



The Institute of Chartered Accountants of India

(Setup by an Act of Parliament)



# **Provisions relating to Loans, Borrowings, Deposits and Related Party Transactions**

*(Practical issues and reporting requirements, Special  
focus for Impact on Private Limited Companies)*

**Intensive Study Course on Companies Act,  
2013  
WIRC of ICAI**

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# Today's Agenda

- Provisions relating to:
  - Acceptance of Deposits by Companies [Sec 73 to 76 Chapter V]
  - Loans to Directors [Sec185 Chapter XII]
  - Loans and Investments [Sec186 Chapter XII]
  - Related Party Transactions [Sec188 Chapter XII]
- Reporting requirements





# Provisions Regarding

# Acceptance of Deposits by Companies [Chapter V]

Fix Deposit



# Acceptance Of Deposits By Companies w.e.f. 01.04.2014



Section 73 Corresponding to Sec 58A

(1) On and after the commencement of this Act, no company shall invite, accept or renew\* deposits under this Act from the public except in a manner provided under this Chapter.

\*- General Circular No. 05/2015 dated March 30, 2015

*Provided that nothing in this sub-section shall apply to a banking company and non-banking financial company as defined in the Reserve Bank of India Act, 1934 (2 of 1934) and to such other company as the Central Government may, after consultation with the Reserve Bank of India, specify in this behalf.*



# Exclusions:

Such companies as specified in the Rules:

- Banking Co. [defined in S. 2(9) of the Act]
- Non-Banking Financial Co. (as defined in RBI Act, 1934)
- Co. specified by CG under proviso to 73(1)



# Deposit Definition Sec 2 (31):

"deposit" includes any receipt of money by way of deposit or loan or in any other form by a company, but does not include such categories of amount as may be prescribed\* in consultation with the Reserve Bank of India;

\*- Rule 2 to The Companies (acceptance of Deposits) Rule, 2014



# Acceptance of Deposit

(2) The Company may "accept" deposit from its members on such terms and conditions including security and interest as may be agreed upon between the company and its members:

- By passing resolution in general meeting and
- rules as may be prescribed in consultation with RBI\*

## Requirements:

- Issue a circular giving all the relevant details like for e.g. Financial Position, Credit rating, total depositors, amts. due etc.
- Filing the copy of the circular with registrar within 30 days before date of issue of circular





# Acceptance of Deposit



## Requirements:

- Depositing not less than 15% maturing during two FY - separate bank account of a scheduled - deposit repayment reserve account
- Insurance as may be prescribed
- Certification -no default in the repayment of deposits & interest - before or after the commencement of this Act
- providing security, if any and creation of charge on the property or assets of the company

## *Proviso*

*In case of unsecured or partially secured deposits – such shall be so quoted in all documents, circulars etc.*

# Deposit from members (conditions)



- repay with interest in accordance with the terms and conditions
- Failure - the depositor may apply to the NCLT repayment or for any loss or damage
- Deposit repayment reserve account not be used for any purpose other than repayment of deposits.



# Provisions - Private Companies

- Notification dated 5th June, 2015
  - Clause (a) to (e) of Sub-section 2 of Section 73 shall not apply to private Companies which accepts from its members monies not exceeding one hundred per cent, of aggregate of the paid up share capital and free reserves and security premium account, and such company shall file the details of monies so accepted to the Registrar in such manner as may be specified
  
- Similar exemption also for Specified IFSC Public Company -  
Notification: 4th January, 2017

# Notification dated 13<sup>th</sup> June 2017



- Clauses (a) to (e) of Sec 73 (2) – not applicable to a Private Co:
  - As above or
  - Is a 'start-up', for five years from date of its incorporation or
  - Which fulfils the following:
    - (a) which is not an associate or a subsidiary company of any other company;
    - (b) 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
    - (c) such a company has not defaulted in the repayment of such borrowings subsisting at the time of accepting deposits under this section:

# Deposit: Rule 2(c) of CAD Rules 2014



## Definitions –

- Section 2(31)- “deposit” includes any receipt of money by way of deposit or loan or in any other form by a company, but does not include such categories of amount as may be prescribed in consultation with the Reserve Bank of India;
- Rule 2(c) - “deposit includes any receipt of money by way of deposits or loan or in any other form, by a company, but does not include the following:
- Three elements which will constitute as deposit
  - Any receipt of money by way of deposit;
  - Any loan; and
  - Any receipt of money in any other form

# Deposit: Rule 2(c) of CAD Rules 2014



- Certain types of monies received by a company are excluded from the definition of 'deposit'- Following amount received **shall not be considered as "Deposit"**
  - i. From Central Government /State Government/ local authority ;
  - ii. Foreign or international banks/multilateral financial institution, foreign authorities and persons resident outside India subject to provisions of FEMA,1999 ;
  - iii. Banking Companies and Banking Institution notified under Banking Regulation Act including co-operative banks;
  - iv. Public Financial Institution /Regional Financial Institutions / Insurance Companies / Scheduled Banks ;
  - v. Commercial paper or any other instruments issued in accordance with the guidelines of Reserve Bank of India.

