

FUNDING FROM COMPANY TO COMPANY-

SERIES NO I36

CONTENT OF ARTICLES

Provisions for Lender Company

- A. Section Involved
- B. Rules Involved
- C. Circulars Involved
- D. Forms/Resolution Involved
- E. Ways of Investment
- F. Provisions applicable

Provisions for Receiver Company

- A. Provisions applicable

BACKGROUND:

If Promoters are starting a business (Company) or trying to grow an existing business (Company), all certainly will need money. This money can come from various sources.

SOURCE OF FUNDING:

Roughly speaking, Investments break down into two different forms: **Debt and Equity.**

Debt Funding: Debt means money borrowed from lenders by the company and it pay the

interest on that investment. Companies are required to repay the money with interest over time. Debt include debentures, loans and borrowing etc.

Capital Funding: Company can take on an equity investment - in which Company can sell a portion of the Company to an investor in return for cash or something else of value. Equity funding includes shares (Equity/Preference Shares).

LET'S FIRST DISCUSS ON THE BASIS OF LENDER COMPANY

INVESTMENT:

- As per Rule 2 sub rule 1 clause (c) sub clause (vi) of the Companies (Acceptance of Deposits) Rules, 2014, Deposit doesn't include any amount received by Company from any other Company.
- As per Section 186(2) company can directly or indirectly
 - (a) Give any **loan** to any person or other body corporate;

- (b) Give any **guarantee** or provide **security** in connection with a loan to any other body corporate or person; and
- (c) Acquire by way of subscription, purchase or otherwise, the **securities** of any other body corporate, upto 60% of its paid-up share capital, free reserves and securities premium account or 100% of its free reserves and securities premium account, whichever is more.

WAYS OF FUNDING:

a) LOAN TO OTHER COMPANY (INTER CORPORATE LOAN)

Sections Involved:

- Section 185: Restriction on Loan to Director or other persons include in Director.
- Section 186: Company can directly or indirectly (a) give any loan to any person or other body corporate.
- Section 187: Investment of the Company to be held in its own name.
- Section 188(g) : No Company shall enter into any contract or arrangement with a related party with respect to- underwriting the subscription of any securities, of the Company
- Section 117(3) (a): Every special resolution and resolution passed under Section 179 required to file in e-form MGT-14.
- Section 179(3): The Board of directors of the Company can investments the fund of Company.

Rules Involved:

- Rule 10 of the Companies (Meetings of Board and its Powers) Rules, 2014. ⁽¹⁸⁵⁾
- Refer rules 11, 12 and 13 of the Companies (Meetings of Board and its powers) Rules, 2014. ⁽¹⁸⁶⁾
- Rule 14 of the Companies (Meetings of Board and its Powers) Rules, 2014. ⁽¹⁸⁷⁾
- Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014. ⁽¹⁸⁸⁾
- Rule 24 of the Companies (Management and Administration) Rules, 2014. ^[117(3)]

Circular/Notification Involved:

Circular No.	Particulars
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¹ General Circular No. 03/2014, dated 14-2-2014 ⁽¹⁸⁵⁾⁽¹⁸⁸⁾	This circular was applicable upto the date Section 186 was not notified.
² Circular 04/2015 dated 10 th March, 2015 ^(185/186)	It is clarified in this circular that loans and/or advances made by the Companies to their employees, other than the managing or whole time directors (which is governed by section 185) are not governed by the requirements of section 186 of the Companies Act, 2013. This clarification will, however, be applicable if such loans/ advances to employees are in accordance with the conditions of services applicable to employees and are also in accordance with the remuneration policy, in case where such policy is required to be formulated
³ Circular 15/2014 dated 9 th June, 2014 ⁽¹⁸⁶⁾	It is hereby clarified that registers maintained by Companies pursuant to sub-section (5) of Section 372A of Companies Act, 1956 may continue as per requirements under these provisions and the new format prescribed vide form MBP2 shall be used for particulars entered in such registers on and from 1.4.2014.
⁴ General Circular 06/2015 dated 9 th April, 2015 ⁽¹⁸⁶⁾	It is hereby clarified that in cases where the effective yield (effective rate of return) on tax free bonds is greater than the prevailing yield of one year, three year, five year or ten year Government security closest to the tenor of the loan, there is no violation of sub-section (7) of section 186 of the Companies Act, 2013.
⁵ General Circular No. 30/2014 dated 17-07-2014 ⁽¹⁸⁸⁾	Clarification on Second proviso of 188(1): It is clarified that 'related party' referred to in the second proviso has to be construed with reference only to the contract or arrangement for which the said special resolution is being passed. Thus, the term 'related party' in the above context refer only to such related party as may be related party in the context of the Contract or arrangement for which the said special resolution is being passed.

