



**Amcon**  
Anand Mehta & Co.  
(CONSULTANTS) PRIVATE LIMITED



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Dear Clients

### **Loans to Directors etc- Recent Amendments**

As mentioned in our earlier Circular, the Companies Act, 2013 has carried extensive amendments in respect of Loans to Directors etc.

In current era, companies need to take/ give loans from/to other Companies in which it is interested for the various reasons, some of which are listed below:

- To meet with requirements under FEMA for a Greenfield Company in case of Pharma Business for example.
- To deal with requirements under FEMA which encourages a subsidiary when compared to a Liaison Office or a Branch Office.
- To deal with the requirements of a separate undertaking under the Incometax Act in backward areas etc.
- To deal with the splits in family businesses.
- To deal with various joint ventures with different owners, with different time cycles and locations.
- To deal with requirements of Banks and financial institutions.
- To provide novel methods of raising funds like ECB.
- To promote companies for near relative (Ex. Father- Son)
- A profitable company helping a loss making company
- To use short term funds to take opportunity to acquire long term assets.

Many of such transactions will now attract the new provision in Sec 185 of Companies Act 2013 which replaces Sec 295 of the Companies Act, 1956 with effect from 12<sup>th</sup> September, 2013.

We attach a Table capturing the differences. The major highlights are as follows:

1. There is no window to take the permission of the Central Government. There is a total prohibition.
2. A book debt was covered as a loan only if it was as such since inception. The new law covers book debts without any such qualification.
3. The new law does not exclude a loan advanced by a private company. This is the most serious part of the amendment.
4. The second most serious part of the amendment is that it does not exclude the loan advanced by a holding company to its subsidiary.



5. The new law however, permits certain loans to the MD/WTD.
6. The new law permits loan by a company which in the ordinary course of its business is advancing loans or giving guarantees provided that the interest in respect of such loans is charged at the bank rate declared by the RBI. Care however will have to be taken to ensure that such a company does not fall in the definition of an NBFC.
7. The new law increases the fine from Rs 50,000 to a range of Rs 5,00,000- 25,00,000.
8. Imprisonment which remains at the same level of 6 months can not be avoided by repaying the loans.
9. The new law thankfully does not rope in all the persons who are knowingly parties to such transaction to make good the loan amount to the company.

Earlier there was Sec 295 dealing with the loans to Directors etc and Sec 372A dealt with the loans and investments. There is a slight overlap toward the loans to a subsidiary. Though the ministry was quick in issuing a clarification that Sec 372A of the old Act is still operative and the corresponding Sec 186 of the new Act has not come into force, it has created more confusion than clarification.

It appears that these provisions will make the provisions of Sec 2(22)(e) and Sec 2(24) (iv) of the Income-tax Act redundant.

Apart from what has been listed above, the new provision still leaves out funds provided

1. By way of Loans, TO a Private Company where relative/partner of director is a member,
2. By way of Loans, TO a Public/private company( body corporate) where more than 25 % of voting power is held/controlled by partner/relative of director,
3. By way of Loans,, TO a Public Company, where less than 25% of voting power is held and controlled by directors,
4. By way of Loans, TO a Company the BOD, MD, manager whereof are accustomed to act with the direction of relative or partner of director of lending co. provided that directors control in affairs of company is not established.
5. BY an LLP resulting from converting the lending private company (having turnover of less than 60 lacs) as an LLP is not a "Company".
6. By way of capital IN an LLP where the lending and borrowing companies are partners .
7. BY creating an LLP where relatives of Director are partners provided that director's control is not established.
8. By way of Current Account transactions which can not be termed as Loans.
9. By way of Capital Advance or Advance for project which shall not be treated as "Loan" (Of course , this need to be backed by adequate documentation.)
10. BY a Holding company to its subsidiary provided director is not covered.



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11. By way of a Security (Debenture) which can be purchased and sold.
12. By way of Share Application Money for a limited period.

So far we have seen one side of the coin- that from the perspective of the lending company. Before we execute any transaction, we need to see the same from the perspective of a borrowing company as well. For this we need to see the provisions of Sec 73 which corresponds to Sec 58A of the old Act.

The law is in evolutionary stage and is being implemented in a piecemeal manner. Various sections are being notified for implementation. Various Rules are being notified first as a draft for public discussion which could be finalized in a manner different than what appears. Consequential changes will have to be made in the way things are done. Changes are likely in other laws as well. For example, there are provisions of Companies Act which were made applicable to LLPs by the LLP Act. These will have to be modified.

On the other hand, representations are being made against the provisions that have been brought in. Some changes are expected on this count also.

This is a mere exploratory and explanatory note. Please do not consider this to be an opinion or a statement of law. We encourage you to discuss your inter group lending needs with us so that we can avoid any violation of law.

Thanking you and assuring you of our best services at all times.

Yours faithfully,  
For *Anand Mehta & Co.*,

*Anand V. Mehta*  
**CHARTERED ACCOUNTANT**

2013