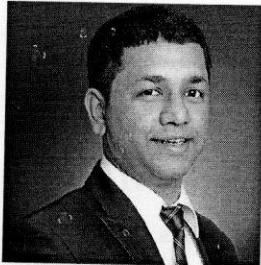


Decoding 'liberalized' Managerial Remuneration

September 26, 2016 [2016] 73 taxmann.com 292 (Article)



On September 12, 2016, MCA issued a Notification¹ and amended Schedule V of the Companies Act, 2013. Vide the amendment, there is a change in the provisions relating to 'managerial appointment' and 'managerial remuneration'. The article is a critical analysis of the said amendments and its impact on the India Inc. with respect to determining managerial remuneration where the company has no profit or inadequate profit.

**Gaurav N.
Pingle**

1. Amendments in provisions relating to 'Managerial Appointment'

CS

Part I of Schedule V of Companies Act, 2013 relates to the 'Conditions to be fulfilled for appointment of MD or WTD or Manager without approval of Central Government'. This part of Schedule V was amended vide the said MCA notification. Pursuant to the amendment, no person shall be eligible for appointment as a MD or WTD or Manager if he had not been sentenced to imprisonment for any period, or to a fine exceeding Rs. 1,000/-, for the conviction of an offence under Companies Act, 2013 or any other previous company law. Before the amendment, there was reference of only 'Companies Act, 2013' and not other previous company law. However, it is noteworthy that the proposed appointee (MD, WTD or Manager) should not be sentenced to imprisonment or fine exceeding Rs. 1,000/- for 'conviction of an offence'. Conviction refers to formal declaration by the Jury or the decision of a judge in a court of law that someone is guilty of criminal offence. Therefore, payment of penalty for compounding of offences under company law or payment of additional fees for late filing will not amount to 'conviction of offence'.

2. Amendments in provisions relating to 'Managerial Remuneration'

Part II of Schedule V of the Companies Act, 2013 relates to 'Remuneration'. Section II of Part II of Schedule V of the Act relates to the 'Remuneration payable by companies having no profit or inadequate profit without Central Government approval'. Section II has been completely substituted vide the said MCA notification.

The amended Section II of Part II of Schedule V of the Act state that where in any financial year during the currency of tenure of managerial person (i.e. Managing Director or Whole-time Director or Manager), a company has no profits or its profits are inadequate, it may, without

Central Government approval, pay remuneration to the managerial person not exceeding the limits under (A) and (B).

The tabular format of (A) in relation to the earlier limits of managerial remuneration is given below:

Where the effective capital is	Existing Limit of yearly remuneration payable shall not exceed (Rs.) (before MCA Notification)	Revised Limit of yearly remuneration payable shall not exceed (Rs.) (After MCA Notification)
Negative or less than Rs. 5 crore	30 lakhs	60 lakhs
5 crore and above but less than Rs. 100 crore	42 lakhs	84 lakhs
100 crore and above but less than Rs. 250 crore	60 lakhs	120 lakhs
Rs. 250 crore and above	60 lakhs plus 0.01% of the effective capital in excess of Rs. 250 crores.	120 lakhs plus 0.01% of the effective capital in excess of Rs. 250 crores.

The said limits can be doubled if the special resolution is passed by shareholders.

Where the effective capital is	Revised Limit of yearly remuneration payable shall not exceed (Rs.)	Doubled limit after passing special resolution
Negative or less than Rs. 5 crore	60 lakhs	120 lakhs
5 crore and above but less than Rs. 100 crore	84 lakhs	168 lakhs
100 crore and above but less than Rs. 250 crore	120 lakhs	240 lakhs
Rs. 250 crore and above	120 lakhs plus 0.01% of the effective capital in excess of Rs. 250 crores.	240 lakhs plus 0.01% of the effective capital in excess of Rs. 250 crores.

Amended Clause (B) of Section II of Part II of Schedule V of the Act relates to the remuneration of managerial persons.

Manager) who is functioning in professional capacity. The amended Clause (B) prescribes two conditions for payment of managerial remuneration, without the approval of Central Government:

- (i) Managerial Personnel is not having any interest in the capital of the company or its holding company or any of its subsidiaries directly or indirectly or through any other statutory structures and not having any direct or indirect interest or related to the directors or promoters of the company or its holding company or any of its subsidiaries at any time during the last 2 years before or on or after the date of appointment and,
- (ii) Managerial Personnel possesses graduate level qualification with expertise and specialised knowledge in the field in which the company operates.

3. Decoding the 1st condition, where managerial person who is functioning in professional capacity

The first condition in the amended Clause (B) of Section II of Part II of Schedule V of the Act contemplates that the managerial personnel does not have any interest in the company (where he is proposed to be appointed) or its holding company or any of its subsidiaries directly or indirectly or through any other statutory structures. The said MCA Notification defines 'statutory structure' that means any entity which is entitled to hold shares in any company formed under any statute. Pursuant to the amendment, it is also contemplated that the managerial personnel does not have any direct or indirect interest or he is not related to the directors or promoters of the company or its holding company or any of its subsidiaries at any time during last 2 years before or on or after the date of appointment.

