

CLUSTER 3

1. Case I

M/s. Tristar Ltd. (an unlisted public limited company) with the annual turnover of Rs. 700 crores entered into a contract of purchasing of raw material from M/s. PTC Pvt. Ltd. during the year 2018. M/s. Tristar Ltd. appointed Mr. Sudhir, a director of the company, to act in this deal of transaction on behalf of the company. Mr. Sudhir is also one of the members of M/s. PTC Pvt. Ltd. Mr. Sudhir settled the said transaction purchase for Rs. 85 crores and entered into the contract. After a few transactions executed under the contract, the Board of M/s. Tristar Ltd finds degradation in the quality of the raw material supplied. Further, in a Board meeting this contract was challenged considering it as a related party transaction and in contravention to Section 188(1) of the Companies Act, 2013 read with rules framed there under, During the period Mr. Sudhir was appointed as director in a newly incorporated company M/s. Raaga Limited.

In the light of the given facts, examine the following situations as per the Companies Act, 2013:

(i) What is the legal position of the contract entered between M/s. Tristar Ltd. through its director Mr. Sudhir, and M/s. PTC Pvt. Ltd.?

(ii) Is there any contravention of Section 188(1)? If yes, then state the liability of the wrongdoer.

(iii) Comment upon the appointment of Mr. Sudhir as a Director in M/s. Raaga Limited.

(CA (Final) May 2019)

Case II

XYZ Ltd. with the turnover of Rs. 500 crore entered into a contract of purchasing of raw material from a private company. XYZ Ltd., appointed Mr. Khurana, a director of the company, to act in this deal of transaction. Mr. Khurana is also a member of that private company. He settled the said transaction into Rs. 60 crore and entered into the contract. After few transactions made under the contract, XYZ Ltd. finds degradation in the quality of the product supplied. In the Board Meeting, this contract was challenged considering it as a related party transaction and in contravention to Section 188(1). During this period, Mr. Khurana was appointed as a director in newly setup. PQR Ltd. in the light of the given facts, examine the following situations as per the Companies Act, 2013.

(i) What is the legal position of the contract entered between XYZ Ltd. through Mr. Khurana, and the private company?

(ii) Is there any contravention of Section 188 (1)? If yes, then the liability of the wrong doer.

(iii) Comment upon the appointment of Mr. Khurana as a director in PQR Ltd.

(ICAI, Mock Test Paper, October 2018)

Ans.

As per Section 188, any contract or arrangement between a company and any related party for sale, purchase or supply of any goods or materials shall require compliance with the requirements specified under Section 188 read with Rule 15.

As per Section 2(76), inter alia, 'a private company in which a director or manager or his relative is a member or director is a related party.

Case I. A contract has been entered into between M/s Tristar Ltd. and M/s PTC Pvt. Ltd. Mr. Sudhir is a director in M/s Tristar Ltd. and a member in M/s PTC Pvt. Ltd. Since Mr. Sudhir is a member in M/s PTC Pvt. Ltd., it amounts to entering into a contract by M/s Tristar Ltd. with a related party, thus attracting the provisions of Section 188 and Rule 15. The following compliances are required:

1. Consent of the Board of directors of M/s Tristar Ltd. is to be obtained by passing a resolution at a Board Meeting.

2. The agenda of the Board meeting in which the approval of the Board is to be obtained shall contain the particulars

3. Mr. Sudhir, who is interested in such contract or arrangement, shall not be present at the Board meeting during discussions on such contract or arrangement.
4. The value of the contract between M/s Tristar Ltd. and M/s PTC Pvt. Ltd. for purchase of raw materials is Rs. 85 crore. 10% of the turnover of the company amounts to Rs. 70 crore. Lower of 10% of the turnover of the company and Rs. 70 crore is Rs.70 crore. Since the value of the contract (Rs. 85 crore) exceeds Rs. 70 crore, the contract or arrangement between M/s. Tristar Ltd. and M/s PTC Pvt. Ltd. shall require the prior approval of the members by an ordinary resolution.
5. The explanatory statement containing all particulars shall be annexed to the notice of the general meeting in which the ordinary resolution is to be passed.
6. Since Mr. Sudhir is a related party, he shall not vote on such ordinary resolution.

Analysis and conclusion

(i) By entering into a contract with M/s PTC Pvt. Ltd. (i.e. a private company in which a director of the company is a member), M/s Tristar Ltd. has contravened the provisions of Section 188. Therefore, the consequences shall be as follows:

(a) The contract is violable at the option of the Board as well as at the option of the shareholders of M/s Tristar Ltd., if such contract is not ratified by the Board and the shareholders at a meeting within 3 months from the date on which such contract or arrangement was entered into.

(b) Mr. Sudhir shall be liable to indemnify Tristar Ltd. against any loss incurred by it.

(c) Tristar Ltd. may proceed against Mr. Sudhir for recovery of any loss sustained by it as a result of such contract or arrangement.

(ii) Section 188 has been contravened. The wrong doer in this case is Mr. Sudhir. Since Tristar Ltd. is not a listed company, Mr. Sudhir shall be punishable with fine which shall not be less than Rs. 25,000 but which may extend to Rs. 5 lakh.

(iii) As per Section 164, a person shall be disqualified for appointment as a director, if he has been convicted of an offence dealing with related party transactions under Section 188 at any time during the preceding 5 years.

In the given case, Mr. Sudhir is liable for punishment for contravention under Section 188. The word 'convicted' used under Section 164 makes it evident that disqualification under Section 164 is not attracted where a person is liable to be punished for contravention of Section 188, but is attracted when a person is proven guilty by the Court.

Since Mr. Sudhir has not yet been convicted for contravention under Section 188, he is not disqualified for appointment as a director. Accordingly, his appointment as a director in Raaga Limited is valid.

Case II. A contract has been entered into between XYZ Ltd. and a private company. Mr. Khuarna is a director in XYZ Ltd., and a member in such private company. Since Mr. Khurana is a member in the private company with which XYZ Ltd. has entered into a contract or arrangement, it amounts to entering into a contract by XYZ Ltd with a related party. The following compliances are required:

1. Consent of the Board of directors of XYZ Ltd. is to be obtained by passing a resolution at a Board Meeting.

2. The agenda of the Board meeting in which the approval of the Board is to be obtained shall contain the particulars

3. Mr. Khurana, who is interested in such contract or arrangement, shall not be present at the Board meeting during discussions on such contract or arrangement.

4. The value of the contract between XYZ Ltd. and the private company for purchase of raw materials is Rs. 60 crore. 10% of the turnover of the company amounts to Rs. 50 crore. Lower of 10% of the turnover of the company and Rs. 50 crore is Rs.50 crore. Since the value of the contract (Rs. 60 crore) exceeds Rs. 50 crore, the contract or arrangement between M/s XYZ Ltd. and the private company shall require the prior approval of the members by an ordinary

resolution.

5. The explanatory statement containing all particulars shall be annexed to the notice of the general meeting in which the ordinary resolution is to be passed.

6. Since Mr. Khurana is a related party, he shall not vote on such ordinary resolution. .

Analysis and Conclusion

(i) By entering into a contract with a private company in which Mr. Khurana is a member, XYZ Ltd. has contravened the provisions of Section 188, since the legal requirements stated in points (1) to (6) above have not been complied with.

Therefore, the consequences shall be as follows:

(a) The contract is violable at the option of the Board as well as at the option of the shareholders of XYZ Ltd. if such contract is not ratified by the Board and the shareholders at a meeting within 3 months from the date on which such contract or arrangement was entered into.

(b) Mr. Khurana shall be liable to indemnify XYZ Ltd. against any loss incurred by it.

(c) XYZ Ltd. may proceed against Mr. Khurana for recovery of any loss sustained by it as a result of such contract or arrangement.

(ii) Section 188 has been contravened. The wrongdoer in this case is Mr. Khurana. Accordingly, Mr. Khurana shall be punishable as follows:

(a) If XYZ Ltd. is a listed company, he shall be punishable with imprisonment upto 1 year or fine which shall not be less than Rs. 25,000 but which may extend to Rs. 5 lakh, or with both.

(b) If XYZ Ltd. is not a listed company, he shall be punishable with fine which shall not be less than Rs. 25,000 but which may extend to Rs. 5 lakh.

(iii) As per Section 164, a person shall be disqualified for appointment as a director, if he has been convicted of an offence dealing with related party transactions under Section 188 at any time during the preceding 5 years.

In the given case, Mr. Khurana is liable for punishment for contravention under Section 188. The word 'convicted' used under Section 164 makes it evident that disqualification under Section 164 is not attracted where a person is liable to be punished for contravention of Section 188, but is attracted when a person proven guilty by a Court.

Since Mr. Khurana has not yet been convicted for contravention under Section 188, he is not disqualified for appointment as a director. Accordingly, his appointment as a director in PQR Ltd. is valid.

