

Legislative Brief

The Companies (Amendment) Bill, 2016

The Companies (Amendment) Bill, 2016 was introduced in Lok Sabha on March 16, 2016.

It was referred to the Standing Committee on Finance on April 12, 2016. The Committee was scheduled to submit its report by the first week of the Monsoon session, 2016. However, the report has not been submitted yet.

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Highlights of the Bill

- ◆ The Bill amends the Companies Act, 2013 in relation to structuring, disclosure and compliance requirements for companies.
- ◆ The Act limits the number of intermediary companies through which investments can be made in a company. Similarly, the Act limits the number of layers of subsidiaries a company can have. The Bill removes these limits.
- ◆ The Act requires an individual who has a beneficial interest in the shares of a company to disclose the same. The Bill also requires a group of persons who exercise beneficial control (above 25%) in a company to disclose such interest.
- ◆ Under the Act, a separate offer letter should be issued to individuals to whom a private offer of shares has been made. The Bill removes the requirement of such offer letter, but retains the provision related to notifying the Registrar of the return of allotment.
- ◆ The Act permits the appointment of members at the level of Joint Secretary to the quasi-judicial tribunal. Under the Bill, a technical member must be at least of the level of an Additional Secretary.

Key Issues and Analysis

- ◆ The Bill removes the limit on layers of subsidiaries and intermediaries. This is in line with the Companies Law Committee's (CLC) recommendations which noted that imposing such limits would affect the company's structuring and ability to raise funds.
- ◆ The Bill permits an Independent Director to have a pecuniary relationship, up to 10% of his total income, with the company. This is in line with the reasoning of the CLC which had stated that minor transactions may not compromise the independence of such Directors.
- ◆ Certain recommendations of the CLC have not been included in the Bill. These include issues related to: (i) residence requirements for directors; and (ii) compliance requirements for dormant companies.
- ◆ The Bill amends provisions related to (i) the qualifications of technical members, and (ii) the composition of the Selection Committee of the National Companies Law Tribunal and the National Companies Law Appellate Tribunal. The amendments bring these provisions in line with a 2015 Supreme Court judgment.

PART A: HIGHLIGHTS OF THE BILL

Context

The Companies Act, 2013 regulates the incorporation and functioning of all types of public and private companies. The 2013 Act came into effect on April 1, 2014 and replaced the earlier Companies Act, 1956. However, different sections of the 2013 Act were notified at different times, and some are yet to be notified.

Since 2014, several companies reported challenges with the implementation of the 2013 Act.¹ They included issues with compliance requirements for public and private companies and inconsistencies with general accounting standards. In 2015, the Act was amended to address certain challenges with respect to the criteria for setting up public and private companies and fraud reporting by auditors.² In June 2015, the government set up the Companies Law Committee to examine issues arising out of the implementation of the 2013 Act. The Committee submitted its report in February 2016.¹ Also, in 2015, the Supreme Court held certain provisions related to the quasi-judicial tribunals set up under the 2013 Act as invalid.³

In March 2016, the Companies (Amendment) Bill, 2016 was introduced in Lok Sabha. This Bill is mainly based on the recommendations of the Companies Law Committee.⁴ The Bill was then referred to the Standing Committee on Finance for examination.

Key Features

The Bill amends the Companies Act, 2013. Table 1 captures key provisions of the 2013 Act and changes proposed by the 2016 amendments.

Table 1: Key changes proposed in the 2016 Bill compared with provisions of the 2013 Act:

Key Features	Companies Act, 2013	Companies (Amendment) Bill, 2016
Memorandum of a company [contains details of the company, its objectives, information of shareholders, etc.] (Section 4)	<ul style="list-style-type: none"> Memorandum must specify the objects for which the company is being incorporated, and other related matters. 	<ul style="list-style-type: none"> Memorandum may contain general objects which state that the company may engage in any lawful act or activity or business. If the memorandum contains specific objects, it cannot pursue anything outside those objects.
Private placement [offer of securities by a company to a select group of persons, as opposed to a public offer.] (Section 42)	<ul style="list-style-type: none"> Separate offer letter to be given to private individuals. A record of such offers must be filed with the Registrar of Companies (RoC) in 30 days; After making an allotment of securities, company must file a return of allotment with the RoC. 	<ul style="list-style-type: none"> Removes the requirement of issuing a separate offer letter, and recording such offers with the RoC. Retains provision related to filing of return of allotment with the RoC.
Forward dealing [purchasing securities of a company at a price in the future] (Section 194) Insider trading [publicly trading stocks with insider information about a company.] (Section 195)	<ul style="list-style-type: none"> Prohibits forward dealing in securities by the Director or key managerial personnel (KMPs). Prohibits insider trading by all persons in a company, including the Director and KMPs 	<ul style="list-style-type: none"> Deletes provisions related to prohibition of forward dealing and insider trading. [They are regulated under the SEBI (Prohibition of Insider Trading) Regulations, 2015.⁵]
Cap on investments through layers (Section 186)	<ul style="list-style-type: none"> Investments in a company cannot be made through more than two layers of investment companies. 	<ul style="list-style-type: none"> Removes the restrictions on number of layers of investment companies.
Cap on layers of subsidiaries (Section 2 (87))	<ul style="list-style-type: none"> Permits the central government to impose a cap on the layers of subsidiaries a company can have. 	<ul style="list-style-type: none"> Removes the restrictions on number of layers of subsidiaries of a company.
Independent directors (Section 149 (6))	<ul style="list-style-type: none"> Independent directors to have no monetary (pecuniary) relationship with the company. 	<ul style="list-style-type: none"> Allows independent directors to have pecuniary interest up to 10% of their income. The amount may be modified by the central government.
Beneficial interest [right to obtain benefits of a share when ownership is by the shareholder or by another.] (Section 89)	<ul style="list-style-type: none"> A person who has a beneficial interest in a company's shares must declare the same; The term 'beneficial interest' is not defined. 	<ul style="list-style-type: none"> Defines beneficial interest in a share to include, in respect of such shares: (i) the right to exercise all rights, or (ii) to receive dividend.
Significant beneficial interest (Section 90)	<ul style="list-style-type: none"> Does not contain provision related to significant beneficial interest. 	<ul style="list-style-type: none"> Adds that those who hold beneficial interest of more than 25% of the company's shares (either alone or with someone) must declare it.

Key Features	Companies Act, 2013	Companies (Amendment) Bill, 2016
Subsidiary company (Section 2(87))	<ul style="list-style-type: none"> Subsidiary company is one in which a parent company holds more than 50% of its <i>shares</i> (includes equity and preferential shareholders). 	<ul style="list-style-type: none"> Replaces the term <i>shares</i> with <i>voting power</i>. Preferential shareholders, who do not have voting power are excluded.
Associate company (Section 2(6))	<ul style="list-style-type: none"> Associate company is one where another company holds at least 20% of its <i>shares</i> (includes equity and preferential shareholders). 	
Acceptance of deposits by companies (Section 73 (2) (d), (e))	<ul style="list-style-type: none"> If a company accepts deposits from its members, it must fulfil several conditions related to security and repayment, including: <ul style="list-style-type: none"> providing deposit insurance; certifying that the company has not committed any default in the repayment of, or on the payment of interest on such deposits. 	<ul style="list-style-type: none"> Omits the requirement of providing deposit insurance. Permits companies that have previously defaulted to accept deposits if five years have passed from such default, and the earlier dues have been paid.
Managerial remuneration (Section 197)	<ul style="list-style-type: none"> If managerial remuneration exceeds prescribed limits, approval of the central government and shareholders must be obtained. 	<ul style="list-style-type: none"> Omits the requirement of obtaining approval from the central government.
Loans to directors (Section 185)	<ul style="list-style-type: none"> A company is not allowed to advance any loan to its directors or to any person in whom the director is interested. 	<ul style="list-style-type: none"> Allows companies to advance a loan in relation to any person a director is interested in if the company passes a special resolution.
Liability of auditors and audit firms for fraud (Section 147 (5))	<ul style="list-style-type: none"> If it is proved that the partner of an audit firm has participated in fraud in relation to audit of a company, the partner and the firm will be jointly and severally liable for civil and criminal punishment. 	<ul style="list-style-type: none"> Adds a proviso that states that in case of criminal punishment, only the partner who has participated in fraud will be liable. The audit firm shall only be liable for payment of fine.
Annual General Meeting of companies (Section 96 (2))	<ul style="list-style-type: none"> Every annual general meeting (AGM) must be held either at the registered office of the company or at a place where the registered office of the company is situated. 	<ul style="list-style-type: none"> Adds a proviso that permits an unlisted company to hold its AGM at any place in India, if members' consent is obtained in advance.
Qualification of technical members of the National Company Law Tribunal (NCLT) [In addition to persons with 15 years of experience as a Chartered Accountant, Cost Accountant or Company Secretary] (Section 409 (3))	<ul style="list-style-type: none"> A member of the Indian Corporate Law or Legal Service for 15 years, and of the same pay scale as a Joint Secretary for three years; Experts: 15 years of experience in law, accountancy, labour, disciplines related to management, industrial finance, etc. 	<ul style="list-style-type: none"> Requires such members to hold the rank of Secretary or Additional Secretary. Limits the areas of expertise to industrial finance, management, or reconstruction, investment and accountancy.
Qualification of technical members of the National Company Law Appellate Tribunal (NCLAT) (Section 411 (3))	<ul style="list-style-type: none"> Experts: 25 years of experience in law, accountancy, labour, disciplines related to management, industrial finance, etc. 	<ul style="list-style-type: none"> Limits the areas of expertise to industrial finance, management, or reconstruction, investment and accountancy.
Selection Committee [for appointing technical members of NCLT and NCLAT] (Section 412)	<ul style="list-style-type: none"> Selection committee to include five members: (i) Chief Justice of India (Chairperson), (ii) Senior Supreme Court or High Court Chief Justice, (iii) Secretaries from the ministries of Corporate Affairs, Finance and Law. 	<ul style="list-style-type: none"> Secretary, Ministry of Finance removed as member of the Committee. Chairperson of Selection Committee to have the casting vote, in case of a tie.

