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India: Impact of The Recent Amendments to The Companies Act, 2013

18 January 2018

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The President of India accorded his assent to the Companies (Amendment) Act, 2017 (the "**Amendment Act**") on 3 January 2018. The Central Government notified the Amendment Act on the same day. However, the provisions of the Amendment Act will come into force on the date, or the dates notified by the Central Government.

The impact of the changes on certain key aspects under the Companies Act, 2013 (the "**Companies Act**") are set out below:

1. **Incorporation of a company and matters connected therewith.** The Amendment Act allows the promoters of a proposed company to reserve the name of the company for up to twenty days (from the earlier period of sixty days). The other procedural change in relation to incorporation is that persons who are proposed to be appointed as the first directors are allowed to submit a declaration in lieu of an affidavit. Newly formed companies shall identify and communicate their registered office address within thirty days of incorporation to the Ministry of Corporate Affairs (the "**MCA**"), if not identified and communicated at the time of incorporation. It has now been clarified that the one hundred and eighty-two days' period for determining the residency status of a resident director will apply proportionately in the case of a newly incorporated company.
2. **Director Identification Number (DIN).** The Central Government may prescribe any identification number which shall be treated as the DIN for the purpose of the Companies Act. If an individual already holds or has acquired such an identification number, the requirement to obtain DIN, as it is currently understood, may stand discontinued. This is a welcome change given the elaborate procedure to obtain the DIN. One could expect the Central Government to approve the usage of Aadhaar number or PAN number as an alternative to the DIN in the days to come.

3. Key definitions.

- a. The definition of the expression "significant influence" has been replaced with a new definition. Significant influence is to be now determined on the basis of control of at least twenty percent of total voting power or control of or participation in business decisions under an agreement. The erstwhile definition of the term "significant influence" had placed emphasis on total share capital as against the currently envisaged total voting power. This change would impact companies which have both equity shareholders and preference shareholders. The intent of the Amendment Act appears to be that significant influence is to be determined on the basis of voting rights exercisable by an equity shareholder only. However, this change would not impact preference shareholders when it comes to exercise of their voting rights in such matters where they are entitled to vote as per the law.
- b. The expression "joint venture" has now been defined. It means a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement. The MCA had defined the expression "joint venture" in one of its earlier circulars issued last year. The said circular was issued in the context of appointment of an independent director by unlisted public companies. Therefore, various stakeholders had voiced concerns about the application of this definition in contexts not dealt with under the said circular. This controversy has now been laid to rest.
- c. An explanation has been inserted in relation to the definition of the expression "holding company". This clarifies the position with respect to an overseas parent company of an Indian company. Such companies would fall under the ambit of a "holding company" in terms of the Companies Act. Therefore, an overseas holding company will now be treated at par with an Indian holding company.
- d. The definition of the expression "key-managerial personnel" now stands considerably enhanced. In addition to the existing category of persons, persons holding an office that is one level below that of a whole-time director, and designated as key-managerial personnel, by the board of directors of the company will also be considered as a key managerial personnel.
- e. The definition of the expression "interested director" has been omitted. This addresses the drafting anomaly that was present in the original text of the law. In fact, the expression "interested director" has not been used in the Companies Act even once. Therefore, the definition was otiose. The concept of a director being interested is covered and dealt with under Section 184 of the Companies Act.
- f. The ambit of the definition of the expression "related party" has been expanded as a new sub-clause (viii) has been inserted in Section 2 (76) of the Companies Act. The new sub-clause states that a body corporate which is a holding, subsidiary, fellow subsidiary, or an associate company of an Indian company will also be treated as a related party

of the Indian company and *vice versa*. In addition, a body corporate which is an "investing company or the venturer of the company" will also be treated as a related party of the Indian company. Investing company or the venturer of a company" means a body corporate whose investment in the company would result in the company becoming an associate company of the body corporate. However, in view of the earlier exemption granted to private limited companies, such persons will be not treated as a related party of a private limited company.

4. **Meetings of shareholders.** An unlisted company can now hold its annual general meeting ("**AGM**") anywhere in India. Such companies are no longer required to hold their AGM at the registered office of the company or at some other place/address within the city, town, or village where the registered office of the company is situated. The other procedural change with respect to an AGM is that the matter of ratification of the appointment of a statutory auditor need not be placed before the shareholders in each and every AGM. Companies that are one hundred percent held by an overseas body corporate can now hold their extraordinary general meetings overseas. Therefore, the rule that all companies need to hold their extraordinary general meeting in India has been relaxed.
5. **Meetings of the board of directors.** The Companies Act had earlier prohibited the discussion of certain items in board meetings in which any director was participating through a video conferencing facility. In a significant departure, this restriction has been liberalized. If the quorum is being fulfilled by the directors who are physically present in a board meeting, the directors can deliberate on any matter, including the hitherto restricted matters.
6. **Issue of securities.** The Amendment Act now provides that proceeds from a private placement of securities cannot be utilized till the return of allotment is filed with the MCA. Therefore, companies who were looking to utilize share application money as a source of meeting their short-term capital needs are no longer allowed to do so. In addition, the Amendment Act clarifies that an offer of shares cannot be renounced by the person to whom the offer is made. There was some ambiguity about this point in the context of a private placement of securities and this ambiguity has now been addressed. It has also been provided that a company can issue shares at a discount to its creditors when its debt is converted into equity pursuant to any statutory resolution plan or debt restructuring scheme in accordance with the Reserve Bank guidelines, etc. It is worth remembering that companies were otherwise not allowed to offer shares at a discounted price. This is a pragmatic change and offers the necessary flexibility in undertaking restructuring activities, particularly, in designing insolvency resolution plans. The earlier restriction that companies cannot issue sweat equity shares until the completion of one year from the commencement of business has been removed. This is a useful change and is expected to benefit start-ups.
7. **Loans to directors and to persons in whom the directors are interested.** In terms of the Amendment Act, a company is allowed to provide a loan (or issue a guarantee or security in connection with such a loan) to a person in whom any of the directors of the company are interested. However, to do so, two conditions are required to be fulfilled. The first condition is that the