# Deposit: Rule 2(c) of CAD Rules 2014



- vi. any other Company
- vii. Subscription for securities including share application money
- viii. a *director* or relative of director of private company
- ix. issue of bonds or debentures secured by first charge on any assets / **listed unsecured NCDs**
- x. an employee of the company not exceeding his annual salary in the nature of non interest bearing security.
- xi. a Non- interest bearing amount received **and** held in trust
- xii. Any amount received in the course of or the purpose of the business for the following:
  - (a) As advance for the supply of goods or provision of services

# Deposit: Rule 2(c) of CAD Rules 2014



- (b) As advance received in connection with consideration for property under an agreement or arrangement,
  - (c) As security deposit for the performance of the contract for supply of goods or provision of services.
  - (d) As advance received under long term projects for supply of capital goods.
  - (e) As advance towards consideration for providing future service
  - (f) As advance Received and as allowed by any sectoral regulator from CG/SG
  - (g) advance for subscription towards publication
- xiii. Any amount brought in by the promoters themselves or their relatives by way of unsecured loan in pursuance of a stipulation of any lending institution on the promoters



# Deposit: Rule 2(c) of CAD Rules 2014



- xiv. any amount accepted by a Nidhi Company in accordance with rules made u/s 406 of the Act
- xv. any amount received by way of subscription by Chit fund company
- xvi. any amount received by company under collective investment scheme framed by SEBI
- xvii. an amount of twenty five lakh rupees or more received by a start-up company, by way of a convertible note in a single tranche, from a person.
- xviii. any amount received by a company from Alternate Investment Funds, Domestic Venture Capital Funds and Mutual Funds registered with the SEBI in accordance with regulations made by it.



# Repayment of deposits, etc., accepted before commencement of this Act (Section – 74)

- **Section 74** new provision

- (1) Any deposit accepted by a company before commencement of the Act, amount of deposit or any interest due thereon remains unpaid on such commencement or becomes due at any time thereafter, the company shall:
  - a. file within a period of three months from such commencement or from the date on which such payments, are due, with the registrar, a statement\*, and;
  - b. repay within one year from such commencement or from the date on which such payments are due, whichever is earlier

# Repayment of deposits, etc., accepted before commencement of this Act...



- (2) The Tribunal may on application made by the Company, after considering financial condition of the company, allow further time as considered reasonable to the company to repay the deposit.
- (3) If company fails to repay the deposit or interest thereon within a time specified in sub section (1) and (2), be punishable with:
- For Company - Fine – Rs. 1 crore to Rs. 10 crore
  - For every officer in default – imprisonment upto 7 years or with the fine of Rs. 25 lakhs to Rs. 2 crores or with both.



# Damages for Fraud (Section 75)

Section 75 (New) enforced w.e.f. 01.06.2016

- (1) It is proved that deposit accepted with intent to defraud the depositors or for any fraudulent purposes, every officer responsible for accepting deposits, will be personally liable without any limitation of liability, for all or any of the losses or damages that may have been incurred by the depositor.
- (2) Any suit, proceedings or other action may be taken by any person or any group of persons or any association of persons.

# Acceptance of Deposits by certain companies (Section 76)



(1) Notwithstanding anything contained in Section 73, a public company, having such net worth or turnover as may be prescribed, may accept deposits from persons other than its members subject to compliance with the requirement provided in sub-section (2) of Section 73 and subject to rules as the CG may prescribe.

(2) First Proviso:

*"such company need to obtain rating from recognized credit rating agency at the time of inviting the deposit and the rating shall be obtained every year during the tenure of deposit"\**

Second Proviso:

*"Every company accepting secured deposit from the public shall create a charge on its assets within 30 days from acceptance to the extent of amount of deposit accepted"*

# Section 76 r.w. CAD Rules 2014



## ▪ Eligible company (Rule 2(1)e) of CAD Rules 2014):

- Net worth –not less than INR 100 cr. **OR**
- Turnover – not less than INR 500 cr. **AND**
- Prior consent of the company in General meeting **(Special Resolution)**
- Filed a copy of Resolution before registrar before making invitation
- **Ordinary Resolution** of the deposit is within the limit of Section 180(1)(c)

## ▪ Term of Deposit (Rule 3 of CAD Rules 2014):

### **Members + Repayable on demand OR**

- Upon receiving notice in less than **6 months\*** OR
- Upon receiving notice in more than **36 months**
- From the date on which such deposits were taken

\* Certain exception for short term requirement of funds

# Section 76 r.w. CAD rules, 2014



## ▪ Limit on quantum of Deposits (Rule 3 of CAD Rules 2014):

### ➤ *Limit on Deposit from Members:*

- A company can take deposit from its members up to ~~25~~35%\* of the aggregate of the paid up share capital, free reserve and Securities Premium Account of the company
- Pvt. Co.- 100% of PSC + FR + SP – new inserted CAD Rules 2016\*\*

### ➤ *Limit on deposits for Eligible Company:*

- From company's members – up to 10 % of PSC+FR+SP
- From Public- up to 25% of PSC + FR + SP

### ➤ *Limit on deposit from public for Govt. Company:*

- *Up to 35% of PSC + FR + SP*

# Section 76 r.w. CAD rules, 2014



- *Deposits from members & public - Maximum interest rate & brokerage regulated by RBI*
- *Alteration in terms and conditions (prejudice or disadvantage of the depositor) not possible*