Sources: The Companies Act, 2013, The Companies (Amendment) Bill, 2016; PRS.

PART B: KEY ISSUES AND ANALYSIS

Rationale behind certain amendments to the 2013 Act

Investment through layers of subsidiaries and investment companies

The 2013 Act prohibits companies from making investments in other companies through more than two layers of intermediary companies. In addition, the central government may specify a cap on the number of layers of subsidiaries that a holding company can have. These provisions sought to address issues related to i) tracing the

Act: Sections 186, 2(87)

source of investments in companies and their ultimate use, and ii) use of multiple levels of subsidiaries to siphon funds.¹ The Companies Law Committee (CLC) recommended that such caps must be deleted as they would affect the company's structuring and ability to raise funds. The CLC noted that certain provisions in the 2013 Act would ensure transparency in the functioning of a company and its subsidiaries. These include provisions that require i) the consolidation of financial statements of a holding company and its subsidiaries, and ii) the disclosure of beneficial ownership of one's shares in a company.¹ By removing the cap on the number of layers of subsidiaries, the 2016 Bill is in line with the CLC's recommendations.

Bill: Clauses 2(xii), 60

Appointment of an Independent Director with transactions up to 10% with the company

The 2013 Act does not permit an Independent Director to have a pecuniary relationship with the company, other than his remuneration. The J.J. Irani Committee in 2005 recommended that an Independent Director could have a monetary relationship up to 10% of his remuneration with the company.⁶ The CLC reasoned that minor transactions may not compromise the independence of such Directors.¹ The 2016 Bill permits an Independent Director to have a monetary relationship, up to 10% of his total income, with the company. This amount may be modified by the central government.

Act: Sections 149 (6) (c)

Bill: Clause 45

Recommendations of the Companies Law Committee not adopted

Certain changes proposed by the CLC in relation to (i) residence requirements for directors; and (ii) compliance requirements for dormant companies have not been included in the Bill. We explain these issues below.

Requirement of year-long residence in India to be appointed as a director of a company

Under the 2013 Act, only a person who is a resident of India is eligible for appointment as a whole-time director of a company. A resident is defined as someone who has stayed in India for a continuous period of 12 months before he is appointed as a director. This may prevent a company from attracting a talented individual residing abroad (even an Indian citizen) back to India as a whole-time director as he will not meet the 12-month continuous residence requirement. The CLC recommended that this residence requirement for a foreign national should be removed. This would enable Indian companies to access a larger pool of global talent, and increase the mobility of professionals across countries.¹

Act: Section 196, Schedule V

Constitution of an audit committee by dormant companies

Under the 2013 Act, any company without transactions for the previous two years may apply to obtain the status of a dormant company. The 2013 Act does not exempt such dormant companies from the requirement to constitute committees such as (i) audit committee, (ii) nomination and remuneration committee, and (iii) stakeholder relationship committee. The CLC suggested that dormant companies may be exempted from constituting an audit committee as they may not have any business activities or employees.¹

Act: Sections 177, 178

Setting up of the NCLT and NCLAT in accordance with the SC judgment

The 2013 Act sets up the National Companies Law Tribunal (NCLT) to hear disputes related to the Companies Act, 2013. Appeals from the decisions of the NCLT will be heard by the National Companies Law Appellate Tribunal (NCLAT). In 2015, the Supreme Court upheld the constitutional validity of the tribunals. However, the Court held certain provisions, in relation to the: i) qualifications of technical members of the NCLT; ii) composition of the Selection Committee for appointment of technical members of the NCLT and NCLAT as invalid. The Bill has modified these provisions to bring it in line with the Supreme Court's decision.³

Act: Sections 409, 411, 412

Bill: Clauses 78, 79, 80

1. The Companies Law Committee Report, Ministry of Corporate Affairs, February, 2016, http://www.mca.gov.in/Ministry/pdf/Report_Companies_Law_Committee_01022016.pdf.

2. The Companies (Amendment) Act, 2015, <http://www.prsindia.org/uploads/media/Company/Companies%20Act.%202015.pdf>.

3. Madras Bar Association v. Union of India, [(2015) 8 SCC 583].

4. Statement of Objects and Reasons, The Companies (Amendment) Bill, 2016.

5. Securities and Exchange Board of India, (Prohibition of Insider Trading) Regulations, 2015.

6. Expert Committee on Company Law (J.J. Irani Committee), Ministry for Company Affairs, May 2005, para 11.1.

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