

APPOINTMENT AND REMUNERATION OF MANAGERIAL PERSONNEL



LEARNING OUTCOMES

After studying this chapter, the students would be able to:

- ❑ Describe the provisions relating to appointment of Managing Director, Whole Time Director and Manager.
- ❑ Explain the provisions regarding appointment of Key Managerial Personnel (KMPs).
- ❑ Comprehend the concept of maximum managerial remuneration and managerial remuneration payable in case of absence or inadequacy of profits.
- ❑ Compute and calculate profits for the purpose of managerial remuneration and recovery of managerial remuneration in certain cases.
- ❑ Explain the concepts of compensation for loss of office of Managing or Whole Time Director or Manager.
- ❑ Explain about the functions of Company Secretary and requirements for Secretarial Audit.



1. INTRODUCTION

This Chapter deals with the appointment of managerial personnel and managerial remuneration payable to them as per the applicable provisions of the Companies Act, 2013, with relevant Rules made thereunder and Schedule V.

MEANING OF CERTAIN TERMS

"Chief Executive Officer" [Section 2(18)] means an officer of a company, who has been designated as such by it.

"Chief Financial Officer" [Section 2(19)] means a person appointed as the Chief Financial Officer of a company.

"Company Secretary" or "secretary" [Section 2(24)] means a company secretary as defined in clause (c) of sub-section (1) of Section 2 of the Company Secretaries Act, 1980 who is appointed by a company to perform the functions of a company secretary under the Companies Act, 2013.

"Company Secretary in practice" [Section 2(25)] means a company secretary who is deemed to be in practice under sub-section (2) of Section 2 of the Company Secretaries Act, 1980.

"Key Managerial Personnel" [Section 2(51)] in relation to a company, means—

- (i) the Chief Executive Officer or the managing director or the manager;
- (ii) the company secretary;
- (iii) the whole-time director;
- (iv) the Chief Financial Officer; -
- (v) such other officer, not more than one level below the directors who is in whole-time employment, designated as key managerial personnel by the Board; and
- (vi) such other officer as may be prescribed.

"Manager" [Section 2(53)] means an **individual** who, subject to the superintendence, control and direction of the Board of Directors, has the management of the whole, or substantially the whole, of the affairs of a company, and includes a director or any other person occupying the position of a manager, by whatever name called, whether under a contract of service or not.

According to the above definition, a manager is an individual person. Such person is given the charge of whole or substantially the whole of managing the affairs of a company. Therefore, a person appointed as manager to head one of the sections of the company (say, marketing department) cannot be said to be a 'manager' within the meaning of Section 2 (53). **A manager functions under the superintendence, control and direction of the Board of Directors.**

It is not necessary that a manager should also be a director of the company though there is no restriction in designating a director as manager of the company. It is not permitted by Section 196(1)

for a company to appoint both managing director and manager at the same time. The simple reason behind this restriction is that when a person is entrusted with whole or substantially the whole of management, how can there be appointed another person for the same purpose. Moreover, due to overlapping of authorities between two powerful persons, the affairs of a company shall not be conducted the way they should, leading to mismanagement.

Managing Director [Section 2(54)] means a director who, by virtue of the articles of a company or an agreement with the company or a resolution passed in its general meeting, or by its Board of Directors, is entrusted with substantial powers of management of the affairs of the company and includes a director occupying the position of managing director, by whatever name called.

On simplifying we can understand, Managing Director means a **director** who is entrusted with **substantial powers of management** of the affairs of the company by:

- (i) virtue of the articles of a company, or
- (ii) an agreement with the company, or
- (iii) a resolution passed in its general meeting, or by its Board of Directors,

and includes a director occupying the position of the managing director, by whatever name called.

Explanation to Section 2(54) clarifies that **substantial powers of the management** shall not be deemed to include the power to do such administrative acts of a routine nature when so authorized by the Board such as:

(i)	the power to affix the common seal of the company to any document, or
(ii)	to draw and endorse any cheque on the account of the company in any bank, or
(iii)	to draw and endorse any negotiable instrument, or
(iv)	to sign any certificate of share, or
(v)	to direct registration of transfer of any share.

Thus, excluding the above administrative acts of a routine nature, the managing director enjoys substantial powers of conducting and managing the business of the company as per its memorandum and articles of association.

From the above definition, it emerges that a managing director needs to be a director in the first place. It is immaterial whether he is appointed as additional director or rotational director or non-rotational director. However, as soon as he ceases to be a director, he shall also cease to be a managing director.

It is not necessary that a director who occupies the position of the managing director needs to be called 'managing director'. He may be called by whatever name. The essential pre-requisite is that the director must be entrusted with substantial powers of management of the affairs of the company

excluding routine administrative acts as entrusted by the Board. If such is the case, the director is a managing director, by whatever name called. It may be noted that Section 196 (1) prohibits a company to appoint both managing director and manager at the same time. However, it shall be appropriate if a person is designated as a Managing Director instead of manager.

The Board of Directors exercises control over the managing director. Thus, powers as managing director are exercisable according to the directions of the Board.

Whole Time Director (WTD) [Section 2(94)]: WTD includes a director in the whole-time employment of the company.

As the definition suggests WTD is a director. Also, he is in the whole-time employment of the company *i.e.* he is a full-time employee who is required to devote his time in totality for the management of the company. A person who is not a director in the company cannot be employed as whole-time director.

Remuneration [Section 2 (78)]: 'Remuneration' means any money or its equivalent given or passed to any person for services rendered by him and **includes perquisites** as defined under the Income-Tax Act, 1961.



2. APPOINTMENT OF MANAGING DIRECTOR, WHOLE TIME DIRECTOR OR MANAGER [SECTION 196]

Section 196 of the Act contains the provisions for appointment of managing director, whole time director or manager. According to this section:

- (i) **Appointment [Section 196(1)]:** A company shall appoint or employ managing director, whole time director or manager. But a company shall not appoint or employ a managing director and a manager at the same time.

In other words, no company is permitted to appoint a manager if a managing director is already appointed and *vice-versa*. However, there can be both MD and whole-time director in a company.

- (ii) **Tenure [section 196(2)]:**
- (a) No company shall appoint or re-appoint any person as its managing director, whole-time director or manager for a term exceeding **five years** at a time.
 - (b) It is further provided that no re-appointment shall be made earlier than one year before the expiry of his term.

Example 1: 'X' was appointed as Managing Director for life by the Articles of Association of a private company which was incorporated on 1st June, 2019. Section 196(2) of the Companies Act, 2013 lays down that no company shall appoint or re-appoint any person as its managing director, whole-time director or manager for a term exceeding five years at a

time. No concession or exception is allowed by the Act to private companies. Hence, 'X' cannot be appointed as managing director for life .

- (iii) **Eligibility Conditions for Appointment:** For appointing a person as a managing director, whole-time director or manager, firstly he shall not be disqualified for appointment as a director under section 164.

As per section 196(3), no company shall appoint or continue the employment of any person as managing director, whole-time director or manager who-

- (a) is below the age of 21 years or has attained the age of 70 years.

Requirement of Special Resolution for appointment of a person above the age of 70 years: There is a relaxation in case of a person above the age of 70 years. Accordingly, where a person has attained the age of seventy years, he may still be appointed to such office if a special resolution is passed in this respect. In such a case, the explanatory statement annexed to the notice for such motion shall indicate the justification for appointing such person.

Government approval required if no Special Resolution is passed: Further, where no such special resolution is passed but votes cast in favour of the motion exceed the votes, if any, cast against the motion and the Central Government is satisfied, on an application made by the Board, that such appointment is most beneficial to the company, the appointment of the person who has attained the age of seventy years may be made.

In other words, approval of the Central Government is required if special resolution could not be passed. The significance of this provision lies in the fact that because majority of the members were in favour of such appointment, their wish should not be turned down simply due to non-passing of special resolution. Thus, the appointment can be regularized by seeking approval of the Central Government, which, if satisfied, can accord such approval.

- (b) is an undischarged insolvent or has at any time been adjudged as an insolvent; or
- (c) has at any time suspended payment to his creditors or makes, or has at any time made, a composition with them; or
- (d) has at any time been convicted by a court of an offence and sentenced for a period of more than six months.
- (e) **Additional eligibility conditions for appointment as per Schedule V:** Part I of Schedule V¹ to the Companies Act, 2013, has prescribed additional eligibility

¹ Heading of Part I of Schedule V reads as 'Conditions to be fulfilled for the appointment of a Managing or Whole-time director of a manager without the approval of the Central Government'.

conditions for appointment as managing director or whole-time director or a manager without seeking approval from the Central Government. They are stated as under:

- (1) he had not been sentenced to imprisonment for any period, or to a fine exceeding one thousand rupees, for the conviction of an offence under 19 Acts² as specified under Part I of Schedule V.
- (2) he had not been detained for any period under the Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974 (COFEPOSA).

