

Legislative Brief

Draft Amendments to the Companies Act, 2013

The Ministry of Corporate Affairs invited feedback on the Draft Bill in November 2018. The last date for comments was November 20, 2018.

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Roshni Sinha
roshni@prsindia.org

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Highlights of the Draft Bill

- ◆ The Draft Bill states that the total monetary relationship of an Independent Director with the company, along with its group companies, should not exceed 25% of his total income.
- ◆ The Act requires certain companies to spend 2% of their profits towards Corporate Social Responsibility (CSR) projects. Reasons for unspent funds must be disclosed in the annual report. The Draft Bill mandates spending of unspent CSR funds within three years.

Key Issues and Analysis

- ◆ The Draft Bill mandates spending of CSR funds. While some argue that unspent CSR funds should be mandatorily spent, others reason that disclosure of reasons for non-spending of CSR funds constitute a sufficient check on non-compliance of the law.
- ◆ Under the Act, resignation of directors is effective immediately. The Draft Bill makes the resignation of an Independent Director effective on the 30th day from the date of resignation. This may result in extending their period of liability in the company.

PART A: HIGHLIGHTS OF THE DRAFT BILL

Context

The Companies Act, 2013 regulates the incorporation, functioning, and dissolution of all types of companies. In July 2018, the government set up a Committee to review offences under the Act.¹ The Committee made certain recommendations with respect to strengthening the corporate governance framework under the Act. These included changes to the provisions on monetary relationship of independent directors with the company and identification of significant beneficial shareholders in the company. Based on these recommendations, the Ministry of Corporate Affairs published certain draft amendments to the Act in November 2018 ('Draft Bill').

Key Features

- **Issuance of dematerialised shares:** Under the Act, certain classes of public companies are required to issue shares in dematerialised form only. This has been extended to all other classes of companies as well.
- **Independent Director:** Under the Act, the remuneration of an Independent Director or his transactions with the company should not exceed 10% of his total income in the last two financial years. The Draft Bill adds that the total monetary relationship of the Director with the company and its group companies should not exceed 25% of his income, of which his income for services to the company should not exceed 10%.
- An individual will be eligible for appointment as an Independent Director only if he completes an assessment conducted by a body, notified by the central government. The government may exempt any individual from the requirement of completing such assessment.
- Further, the Draft Bill states that the resignation of an Independent Director from a company will only take effect on the 30th day from the date of receipt of notice by the company.
- **Charitable companies:** Under the Act, a not-for-profit charitable company (under Section 8) could convert itself to any other kind of company after following certain rules. This provision has been deleted.
- **Corporate Social Responsibility (CSR):** Under the Act, companies above a certain specified net worth, turnover or profits are required to spend 2% of their average net profits in the last three financial years, towards its CSR policy. If the CSR funds are not fully spent, reasons for non-spending must be disclosed in the annual report of the company. As per the Draft Bill, any unspent CSR funds in that year will have to be

transferred to an Unspent CSR Account within 30 days of the end of the financial year, and spent within three years from the date of transfer.

- **Striking off:** If the name of a company is struck off from the Register of Companies, it stands dissolved. Under the Draft Bill, upon striking off, the company's properties will vest in a Board of Administrators (BoA) constituted by the government. The BoA may sell the company's property and remit the proceeds to the Consolidated Fund of India. These changes will apply from December 26, 2016 (when the provision was notified). The NCLT may, within 20 years, restore the name of the company in the Register. Upon restoration, the BoA may return unsold properties or refund proceeds (of sold properties) to the company.
- **Bar on holding office:** Under the Act, the central government or certain shareholders can apply to the NCLT for relief against mismanagement of the affairs of the company. The Draft Bill states that in such a complaint, the government may also make a case against an officer of the company on the ground that he is not fit to hold office in the company, for reasons such as fraud or negligence. If the NCLT passes an order against the officer, he will not be eligible to hold office in any company for five years.

PART B: KEY ISSUE AND ANALYSIS

Spending on Corporate Social Responsibility (CSR) Policies

Mandating spending on CSR Policies

Draft Bill:
Clause 8 Under the Act, certain companies are required to ensure that at least 2% of their average net profits in the last three financial years are spent in the same year on projects under the company's CSR policy. If the company does not have adequate profits or cannot spend the prescribed amount on CSR projects, it is required to disclose the reason in its annual report. The Draft Bill adds that unspent CSR funds should be transferred to a separate Unspent CSR Account and spent within three years. The question is whether it is adequate to disclose the reasons for the unspent amounts in the annual report or whether spending it should be made mandatory.

A Committee on CSR (2015) had noted that long gestation periods in CSR projects result in unspent CSR funds.² It recommended that companies should carry forward the unspent balance, and after five years, transfer it to one of the funds listed in the Act (e.g., PM Relief Fund). However, over the years, various committees have recommended that disclosure of reasons in the annual report for non-spending of CSR funds is adequate.^{3,4}

Mandating transfer of unspent CSR funds within thirty days of end of financial year

The Draft Bill requires that all unspent CSR funds must be transferred to a separate Unspent CSR Account within 30 days of the end of the financial year. It may be difficult for companies to audit their CSR expenditure and transfer the unspent monies within the 30-day period.

An audit requires detailed examination of the company's financial statements, which are then adopted by the Board of the company, and presented at the Annual General Meeting. It may not be feasible for companies to complete this within 30 days. This may result in a situation where funds are transferred on the basis of the provisional CSR expenditure, which may not match the audited CSR expenditure. In such a case, the company may be subject to penalties under the Act for non-compliance with the provision of the Draft Bill. Note that under Section 96 of the Act, companies are provided a six-month period to finalise the audited accounts.

Extending window of liability for Independent Directors after resignation

Draft Bill:
Clause 10 Under the Act, the resignation of any director is effective on the date in the resignation letter, or the date on which the company receives the letter, whichever is later. Under the Draft Bill, the resignation of an Independent Director will take effect on the 30th day from the date of receipt of notice by the company. It may be questioned if it is appropriate to extend the effective date of resignation of an Independent Director.

Independent Directors are liable for wrongful acts of the company during their tenure if it occurred with their knowledge, consent or lack of diligence. Extending the effective period of resignation increases the time period during which an Independent Director may be liable, even though he may already have tendered his resignation.

1. [Report of the Committee to Review Offences Under the Companies Act, 2013](#), August 14, Ministry of Corporate Affairs.
2. [Report of the High Level Committee on CSR](#), Ministry of Corporate Affairs, September 2015.
3. The Companies Bill, 2009, Standing Committee on Finance, [21st Report](#), 15th Lok Sabha, August 31, 2010.
4. [Report of the Company Law Committee](#), Ministry of Corporate Affairs, February 2016.

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