

Section 372A of the Companies Act, 1956
Inter corporate Loan/Investment/Guarantee/ Security

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Section 372A of the Companies Act, 1956 (The Act) deals with inter corporate Loan, Investment, Guarantee and Securities in connection with loan. All the four transactions are frequently taken place in any company and henceforth the section becomes more important and therefore it requires to special heed by virtue of strict penal provisions and because of no much space to play. Here the author has made an attempt to reduce & brief the provisions of section 372A in analytical way which is more handy to remember and apply rather than to describe it in legal language.

Table A

No.	Particular	Rs.
a.	Paid up Capital as per last audited Balance sheet (equity & Preference share capital)	
b.	Free Reserve as per last audited Balance sheet	
c.	Total Rs.	
	60 % of the total at c or 100 % of reserve (b), which ever is higher, (Dead line figure)	

Table B

No.	Transaction covered by sec. 372A	Rs
a.	Loan to any other body corporate including Deposit and debenture	
b.	Guarantee / Security, in connection with loan made by any other person to any body corporate & vice versa	
c.	Security, in connection with loan made by body corporate to any other person & vice versa	
d.	Investment by way of subscription, purchase or other wise in securities of any other body corporate	
	Total Rs.	

If the total of table B is within the deadline figure, Board resolution will do.

If the total of table B is exceeds the dead line figure, the following provisions of the section becomes mandatory to be complied with.

1. A resolution at Board meeting shall be passed in this regard with consent of the all the director present at the meeting. (Power u/s. 372A can not be delegated nor can board resolution be passed by circular.)

Every inter corporate investment/loan/guarantee/security falling within section 372A (even within limit) must be sanctioned by a resolution of the board passed at its meeting. Such decision can not be taken by circular resolution nor can it be delegated by the Board.



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Section 292(1) (d) & (e) permits delegation of power to invest and loan, however S. 372A does not permit. S. 292 is general whereas s. 372A is special in nature. As per settled principle of interpretation, special provision shall prevail over general provisions. The MCA is of the view that in view of the specific provision contained in erstwhile s. 372(5)-corresponding to S. 372A(2), the power of the board under the section can not be delegated – DCA circular No. 48(50)-CL-IV/61 dated 12th February, 1962. However, delegation u/s. 292 is permitted for transactions which are not fall within s. 372A, e.g. loan to Individual/firm/trust/ mutual fund.

2. Prior approval of public financial institution, where any term loan is subsist (this is not necessary, if there is no default in payment of interest and installment as per agreement and proposed amount in aggregate is within the dead line figure).

3. Rate of interest on loan shall not be lower than prevailing bank rate, being the standard rate made public under section 49 of RBI Act, 1934.

4. A special resolution shall be passed at general meeting by giving 21 clear days notice. In case of listed company, resolution shall be passed by following postal ballot procedure pursuant to section 192A of the Companies Act, read with postal ballot Rules.

5. The word used in the section is "Body corporate" and not the "Company". Body Corporate means as defined u/s. 2(7) of the Act. It is inclusive definition. In legal parlance and for the purpose of the section, Body corporate means body having separate legal entity, perpetual existence and common seal.

6. As provided by proviso, Notice of general meeting shall indicate clearly the specific limit, the particular of body corporate in which the investment is proposed to be made or security provided, or guarantee to be given, the purpose of the transaction and specific source of funding.

As per the proviso, all the above details are required to be mention in the Notice convening the general meeting. I am of the opinion that the specific limit and name of the body corporate should be mention in resolution itself and rest of the details can be mentioned in explanatory statement along with other information as required by Section 173 of the Act. Explanatory statement can be considered as part of Resolution and Notice too.

7. Company defaulting in complying section 58A of the Act, pertaining to deposit, can not entered in to, directly or indirectly, in any transaction as covered by section 372A, till such default is subsisting. By this proviso, Legislature has secured compliance of the tricky provisions of section 58A of the Act.

8. A Company shall require to maintain register at registered officer for this purpose by entering prescribed details within 7 days.

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9. In exceptional Circumstances, Board may give guarantee without being previously authorized by special resolution subject to conditions that the Board resolution is confirmed by special resolution within 12 months or forth coming Annual General Meeting, which ever is earlier. This window can be used only for giving guarantee.

10. However it's not clearly mentioned, but by interpreting the wording of the section, it can be said that Guarantee means Guarantee given for Loan to or by any body corporate and it does not includes guarantee given by a company for any borrowing availed for itself.

