



## COMPANY LAW

[2017] 139 CLA (Mag.) 1

### Exemptions granted to private companies under Companies Act, 2013 – Critical Analysis

Gaurav N Pingle\*



*Recently, the Ministry of Corporate Affairs has amended the principal notification dated 5th June, 2015 to provide for some more exemptions to private companies, small companies, one person company, and start ups. This article is intended to analyse exemptions that have been granted to the aforesaid entities by the recent notification dated 13th June, 2017.*

❖❖EFW❖❖

#### Introduction

1. In the Companies Act, 1956, there were specific provisions which granted exemptions to private companies. However, under the Companies Act, 2013 ('the Act'), there are very few provisions which provide for such specific exemptions to private companies. Taking into consideration the representation made by the stakeholders, Chamber of Commerce and Professional Institutes, the Ministry of Corporate Affairs ('MCA') issued a Notification<sup>1</sup> ('Principal Notification') that provided for certain exemptions. However, the said exemptions are subject to compliance of certain conditions and disclosures. With an objective to provide more exemptions to private companies, the MCA issued yet another Notification<sup>2</sup> ('recent MCA Notification') and provided for some more exemptions to private companies, small companies, start-ups, one person company ('OPC'). The exemptions granted by recent MCA Notification are also subject to certain compliances and disclosures. It

\* Practising Company Secretary, Pune, gp@csgauravpingle.com / acsgauravpingle@gmail.com.

1. MCA Notification No. GSR 464(E) dated 5th June, 2015.

2. MCA Notification No. GSR 583(E) dated 13th June, 2017.

is also noteworthy that the recent MCA Notification amends the Principal Notification. This article is a critical analysis of the exemptions to private companies in the light of recent MCA Notification.

### **Requirement of cash flow statement**

2. Pursuant to the extant provisions, OPC, small company and dormant company are not required to attach 'cash flow statement' to the financial statements. The Principal Notification is amended by the recent MCA Notification and the exemption has been extended to a private company which is a 'start-up' as recognised by DIPP. It's noteworthy that the requirement of 'cash flow statement' remains applicable to the private companies which are not start-ups.

### **Acceptance of deposits under section 73 of the 2013 Act**

3. Pursuant to the recent MCA Notification, the following conditions are *not applicable to a private company* (subject to conditions, discussed later) for accepting money from its members from time-to-time :

- Issuance of a circular to its members including therein a statement showing the financial position of the company, the credit rating obtained, the total number of depositors and the amount due towards deposits in respect of any previous deposits accepted by the company and such other particulars in prescribed form.
- Filing a copy of the circular along with such statement with the Registrar within 30 days before the date of issue of the circular.
- Depositing such sum which shall not be less than 15 per cent of the amount of its deposits maturing during a financial year and the financial year next following, and kept in a scheduled bank in a separate bank account to be called as deposit repayment reserve account.
- Providing such deposit insurance in prescribed manner.
- Certifying that the company has not committed any default in the repayment of deposits accepted either before or after the commencement of this Act or payment of interest on such deposits.

3.1 According to the recent MCA notification, the above mentioned provisions are not applicable to private company which satisfies any of the following conditions :

- Private company which accepts from its members monies not exceeding 100 per cent, of aggregate of the paid-up share capital, free reserves and securities premium account. Under the Principal Notification, the monetary limit was only up to paid-up share capital, free reserves. The same has been extended by including securities premium account, as the same 'securities premium account' are also shareholders funds.