However, where the Central Government has given its approval to the appointment of a person convicted or detained under para (1) or para (2), as the case may be, no further approval of the Central Government shall be necessary for the subsequent appointment of that person if he had not been so convicted or detained subsequent to such approval.

- ³(3) he has completed the age of twenty-one years and has not attained the age of seventy years.

However, where he has attained the age of seventy years; and where his appointment is approved by a special resolution passed by the company in general meeting, no further approval of the Central Government shall be necessary for such appointment.

² The 19 Acts are:

- (i) the Indian Stamp Act, 1899.
- (ii) the Central Excise Act, 1944.
- (iii) the Industries (Development and Regulation) Act, 1951.
- (iv) the Prevention of Food Adulteration Act, 1954.
- (v) the Essential Commodities Act, 1955.
- (vi) the Companies Act, 2013 or any previous company law (Substituted by notification dated 12th September 2016)
- (vii) the Securities Contracts (Regulation) Act, 1956.
- (viii) the Wealth-tax Act, 1957.
- (ix) the Income-tax Act, 1961.
- (x) the Customs Act, 1962.
- (xi) the Competition Act, 2002.
- (xii) the Foreign Exchange Management Act, 1999.
- (xiii) the Sick Industrial Companies (Special Provisions) Act, 1985.
- (xiv) the Securities and Exchange Board of India Act, 1992.
- (xv) the Foreign Trade (Development and Regulation) Act, 1922.
- (xvi) the Prevention of Money-Laundering Act, 2002.
- (xvii) the Insolvency and Bankruptcy Code, 2016.
- (xviii) the Goods and Services Tax Act, 2017.
- (xix) the Fugitive Economic Offenders Act, 2018.

³ This condition is also specified by Section 196 (3) and mentioned earlier.

(4) he is resident of India.

Explanation I clarifies that **resident in India** includes a person who has been staying in India for a continuous period of not less than twelve months immediately preceding the date of his appointment as a managerial person and who has come to stay in India, -

- (a) for taking up employment in India; or
- (b) for carrying on a business or vacation in India.

Explanation II clarifies that the condition above shall not apply to the companies in Special Economic Zones (SEZ).

However, a person, being a **non-resident in India** shall enter India only after obtaining a proper Employment Visa from the concerned Indian mission abroad. For this purpose, such person shall be required to furnish, along with the visa application form:

- profile of the company,
- the principal employer, and
- terms and conditions of such person’s appointment.

(iv) **Procedure of Appointment [Section 196(4)]:**

Approval by Board and Shareholders	Approval by Central Government
Subject to the provisions of section 197 and Schedule V, a managing director, whole-time director or manager shall be appointed, and the terms and conditions of such appointment and remuneration payable shall be-	In case such appointment is at variance to the conditions specified in Part I of Schedule V, the appointment shall be approved by the Central Government.
	
<ul style="list-style-type: none"> (i) approved by the Board of Directors at a meeting; and (ii) approved by shareholders by a resolution at the next general meeting of the company. 	Form MR-2 has been prescribed by Rule 7 of the <i>Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014</i> in which application for seeking approval from the Central Government shall be made within ninety days of such appointment of MD or WTD or manager in the company.

Inclusion of certain disclosures in Notice	The notice convening Board or general meeting for considering such appointment shall include: (i) the terms and conditions of such appointment, remuneration payable, and (ii) such other matters including interest, of a director or directors in such appointments, if any.
Filing of Return:	A return in the prescribed form ⁴ along with the prescribed fee shall be filed with the Registrar within sixty days of such appointment.

- (v) **Validity of Acts [Section 196(5)]:** Subject to the provisions of this Act, where an appointment of a managing director, whole-time director or manager is not approved by the company at a general meeting, any act done by him before such approval shall be deemed to be valid.

Example 2: A Managing Director is appointed in the board meeting held on 20th May 2019. General meeting was to be held on 17th June, 2019 for approval of such appointment. Before the holding of general meeting, the managing director executed an agreement with another company of considerable importance on 3rd June, 2019. The general meeting was held accordingly on 17th June, 2019 but did not approve the appointment of managing director. Here, the agreement executed by Managing Director is valid. The acts done by the managing director from 20th May, 2019 to 17th June, 2019 *i.e.* upto the non-approval of his appointment by the shareholders at the general meeting, shall be valid subject to the provisions of the Companies Act, 2013.

Exemptions

- (i) In case of a **Government Company**, Section 196(2), (4) and (5) shall not apply. However, for availing the exemption, such Government Company must not have committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar. (Notification No. G.S.R. 463(E) dated 5th June, 2015 as amended by Notification No. G.S.R. 582 (E), dated 13-06-2017).
- (ii) In case of **Private Company**, Section 196(4) and (5) shall not apply provided such private company has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar. (Notification No. G.S.R. 464(E) dated 5th June, 2015 as amended by Notification No. G.S.R. 583(E) dated 5th June, 2015).

⁴ Rule 3 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 prescribes Form No. MR-1.

Example 3: Sukanya Limited, a company incorporated under the Companies Act, 2013, approved the appointment of Mr. Rajaram as the managing director of the company in the company's last annual general meeting. Accordingly, Mr. Rajaram was vested with the substantial powers of managing the business of the company. After a period of 1 year from the appointment of Mr. Rajaram, the company wants to employ Mr. Rakesh, the whole time employee of the company, as the manager of the finance department of the company. Now the company is in dilemma regarding the appointment of Mr. Rakesh.

In the said case, according to section 2(53) of the Companies Act, 2013, manager means an individual who, subject to the superintendence, control and direction of the Board of Directors, has the management of the whole, or substantially the whole, of the affairs of a Company, and includes a director or any other person occupying the position of a manager, by whatever name called, whether under a contract of service or not. According to the above definition, a manager is an individual person. Such person is given the charge of whole or substantially the whole of managing the affairs of a company. Therefore, a person appointed as manager to head any department of the company cannot be said to be a 'manager' within the meaning of section 2(53).

Further the provisions of section 196(1) of the Companies Act, 2013 applies to manager falling within the meaning of the definition of section 2(53)

In the given example, Mr. Rakesh is not falling within the meaning of the definition of section 2(53) and accordingly section 196(1) is not applicable. Hence company can go ahead with the appointment of Mr. Rakesh as manager of the Finance Department.

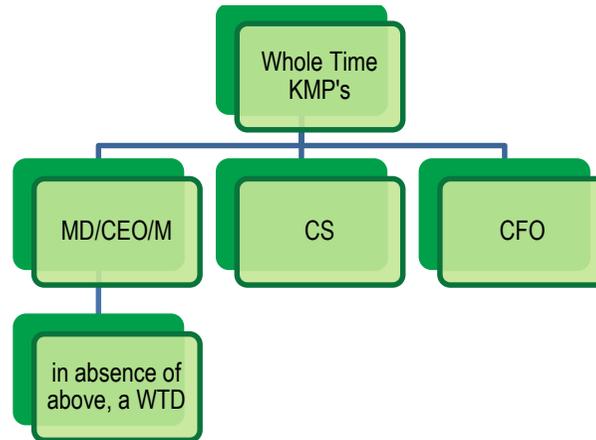
High Court of Bombay decided in Sridhar Sundararajan v. Ultramarine & Pigments Limited that Special resolution under section 196(3)(a) is to be passed to continue any person aged 70 years as MD even if his appointment was made before coming into force of Companies Act, 2013, i.e., before 1-4-2014 when he was below 70 years.



3. APPOINTMENT OF KEY MANAGERIAL PERSONNEL [SECTION 203]

Section 203 of the Act, and Rule 8 as well as Rule 8A of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 contain the provisions for appointment of Key Managerial Personnel in the prescribed companies.

- (i) **Appointment of Key Managerial Personnel [Section 203(1)]:** Every company belonging to the prescribed class or classes of companies shall have the following whole time key managerial personnel:



According to **Rule 8** following companies shall have whole-time key managerial personnel:

- (a) every listed company; and
- (b) every other public company having a paid-up share capital of 10 crore rupees or more.

Requirement of Company Secretary in certain other companies: According to Rule 8A, every private company which has a paid up share capital of 10 crore rupees or more shall have a **whole-time company secretary**.

In other words, it is now mandatory for every private company to have a whole-time company secretary if its paid up share capital is 10 crore rupees or more.

(ii) **Prohibition on individual to be appointed as Chairperson as well as Managing Director or Chief Executive Officer at the same time [Proviso to Section 203(1)]:**

An individual shall not be appointed or reappointed as the Chairperson of the company, in pursuance of the articles of the company, as well as the Managing Director or Chief Executive Officer (CEO) of the company at the same time, **unless** —

- (a) the articles of such a company provide otherwise; or
- (b) the company does not carry multiple businesses. [First proviso to Section 203(1)]

Exemption from restriction: However, above-mentioned prohibition shall not apply to such class of companies which is engaged in multiple businesses and which has appointed one or more Chief Executive Officers for each such business as may be notified by the Central Government. [refer Second proviso to Section 203(1)]

In other words, a person appointed as Chairperson of a company cannot be appointed as MD or CEO at the same time in that company. This prohibition is not applicable in the following cases: [Second proviso to Section 203(1)]

- Where the articles of such company provide otherwise *i.e.*, they allow the Chairperson to be appointed as MD or CEO.

