

CLIENT UPDATE

April 2015

EXECUTIVE SUMMARY

CLARIFICATIONS TO SECTIONS 185, 186 AND 186 (7) OF THE COMPANIES ACT, 2013

The Ministry of Corporate Affairs vide its General Circular Number 6/2015 dated April 9, 2015 notified a clarification that issue of tax free bonds providing higher returns to investors than prevailing bank rates does not violate section 186 (7) of the Companies Act, 2013.

The Ministry of Corporate Affairs vide its General Circular Number 4/2015 dated March 10, 2015 notified a clarification under Sections 185 and 186 of the Companies Act, 2013 that loans or advances made by companies to their employees (other than the managing or whole-time directors, which is governed by the provisions of Section 185 of the Companies Act, 2013) are not governed by the requirements of Section 186 of the Companies Act, 2013.

These clarifications have been notified by the Ministry of Corporate Affairs in the light of ambiguity in these provisions of the Companies Act, 2013.

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I. CLARIFICATION UNDER SUB-SECTION (7) OF SECTION 186 OF THE COMPANIES ACT, 2013

- Under sub-section (7) of Section 186 it has been laid down that no loan shall be given 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.
- It has been clarified that in cases where the effective yield (effective rate of return) on tax free bonds is greater than the prevailing yield of one year, three year, five year or ten year Government Security closest to the tenor of the loan, there is no violation of sub-section (7) of Section 186 of the Companies Act, 2013.

II. CLARIFICATION UNDER SECTIONS 185 AND 186 OF THE COMPANIES ACT, 2013

- Under Section 185 it has been laid down that no company shall, directly or indirectly, advance any loan 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 except the giving of any loan to a managing or whole-time director as part of the conditions of service extended by the company or pursuant to any scheme approved by the members by a special resolution.
- It has been laid down under Section 186 (2) that no company shall directly or indirectly give any loan to any person or other body corporate, give any guarantee or provide security in connection with a loan to any other body corporate or person and acquire by way of subscription, purchase or otherwise, the securities of any other body corporate, exceeding sixty per cent of its paid-up share capital, free reserves and securities premium account or one hundred per cent of its free reserves and securities premium account, whichever is more.
- It has been laid down under Section 186 (3) that where the giving of any loan or guarantee or providing any security or the acquisition exceeds the specified limits, prior approval by means of a special resolution passed at a general meeting shall be necessary.
- It has been clarified that loans or advances made by companies to their employees, other than the managing or whole-time directors (which is governed by the provisions of Section 185 of the Companies Act, 2013) are not governed by the restrictions of Section 186 of the Companies Act, 2013.
- This clarification shall only be applicable if such loans or advances to employees are in accordance with the conditions of service applicable to employees and are also in accordance with the remuneration policy, in the cases where such policy is required to be formulated.