2. The register of contracts or arrangement under Section 189 of the Companies Act, 2013 is maintained at the registered office of Fortune Ltd., under the custody of the Company Secretary. The AGM was held in different place but in the same town where the registered office is situated. Mr. Semar, a shareholder of the company and Mr. Raj, proxy of a shareholder insisted for producing the sold register at the commencement of the AGM for inspection. The Company Secretary refused to produce the register stating that being the statutory register it has to be maintained at the registered office only. Examine whether Mr. Semar and Mr. Raj will succeed in their attempt under the provisions of the Companies Act, 2013? (CA (Final) May 2018)

Ans. Section 189 requires that the register of contracts and arrangements shall be kept at the registered office of the company, and shall be open to inspection at the registered office during business hours. It shall be produced at the commencement of every annual general meeting, and during the continuance of the annual general meeting, it shall remain open and accessible to any person having the right to attend the annual general meeting.

In the given case, the annual general meeting of Fortune Ltd. is held at a place other than the registered office of the company. The company secretary of Fortune Ltd. contends that the register of contracts and arrangements is not to be produced at the annual general meeting as it is a statutory register and is to be kept at the registered office of the company.

With respect to place of keeping the register of contracts and arrangements, Section 189 has prescribed two different requirements; first is to keep the register of contracts and arrangements at the registered office, and second is to produce the register of contracts and arrangements at every annual general meeting. Every company needs to comply with both these requirements.

Hence, where any annual general meeting of a company is held at a place other than the registered office of the company, it is the duty of the company to move the register of contracts and arrangements from the registered office to the venue of the annual general meeting. Also, Section 189 entitles every person having right to attend the annual general meeting to access (viz. inspect) the register of contracts and arrangements. As per Section 105, a proxy is entitled to attend an annual general meeting. Hence, a member personally present as well as a proxy are entitled to inspect the register of contracts and arrangements. In the given case, the refusal of the company secretary to produce the register of contracts and arrangements at the annual general meeting is not valid. Accordingly, Mr. Semar (a member personally present) as well as Mr. Raj (a proxy) is entitled to inspect the register of contracts and arrangements.

- 3. Mr. K is making an arrangement to acquire some stock-in-trade from BL Limited for consideration of some furniture lying with him. He is a Director at JS Limited, which is the holding company of BL Limited. Advise him on the basis of provisions of Companies Act, 2013. What will be the position of the arrangement if there is a contravention of the applicable provisions of the Companies Act, 2013? (CA (Final) Nov. 2016)**

Ans.

1. Applicability of Section 192

Section 192 applies where an arrangement is entered into by which assets are acquired or to be acquired for consideration other than cash, from the company, by-

- (i) A director of the company; or
- (ii) A director of its holding, subsidiary or associate company; or
- (iii) A person connected with such director

2. Provisions

A company may enter into an arrangement of such nature as is specified under Section 192(1), if-

- (a) prior approval for such arrangement is accorded by a resolution of the company in general meeting;
- (b) prior approval for such arrangement is also accorded by a resolution of the holding company in general meeting, if the director or connected person is a director of its holding company; and
- (c) The notice of the general meeting sent by the company or holding company for obtaining the approval of the members, shall include —
 - (i) the particulars of the arrangement; and
 - (ii) the value of the assets involved in such arrangement duly calculated by a registered valuer.

In the given case, an arrangement is proposed to be entered into by which assets (viz. stock in trade) of BL Limited is to be acquired by Mr. K (viz. a director of holding company, viz. JS Limited) for consideration other than cash (viz. furniture lying with Mr. K). This arrangement clearly falls under Section 192.

Thus, Mr. K can acquire the stock in trade of BL Limited, if —

- (a) prior approval for such arrangement is accorded by a resolution passed in the general meeting of BL Limited;
- (b) prior approval for such arrangement is also accorded by a resolution passed in the

general meeting of JS Limited; and

(c) the notices of the general meetings sent by BL Limited and JS Limited for obtaining the approval of the members, shall include —

(i) the particulars of the arrangement; and

(ii) the value of the assets involved in such arrangement duly calculated by a registered valuer.

Contravention

If any arrangement is entered into by BL Limited or JS Limited in contravention of the provisions of Section 192, such arrangement shall be voidable at the instance of the company unless —

(a) the restitution of any money or other consideration which is the subject matter of the arrangement is no longer possible and the company has been indemnified by any other person for any loss or damage caused to it: or

(b) any rights are acquired bona fide for value and without notice of the contravention of the provisions of this Section by any other person.

4. Mr. X is a director of several companies. He has approached the following companies in which he is a director for financial help to start his own personal business.

(i) Expandable Industries Ltd.

(ii) Expensive Gadgets Private Ltd.

(iii) Easy Finance Ltd.

The first named company has agreed to grant a loan of Rs. 50 lakhs. The second company also offered another loan of Rs. 50 lakhs. The third company has agreed to provide guarantee for the repayment of a loan sanctioned to Mr. X by a Private Bank to the tune of Rs. One crore. Advise Mr. X about the legal visions that should be complied with under the Companies Act, 2013. (CA (Final) Nov. 2008)

Ans. As per Section 185(1) of the Companies Act, 2013, no company shall, directly or indirectly, advance any loan to a director or give any guarantee in connection with a loan taken by a director. Section 185(1) does not permit a company to advance any loan or give any guarantee even with the approval of the Central Government. However, the prohibition under Section 185 (1) shall not apply in the following cases, as per Section 185(3) and notification

1. Where loans given to a managing director or whole-time director as a part of the conditions of service extended by the company to all its employees.
2. Where loan is given to a managing director or whole-time director pursuant to any scheme approved by the members by a special resolution.
3. Where a company in the ordinary course of its business, provides loans or gives guarantees or securities for the due repayment of any loan and in respect of such loans an interest is charged at a rate not less than the rate of prevailing yield of 1 year, 3 years, 5 years or 10 years Government security closest to the tenor of the loan.
4. As per Notification No. G.S.R. 464(E) dated 5th June, 2015, the provisions of Section 185 shall not apply to a private Company-
 - (a) in whose share capital no other body corporate has invested any money;
 - (b) if the borrowings of such a company from banks or financial institutions or anybody Corporate is less than twice of its paid-up share capital or Rs. 50 crore, whichever is lower;
 - (c) such a company has no default in repayment of such borrowings subsisting at the time of making transactions under this Section; and
 - (d) it has not committed any default in filing with the Registrar its financial statements under Section 137 or annual return under Section 92.

Conclusion

1. Expandable Industries Ltd. may grant a loan of Rs. 50 lakhs to Mr. X, if Mr. X is managing director or whole-time director in such company. If Mr. X is not the managing director or

whole-time director of such company, loan of Rs. 50 lakhs cannot be granted

2. Expensive Gadgets Pvt. Ltd. may grant a loan of Rs. 50 lakhs to Mr. X, if Mr. X is managing director or whole-time director in such company. If Mr. X is not the managing director or whole-time director of such company, loan of Rs. 50 lakhs cannot be granted. If Expensive Gadgets Pvt. Ltd. satisfies all the 4 conditions specified in Notification No. G.S.R. 464(E) dated 5th June, 2015, the provisions of Section 185 shall not apply to it, and so it may make loan of Rs. 50 lakhs to Mr. X.

3. Easy Finance Ltd. may provide guarantee for the repayment of loan sanctioned by a private bank in accordance with point 3 above

- 5. Mr. DRT is a director of PCS Ltd. The said company is having sufficient liquid funds and Mr. DRT is in dire need of funds. In order to mitigate the hardship of Mr. DRT the Board of directors of PCS Ltd. wants to lend Rs. 5 lakhs to him and Rs. 2 lakhs to his wife. State whether such loans can be given and if so under what conditions. What would be your answer if the company PCS LTD would have been PCS Private Ltd. (CA (Final) Nov. 2012)**

Ans. As per Section 185(1) of the Companies Act, 2013, no company shall, directly or indirectly, advance any loan to a director or to relative of a director. Among others, the relative of a director is included in the term 'any other person in whom a director is interested'.

As per Clause (77) of Section 2, wife is a relative.

Thus, loan shall not be given by PCS Ltd. to its director, Mr. DRT or to the wife of Mr. DRT. Section 185 does not permit a company to give loan even with the approval of the Central Government. However, the prohibition under Section 185 (1) shall not apply in the following cases, as per Section 185(3) and notification

1. Where loans given to a managing director or whole-time director as a part of the conditions of service extended by the company to all its employees.
2. Where loan is given to a managing director or whole-time director pursuant to any scheme approved by the members by a special resolution.
3. Where a company in the ordinary course of its business, provides loans or gives guarantees or securities for the due repayment of any loan and in respect of such loans an interest is charged at a rate not less than the rate of prevailing yield of 1 year, 3 years, 5 years or 10 years Government security closest to the tenor of the loan.
4. As per Notification No. G.S.R. 464(E) dated 5th June, 2015, the provisions of Section 185 shall not apply to a private Company-
 - (a) in whose share capital no other body corporate has invested any money;
 - (b) if the borrowings of such a company from banks or financial institutions or anybody Corporate is less than twice of its paid-up share capital or Rs. 50 crore, whichever is lower;
 - (c) Such a company has no default in repayment of such borrowings subsisting at the time of making transactions under this Section; and
 - (d) it has not committed any default in filing with the Registrar its financial statements under Section 137 or annual return under Section 92.

