

Clarification on section 185 of the Companies Act, 2013

17 February 2014



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The Ministry of Corporate Affairs ('MCA') vide its circular in November 2013 had clarified that section 372A of the Companies Act, 1956, would continue to remain in force till section 186 of the Companies Act, 2013 ('the Act') is notified. However, despite this clarification, there were different interpretations in practice with reference to the validity of loans made, guarantee given or security provided by a holding company to a subsidiary under section 185 of the Act vis-a-vis the exemption provided under section 372A of the Companies Act, 1956.

Section 185 of the Act, amongst other matters, states that no company shall, directly or indirectly, advance any loan to any other person in whom the director is interested or give any guarantee or provide any security in connection with a loan taken by any other person in whom the director is interested. The expression 'any other person in whom the director is interested' covers amongst others, a subsidiary company.

Section 372A(8)(d) of the Companies Act, 1956, provides that the limits specified in the section would not apply to any guarantee given or any security provided by a holding company in respect of loan made to its wholly owned subsidiary.

The MCA vide circular no. 3/2014, dated 14 February 2014, has issued a further clarification with regard to section 185 of the Act.

In order to harmonise the two conflicting sections, MCA has now clarified that for any guarantee given or security provided by a holding company in respect of loans made by a bank or financial institution to its subsidiary company, the exemption as provided in section 372A(8)(d) shall be applicable till section 186 of the Act is notified. This clarification will be applicable to cases where loans so obtained are exclusively utilised by the subsidiary for its principal business activities.

Our comments

Section 372A(8)(c) provides that the limits provided in the section do not apply to any loan made by a holding company to its wholly owned subsidiary; the clarification provided by MCA, however, does not provide a safe harbour with respect to loans given by a holding company to its wholly owned subsidiaries. The clarification/exemption is limited to guarantees given or security provided.

Also, once section 186 under the Act is notified, the corresponding section 372A under the Companies Act, 1956 would be repealed and clarification provided under this circular would cease to be valid.

The bottom line

- The clarification provided by MCA clarifies one of the areas of confusion/interpretation relating to the application of Section 185/186 and Section 372A.
- However, other issues continue to remain unaddressed (in particular the application of these sections to loans provided to a subsidiary company).

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