- Where the company belongs to the prescribed class of companies (*refer Box below*); is engaged in multiple businesses; and has appointed Chief Executive Officer for each such business.

Notified Public Companies: The MCA vide Notification No. S.O. 1913(E) dated 25th July, 2014 has notified that public companies having paid-up share capital of 100 crore rupees or more and annual turnover of 1,000 crore rupees or more which are engaged in multiple businesses and have appointed Chief Executive Officer for each such business shall be the class of companies for the purposes of the second proviso to sub-section (1) of section 203.

Explanation-For the purpose of this notification, the paid-up share capital and the annual turnover shall be decided on the basis of the latest audited balance sheet.

(iii) Conditions for Appointment:

- (a) **Requirement of Board Resolution**⁵: Every whole-time key managerial personnel of a company shall be appointed by means of a resolution of the Board. The resolution shall contain the terms and conditions of the appointment including the remuneration. [refer Section 203 (2)]
- (b) **Bar on multiple appointments:** A whole-time key managerial personnel shall not hold office in more than one company at the same time **except in its subsidiary company**. [Section 203 (3)]

However, key managerial personnel shall not be disentitled from being a director in any company with the permission of the Board. [refer Proviso to Section 203 (3)]

Provided further that whole-time key managerial personnel holding office in more than one company at the same time on the date of commencement of this Act, shall, within a period of six months from such commencement, choose one company, in which he wishes to continue to hold the office of key managerial personnel.

- (iv) Managing Director or Manager in more than one company [Third Proviso to Section 203(3)]:** If a person is MD or manager in some other company it is permissible for a company to appoint him as its managing director. The *modus operandi* is as under:

⁵ Rule 8 of the Companies (Meetings of Board and its Powers) Rules, 2014 requires passing of Board Resolution at a meeting of the Board if a key managerial personnel is appointed (or removed).

Person so appointed /employed as MD

- should be MD/M in one company, and of not more than one other company
- made/approved by Board resolution
- passed with the consent of all the directors present at the meeting
- specific notice of such meeting, and of the resolution to be moved thereat has been given to all the directors then in India.

Example 4: Virasat Limited, a company incorporated under the Companies Act, 2013, has a board of directors consisting of 10 directors, wants to appoint Mr. Vakharia as its Managing Director (MD) in the upcoming Annual General Meeting (AGM). Mr. Vakharia is already serving as the MD of other public company. Accordingly, for the appointment of Mr. Vakharia specific notice for the board meeting and the resolution to be moved thereat has been given to all the directors. The resolution for the appointment of Mr. Vakharia has been passed at the board meeting. Out of 8 directors present, 6 directors voted in favour of the resolution and the remaining 2 directors refrained from voting. Thereafter, the company approved the appointment of Mr. Vakharia in the AGM. Here in the given instance, appointment of Mr. Vakharia is not valid in law as the resolution is not passed by all the directors present in the board meeting.

- (v) **Filling of Vacancy of Key Managerial Personnel (KMP) [Section 203(4)]:** If the office of any whole-time KMP is vacated, the resulting vacancy shall be filled-up by the Board at a meeting of the Board within a period of six months from the date of such vacancy.
- (vi) **Penalty for non-compliance [Section 203(5)]:**
- Company:** If any company makes any default in complying with the provisions of this section, such company shall be liable to a penalty of 5 Lakh rupees.
 - Director and KMP:** Every defaulting director and KMP shall be liable to a penalty of 50,000 rupees. Where the default is a continuing one, they shall be liable with a further penalty of 1,000 rupees for each day after the first during which such default continues but not exceeding 5 Lakh rupees.

Exemptions

*In case of **Government companies**, after sub-section (4) of Section 203, the following sub-section shall be inserted vide Notification No. G.S.R. 463(E), dated 5th June, 2015 as amended by Notification No. G.S.R. 582 (E), dated 13th June, 2017, namely:*

“(4A) The provisions of sub-section (1), (2), (3) and (4) of this section shall not apply to a managing director or Chief Executive Officer or manager and in their absence, a whole-time director of the Government company.”

*The sub-section (4A) shall be applicable to a **Government company** only if it has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar.*

In a decision given by National Company Law Tribunal, Kolkata Bench in *Usha Martin Telematics Ltd., In re*, it was held that where Tribunal had already compounded offences for company in respect of appointment of CFO and CS, application of Ex-Directors & Managers seeking compounding of offence, was to be allowed.

In the said case in financial year 2014-15, company's paid up capital was Rs. 197.60 crores and still, company had not appointed CFO and CS and, thus, violated provisions of section 203(1)(iii). Subsequent to show cause notice, company appointed CFO and CS. Form DIR-12 was filed in relation to such appointment. Applicants ex-directors and ex-managers admitted offence and thus, filed instant application seeking compounding of offence under section 441 of the Companies Act, 2013. Here the Tribunal held liable to ex-directors and managers for alleged offence only for period for which such applicants were directors/officers in company. Even where tribunal had already compounded offence for company, application by ex-directors and managers of company seeking compounding of offence was also to be allowed.

4. FUNCTIONS OF COMPANY SECRETARY [SECTION 205]

The provisions of Section 205 of the Act are stated as under:

(i) Functions to be performed by Company Secretary: According to Section 205 (1) and Rule 10 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, a Company Secretary shall perform the following functions:

- (a) **to report to the Board about compliance with the provisions of the Companies Act, 2013**, the rules made thereunder and other laws applicable to the company;
- (b) to ensure that the company **complies with the applicable secretarial standards**;
- (c) to provide to the directors of the company, collectively and individually, such **guidance** as they may require, with regard to their duties, responsibilities and powers;
- (d) to facilitate the convening of **meetings** and attend Board, committee and general meetings and **maintain the minutes** of these meetings;
- (e) to **obtain approvals** from the Board, general meeting, the government and such other authorities as required under the provisions of the Companies Act, 2013;
- (f) to **represent before various regulators**, and other authorities under the Companies Act, 2013 in connection **with discharge of various duties** under the said Act;
- (g) to **assist the Board in the conduct of the affairs** of the company;
- (h) to **assist and advise the Board in ensuring good corporate governance** and in complying with the corporate governance requirements and best practices; and
- (i) to discharge such **other duties** as have been specified under the Companies Act, 2013 or the Rules made thereunder; and
- (j) **such other duties as may be assigned by the Board** from time to time.

Functions performed by CS

report to board about compliance of Companies Act	ensure company complies applicable SS's	guidance to directors w.r.t.their duties, responsibilities and powers	convening and attending and maintaining minutes of meetings	obtains approvals	represent w.r.t discharge of various duties	assist board in conduct of affairs	assist & advice board in complying with corporate governance	other duties as assigned by board
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Clarification: The expression “secretarial standards” means secretarial standards issued by the Institute of Company Secretaries of India constituted under section 3 of the Company Secretaries Act, 1980 and approved by the Central Government. Under Section 118 (10) of the Act, the Central Government has approved SS-1 (Secretarial Standard on Meetings of the Board of Directors) and SS-2 (Secretarial Standard on General Meetings).

(ii) **No effect on duties and functions of certain important functionaries:** According to Section 205 (2), the provisions contained in Section 204 relating to the ‘secretarial audit for bigger companies’ and Section 205 relating to the ‘functions of company secretary’ shall not affect the duties and functions of the Board of Directors, Chairperson of the company, Managing Director or Whole-time Director under this Act, or any other law for the time being in force.

In other words, these important functionaries of the company cannot be absolved of their duties and functions simply because a secretarial audit has been conducted or certain functions have been assigned to the company secretary. They shall always remain responsible to the company and in no way their responsibility shall be reduced.



5. COMPANY TO FIX LIMIT WITH REGARD TO REMUNERATION [SECTION 200]

Section 200 of the Act is instructive in nature. According to this section, a company needs to take care of certain parameters and may adopt an administrative ceiling as it may deem fit within the statutory ceiling with regard to fixing of managerial remuneration where it has inadequate or no profits. However, effective from 12-09-2018 in such cases the company is not required to seek any approval from the Central Government.

Section 200 states that notwithstanding anything contained in this Chapter, a company may, while according its approval under Section 196 to any appointment or to any remuneration under Section 197 in respect of cases where the company has inadequate or no profits, fix the remuneration within the limits specified in this Act, at such amount or percentage of profits of the company, as it may deem fit.