Conclusion

1. PCS Ltd. may grant a loan of Rs. 5 lakh to Mr. DRT, if Mr. DRT is managing director or whole-time director in PCS Ltd. If Mr. DRT is not the managing director or whole-time director of PCS Ltd., loan cannot be given.
2. PCS Ltd cannot grant a loan of Rs. 2 lakh to wife of Mr. DRT
3. If PCS Ltd. were a private company, the provisions of Section 185 shall not apply to it if it satisfies all the 4 conditions specified in Notification No. GS.R, 464/E) dated 5th June, 2015 as explained above, and so it may grant a loan of Rs. 5 lakh to Mr. DRT and a loan of Rs. 2 lakh to wife of Mr. DRT.

6. Following transaction is made by a public company. You are required to examine whether this transaction is covered under Section 185 of the Companies Act, 2013: Loan to its 100% (One hundred per cent) subsidiary company (CA (Final) Nov. 2005)

OR

Can a holding company advance any loan to a wholly owned subsidiary company? What are the relevant provisions of the Companies Act, 2013 with regard to granting of loans by holding company to its wholly owned subsidiary company? Mention the penalties for the contravention of the provisions of the Company Act, 2013. (CA (Final) Nov. 2016)

Ans. Section 185(1) imposes certain prohibitions and Section 85(2) requires fulfilment of certain conditions with respect to loans to directors etc. and guarantees or securities in connection with loans to directors etc.

However, as per Section 185(3), the provisions of Section 185(1) and 185(2) shall not apply in case of the following transactions i.e. following transactions are permitted

(a) Where a holding company makes a loan to its wholly owned subsidiary company provided such loan is utilized by the wholly owned subsidiary company for its principal business activities.

(b) Where a holding company gives guarantee or provides security in connection with a loan made by any person to its wholly owned subsidiary company provided such loan is utilized by the wholly owned subsidiary company for its principal business activities.

Effects of contravention of Section 185 (Section 185(4))

(a) The company shall be punishable with fine which shall not be less than Rs. 5 lakh but which may extend to Rs. 25 lakh.

(b) 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 up to 6 months or with fine which shall not be less than Rs. 5 lakh but which may extend to Rs. 25 lakh, or with both.

(c) Every officer of the company who is in default shall be punishable with imprisonment up to 6 months or with fine which shall not be less than Rs. 5 lakh but which may extend to Rs. 25 lakh.

7. Following information is available from the audited Balance Sheet as at 31st December, 2014 of ASK Ltd.,

Capital and Liabilities	Rs.	Assets	Rs.
Share Capital:		Fixed Assets:	
Equity Share Capital (5, 00,000 shares of Rs. 10 each fully paid up in cash)	50, 00,000	Goodwill	10, 00,000
Less: Calls in arrears	50,000	Land & buildings	75, 00,000
	49, 50,000	Plant & Machinery	1, 50, 00,000
Preference Share Capital	15, 00,000	Furniture & Other Assets	2, 50,000
Share Application Money	10, 00,000		
Reserves and surplus:		Investments:	
Securities Premium A/c	15, 00,000	Equity shares in wholly owned	
Capital Redemption Reserve	12, 00,000	Subsidiary company- KMC Ltd.	12, 50,000
Fixed Assets			

Revaluation Reserve	10, 50,000	Equity shares	
Sinking Fund Reserve	11, 00,000	representing 90% of	4, 50,000
General Reserve	40, 00,000	share capital of MTC	
Profit & Loss A/c	22, 00,000	Ltd.	12, 00,000
Dividend Equalization Reserve	6, 00,000	Debentures in SKT Ltd.	
		Preference Shares in HUT Ltd.	5, 00,000
		Balance in Partnership Firm – BKP & Co.	8, 00,000
Secured Loans:		Current Assets:	
Cash Credit facility From Bank	1, 00, 00,000	Stock and Book Debts	14, 00,000
		Cash & Bank Balances	1, 00,000
Unsecured Loans:		Loans & Advances:	
Fixed Deposits (From general public Maturing offer 31.12.2015)	20, 00,000	Inter corporate Deposits	25, 00,000
		Business Advances	14, 00,000
Current Liabilities & Provisions:			
Current Liabilities	12, 50,000		
Provision for Taxation	10, 00,000		
TOTAL	3, 33,50,000	TOTAL	3, 33,50,000

The directors of the company want to make further Investments stated below by taking a decision in the meeting of Board of directors without seeking approval of the shareholders:

(a) Loan to KMC Ltd.	25,00,000
(b) Purchase of further debentures in SKT Ltd.	15,00,000
(c) Purchase of further debentures in SKT Ltd.	8,00,000
(d) Purchase of shares from the open market in Glaxo Ltd.	15,00,000

You are required to state, with to the relevant provision of the Companies Act, 2013, whether the directors can do so and mention the relevant calculations.

Ans.

Requirements for making loans, investments etc.

(a) Unanimous approval of Board is required. The approval shall be obtained by passing a resolution at a 50ard meeting.

(b) Special resolution is required if the aggregate of loans etc. (already made plus proposed) exceeds the higher of –

60% of the aggregate of paid up share capital, free reserves and securities premium account;

or
100% of its free reserves and securities premium account.

(c) Approval of Public Financial Institution shall be obtained unless-
the limit under Section 186(2) is not exceeded; and
there is no default in repayment of loan instalments or interest.

(d) No default with respect to repayment of deposits or payment of interest on deposits is subsisting.

Other points:

(i) Share application money shall not be considered while calculating the limits under Section 186(2), since it is not 'paid up share capital' or 'free reserves' or "securities premium account".

(ii) Capital redemption reserve, Fixed Assets Revaluation Reserve and sinking fund are not available for distribution as dividend and hence are not included in free reserves.

(iii) Dividend Equalization Reserve is available for distribution as dividend, and is therefore,

included in the free reserves.

(iv) Provision for taxation is a liability and is therefore, not included in free reserves.

(v) Investment made in Partnership firm BKP & Co. is neither loan' nor 'investment in securities of a body corporate", and is therefore, not included in the 'loans, investments etc.' already made.

Step 1. Calculation of limits

Equity share capital	50,00,000
Less: Calls unpaid	50,000
Balance	49,50,000
Preference share capital	15,00,000
Paid up share capital	64,50,000

General reserve	40,00,000
Profit & loss A/c	22,00,000
Dividend equalization reserve	6,00,000
Free reserves	68,00,000

Overall limit for loans, investments etc., i.e. higher of 60% of (paid up share capital, free reserves and securities premium account) or 100% of free reserves and securities premium account)

60% of (64,50,000 + 68,00,000+ 15,00,000)	88,50,000
100% of (68,00,000 +15,00,000)	83,00,000
Overall limit for loans, investments etc.	88,50,000

Step 2. LGSi already made

Equity Shares in wholly owned Subsidiary Company -KMC Ltd.	12,50,000
Equity Shares of MTC Ltd.	4,50,000
Debentures in SKT Ltd.	12,00,000
Preference Shares in HUT Ltd.	5,00,000
Inter-corporate Deposits	25,00,000

Total loans, investments etc. already made **59,00,000**

As per Rule 11 of the Companies (Meetings of Board and its Powers) Rules, 2014, where investment is proposed to be made by a holding company in its wholly owned subsidiary., the requirement of passing special resolution as per Section 186(3) shall not be applicable. However, any investment in wholly owned subsidiary already made by the holding company shall be included in loans, investments etc, already made by the company. Therefore, investment of Rs. 12,50,000 made in equity shares of KMC Ltd. has been included while determining loans, investment etc. already made.

Step 3. Determine loans, investments etc. that can still be made

Step 1 – Step 2 -88,50,000-59,00,000 = 29,50,000

Step 4- Comparison of the proposed loans, investments etc with Step 3

Loan to KMC Ltd.	N.A.
Loan to MTC Ltd.	15,00,000
Debentures in SKT Ltd.	8,00,000
Shares in Glico Ltd	15,00,000
proposed loans, investments etc.	38,00,000

As per Rule 11 of the Companies (Meetings of Board and its Powers) Rules, 2014, where loan is proposed to be given by a holding company to its wholly owned subsidiary, the requirement of passing special resolution as per Section 186(3) shall not be applicable. Therefore, proposed loan of Rs. 25, 00,000 to KMC Ltd. (a wholly owned subsidiary of ASK Ltd.) has been ignored.

Since step 4 exceeds steps 3, Special resolution is required.

Therefore, ASK Ltd. may make the proposed loans, investments etc. as follows:

- a) A resolution shall be passed at a Board meeting with the consent of all the directors present.
- b) A Special resolution shall be passed in the general meeting authorizing the company to make loans, investments etc. up to or exceeding the limit
 - i. The company shall enter the prescribed particulars in the register within 7 days.
 - ii. The company shall disclose to the members in the financial statement- the full particulars of the loans, investment made or guarantee given or security provided: and
 - iii. The purpose for which the loan or guarantee or security is proposed to be utilized by the recipient.
- c) The company shall ensure that no default with respect to deposits is subsisting. Since deposits are maturing only after 31.12.2015, this condition is fulfilled.
- d) The company shall enter into the register maintained under Section 186(9) such particulars, as have been prescribed under Rule 12.