¹ http://www.mca.gov.in/Ministry/pdf/General_Circular_3_2014.pdf² http://www.mca.gov.in/Ministry/pdf/Circular_04_10032015.pdf³ http://www.mca.gov.in/Ministry/pdf/General_Circular_15_2014.pdf⁴ http://www.mca.gov.in/Ministry/pdf/General_Circular_06_2015.pdf⁵ http://www.mca.gov.in/Ministry/pdf/Circular_No_30_17072014.pdf

G ⁶ eneral Circular No. 28/2014 dated 9-7-2014 (117)	All cases except change of name, change of object, resolution for further issue of capital and conversion of companies will be STP mode.

- ⁷Notification no. G.S.R. 464(E) dated 5th June 2015
- ⁸Notification no. G.S.R. 465(E) dated 5th June, 2015
- ⁹Notification no. G.S.R. 463(E) dated 5th June, 2015
- Word 'resolution' substituted for words 'special resolution' by the Companies (Amendment) Act, 2015 (21 of 2015), notified on 26th May, 2015, with effect from 29th May 2015 vide notification S.O. 1440(E)
- Word 'resolution' substituted for words 'special resolution' by the Companies (Amendment) Act, 2015 (21 of 2015), notified on 26th May, 2015, with effect from 29th May 2015 vide notification S.O. 1440(E).

Resolution Involved:

- For the giving of Loans by the Private Limited Company a **“¹⁰Board Resolution”** shall be passed in the Board Meeting of the Company. Except investment within the ceiling given under Section 186. If limit exceed then Special Resolution required to be pass.
- Board Meeting can be held through video conferencing also.

- b) Investment in Equity Shares
- c) Investment in Preference Shares
- d) Investment in Debenture

PROCESS OF FUNDING FROM THE POINT OF VIEW OF THE LENDER OF MONEY:

INVESTMENT IN FORM OF “LOAN”

I. Whether Company is allowed to invest money in other Company?

⁶ http://www.mca.gov.in/Ministry/pdf/General_Circular_28_2014.pdf

⁷ http://www.mca.gov.in/Ministry/pdf/Exemptions_to_private_companies_05062015.pdf

⁸ http://www.mca.gov.in/Ministry/pdf/Exemptions_to_nidhis_companies_05062015.pdf

⁹ http://www.mca.gov.in/Ministry/pdf/Exemptions_to_govt_companies_05062015.pdf

¹⁰ Board resolution can't be passed by Circular Resolution in case of acceptance of loan.

As per Rule 2 sub rule 1 clause (c) sub clause (vi) of the Companies (Acceptance of Deposits) Rules, 2014, Deposit doesn't include any amount received by Company from any other Company.

Therefore, Company can invest in other Company by any way (Capital or Loan).

II. Whether Loan by a Company to another Company restricted anywhere in the Companies Act, 2013?

Yes, Loan by a Company to its Directors or any other person interested in directors is restricted under Companies Act, 2013.

A. "Loan to Companies fall under Section 185:

As per Section 185: No Company (Private & Public)

- Directly or Indirectly
- Advance any loan, including book debt,
- to any of its **directors** or to any ****other person in whom the director is interested**

Other person in whom the director is interested:

- i. Any private company of which director is a director or member
- ii. Body Corporate in which 25% or more voting power rests with one or more directors
- iii. Body Corporate whose Board accustomed to act on directions of BOD or Directors of lending company.

It is clear from the above mentioned extract provision of Section 185 that, A Company can't give the loan to Director and person in whom the director is interested.