# Section-76A – Punishment for contravention of sec 73 or sec 76 (29/5/15)

- Any company accept or invite deposit in contravention of the manner or the conditions prescribed under sec 73 or sec 76
- Or if a company fails to repay the deposit or any interest thereon within the time specified
- *the company shall, in addition to the payment of the amount of deposit or part thereof and interest due, punishable with fine not less than one crore rupees but which may extend to ten crore rupees*
- *Every officer in default with imprisonment of seven years or with a fine which shall not be less than twenty five lakh rupees which may extend to two crore rupees, or with both. \**



# Rule 16A (29/6/16)

## Disclosures in the financial statement.-

- (1) Every company, other than a private company, shall disclose in its financial statement, by way of notes, about the money received from the director.
- (2) Every private company shall disclose in its financial statement, by way of notes, about the money received from the directors, or relatives of directors.”.

# Net Worth



## Section 2(57) Definition is modified

“net worth” means the aggregate value of the paid-up share capital and all reserves created out of the profits and securities premium account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet, but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation;



# Free Reserves

Section 2(43) Definition is modified

“free reserves” means such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend;

Provided that:

- i. any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or
- ii. any change in carrying amount of an asset or of a liability recognised in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value,

shall not be treated as free reserves

# Turnover



## Section 2(91) New Definition

“turnover” means the aggregate value of the realisation of amount made from the sale, supply or distribution of goods or on account of services rendered, or both, by the company during a financial year.



# FAQs

- Can a Private Company Accept deposit from its members?
  - If yes – upto what limit?
  - What are the compliances required?
- Can a Private Company Accept deposit from its directors and/or relatives of such directors?
  - If yes – upto what limit?
  - What are the compliances required?
- Can a Private Company Accept deposit from public?
  - What is the maximum limit



# FAQs

- Does deposits provisions cover debentures?
- Secured CCDs/OCDs/NCD – not a deposit
- Unsecured CCDs/OCDs/NCDs issued to a co.- not a deposit
- Unsecured CCDs/OCDs/NCDs issued to a resident - not a deposit if converted within 10 years
- Unsecured CCDs/OCDs/NCDs issued to a resident - not a deposit if listed otherwise deposit
- Unsecured CCDs/OCDs/NCDs issued to a foreign body - not a deposit



What happened  
Sharma Ji??



I lost my money  
in Company Fixed  
Deposit







# Loans to Directors [Sec185 Chapter XII]





# Loans to Directors (section 185)

- Corresponding to Sec. 295 & 296 of the 1956 Act

**(1) Save as otherwise provided** in this Act,

- **Prohibition to advance any loan:** a company shall not directly or indirectly advance any loan, including any loan represented by a book debt, to—
  - ✓ any of its directors; or
  - ✓ any other person in whom such director is interested
- **Prohibition to provide any guarantee or security:** a company shall not directly or indirectly:
  - ✓ give any guarantee; or
  - ✓ provide any security in connection with any loan taken by him or such other person



# Loans to Directors (section 185)

➤ **Provisions not to apply in the following cases:—**

- ✓ giving of any loan to a **managing or whole-time director**-
  - ❖ as 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 guarantee or securities** for the due repayment of any loan and interest on such loans is charged at a rate not less than the bank rate declared by the RBI



# Loans to Directors (section 185)

➤ Provisions not to apply in the following cases:—

✓ **Wholly owned Subsidiary:\***

❖ Any loan made by a holding company to its *wholly owned subsidiary company*; or

❖ Any guarantee given or security provided by a holding company in respect of any loan made to its *wholly owned subsidiary company*

✓ **Subsidiary:** Section not to be complied for:

❖ 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*

✓ **Cardinal Condition for Exemptions:** Such loans are utilised by the subsidiary company for its principle business activities.



# Loans to Directors (section 185)

**Any other person in whom director is interested – meaning thereof:**

- any **director of the lending** 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; or
- any **private company** of which any such director is a director or member; or (Refer notification 4<sup>th</sup> January 2017)
- 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; 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.



# Loans to Directors (section 185)

- **Exemption to Private Companies:\***
  - ✓ Section 185 shall not apply to Private company-
    - ❖ In whose share capital no other "**body corporate**" has invested any money ;
    - ❖ If **borrowing** from Banks or FI's or any body corporate is less than **twice of paid up capital or fifty crore**, whichever is lower ;
    - ❖ Such a company has **no defaults in repayment of such borrowing** subsisting at the time of making transactions under this section.



# Loans to Directors (section 185)

- **Other Exemption :**
  - ✓ Section 185 shall not apply to Government company-
    - ❖ In case such company obtains approval of the Ministry or Department of the Central Government/State Government before making any loan or giving any guarantee or providing any security under the section ;
  - ✓ Section 185 shall not apply to Nidhi company-
    - ❖ 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.