8. Following transaction is made by a public company. You are required to examine whether this transaction can be termed as loan to directors:

Sale of company's flat to a director at prevailing market price, out of which the director pays 50% (fifty percent) immediately and contracts to pay balance amount in 10 equal annual instalments. (CA (Final) Nov. 2005)

OR

In the light of the conditions laid down under the Companies Act, 2013 examine if the following transaction can be considered as loans to directors. A sale of flat of the company at the current market rate and price. The director pays sixty per cent cash immediately and contracts to pay the balance in ten monthly instalments. (CA (Final) Nov. 2002)

OR

M/s. International Carrier Limited purchased a flat in Mumbai to give residential accommodation to Shri Ravi Mehta, the managing director. At the time of Purchase of flat, the managing director was given an option to buy the flat during the course of his employment. The managing director exercised his option and paid the company half of the purchase price and requested for time to pay the balance amount in three equal half yearly instalments at 10% interest per annum. Examine whether the arrangement would amount to a loan to the managing director and if so, whether the loan was in order. (CA (Final) May 1997)

OR

A Public Company purchases a flat which is subsequently sold to a director at the prevailing market price, out of which the director pays 50% immediately and contracts to pay the balance in 10 equal annual instalments. Does it amount to a loan to a director under the Companies Act, 2013? (CA (Final) Nov. 1999)

OR

A company sold one of its flats to one of the directors and received 50% of the price in

cash and agreed to receive the balance in instalments. Would you consider this as a loan granted to director? (CS (Final) June 1995; June 1999)

Ans. Section 185(1) of the Companies Act, 2013 says "No company shall, directly or indirectly, give any loan to a director"

In the given case, the company sold a flat to a director, and the director paid to the company 50% of the price of the flat and balance 50% was to be paid by the director in instalments, resulting in a debt payable by the director to the company. The debt arose not out of an advance given by the company to the director, but out of a transaction of sale of a flat by the company to its director. The company gave time to the director to pay a part of the purchase price.

The facts in the given case are exactly similar to the facts in **Fredie Ardeshir Mehta v Union of India (1991) 70 Comp Case 210**, as discussed below:

The essential requirement of a 'loan' is the advance of money upon the understanding that it shall be returned back and it may or may not carry interest. Where a company sells a flat to one of its directors and receives half the price in cash and agrees to receive the balance in instalments, the transaction amounts to a credit sale; it does not amount to even an 'indirect' sale

The word 'indirectly' used in Section 185 of the Companies Act, 2013 only means that company shall not give a loan to a director through the agency of one or more intermediaries. The word 'indirectly' cannot be read as converting 'what is not a loan' into 'a loan'. Therefore, in the given case, there is no contravention of Section 185 of the Companies Act, 2013 [**Dr. Fredie Ardeshir Mehta v Union of India (1991) 70 Comp Case 210**].

Accordingly, applying the provisions of Section 185 of the companies, Act, 2013 and the decision given in **Fredie Ardeshir Mehta v Union of India**, it can be said that sale of a flat by a company to director shall be held to be a credit sale, and neither a 'loan' nor a loan represented by a book debt, unless facts of the case circumstances indicate that it is indeed a loan represented by book debt.

9. Following transaction is made by a public company. You are required to examine whether this transaction can be termed as loan to directors under the Companies Act, 2013:

Making a deposit with the landlord under a license arrangement for securing a residential accommodation for the managing director of the company. (CA (Final) Nov. 2005)

OR

A Public Company secures residential accommodation for the use of its managing director by entering into a license arrangement under which the company has to deposit a certain amount with the landlord to secure compliance with the terms of the license agreement. Can it be considered as a loan to a director? (CA (Final) Nov. 1999)

Ans. As per Section 185(1) of the Companies Act, 2013, no company shall, directly or indirectly, make any loan to a director.

In the present case, the company has provided the managing director with a housing accommodation. It does not amount to a loan because of the following reasons:

The company has not given any deposit or advance to the managing director. The amount deposited with the landlord cannot be said to be an 'indirect loan' to the managing director. It is a usual practice to give a security deposit to the landlord with whom a rent or lease agreement is entered into. Thus, the company has made the security deposit on account of bonafide business considerations.

It doesn't concern the managing director as to the terms on which the company secures residential accommodation for him.

It is the company and not the director who has entered into the lease agreement. Therefore, the company can at any time use the accommodation for any other purpose and the

managing director will have to vacate it, as and when desired by the company.

10. In the light of the conditions laid down under the Companies Act, 2013 examine if the following transaction can be considered as a loan to directors: A loan to a firm in which the director of the company is a partner. (CA (Final) Nov. 2002)

Ans. As per Section 185(1) of the Companies Act, 2013, no company shall, directly or indirectly, make a loan to any person specified under Section 185(1) of the Companies Act, 2013. Amongst the persons specified under Section 185(1), a firm in which any director or relative of a director is a partner is also covered. Accordingly, loan cannot be made to a firm, in which the director of the company is a partner.

11. Following transaction is made by a public company. You are required to examine whether this transaction can be termed as loan to directors under the Companies Act, 2013:

A salary advance of Rs. 5,000 to an employee, who is the wife of the managing director of the company (CA (Final) Nov. 2005)

OR

In the light of the conditions laid down under the Companies Act, 2013 examine if the following transaction can be considered as a loan to directors:

An advance payment of salary to the employee, who is also the spouse of the managing director of the company (CA (Final) Nov. 2002)

OR

Does an advance payment of salary of Rs.10,000 to an employee who is the wife of the managing director amount to a loan to a director under the Companies Act, 2013? (CA (Final) Nov. 1999)

OR

Wife of the managing director is employed in the company as an administrative officer. She wants an advance equal to six months' salary deductible in 24 equal instalments in accordance with the rules applicable to company's employees. (CA (Final) Dec. 1998)

Ans. No company shall, directly or indirectly, make any loan to a person specified under Section 185(1) of the Companies Act, 2013.

The same issue as in the given case, was discussed in **M.R. Electronics Components Ltd. and Others v Assistant Registrar (1986) 3 Comp LJ 28**. The wife of the managing director was employed by the company on a monthly salary. The company paid her an advance of Rs. 5,000. It was held that, merely because she is the wife of the managing director, it cannot be said that Rs.5,000 paid as advance, is in the nature a loan to the managing director. The advance payment of salary does not per se amount to a loan.

The burden of proving otherwise lies with the prosecution. The Court had to find out whether it was a genuine advance against salary or a loan disguised as salary advance. For this purpose, facts of the case shall be considered and in particular the following:

- Whether the beneficiary is a bona fide employee.
- Whether the advance falls in the general scheme of advances given by the company to other employees.
- Whether the amount paid is disproportionate to the salary of the employee.
- The conditions of repayment, like the rate of interest.
- Whether there was laxity in the recovery of advance.
- What is the capacity of the person receiving the advance?

Therefore, if the advance is bona fide and paid to the wife of the managing director in her capacity of an employee, it cannot be treated as a loan and as such, the provisions of Section 185(1) of the Companies Act, 2013 will not be attracted. Accordingly, salary advance

to the wife of a director does not per se amount to a loan so as to violate Section 185(1) of the Companies Act, 2013. The burden of proving that such transaction is a sham lies on the prosecution.

12. Mr. OK is a director of VRS Ltd. He intends to construct a residential building for his own use. The cost of construction is estimated of Rs. 1.35 crores, which Mr. OK proposes to finance partly from his own sources to the tune of Rs. 60 lacs and the balance Rs. 75 lacs from housing loan to be obtained from a housing finance company. For the purpose of obtaining the loan, he has approached the housing finance company which has in principle agreed to grant the loan, but has put a condition. The condition put by the housing finance company is that the Company VRS Ltd. of which Mr. OK is a director should provide the guarantee for repayment of the loan and interest as per the terms of the proposed agreement for granting the loan to Mr. OK. You are required to advise Mr. OK on the matter with reference to the provisions of the Companies Act, 2013. (CA (Final) May 2014; June 2009; May 2005)

OR

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 instalments by Mr. X. Advise Mr. X. (CA (Final) Nov. 2001)

Ans. As per Section 185(1) of the Companies Act, 2013, no company shall, directly or indirectly, give any guarantee in connection with a loan taken by a director. Section 185(1) does not permit a company to give guarantee even with the approval of the Central Government.

In the given case, guarantee cannot be given by VRS Ltd. in respect of a loan advanced to Mr. OK by a housing finance company

13. Amar Textiles Ltd. is a company engaged in manufacture of fabrics. The company has investments in shares of other bodies corporate including shares in Amar Cotton Co. Ltd. and it has also advanced loans to other bodies corporate. The aggregate of all the investments made and loans granted by Amar Textiles Ltd. exceeds 60% of its paid up share capital, free reserves and securities premium account and also exceeds 100% of its free reserves and securities premium account. In course of its business requirements, Amar Textiles Ltd. has obtained a term loan from Industrial Development Bank of India and the same is still subsisting. Now the Company wants to increase its holding from 70% to 80% of the equity share capital in Amar Cotton Co. Ltd. by purchase of additional 10% shares from other existing shareholders.

State the legal requirements to be complied with by Amar Textiles Ltd. under the provisions of the Companies Act, 2013 to give effect to the above proposal.

