PART XXVII

INTER-CORPORATE LOANS, INVESTMENTS, GUARANTEES AND SECURITIES

Chapter 1

Inter-Corporate Loans and Investments

Synopsis

Important Provisions at a Glance

Sl. No.	*Sections*	*Matters dealt with*	*Form Nos.*
1.	372A	Making of loans and investments, giving guarantee and providing security to other bodies corporate.	
2.	2(7)	Definition of body corporate.	

1. Meaning of "Loan"

As per the *Explanation* given under section 372A of the Act, 'loan' includes debentures or any deposit of money made by one company with another company, not being a banking company.

2. Non-applicability of section 372A

Sub section (8) of section 372A provides that the conditions of section 372A shall not apply in the following situations and the transactions of making of loans or investments, giving of guarantee and providing security which are outside the provisions of section 372A of the Act are as under:—

(*a*) to any loan made, any guarantee given, or any security provided, or any investment made by:

(*i*) a banking company, or an insurance company, or a housing finance company in the ordinary course of its business, or a company established with the object of financing industrial enterprises, or of providing infrastructure facilities;

(*ii*) a company whose principal business is the acquisition of shares, stocks, debenture or other securities;

(*iii*) a private company unless it is a subsidiary of a public company.

(*b*) to investment made in shares allotted in pursuance of clause (*a*) of sub-section (1) of section 81 of the Companies Act, 1956;

(*c*) to any loan made by a holding company to its wholly owned subsidiary;

(*d*) to any guarantee given or security provided by a holding company in respect of a loan made to its wholly-owned subsidiary;

(*e*) to acquisition by a holding company, by way of subscription, purchase or otherwise, the securities of its wholly owned subsidiary.

3. Meaning of "Investment"

'Investment' means investment in the securities of any other body corporate, which includes shares, debentures, convertible debentures, bonds, etc. as defined under the Securities and Exchange Board of India Act, 1992 and the Securities Contract (Regulation) Act, 1956.

4. Meaning of "Free Reserves"

As per the *Explanation* given under section 372A, 'free reserves' means those reserves which, as per the latest audited balance sheet of the company, are free for distribution as dividend and shall include balance to the credit of the securities premium account but shall not include share application money.

5. Definition of "Body Corporate"

Section 2(7) of the Companies Act, 1956 defines 'body corporate' as a company incorporated outside India but does not include:—

(*a*) a corporation sole;

(*b*) a co-operative society registered under any law relating to co-operative societies; and

(*c*) any other body corporate not being a company as defined in the Act, which the Central Government may, by notification in the Official Gazette, specify in this behalf.

6. Powers of the Board shall be exercised only at their meeting by way of a resolution

The Board of directors of a company has the following powers:—

(*a*) to make loans to any body corporate;

(*b*) to give any guarantee, or provide security to any person in connection with a loan made by that person to any body corporate; and

(*c*) to subscribe or purchase the securities of any other body corporate.

Whenever there is a proposal before a company to make loan or investment or to give guarantee or provide security, each such proposal upto the overall limit stated below (or in excess of the limit after approval by company in general meeting) will be considered and approved by the Board of directors of the company at a meeting of the Board by way of a resolution which shall be passed with the consent of all the directors present at the meeting. (Appendix 1)

7. Limitation on the powers of the Board

The Board of directors of a company can approve the above said proposals only upto 60% of the paid up capital and free reserves or 100% of the free reserves of the company, whichever is more. The said limit applies either to loans, investments or guarantee/security individually or to all the above transactions put together.

8. Approval of shareholders is necessary where the Board of directors needs to make investment in excess of the prescribed limits

Where the aggregate of the loans and investments so far made and the amount of guarantee or security so far given together with the loans, investments, guarantee or security proposed to be made or given exceeds the limit of 60% or 100%, referred to above, no loan or investment or guarantee or security in excess of the said limits shall be made or given unless the proposal is previously authorised by a special resolution passed in a general meeting. (Appendix 2)

9. Notice and the explanatory statement for the general meeting shall contain adequate details

The notice of the general meeting for passing resolution shall indicate clearly the following:

(*i*) the limits that will be required in excess of the prescribed limits involved in the proposal;

(*ii*) the particulars of the body corporate in which the investment is proposed to be made or to which the loan or guarantee or security proposed to be given;

(*iii*) the purpose of the investment, loan, guarantee or security;

(*iv*) the sources of funding for meeting the proposal; and

(*v*) other details as may be specified.

10. No blanket permission will be given by the shareholders

The particulars that are required to be given in the notice for the general meeting envisage that every proposal in excess of the limits of 60% or 100% shall be specifically approved at the general meeting. A blanket permission of the shareholders empowering the Board to make loans or investments or to give guarantee or security upto a certain aggregate limit will not be adequate compliance with the provisions. Circular No. 8/99, dated 4-6-1999 issued by the DCA, stating, *inter alia*, that *en-block* approval should be avoided (except in the case of guarantee where the resolution can indicate an amount on annual basis). The said circular is quoted below which is self-explanatory:

"1. The provisions in the Companies Act, 1956 relating to inter-corporate investments, loans and guarantees have been recently liberalised by the government through Companies (Amendment) Act, 1999. However, apprehensions have been expressed in some quarters with regard to possible misuse of these provisions by companies. I shall, therefore, be grateful if the Chambers could draw the attention of their constituents to the following:—

(*i*) The companies are expected to obtain the approval for making investments into securities or grant of loan to other companies of amounts, which are linked with company's available financial resources and the resolution for investment much beyond the net worth should not be passed by the companies.

(*ii*) The companies should specifically indicate in the explanatory statement to the resolution, the specific securities in which it is proposed to invest the amount. *En-block* approval should normally be avoided (except in the case of guarantee where the resolution can indicate an amount on annual basis).

2. If above broad parameters are not complied, the government will be constrained to take suitable action against those who contravene these."

11. Guarantee may be given even in excess of limits without prior approval of the shareholders

It is provided in the second proviso to sub-section (1) of section 372A that the Board of directors of a company may give guarantee in excess of the limit of 60% or 100% without being previously authorised by a special resolution of the shareholders, if the following conditions are satisfied:—

(*i*) The Board passes a resolution to give the said guarantee and the resolution is passed with the consent of all the directors present at the Board meeting.

(*ii*) The prior approval of the public financial institution, to which repayment of a tern loan is subsisting, has been received, in case the proposal will make the aggregate of loan, investment and guarantee in excess of 60% or 100%, as the case may be.

(*iii*) There exist exceptional circumstances, which prevent the company from obtaining previous authorisation by a special resolution passed in the general meeting for giving the said guarantee.