While fixing such remuneration the company shall have regard to:

(a)	the financial position of the company;
(b)	the remuneration or commission drawn by the individual concerned in any other capacity;
(c)	the remuneration or commission drawn by him from any other company;
(d)	professional qualifications and experience of the individual concerned;
(e)	<p>any other matters as may be prescribed.</p> <p>Parameters for consideration of remuneration</p> <p>In this respect, Rule 6 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, prescribes that the company shall have regard to the following matters:</p> <ul style="list-style-type: none"> (i) the Financial and operating performance of the company during the three preceding financial years. (ii) the relationship between remuneration and performance. (iii) the principle of proportionality of remuneration within the company, ideally by a rating methodology which compares the remuneration of directors to that of other directors on the board and employees or executives of the company. (iv) whether remuneration policy for directors differs from remuneration policy for other employees and if so, an explanation for the difference. (v) the securities held by the director, including options and details of the shares pledged as at the end of the preceding financial year.



6. OVERALL MAXIMUM MANAGERIAL REMUNERATION AND MANAGERIAL REMUNERATION IN CASE OF ABSENCE OR INADEQUACY OF PROFITS [SECTION 197]

Section 197 of the Act lays down the provisions relating to overall maximum managerial remuneration payable by every **public company** and the managerial remuneration payable by it in case of absence or inadequacy of profits. Section 197 read with Schedule V to the Companies Act,

2013 defines maximum remuneration payable to **KMPs and other directors**. This section does not apply to a private company. These provisions are discussed as under:

(i) **Overall Maximum Managerial Remuneration [Section 197(1)]**

- (a) Section I of Part II of Schedule V headed as 'Remuneration Payable by Companies having Profits' states that 'subject to the provisions of Section 197, a company having profits in a financial year may pay remuneration to a managerial personnel or persons or other director or directors not exceeding the limits specified in this section'. Accordingly, the overall managerial remuneration to the **Directors** including managing director, whole time director and manager in respect of any financial year is summarized as below:

S. No.	Conditions	Maximum remuneration payable by Public company to directors, including managing director and whole time director and manager in any financial year	When remuneration can be exceeded as referred to in column (b)
	(a)	(b)	(c)
(i)	Overall limit applicable to managerial remuneration	11% of the net profits of the company for that financial year Note: Net profits are to be calculated in accordance with Section 198 except that the remuneration payable to the directors shall not be deducted from the gross profits.	Subject to the provisions of Schedule V, the company in general meeting may authorize exceeding the overall limit of 11%.
(ii)	If there is one Managing director/ Whole time director/ manager i.e. Remuneration payable to one managing director/whole time director/manager	5% of the net profits of the company for that financial year.	This limit of 5% may be exceeded with the approval of the company in general meeting by passing a Special Resolution.
(iii)	If there is more than one	10% of the net profits of	This limit of 10% may be

	Managing Director/ Whole time director/manager i.e. Remuneration payable to all such Managing Director/Whole time Director/Manager taken together	the company for that financial year.	exceeded with the approval of the company in general meeting by passing a Special Resolution.
(iv)	Remuneration payable to directors who are neither Managing Directors nor Whole time directors	1% of the net profits of the company if there is a Managing Director or a Whole time director	This limit of 1% may be exceeded with the approval of the company in general meeting by passing a Special Resolution.
(v)	Remuneration payable to directors who are neither Managing Directors nor Whole time directors	3% of the net profits of the company provided there is no Managing Director or Whole time director	This limit of 3% may be exceeded with the approval of the company in general meeting by passing a Special Resolution.

Instances to obtain prior approval in case of default: It is to be noted that where the company has defaulted in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor, prior approval of such person (as applicable) shall have to be obtained by the company before obtaining the approval in the general meeting.

Exclusion of sitting fees: Section 197(2) provides that above percentages shall be exclusive of any fees payable to directors under section 197(5).

- (b) Section 197(8) provides that the net profits shall be computed in the manner laid down in section 198. This stipulation is already covered by Section 197 (1) which further provides that the remuneration of the directors shall not be deducted from the gross profits.

(ii) No profits or inadequate profits [Section 197(3) & (11)]

- (a) If in any financial year, a company has no profits or its profits are inadequate, the company shall not pay by way of remuneration any sum (exclusive of sitting fees) to its directors, including any managing or whole- time director or manager or any other non-executive director including an independent director, except in accordance with the provisions of Schedule V.
- (b) In cases where Schedule V is applicable on grounds of no profits or inadequate profits,

any provision relating to the remuneration of any director which purports to increase or has the effect of increasing the amount thereof, shall not have any effect unless such increase is in accordance with the conditions specified in that Schedule.

Accordingly the following provisions which purport to increase or has the effect of increasing the remuneration payable to directors shall not have any effect unless are in accordance with the conditions specified in that schedule:

- ✓ the provision contained in the memorandum or articles of the company, or
- ✓ in an agreement entered into by the company, or
- ✓ in any resolution passed by the company in general meeting or its Board.

SECTION II OF PART II OF SCHEDULE V- Remuneration payable by companies having no profit or inadequate profit

Where in any financial year during the currency of tenure of a managerial person, a company has no profits or its profits are inadequate, it may pay remuneration to the managerial person or other director not exceeding the limits under (A) and (B) given below:

Limits under (A):

(1)	(2)	(3)
Where the effective capital is (in any FY)	Limit of yearly remuneration payable shall not exceed (in any FY) in case of managerial remuneration	Limit of yearly remuneration payable shall not exceed (in any FY) in case of other directors
(i) Negative or less than ₹ 5 crores	₹ 60 lakhs	₹ 12 lakhs
(ii) ₹ 5 crores and above but less than ₹ 100 crores	₹ 84 lakhs	₹ 17 lakhs
(iii) 100 crores and above but less than ₹ 250 crores	₹ 120 lakhs	₹ 24 lakhs
(iv) ₹ 250 crores and above	₹ 120 lakhs plus 0.01% of the effective capital in excess of ₹ 250 crores	₹ 24 Lakhs plus 0.01% of the effective capital in excess of ₹ 250 crores:]"

However, the remuneration in excess of above limits may be paid if the resolution passed by the shareholders is a special resolution.

Explanation 1.—For the purposes of Section II of this Part, “**effective capital**” means the aggregate of the paid-up share capital (excluding share application money or advances against shares); amount, if any, for the time being standing to the credit of share premium account; reserves and surplus (excluding revaluation reserve); long-term loans and deposits repayable after one year (excluding working capital loans, over drafts, interest due on loans unless funded, bank guarantee, etc., and other short-term arrangements) as reduced by the aggregate of any investments (except in case of investment by an investment company whose principal business is acquisition of shares, stock, debentures or other securities), accumulated losses and preliminary expenses not written off.

Explanation 2. —

- a) Where the appointment of the managerial person is made in the year in which company has been incorporated, the effective capital shall be calculated as on the date of such appointment;
- b) In any other case the effective capital shall be calculated as on the last date of the financial year preceding the financial year in which the appointment of the managerial person is made.

Explanation 3- It is hereby clarified that for a period less than one year, the limits shall be pro-rated.

Thus, if a managerial person is employed for a part of the year, the remuneration payable to him shall be pro-rated.

Limits under (B):

In case of a managerial person or other director who is functioning in a **professional capacity**, remuneration as per item (A) may be paid, if such managerial person or other director:

- 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 (*i.e. does not hold any shares subject to the deeming provision below*);

Note: “Statutory Structure” means any entity which is entitled to hold shares in any company formed under any statute.

- is 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 two years before or on or after the date of appointment;
- possesses graduate level qualification with expertise and specialised knowledge in the field in which the company operates:

Deeming provision as to the holding of shares: It is provided 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 Employees Stock Option Plan or by way of qualification shall be deemed to be a person not having any interest in the capital of the company.

Applicable conditions for payment of remuneration: The limits specified under items (A) and (B) above shall apply, if-

- (i) payment of remuneration is approved by a resolution passed by the Board and, in the case of a company covered under Section 178 (1), also by the Nomination and Remuneration Committee;
- (ii) the company has not committed any default in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor, and in case of default, the prior approval of the bank or public financial institution concerned or the non-convertible debenture holders or other secured creditor, as the case may be, shall be obtained by the company **before obtaining the approval in the general meeting;**
- (iii) an ordinary resolution or a special resolution, as the case may be, has been passed for payment of remuneration as per item (A) or a special resolution has been passed for payment of remuneration as per item (B), at the general meeting of the company for a period **not exceeding three years.**
- (iv) a statement along with a notice calling the general meeting referred to in clause (iii) is given to the shareholders containing the following information, namely:
 - I. General information:
 - (1) Nature of industry
 - (2) Date or expected date of commencement of commercial production
 - (3) In case of new companies, expected date of commencement of activities as per project approved by financial institutions appearing in the prospectus
 - (4) Financial performance based on given indicators
 - (5) Foreign investments or collaborations, if any.
 - II. Information about the appointee:
 - (1) Background details
 - (2) Past remuneration
 - (3) Recognition or awards

- (4) Job profile and his suitability
- (5) Remuneration proposed
- (6) Comparative remuneration profile with respect to industry, size of the company, profile of the position and person (in case of expatriates the relevant details would be with respect to the country of his origin)
- (7) Pecuniary relationship directly or indirectly with the company, or relationship with the managerial personnel or other director, if any.

