

CHAPTER TEN : LOAN TO DIRECTORS

A. PROHIBITION OF LOAN TO DIRECTORS

1. Section 133(1) of the Companies Act 1965 prohibits loans to directors.
2. This is to prevent self-dealing by directors who may use the company's funds for their own personal needs.
3. A company (other than an exempt private company) shall not make a loan to a director of the company or a related company.
4. The company shall not enter into any guarantee or provide any security in connection with a loan made to such a director by any other person.
5. However, the section also provides several exceptions to the rule:
 - a) The company may provide the director with funds to meet expenditure incurred or to be incurred by him for the purpose of the company. The company may also provide a loan to enable the director to perform properly his duties as an officer of the company.
 - b) The company may provide a director in full time employment with the company or its holding company with funds (loans) to enable him to acquire a home.
 - c) The company may give loans to directors in full time employment with the company or holding company under a loan scheme for employees approved by the general meeting.
6. But, the company could only do so subject to section 133(2):
 - i) with the prior approval of the company given at a general meeting in which the full details of the loan is disclosed; or
 - ii) on condition, if the approval of the company is not given at or before the next following annual general meeting, the loan shall be repaid or the liability shall be discharged within 6 months from the conclusion of that meeting.

B. EXEMPT PRIVATE COMPANY

1. Section 4 of the Companies Act 1965 defines an exempt private company as a private company in the shares of which no beneficial interest is held directly or indirectly by any corporation and which has not more than 20 members none of whom is a corporation.
2. Thus, if all the shareholders are individuals not holding shares on behalf of any corporation, the company is an exempt private company.

1. It has been a long established principle in company law that a company cannot purchase its own shares. This rule is found in the case of *Trevor v Whitworth*.
2. The purpose of the rule was to ensure that a company's share capital is properly maintained. Any purchase by a company of its own shares will certainly whittle down the company's capital.
3. The rule was later extended by statute to include the giving of financial assistance for the purchase of its own shares.
4. In Malaysia, the relevant statutory provision which governs this is section 67 of the Companies Act 1965.
5. By virtue of section 67 of the Companies Act 1965, a company cannot purchase its own shares.
6. Neither can it give any financial assistance, whether directly or indirectly, in connection with the purchase of the company's shares by any other person. This prevents a company from giving a loan to enable any person to purchase the shares. It also is prohibited from giving any guarantee or security to facilitate the obtaining of a loan from some other party for such a purchase.
7. Where such financial assistance is given, the transaction is void but the company will be entitled to recover the financial assistance given.
8. However section 67(2) provides several exceptions to the general prohibition:
 - a) Where the lending of money is part of the ordinary business of a company, the company may lend money in the ordinary course of its business.
 - b) The provision of money, in accordance with any scheme for the time being in force, for the purchase of or subscription for fully paid shares in the company or its holding company, if the purchase or subscription is by trustees for the benefit of employees of the company or a subsidiary of the company, including directors holding a salaried employment or office in the company or a subsidiary of the company.
 - c) The giving of financial assistance to employees (excluding directors) in the employment of the company or of a subsidiary of the company, to enable them to purchase fully paid shares in the company or its holding company.
9. Any financial assistance given in contravention of the section is recoverable (S 67(6)).
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Learning outcome

1. Able to advise company on providing loan to directors.
2. To understand the underlying principle on prohibition of loan to directors.
3. To guide company on instances where loan to directors are allowed by the law.

Exercise

1. Briefly explain the Malaysia position to giving loan to directors.
2. What are disadvantages of giving loan to directors of company.
3. Explain the principle and law that was laid down by the case of Trevor v Whithworth.
4. Why an exempt private company is allowed to provide loan to its director?
5. Explain the exception when can a company provide loan to its directors.