Considering the language used in drafting Clause (B) of Section II of Part II of Schedule V of the Act, it can be said that the managerial personnel who is proposed to be appointed should be professional and independent person. Here the independence is not in accordance with the provisions of sub-section (6) of Section 149 of Companies Act, 2013 but in accordance with the criteria laid down in the revised provisions. However, it is noteworthy that such criteria are applicable to managerial personnel – MD, WTD and Manager and not to non-executive directors of the company.

The proviso to the Clause (B) clarifies that any employee of a company holding shares of the company not exceeding 0.5% of its paid-up share capital under any scheme formulated for allotment of shares to such employees including ESOP or by way of qualification shall be deemed to be a person not having any interest in the capital of the company.

4. Decoding the 2nd condition, where managerial person who is functioning in professional capacity

The Managerial Personnel (MD, WTD or Manager) possesses graduate level qualification with expertise and specialised knowledge in the field in which the company operates. It is essential to read this condition of Clause (B) of Section II of Part II of Schedule V in relation to Section 197(4) of the Companies Act, 2013.

Sub-section (4) of Section 197 states that the remuneration payable to the directors of a company, including any managing or whole-time director or manager, shall be determined, in accordance with and subject to the provisions of Section 197, either by the Articles of Association, or by a resolution or, if the Articles of Association so require, by a special resolution, passed by the company in general meeting and the remuneration payable to a director determined aforesaid shall be inclusive of the remuneration payable to him for the services rendered by him in any other capacity.

The proviso to sub-section (4) of Section 197 states that any remuneration for services rendered by any such director in other capacity shall not be so included if—

- (a) Services rendered are of a professional nature; and
- (b) In the opinion of the Nomination and Remuneration Committee, if the company is covered under sub-section (1) of Section 178, or the Board of Directors in other cases, the director possesses the requisite qualification for the practice of the profession.

The proviso creates an exception to Section 197(4), whereby the remuneration paid for services rendered by any director shall not be included in the limits if the director renders professional services and the Nomination and Remuneration Committee (if required to be constituted) or Board of Directors opine that the director possesses requisite qualification for the practice of profession.

The proviso to Section 197(4) is applicable to all directors (executive director, non-executive director, independent director or non-independent director) providing professional services. The payment of remuneration under the said proviso can be made when the company is in profits or when the company is having inadequate profits or losses. In comparison to this, Clause (B) of Section II of Part II of Schedule V of the Act is applicable only to Managing Director, Whole-time Director or Manager and applicable only when the company is having inadequate profits or losses.

Pursuant to the proviso to Section 197(4), the director renders professional services and some authority (Committee or Board) opine that the director possesses requisite qualification for the practice of profession. Whereas, pursuant to Clause (B) of Section II of Part II of Schedule V of the Act, the managerial personnel should possess only graduate level qualification with expertise and specialised knowledge in the field in which the company operates.

operates. There is no authority (Committee or Board) to acknowledge or sanction that the director possesses expertise and specialised knowledge in the field in which the company operates.

5. 'Limits' under Clause (B) of Section II of Part II of Schedule V

In the said MCA notification, at various places, there is reference of the phrase 'limits under (B)', however, it is noteworthy that there is no limit prescribed in substituted Clause (B) of Section II of Part II of Schedule V. With reference to the earlier provision there was a limit prescribed for payment of remuneration (i.e. 2.5% of current relevant profit, which could be doubled by passing special resolution). Due to the absence of such limit in the revised Clause (B), it can be said that the revised Clause (B) is at par with proviso to Section 197(4) in terms of no limit on payment of remuneration; however the conditions for the same are different (as discussed above). Where the company is in loss or has inadequate profits, it would prefer to take advantage of Clause (B) of Section II of Part II of Schedule V rather than proviso to Section 197(4), considering the qualifications required under the both provisions.

6. Secured creditor's prior approval in case of default

Under the existing provisions, there was a prohibition on the company to pay remuneration to managerial personnel where there was default in repayment of any debt (including public deposits), debentures or interest thereon for a continuous period of 30 days in the preceding financial year before the date of appointment. Pursuant to the said MCA Notification, the companies having such default may pay remuneration to its managerial personnel provided secured creditors' prior approval is obtained and such fact is mentioned in Explanatory Statement of the Notice convening the general meeting.

7. Conclusion

Pursuant to the said MCA notification, it can be said that the managerial remuneration for professional directors has been liberalized and also the provisions relating to secured creditors' prior approval is relaxed. However, in my view, there lies anomaly in reading the revised Clause (B) of Section II of Part II of Schedule V vis-à-vis the proviso to Section 197(4) and also no limit on the payment of remuneration under the said Clause (B).

■ ■