

Guarantee by Holding Company to Banks with Regard to Its Subsidiary Companies

Bank...
 ons precedent of...
 ndment Request. In case...
 ndment Request of a Bank Guarantee...
 applicable conditions precedent were satisfied...
 e Bank may authorize the renewal of a Bank Guarantee or...
 xceeding the Duration of that Credit Facility, but this shall not be...
 Duration of the entire Credit Facility.

Payments under the Bank Guarantees or Letters of Credit

Each Borrower irrevocably and unconditionally authorizes the
 Request addressed to and considered by the latter to be in
 conditions of the Credit Product under which this request is in
 authorization or confirmation from the Borrower or any other
 that the Borrower disputes the respective Payment
 and without carrying out any investigat
 or the validity, genuineness or
 Bank in relation to th
 Request sh

Section 185 of the new Companies Act, 2013, which is applicable on both private and public companies, prohibits a holding company to provide corporate guarantee as a security to a bank for sanctioning loans to its subsidiary. The Section says: no company shall, directly or indirectly, advance any loan, including any loan represented by a book debt, to any of its directors or to any other person in whom the director is interested or give any guarantee or provide any security in connection with any loan taken by him or such other person. The author through his article also examines the issue of applicability of the Section 185 the Companies Act, 2013 and Section 372A of the Companies Act, 1956, which provide corporate guarantee as a security to a bank for sanctioning loans to its subsidiary. Read on...



CA. Sanjay Lalit

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Giving a corporate guarantee to banks/lenders by a company, other than the borrower, that the loan will be paid back, is a usual practice in the normal course of trade and commerce across the world. By and large, a larger company (often a known flagship or holding or parent company or another related company) will provide corporate

As per the intent of the legislation, there is a restriction for loans to directors, etc., and to any other person in whom the director is interested, which was earlier permitted under Section 295 of the Companies Act, 1956. But in this connection, if there are no common directors in the Board of the Directors of the companies giving corporate guarantee to bank on behalf of its subsidiary company wherein no directors or directors exercise or control of voting power in excess of 25% in the other company, the said corporate guarantees can be provided to any bank.

guarantee to banks/lenders on behalf of a smaller or its subsidiary company that may not be well-known or have developed a relationship with the banks/lenders.

Corporate Guarantee is a written declaration or guarantee of payment made by a known flagship, or holding or parent company, on behalf of its other business entity who would be normally smaller or a subsidiary company. This guarantee to banks is provided in consideration of bankers/vendors providing credit to a business on whose behalf the guarantee is made. A corporate guarantee is a guarantee in which a flagship or holding or parent company agrees to be held responsible for completing the duties and obligations of a smaller/subsidiary company/debtor to banks/lenders, in the event that the smaller/subsidiary company/debtor fails to fulfill the terms of the debtor-lender contract.

Section 185 of the Companies Act, 2013 which was notified on 12th September, 2013, has replaced the old Section 295 of the Companies Act, 1956 which provides loans to the directors. This Section 185 now applies to all companies including private companies too. While under the old provisions of Section 295 of the Companies Act, 1956, private companies had been exempted. So now, both public and private companies cannot give any loans to directors or to persons in whom the director is interested.

Since Section 185 of the new Companies Act, 2013 became effective in September 2013, there is all-round confusion in the banking sector whether a bank on sanction of certain credit facilities to any company can stipulate and corporate guarantee. Can the banks take corporate guarantee of holding

private limited companies while sanctioning certain credit facilities to subsidiaries of any company, in view of the Section 185 of the new Companies Act, 2013?

Detailed analysis of Sections 185 and 186 of the new Companies Act, 2013 and Section 372A of the Companies Act, 1956 gives us the following inputs:

Relevant provisions of the new Companies Act, 2013 are:

Section 185: Loan to Directors, etc.

(The above section is notified and operative with effect from 12th September, 2013.)

(1) Save as otherwise provided in this Act, no company shall, directly or indirectly, advance any loan, including any loan represented by a book debt, to any of its directors or to any other person in whom the director is interested or give any guarantee or provide any security in connection with any loan taken by him or such other person:

Provided that nothing contained in this sub-Section shall apply to:

(a) the giving of any loan to a managing or whole-time director:

(i) as a part of the conditions of service extended by the company to all its employees; or

(ii) pursuant to any scheme approved by the members by a special resolution; or

(b) a company which in the ordinary course of its business provides loans or gives guarantees or securities for the due repayment of any loan and in respect of such loans an interest is charged at a rate not less than the bank rate declared by the Reserve Bank of India.

Explanation: For the purposes of this section, the expression “to any other person in whom director is interested” means:

(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 25% of the total voting power may be exercised or controlled by any such director, or by two or more such directors, together; or

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(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.