(*iv*) The resolution of the Board under clause (*i*) above is confirmed within 12 months by a general meeting or the annual general meeting held next after the resolution is passed by the Board, whichever is held earlier.

12. Requirement for prior approval of the public financial institution

In the case of a company which has received any term loan from a public financial institution referred to in section 4A of the Act and if there is a default in loan repayment or payment of interest, the company concerned shall obtain the prior approval of the institution concerned before the Board of directors accord its approval to make loan or investment or give guarantee or security even within the limit of 60% of paid up capital and free reserves or 100% of free reserves, whichever is higher. In a company which has received the approval of shareholders to make loan or investment or to give guarantee or security in excess of the prescribed limits, it will also be necessary to obtain the prior approval of the public financial institution which has granted term loan to the company and the same has not been repaid even where there is no default. The need for prior approval of the public financial institution concerned re-in forces the understanding that the approval of the institution and the shareholders shall be specifically stated for each proposal.

13. Obtain counter-guarantee before providing guarantee to a body corporate

Having allowed free hand for the companies in the matter of making loans and investment and giving guarantees, the Government now seems to think that it is necessary for companies that they should not venture to give loans and make investment beyond the net worth of the companies. There is no doubt that the Board of directors of companies will exercise adequate financial prudence in the matter of utilising funds of their companies for giving loans and making investments. When guarantees are given, the guarantor company should be protected by obtaining a counter-guarantee from the company on whose behalf the guarantee is given.

14. Limitation on the powers of a company

The powers of the Board and/or of the company to make loans and investment and giving guarantees or providing security or subject to the following limitations which must be observed by a company:—

14.1. Minimum rate of interest

The loan given to a body corporate under section 372A shall carry interest at a rate not lower than the prevailing Bank rate made under section 49 of the Reserve Bank of India Act, 1934.

14.2. Company should not continue defaults under section 58A(4)

A company which has defaulted in the payment of interest or repayment of principal in respect of deposits accepted from the public under section 58A of the Act cannot:—

(*a*) make any loan to a body corporate;

(*b*) give any guarantee or provide any security in respect of any loan extended to a body corporate; and

(*c*) subscribe or purchase the securities of any other body corporate till the said default is made good.

15. Penalty

If default is made in complying with this section, (other than maintenance of the Register), the company and every officer who is in default shall be punishable with imprisonment upto two years or with fine, which may extend to Rs. 50,000.

16. Register of loan made, guarantee given, or security provided to body corporate

Section 372A(5) provides that every company shall keep a Register and show the following particulars in respect of every investment or loan made and guarantee/security given (Appendix 3):—

(*i*) the name of the body corporate;

(*ii*) the amount, terms and purpose of the investment or loan or guarantee or security;

(*iii*) the date on which the investment or loan has been made; and

(*iv*) the date on which the guarantee is given or security is provided.

16.1. Time-limit for entering particulars in the Register

The particulars of investments, loan, guarantee or security referred to in section 372A(5)(*a*) shall be entered chronologically in the Register aforesaid within 7 days of the making of such investment or loan, or the giving of such guarantee or the provision of such security.

16.2. Place for keeping Register and its inspection

The Register of investments, etc., shall be kept at the Registered office of the company concerned and it shall be open to inspection and extracts may be taken there from and copies thereof may be required by any member of the company to the same extent, in the same manner and on payment of the same fees as in the case of the Register of members and the provisions of section 163 shall apply accordingly. [Section 372A(6)]

16.3. Penalty

Non-maintenance of the Register is liable to be punished with fine upto Rs. 5,000 and with a further fine upto Rs. 500 for every day during which the default continues.

Appendix 1

Specimen of Board resolutions

I. Authority to invest company's funds in shares/debentures/bonds of another company

RESOLVED THAT pursuant to the provisions of section 372A of the Companies Act, 1956 the unanimous consent of all the directors present at the meeting is given that the Company do invest a sum not exceeding Rs. 100.00 Lacs (Rupees One Hundred Lacs) in the Equity Shares of Rs. 10 each of ABC Corporation Ltd. and that Shri PQR, the Managing Director of the Company be and is hereby authorised to sign application forms/transfer deeds and other necessary documents in this connection.

II. Acquisition of shares of another company

RESOLVED THAT pursuant to section 372A of the Companies Act, 1956 the consent of the Board of Directors of the Company be and is hereby accorded to make investment of Rs. 17.80 Lacs, for acquisition of 8,90,000 Equity shares of Rs. 10 each fully paid up in VWI Ltd. from Shri AV and Shri MSJ at a total price/consideration of Rs.2 per share and that Mr. HV, Managing Director of the Company be and is hereby authorised to execute the transfer deeds, as placed at the meeting, for and on behalf of the Company and to submit the same to VWI Ltd. alongwith copies of letters received as above.

FURTHER RESOLVED THAT Mr. HV, Managing Director of the Company is also authorised to make payment of consideration to the transferors of above shares at the rate of Rs. 2 per share and to do all such things as may be necessary in this matter.

III. Authority to invest in the public issue/offer for sale of shares of other company

The Chairman appraised that the Government of India is planning for dis-investment of its equity shares in the DCIL of Equity Shares of Rs. 10 each at a price as may be notified by the Company/Book Builder.

He appraised that it shall be a good investment if the Company apply for the allotment of 10,000 Equity Shares in the Public Issue offer for bid under process at price as may be considered by the Company looking into the market response.

The Board appreciated the idea of the Chairman and thereafter the Board passed the following resolution unanimously:

RESOLVED THAT pursuant to the provisions of section 372A of the Companies Act, 1956 the consent of the Board of directors of the Company be and is hereby accorded to apply for issuance/allotment of 10,000 Equity Shares of Rs. 10 each of DCIL at a premium as may be considered appropriate by Shri RCM, the Managing Director of the Company against the Offer for bid for sale of shares for and on behalf of the Company and to sign the Share Application Form and to deposit the necessary Share Application Money in terms of the Offer for sale of shares of the Corporation subject to the maximum price band as may be declared by the appropriate authority.

FURTHER RESOLVED THAT Shri RCM, the Managing Director of the Company be and is hereby authorised to submit the above said resolution with a copy of the Memorandum & Articles alongwith the Share Application Form.

