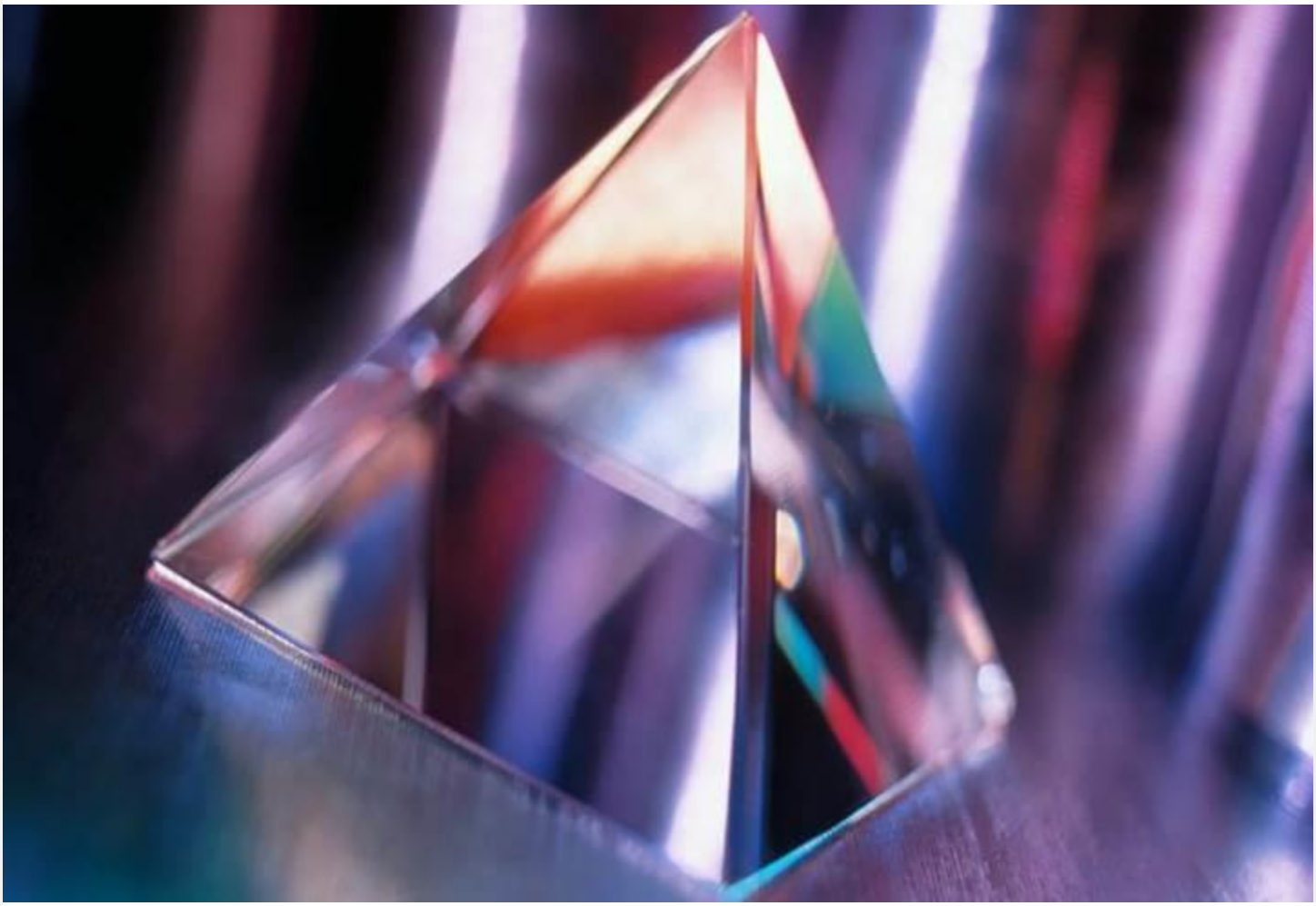
Deloitte.