- Private company which is a start-up, for 5 years from the date of its incorporation. This exemption has been introduced by the recent MCA Notification. It is noteworthy that private company which is a recognized start-up can raise deposits from its members without any monetary limit. At the same time, the recognised start-up is not required to even comply with conditions relating to the issuance circular, filing of copy of circular with Registrar of Companies, depositing prescribed amount in separate bank account, providing deposit insurance and certification with respect to no default in the repayment of deposits accepted.
- If a private company complies with the certain conditions (as given below), it is not required to comply with the provisions of clauses (a) to (e) of sub-section (2) of Section 73 of the Act. These conditions are :
  - ▶ Private company is not an associate company or subsidiary company of any other company
  - ▶ If the borrowings of the private company from banks or financial institutions or any body corporate is less than twice of its paid up share capital or Rs. 50 crore, whichever is lower.
  - ▶ Private company has not defaulted in repayment of the borrowings subsisting at the time of accepting deposits.

3.2 In my view, this exemption is very critical as it has prescribed three conditions that a private company is required to comply with. The private company in a group of companies will not be able to take the benefit of the said exemption, as it would be either an associate company or subsidiary company of the other company. However, a private company, which is a holding company in a group company, and at the same time satisfies other conditions, can take advantage of the said exemptions. The second condition has been introduced with an objective to impose a monetary limit on the borrowings of the private company. In my view, the third condition is very critical to comply with. The condition relates to no default with respect to the borrowings subsisting at the time of deposits. The 'borrowings' are not defined and, hence, may include short-term or long-term borrowing or the borrowings from banks/financial institutions or creditors in the course of business. Considering the drafting of the said clause and intention of Government, the 'borrowings' ought to have been 'borrowings from banks or financial institutions', but it is not mentioned accordingly in the recent MCA Notification. In the recent MCA notification, it is also clarified that the said companies are required to file a return with the Registrar of Companies in prescribed format with respect to the details of monies accepted.

It is noteworthy that neither Principal Notification nor the recent notification exempts the compliance of clause (f) of sub-section (2) of section 73 of the Act. Therefore, a private company (whether start-up or not) is required to comply

with the said condition. The condition relates to providing security, if any, for the due repayment of the amount of deposit or the interest thereon including the creation of such charge on the property or assets of the company. In my view, this condition ought to have been exempted for private company (whether start-up or not) with or without condition or compliances.

#### **Annual return under section 92 of the Act**

4. According to section 92, every company shall prepare and file annual return with the Registrar of Companies. The details of the annual return shall be as on the close of the financial year. Amongst others, the company is required to disclose 'remuneration of directors and key managerial personnel' in the annual return. According to the recent MCA Notification, private company and small company will be required to disclose only aggregate amount of remuneration drawn by directors. The remuneration drawn by key managerial personnel need not be disclosed by private company and small company. However, this exemption is not applicable to DIPP recognized start-ups, which are private companies. Pursuant to the provisions of section 92, the annual return of OPC and small company shall be signed by the company secretary, or where there is no company secretary, by the director of the company. The exemption with respect to signing of annual return has been extended to start-ups by the recent MCA Notification. Accordingly, the annual return of following companies shall be signed by company secretary, or where there is no company secretary, by the director :

- (i) OPC,
- (ii) small company and
- (iii) private company (if such private company is a 'start-up' recognized by DIPP).

#### **Reporting by the statutory auditor under sub-section (3) of section 143 of the Act**

5. According to sub-section (3) of section 143 of the Act, the statutory auditor of the company is required to report certain prescribed matters. For a private company which is satisfying certain conditions (as prescribed below), the statutory auditor is not required to report whether the said company has adequate internal financial controls system in place and the operating effectiveness of such controls. The statutory auditor is not required to report the above matter for –

- (i) private company which is an OPC or small company ; or
- (ii) private company which has turnover less than Rs. 50 crore as per latest audited financial statement or which has aggregate borrowings from banks or financial institutions or anybody corporate at any point of time during the financial year less than Rs. 25 crore.



The exemption is not applicable to a private company recognised by DIPP as 'start-up'.