B. No Company, which is in default in the repayment of any deposits accepted before or after the commencement of this Act or in payment of interest thereon, shall give any L, G, S & I till such default is subsisting.

¹¹ ****But after publication of Exemption Notification on Private Limited Companies (Dated 05.06.2015):**

The above restriction will now no longer be applicable to the Private Companies which satisfies **All The 3 Conditions** mentioned below:

- 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 any body corporate is less than [lower of (i) Two times of paid up share capital or (ii) Rs. 50 Crore]; and



III. What is the ceiling of investment by a Company in other Company?

Company can give loan or guarantee or providing any security or the acquisition by Passing of Unanimous Board Resolution at the meeting of Board of Directors, when limit does not exceed:

60% of Paid up share capital + Free Reserve + Security Premium Account

OR

100% of Free Reserve + Security Premium Account

Whichever is more.

General Meeting Approval: Where any Loan & Guarantee or providing any security or the acquisition exceeds the limit mention above then prior approval of Shareholder by passing of Special Resolution requires.

IV. What is mode of resolution required to be passed for investment in other Company?

- ✓ Board Resolution if, investment within the limit mentioned under Section 186
- ✓ Special Resolution if, investment outside the limit mentioned under Section 186

V. Which form required filing for investment in other Company?

- ✓ In case of Passing of *Board Resolution*: MGT-14 required to file by all the Companies except Private Limited Company
- ✓ In case of Passing of *Special Resolution*: MGT-14 required to file by all the Companies

VI. What are the other Conditions Companies are required to follow while investing money in other Company?

- ✓ The Company shall disclose to the member in the financial statement the full particular of L, G, S & I made and purpose for which L, I, G & S Proposed to be utilized.

VII. Whether a company can give interest-free loan?

- ✓ No company can give loans at rate of interest lower than the prevailing yield of one year, three year, five year or ten year Government Security closest to the tenor of the loan.

VIII. Whether there is any other restriction on entering into specified transactions by a company?

- ✓ No company which is in default in the repayment of any deposits accepted before or after 1.4.2014 or in payment of interest thereon, can give any loan or give any guarantee or provide any security or make an acquisition till such default is subsisting. Other restrictions to be kept in mind are:
- ✓ – Company cannot give loan for purchase of its own shares (Section 67).
- ✓ – Section 2(22)(e) of Income Tax Act 1961 which provides that even loan can be deemed to be dividend in certain cases
- ✓ – RBI Act (for provisions relating to NBFC)

IX. What is the procedure for entering into specified transactions?

- ✓ Pass Board resolution in a meeting with the approval of all directors present in the meeting.
- ✓ File return with ROC in Form MGT.14 with copy of Board resolution.
- ✓ Take prior approval of members by special resolution in case the ceiling exceeds specified limits as above.
- ✓ File return with ROC in Form MGT.14 with copy of special resolution.
- ✓ Take prior approval of public financial institutions in case any term loan is subsisting and there is any default in repayment of loans and/or payment of interest or if the total amount of specified transactions is exceeding limit as specified above.
- ✓ Disclosure to be made in the financial statements of the full particulars of the loans given, investment made or guarantee given or security provided and the purpose for which the loan or guarantee or security is proposed to be utilised by the recipient of the loan or guarantee or security.
- ✓ Particulars of loans/guarantees/security/investments to be entered into register maintained for this purpose at the registered office, which shall be open for inspection and extracts may be taken by members on payment of prescribed fee.



INVESTMENT IN FORM OF “CAPITAL INVESTMENT”

I. EQUITY INVESTMENT:

A Company can invest in the equity shares of other Company subject to compliance of the Companies Act, 2013 like:

- a) Provision of Section 179(3), 117(3), 186 as discussed above.
- b) Whether it is mandatory for the Companies to hold securities (investments) in its Own Name?

YES, as per Section 187 “All investment made or held by a Company in any property, security or other asset shall be made and held by it in its own name”.

Except one condition: Company can hold investment in the name of depository when such investments are in form of securities held by the Company as beneficial owner.

- c) Whether investment in shares covered under Related Party Transaction under Section 188?

YES, as per 188(1)(g) “underwriting the subscription of securities or derivatives” covered under related party transaction.

