

Loan to Director

Under Companies Act, 2013

The Section 185 of the Companies Act, 2013 deals with the matters relating giving loan, guarantee and providing security to Director, his relatives and entities in which Director has interest.

The Section 185 is divided into four sub-sections

- **Sub-Section (1)** prohibits the Company to give Loan, Guarantee and security to Director.
- **Sub-Section (2)** states that the Company can give loan, Guarantee and security to entity in which Director has interest subject to certain conditions.
- **Sub-Section (3)** states the exceptional circumstances where a Company can give Loan, Guarantee and provide security.
- **Sub-Section (4)** contains the penal provisions in respect of violation of Section 185.

Sub-Section (1)

prohibition on Company to give Loan, Guarantee and provide security to Director.

Sub-Section (1) states that 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,—

Any Director of Company, or of a Company which is its Holding Company or any Partner or Relative of any such Director.

Any Firm in which any such Director or Relative is a Partner.

In other words a Company, directly or indirectly, cannot give any Loan, Guarantee and provide security to its Director, Director of its Holding Company, Partner or Relative of its Director or a Firm in which such Director or Relative of such Director is a Partner.

Sub-Section (2)

Giving loan, Guarantee and providing security to entity in which Director has interest subject to certain conditions

Sub-Section (2) states that 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 director of the Company is interested, subject to the condition that—

→ A special resolution is passed by the Company in general meeting.

→ The loans are utilised by the borrowing Company for its principal business activities.

In other words a Company can give any Loan, Guarantee and provide security to a person in whom Director of the Company is interest by passing a Special Resolution in General Meeting and such person shall use such Loan only for its Principal Business Activity.

Any person in whom Director of the Company is interested means:

- (a) A Private Company in which Director of Lending Company is a Director or Member.
- (b) A Body Corporate in which one or more Director of Lending Company hold 25% or more voting power.
- (c) A Body Corporate of which Board of Directors, MD or Manager is accustomed to act in accordance with the directions or instructions given by the Board, any Director or Directors, of the Lending Company.

Sub-Section (3)

Exceptional circumstances where a Company can give Loan, Guarantee and provide security

Sub-Section (3) states that nothing contained in sub-sections (1) and (2) shall apply to—

(a) Giving of any Loan to a MD or WTD of the Company:

- (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

(b) A Company which in the ordinary course of its business provides Loans or gives Guarantees or Securities 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 years, five years or ten years Government security closest to the tenor of the loan.

(c) Any Loan made by Holding Company to its Wholly Owned Subsidiary Company or any Guarantee given or Security provided by a Holding Company in respect of any Loan taken by its Wholly Owned Subsidiary Company.

(d) Any Guarantee given or Security provided by Holding Company in respect of Loan given by any Bank or Financial Institution to its Subsidiary Company.

It should be noted that Loan as mentioned in point No. (c) and (d) above must be used for Principal Business Activity.

Sub-Section (3)

Exceptional circumstances where a Company can give Loan, Guarantee and provide security

(a) A Company can give Loan to its Managing Director or Whole-Time Director only where the Company in its ordinary business practice gives loan to its all employees or under a scheme which is approved by the Members of the Company by way of Special Resolution.

(b) A Company which engaged in the business of giving Loan, Guarantee or providing Security (such as Bank, Financial Institutions, NBFC etc.) can give Loan, Guarantee or provide Security to its Director provided that such Company shall charge interest on it.

(c) The Holding Company can give Loan, Guarantee or provide Security to its Wholly Owned Subsidiary Company (WOS) provided that such Loan shall be used by the WOS for its Principal Business Activity only.

(d) The Holding Company can give Guarantee or provide Security to its Subsidiary Company in respect of Loan taken by such Subsidiary Company from a Bank or Financial Institution provided that such Loan shall be used by the Subsidiary Company for its Principal Business Activity only.

Sub-Section (4)

Penal provisions in respect of violation of Section 185

Sub-Section (3) states that If any Loan is advanced or a Guarantee or Security is given or provided or utilised in contravention of the provisions of this section,—

→ 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.

→ Every Officer of the Company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than Five Lakh Rupees but which may extend to Twenty-Five Lakh Rupees.

→ The Director or the other person to whom any Loan is advanced or Guarantee or Security is given or provided in connection with any Loan taken by him or the other person, shall be punishable with imprisonment which may extend to six months or with fine which shall not be less than Five Lakh Rupees but which may extend to Twenty-Five Lakh Rupees, or with both.

Important aspects of Section 185

Can a Company give Guarantee or provide Security in respect of Loan taken by MD or WTD of the Company?

Nb, Sub-Section (3) states that a Company can give Loan to its MD or WTD subject to conditions mentioned in it but it does not say anything about giving Guarantee or providing Security in respect of Loan taken by its MD or WTD, accordingly, a Company can not give Guarantee or provide Security in respect of Loan taken by MD or WTD of the Company.

Can a Company give Loan, or give Guarantee or provide Security in respect of Loan taken by Non Executive Directors or Independent Director of the Company?

Nb, as per joint reading of Sub-Section (1) and (3) a Company cannot give Loan, or give Guarantee or provide Security in respect of Loan taken by its Executive Director or Independent Director of the Company.

Important aspects of Section 185

Can a Company give Loan, or give Guarantee or provide Security in respect of Loan taken by a Firm in which Company itself is a Partner?

Yes, Sub-Section (1) states that a Company cannot give Loan, or give Guarantee or provide Security in respect of Loan taken by the Firm in which its Director or Relative of its Director is Partner but it does not say anything about situation where a Company itself is a Partner of a Firm, accordingly, a Company can give Loan, or give Guarantee or provide Security in respect of Loan taken by the Firm in which Company itself is a Partner.

Can a Company give Loan to its Subsidiary Company?

No, Clause (d) of Sub-Section (3) states that a Company can give Guarantee or provide Security in respect of Loan taken by its Subsidiary Company from any Bank or Financial institution, accordingly, a Company cannot give Loan to its Subsidiary Company.

Important aspects of Section 185

Can a Company give interest free under Section 185?

Yes, a Company other than Bank, Financial Institution and NBFC can give interest free loan under Section 185.

The Bank, Financial Institution and NBFC shall charge interest at the rate not less than the rate of prevailing yield of one year, three years, five years or ten years Government security closest to the tenor of the loan.