D’Prism

A series on the Companies Act, 2013

The Companies (Amendment) Bill, 2014

Issue 6[1]: The Companies (Amendment) Bill, 2014

January 2015

In this issue:

Introduction

The Companies Act, 2013 ('the Principal Act') was notified on 29 August 2013. Consequent to the Government having received representations from various stakeholders expressing practical difficulties in the implementation of the provisions of the Principal Act, amendments to the Principal Act were proposed and passed in the Lok Sabha session on 16 December 2014. These would be required to be approved by the Rajya Sabha and then notified in the Official Gazette before they become operational.

This issue provides an insight into some of the amendments that have been proposed in the Companies (Amendment) Bill, 2014 ('the Bill') and the impact of such amendments.

Independent of the Bill, the Ministry of Corporate Affairs (MCA) had in its draft notification dated 24 June 2014, contemplated certain exemptions specifically for private companies. It is to be noted that this draft notification is pending final issuance and the matters considered in the draft notification are not included in the Bill. Broadly, the exemptions relate to related party transactions, loans to directors, acceptance of deposits, restrictions on powers of the board of directors etc.

Definitions

The Principal Act had defined a private company to be a company having a minimum paid-up share capital of Rs. one lakh or such higher paid-up share capital as may be prescribed; and had defined a public company to be a company having a minimum paid-up share capital of Rs. five lakh or such higher paid-up capital as may be prescribed. The Bill seeks to remove the threshold of Rs. one lakh and Rs. five lakh in the case of private companies and public companies respectively.

[1] Includes updates up to 19 January 2015

While the Central Government retains its right to prescribe a minimum paid-up share capital for a company to qualify as a private company or a public company, until such prescription, it appears that companies can be formed below the threshold. This is proposed as an 'ease of doing business' amendment.

Acceptance of deposits

A new section 76A in the chapter which relates to 'Acceptance of Deposits by Companies' has been introduced by the Bill. This section essentially provides for a fine up to Rs. 10 crore for the company, and imprisonment up to seven years or fine up to Rs. 2 crores or both, for every officer who is in default, where there is a contravention of the provisions relating to acceptance, invitation or repayment of deposits. Further, such officer would be liable for action under section 447 which deals with frauds, where it is proved that he has wilfully contravened such provisions with an intention to deceive the company or its shareholders or depositors or creditors or tax authorities.

The punitive action described above was originally provided in the Principal Act only with respect to failure to repay deposits accepted before the commencement of the aforesaid Act. Also, no specific punitive action was considered for contravention of provisions relating to invitation and acceptance of deposits from members or the public under the Principal Act. The addition of this section aligns the punitive action in respect of all deposits, right from the stage of their invitation and acceptance to their repayment.

In addition, where an officer of a company has contravened the provisions relating to deposits, knowingly or wilfully, action can be taken under the provisions related to 'Punishment for Fraud' under section 447. Punitive action under section 447 provides for imprisonment for a term not less than six months but which may extend up to ten years and fine not less than the amount involved in the fraud but which may extend to three times the amount involved in the fraud. Through this introduction, the Government has demonstrated its commitment to protect public interest and ensure good corporate governance.

Public inspection of board resolutions

The Principal Act requires all companies to file a copy of every resolution or any agreement, together with explanatory statement in respect of certain identified matters (for e.g., special resolutions, board resolutions or agreement relating to appointment of a managing director, board resolutions relating to borrowing monies, investing of funds, restructuring of business, etc.) with the Registrar. The Principal Act, through its section 399 ('General Provision'), further enabled any person to inspect any documents filed or registered by the Registrar, or make a record, on payment of fee prescribed. The Bill has provided that no person would be entitled per this General Provision to inspect or obtain copies of resolutions passed at meetings of the board in pursuance of section 179(3) covering, inter alia, resolutions to authorise buy-back of securities, to borrow monies, to invest the funds of the company, diversify business, amalgamation, merger or reconstruction etc.