Will your answer be different if Amar Textiles Ltd. would have defaulted in payment of matured fixed deposits accepted by it from the public? (CA (Final) May 2012, May 2008, May 2005)

OR

Amar Textiles Ltd. is a Company engaged in manufacture of fabrics. The Company has investments in Shares of other Bodies Corporate including 70% Shares in Amar Cotton Co. td. And it has also advanced loans to other bodies corporate. The aggregate of all the investments made and loans granted by Amar Textiles Ltd. exceeds 60% of Its Paid up Share Capital, Free Reserves and securities premium account and also exceeds 100% of its Free Reserves and securities premium account. In course of its business requirements, Amar Textiles Ltd. has obtained a term loan from industrial Development Bank of India

and the said loan is still subsisting. Now the Company wants to increase its holding from 70% to 80% of the Equity Share Capital in Amar Cotton Co. Ltd. by purchase of additional 10% Shares from other existing Shareholders. State the legal requirements to be complied with by Amar Textiles Ltd under the provisions of the Companies Act, 2013 to give effect to the above proposal. (CA (Final) June 2009)

Ans. In the given case, the aggregate of loans and investments already made by Amar Textiles Ltd. exceeds the two limits of 60% and 100% specified under Section 186(2). Therefore, the company may make new intercorporate investments only by passing a special resolution. As per Rule 11 of the Companies (Meetings of Board and its Powers) Rules, 2014, where investment is made by a holding company in its wholly owned subsidiary, special resolution is not required. However, the benefit of Rule 11 shall not be available in the given case since Amar Cotton Co. Ltd. is only a subsidiary of Amar Textiles Ltd., and is not a wholly owned subsidiary.

The proposed investment can be made as follows:

(a) A resolution shall be passed at a Board meeting with the consent of all the directors present.

(b) A special resolution shall be passed in the general meeting. Notice of the meeting in which the special resolution is to be passed shall contain an explanatory statement including all the particulars as required under Section 102.

The special resolution passed by the members shall specify the total amount up to which the Board is authorized to make loan guarantee, security or investment

(c) IDBI is not a Public Financial Institution within the meaning of Clause (72) of Section 2 of the Companies Act, 2013. Therefore, prior approval of IDBI is not required.

(d) The company shall enter the prescribed particulars of the investment in the register maintained for this purpose within 7 days of making the investment.

(e) The company shall ensure that no default in repayment of deposits or payment of interest on deposits is subsisting. If the company has defaulted in repayment of deposits, the company cannot make any investments even if unanimous resolution is passed in the Board meeting and special resolution is passed in the general meeting. The investments can be made only after the default has been made good.

(f) The company shall disclose to the members in the financial statement the full particulars of the investment made.

(g) The company shall enter into the register maintained under Section 186(9) such particulars, as have been prescribed under Rule 12.

14. Advise the Board of directors of a public company about their powers in respect of the following proposals explaining the relevant provisions of the Companies Act, 2013: Delegating to the managing director of the company the power to invest surplus funds of the company in the shares of some companies. (CA (Final) May 2003, June 2009 (Modified))

OR

Advise the Board of directors of Spectra Papers Ltd. regarding validity and extent of their powers, under the provisions of the Companies Act, 2013 in relation to delegation of power to the managing director of the company to invest surplus funds of the company in the shares of same companies. (CA (Final) May 2010 (Modified))

Ans. As per Section 179(1) of the Companies Act, 2013, the Board is entitled to exercise all such powers as the company is authorised to exercise. Similarly, the Board is authorized to do all such acts and things as the company is authorized to do. However, the provisions of Section 179(1) of the Companies Act, 2013 are subject to the other provisions of the Companies Act, 2013 (e.g. Sections 179(3), 180, 181 and 182 of the Companies Act, 2013).

As per Section 179 (3) of the Companies Act, 2013, the powers relating to investment of funds

of the company shall be exercised by the Board at a Board meeting only. However, such power may be delegated by the Board, subject to the following:

(a) The power to invest the funds of the company may be delegated to a committee of directors, managing director, and manager, a principal officer of the company or a principal officer of the branch office.

(b) The delegation of power shall be made by passing a resolution at a Board meeting.

(c) The Board may delegate such power subject to such conditions as it may deem fit.

However, as per Section 186 of the Companies Act, 2013, acquisition of securities of anybody corporate shall be made by passing a unanimous resolution at a Board meeting only. Therefore, as per Section 186, the power to invest the funds in the shares of other companies cannot be delegated.

In the present case, the power to invest surplus funds of the company in the shares of some companies is proposed to be delegated to the managing director of the company. Such delegation is not permissible in view of provisions of Section 186 of the Companies Act, 2013.

15. Star Limited proposes to acquire 15% equity shares of Gain Investments (P) Limited for 45 lakhs which has a face value of Rs. 35 lakhs. Star Limited has an outstanding loan of Rs. 15 lakhs to a public financial institution and had not defaulted in the repayment of loan instalments stipulated in the loan agreements. Based on the following financial data, advise Star Limited about the legal position regarding the allowability of the proposed investment under the provisions of the Companies Act, 2013. (Rs. In Crores Star Ltd. Gain Investments (P) Ltd. (CA (Final) Nov. 2017)

Authorized Capital	1.00	3.00
Paid up Share Capital	0.50	2.00
Free Reserves	0.20	1.50

As on the date of proposition, Star Ltd. does not hold any shares of any company

Ans.

Requirements

(a) Unanimous approval of Board is required. The approval shall be obtained by passing a resolution at a Board meeting.

(b) Special resolution is required if the aggregate of loans etc. (already made plus proposed) exceeds the higher of –

60% of the aggregate of paid up capital, free reserves and securities premium account: or 100% of its free reserves and securities premium account.

(c) Approval of Public Financial Institution shall be obtained unless the limit under Section 186(2) is not exceeded; and there is no default in repayment of loan instalments or interest.

(d) No default with respect to repayment of deposits or payment of interest on deposits is subsisting.

First determine whether a special resolution is required for making the proposed loans, investments etc. This can be determined as under:

Step 1- Determine the overall limit for loans, investments etc

Higher of 60% of (paid up share capital, free reserves and securities premium account) or 100% of (free reserves and securities premium account)

60% of (0.5 crore +0.2 crore)	0.42crore
100% of Rs. 0.2 crore	0.2 crore

Overall limit for loans, investments etc. 0.42crore

Step 2- Loans, investments etc. already made by Star Limited Nil

Step 3- Determine loans, investments etc. proposed to be made = Step 1-Step 2

Investments in equity shares of Gain Investments (P) Limited Rs. 0.45 crore
(For the purpose of Section 186, the face value of shares is immaterial)

Step 4 - Proposal

Since loans, investments etc. already made plus loans, investments etc. proposed to be made exceed the overall limit for loans, investments etc., special resolution is required. Therefore, Star Ltd. may make the investments in equity shares of Gain Investments (P) Limited as follows:

- a) A resolution shall be passed at a Board meeting with the consent of all the directors present.
- b) A Special resolution shall be passed in the general meeting authorizing the company to make investments in equity shares of Gain Investments (P) Limited.
- c) The company shall enter the prescribed particulars in the register within 7 days.
- d) The company shall disclose to the members in the financial statement-
 - (i) the full particulars of the loans, investment made or guarantee given or security provided; and
 - (ii) the purpose for which the loan or guarantee or security is proposed to be utilized by the recipient.
- e) The company shall ensure that no default with respect to deposits is subsisting.
- f) Star Limited shall have to obtain the prior approval of the Public Financial Institution from which it has obtained the term loan, since the proposed investment exceeds the limit specified u/s 186(2), even though there is no default in repayment of loan instalments.
- g) The company shall enter into the register maintained under Section 186(9) such particulars, as have been prescribed under Rule 12.

16. Soft and Secure Lenders Limited has convened a Board Meeting on 25th October, 2016. One of the items of the agenda is to approve the grant of loan of Rs. 20 crore to Easy Going Industries Limited, for expansion of its business activities. At the Board Meeting, out of the total of six directors of the lending company, five directors were present and except one director, the remaining four directors approved the grant of loan of Rs. 20 crores to Easy Going Industries Limited. The borrowing company has taken loans from a public financial institution and also deposits from public. Examine the loan proposal with reference to the provisions of the Companies Act, 2013. (CA (Final) Nov. 2016)

Ans. The given problem relates to Section 186 of the Companies, as discussed below:
Section 186 imposes a number of conditions on the company making a loan to any other body corporate or person. Some of these conditions are as under

1. Unanimous approval of the Board is required, i.e. a resolution is to be passed in the Board meeting with the consent of all the directors present in the Board meeting.
2. Approval of the members is also required, if the limit specified under Section 186(2) is exceeded.
3. Prior approval of the Public Financial Institution (from which the lending company has taken a term loan) is required, subject to some exception.
4. The lending company shall make a loan only if there is no default in repayment of deposits or payment of interest on deposits accepted by it.
5. The rate of interest to be charged on loan by the lending company shall not be less than the yield of Government securities closest to the tenor of the loan.
6. The lending company shall make the required disclosures in its financial statements.
7. The company shall enter into the register maintained under Section 186(9) such particulars, as have been prescribed under Rule 12.