# Loans to Directors (section 185)

- **Other Exemption** (Notification Dated 4th January, 2017) :
  - Explanation to clause (c) of Sec 185 (1)
- ✓ In case of Specified IFSC Public Company & In case of Specified IFSC Private Company
  - ❖ any private company of which any such director is a director or member in which director of the lending company do not have direct or indirect shareholding through themselves or through their relatives and a special resolution is passed to this effect;”;

International Financial Services Centre (IFSC)





# Loans to Directors (section 185)

- **Penal provision in contravention of section 185(1):**
  - ✓ The **company** shall be punishable with fine which shall not be less than five lakh rupees but which may extend to **twenty five lakh rupees**;
  - ✓ **Director** or other person to whom any loan is advanced or guarantee or security is given or provided in connection with any loan by him or other person- **imprisonment of six months or with minimum fine of five lakhs but can be extended to twenty five lakhs or both**



# Section 185 – Case Study

A Ltd. has two directors PM and AM , both holds 50% share each of company. A Ltd. wish to give loan to following and have asked your views on same.

- Loan to Director PM
- Loan to a relative of Director AM
- Director of D Ltd. which is holding company of A Ltd.
- A Partner of Director of Holding Company
- A Partner of Director of A Ltd.
- To a firm in which Mr. PM is partner
- To a firm in which relative of Mr. AM is a Partner
- To a LLP in which PM is partner



## Definition of Relative

- Sec 2(77) - “**relative**”, with reference to any person, means anyone 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\*;

\*- Father, mother, son, son’s wife, daughter, daughter’s husband, brother, sister, (including step relations)



## Takeaways

- **No distinction between Private & Public company initially**
- Certain exemptions for Private coms brought back
- Loans given before 12-Sep-13??
- What happens to loans between 12-Sept and 31-March ?
- Even if a loan etc. obtained in contravention of the above provisions is repaid, the contravener would still be exposed to punishment by way of imprisonment
- applicable prospectively and should not affect existing loans etc.
- renewals of loan etc. needs to be in conformity with the 2013 Act
- **Section does not contain any remedial proviso**



## Issues & solutions:

- What happen to existing loans?
- Loans between September and March?
- Can a subsidiary give a loan to Holding Co?
- Shares held by directors as “nominee”
  
- Rearrange or realign – shareholding and/or directorship
- Appoint new directors
- Convert to LLP
- Use of dependent relatives

# FAQs



- Can a private limited Company give loans to its Directors?
- Can loan be given by a holding company to its wholly owned subsidiary company or a guarantee given or security provided by a holding company to any loan made to its wholly owned subsidiary?





# Provisions Regarding Loans and Investments [Sec186 Chapter XII]







## Loans and Investments (Section 186)

- Sec 186 {corresponds to sec 372A of Old Act}
- **Investment through two layers of companies only [Section 186(1)]:** A company shall, unless otherwise prescribed, make investment through not more than two layers of investment companies.
- **Exception: However, this provision shall not affect—**
  - ✓ 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;
  - ✓ A subsidiary company from having any investment subsidiary for the purposes of meeting the requirements of any law or under any rule or regulation framed under any law for the time being in force.



## Loans and Investments (Section 186)

- Limit for making inter-corporate loan, guarantee, providing security or investment [Section 186(2)]:

A company can not, *directly or indirectly*-

- ✓ give loan to any person or other body corporate.
- ✓ give any guarantee or provide security in connection with a loan to any body corporate or person; and
- ✓ acquire by way of subscription, purchase or otherwise, the securities of any other body corporate.

### ***Exceeding:***

- ❖ 60% of [Paid Up Share Capital (+) Free Reserves (+) Securities Premium Account]; or
- ❖ 100% of [Free Reserves (+) Securities Premium Account],  
whichever is more



## Loans and Investments (Section 186)

- **If:** Amounts Involved > Specified Limit
- **Then:** Prior Approval by way of Special Resolution is required [Section 186(3)]
- **Disclosure in F.S.:** Particulars & purposes of such loans, investments etc. required to be disclosed [Section 186(4)];
- **BOD Approval** always required: Consent by **All the directors** present in the BOD Meeting [Section 186(5)];
- **Public Financial Institution Approval** – when **required**: if any term loan is subsisting;
- **Public Financial Institution Approval** – when **not required**: If:
  - ❖ Amounts Involved [present (+) proposed]  $\leq$  Ceiling Limit; **and**
  - ❖ No default in repayment of their loan installments or payment of interest thereon



## Loans and Investments (Section 186)

- **NO:** Loan can be given under this section at a rate of interest lower than the prevailing yield of one/three/five or ten year Government Security closest to the tenor of the loan



## Loans and Investments (Section 186)

- **Default in the repayment of any deposits [section 186(8):**  
Company prohibited to give any loan or give any guarantee or provide security or make an acquisition till such default is subsisting;
- **Register of loan, guarantee, security, or acquisition [section 186(9) & (10)]:**  
To be kept at the registered office, in manual or e-mode, in Form MBP 2 & to be updated within 7 days of such transactions;
- **S. 186(2) to (10) not to apply in certain cases [Section 186(11)]:**
  - ✓ Loan, Guarantee, Security by Banking Co./ Insurance Co./ HFC/ Company engaged in business of financing companies or providing infra facilities;
  - ✓ Acquisitions made by NBFC in ordinary course of business;
  - ✓ Acquisitions through Right Issue
  - ✓ Acquisition made by banking company or any insurance company or HFC in ordinary course of business.\*

# Loans and Investments (Section 186)



- **Contravenes the provisions [section 186(13):**
  - ✓ **Company** shall be punishable not less than twenty five thousand rupees but which may extend to five lakh rupees;
  - ✓ Every officer in default shall be punishable with imprisonment for term which may extend to two years **and** with fine not less than twenty five thousand rupees but which may extend to one lakh rupees;
  
- **Section 186 is not applicable to :**
  - ✓ Govt. company engaged in defense production;
  - ✓ Govt. company, other than listed company, in case such company obtains approval of the Ministry/ Department of CG/ SG before making any loans or giving any guarantee.