When the Principal Act was introduced, it provided complete access to any person who could, by paying an inspection fee, access resolutions, agreements as well as explanatory statements of any company, including resolutions passed at meetings of the board. This amendment seeks to prohibit public inspection of certain board resolutions filed with the Registrar thereby enabling companies to maintain confidentiality of decisions taken by the board and keeping the internal working of the board protected. Whilst this is certainly a welcome amendment, it is unclear as to what would be the purpose of merely filing these board resolutions with the Registrar when records of such resolutions are anyway required to be maintained by the company under the Principal Act.

For listed entities, Clause 36 of the Equity Listing Agreement (ELA) (currently under re-consideration by the SEBI) prescribes disclosures required for events which will have a bearing on the performance/operations of the listed entity as well as 'price sensitive information'. This will ensure timely and transparent disclosures at least to investors of listed entities.

Payment of dividend, transfer of shares to Investor Education and Protection Fund (IEPF)

- The Bill has inserted a proviso in the chapter relating to ‘Declaration and Payment of Dividend’ which requires that no company shall declare dividend unless carried over previous losses and depreciation not provided in the previous year or years are set off against profit of the company for the current year.

The Companies (Declaration and Payment of Dividend) Rules, 2014 had been amended to include a similar provision in the Rules which related to situations where a company sought to declare dividend out of free reserves in case of inadequacy or absence of profits. However, it was not clear whether the aforesaid provision would apply to a company that had adequate profits in a year and therefore could declare dividend even if it had carried over previous losses and depreciation. With the insertion of this provision in the Principal Act itself, there remains no ambiguity that prior to the declaration of dividend, all previous losses and depreciation need to be set off in all cases.

- The Bill seeks to amend the provisions of the Principal Act that related to transfer of shares to IEPF, wherein it is stated that in case any dividend is paid or claimed for any year during the period of seven consecutive years, the share shall not be transferred to IEPF.

With this proposed amendment, the Bill requires transfer of the underlying shares to IEPF in the rare circumstance when dividend related to seven consecutive years has not been paid or claimed. This will enable companies to reach out to shareholders for claiming dividend and consequently protecting their shareholding. However, the concern relating to the fact that the underlying shares would require transfer to IEPF still remains. The concept of transfer to IEPF is yet not clear and the doubt remains as to who will be the shareholder of the company in the event of such transfer of shares to IEPF.

Reporting on frauds

The Bill proposes to substitute section 143(12) of the Principal Act, whereby auditors will be required to report to the Central Government only those frauds that are in excess of the threshold to be specified by the MCA. In case of frauds below the specified threshold, the same would have to be reported by the auditors to the audit committee or the board of directors. In such cases, the report of the board of directors to the shareholders would be required to include details in respect of such frauds (i.e., frauds other than those which are reportable to the Central Government) reported by the auditors.

The Principal Act had placed the onus on the auditor to report to the Central Government, frauds that he encounters in the course of performance of his duties as auditor, irrespective of the amount involved in the fraud. The Bill seeks to make a distinction, by bringing in thresholds, whereby the Central Government requires information only in cases where there are frauds that exceed the prescribed threshold, leaving the ones below the threshold to be reported only to the governing body of the company.

It is rather unusual though, that the disclosures in the report of the board of directors is mandated only in respect of frauds below the specified thresholds that are reported to them and such a requirement is not stated for those frauds that exceed the threshold (given that they would be the significant frauds) which would be communicated to the Central Government.

Related party transactions

- The Principal Act had required every audit committee to approve transactions of the company with related parties and any subsequent modification thereof. The Bill has provided that the audit committee may make omnibus approval for related party transactions proposed to be entered into by the company subject to such conditions as may be prescribed.

While the ‘Statement of Objects and Reasons’ appended to the Bill states that the aforesaid amendment would empower audit committees to give omnibus approvals for related party transactions on an annual basis, the word ‘annual’ per se has not been used in the proviso sought to be inserted.