Analysis: In accordance with the Section 185 which is notified and operative with effect from 12th September, 2013, no company, whether public or private, can give any loan or provide any security or guarantee in connection with a loan to a director or any other person in whom he is interested. As per the intent of the legislation, there is a restriction for loans to directors, etc., and to any other person in whom the director is interested, which was earlier permitted under Section 295 of the Companies Act, 1956. But in this connection, if there are no common directors in the Board of the Directors of the companies giving corporate guarantee to bank on behalf of its subsidiary company wherein no directors or directors exercise or control of voting power in excess of 25% in the other company, the said corporate guarantees can be provided to any bank. No legislation or statutory enactment can put speed breakers or bottlenecks for the growth of trade and commerce. Because when corporate guarantees are provided to a bank, the bank lends monies in the economic system of the country and that money, is normally used, in the ordinary course of business for productive purposes in the overall growth the economy of the country. The ultimate purpose of Section 185 of the new Companies Act, 2013 is to put additional restrictions on loan to directors only and not on giving of corporate guarantee by the holding company to its subsidiary company if the Boards of Directors are not common. Even under the (old) Section 295 of the Companies Act, 1956, a corporate guarantee by the holding company to its subsidiary company is permissible.

In accordance with the Section 186 which is yet to be notified, this would be relevant Section/Proviso in the future (when this Section is notified or made operative by the Government) in dealing with the matter of loan and investment by company including giving of corporate guarantee by the holding company to its subsidiary company.

Section 186: Loan and Investment by Company

(The above section is yet to be notified and not operative.)

(1) Without prejudice to the provisions contained in this Act, a company shall unless otherwise prescribed, make investment through not more than two layers of investment companies:

Provided that the provisions of this sub-Section shall not affect:

- (i) a company from acquiring any other company incorporated in a country outside India if such other company has investment subsidiaries beyond two layers as per the laws of such country;
- (ii) a subsidiary company from having any investment subsidiary for the purposes of meeting the requirements under any law or under any rule or regulation framed under any law for the time being in force.

(2) No company shall 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,

exceeding 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.

(3) Where the giving of any loan or guarantee or providing any security or the acquisition under sub-Section (2) exceeds the limits specified in that sub-Section, prior approval by means of a special resolution, passed at a general meeting shall be necessary.

(4) The company shall disclose to the members in the financial statement 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.

(5) No investment shall be made or loan or guarantee or security given by the company unless the resolution sanctioning it is passed at a meeting

of the Board with the consent of all the directors present at the meeting and the prior approval of the public financial institution concerned where any term loan is subsisting, is obtained:

Provided that prior approval of a public financial institution shall not be required where the aggregate of the loans and investments so far made, the amount for which guarantee or security so far provided to or in all other bodies corporate, along with the investments, loans, guarantee or security proposed to be made or given does not exceed the limit as specified in sub-Section (2), and there is no default in repayment of loan instalments or payment of interest thereon, as per the terms and conditions of such loan to the public financial institution.

Analysis: In accordance with the Section 186 which is yet to be notified, this would be relevant Section/*Proviso* in the future (when this Section is notified or made operative by the Government) in dealing with the matter of loan and investment by a company including giving of corporate guarantee by the holding company to its subsidiary company. It can be observed that giving of corporate guarantee to bank on behalf of its subsidiary company would be in line with the spirit of the said Section 186, provided the respective companies are ensuring with the various compliances mentioned herein including limits specified in Clause (2), passing of special resolutions, approval of public financial institution if required. The spirit of this new Section 186 is in line with the existing Section 372A of the Companies Act, 1956. As of now, the companies must ensure compliance with the existing Section 372A of the Companies Act, 1956 (which is being reproduced and interpreted herein below) and not this Section 186 of the new Companies Act, 2013, which is yet to be notified.

Section 372A: Inter-corporate Loans and Investments (including giving of Guarantee)

(The above Section 372A is still operative)

(1) No company shall, directly or indirectly:

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

The aforementioned Section 372A of the Companies **Act, 1956 that is still in operation, specifically deals** with inter-corporate loans, giving of any guarantee including corporate guarantee or providing any security and exempts the limits applicable for loans advanced by holding company to its wholly-owned subsidiary.