IV. Delegation of authority to directors/committee of directors to invest company's funds within the permissible limit

RESOLVED THAT pursuant to the provisions of section 292 of the Companies Act, 1956 and subject to other provisions of the said Act or other laws, and the Articles of Association of the Company Mr. PQR, the Managing Director of the Company be and is hereby authorised to invest funds of the company in fixed/term deposits with bank(s), bodies corporate in shares/debentures (convertible or non-convertible) of Companies, Government securities (Central, State or semi-Government) provided that the total amount upto which the funds may be invested as aforesaid shall not exceed the sum of Rs. 25.00 Lacs (Rupees Twenty Five Lacs) at any one time until otherwise decided by the Board in this regard.

RESOLVED FURTHER THAT Mr. PQR, the Managing Director be and is hereby authorised to disinvest money, demand before maturity, renew, subscribe and to sign application form, forms of renunciation, transfer deeds, receipts and all other paper and document as may be required in the matter of investment of company's funds.

V. Authority to subscribe for shares in the individual capacity instead in the name of the company

RESOLVED THAT pursuant to the provisions of section 372A read with the provisions of section 49 of the Companies Act, 1956 and the Articles of Association of the Company the consent of the Board of directors of the Company be and is hereby accorded to make investment of Rs. 1,000 only in the 100 equity shares of Rs. 100 bearing distinctive Nos. 1 to 100 of M/s. RRR Limited and the said shares be jointly held in the name of Mr. X and Mr. Y, the Directors of the Company.

RESOLVED FURTHER THAT the share certificate in respect of the above shares be kept under the safe custody of the Managing Director and Shri Anil Bhaskaran the Company Secretary be and is hereby instructed to make necessary entries be made in the Register as required under section 49 and 372A of the Companies Act, 1956 and to comply with all requirements in this regard.

Appendix 2

Specimen of special resolutions general meeting

I. Authority to the Board of directors to make investment in excess of the prescribed limits

RESOLVED THAT pursuant to section 372A and other applicable provisions, if any, of the Companies Act, 1956, the consent of the members of the Company be and is hereby granted to make an investment of a sum not exceeding Rs. 125.00 Lacs by way of subscription and/or purchase of Equity Shares of Rs. 10 each for cash at par of ABC Corporation Ltd., notwithstanding that such investment or such investment together with the company's existing investment in all other bodies corporate shall be in excess of the limits prescribed under section 372A of the Act and the Board of directors of the Company be and is hereby authorised to determine the actual sum to be so invested and all matters arising out of or incidental to the proposed investment and to do all such acts and things as may be necessary to implement this resolution.

Explanatory Statement

ABC Corporation Ltd. has been recently incorporated in 2005 with the support of the company in the state of Madhya Pradesh with the Authorised Share Capital of Rs. 50.00 Crores and at present, the paid up capital and free reserves of the Company are Rs. 100.00 Lacs only.

While the main object of ABC Corporation Ltd. is to undertake the business of manufacturing, assembling, designing of electrical and electronic equipments, circuit breakers, electric motors, generators and switchgears, transformers, regulators, battery chargers and eliminators, etc.

ABC Corporation Ltd. is proposed to be made wholly owned subsidiary of the company. It is intended to operate the Company's present electrical business activities through the subsidiary of the company.

With a view to meet the capital requirement of ABC Corporation Ltd., it is proposed that the Company invests a sum not exceeding Rs. 125.00 Lacs in the Equity Capital of ABC Corporation Ltd.

Since the limits prescribed under section 372A of the Companies Act, 1956 is likely to be exceeded as a result of the proposed investment, this special resolution is commended for approval.

Shri AB and Shri AC being the directors of the Company may be deemed to be concerned or interested in these resolutions.

II. Authority to directors to invest in shares of a company to be promoted

RESOLVED THAT pursuant to section 372A and other applicable provisions, if any, of the Companies Act, 1956, and subject to such other consents, as may be necessary in law, sanction be and the same is hereby accorded to the Board of directors of the Company for making investment by the Company of a sum not exceeding Rs. 200.00 Lacs by subscription to and/or purchase of equity shares to be issued and allotted by a new company proposed to be promoted by the Company with the object to manufacture of tyres and allied products, even though such investment may be in excess of the percentages prescribed by the rules and the Board of directors of the Company be and is hereby authorised to determine the actual sum, subject as aforesaid, to be so invested and any matters arising out of and incidental to the said investment.

Explanatory Statement

The Company has been granted a Letter of Intent for the manufacture of 1500 M.T. nylon per annum. The project was conceived for implementation through a new company, accordingly it is proposed to implement the project under the separate company, which would be promoted by your Company.

The authorised capital of the new company is proposed at Rs. 200.00 Lacs divided into 20 Lacs Equity Shares of Rs. 10 each. The Foreign Collaboration arrangements for technical know-how and equity participation are under discussion.

It is proposed to invest a sum not exceeding Rs. 125.00 Lacs which would be about 75% of the issue of the equity shares as visualised at present. The foreign collaborator will subscribe not exceeding 25% of the initial equity issue.

Since, the proposed investment will be in excess of the prescribed limits, approval of the shareholders is required to the said investment.

Your directors commend the resolution for acceptance by the members. None of the directors is interested in this resolution.

III. Authority to give loans and make investments in other bodies corporate

RESOLVED THAT pursuant to the provisions of section 372(A) of the Companies Act, 1956 and other applicable provisions, if any of the Companies Act, 1956 (including any statutory modification or re-enactment thereof for the time being in force) and in accordance with the provisions of Articles of

Association of the Company and subject to further approval of statutory and other authorities as may be necessary and subject to such terms, conditions, stipulations, alterations, and modifications, if any, as may be prescribed and specified by such authorities while granting such approvals and which may be agreed by the Board of directors of the Company (hereinafter referred to as the `Board' which expression shall include a Committee of directors duly authorised in this behalf) the consent of the Company be and is hereby accorded to the Board of directors of the Company to make investments and to provide loan, give securities, guarantee in excess of the 60 % of the aggregate of the paid-up share capital and free reserves and/or upto 100% of the aggregate of free reserves of the Company as per the limits prescribed under section 372(A) in the following bodies corporate as they may in their absolute discretion deem beneficial and in the interest of the Company subject to the maximum aggregate amount not exceeding Rs. 365.00 Lacs at any time together with the existing loan and investments.

(Rs. in Lacs)

Name of Company	*Investment*	*Loan*	*Total*
RWPL	85.00	85.00	170.00
PGFL	45.00	—	45.00
KSL	80.00	20.00	100.00
DPWPL	25.00	25.00	50.00
Total	235.00	130.00	365.00

RESOLVED FURTHER THAT the Board of directors of the Company be and is hereby authorised to negotiate the terms, condition, quantum of loan, repayment, interest and other related matters for providing any loan, guarantee and securities to the above said bodies corporate and to do all such deeds and things as may be deemed expedient and necessary to give effect to this resolution.