III. Other information:

- (1) Reasons of loss or inadequate profits
- (2) Steps taken or proposed to be taken for improvement
- (3) Expected increase in productivity and profits in measurable terms

IV. Disclosures: The following disclosures shall be mentioned in the Board of Director's report under the heading "Corporate Governance", if any, attached to the Financial statement:

- (i) all elements of remuneration package such as salary, benefits, bonuses, stock options, pension, etc., of all the directors;
- (ii) details of fixed component and performance linked incentives along with the performance criteria;
- (iii) service contracts, notice period, severance fees; and
- (iv) stock option details, if any, and whether the same has been issued at a discount as well as the period over which accrued and over which exercisable.

(iii) Determination of Remuneration [Section 197(4)]

- (a) 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 this section, either
 - (i) by the articles of the company, or
 - (ii) by a resolution or,
 - (ii) if the articles so require, by a special resolution, passed by the company in general meeting, and
- (b) 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.

- (c) Any remuneration for services rendered by any such director in other capacity shall not be so included if—
- (1) the services rendered are of a professional nature; and
 - (2) in the opinion of the Nomination and Remuneration Committee, if the company is covered under Section 178 (1), or in the opinion of the Board of Directors in other cases, the director possesses the requisite qualification for the practice of the profession.

Simply stated, the Board of Directors cannot determine the remuneration payable to the directors. The remuneration shall be determined (subject to the provisions of Section 197) by the articles or by a resolution or if required by the articles, by passing a special resolution.

However, besides remuneration, a director may be paid some other remuneration if he provides professional services to the company and further, in the opinion of the Nomination and Remuneration Committee (if the company has formed such committee) or in the opinion of the Board of Directors (where no such committee exists) the director possesses the requisite qualification for practicing his profession.

Example 5: Star Health Specialties Ltd. owns a Multi-Specialty Hospital in Chennai. Dr. Hamilton, a practicing Heart Surgeon, has been appointed by the company as its director and it wants to pay him fee, on case to case basis, for surgery performed on the patients at the hospital.

In the given **example**, as Dr. Hamilton has been appointed as a director. He has to be paid a fee for surgeries performed by him. It is to be noted that such payment is permissible under Section 197(4) which states that the remuneration payable to the directors including managing or whole-time director or manager shall be inclusive of the remuneration payable for the services rendered by him in any other capacity except the following:

- (a) the services rendered are of a professional nature; and
- (b) in the opinion of the Nomination and Remuneration Committee (if applicable) or the Board of Directors in other cases, the director possesses the requisite qualification for the practice of the profession.

The company, therefore, can pay extra remuneration to Dr. Hamilton like professional fee for surgeries performed by him in his professional capacity; and such payment shall not be construed as managerial remuneration under the Act.

(iv) Sitting Fees to Directors [Section (5)]:

- (a) **Fees for attending meeting:** A director may receive remuneration by way of fee for attending meetings of the Board or Committee thereof or for any other purpose whatsoever as may be decided by the Board subject to the conditions imposed by Rule

4 of the Companies (Appointment and Remuneration of Managerial personnel) Rules, 2014 as under:

- The sitting fees shall not exceed one lakh rupees per meeting of the Board or committee thereof. [As per Rule 4]
- The sitting fee payable to the Independent Directors and Women Directors shall not be less than that payable to other directors. [As per Proviso to Rule 4]

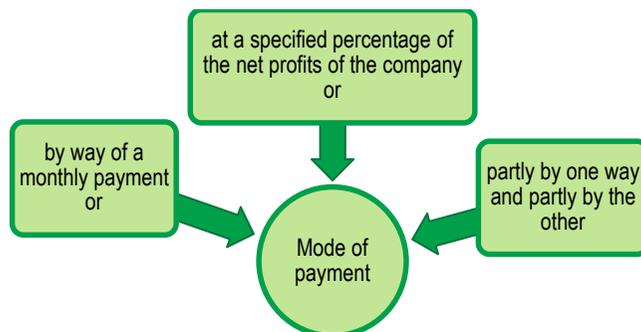
Note: According to Section 197 (2), the percentages mentioned under Section 197 (1) shall be **exclusive of any sitting fees** payable to directors for attending meetings of the Board or committee thereof or for any other purpose whatsoever as may be decided by the Board.

- (b) **Scale of fees may differ:** Different fees for different classes of companies and fees in respect to independent directors may be such as may be prescribed.

Example 6: The Articles of Association of a listed company have fixed payment of sitting fee for each Meeting of Directors subject to a maximum of ₹ 30,000. In view of the increased responsibilities of the independent directors of listed companies, the company proposes to increase the sitting fee to ₹ 45,000 per meeting. W.r.t. to the said proposal, Section 197(5) of the Companies Act, 2013 provides that a director may receive remuneration by way of fee for attending the Board/Committee meetings or for any other purpose as may be decided by the Board provided that the amount of such fees shall not exceed the prescribed amount. As per Rule 4 of the Companies (Appointment and Remuneration of Managerial personnel) Rules, 2014 the amount of sitting fees payable for attending meetings of the Board or Committees thereof may be decided by the Board but such sitting fees shall not exceed 1 lakh rupee per meeting. Further, the sitting fee payable to an independent director shall not be less than that payable to other directors.

From the above, it is clear that sitting fees can be increased from 30,000 rupees to 45,000 rupees per meeting by passing a resolution in the Board Meeting and altering the Articles of Association by passing a Special Resolution. When sitting fees stands increased for other directors, it shall automatically be increased in case of independent directors because the latter cannot be paid less than that payable to former.

- (v) **Mode of payment of Remuneration [Section 197(6)]:** A director or manager may be paid remuneration in any of the following manner:



The term used in Section 197 (6) is 'director' which may be taken to mean all types of directors *i.e.* MD or whole-time director or executive/non-executive director. Further, remuneration can be paid on monthly basis or on the basis of specified percentage of the net profits. Even, a combination of both the methods may also be adopted.

- (vi) **Refund of excess remuneration if paid to a director [Section 197(9) and (10)]:** If any director draws or receives excess remuneration than the limit prescribed by Section 197 or without approval required under this section, such director shall:



Waiver, whether possible: The company shall not waive the recovery of any sum refundable to it under Section 197 (9). However, the waiver is possible only if it is approved by the company by passing a special resolution within two years from the date the sum becomes refundable.

Instances to obtain prior approval of waiver in case of default: It is to be noted that where the company has defaulted in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor, the prior approval of such person respectively shall be obtained by the company before obtaining approval of such waiver by a special resolution.

(vii) Disclosure in Board's Report by a Listed Company [Section 197(12) and Rule 5]

Every listed company shall disclose in the Board's report-

- ratio of the remuneration of each director to the median employee's remuneration
- other details given under rule 5
 - disclosure prescribed under section 197(12)
 - % increase in remuneration of each director, CFO,CEO,CS or manager in FY
 - % increase in the median remuneration of employees in the FY
 - no. of permanent employees on rolls of company
 - average percentile increase made in te salaries of employees other than managerial personnel in the last FY
 - affirmation of remuneration as per remuneration policy
- statement showing top 10 employees in terms of remuneration
 - employed through out FY
 - received remuneration in aggregate not less than 1.02 cr
 - employed for part of the FY
 - received remuneration in aggregate not less than 8.50 lakhs /month
 - employed throughout FY/part thereof
 - received remuneration aggregate not less than 2% of the equity shares of the company , or in excess of that drawn by MD/WTD/M +holds by himself/along his spouse +dependent children
 - particulars of all the employees as per rule Rule 5(3) + whether such employee is a relative of any D/M

- (a) Every listed company shall disclose in the Board's report, the ratio of the remuneration of each director to the median employee's remuneration and other details as prescribed under Rule 5 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014.
- (b) According to Rule 5 (1) every listed company shall disclose in the Board's report:
 - (i) the ratio of the remuneration of each director to the median remuneration of the employees of the company for the financial year; this disclosure is also prescribed by Section 197 (12).
 - (ii) the percentage increase in remuneration of each director, Chief Financial Officer, Chief Executive Officer, Company Secretary or manager, if any, in the financial year;
 - (iii) the percentage increase in the median remuneration of employees in the financial year;
 - (iv) the number of permanent employees on the rolls of company;

- (v) average percentile increase already made in the salaries of employees other than the managerial personnel in the last financial year and its comparison with the percentile increase in the managerial remuneration and justification thereof and point out if there are any exceptional circumstances for increase in the managerial remuneration; and
- (vi) affirmation that the remuneration is as per the remuneration policy of the company.