(c) acquire, by way of subscription, purchase or otherwise the securities of any other body corporate, exceeding 60% of its paid-up share capital and free reserves, or 100% of its free reserves, whichever is more:

Provided that where the aggregate of the loans and investments so far made, the amounts for which guarantee or security so far provided to or in all other bodies corporate, along with the investment, loan, guarantee or security proposed to be made or given by the Board, exceeds the aforesaid limits, no investment or loan shall be made or guarantee shall be given or security shall be provided unless previously authorised by a special resolution passed in a general meeting:

Provided further that the Board may give guarantee, without being previously authorised by a special resolution, if:

- (a) a resolution is passed in the meeting of the Board authorising to give guarantee in accordance with the provisions of this section ;
- (b) there exists exceptional circumstances which prevent the company from obtaining previous authorisation by a special resolution passed in a general meeting for giving a guarantee; and
- (c) the resolution of the Board under clause (a) is confirmed within twelve months, in a general meeting of the company or the annual general meeting held immediately after passing of the Board's resolution, whichever is earlier :

Provided also that the notice of such resolution shall indicate clearly the specific limits, the particulars of the body corporate in which the investment is proposed to be made or loan or security or guarantee to be given, the purpose of the investment, loan or security or guarantee, specific sources of funding and such other details.

(2) No loan or investment shall be made or guarantee or security given by the company unless the resolution sanctioning it is passed at a meeting

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of the Board with the consent of all the directors present at the meeting and the prior approval of the public financial institution referred to in Section 4A, where any term loan is subsisting, is obtained.

Provided that prior approval of a public financial institution shall not be required where the aggregate of the loans and investments so far made, the amounts for which guarantee or security so far provided to or in all other bodies corporate, along with the investments, loans, guarantee or security proposed to be made or given does not exceed the limit of 60% specified in sub-Section (1), if there is no default in repayment of loan instalments or payment of interest thereon as per the terms and conditions of such loan to the public financial institution:

(3) No loan to any body corporate shall be made at a rate of interest lower than the prevailing bank rate, being the standard rate made public under Section 49 of the Reserve Bank of India Act, 1934.

(4) No company, which has defaulted in complying with the provisions of Section 58A, shall, directly or indirectly:

- (a) make any loan to any body corporate;
- (b) give any guarantee, or provide security, in connection with a loan made by any other person to, or to any other person by, any body corporate; and
- (c) acquire, by way of subscription, purchase or otherwise the securities of any other body corporate, till such default is subsisting.

(5) (a) Every company shall keep a register showing the following particulars in respect of every investment or loan made, guarantee given or security provided by it in relation to any body corporate under sub-Section (1) namely:

- (i) the name of the body corporate;
- (ii) the amount, terms and purpose of the investment or loan or security or guarantee;
- (iii) the date on which the investment or loan has been made; and
- (iv) the date on which the guarantee has been given or security has been provided in connection with a loan.

(b) The particulars of investment, loan, guarantee or security referred to in clause (a) shall be entered chronologically in the register aforesaid within seven days of the making of such investment or loan, or the giving of such guarantee or the provision of such security.

(6)---

(7)---

(8) Nothing contained in this Section shall apply:

(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 infrastructural facilities;

(ii) a company whose principal business is the acquisition of shares, stock, debentures 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;

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

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

Analysis: The aforementioned Section 372A of the Companies Act, 1956 that is still in operation, specifically deals with inter-corporate loans, giving of any guarantee including corporate guarantee or providing any security and exempts the limits applicable for loans advanced by holding company to its wholly-owned subsidiary. The intent of the legislation is clear as to exempt limits on inter-corporate loans between holding companies to its subsidiaries and also any guarantee given or any security provided by a holding company in respect of the loan made to its wholly-owned subsidiary. In view of all these related *proviso* of Section 372A of the Companies Act, 1956 that is still in operation, holding or parent company can provide corporate guarantee to banks for the loan being provided to its subsidiary company or other smaller group company.

As on date, Section 372A of the Companies Act, 1956 permits giving corporate guarantee by holding or parent company to the bank for the loan being provided to subsidiary company or other smaller group company by any bank. The statutory provisions of Section 372A of the Companies Act, 1956 specifically deals with inter-corporate loans and exempts loans advanced or Corporate Guarantee by holding company to its wholly owned subsidiary.

It should be undoubtedly noted that no law can ever restrict the smooth flow of trade and commerce or create bottlenecks in the economic growth of any nation. The ultimate objective of any economic legislation like the new Companies Act, 2013 is to facilitate and improve the efficacy of the economic structure of a nation in line with the changing and dynamic requirements of a vibrant Indian economy. But, recently a lot of banks in the country, only on account of a narrow interpretation of Section 185 of the new Companies Act, 2013 stopped taking corporate guarantee as a security as one of security from holding companies for sanctioning loans to its subsidiary. Ultimately, this narrow interpretation has created a speedbreaker or bottleneck in the flow of loaned funds from banks to corporations that can definitely and adversely affect the economic growth of the resources-starved nation like India.