Explanatory Statement

Your Company proposes to make investment in the Equity Shares and to provide loans to KSAPL, PGFL, KSL and DPWPL, in which one of the directors is interested and other directors are members in that Company. The investment in other Companies may exceed the limits prescribed in section 372A of the Companies Act, 1956.

Section 372A of the Companies Act 1956 requires approval of the shareholders by way of a special resolution for investment in the equity shares of another body corporate beyond the limits specified in the said section.

Looking into the previous business association, your Company proposes to make investment at the face value of Rs. 10 per shares in the Companies as referred in the notice of the meeting and also proposes to provide Loans/Inter-corporate Deposits to them for their financial requirements.

The special resolution set out at item … of the accompanying notice is recommended by the Board for the approval of members.

All the directors of the Company may be considered as interested as a director/member of other body corporate.

Alternate resolution

Authority to make inter-corporate loan

IV. Authority to invest in capital gains bonds

RESOLVED THAT, pursuant to section 372A of the Companies Act, 1956, the Board of directors of the Company be and is hereby authorised to make a loan not exceeding Rs. 500.00 Lacs to M/s ABC Ltd. on the terms and conditions set out in the 'Loan Agreement', a copy of which is placed before the meeting duly initialed by the Chairman (for the purpose of identification).

RESOLVED FURTHER THAT the Board of directors of the Company be and is hereby authorised to do all such acts, deeds and things which are required to give effect to this resolution.

RESOLVED THAT the consent of the Company be and is hereby accorded in terms of Section 372A of the Companies Act, 1956, and subject to such consents and approvals as may be necessary, the Board of Directors of the Company be and is hereby authorised to invest an amount not exceeding Rs. 310 crores in any one or more of the capital gains bonds issued by the institutions/body corporates i.e. National Bank for Agriculture and Rural Development (NABARD) (Formed under NABARD Act, 1981), National Housing Bank (NHB) (Formed under National Housing Bank Act-1987) and Small Industrial Development Bank of India (SIDBI) (Formed under SIDBI Act-1989) for a maximum period of 7 years.

RESOLVED FURTHER THAT the Board of Directors of the Company be and is hereby authorised to do all acts, deeds and things as may be required or considered necessary or incidental for making investment in the aforesaid capital gains bonds including signing of appropriate application forms etc. for giving effect to the above resolution.

Explanatory Statement to the above Resolution

The Company has sold its Tractors, Engines and Gears divisions at Mandideep, Alwar and Parwanoo respectively ("**Divisions**") by way of a "slump sale" (as defined under Section 2(42C) of the Income Tax Act, 1961) on a 'going concern' basis for a total consideration of Rs.310 crores to TAFE Motors and Tractors Limited (TMTL).

The profit/gain arising from the slump sale shall be taxed as long-term capital gain @ 20% plus surcharge @ 10% plus education cess @ 2%. The total effective rate on long-term capital gain is 22.44% [section 112(1)(*b*) of Income Tax Act, 1961]. In case the amount of long term capital gain arising on slump sale or part thereof is invested in specified assets within six months from the date of transfer of the divisions, then the long term capital gains will not be subject to tax to the extent it is invested in specified assets.

In view of the above, it is proposed to invest an amount not exceeding Rs. 310 crores in any one or more of the capital gains bonds issued by the following institutions/body corporates:

(*a*) National Bank for Agriculture and Rural Development (NABARD) (Formed under NABARD Act, 1981) for a maximum period of 7 years @ 5.20% to 5.30%;

(*b*) National Housing Bank (NHB) (Formed under National Housing Bank Act, 1987) for a maximum period of 7 years @ 5.20% to 5.30%; and

(*c*) Small Industrial Development Bank of India (SIDBI) (Formed under SIDBI Act, 1989) for a maximum period of 7 years @ 5.20% to 5.30%.

The investment for an amount not exceeding of Rs.310 crores in the specified assets viz. capital gains bonds is in excess of the limits as specified under Section 372 A of the Companies Act, 1956 and requires approval of the Shareholders.

Your Board recommends the passing of this special resolution in the interests of the Company.

None of the Directors is interested or concerned in the passing of the resolution.

Appendix 3

Specimen of format for Register of loans and investment and giving guarantees and providing securities

Sl. No.	*Date of entry in the Register*	*Name and address of the body corporate*	*Amount of Loan/ Invest-ment/ security or guarantee*	*Purpose & nature of the Loan/ Invest-ment/ guarantee & security*	*Terms and condi-tions thereof*	*Date on which loan or investment has been made*	*Date on which guarantee/ security has been provided*	*Date of the resolution authoris-ing and authority thereof*	*Date of disposal of loan/invest-ment or discharge of guarantee/ security*	*Rem-arks*

Chapter 2

Loan to Directors

Synopsis

Important Provisions at a Glance

Sl. No.	*Sections*	*Matters dealt with*	*E-Form Nos.*
1.	295	Making of loans, or to give guarantee or to provide security to directors or their related parties.	
2	295	Application for approval to the Central Government for providing loan, or giving guarantee or security by the public limited company to directors and related parties	24AB
3.	296	Section 295 to apply to book debts in certain cases.	
4.	372A	Inter-corporate loans and investments.	

1. Restrictions on providing loan to a director or to a person connected with a director

Section 295 put restrictions on a public company or a private company being a subsidiary of a public company intending to make any type of transaction with a director of the company or partner or relative of a director, etc. whether, directly or indirectly to make any loan, or to give any guarantee, or to provide any security in connection with a loan made by any other person to, or to any other person by, and it calls for obtaining the previous approval of the Central Government.

Section 295 provides that:

(1) Save as otherwise provided in sub-section (2) no company (hereinafter in this section referred to as "the lending company") without obtaining the previous approval of the Central Government in that behalf shall, directly or indirectly, make any loan to, or give any guarantee, or provide any security in connection with a loan made by any other person to, or to any other person by,—

(*a*) any director of the lending company, or of a company which is its holding company, or any partner, or relative of any such director;

(*b*) any firm in which any such director or relative is a partner;

(*c*) any private company of which any such director is a director or member;

(*d*) any body corporate at a general meeting of which not less than twenty-five per cent of the total voting power may be exercised or controlled by any such director, or by two or more such directors, together; or

(*e*) any body corporate, the Board of directors, managing director or manager whereof is accustomed to act in accordance with the directions or instructions of the Board, or of any director or directors, of the lending company.

