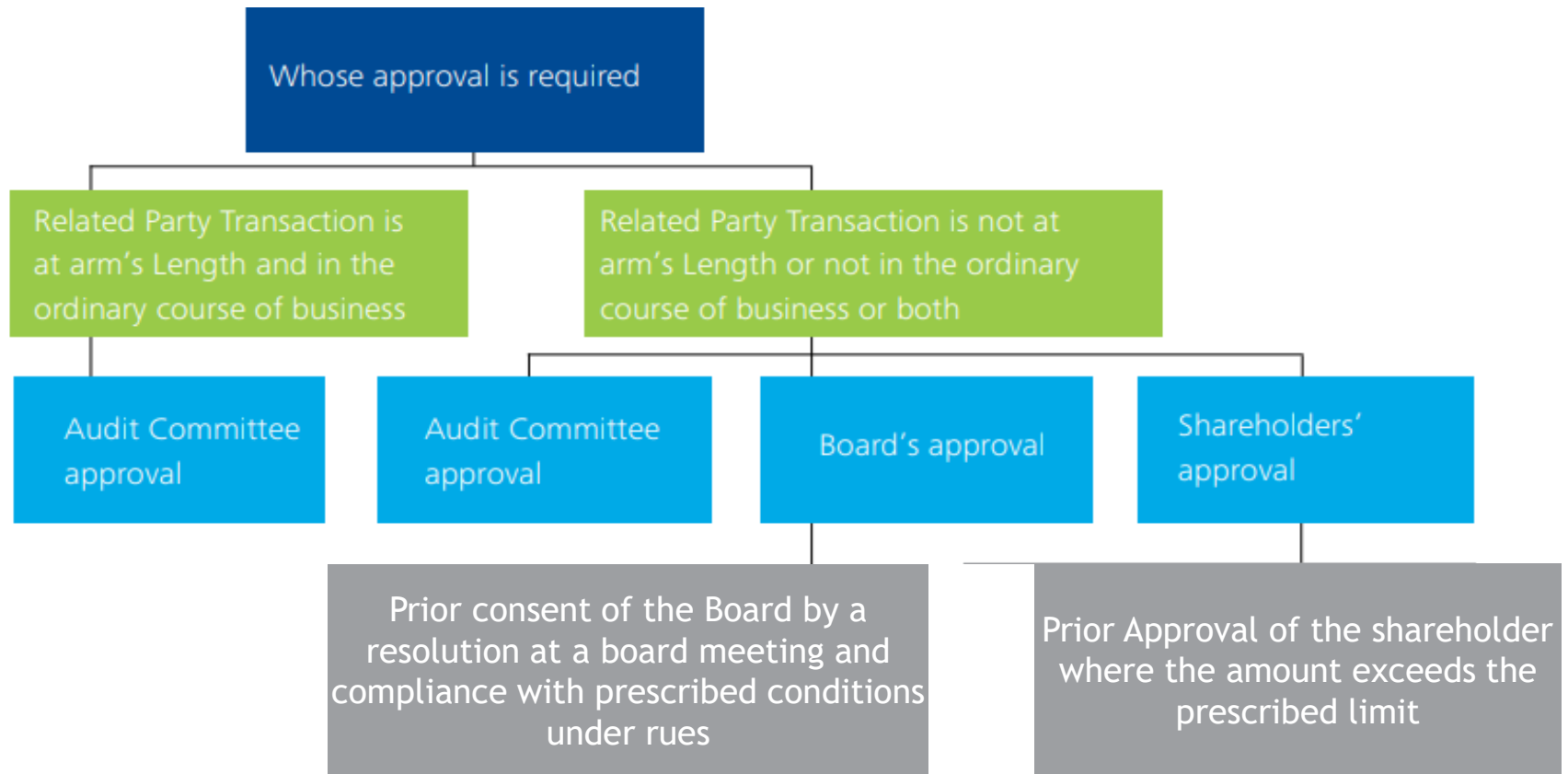
- i. Father: Provided that the term “Father” includes step-father
- ii. Mother: Provided that the term “Mother” includes the step-mother
- iii. Son: Provided that the term “Son” includes the step-son
- iv. Son’s wife
- v. Daughter
- vi. Daughter’s husband
- vii. Brother: Provided that the term “Brother” includes the step-brother
- viii. Sister: Provided that the term “Sister” includes the step-sister

Illustration

PQR	Private	Private	Public	Public
XYZ	Public	Private	Public	Private
Common Director	Yes	Yes	Yes	Yes
Directors Shareholding in XYZ	2%	2%	Nil	Nil
Is XYZ a related party for PQR	YES	YES	NO	YES

Identification of related parties under the 2013 Act is not based on the principle of reciprocity. It is possible that one company identifies other company as its related party. However, it does not necessarily mean that the second company will also identify the first one as its related party.

Approval u/s 188 under Companies Act, 2013



- Transactions not on arm's length basis and material contracts/arrangements/ transactions shall be disclosed in the Board's report.
- In case where prior approval has not been obtained, there is an option to ratify the same within a period of 3 months from the date of the transaction.
- Arm's length transaction means transaction between to related parties is conducted as if they were unrelated.

Limits for Shareholders' Approval

*Sale/ purchase/ supply of goods / materials (directly or through agent) $\geq 10\%$ of Annual turnover

*Selling/ disposing /buying, property of any kind(directly or through agent) $\geq 10\%$ of Net Worth

*Leasing of property of any kind $\geq 10\%$ of Net worth or 10% of Turnover or Rs. 100 crore, whichever is lower

*Availing /rendering of any services(directly or through agent) $\geq 10\%$ of Turnover

Office/place of profit in company/subsidiary/associate company - monthly remuneration > 2.5 Lakh per person

Underwriting subscription of any securities /derivatives $>1\%$ of Net Worth

CARO 2020

Clause (xiii) of Companies (Auditor's Report) Order, 2020

Auditor to report:

- whether or not there have been transactions between the related parties.
- whether all transactions with the related parties are in compliance with sections 177 and 188 of Companies Act where applicable and
- the details have been disclosed in the financial statements, etc., as required by the applicable accounting standards

SOME IMPORTANT POINTS

- Challenge lies in searching for a comparable transaction at arms length price
- A non-independent director can receive stock options of a company but where they exceed 2% it becomes a related party
- Board Report needs to have justification for each transaction with related parties
- Where holding company has passed resolution for WOS, it is sufficient compliance
- If a person becomes a relative post appointment it is fine as the clause requires assessment of related parties at the time of appointment
- Postal Ballot allowed

THANK YOU