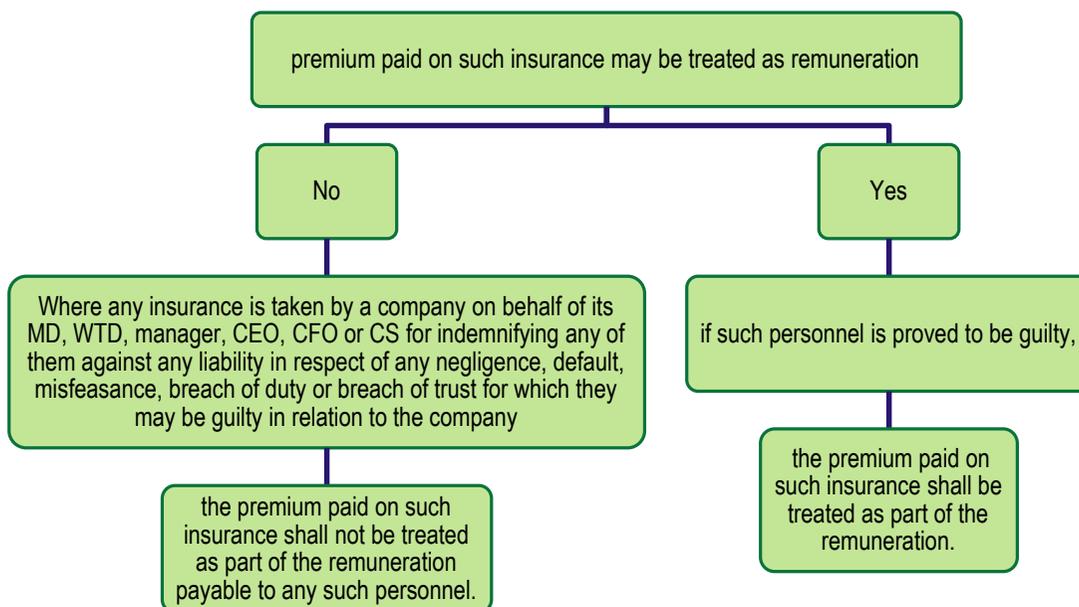
Meaning of median: (i) The expression “median” means the numerical value separating the higher half of a population from the lower half and the median of a finite list of numbers may be found by arranging all the observations from lowest value to highest value and picking the middle one;

(ii) if there is an even number of observations, the median shall be the average of the two middle values.

- (c) According to Rule 5 (2) the board’s report shall include a statement showing the **names of the top ten employees** in terms of remuneration drawn and the **name of every employee, who-**
 - (i) if employed throughout the financial year, was in receipt of remuneration for that year which, in the aggregate, was not less than one crore and two lakh rupees *i.e.* rupees 1.02 crore;
 - (ii) if employed for a part of the financial year, was in receipt of remuneration for any part of that year, at a rate which, in the aggregate, was not less than eight lakh and fifty thousand rupees per month;
 - (iii) if employed throughout the financial year or part thereof, was in receipt of remuneration in that year which, in the aggregate, or as the case may be, at a rate which, in the aggregate, is in excess of that drawn by the managing director or whole-time director or manager and holds by himself or along with his spouse and dependent children, not less than two percent of the equity shares of the company.
- (d) According to Rule 5 (3), the statement referred to in Rule 5 (2) [refer para (c) above] shall also indicate some particulars of the above employees like designation, remuneration received, nature of employment, qualification and experience, date of commencement of employment, age, last employment held by such employee before joining the company, the percentage of equity shares held by the employee in the company within the meaning of clause (iii) of Rule 5 (2) [refer para (c) (iii) above], and whether any such employee is a relative of any director or manager of the company and if so, name of such director or manager.

(viii) Premium paid in respect of Insurance taken for indemnification [Section 197(13)]:

Section 197 (13) deals with taking of insurance by a company on behalf of its MD, WTD, manager, CEO, CFO or CS and whether to treat the premium paid on such insurance as remuneration or not.



(ix) Remuneration/Commission permissible from holding/subsidiary company [Section 197(14)]:

If any director who is a managing or whole-time director receives any commission from the company, he shall not be disqualified from receiving any remuneration or commission from any holding company or subsidiary company of such company subject to the provisions of Section 197.

However, the requirement is that such fact must be disclosed by the company in the Board's report.

(x) Penalty for non-compliance [Section 197(15)]: Non-compliance with the provisions of Section 197 gives rise to following penalty:

- **Defaulting person:** liable to a penalty of rupees one lakh.
- **Company:** liable to a penalty of rupees five lakhs.

(xi) Auditors' report to contain a statement regarding remuneration [Section 197(16)]: The auditor of the company shall, in his report under section 143, make a statement regarding remuneration as under:

- whether the remuneration paid by the company to its directors is in accordance with the provisions of Section 197;
- whether remuneration paid to any director is in excess of the limit laid down under Section 197; and
- give such other details as may be prescribed.

(xii) **Application pending with Central Government as on 12-09-2018 [Section 197(17)]:** On and from the commencement of the Companies (Amendment) Act, 2017, any application made to the Central Government under the provisions of Section 197 [as it stood before such commencement *i.e.* before 12-09-2018], which is pending with that Government shall abate, and the company shall, within one year of such commencement, obtain the approval in accordance with the provisions of this section, as so amended.

In other words, in case of pendency of any application as on 12-09-2018, the company shall obtain the approval from the Central Government according to the amended Section 197 within one year from this date.

Exemptions/Modifications

(i) In case of **Government Companies**, Section 197 shall not apply. However, for availing the exemption, such Government Company must not have committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar. (Notification No. G.S.R. 463(E) dated 5th June, 2015 as amended by Notification No. G.S.R. 582 (E), dated 13-06-2017).

(ii) In case of **Nidhi Company**, second proviso to sub-section (1) of section 197 shall apply with the modification that the remuneration of a director who is neither managing director nor whole-time director or manager for performing special services to the Nidhis specified in the articles of association may be paid by way of monthly payment subject to the approval of the company in general meeting and also to the provisions of section 197:

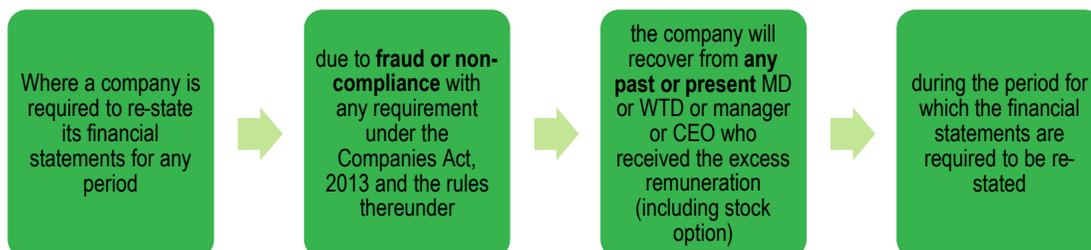
Provided that no approval of the company in general meeting shall be required where,

- a Nidhi does not have a managing director or a whole-time director or a manager;*
- the remuneration payable during a financial year to all the directors of the Nidhi does not exceed ten per cent. of the net profits of such Nidhi or fifteen lakh rupees, whichever is less; and*
- a remuneration payable under clause (b) is approved by a special resolution passed in this behalf by the Nidhi.*

Note: while availing the above modification, the Nidhi Company shall ensure that the interests of their shareholders are protected. (Notification No. G.S.R. 465(e) dated 5th June, 2015)

7. RECOVERY OF MANAGERIAL REMUNERATION IN CERTAIN CASES [SECTION 199]

Section 199 of the Act provides for recovery of managerial remuneration in following case-



The excess remuneration to be recovered shall be the difference between actual amount of remuneration received by such person and the remuneration that would have been payable to him as per restatement of financial statements.

Liability of the defaulter: The recovery of remuneration does not prejudice (*i.e.* impair) any liability that may be incurred under the provisions of the Companies Act, 2013 or any other law for the time being in force. In other words, the defaulting person because of whom fraud or non-compliance took place and the financial statements were restated at that time, even though has repaid excess remuneration, shall not escape from any liability that may be incurred under the provisions of the Companies Act, 2013 or any other law.

8. CALCULATION OF PROFITS [SECTION 198]

According to Section 198 of the Act, net profits for any financial year for the purpose of managerial remuneration payable under section 197 shall be calculated as follows:



(i) **Credit shall be given for the sums specified in Section 198(2)**

Add: Bounties and subsidies received from any Government, or any public authority constituted or authorised in this behalf, by any Government, unless and except in so far as the Central Government otherwise directs.