(2) Sub-section (1) shall not apply to—

(*a*) any loan made, guarantee given, or security provided—

(*i*) by a private company unless it is a subsidiary of a public company, or

(*ii*) by a banking company;

(*b*) any loan made by a holding company to its subsidiary company;

(*c*) any guarantee given, or security provided by a holding company in respect of any loan made to its subsidiary company.

(3) Where any loan made, guarantee given, or security provided by a lending company and outstanding at the commencement of this Act could not have been made, given or provided, without the previous approval of the Central Government, if this section had then been in force, the lending company shall, within six months from the commencement of this Act or such further time not exceeding six months as the Central Government may grant for that purpose, either obtain the approval of the Central Government to the transaction or enforce the repayment of the loan made, or in connection with which the guarantee was given or the security was provided, notwithstanding any agreement to the contrary.

(4) Every person who is knowingly a party to any contravention of sub-section (1) or (3), including in particular any person to whom the loan is made or who has taken the loan in respect of which the guarantee is given, or the security is provided, shall be punishable either with fine which may extend to fifty thousand rupees or with simple imprisonment for a term which may extend to six months:

Provided that where any such loan, or any loan in connection with which any such guarantee or security has been given or provided by the lending company, has been repaid in full, no punishment by way of imprisonment shall be imposed under this sub-section; and where the loan has been repaid in part, the maximum punishment which may be imposed under this sub-section by way of imprisonment shall be proportionately reduced.

(5) All persons who are knowingly parties to any contravention of sub-section (1) or (3) shall be liable, jointly and severally, to the lending company for the repayment of the loan or for making good the sum which the lending company may have been called upon to pay in virtue of the guarantee given or the security provided by such company.

(6) No officer of the lending company or of the borrowing body corporate shall be punishable under sub-section (4) or shall incur the liability referred to it sub-section (5) in respect of any loan made, guarantee given, or security provided after the 1st day of April, 1956 in contravention of clause (*d*) or (*e*) of sub-section (1) unless at the time when the loan was made, the guarantee was given, or the

security was provided by the lending company, he knew or had express notice that clause was being contravened thereby.

2. Applicability

Section 295 is applicable to a public company or a private company, which is a subsidiary of a public company. Therefore, a private company shall be exempted from the provisions of section 295 of the Act.

3. Exemption

Following companies are exempted from provisions of section 295 and these companies can give loan to their directors without the approval of Central Government:

(*a*) Private Company which is not a subsidiary of public company;

(*b*) Banking Company;

(*c*) Government Company'

(*d*) Loan made by holding company to its subsidiary company;

(*e*) Guarantee given or security provided by holding company in respect of any loan made to its subsidiary company.

4. Persons covered under section 295

The section has wider scope and any transaction with the following types of persons by a public company or a private company which is a subsidiary of a public company shall be within the purview of section:—

(*a*) any director of the lending company;

(*b*) any director of the holding company;

(*c*) any partner of any such director;

(*d*) any relative of any such director;

(*e*) any firm in which any such director is a partner;

(*f*) any firm in which a relative of such a director is a partner;

(*g*) any private company of which any such director is a director;

(*h*) any private company of which any such director is a member;

(*i*) any body corporate of which not less than 25% of the total voting power may be exercised or controlled at a general meeting by any director or by two or more directors together; and

(*j*) any body corporate, the Board of directors, managing director or manager whereof is accustomed to act in accordance with the directions or instructions of the Board, or of any director or directors, of the lending company.

5. Restrictions apply only at the time of entering into the transaction

The section is applicable only at the time of granting the loan and any change in circumstances thereafter will not make the section applicable. Thus, section 295 will not be attracted in respect of a loan given to an employee, who does not fall within the ambit of specified persons as listed above, but who subsequently becomes a member of the Board, because at the time of the loan, no contravention was involved.

If the private limited company which is not a subsidiary of a public limited company has given loan/guarantee or security provided to any of the person as mentioned above and later such private limited company is converted into public limited company, the loan/guarantee given or security provided is exempted from the provisions of section 295 even after it ceases to be a private limited company. Once, the company becomes public limited company, it cannot give further loan without complying the provisions of section 295.

6. Non-applicability of the provisions of section 295

Any transaction of making any loan or giving any guarantee or providing any security in connection with a loan made by any other person to, or to any other person will not apply on:—

1. any loan made to an employee of the company, who is not a relative of any director;

2. any loan or advance made to a trust in which directors are trustees;
3. any quasi-loan;
4. any advance or deposit made in connection with leasing/hire-purchase transaction;
5. any advance payment of salary given to an employee who is a relative of a director as per the rules of the company;
6. any investment made in acquiring residential accommodation for director(s) (whether by way of purchase or entering into a lease agreement);
7. house building loan given to a director subject to the guidelines issued for that purpose by the Central Government;
8. any loan made to a Registered Co-operative Society;
9. any loan given by a holding company to any director of its subsidiary company;
10. advance given for services to be rendered or goods to be supplied provided it is reasonable and commensurate with the services to be rendered or goods to be supplied;
11. section 295(1) does not apply to a government company provided that such company has obtained the approval of the Ministry or Department of the Central Government, which is administratively in charge of the company, or as the case may be or the State Government.

7. Transaction relating to the nature of book-debts

Section 296 provides that restrictions of section 295 shall apply to any transaction represented by a book-debt, which is in the nature of a loan or advance from its inception. However, this section is not applicable to:—

(*a*) any loan made, guarantee given or security provided in connection with a loan—
- — by a private company;
- — by a banking company.

(*b*) any loan made by a holding company to its subsidiary;

(*c*) any guarantee given or security provided by a holding company in respect of any loan made to its subsidiary;

(*d*) any housing loan to a managing director/whole-time director, on such terms and conditions as are applicable to its officers/employees;

(*e*) deposit with banking companies.

8. Requirement of approval of the Board of directors and the members

The transactions also require the appropriate approvals of the Board of directors as per section 292(1) (*e*) in addition to the provisions of section 372A of the Act.

9. Requirement for obtaining previous approval of the Central Government

Previous approval of the Central Government (Ministry of Company Affairs) is required before making any loan or giving any guarantee or providing security in connection with any loan. (Specimen of the application in e-Form 24AB to the Central Government have been given in Appendix 1)

10. Application for approval of the Central Government

The Central Government has prescribed new e-Form 24AB under the Companies (Central Government's) General Rules and Forms, 1956 vide Notification No. GSR 56(E) dated 10th Feb., 2006 for seeking approval of the Government under this section (previously there was no form prescribed for that purposes). However, all the necessary information and disclosure should be furnished as per the guidelines issued by the Department and the application will be considered on its merits, having regard to the following points:—

(*a*) purpose for which loan is to be granted;

(*b*) purpose for which guarantee given or security provided;

(*c*) financial position of the borrower and the lending company; and (*d*) other relevant facts and circumstances of the case, such as—

- — whether the lending company possesses surplus funds to lend;
- — whether the loan is secured or not and, if secured, whether the security is adequate and free from encumbrances;
- — whether the rate of interest offered on the loan is reasonable;
- — whether the loan is for a definite period;
- — whether the general financial position of the lending company is satisfactory;
- — whether the individual borrower or the borrowing company or firm, as the case may be, is fully solvent; and
- — if the borrower is a company, whether it has a good profit record.