Conclusion

Based on the above analysis of Sections 185 and 186 of the new Companies Act, 2013 and Section 372A of the Companies Act, 1956, even after the effectiveness of Section 185 of the new Companies Act, 2013, the bank can take the corporate guarantee from holding or parent company to the bank for the loan being provided to subsidiary company or other smaller group company in accordance with the existing Section 372A of the Companies Act, 1956, which is operative as of now along with ensuring required compliance with the Section 185 the new Companies Act 2013.

But the company needs to maintain the proper documentation of board resolutions, share holder's resolutions, various compliances mentioned in Section 372A of the Existing Companies Act, 1956, passing of appropriate Special Resolutions with permissible limits, approval of public financial institution if required, and ensure other compliances in accordance with the provisions of existing Companies Act, 1956 and New Companies Act, 1956, to ensure at all times the enforceability of corporate guarantee being given by holding or parent company to the bank for the loan being provided to subsidiary company or other smaller group company.

Even as per recent Circular No. 18/2013 dated 19-11-2013, the Ministry of Corporate Affairs has issued a clarification with regard to applicability of provision of Section 372A of the Companies Act,

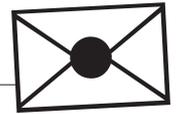
As on date, Section 372A of the Companies Act, 1956 permits giving corporate guarantee by holding or parent company to the bank for the loan being provided to subsidiary company or other smaller group company by any bank.

in case of a Bank Guarantee, the precedent were satisfied to authorize the renewal of a Bank Guarantee Credit Facility, and the Credit Facility, and the Credit Facility.

the Bank Guarantees or Loans are irrevocably and unconditionally accepted to and considered by the Credit Product under which the confirmation from the Financial institution over disputes the

1956 on account of number of representations received consequent upon notifying Section 185 of the Companies Act, 2013 dealing with loans to directors which is corresponding to Section 295 of the Companies Act, 1956. It was candidly clarified in the said Circular that Section 372A of the Companies Act, 1956 dealing with inter-corporate loans continue to remain in force till Section 186, of the Companies Act, 2013 is notified.

Banking industry is advised to review the narrow interpretation of Section 185 and start taking corporate guarantees from the respective holding or parent companies for the credit facilities/loan being provided to subsidiary company or other smaller group company in accordance with the existing Section 372A of the Companies Act, 1956. ■



Welcome Change in Journal

I am happy to see the welcome change in the content selection & quality and the overall look and feel of our journal in the last few months. Both March and April 2014 issues of the journal, which focused on refreshing themes of 'Moving Towards New Frontiers' and 'Women CA Empowerment', were very informative and thought provoking. Particularly, the editorials and President's messages of these issues, complimented the good overall content and presentation. All the articles presented under the new themes were worth preserving for long term reference. I eagerly wait for more such good work in the forthcoming issues of the journal too.

-CA. S. Gulati

President's Messages are Inspiring and Motivating

The president's message of April 2014 issue of the journal, which covered various aspects of the profession, was really motivating to the members and students at large. The ICAI's new initiative regarding its women members is a welcome sign. However, I think that the rate of campus recruitment needs to widely enhanced.

-CA. S. N. Babugovindaraj

It was indeed a pleasure reading through president's views and actions undertaken by the ICAI in March and April 2014 issues of the journal. I request the ICAI to also look into the matter concerning some students who are dropping out of Chartered Accountancy course and strengthen the student counseling mechanism in this regard. I appreciate and welcome the recent upgrading of journal content, look and feel. Keep up the good show.

-CA. Anurag Sureka

Cloud Campus Initiative is Welcome

I welcome the change in look and feel and content selection of the journal. Particularly, the message from the president was indeed inspiring and prompted me to write this letter. Any 'change' needs buy-in & unflinching commitment right at the top. Given our President's commitment to take personal interest in technology led innovations, I sincerely hope that the 'Cloud Campus' dream for CA students soon becomes a reality, obviating the need to attend private coaching classes. I used to work (2006-2008) for a global leader in custom e-learning solutions in a senior position. I was responsible for managing

a portal hosting 160 business simulations accessed by leading universities worldwide. In this course, I used to wish then that if ICAI could also come up with a cloud campus since as a student I never attended private coaching classes but always wished if ICAI could offer comprehensive on-site/online coaching. I look forward to fulfillment of that wish now.

-CA. Jaishankar M. Talreja

Let's Think of Saving Paper

As the time goes by, we have seen the hard copy and print material are getting reduced. As such, I feel it will be good if the journal is sent by email to all the members and only to those who wish to have hard copy should get the hard copy to save paper.

-CA. Arvind V. shah

Corrigendum:

Readers please note that the author of April 2014 issue article titled 'Guarantee by Holding Company to Banks with Regard to Its Subsidiary Company,' Sanjay Lalit, is not a Chartered Accountant but a Chartered Secretary. The error is regretted.

EDITOR

For the Attention of Readers

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