(ii) **Credit shall not be given for those sums specified in Section 198(3)**

Less: (if credited to the P & L A/c for arriving at profit before tax)

- (a) profits, by way of premium on shares or debentures of the company, which are issued or sold by the company unless the company is an investment company as referred to in clause (a) of the Explanation to section 186;
- (b) profits on sales by the company of forfeited shares;
- (c) profits of a capital nature including profits from the sale of the undertaking or any of the undertakings of the company or of any part thereof;

- (d) profits from the sale of any immovable property or fixed assets of a capital nature comprised in the undertaking or any of the undertakings of the company, unless the business of the company consists, whether wholly or partly, of buying and selling any such property or assets:

Provided that where the amount for which any fixed asset is sold exceeds the written-down value thereof, credit shall be given for so much of the excess as is not higher than the difference between the original cost of that fixed asset and its written-down value;

- (e) any change in carrying amount of an asset or of a liability recognized in equity reserves including surplus in profit and loss account on measurement of the asset or the liability at fair value.
- (f) any amount representing unrealized gains, notional gains or revaluation of assets.

(iii) In making the computation aforesaid, the following sums specified under Section 198(4) shall be deducted,

- (a) all the usual working charges;
- (b) directors' remuneration;
- (c) bonus or commission paid or payable to any member of the company's staff, or to any engineer, technician or person employed or engaged by the company, whether on a whole-time or on a part-time basis;
- (d) any tax notified by the Central Government as being in the nature of a tax on excess or abnormal profits;
- (e) any tax on business profits imposed for special reasons or in special circumstances and notified by the Central Government in this behalf;
- (f) interest on debentures issued by the company;
- (g) interest on mortgages executed by the company and on loans and advances secured by a charge on its fixed or floating assets;
- (h) interest on unsecured loans and advances;
- (i) expenses on repairs, whether to immovable or to movable property, provided the repairs are not of a capital nature;
- (j) outgoings inclusive of contributions made under section 181 (Company to contribute to bona fide and charitable funds);
- (k) depreciation to the extent specified in section 123;
- (l) the excess of expenditure over income, which had arisen in computing the net profits in accordance with this section in any year which begins at or after the commencement

of this Act, in so far as such excess has not been deducted in any subsequent year preceding the year in respect of which the net profits have to be ascertained;

- (m) any compensation or damages to be paid in virtue of any legal liability including a liability arising from a breach of contract;
- (n) any sum paid by way of insurance against the risk of meeting any liability such as is referred to in clause (m);
- (o) debts considered bad and written off or adjusted during the year of account.

(iv) In making the computation aforesaid, the following sums specified under Section 198(5) shall not be deducted:

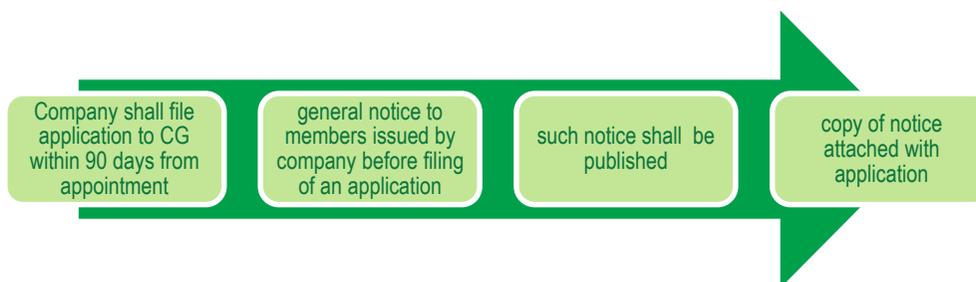
- (a) income-tax and super-tax payable by the company under the Income-tax Act, 1961, or any other tax on the income of the company not falling under clauses (d) and (e) of sub-section (4);
- (b) any compensation, damages or payments made voluntarily, that is to say, otherwise than in virtue of a liability such as is referred to in clause (m) of sub-section (4);
- (c) loss of a capital nature including loss on sale of the undertaking or any of the undertakings of the company or of any part thereof not including any excess of the written-down value of any asset which is sold, discarded, demolished or destroyed over its sale proceeds or its scrap value;
- (d) any change in carrying amount of an asset or of a liability recognised in equity reserves including surplus in profit and loss account on measurement of the asset or the liability at fair value.



9. FORMS OF, AND PROCEDURE IN RELATION TO, CERTAIN APPLICATIONS [SECTION 201]

Section 201 of the Act contains provisions which need to be followed for seeking approval from the Central Government if an application is made under Section 196 for the appointment of a person as Managing Director who has attained the age of seventy years but in whose case the appointment could not be regularised by passing a special resolution though votes cast in favour of the motion exceeded the votes cast against the motion. Non-passing of special resolution as before also contravenes Schedule V. Accordingly, for regularizing the appointment the company would apply to the Central Government for approval based on the fact that majority of the shareholders are in favour of such appointment as they find this appointment to be most beneficial to the company. It may be noted that now no approval is required for managerial remuneration in any case.

The process for seeking approval as given in Section 201 and Rule 7 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 is stated as under:



- (i) **Making of Application for Approval:** Every application made to the Central Government under Section 196 shall be in Form No. MR-2 as prescribed by Rule 7 and shall be accompanied by the specified fee. Rule 7 also requires that every such application shall be made to the Central Government within a period of **ninety days from the date of such appointment**.
- (ii) **General Notice to Members:** Before any application is made by a company to the Central Government under section 196, a general notice to the members of the company shall be issued by or on behalf of the company, indicating the nature of the application proposed to be made.
- (iii) **Publication of Notice:** Such notice shall be published:
 - at least once in a newspaper in the principal language of the district in which the registered office of the company is situate and circulating in that district; and
 - at least once in English in an English newspaper circulating in that district.
- (iv) **Attaching of Notice with the Application:** The copies of the notices, together with a certificate by the company as to the due publication thereof, shall be attached to the application.



10. COMPENSATION FOR LOSS OF OFFICE OF MANAGING OR WHOLE-TIME DIRECTOR OR MANAGER [SECTION 202]

Section 202 of the Act contains provisions for compensation for loss of office of Managing Director or Whole-time director or Manager as under:

When payment to be made: A company may make payment to a Managing Director (MD) or Whole-time director (WTD) or Manager	Prohibition on payment of compensation: No payment of compensation shall be made in the following cases-	Quantum of compensation payable to such Managing Director or Whole-time director or manager:
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<p>(but not to any other director) by means of:</p>	<ul style="list-style-type: none"> • where the director resigns from his office as a result of the reconstruction of the company, or of its amalgamation and is appointed as the managing or whole-time director, manager or other officer of the reconstructed company or of the body corporate resulting from the amalgamation; • where the director resigns from his office otherwise than on the reconstruction of the company or its amalgamation <i>i.e.</i> resigns on his own; • where the office of the director is vacated under section 167(1)⁶; • where the company is being wound up, (by an order of the Tribunal or voluntarily), due to the negligence or default of the director; • where the director has been guilty of fraud / breach of trust / of gross negligence / gross mismanagement in relation to the conduct of the affairs of the 	<p>shall not exceed the remuneration he would have earned if he would have been in office for the remainder of his term or three years, whichever is shorter.</p> <p>In other words, if the remaining period of his term in the office is more than three years the compensation shall be restricted to three years only; otherwise it is to be paid for the remainder of his term.</p>
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⁶ Various grounds of vacation of office covered by Section 167 (1) are mentioned in an earlier Chapter.

	<p>company or any subsidiary company or holding company thereof; and</p> <ul style="list-style-type: none"> • where the director has instigated/ has taken part directly or indirectly in bringing about, the termination of his office. 	
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Calculation of compensation: The compensation shall be calculated on the basis of the **average remuneration** earned by him during a period of three years immediately preceding the date on which he ceased to hold such office, or where he held the office of less than three years, then for such shorter period.

No compensation if company is being wound up: No such payment of compensation can be made if winding up of the company is commenced whether:

- before the date on which he has ceased to hold office; or
- within 12 months after the date on which he has ceased to hold office,

if the assets on winding up (after deducting expenses on winding up) are not sufficient to repay the shareholders the share capital, including premiums if any, contributed by them.

Note: Section 202 does not prohibit the payment to a managing director or whole-time director, or manager, of any remuneration for services rendered by him to the company in **any other capacity**.

11. SECRETARIAL AUDIT FOR BIGGER COMPANIES [SECTION 204]

Section 204 of the Act contains provisions for secretarial audit for bigger companies. These provisions are discussed as under:

(i) **Which companies to get conducted secretarial audit:** Section 204(1) requires the following types of companies to get conducted secretarial audit:

- every listed company; and
- a company belonging to the other prescribed class of companies. In this respect Rule 9(1) of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 prescribes following companies for the purpose of secretarial audit:

- | | |
|-----|--|
| (a) | Every public company having a paid-up share capital of 50 crore rupees or more; or |
|-----|--|

(b)	Every public company having a turnover of 250 crore rupees or more; or
(c)	Every company having outstanding loans or borrowings from banks or public financial institutions of one hundred crore rupees or more.

Explanation to Rule 9 : For the purposes of this sub-rule, it is hereby clarified that the paid up share capital, turnover, or outstanding loans or borrowings as the case may be, existing on the last date of latest audited financial statement shall be taken into account.