It should be noted that no approval for the grant of loan to any director would be given by the Central Government for the purchase of furniture.

11. Enclosures

The application has to be submitted with following enclosures in the PDF files:

(1) Copy of the Board resolution indicating the proposal of the company, terms and conditions, interest of directors or relatives, if any, specifying rate of interest chargeable, the schedule and terms of repayment, the loan is not being made out of borrowed funds of the company.

(2) Any other major or important condition having bearing on the loan or financial position of the company.

(3) A declaration that company has not defaulted in making repayments to the investors as and when they become due to them.

(4) Copy of draft loan agreement.

(5) Declaration to the effect that funds proposed to be loaned are not required for its working capital requirements at least for a year.

(6) A declaration from the statutory auditor or a company secretary in whole-time practice that:—

(*a*) The company has not defaulted in:

- — The repayment of any fixed deposits or part thereof or interest thereon;
- — Payment of dividend;
- — Redemption or repayment of debenture and timely payment of interest thereon;
- — Redemption of preference shares; and

(*b*) The company is regular in filing all e-forms or returns as required to be filed under the Companies Act, 1956;

(*c*) The proposal is in conformity with the provisions of section 372A of the Companies Act, 1956;

(*d*) The company is not in any default on account of undisputed dues of the Central Government *e.g.* income tax, central excise etc. For this purpose, the status of disputed and undisputed dues shall be made available so as to enable the Ministry to form a view in the matter *vis-a-vis* the coverage thereof available and assessed against the Net Worth/Profits of the applicant company.

(7) Copy of member resolution containing specific approval of required members along with explanatory statement.

(8) List of directors of board of both the companies and disclosing inter-se interest if any.

(9) Copy of loan scheme for the employees of the company, if any.

(10) No objection certificate (NOC) or prior approval of public financial institutions or banks in case any term loan is subsisting.

(11) Copy of letter from bank or financial institutions wherein the company has been asked to furnish corporate guarantee or security for the loan sanctioned to the borrower company.

(12) Shareholding pattern of applicant and borrowing company.

(13) Certified copy of the Memorandum and Articles.

(14) Certified copy of the balance sheet and profit and loss account of the company for last three financial years.

12. Fees and mode of payment

The fees is payable on the application depending upon the authorised share capital of the company as per the Companies (Fees on Applications) Rules, 1999.

13. Guidelines issued by the MCA

(*i*) The rate of interest proposed on the loan should not be less than four percent above the prevailing bank rate being the standard rate made public under section 49 of the Reserve Bank of India Act, 1934.

(*ii*) The quantum of loan along with other loans taken, if any, should not exceed 25 times of gross salary drawn in the preceding six months prior to making of the application.

(*iii*) No guarantee commission shall be allowed to be paid to any one in respect of the proposals.

14. Pre-certification

e-Form 24AB is required to be pre-certified by any professional viz chartered accountant, company secretary cost accountant, in whole time practice before filing with the MCA.

15. Records

1. Copy of the application with necessary annexure.
2. Letter of approval letter received from the Central Government.
3. Minute's books.
4. Document evidencing payment of fees and filing of the application.

16. Secretarial checklist for making loan to directors

Check whether exempting provisions contained in sub-section (2) of section 295 of the Act are applicable. If not, check whether:—

1. any loan has been made to:—
   (*a*) any director of the lending company;
   (*b*) any director of the holding company;
   (*c*) any partner of any such director;
   (*d*) any relative of any such director;
   (*e*) any firm in which any such director is a partner;
   (*f*) any firm in which a relative of such director is a partner;
   (*g*) any private company of which any such director is a director or member;
   (*h*) any body corporate of which not less than 25% of the total voting power is exercised or controlled at a general meeting by any director, or by two or more directors together;
   (*i*) any body corporate, the Board of directors, managing director or manager whereof is accustomed to act in accordance with the directions or instructions of the Board, or of any director or directors of the lending company;
2. the previous approval of the Central Government has been obtained for making any loan (except housing loan to a managing director, made in accordance with the terms and conditions applicable to its officers, employees) to the director;
3. no loans, etc. were provided in contravention of the provisions of this section and the guidelines made by the Central Government in this regard;
4. approval of the Central Government is obtained after the lending company ceases to be an exempted company in respect of all future loans, guarantees and security given in connection with a loan or any renewals of earlier transactions;

5. provisions of sections 292 and 372A are complied with, if applicable;
6. necessary entries are made in the Register of Loans;
7. the requisite resolutions are recorded in the minutes of Board/Committee meeting, etc.

17. Person liable

All persons who are knowingly parties to the contravention and any person to whom the loan is made and any person who has taken the loan in respect of which the guarantee is given or the security is provided.

18. Consequences for contravention of section 295

In case of any contravention of the provisions of section 295 of the Companies Act, 1956 all persons who are knowingly party to any contravention; any person to whom the loan is made and any person who has taken the loan in respect of which the guarantee is given or the security is provided shall be punishable:—

(*a*) with fine which may extend to fifty thousand rupees or with simple imprisonment for a term which may extend to six months.

However, no punishment by way of imprisonment shall be imposed under sub-section (4) of section 295 of the Act where any loan, or any loan in connection with which any guarantee or security has been given or provided by the lending company, has been repaid in full. Where the loan, or any loan in connection with which any guarantee or security has been given or provided by the lending company, has been repaid in part, the maximum punishment, which may be imposed under this sub-section by way of imprisonment shall be proportionately reduced;

(*b*) all persons who are knowingly parties to any contravention shall be jointly and severally liable, to the lending company for the repayment of the loan or making good the sum which the lending company may have been called upon to pay by virtue of the guarantee given or the security provided by such company.

No person shall be liable or punishable under sub-section (4) or (5) of section 295, unless at the time when the loan was made, the guarantee was given or the security was provided by the lending company, he knew or had express notice that there was any contravention under clause (*d*) or (*e*) of sub-section (1) of section 295 of the Act;

(*c*) office of the director shall be deemed to be vacated as per provisions of section 283(1)(*h*) of the Act.