## Exemptions: (Section 186)

### Exemption to subsidiary company/joint ventures – conditions thereof:

As per Rule 11(1) of the Companies (Meetings of Board and Its Powers) Rules, 2014:

- 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
  
- Where an **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 sub-section (3) of section 186 shall not apply.



## Exemptions: (Section 186)

- **Nothing contained in this section except sub-section (1) shall apply –**
  - to a **loan made**, guarantee given or security provided by banking company or insurance company or a housing finance company or company engage in business of financing or of providing infrastructural facilities
  - to **any acquisition** made by NBFC, principal business is acquisition of securities



# Explanation.—For the purposes of this section



- “investment company” means a company whose principal business is the acquisition of shares, debentures or other securities
- “infrastructure facilities” means the facilities specified in Schedule VI



## Loans and Investments certain issues...

- Securities – defined under 2 (81) - means the securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956-
  - To include shares, bonds, stocks, debentures, warrants or other marketable securities of a similar nature offered by a corporate body
- Sec 2(11) “body corporate” or “corporation” includes a company incorporated outside India, but does not include—
  - a co-operative society registered under any law relating to co-operative societies; and
  - any other body corporate (not being a company as defined in this Act), which the Central Government may, by notification, specify in this behalf;

# Notification Dated 4<sup>th</sup> January 2017



Certain exemptions in case of Specified IFSC Public & Private Companies

- Section 186 (1) – layers of investment companies
- Section 186 (2) & (3) – BOD pass a circular resolution



# Layers of Investment Companies

- New Concept
- Only for investment companies –
- Operating cos – seems to be no problem
- Maximum two layers of investment companies
- “investment company” means a company whose principal business is the acquisition of shares, debentures or other securities
- Investments in all classes of assets covered – like land etc.
- Partnership firm, LLP may not be covered as investment companies?????
- Debate on principal business

# Layers of Investment Companies



# FAQs

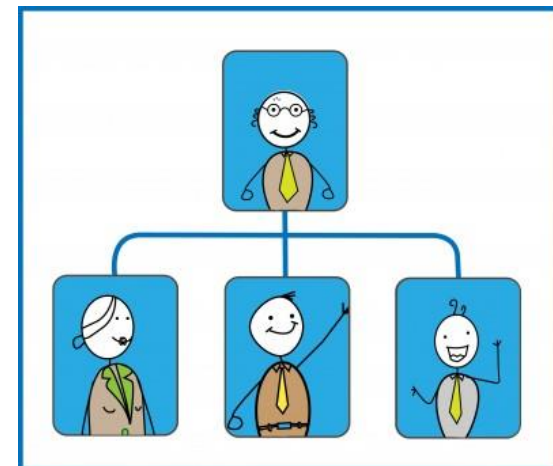


- Is a private company exempt from Sec 186 of CA, 2013?
- Is loan to an employee covered within Sec 186?
- Will salary advances made by the Company for only one or two months (without interest) come within the preview of “Loan”?
- Is unanimous consent of the board required for entering into a transaction under Sec 186?
- When is the approval from the public financial institutions not required for entering into transactions under Section 186?
- Can Company provide interest free loans?



# Provisions Regarding

# Related Party Transactions [Sec188 Chapter XII]



# Related Party Transactions (RPT)



Identification of Related Parties

Related Party transactions

Approval process

Disclosure requirements





# Identification of Related Parties

Accounting  
Standard 18/Ind  
AS 24

*Section  
40A(2)(b) of  
Income Tax Act*

*Domestic  
Transfer Pricing*

LODR/(earlier  
clause 49 of  
Listing  
Agreement)

**Companies Act  
2013**

# Related Party



- Sec 2 (76) “related party” with reference to a company, means -
  - ✓ **director** or his **relative**;
  - ✓ **Key Managerial Personnel** or his **relative**;
  - ✓ firm, in which a director, manager or his relative is a partner;
  - ✓ private company in which a director or manager or his relative\* is a member or director ;
  - ✓ public company in which a director or manager is a director or holds\*\* along with his relatives, more than 2% of its paid-up share capital;
  - ✓ any body corporate whose Board Of Directors, MD, or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager;

# Related Party



- Sec 2 (76) “related party” with reference to a company, means -
    - ✓ any person under whose advice, directions or instructions a director or manager is accustomed to act; Provided that nothing in sub-clause (vi) and (vii) shall apply to the advice, directions or instructions given in a professional capacity;
    - ✓ any company which is\* –
      - a holding, subsidiary or an associate company of such company; or
      - a subsidiary of a holding company to which it is also a subsidiary;
- (\* Shall not apply to Section 188; to a private company)***
- ✓ such other persons as may be prescribed (director other than independent, KMP of the holding company or his relative to be deemed a related party)