8. In the given case, Soft and Secure Lenders Limited is the lending company which intends to make a loan of Rs. 20 crore to Easygoing Industries Limited (viz. the borrowing company), Since, Easy Going Industries Limited is the borrowing company, the facts that Easy Going industries Limited has taken loans from a public financial institution and has accepted deposits from public are irrelevant for the purpose of Section 186.
9. In the Board meeting of Soft and Secure Lenders Limited, the decision to make a loan of Rs. 20 crore was passed with the consent of 4 directors out of 5 directors present in the Board meeting. It is evident that the requirement of Section 186 that the decision to make a loan has to be approved by a unanimous resolution in the Board meeting (i.e, with the consent of all the directors present in the Board meeting, viz. 5, in the given case] has not been satisfied. Accordingly, Soft and Secure Lenders Limited cannot make a loan of Rs. 20 crore to Easy Going Industries Limited.

17. ASK Housing Finance Company Limited are prepared to give housing loans to the employees of M/s NEWS pharmacy limited subject to the condition that the loans are guaranteed by M/s NEWS Pharmacy Limited. M/s NEWS Pharmacy Limited is not a listed company and the company will be exceeding the limits prescribed under the Companies Act, 2013 by providing the guarantees. Advise the company about this legal requirement under the Companies Act, 2013 to give effect to the above proposal. What would be your advice the company was required to provide security instead of guarantee? (CA (Final) May 2018)

Ans.

Provisions

1. Where a company gives any guarantee or provides any security in connection with a loan made to anybody corporate or to any other person, it is required to comply with the provisions contained in sub-Sections (2), (3), (4), (5), (7) and (8) of Section 186.
2. However, as per Explanation to Section 186(2), any guarantee given or any security provided by a company in connection with a loan made to an individual who is in the employment of the company shall not be covered.

Analysis

1. M/s NEWS Pharmacy Limited intends to give guarantee in connection with loans made by ASK Housing Finance Company Limited to the employees of M/s NEWS Pharmacy Limited.
2. The guarantees to be given by M/s NEWS Pharmacy Limited shall be covered in the Explanation to Section 186(2), and so such guarantees shall be out of the purview of Section 186.

Conclusion

1. The provisions of Section 186 shall not apply to the guarantees given by M/s NEWS Pharmacy Limited. However, it shall have to comply with the provisions of Section 179(3) i.e. the guarantees shall be given pursuant to a resolution passed by the Board in Board meeting only, or the Board may delegate the power to give such guarantees in accordance with the provisions contained in proviso to Section 179(3).
2. The answer would remain same even if M/s NEWS Pharmacy Limited provides security in connection with the loans made to its employees, since the provisions of Section 186 shall not apply in such a case also, as per Explanation to Section 186(2).

18. Vogue Limited has an authorized capital of Rs. 250 lakhs and paid up capital of Rs. 200 lakhs. The free reserves are there to the tune of Rs. 150 lakhs. The company has advanced a loan of Rs. 160 lakhs to other companies as on 30th November, 2018. Now the company proposes to advance an interest free loan of Rs. 60 lakhs to its wholly owned subsidiary Fashion Limited.

Discuss the validity of the proposed transaction with reference to the restrictions imposed by the applicable provisions of the Companies Act, 2013 and relevant Rules made there under. (CA (Final) May 2019)

Ans.

Legal Requirements

(a) Unanimous approval of Board is required. The approval shall be obtained by passing a resolution at a Board meeting.

(b) Special resolution is required if the aggregate of loans etc. (already made plus proposed) exceeds the higher of-

60% of the aggregate of paid up capital, free reserves and securities premium account; or 100% of its free reserves and securities premium account.

(c) Approval of Public Financial Institution shall be obtained unless - the limit under Section 186(2) is not exceeded: and there is no default in repayment of loan instalments or interest.

(d) No default with respect to repayment of deposits or payment of interest on deposits is subsisting.

(e) The rate of interest chargeable on any loan shall not be less than the prevailing yield of 1 year, 3-year, 5-year or 10-year Government Security closest to the period of the loan.

Step 1

Determine the overall limit for loans, investments, etc., i.e. higher of 60% of (paid up share capital, free reserves and securities premium account) or 100% of (free reserves and securities premium account)

60% of (200 lakhs + 150 lakhs)

Rs. 210 lakhs

100% of Rs. 150 lakhs

Rs. 150 lakhs

Overall limit for loans, investments, etc.

Rs. 210 lakhs

Step 2

Loans, investments, etc. already made by Vogue Limited

Rs. 160 lakhs

Step 3 = Step 1 - Step 2

Loans, investments, etc. that can be made without requiring a special resolution

Rs. 50 lakhs

Step 4-

Loan proposed to be made to Fashion Ltd.

(A wholly owned subsidiary of Vogue Ltd.)

Rs. 60 lakhs

As per Rule 11 of the Companies (Meetings of Board and its Powers) Rules, 2014, where loan is given by a holding company to its wholly owned subsidiary company or a joint venture Company, the requirement of passing special resolution as per Section 186(3) shall not be applicable. Therefore, Vogue Limited may make a loan of Rs. 60 lakhs to Fashion Limited without requiring a special resolution.

Vogue Limited intends to make the loan of Rs. 60 lakhs to Fashion Limited as an interest free loan. However, Section 186 requires that the rate of interest chargeable on any loan shall not be less than the prevailing yield of 1-year, 3-year, 5-year or 10-year Government Security closest to the period of the loan. Accordingly, it is not possible for Vogue Limited to grant a loan of Rs. 60 lakhs to Fashion Limited as an interest free loan.

19. Directors of ABC Limited are not holding any shares in MDJ Company Limited. Similarly, directors of MDJ Company Limited are not holding any shares in ABC Limited. But, wife of director A of ABC Limited holds 40% of the paid-up share capital of MDJ Company Limited. Board of directors of ABC Limited entered into a contract with MDJ Company Limited for purchase of goods and director A did not disclose his Indirect interest in MDJ Company Limited. Examine whether 'A' has violated any of the provisions of the Companies Act, 2013 and also the validity of the contract.

Ans. Section 184(2) applies where a director is in anyway, whether directly or indirectly, concerned or interested in a contract or arrangement or proposed contract or arrangement entered into or to be entered into with a body corporate in which such director in association with any other director, holds more than 2% shareholding of that body corporate.

Section 184(2) requires the interested director to disclose his interest including the nature of his concern or interest. Further, the interested director is prohibited from participating in the Board meeting. The disclosure of interest shall be made at the Board meeting in which the contract or arrangement is first discussed.

In the given case, 'A' is required to disclose his interest since he is indirectly interested in the contract, as his wife is holding 40% of the paid-up share capital of MDJ Company Limited. Failure to disclose the interest by 'A' amounts to non-compliance of Section 184, and the following consequences shall follow:

'A' shall vacate the office of director held by him (Section 167).

As per Section 184(4). Mr. A shall be punishable with-

- (a) imprisonment up to 1 year; or
- (b) fine up to Rs. 1 lakh; or
- (c) both.

The contract or arrangement entered into by ABC Limited shall be voidable at the option of ABC Limited [Section 184(3)].

20. X Ltd. entered into a contract with M and Co. Ltd. for purchase of raw materials of Rs. 2,50,000 at the prevailing market rate. The director of X Ltd., Mr. B, was holding shares of the value of 1% of the paid-up capital of M and Co. Ltd. Another director of X Ltd. Mr. C was holding shares of the value of 1.5% of the paid-up capital of M and Co. Ltd. Mr. B at the beginning of the year, gave a general notice to X Ltd. that he was interested in M and Co. Ltd.

Mr. B claims that he had given notice to X Ltd. as required under the Companies Act, 2013 and that his holding being only 1% is within the limit under the Companies Act, 2013.

Ans. As per Section 184(2), every director who is any way, directly or indirectly, interested in a contract or arrangement shall disclose the nature of his interest. However, Section 184(2) shall not apply to a contract or arrangement entered into between two companies, where any of the directors of the one company or two or more of them together holds or hold not more than 2% of the paid-up share capital of the other company.

If the aggregate shareholding of two or more directors in the other company exceeds 2% of the paid-up share capital of the other company, all such directors shall make a disclosure as required under Section 184(2), irrespective of the fact that individual shareholding of each of the directors is not more than 2% of the paid-up share capital of the other company.

Section 184(1) requires every director to disclose the nature of his concern or interest (along with the shareholding, if applicable) in any company, body corporate, association of individuals or firm. Such disclosure is to be made by the director in the first Board meeting in which he participates as a director, the first Board in every financial year and the first Board meeting held after any change in the interest or concern takes place.

In the present case, the aggregate shareholding of Mr. B and Mr. C is more than 2% of the paid-up share capital of M and Co., and so Section 184(2) has become applicable.

Accordingly, Mr. B and Mr. C, both, are required to disclose the nature of their interest (viz. their shareholding in M and Co. Ltd.) in the Board meeting of X Ltd. in which the contract or arrangement between X Ltd. and M and Co. Ltd. is first discussed.

The requirement specified under Section 184(2) is independent of the requirement of Section 184(1). In other words, even where a director has disclosed his concern or interest as per Section 184(1), he is still required to disclose his concern or interest in each and every contract or arrangement covered under Section 184(2), although such contract or arrangement is with a company or body corporate in respect of which disclosure of interest was already given by him in terms of Section 184(1).

