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## India

### Financial Assistance

### IBA Corporate and M&A Law Committee 2022

#### Contact

Sameer Sah

*Khaitan & Co, Mumbai, Maharashtra*

[sameer.sah@khaitanco.com](mailto:sameer.sah@khaitanco.com)

Smita Jha

*Khaitan & Co, Bengaluru, Karnataka*

[smita.jha@khaitanco.com](mailto:smita.jha@khaitanco.com)

Nabarun Chandra Ray

*Khaitan & Co, West Bengal*

[nabarun.ray@khaitanco.com](mailto:nabarun.ray@khaitanco.com)

Riddhiman Sarkar

*Khaitan & Co, Bhopal, Bhopal State*

[riddhiman.sarkar@khaitanco.com](mailto:riddhiman.sarkar@khaitanco.com)

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## INTRODUCTION

This guide sets out an overview of the laws dealing with the concept of financial assistance in India, as currently regulated by the Companies Act 2013 (the Companies Act), in connection with public limited companies and private limited companies.

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## GENERAL OVERVIEW

### **What are the origins of financial assistance under Indian law?**

The provision of financial assistance has been an offence since the Companies Act 1956 (the Previous Companies Act).

The current prohibition on the giving of financial assistance is set out in:

- Section 67 of the Companies Act, which has its genesis in English company law; and
- notification GSR 464(E), issued by the Ministry of Corporate Affairs under Section 462 of the Companies Act, dated 5 June 2015 (the MCA Notification).

The primary objective of the legislators is to ensure that no money that is made available by a public company to a person is returned to the company as a payment made towards the company's share capital.

### **What should be understood as financial assistance under Indian law?**

While the Companies Act does not define the term 'financial assistance', Section 67(2) of the Companies Act provides for a non-exhaustive list of forms of financial assistance, such as loans, guarantees and security.

Accordingly, any support by a public company in form of direct credit, any form of credit enhancement backed by assets or any guarantee provided for the purpose of, or in connection with, a purchase or subscription by any person of, or for any shares in, the company or in its holding company may constitute financial assistance. There is no legal test or criteria for interpreting the terms, and these broad terms encompass a wide range of commercial transactions.

### **Is financial assistance accepted under Indian law?**

As a general rule under the Companies Act, public companies are prohibited from providing financial assistance, directly or indirectly, for the purpose of acquiring their own shares. There are no specific restrictions on private companies providing financial assistance for acquisition or subscription to their own shares, as long as the other generally applicable restrictions of extension of loans, guarantees and security under the Companies Act are satisfied.

### **Are there any exceptions under Indian law as regards the general prohibition of providing financial assistance to third parties?**

The general prohibition on public companies on providing financial assistance to third parties for subscription to or acquisition of their own shares (or a holding company's shares) is subject to the following exceptions:

- lending of money by a banking company where money lending is part of the ordinary business of that company. However, banking companies in India are generally subject to certain lending restrictions for the purpose of acquisition of shares of a company under banking regulations;
- providing money as per any company-approved scheme for purchase or subscription of shares held for the benefit of employees or by the employees of the company; and

- granting loans to employees of the company (other than directors or key managerial personnel) to enable them to purchase or subscribe fully paid-up shares in the company or its holding company, provided that such loan does not exceed their salary or wages for a period of six months.

### **What are the general restrictions on financial assistance for private and public companies?**

#### *Private limited companies*

There are no specific restrictions on provision of financial assistance by private companies. However, any extension of a loan, guarantee or security by a company is required to adhere to certain general requirements – eg, there are additional conditions in cases where the loans are extended or security/a guarantee is provided to any entity with interested directors. There are also certain interest rate-related stipulations that a company to which needs to adhere, to ensure compliance with the arm's-length principle for extension of loans.

#### *Public limited companies*

Under the Companies Act, public companies are prohibited from providing financial assistance, directly or indirectly, for the purpose of acquiring or subscription to their own shares. However, there are three exceptions to this general rule (stated above).

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## **CONSEQUENCES OF PROVIDING FINANCIAL ASSISTANCE**

### **What are the consequences of providing financial assistance?**

#### *Civil penalties*

As per the Contract Act 1872, any agreement that provides for unlawful object or consideration is void and cannot be enforced in a court of law. Therefore, any agreement to provide financial assistance in contravention of Section 67(2) of the Companies Act is void and cannot be enforced by either party.

#### *Liability of the managing body*

Every 'officer in default' is liable to be punished with up to three years' imprisonment, along with a penalty that may range from INR 100,000 to INR 2.5m.

#### *Liability of the company*

The company is liable to be punished with a penalty that may range from INR 100,000 to INR 2.5m.

#### *Compoundable offence*

Under Section 441 of the Companies Act, contravention of the provisions on prohibition on financial assistance is not a compoundable offence. Compounding is a process involving admission of contravention and seeking leniency on penalty.

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## **OTHER RELATED MATTERS**

### **Transaction which are specifically permitted**

Apart from the exemptions referred above, transactions which are specifically enabled by the Companies Act – such as reduction of share capital under Section 66, buy-back of shares under Section 68, or redemption of preferred shares – are all exempt from the general prohibition on public companies providing financial assistance.

It must be noted that buy-back, reduction of share capital and the redemption of preferred shares are subject to various conditions imposed under the Companies Act.

**Indirect purchases**

The Companies Act prohibits companies from purchasing its own shares, *inter alia*, if:

- such purchase is made through a subsidiary company, including its own subsidiary companies; and
- such purchase is made through any investment company or group of investment companies.

Given the above, it must be ensured that shares are not purchased by subsidiary companies or investment companies.

**Receipt of shares by way of gift or surrender**

It may also be noted that the Companies Act does not allow a company to receive and hold its own shares. However, there is no prohibition on conducting a buy-back of shares. By corollary, the gift of shares to a company may not be allowed either.