# Definition of Relative



- Sec 2(77) - “**relative**”, with reference to any person, means anyone 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 which is as follows;
    - Father (including step-father)
    - Mother ( including step-mother)
    - Son ( including step-son)
    - Son’s wife
    - Daughter
    - Daughter’s husband
    - Brother ( including step-brother)
    - Sister (including step-sister)

# COVERAGE OF RELATIVE



Cases of Relative	Co. Act, 1956	Co. Act, 2013	IT Act, 1961	Cases of Relative	Co. Act, 1956	Co. Act, 2013	IT Act, 1961
Members of HUF	Yes	Yes	Yes	Mother's father	Yes	No	No
Husband/Wife	Yes	Yes	Yes	Son's son/ daughter	Yes	No	Yes
Father (including step-Father)	Yes	Yes	Yes	Daughter's husband	Yes	Yes	Yes
Mother (including step-mother)	Yes	Yes	Yes	Son's daughter's husband	Yes	No	No
Son (including step-son)	Yes	Yes	Yes	Daughter's son	Yes	No	No
Daughter (including step-daughter)	Yes	Yes	Yes	Daughter's Son's wife	Yes	No	No
				Son's son's wife			Yes
Brother (including step-brother)	Yes	Yes	Yes	Daughter's daughter	Yes	No	No
Sister (including step-sister)	Yes	Yes	Yes	Daughter's daughter's husband	Yes	No	No
Son's Wife	Yes	Yes	Yes	Son's daughter's husband	Yes	No	No
Father's father	Yes	No	Yes	Daughter's son's wife	Yes	No	No
Father's mother	Yes	No	Yes	Brother's wife	Yes	No	Yes
Mother's mother	Yes	No	No	Sister's husband	Yes	No	Yes



# Other Definitions

- Sec 2(51) - “key managerial personnel”, (KMP) in relation to a company, means -
  - ✓ Chief Executive Officer or the managing director or the manager;
  - ✓ company secretary;
  - ✓ whole-time director;
  - ✓ Chief Financial Officer; and
  - ✓ such other officer as may be prescribed;

## As per AS-18:

KMP means those persons who have the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise.



# Private Company

Section 2(68) Definition is modified

“private company” means a company having a minimum paid-up share capital ~~of Rs.1 Lakh or such higher paid-up share capital~~ as may be prescribed, and which by its articles, -

- i. Restricts the rights to transfer its shares;
- ii. Except incase of one person company, **limits the number of its members to 200**; and
- iii. *Prohibits any invitation to the public to subscribe for any securities of the company.*



# Subsidiary Company

Section 2(87) Definition is modified

“subsidiary company” or “subsidiary”, in relation to any other company (that is to say the holding company), means a company in which the holding company—

- i. controls the composition of the Board of Directors; or
- ii. exercises or controls more than one-half of the **total share capital** either at its own or together with one or more of its subsidiary companies

***Total share capital would mean Paid up Eq Sh Cap + convertible Pref. Sh.***

Provided that such class or classes of holding companies as may be prescribed shall not have layers of subsidiaries beyond such numbers as may be prescribed.





