

3. Inter-Corporate Loans and Investments

Requirements for making incorporate loans and investments (Section 372A)

➤ Scope

1. Making any loan to anybody corporate.
2. Acquiring the securities of any other body corporate.
3. Giving any guarantee or providing any security to person who gives a loan to any body corporate or a body corporate which gives a loan to any other person.

➤ Requirements

1. *Approval by board meeting*

- Approval of board is to be obtained prior to making of loan, investment, guarantee or security irrespective of their amount.
- The approval of board shall be obtained by passing a resolution at a board meeting only. Circular resolution under section 289 or a resolution of committee of director is not sufficient.
- Important is that power to make incorporate loans and investments cannot be delegated by a public company. (Section 292(1)(d) or 292(1)(e) not contravention the section 372A).
- All the directors present at the Board meeting must vote in favor of the resolution (unanimous approval)
- No specific notice required to give to director before board meeting about the business relating to making of loan, investment, guarantee or security.

2. *Approval by special resolution*

- Ceiling Limit : higher if the below two amount
 - i. 60% of the aggregate of paid-up capital (Equity +Preference) and free reserves of the company
 - ii. 100% free reserves of the company
- If Ceiling limit is not exceeded than no requirement of special resolution (SR) and if exceeded than the aggregate of loan, investment, guarantee or security already made together with loan, investment, guarantee, or security proposed to be made exceeds the ceiling limit, previous authorization by a SR is required.
- The SR shall be passed in the general meeting (annual or extraordinary)
- The SR passed by postal ballot if the company is public company and the proposed business relates to making of any loan, investment or security.
- The notice of SR must state clearly the following particulars
 - i. The specific limits
 - ii. The particular of other body corporate in which investment to be made.
 - iii. Purpose of making loan, investment, guarantee or security.
 - iv. Specific sources of funding.
 - v. Other relevant details.
- The notice must also specify the specific securities in which the investment to be made. A blanket approval by the shareholders empowering the Board to make loans, investments, guarantee or security up to a certain limit will not be adequate compliances of the provision (Except in the case of guarantee where the resolution may indicate amount on annual base)

3. *Approval of public financial institution*

- The company shall obtain the prior approval of the PFI from which it has taken a term loan.
- The expression 'Public Financial Institution' has been defined under section 4A and includes ICICI, IFCI, IDBI, LIC, and UTI.
- No approval is required if company is not in default of payment or principal or interest in past loan or the aggregate of loans, investment, guarantee or security already made together with loan, investment, guarantee or security proposed to be made does not exceed 60% of the aggregate of paid up share capital and free reserves.
- As such where a company fails to repay the public deposit or interest thereon, on the due date, it may make loan, investment, guarantee or security only after the default has been good.

➤ **Relaxation in conditions**

- The board may give guarantee in excess of the ceiling limit without passing a SR if the following conditions are satisfied:
 - i. Unanimous resolution is passed in a board meeting for giving guarantee.
 - ii. There exist exceptional circumstances which prevent the company from passing a Special resolution.
 - iii. The resolution of board is confirmed within the 12 months in the general meeting of the company or in the annual general meeting held immediately after passing of the board's resolution. Whichever is earlier.

➤ **Non-applicability of section 372A**

1. Section 372A does not apply to investment made in shares allotted by way of right shares. Also investment made in the right shares by a company shall continue to be excluded in future at the time of calculating interoperate loans , guarantee, security or investment already made.
2. Section 372A does not apply to following companies:
 - i. A banking company
 - ii. An insurance company
 - iii. A housing finance company
 - iv. A company established with the object of financing industrial enterprise or providing infrastructure facilities
 - v. A company whose principal business is the acquisition of shares, stock, debentures or other securities
 - vi. A private company.
3. Section 372A shall not apply if –
 - i. Loan is made by a holding company to its wholly owned subsidiary, or
 - ii. Guarantee or security is given by a holding company in respect of a loan made by its wholly owned subsidiary company; or
 - iii. Investment is made by a holding company in its wholly owned subsidiary. (also by virtue of this exemption such investment is excluded in future while calculating of investment already made.)

➤ **Register of incorporation loans and investments [Section 372(5) and (6)]**

- *Contents*

- i. Name of the other body corporate
- ii. Amount, terms and purpose of making loan, investment, guarantee or security.
- iii. Date of making loan, investment, guarantee or security.
- Entries in the register shall be made within 7 days of transaction.
- Register shall be kept at registered office of the company.
- Any member can inspect the register or make or take copy of it.

➤ **Penalty for Contravention of Section 372A**

- If the company not maintain register or any contravention related to register than the company and every officer of the company who is in default shall be punishable with fine of Rs. 5000 plus Rs. 500 for every day till the offence continues.
- For any other provision contravention the company and the officer of the company who is in such default shall be punishable with imprisonment up to 2 years or with fine up to Rs. 50,000. If the loan is repayable in full then no imprisonment and if repayment is in proportion then imprisonment also in proportion of default.

➤ **Points for Practical problem**

- *Investments*: means acquisitions of shares, debentures, convertible debenture, bonds etc. investment in any assets, other than securities are not covered in this section.
- *Free reserves*: means those reserves which as per the latest audited balance sheet, are free for distribution as dividend and includes the balance to the credit of securities premium account but does not include the share application money.
- Capital redemption reserve, sinking fund, provision for taxation and fixed assets revaluation reserve are not free reserves so not include in calculation of free reserves.
- *Body corporate*: include a company incorporated outside India but does not include-
 - i. a corporate sole;
 - ii. a co-operative society registered under any law relating to co-operative societies act;
 - iii. Any other body corporate (not being a company as defined in this act), which the central government may, by notification in the official gazette, specify in this behalf.
- Section 372A shall apply to a public company even though it does not have any share capital.