This proviso has largely been harmonised with SEBI’s ELA. While the ELA clearly requires a prior approval of the audit committee in the case of omnibus approvals, the wordings in the proposed proviso also seem to require a prior approval. Further, while the Bill is yet to prescribe conditions attached with such omnibus approvals, the ELA has clearly listed out the conditions necessary to be fulfilled by a company when it wants to take the ‘omnibus’ route of approval by the audit committee for certain types of transactions. It may, therefore, be appropriate for all companies to be cognizant of the following conditions prescribed in the ELA for guidance in this regard:

a) The audit committee shall lay down the criteria for granting the omnibus approval in line with the policy on related party transactions of the company and such approval shall be applicable in respect of transactions which are repetitive in nature.

b) The audit committee shall satisfy itself the need for such omnibus approval and that such approval is in the interest of the company.
c) Such omnibus approval shall specify (i) the name/s of the related party, nature of transaction, period of transaction, maximum amount of transaction that can be entered into (ii) the indicative base price/current contracted price and the formula for variation in the price, if any and (iii) such other conditions as the audit committee may deem fit; provided that where the need for related party transaction cannot be foreseen and the aforesaid details are not available, the audit committee may grant omnibus approval for such transactions subject to their value not exceeding Rs. 1 crore per transaction.
d) The audit committee shall review, at least on a quarterly basis, the details of related party transactions entered into by the company pursuant to each of the omnibus approval given.
e) Such omnibus approvals shall be valid for a period not exceeding one year and shall require fresh approvals after the expiry of one year.

Compliance with conditions is purely to improve good governance and this proviso is expected to significantly improve operational efficiencies. Companies can assess various related party transactions of the past years and identify those situations where they can take the 'omnibus' route.

- The Bill has inserted two provisos whereby a holding company is not precluded from giving loans to its wholly owned subsidiary or giving any guarantee or security for loans made to its wholly owned subsidiary or giving any guarantee or security for loans made by any bank or financial institution to its subsidiary, provided that the loans are utilised by the subsidiary company for its principal business activities. While this would be exempt from the provisions of section 185, the provisions of section 188 would be triggered, wherein the Bill has inserted a proviso that prior approval of shareholders as contemplated in the first proviso to section 188(1) would not be required for transactions entered into between a holding company and its wholly owned subsidiary whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval.

- The Bill also provides for substitution of the word 'resolution' for the words 'special resolution' in section 188.

Although certain sections of the industry expected exemptions for loans granted to any subsidiary, akin to the Companies Act, 1956, the Bill proposes exemption only in respect of loans granted to a wholly owned subsidiary. It appears that the exemption has been provided in line with the MCA's thinking that wholly owned subsidiaries do not have external interests.

While the proposed amendments to section 188 provide a breather for transactions between a holding company and its wholly owned subsidiary, such benefit would not be available for transactions between a holding company and its non-wholly owned subsidiary (for e.g., a 99 percent subsidiary). An important condition to note here would be that to avail this benefit, the accounts of the wholly owned subsidiary would have to be consolidated and placed before the shareholders of the holding company. In situations where consolidated financial statements are not being prepared, for e.g., where control is expected to be temporary or where there is an ultimate holding company in India and the transaction is between an Indian subsidiary of such company (intermediate holding company) and its subsidiary (step down subsidiary of the ultimate holding company), the relaxation of not obtaining the approval of the shareholders of the holding company is not available.

The replacement of the requirement for special resolution with the requirement of an ordinary resolution, in case of transactions with related parties beyond certain thresholds that are not at arm's length or not in the ordinary course of business, is expected to increase operational efficiencies and also bring the same broadly in line with the ELA, although there are still some differences between the two legislations that listed companies will need to separately deal with. It is our understanding that where companies were not able to pass a special resolution, for want of the requisite 75 percent majority previously, they would have to propose a fresh resolution for approval by the eligible shareholders upon enactment of the new provisions.

Conclusion

The Bill seeks to facilitate operational efficiencies, ease of doing business and in some instances enhance corporate governance already prescribed in the Principal Act. It needs to be seen if the draft notification that contemplated certain exemptions to private companies will be separately notified.