19. Compounding of offence

The offence committed under this section is compoundable in accordance with the provisions of section 621A of the Act.

20. Loans to directors of holding or subsidiary company

In order to make any loan to or give any guarantee or provide any security in connection with a loan made by any other person to, or to any other person by any director of the company's holding company, previous approval of the Central Government is required.

However, previous approval of the Central Government as envisaged by section 295(1) is not required in case a holding company intends to make any loan to a director of its subsidiary company.

21. Disclosures in the Balance Sheet, etc.

As prescribed under Schedule VI to the Act, a company is required to make the following disclosures separately:—

(*a*) Debts due by directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or private companies respectively in which any director is a partner or a director or a member.

(*b*) The maximum amount due by directors or other officers of the company at any time during the year.

22. Exemption in respect of house building loans to the managing and/or whole-time directors

The Central Government has, *vide* its Press Note No. 4/93, dated 20-8-1993, permitted companies to grant loans to their managing and whole-time directors for house building purpose. The text of the Press Note is furnished below:—

(*i*) Section 295 of the Companies Act, 1956 prohibits a public company and a private company, which is a subsidiary of a public company from making a loan to its directors, etc., without prior approval of the Central Government. This Department has formulated guidelines for the grant of house building loans by such companies to their managing and/or whole-time directors. The existing guidelines envisage grant of house building loan upto a ceiling of Rs. 5.00 lakhs on payment of interest @ 10% per annum.

(*ii*) Various Associations of Trade and Industry have been making requests/representations for increasing the ceiling of house building loans and the companies have also been making applications for grant of house building loans of Rs. 10.00 lakhs or more at the reduced rate of interest, as per schemes applicable to the other officers of the company. In view of the increasing cost of land, construction and also the upward revision in the remuneration of managerial personnel of the companies, the current ceiling on house building loan of Rs. 5.00 lakhs has become out-dated and needs revision.

(*iii*) The Government has, therefore, decided to allow the companies to make house building loans to their managing and/or whole-time directors without obtaining prior approval of the Central Government under section 295 of the Companies Act, 1956 on such terms and conditions as are applicable to its officers/employees. The approval of the Central Government will, however, be necessary in the case of companies having no such scheme or where the house building loan proposed to be made is not covered by the terms and conditions as are applicable to its officers/employees.

23. Director standing as surety for outsider against whom prosecution was launched whether *ultra vires* the company

This Department is of the view that the action of the director in furnishing the company's surety to an outsider (*i.e.* one not connected with the company's administrative structure) is *ultra vires* the company. The directors of companies are hence advised that they should not expose themselves and the companies of which they are directors to the risk of standing sureties in the circumstances described for accused persons. This Department is of the view that by doing so the director may be held personally liable for having acted outside the scope of the company's authority and in a manner prejudicial to the interests of the companies concerned. [*Source*: Circular No. 37/75 (F. No. 14/5/74-CL.V), dated 17 January, 1976].

Appendix 1

Specimen of e-Form 24AB

Form for filing application for giving loan, providing security or guarantee in connection with a loan

[Pursuant to section 295 of the Companies Act, 1956]

Note.—All fields marked in * are to be mandatorily filled.

1. (*a*)*Corporate identity number (CIN) of company	XXXXXXXXXXXX
(*b*) Global location number (GLN) of company	
2. (*a*) Name of the company	AB WIRES LTD.
(*b*) Address of the registered office of the company	123, DHENU MARKET, INDORE (M.P.) 452003

3. Working results of the company for the last three financial years

(*a*) (*i*) FY1 From 01/04/2003 (DD/MM/YYYY)

To 31/03/2004 (DD/MM/YYYY)

(*b*) Net profit under section 198 4,98,00,000

(*a*) (*ii*) FY2 From 01/04/2004 (DD/MM/YYYY)

To 31/03/2005 (DD/MM/YYYY)

(*b*) Net profit under section 198 5,60,00,000

(*a*) (*iii*) FY3 From 01/04/2005 (DD/MM/YYYY)

To 31/03/2006 (DD/MM/YYYY)

(*b*) Net profit under section 198 7,50,00,000

4. (*a*) *Amount of loan or security or guarantee (in Rs.) 1,00,00,000

(*b*) * Indicate the sub-section of section 295 of the Act under which the application is made (2)(*c*)

(*c*) * Details of the proposal mentioned in the application.

Application for approval for providing loan of Rs.100.00 Lacs to M/s Swaraj Technocrafts Pvt. Ltd., in which Shri SC, the director of the company is also member and director.

5. * Justification for the proposal.

The company is having close business association with the Swaraj Technocrafts Pvt. Ltd., as it is carrying job work for the company since past two years and it needs long term financial resources to increase the machining capacity to fulfill the requirement of the company for timely supply and quality of products. Since the company is not having adequate property to provide security to the Banks and financial institutions, whereas the company is having adequate surplus funds, therefore, if the company provides financial support by way of making loan to Swaraj Technocrafts Pvt. Ltd., it will be in the interest of the company.

6. (*a*) * Whether the loan will be backed by guarantee ∅ Yes ○ No

(*b*) If yes, give details Personal guarantee of Shri SC, the director of the Company.

7. (*a*) CIN of borrowing company xxxxxxxxxxxxxxxxxxxxxx

(*b*) GLN borrowing company

(*c*) Name of borrowing company SWARAJ TECHNOCRAFTS PVT.LTD.

(*d*) (*i*) common interest in shareholding pattern of the applicant company

Shri SC, the director of the Company who is holding 27% shares in the Company.

(*ii*) controlling interest in shareholding pattern of the applicant company

Shri SC is having 27% shares in the company, and is the biggest shareholder as well as promoter director and the chairman cum managing director of the applicant company.

(*iii*) common interest in shareholding pattern of the borrowing company

Shri SC, the director of the company is also holding 51% shares in the Swaraj Technocrafts Pvt. Ltd.

(*iv*) controlling interest in shareholding pattern of the borrowing company

Shri SC is having 51% shares in the company, and is the biggest shareholder as well as promoter director of the applicant company.

8. (*a*) Name of the borrowing firm

(*b*) Address of the borrowing firm

(*i*) Address Line I

Line II

(*ii*) City

(*iii*) State

(*iv*) Country

(*v*) Pin code

9. Detail of loan given or corporate guarantee or security provided to any company or person or firm etc. so far under section 295 along with details thereof and proof of compliance of section 372A wherever applicable.

The Company has not previously given any loan under section 295 of the Companies Act, 1956.