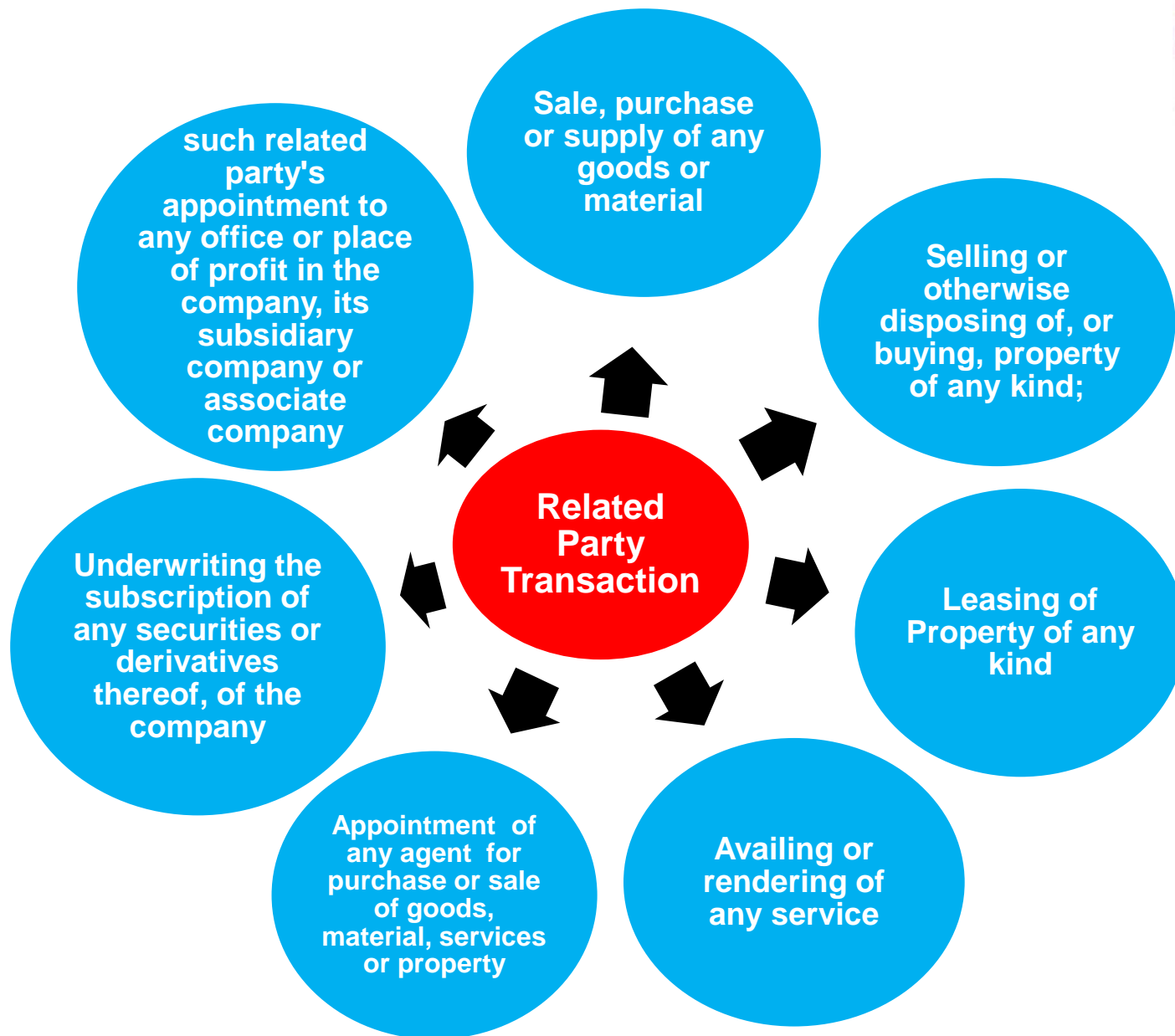
# Associate Company

- Sec 2(6) - “**associate company**”, in relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company.
- Explanation.—For the purposes of this clause, “significant influence” means control of at least twenty percent of total share capital, or of business decisions under an agreement

# Related Party Transactions (RPT): (Sec. 188)



- “Except with the consent of the BOD given by a resolution at a meeting of the Board and subject to such conditions as may be prescribed, no company shall enter into any contract or arrangement with a related party with respect to:—”





# First Proviso – Shareholder’s Approval

- A company shall not enter into a transaction or transactions, where the transaction or transactions to be entered as contract or arrangement, except with the **prior approval** of the company by way of a **Special Resolution**:

Sr No.	Criteria	Limit *
1.	Sale, purchase or supply of any goods or materials directly or through appointment of agents	<b>10 % of Turnover</b> of the Company or <b>Rs.100 Crores</b> whichever is lower.
2.	Selling or otherwise disposing of, or buying, property of any kind directly or through appointment of agents	<b>10 % of Net worth</b> of the Company or <b>Rs.100 Crores</b> whichever is lower.



# First Proviso – Shareholder’s Approval

Sr No.	Criteria	Limit *
3.	Leasing of property of any kind	<b>10 % of Net worth</b> of the Company or <b>10 % of Turnover</b> of the Company or <b>Rs.100 Crores</b> whichever is lower.
4.	Availing or rendering of any services directly or through appointment of agents for purchase or sale of goods, materials ,services or property	<b>10 % of Turnover</b> of the Company or <b>Rs.50 Crores</b> whichever is lower.

**\* Limit shall apply for transaction or transactions entered into either individually or taken together with the previous transactions during a financial year.**



# First Proviso – Shareholder’s Approval

Sr No.	Criteria	Limit *
5.	Appointment to any office or place of profit in the company, its subsidiary company or associate company	<b>Monthly Remuneration of Rs.2,50,000/-</b>
6.	Remuneration for Underwriting the subscription of any securities or derivatives thereof, of the company	<b>1% of Net Worth of the Company.</b>



# Exemption u/s 188

- The above subsection will not apply to transactions entered by company in its Ordinary Course of business on arm's length basis
- Requirement of passing resolution under first proviso shall not be applicable for transaction entered into between a holding company and its wholly owned subsidiary whose accounts are consolidated with such holding company and placed before shareholders at GM approval.

# Important Definitions



## ▪ Office or place of profit:

(i) where such office or place is held by a director, if the director holding it receives from the Company anything by way of remuneration over and above the remuneration to which he is entitled as director, by way of salary, fee, commission, perquisites, any rent – free accommodation, or otherwise;

(ii) where such office or place is held by an individual other than a director or by any firm, private company or other body corporate, if the individual, firm, private company or body corporate holding it receives from the company anything by any way of remuneration, salary, fee, commission, perquisites, any rent-free accommodation, or otherwise;



# Important Definitions



## ■ Arm's Length Transaction:

- The expression “arm's length transaction” means a transaction between two related parties that is conducted as if they were unrelated , so that there is no conflict of interest.
- In short, there is no interest in any contract; such contract automatics cover the meaning of Arm Length Transactions.
- The ultimate scope of this section is “interest”, if any interest is there by anyway the Section shall be effective, if there is no interest is there, the section shall be in neutral.