The general notice given by Mr. B in terms of Section 184 (1) is not a sufficient compliance of the requirements of Section 184(2), and so Mr. B has contravened the provisions of Section 184(2). Also, Mr. C has not disclosed his concern or interest in the Board meeting in which the contract or arrangement is first discussed, and so, Mr. C has also contravened the provisions of Section 184 (2).

Consequences of contravention of Section 184(2) shall be as follows:

Mr. B and Mr. C shall vacate the office of director held by them (Section 167).

As per Section 184(4). Mr. B and Mr. C shall be punishable with-

- (a) imprisonment up to 1 year; or
- (b) fine up to Rs. 1 lakh; or
- (c) both.

The contract or arrangement entered into by X Limited shall be voidable at the option of X Limited [Section 184(3)].

21. Sweet Tea Limited wants to sell its tea by entering into contract with the following parties:

(1) Tea Bros, a partnership firm in which a director of Sweet Tea limited is a partner.

(2) R&T Private Limited in which one of the directors of Sweet Tea Limited is a member.

(3) Strong Tea Limited in which one of the directors of Sweet Tea Limited is a director holding 3% of the paid-up capital of strong Tea Limited.

Advice the steps that should be taken by Sweet Tea Limited taking into account the relevant provision of the Companies Act, 2013 for entering into contracts in which the directors are interested. (CA (Final) May 2014)

Ans. As per Section 188 of the Companies Act, 2013, any contract or arrangement between a company and any related party for sale, purchase or supply of any goods or materials shall require compliance with the requirements specified under Section 188 read with Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014.

As per Section 2(76), among others, following are the related parties:

- (i) A firm, in which a director, manager or his relative is a partner.
- (ii) A private company in which a director or manager or his relative is a member or director.
- (iii) A public company in which a director or manager is a director and holds along with his relatives, more than 2% of its paid-up share capital.

In the given case, all the three parties are related parties. Therefore, following legal requirements are required to be complied with for sale of tea to any of these parties:

1. Consent of the Board is to be obtained by passing a resolution at a Board Meeting.
2. The agenda of the Board meeting in which the approval of the Board is to be obtained shall contain the particulars prescribed in the rules
3. If any director is interested in such contract or arrangement, he shall not be present at the Board meeting during discussions on such contract or arrangement.
4. The contract or arrangement shall require the prior approval of the members by an ordinary resolution if the value of the contract or arrangement for sale, purchase or supply of any

goods or materials exceeds 10% of the turnover of the company or Rs. 100 crore, whichever is lower.

5. The explanatory statement annexed to the notice of the general meeting in which the ordinary resolution is to be passed, shall contain the prescribed particulars?

6. If a member is a related party, he shall not vote on such ordinary resolution.

22. The Board of directors of M/s ABC Motors Ltd. made the following appointments at its meeting held on 1st January, 2018.

(i) Mr. X, a director of its subsidiary company, namely, M/s ABC Forgings Ltd., was appointed as purchase manager on a consolidated salary of Rs. 1,00,000 per month with effect from 1st January, 2018.

(ii) Mr. Y was appointed as the sales manager on a consolidated salary of Rs. 1,50,000 per month with effect from 1st January, 2018. Answer the following, explaining the relevant provisions of the Companies Act, 2013.

(1) Does the appointment of Mr. X require the approval of the members in a general meeting of the company?

(2) Mr. PO, a relative of Mr. Y was appointed as a director of M/s ABC Motors Ltd. on 1st August, 2018. Does it affect the continuation of Mr. Y as the sales manager? (CA (Final) Nov. 2018)

Ans. Appointment of any related party to an office or place of profit in the company, its subsidiary company or associate company attracts Section 188 of the Companies Act, 2013. The given problems are answered as under:

(1) Mr. X is the director of ABC Forgings Ltd. As per Clause (76) of Section (2), a director of a company is a related party, and so Mr. X is a related party. He is appointed as purchase manager in ABC Motors Ltd. at a monthly remuneration of Rs. 1,00,000. The appointment of Mr. X as purchase manager in ABC Motors Limited amounts to appointment of a related party to an office or place of profit in the holding company, which is not covered under Section 188. Therefore, the appointment of Mr. X does not attract the provisions of Section 188. Such appointment can be made without requiring any compliance with any of the legal requirements specified under Section 188.

(2) Mr. Y is not related to any director at the time of appointment (i.e. 1st January, 2018), and so he is not a related party in terms of clause (76) of Section 2. Therefore, his appointment does not attract the provisions of Section 188, and so he can be appointed as sales manager in ABC Motors Limited at a monthly remuneration of Rs. 1,50,000 without requiring any compliance with any of the legal requirements specified under Section 188.

Subsequent appointment of a relative of Mr. Y as a director in ABC Motors Limited shall not affect the appointment of Mr. Y as sales manager, since the appointment of Mr. Y as sales manager was made prior to appointment of his relative as a director. Thus, no compliance with the provisions of Section 188 is required even after appointment as a director of relative of Mr. Y.

23. The articles of association of a company states that a director shall not vote in respect of a contract in which he is interested. In a resolution put up for approval of the shareholders, can a director exercise his voting right in favour of a contract in which he is interested? CA (Final) Nov. 2001)

OR

Examine the validity of the following with reference to the relevant provisions of the Companies Act, 2013 and/or decided case laws:

Mr. G. a director of Sam Limited was interested in a contract to be entered into by the company. The articles of association of Sam Limited contained a clause, which prohibited the directors from voting on the resolution in respect of any contract in which

he is interested. The matter in respect of the said contract was put up for approval of the shareholders in a general meeting. The general meeting was attended by Mr. G and he also voted on the resolution. Mr. G. claims that he has a right to vote on the resolution in the general meeting.

(CA (Final) Nov. 2005)

Ans. Section 184 read with Sections 6, 102, 106 and 188 of the Companies Act, 2013

The directors stand in a fiduciary relationship with the company and they must exercise their voting powers in the best interest of the company. This is the objective of Section 184. As per Section 184, a director shall disclose his interest where he 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 with a body corporate in which such director in association with any other director, holds more than 2% shareholding of that body corporate. Also, the interested director shall not participate in discussion and voting.

It must be noted that restrictions imposed under Section 184 is attracted only in case of a resolution put for the approval of the Board. Where the same matter comes before a general meeting, the right of an interested director to vote on it is not affected by Section 184 [Seth Mohanlal v Grain Chambers Ltd. AIR 1959 All 276].

The shareholders do not owe any fiduciary duty to the company and they are free to exercise their voting rights in their own interests, even if his interest is opposed to the interest of the company. The shareholders are not the trustees for the company or for one another. Accordingly, where a director exercises his voting rights as a shareholder, he is free to vote in his own best interests like any other shareholder. In case of a public company, the only restriction on the voting rights of a shareholder can be on the ground of non-payment of calls on shares or other sums due from the shareholder to the company, or where the company has exercised lien on shares of a shareholder (Section 106). As per Section 6, any other restriction or prohibition shall be ultra-virus the provisions of Section 106 and consequently void. Therefore, a provision in the articles shall be invalid if it restrains a director from voting in the general meeting, on a contract in which he is interested. However, one exception to this rule may be found under Section 188. As per Section 188, if a contract or arrangement requires the approval of the members by way of an ordinary resolution, no member shall vote on such ordinary resolution if he is a related party.

But, where the directors usurp the corporate opportunity (i.e. where the directors convert to their own benefit, opportunities belonging to the company), they cannot use their voting power as shareholders to prevent the company from recovering damages from the directors. For example, three directors holding 75% of the share capital of the company used their positions as directors and obtained contract in their own names. As it amounted to breach of duty towards the company, they called a general meeting in which a resolution was passed to the effect that the company had no interest in the contract, it was held that the company could claim the profits realized by the directors [Cook v Deeks (1916) 1 AC 554].

Conclusion: Mr. G., the director of Sam Limited, can vote in the general meeting even though he is interested in such contract. Therefore, the contention of Mr. G is correct.

1. The scope of Section 184 is limited to Board meetings only; Section 184 does not apply when a resolution is put before the general meeting.
2. A director may exercise his voting right at a general meeting on a contract in which he is interested, provided –
 - (a) it does not result in misappropriation of a corporate opportunity by the director, and
 - (b) the interest of the director has been sufficiently disclosed in the explanatory statement annexed to the notice of the general meeting (Section 102)

24. Company Y with a paid-up capital of Rs. 50 lakhs entered into a contract with Company Z in which a director of Company Y is holding equity shares of the nominal value of Rs.

50,000. The director did not disclose his interest at the Board meeting under Section 184 of the Companies Act, 2013. Is the director liable for his act? (ICAI, Practice Manual, Nov. 2016 Exams (Modified))

Ans. Section 184(2) applies where a director is in anyway, whether directly or indirectly, concerned or interested in a contractor arrangement or proposed contract or arrangement entered into or to be entered into with a body corporate in which such director in association with any other director, holds more than 2% shareholding of that body corporate.