11. The word used in the section is "Securities", it means as defined under Security (contract & Regulation) Act. It is vide definition and covers also, bond, debenture, script, or any other marketable securities of like nature of body corporate and also derivatives and right & interest in the securities. In this context, it can be inferred that warrant / instrument convertible in to shares is also comes under the net of the Section 372A.

12. **Investment in Mutual Fund & Govt. Securities** are falls outside Section 372A as the same are not issued by body corporate. Most of the mutual funds are constituted as "Trust" under Indian Trust Act. Such trusts are not body corporate. However investment in units of UTI Mutual fund which are issued by UTI trust company Pvt. Ltd. is well covered u/s. 372A and investment in unit of UTI set up u/s. 3 of Unit trust of India Act, 1963 is also covered u/s. 372A.

13. Capital Market Derivatives / Future & Options :

Section 372A is not applicable: In Future & option, there is no acquisition of securities. In present scenario in India, Its just contract to settle the difference in price by payment. There is no delivery of securities. To meet the wording in the section "acquire" there must be delivery. How can we say "acquire without delivery?". In derivative, there is no delivery of securities and therefore the section is not applicable.

The crux word "otherwise" definitely relevant to "derivative" if there is acquisition / delivery of securities by way of derivative/future/option.

Even if we consider derivative as "agreement to acquire securities, it doest meant to say investment. Because it can be said as acquisition/Investment when delivery take place. Until and unless delivery take place, Section 372A will not be applicable just to "contract to acquire", which may or may not be materialize.

14. As per DCA Circular F.No. 5/17/99-CLV; General Circular No. 8/99 dated 4/6/99

a) Resolution for "Investment" much beyond the net worth should not be passed by the Company. Here it is pertinent to underline the word "Investment". It means the restriction is not applicable for Loan, guarantee, and securities.



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b) The Company should specifically indicate in 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.)

Here, it seems that the DCA eyes on mentioning the name of security, i.e. equity, preference, debenture etc. rather than to cover everything under umbrella of "Securities" as the definition is very wide.

Explanation:

a) "Loan" includes debentures or any deposit of money made by one company with another company, not being banking company. (Deposit with Bank is exempted). So, whenever one applying his mind for exempting inter corporate deposit from Section 58A, at the same time one should check compliance with Section 372A. Because what is exempted by one section is covered by another.

b) "Free reserve" 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 to the security premium account but shall not include share application money. (Paid up capital can be considered as on the date of investment).

(It is not expressly provided that in arriving at the aggregate of the free reserve, the amount of accumulated balance of loss, balance of deferred revenue expenditure and other intangible assets, should be deducted. Capital and debenture redemption reserve is free reserve after redemption of preference shares and debenture respectively.)

Exemption:

As per Sub section (8) nothing contained in this section shall apply

a) To Banking Company

b) A company whose principal business is the acquisition of shares, stock, debentures or other securities.

This can be considered as NBFC/ Investment company. Before availing exemption under the category, it is advisable to check compliance with NBFC relevant laws /rules / regulation / RBI directions.

c) To a private company, unless it is a subsidiary of public Company.

d) To investment made in shares pursuant to sec. 81(1) (a) – Rights shares.

(This can be happen only in case right issue offer by public company because the section 81 is inapplicable to private companies. Right shares offered by private company as per its articles or otherwise can not be said to have been offered u/s. 81(1) (a) and therefore investment in rights shares issued by private company can not be eligible for exemption u/s.372A.



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Here, It worth to make it clear that, the above will be counted for the purpose of subsequent investment / loan/ guarantee / securities.

e) To any loan made by holding company to it's wholly owned subsidiary
f) To any guarantee / security by holding company, in connection with loan made to it's wholly owned subsidiary Company.

g) To acquisition by a holding company, by way of subscription, purchases or otherwise, the securities of its wholly owned subsidiary.

In between reading of the words, it can be inferred that Investment in other body corporate for the purpose of make that company, a wholly owned subsidiary is not exempted because the exemption is for investment in wholly owned subsidiary. So needless to say that there must be status of wholly owned subsidiary before the proposal of investment in a company.

The exemption is also available for indirect wholly owned subsidiary. The continuation of investments made by the exempted companies, after the exemption ends would not require compliance with S. 372A. Thus, investments made during the period when the company was exempt under this section and remained outstanding after the cessation of the exemption, would not come within the restrictions contained in S. 372A. (DCA Circular no 13/98/CL-VI/67, dated 24 February 1971.)

Penal Provision

As per Ss. (9), the company and every officer of the company who is in default shall be punishable with imprisonment up to 2 years or fine up to Rs. 50,000/-. Provide further that all persons who are knowingly parties to any such contravention shall be liable, jointly and severally, to the company for the repayment of loan.

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