# Second Proviso:

- A member of the company shall not vote on such special resolution, to approve any contract or arrangement which may be entered into by the company, if such member is a related party.
  
- **First and second proviso shall not apply to :**
  - ✓ A Government Company in respect of contracts or arrangements entered into by it with any other Government Company;
  - ✓ A Government company , other than listed company in respect of contracts or arrangement other than those referred to in clause (a) ,in case such company obtains approval of the Ministry of Department of the Central Government which is administratively in charge of the company, or, as the case may be ,the State Government before entering into such contract or arrangement. \*
  
- **Second proviso shall not apply to :**
  - ✓ Private Companies.\*



# Other relevant sub-sections of 188

- Every Contracts or arrangements mentioned in earlier slides shall be referred to in Board's report to the shareholders along with justification for entering into such contracts or arrangements;
- The contract will be voidable, if it is entered:
  - ✓ Without obtaining consent of the Board or approval in GM;
  - ✓ Not ratified by the Board / shareholders in GM within 3 months from the date on which it is entered into;
- If the contract or arrangement is with related party to any Director, or is authorised by any other Director, the Director concerned shall indemnify the company against any loss incurred by it.;
- Without prejudice to the above, the company shall be open to proceed against a director or any other employee who had entered into such contracts or arrangements in contravention for recovery of any loss.

# Important points covered under Rule 15 of Companies (Meetings of Board and its powers) Rules, 2014



- Where any director is interested in any contract or arrangement with related party, such director shall not be present at the meeting during discussions on the subject matter of the resolution relating to such contract or arrangement.
- The Turnover or net worth referred in the above slides shall be computed on the basis of the Audited Financial Statement of the preceding Financial year.
- In case of a Wholly Owned Subsidiary, the special resolution passed by the holding company shall be sufficient for the purpose of entering into the transaction between wholly owned subsidiary and the holding company.

# Important points covered under Rule 15 of The Companies (Meetings of Board and its powers) Rules, 2014



## ■ Disclosures required in Board Meeting Notice

- ✓ The name of the related party and nature of relationship;
- ✓ The nature, duration of the contract and particulars of the contract or arrangement;
- ✓ The material terms of the contract or arrangement including the value, if any;
- ✓ any advance paid or received for the contract or arrangement, if any;
- ✓ the manner of determining the pricing and other commercial terms, both included as part of contract and not considered as part of the contract;
- ✓ whether all factors relevant to the contract have been considered, if not, the details of factors not considered with the rationale for not considering those factors; and
- ✓ any other information relevant or important for the Board to take a decision on the proposed transaction.



# Important points covered under Rule 15 of The Companies (Meetings of Board and its powers) Rules, 2014

- The content of explanatory statement to be annexed with the notice of general meeting shall contain the following particulars, namely:
  - ✓ Name of the related party;
  - ✓ Name of the director of KMP, who is related, if any;
  - ✓ Nature of relationship;
  - ✓ Nature, material terms, monetary value and particulars of the contract or arrangement;
  - ✓ Any other information relevant or important for the member to take a decision on the proposed resolution.

# Penal Consequences u/s 188



- Any director or any other employee of a company, who had entered into or authorized the contract or arrangement in violation of the provisions of this

Sr No.	Company	Penalty
1.	Listed Company	Imprisonment for a term up to 1 year or Fine of Rs.25,000/- to Rs.5,00,000/- or Both.
2.	Other Company	Fine of Rs.25,000/- to Rs.5,00,000/-

# FAQs



- Which are the transactions that would not require approval of the shareholders under Section 188??





# REPORTING REQUIREMENTS



# Reporting Requirements

- By the Company
  - Section 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.
  - Every private company shall disclose in its financial statement, by way of notes, about the money received from the directors, or relatives of directors.”.



# Reporting Requirements

- By the Auditor (CARO 2016 reporting):
  - **Loan given by Company [Clause 3 (iii)]**
  - Whether the company has granted any loans, secured or unsecured to companies, firms, LLP or other parties covered in the registered maintained under Section 189 of the Companies Act, 2013. If so,
    - (a) Whether terms and conditions of the grant of such loan are not prejudicial to the company's interest.
    - (b) Whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments and receipts are regular
    - (c) If the amount is overdue, state the total amount overdue, state the total amount overdue for more than 90 days and whether reasonable steps have been taken by the company for recovery of principal



# Reporting Requirements

- By the Auditor (CARO 2016 reporting):
  - **Loan to director and investment by the company [Clause 3 (iv)]**  
In respect of loan, investment, guarantees and security whether provision of Sections 185 and 186 of the Companies Act, 2013 has been complied with. If not, provide the details thereof.

- **Deposits [Clause 3 (v)]**

In case, the company has accepted deposits, whether the following has been complied with:

- Directives issued by the reserve bank of India
- (a) The provision of sec 73 to 76 or any other relevant provision of Companies Act, 2013 and the rules framed there under, and
- (b) If the order has been passed by company law board (CLB) or National company law tribunal (NCLT) or RBI or any court or any other tribunal.
- (c) However, if any of the above not complied with, the nature of contraventions should be stated



*Thank you*

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