### **Meetings of the Board of directors under section 173 of the Act**

6. It is interesting to note that sub-section (5) of section 173 (relating to 'Meetings of the Board') has been substituted by the recent MCA Notification whereby, OPC, small company, dormant company and private company ('recognised' as start-up by the DIPP) shall be deemed to have complied with provisions of section 173, if at least one meeting of the Board of directors has been conducted in each half of a calendar year and the gap between the two meetings is not less than 90 days. The provisions of sub-section (5) of section 173 has been extended to start-ups. It is further clarified in section 174 of the Act (relating to 'Quorum') that the provisions are not applicable to OPC, if there is one director on its Board of directors. It's quite astonishing that provisions of the Act are replaced by a Notification issued by MCA.

### **Quorum for the meeting of the Board under section 174**

7. Section 174 states that the quorum for a meeting of the Board of directors of a company shall be one-third of its total strength or two directors, whichever is higher. The provisions further clarify that the participation of the directors by video-conferencing or by other audio visual means shall also be counted for the purposes of quorum. Sub-section (3) of section 174 states that where at any time the number of interested directors exceeds or is equal to two-third of the total strength of the Board of directors, the number of directors who are not interested directors and present at the meeting, being not less than two, shall be the quorum during such time. Such provision is a hurdle for closely-held public companies and private companies. Taking into consideration that there is no exception to the said provision, the recent MCA Notification clarifies that in the case of private companies, interested director may be counted towards quorum in the meeting after disclosure of his interest pursuant to section 184 of the Act. 'Interested director' as a term has been defined in clause (49) of section 2 of the Act, but the same is referred to only in section 174 of Act. Considering this, there is a proposed amendment [in Companies (Amendment) Bill, 2016] to omit the definition of 'interested director'. Therefore, in my view the amendment suggested by the recent MCA Notification may not have a long-term effect.

### **Participation under section 184(2) of the Act**

8. Sub-section (2) of section 184 provides that every director of a company who is in any way, whether directly or indirectly, concerned or interested in a contract or arrangement or proposed contract or arrangement entered into or to be entered into with prescribed parties [as elaborated in clauses

(a) and (b)] shall disclose the nature of his concern or interest at the Board meeting in which the contract or arrangement is discussed and shall not participate in such meeting. The provision further states that where any director who is not so concerned or interested at the time of entering into such contract or arrangement, he shall, if he becomes concerned or interested after the contract or arrangement is entered into, disclose his concern or interest forthwith, when he becomes concerned or interested or at the first Board meeting held after he becomes so concerned or interested.

According to the MCA's Principal Notification, in the case of private companies, the provisions shall apply with an exception that the interested director may participate in such meeting after disclosure of his interest. Whether such participation means 'discussion' or 'voting' or both? In my view, the MCA ought to have clarified expression 'participate' in the recent MCA Notification.

### **Applicability of MCA Notification**

9. Pursuant the recent MCA Notification, the exceptions, modifications and adaptations provided shall be applicable to a private company which has not committed a default in filing its financial statements (under section 137 of the Act) or annual return (under section 92 of the Act) with the Registrar of Companies. By this amendment, the MCA has amended the Principal Notification as well. However, it is interesting to note that there is a reference of 'default'. So the question that arises is : Can a private company take advantage of the MCA's Notification (Principal and Recent Notification) if such company 'delays' (but not 'default') in either filing its financial statements or annual return? Another question that arise : Suppose if the private company 'defaults' (or 'delays', as interpreted) in either filing its financial statements or annual return, then is such company required to amend its articles of association (which it had amended pursuant to the Principal Notification) ?

### **Conclusion**

10. The present notification provides for the exemptions for various classes of private companies as: (i) small company, (ii) OPC, (iii) private company recognised under start-up India, (iv) private company not recognised under start-up India. For every exemption for each class of private company, the MCA has prescribed separate conditions. The complexity is further compounded when the applicability of the MCA Notification is taken into consideration. Also, taking into consideration the number of start-ups recognised and registered by DIPP are very less, if the exemptions are granted to private company as a whole (rather than bifurcating exemptions between small company, OPC, start-up, etc.), the Government would be better placed to achieve the objective of 'ease of doing business'. ❖❖❖