Attachments

1.	* Copy of Board of directors resolution indicating (*i*) The proposal of the company, terms and conditions (*ii*) Interest of directors or relatives, if any (*iii*) Rate of interest chargeable (*iv*) The schedule and terms of repayment (*v*) The loan is not being made out of borrowed funds of the company (*vi*) Any other major or important condition having bearing on the loan or financial position of the company.	Attach	
2.	Copy of member resolution containing specific approval of required members along with explanatory statement.	Attach	
3.	*A declaration that company has defaulted in making repayments to the investors as and when they become due to them.	Attach	
4.	List of directors of board of both the companies and disclosing *inter se* interest if any.	Attach	
5.	*Copy of draft loan agreement.	Attach	
6.	*Declaration to the effect that funds proposed to be loaned are not required for its working capital requirements at least for a year.	Attach	
7.	Copy of loan scheme for the employees of the company, if any.		
8.	*A No objection certificate (NOC) or prior approval of public financial institutions or banks in case any term loan is subsisting.		
9.	A declaration from the statutory auditor or a company secretary in whole-time practice that: (*a*) The company has not defaulted in: (*i*) The repayment of fixed deposit (*ii*) Payment of dividend (*iii*) Redemption or repayment of debenture and timely payment of interest thereon (*iv*) Redemption of preference shares, and (*b*) The company is regular in filling all forms or returns as required to be filed under the Companies Act, 1956. (*c*) The proposal is in conformity within the provisions of the section 372A of the Companies Act, 1956.	Attach	

	(*d*) That the company is not in any default on account of undisputed dues of the Central Government, *e.g.* income tax, central excise, etc.		
10.	Copy of letter from bank or financial institutions wherein the company has been asked to furnish corporate guarantee or security for the loan sanctioned to the borrower company.	Attach	
11.	Shareholding pattern of applicant and borrowing company.	Attach	

Declaration

To the best of my knowledge and belief, the information given in this application and its attachments is correct and complete.

I have been authorised by the board of directors' resolution dated * 15/04/2006 (DD/MM/YYYY) to sign and submit this application.

To be digitally signed by

Managing director or director or manager or secretary of the company **SC**

Certificate

It is hereby certified that I have verified the above particulars from the books of account and records of M/s ABC Wires Ltd. and found them to be true and correct.

To be digitally signed by

Chartered accountant or cost accountant or company secretary in whole-time practice **D.K. Jain**

For office use only

Digital signature of the authorizing officer

This e-Form is hereby approved

This e-Form is hereby rejected

Appendix 2

Instances relating to loans to concerns in which directors are interested

A public company belonging to a well known management group advanced a large sum free of interest to one of its directors and his relative without obtaining the approval of the Central Government under section 295. It was asked to explain the irregularity. In its explanation the company contended that the advances were made to these persons in connection with the company's business, as in their capacity as employees of the company, they were required to purchase stores, spare parts, etc. on behalf of the company and to incur expenses on traveling on company's business. It appeared that all such advances could hardly be considered as having been made for the purposes of the business of the company as the amount involved was large and remained unadjusted for quite a long time. Since, however, the company subsequently realised all the outstanding amounts, no penal action was taken against the company, but it was informed that its action had been irregular and improper. It was noticed that some companies continued to keep excessive amount of money in current accounts with firms of bankers and with charitable trusts in which some of the directors were directly or indirectly interested, or concerned, instead of keeping their balances with scheduled banks, thus, rendering it possible to advance loans or make investments, in violation of the spirit, if not in letter, the provisions of sections 295 and 372. [*Source*: The Sixth Annual Report on Working and Administration of the Companies Act, 1956, for the year ended 31 March, 1961].

A public company sought the approval of the Government under section 295 to make loans to third parties through a firm of which one of the company's directors was the sole proprietor, on the ground that it wishes to earn higher interest on its surplus capital till such time as certain items of machinery for a project sponsored by the company had been imported. When the company was asked to clarify certain points relating to its application, the Department was informed that the loans would be made through the sole proprietary firm mentioned above to some members of a stock exchange against the security of the shares of certain well established companies, and that two of the company's directors would assume full responsibility for keeping the loan accounts duly secured, and also for making good the advances in case of failure on the part of the individual loanees. The company could not furnish the audited accounts of the sole proprietary firm. In the absence of any satisfactory evidence of financial worth of either the sole proprietary firm or of the two directors, and having regard to the peculiar nature of the proposal in which the names of ultimate loanees were not disclosed to the Government, the company's proposal was rejected. [*Source*: The Fifth Annual Report on Working and Administration of the Companies Act, 1956, for the year ended 31 March, 1961]

In another case, the practice of keeping deposits with banking firms in which directors of the company were interested as partners was noticed. This practice is followed ostensibly as a device for channeling the funds of companies, in which the public are substantially interested, to those in which the directors are interested in their personal capacity. It is also used to circumvent the provisions of section 295 as such transactions may not always be regarded as "loans" within the meaning of that section. [*Source*: The Fourth Annual Report on Working and Administration of the Companies Act, 1956 for the year ended 31 March, 1960]

A public company in West Bengal with a paid-up capital of Rs. 1.59 lakhs whose principal object was to carry on the business of electricity supply sold off its entire assets, except some land, to the State Government for an amount of Rs. 3 lakhs, on the revocation of its licence under the Indian Electricity Act. After meeting its liabilities the company proposed to lend the balance of the amount, to a private limited company owned by the directors of the public company. As the proposed loan attracted the provisions of section 295(1)(*c*), the company had to obtain the prior approval of the Central Government for making the loan. During the scrutiny of the company's application, it was noticed that the financial position of the private company was bad; it had accumulated losses to the extent of Rs. 2.11 lakhs and had lost its entire paid-up capital and the loan capital amounting to Rs. 2.09 lakhs. If the public company had been allowed to make the proposed loan, the amount would not only have been allowed to be blocked up for an indefinite period but also there was every possibility of the money being lost. The Central Government, therefore, rejected the application of the company. During the scrutiny of the balance sheets of some companies belonging to a certain group in Rajasthan, it was noticed that seven bodies corporate belonging to the group had formed two private limited companies and had made loans to these two companies. These two companies had in their turn lent funds to a partnership firm owned by the principal members of the group. The composition of the boards of the private companies was so arranged that the loans from the public companies would not attract the provisions of section 295. By this device, the provisions of section 295 were cleverly circumvented. A direct loan from the public companies to the partnership firm would have attracted section 295(1)(*b*). [*Source*: The Third Annual Report on Working and Administration of the Companies Act, 1956, for the year ended 31 March, 1959].