shareholders of the lender company shall have accorded their consent to the transaction through a special resolution. The second condition is that the borrower company should utilize the loan proceeds only for the purpose of its principal business activity (the expression "principal business activity" continues to remain undefined). This is an important and pragmatic change and will facilitate legitimate business transactions. The second condition as above would not apply in respect of transactions involving a holding company and its wholly owned subsidiary. The Amendment Act continues to prohibit the providing of loans to a director of a company or that of its holding company.

8. **Clarification on disqualification of directors and the consequent vacation of their office.** In terms of Section 164(2) of the Companies Act, a person who is or has been a director of a company which has (a) not filed its financial statements or annual returns for any continuous period of three financial years or (b) has failed to repay the deposits accepted by it or pay interest thereon or to redeem any debentures on the due date or pay interest due thereon or pay any dividend declared and such failure continues for one year or more, is not eligible to be re-appointed as a director of that company or as a director of any other company. Section 167(1) states that if a director has incurred any of the disqualifications under Section 164, he / she shall automatically vacate office. The MCA was of the opinion that in view of the language of this section, a director would automatically vacate his / her office in all the companies in which such person was a director. This was creating a peculiar situation where the company in default under Section 164(2) was left without any director. Consequently, any new appointment would also be hit by the disqualification under Section 164(2). Therefore, an attempt has been made to clarify that the directors of such companies will vacate their office in all the companies except in the company which has committed the default under Section 164(2). Furthermore, persons who are appointed as a director of such a company will not incur the disqualification under Section 164(2) for a period of six months from the date of their appointment. The result of this is that persons agreeing to become directors a company which has committed a default under Section 164(2) should be very careful and diligent to regularize the non-compliances within six months failing which the disqualification under Section 164(2) and the consequence under Section 167(1) will get attracted in their case.
9. **Managerial remuneration.** The restrictions on payment of managerial remuneration have been rationalized. The approval of the Central Government is no longer required in respect of payment of managerial remuneration in excess of the limits prescribed under the Companies Act (that is 11% of the net profits). The matter of payment of managerial remuneration in excess of the limits is now allowed to be settled / decided at the shareholder level. If shareholders accord their approval, such proposals can be implemented without the approval of the Central Government. However, a company that has defaulted on its payment obligations to a bank / financial institution, secured creditor or the holder of non-convertible debenture can implement such a proposal only after obtaining the consent of such persons. The Amendment Act also clarifies that the applications pending with the Central Government as on date shall abate.

10. **Consolidation of accounts.** Earlier, companies were required to consolidate the accounts of their subsidiary company along with theirs and lay the same before the shareholders in an AGM. This requirement has now been extended to include associate companies also. Therefore, companies will now be required to consolidate the accounts of both their subsidiary and associate companies in the same form and manner in which their financial statements are prepared. This requirement will create an additional compliance and reporting burden on the companies, especially given the broad ambit of what would constitute an associate company.
11. **Foreign Companies.** The reporting and compliance burden on foreign companies stands enhanced. The provisions that were hitherto applicable only to foreign companies with a substantial Indian ownership has now been made applicable to all foreign companies (regardless of its ownership composition).
12. **Compounding of offences.** The impact of the changes is that contraventions that were punishable with (i) imprisonment or fine; or with (ii) imprisonment or fine or with both, can now be compounded. The earlier position was that unless a contravention was punishable with fine only, such contraventions could not be compounded.
13. **Forward contracts and insider trading.** Sections 194 (Prohibition on forward dealing in securities of company by director or key managerial personnel) and 195 (Prohibition on insider trading of securities) stands repealed. These sections were causing a lot of practical challenges in the context of private limited companies. Since listed companies are anyway subject to a securities law regime which deals with these aspects, these sections were not necessary in the first place.

Conclusion

The Amendment Act is an incremental and natural step towards liberalizing and rationalizing some of the aspects of the Companies Act. It also removes some drafting ambiguities plaguing the Companies Act. It has also sought to align the provisions of the Companies Act with other statutes, like securities laws and the regulations of the Reserve Bank of India. To that extent, it is a welcome step.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

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