In the given case, a director of Company Y holds equity shares of Rs. 50,000 in Company Z. However, the shareholding of such director in Company Z cannot be said to be 1% since in the given question, Rs. 50 lakh is the paid up share capital of Company Y, and not of Company Z. So, the percentage shareholding held by a director of Company Y in Company Z cannot be determined.

If the paid-up share capital of Company Z is less than Rs. 25 lakh, then, the shareholding of director of Company Y in Company Z shall be more than 2% of the paid up share capital of Company Z, and so the director of Company Y is required to disclose his interest and he shall not participate in discussion and voting. However, the director of Company Y did not disclose his interest, and so he shall be liable for contravention of Section 184(2).

However, if the paid-up share capital of Company Z is Rs. 25 lakh or more, then, the director of Company Y is not required to disclose his interest and he can participate in discussion and voting also, and so the director of Company Y shall not be liable for contravention of Section 184(2).

It should be noted that the director of Company Y shall be liable to disclose his concern or interest in Company Z in Form MBP-1 as per the provisions of Section 184(1). Disclosure of concern or interest under Section 184(1) is required irrespective of the percentage of shareholding in the other body corporate.

25. M/s Kith and Kin Consultants Private Limited seeks your legal advice regarding the following appointments relating to directors and their relatives:

(i) Miss Niece, a relative of a director, is to be appointed as Chief Public Relations Officer on a salary of Rs. 65,000 per month.

(ii) Mr. Well connected, a relative of a director, is to be appointed as Chief Executive Officer on a consolidated salary of Rs. 2,55,000 per month.

(iii) Mr. Nephew, who is a relative of one of the directors, is to be appointed as the managing director on a monthly salary of Rs. 2,80,000 plus other perquisites as applicable to other executives of the company.

Advise explaining the relevant provisions of the Companies Act, 2013. (CA (Final) May 2002 (Modified))

Ans. Appointment of any related party to an office or place of profit in the company, its subsidiary company or associate company attracts Section 188 of the Companies Act, 2013.

Provisions

Section 188 requires compliance with the following legal requirements:

1. Consent of the Board is to be obtained by passing a resolution at a Board Meeting.
2. The agenda of the Board meeting in which the approval of the Board is to be obtained shall contain the particulars prescribed under sub-rule (1) of Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014.
3. If any director is interested in such appointment, he shall not be present at the Board meeting during discussions on such appointment.
4. The appointment shall require the prior approval of the members by an ordinary resolution if the monthly remuneration exceeds Rs. 2,50,000.
5. The explanatory statement annexed to the notice of the general meeting in which the ordinary resolution is to be passed, shall contain the prescribed particulars.

6. If a member is a related party, he shall not vote on such ordinary resolution.
7. The term office or place of profit is defined under Explanation to sub-Section (1) of Section 188, as follows:

(a) An office or place held by a director is an office or place of profit 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.

(b) An office or place held by a person other than a director is an office or place of profit if such person receives from the company anything by way of remuneration.

Analysis and Conclusion

(i) Miss Niece is a relative of a director. As per Clause (76) of Section (2), a relative of a director is a related party. Thus, appointment of Miss Niece as Chief Public Relations Officer at a monthly remuneration of Rs. 65,000 amounts to appointment of a related party to an office or place of profit in the company, attracting the provisions of Section 188.

However, such appointment does not require the prior approval of the members by passing an ordinary resolution since the monthly remuneration does not exceed Rs. 2,50,000.

Thus, the appointment of Miss Niece as Chief Public Relations Officer at a monthly remuneration of Rs. 65,000 requires compliance with legal requirements as stated earlier in Points 1 to 3.

(ii) Mr. Well connected is a relative of a director. As per Clause (76) of Section (2), a relative of a director is a related party. Thus, appointment of Mr. Well connected as Chief Executive Officer at a monthly remuneration of Rs. 2,55,000 amounts to appointment of a related party to an office or place of profit in the company, attracting the provisions of Section 188.

Such appointment also requires the prior approval of the members by passing an ordinary resolution since the monthly remuneration exceeds Rs. 2,50,000.

Thus, the appointment of Mr. Well connected as Chief Executive Officer at a monthly remuneration of Rs. 2,55,000 requires compliance with legal requirements

(iii) Mr. Nephew is a relative of a director. As per Clause (76) of Section (2), a relative of a director is a related party. He is proposed to be appointed as a managing director of the company at a monthly remuneration of Rs. 2,80,000. It is assumed that managing director does not draw anything more than the remuneration to which he is entitled as a director, and is within arm's length. Hence, the office of managing director cannot be said to be an office or place of profit. Thus, the appointment of Mr. Nephew as a managing director does not attract the provisions of Section 188, and so compliance with any of the legal requirements specified under Section 188 is not required.

26. Reliable Castings Limited is a subsidiary of Unique Machineries Limited. The Board of Directors of the respective companies has made the following appointments on a consolidated monthly salary of Rs. 2,52,000 with effect from 1.6.2014:

(i) Shri Ram Singh, a director of Unique Machineries Limited, as factory manager of Reliable Castings Limited.

(ii) Shri Rajesh Patel, a director of Reliable Castings Limited, as purchase manager of Unique Machineries Limited.

(iii) Shri Sundar, relative of a director of Unique Machineries Limited, as sales manager of Unique Machineries Limited.

(iv) Shri Rakesh, not related to any director of both the companies, as chief accountant of Unique Machineries Limited. But his relative has been appointed as additional director of Unique Machineries Limited with effect from 1.11.2014. Explain the legal requirements to be complied with under the Companies Act, 2013 to give effect to or continuation of the above appointments of employees. (CA (Final) May 1997 (Modified))

Ans. Appointment of any related party to an office or place or profit in the company, its subsidiary company or associate company attracts Section 188 of the Companies Act, 2013.

Legal requirements

Section 188 requires compliance with the following legal requirements:

1. Consent of the Board is to be obtained by passing a resolution at a Board Meeting.
2. The agenda of the Board meeting in which the approval or the Board is to be obtained shall contain the particulars prescribed under sub-rule (1) of Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014.
3. If any director is interested in such appointment, he shall not be present at the Board meeting during discussions on such appointment.
4. The appointment shall require the prior approval of the members by an ordinary resolution if the monthly remuneration exceeds Rs. 2,50,000.
5. The explanatory statement annexed to the notice of the general meeting in which the ordinary resolution is to be passed shall contain the prescribed particulars.
6. If a member is a related party; he shall not vote on such ordinary resolution.
7. The term 'office or place of profit' is defined under Explanation to sub-Section (1) of Section 188, as an office or place held by a director is an office or place of profit 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.

An office or place held by a person other than a director is an office or place of profit if such person receives from the Company anything by way of remuneration.

Analysis and Conclusion

(i) Reliable Castings Limited is the subsidiary company of Unique Machineries Limited. Shri Ram Singh is the director of Unique Machineries Limited. As per Clause (76) of Section (2), a director of a company is a related party. Therefore, appointment of Shri Ram Singh as a factory manager of Reliable Castings Limited amounts to appointment of a related party to an office or place of profit in the subsidiary company, thus attracting the provisions of Section 188. Such appointment also requires the prior approval of the members by passing an ordinary resolution since the monthly remuneration exceeds Rs. 2,50,000.

Thus, the appointment of Shri Ram Singh as a factory manager of Reliable Castings Limited at a monthly remuneration of Rs. 2,52,000 requires compliance with legal requirements

(ii) Shi Rajesh Patel is the director of Reliable Castings Limited. As per Clause (76) of Section (2), a director of a company is a related party, and so Mr. Rajesh Patel is a related party. He is to be appointed as purchase manager in Unique Machineries Limited. The appointment of Shri Rajesh Patel as purchase manager in Unique Machineries Limited amounts to appointment of a related party to an office or place of profit in the holding company, which is not covered under Section 188. Therefore, the appointment of Shri Rajesh Patel does not attract the provisions of Section 188. Such appointment can be made without requiring any compliance with any of the legal requirements specified under Section 188.

(iii) Shri Sundar is a relative of a director of Unique Machineries Limited. As per Clause (76) of Section (2), a relative of a director is a related party. He is to be appointed as sales manager in Unique Machineries Limited. The appointment of Shri Sundar as sales manager in Unique Machineries Limited amounts to appointment of a related party to an office or place of profit in the company, thus attracting the provisions of Section 188. Such appointment also requires the prior approval of the members by passing an ordinary resolution since the monthly remuneration exceeds Rs. 2,50,000.

Thus, the appointment of Shri Sundar as sales manager of Unique Machineries Limited at a monthly remuneration of Rs. 2,52,000 requires compliance with legal requirements

(iv) Shri Rakesh is not related to any director at the time of appointment, and so he is not a related party in terms of Clause (76) of Section 2. Therefore, his appointment does not attract the provisions of Section 188, and so he can be appointed as Chief Accountant in Unique Machineries Limited at a monthly remuneration of Rs. 2,52,000 without requiring any compliance with any of the legal requirements specified under Section 188.

Subsequent appointment of a relative of Shri Rakesh as a director in Unique Machineries Limited shall not affect the appointment of Shri Rakesh as Chief Accountant, since the appointment of Shri Rakesh as Chief Accountant was made prior to appointment of his relative as a director. Thus, no compliance with the provisions of Section 188 is required even after appointment as a director of relative of Shri Rakesh.