II. PREFERENCE SHARE INVESTMENT:

Conditions for investments in the preference are same like Equity shares. Except: Preference share holders have right to fixed dividend on their investment. This dividend will be income of the lender Company and will be liable for the tax.

III. DEBENTURES INVESTMENT:

Conditions for investments in the preference are same like Equity shares and Loan. Except: Debentures holders have right to fixed rate of interest on their investment. This interest will be income of the lender Company and will be liable for the tax.

LET'S FIRST DISCUSS ON THE BASIS OF RECEIVER COMPANY

a) LOAN FROM OTHER COMPANY (INTER CORPORATE LOAN)

Sections Involved:

- Section- 73: Deposit
- Section 180(1)(c): To Borrow Money
- Section 179(3): The Board of directors of the Company has power to Borrow Money.
- Section 117(3) (a): Every special resolution and resolution passed under Section 179 required to file in e-form MGT-14.

Rules Involved:

- As per Rule 2 sub rule 1 clause (c) sub clause (vi) of the Companies (Acceptance of Deposits) Rules, 2014, Deposit doesn't include any amount received by Company from any other Company. ⁽⁷³⁾
- Rule 24 of the Companies (Management and Administration) Rules, 2014⁽¹¹⁷⁾

Circular/Notification Involved:

- ¹²General Circular No. 04/2014, dated 25-3-2014
- G.S.R. 464(E) dated 5th June 2015- Section 180 not applicable on Private Limited Company.

Resolution Involved:

- For the acceptance of Loans by the Company a "¹³Board Resolution" shall be passed in the Board Meeting of the Company.
- Board Meeting can be held through video conferencing also.
- For the acceptance of Loans by the Company a "Special Resolution" shall be passed in the General Meeting of the Company, if Crossed the limit mentioned under 180(1)(c).

¹² It is clarified that the resolution passed under section 293 of the Companies Act, 1956 prior to 12.09.2013 with reference to borrowings (subject to the limits prescribed) and/or creation of security on assets of the Company will be regarded as sufficient compliance of the requirements of section 180 of the Companies Act, 2013 for a period of one year from the date of notification of section 180 of the Act.

http://www.mca.gov.in/Ministry/pdf/gencircular_042014.pdf

¹³ Board resolution can't be passed by Circular Resolution in case of acceptance of loan.

b) EQUITY SHARES:

Sections Involved:

Common Sections	Right Issue of Shares	Private Placement of Shares
Section 43- Kinds of Share Capital	Section 62 further allotment of shares to existing Shareholders.	Section 42 Private placement of Shares
Section 179(3): The Board of directors of the Company can issue shares.		Section 100-102 Notice for calling of Extra Ordinary General Meeting
Section 46: Share Certificates		

Rules Involved:

Common Rules	Right Issue of Shares	Private Placement of Shares
Rules 3 and 4 of the Companies (Share Capital and Debentures) Rules, 2014	Rules 12 and 13 of the Companies (Share Capital and Debentures) Rules, 2014 AND Rule 14 of the Companies (Prospectus and Allotment of Securities) Rules, 2014	Rule 14 (private placement) of the Companies (Prospectus and Allotment of Securities) Rules, 2014
No Rule		Rule 13 (preferential allotment) of the Companies (Share Capital and Debentures) Rules, 2014
Rules 5, 6 and 7 of the Companies (Share Capital and Debentures) Rules, 2014		Rule 17 of the Companies (Management and Administration) Rules, 2014

Circular/Notification Involved:

- G.S.R. 464 (E) dated 5th June 2015
- ¹⁴Notification no. G.S.R. 465(E) dated 5th June 2015

¹⁴ http://www.mca.gov.in/Ministry/pdf/Exemptions_to_private_companies_05062015.pdf

c) **PREFERENCE SHARES:**

Sections Involved:

Common Sections	Right Issue of Shares	Private Placement of Shares
Section 43- Kinds of Share Capital	Section 62 further allotment of shares to existing Shareholders.	Section 42 Private placement of Shares
Section 179(3): The Board of directors of the Company can issue shares by passing of Board Resolution.		Section 100-102 Notice for calling of Extra Ordinary General Meeting
Section 46: Share Certificates	Section 55 Issue of Preference Shares	Section 55 Issue of Preference Shares

Rules Involved:

Common Rules	Right Issue of Shares	Private Placement of Shares
Rules 3 and 4 of the Companies (Share Capital and Debentures) Rules, 2014	Rules 12 and 13 of the Companies (Share Capital and Debentures) Rules, 2014 AND Rule 14 of the Companies (Prospectus and Allotment of Securities) Rules, 2014	Rule 14 (private placement) of the Companies (Prospectus and Allotment of Securities) Rules, 2014 Rule 13 (preferential allotment) of the Companies (Share Capital and Debentures) Rules, 2014
No Rule		Rule 17 of the Companies (Management and Administration) Rules, 2014
Rules 5, 6 and 7 of the Companies (Share Capital and Debentures) Rules, 2014	Rules 9 and 10 of the Companies (Share Capital and Debentures) Rules, 2014	Rules 9 and 10 of the Companies (Share Capital and Debentures) Rules, 2014

d) **DEBENTURE:**

Sections Involved:

- Section 179(3): The Board of directors of the Company can Issue securities by passing of Board Resolution.
- Section 71: Issue of Debentures.

Rules Involved:

- Rule 18 of the Companies (Share Capital and Debentures) Rules, 2014

PROCESS OF BORROWING FROM THE POINT OF VIEW OF THE RECEIVER OF MONEY:

BORROWING IN FORM OF “LOAN”

- I. Whether Company is allowed to borrow money from other Company, will it be treated as deposit?

As per Rule 2 sub rule 1 clause (c) sub clause (vi) of the Companies (Acceptance of Deposits) Rules, 2014, Deposit doesn't include any amount received by Company from any other Company.

Therefore, Company can borrow money from other Company by any way (Capital or Loan) it will not treat as deposit.

- II. What is the ceiling of borrowing by a Company?

Company can borrow by passing of Board Resolution at the meeting of Board of Directors, when limit does not exceed: 100% of paid up share capital and free reserve.

General Meeting Approval: Where borrowing exceeds the limit mention above then prior approval of Shareholder by passing of Special Resolution requires.

III. Whether Company is allowed to borrow money from Directors/Relative of Directors/ Foreigner, will it be treated as deposit?

As per Rule 2 sub rule 1 of the Companies (Acceptance of Deposits) Rules, 2014, Deposit doesn't include any amount received by Company from any director/relative of director or foreigner. Therefore, Company can borrow money from director/relative of director or foreigner by any way (Capital or Loan) it will not treat as deposit.

IV. What is the process of borrowing?

- Pass Board resolution in a meeting with the approval of all directors present in the meeting.
- File return with ROC in Form MGT.14 with copy of Board resolution.
- Take prior approval of members by special resolution in case the ceiling exceeds specified limits as above.
- File return with ROC in Form MGT.14 with copy of special resolution.

V. What is mode of resolution required to be passed for investment in other Company?

- ✓ Board Resolution if, borrowing within the limit mentioned under Section 180(1)(c).
- ✓ Special Resolution if, borrowing outside the limit mentioned under Section 180(1)(c).

VI. Which form required filing for investment in other Company?

- ✓ In case of Passing of *Board Resolution*: MGT-14 required to file by all the Companies except Private Limited Company
- ✓ In case of Passing of *Special Resolution*: MGT-14 required to file by all the Companies

BORROWING IN FORM OF "DEBENTURE"

Debenture is another form of Loan. Process of issue of Debentures and detailed provisions relating to debentures already discussed in my earlier articles.

BORROWING IN FORM OF "EQUITY/PREFERENCE SHARES"

Process of issue of equity shares by way of Right issue of shares or private placement of shares I have already discussed in earlier issues articles. But will discuss some common question which we should consider before inviting application money.

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- I. Whether Company has excess authorized share capital to issue new equity shares?
First check in the MOA Company should have excess unpaid share capital.
 - II. Whether Company is going to issue shares to existing shareholders or new group of persons?
 - If Company is issuing shares to existing shareholders then go for right issue of shares.
 - If Company is going to issue shares to outsider then prefer private placement of shares.

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