- (ii) **Who is authorised to give secretarial audit report:** According to Section 204 (1), a company secretary in practice is authorised to give Secretarial Audit Report. Such Report shall be in Form No.MR - 3⁷.
- (iii) **Annexing of secretarial audit report:** A company shall annex the secretarial audit report so obtained with its Board's report made in terms of section 134 (3).
- (iv) **Duty of the company as regards secretarial audit:** The company is duty-bound to give all assistance and facilities to the company secretary in practice, for auditing the secretarial and related records of the company Section 204(2)].
- (v) **Duty of the Board of Directors:** The Board of Directors, in the Board's Report prepared under section 134(3) shall explain in full any qualification or observation or other remarks made by the company secretary in practice in his report [Section 204 (3)].
- (vi) **Penalty for contravention:** If a company or any officer of the company or the company secretary in practice, contravenes the provisions of Section 204, then

(a)	the company; or
(b)	every officer of the company; or
(c)	the company secretary in practice,

who is in default, shall be liable to a penalty of two lakh rupees [Section 204(4)].

Example 7: Agro Chemical Ltd. a pharmaceutical company wants to know the provision for applicability to conduct secretarial audit. Board of director of the Company appointed an expert to analyse the business of the organisation and advise whether they are contravening the provision of Companies Act, 2013 as they never conducted secretarial audit thinking they don't have enough business transactions to consider these requirements earlier. Company provides you following information: Paid-up share capital rupees 45 crore, Turnover rupees 200 crore and Outstanding

⁷ Form prescribed by Rule 9 (2) of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014.

Loans and Borrowing of rupees 150 crore. In given case, Agro Chemical Ltd. crosses the threshold limit of outstanding loans and borrowings of rupees 100 crore or more for getting Secretarial Audit conducted. Accordingly, Agro chemical Ltd. is required to conduct secretarial audit under Companies Act, 2013.



12. A. PART II OF SCHEDULE V [SECTIONS I TO V] - MANAGERIAL REMUNERATION

B. PART III OF SCHEDULE V-PROVISIONS APPLICABLE TO PARTS I AND II

C. PART IV OF SCHEDULE V-EXEMPTION BY CENTRAL GOVERNMENT

A. PART II OF SCHEDULE V [SECTIONS I TO V] – Managerial Remuneration

(i) **SECTION I - Remuneration payable by companies having profits:** Subject to the provisions of Section 197, a company having profits in a financial year may pay remuneration to a managerial person or persons or other director or directors not exceeding the limits specified in such section.

Note: Refer Provisions of Section 197 discussed earlier.

(ii) **SECTION II - Remuneration payable by companies having no profit or inadequate profit [Discussed earlier u/s Section 197(3)]**

(iii) **SECTION III — Remuneration payable by companies having no profit or inadequate profit in certain special circumstances:** In the following circumstances a company may pay remuneration to a managerial person or other director in excess of the amounts provided in Section II above:

(a) where the remuneration in excess of the limits specified in Section I or II is paid by any other company and that other company is either a foreign company or has got the approval of its shareholders in general meeting to make such payment, and treats this amount as managerial remuneration for the purpose of section 197 and the total managerial remuneration payable by such other company to its managerial persons or other directors including such amount or amounts is within permissible limits under section 197.

(b) where the company—

(i)	a newly incorporated company	for a period of seven years from the date of its incorporation, or	it may pay any remuneration to its managerial persons or other directors
(ii)	is a sick company , for whom a scheme of revival or rehabilitation has been ordered by the Board for Industrial and Financial Reconstruction	for a period of five years from the date of sanction of scheme of revival, or	
(iii)	is a company in relation to which a resolution plan has been approved by the National Company Law Tribunal under the Insolvency and Bankruptcy Code, 2016	for a period of five years from the date of such approval,	

(c) where remuneration of a managerial person or other director exceeds the limits in Section II but the remuneration has been fixed by the Board for Industrial and Financial Reconstruction or the National Company Law Tribunal:

Provided that the limits under this Section shall be applicable subject to meeting all the conditions specified under Section II and the following additional conditions:

- (i) except as provided in para (a) of this Section, the managerial person is not receiving remuneration from any other company;
- (ii) the auditor or Company Secretary of the company or where the company has not appointed a Secretary, a Secretary in whole-time practice, certifies that all secured creditors and term lenders have stated in writing that they have no objection for the appointment of the managerial person or other director as well as the quantum of remuneration and such certificate is filed along with the return as prescribed under sub-section (4) of section 196.
- (iii) the auditor or Company Secretary or where the company has not appointed a secretary, a secretary in whole-time practice certifies that there is no default on payments to any creditors, and all dues to deposit holders are being settled on time.

Explanation- For the purposes of Section I, Section II, and Section III, the term “ or other director” shall mean a non-executive director or an independent director.

(iv) SECTION IV— Perquisites not included in managerial remuneration:

1. A managerial person shall be eligible for the following perquisites which shall not be included in the computation of the ceiling on remuneration specified in Section II and

Section III:

- (a) **Contribution to provident fund, superannuation fund or annuity fund** to the extent these either singly or put together are not taxable under the Income-tax Act, 1961;
 - (b) **Gratuity** payable at a rate not exceeding half a month's salary for each completed year of service; and
 - (c) **Encashment of leave** at the end of the tenure.
2. In addition to the perquisites specified in paragraph 1 of this section, an expatriate managerial person (including a non-resident Indian) shall be eligible to the following perquisites which shall not be included in the computation of the ceiling on remuneration specified in Section II or Section III:
- (a) **Children's education allowance:** In case of children studying in or outside India, an allowance limited to a maximum of rupees 12,000 per month per child or actual expenses incurred, whichever is less. Such allowance is admissible up to a maximum of two children.
 - (b) **Holiday passage for children studying outside India or family staying abroad:** Return holiday passage once in a year by economy class or once in two years by first class to children and to the members of the family from the place of their study or stay abroad to India if they are not residing in India, with the managerial person.
 - (c) **Leave travel concession:** Return passage for self and family in accordance with the rules specified by the company where it is proposed that the leave be spent in home country instead of anywhere in India.

Explanation I.— For the purposes of this Schedule, “family” means the spouse, dependent children and dependent parents of the managerial person.

Explanation II.— The Nomination and Remuneration Committee while approving the remuneration under Section II or Section III, shall—

- (a) take into account, financial position of the company, trend in the industry, appointee's qualification, experience, past performance, past remuneration, etc.;
- (b) be in a position to bring about objectivity in determining the remuneration package while striking a balance between the interest of the company and the shareholders.

Explanation III — For the purposes of this Schedule, “**negative effective capital**” means the effective capital which is calculated in accordance with the provisions contained in Explanation I of this Part is less than zero.

Explanation IV — For the purposes of this Schedule: —

- (A) *Omitted*
- (B) “Remuneration” means remuneration as defined in clause (78) of Section 2 and includes reimbursement of any direct taxes to the managerial person.

(v) SECTION V—Remuneration payable to a managerial person in two companies:

Subject to the provisions of sections I to IV, a managerial person shall draw remuneration from one or both companies, provided that the total remuneration drawn from the companies does not exceed the higher maximum limit admissible from any one of the companies of which he is a managerial person.

B. PART III OF SCHEDULE V- Provisions applicable to Parts I and II

1. The appointment and remuneration referred to in Part I and Part II of this Schedule shall be subject to approval by a resolution of the shareholders in general meeting.
2. The auditor or the Secretary of the company or where the company is not required to appoint a Secretary, a Secretary in whole-time practice shall certify that the requirement of this Schedule have been complied with and such certificate shall be incorporated in the return filed with the Registrar under sub-section (4) of section 196.

C. PART IV OF SCHEDULE V: Exemption by Central Government

The Central Government may, by notification, exempt any class or classes of companies from any of the requirements contained in this Schedule.

Clarification

The MCA vide General Circular No. 07/2015 dated 10th April, 2015 has clarified that a managerial person who has been appointed in accordance with provisions of Schedule XIII of the Companies Act, 1956, may continue to receive remuneration for his remaining term in accordance with terms and conditions approved by the company as per relevant provisions of Schedule XIII of the Companies Act, 1956 even if the part of his/her tenure falls after 1st April, 2014.

TEST YOUR KNOWLEDGE**Multiple Choice Questions**

1. *Due to non-compliance of certain requirements under the Companies Act, 2013 not amounting to fraud, Shikha Super-Market Limited was required to re-state its financial statements for the financial year 201718 during the current year. After the financial statements were restated, it was found that Mr. Kumar, the Managing Director (MD) of that period, who is now retired, was paid excess remuneration to the extent of ₹ 5,00,000. In the given situation, choose the correct option out of those given below, which indicates whether such excess remuneration paid to ex-MD Mr. Kumar is recoverable or not.*
 - (a) *Excess remuneration of ₹ 5,00,000 paid to Mr. Kumar, ex-MD of Shikha Super-Market Limited, cannot be recovered since such recovery after retirement is invalid.*
 - (b) *Excess remuneration of ₹ 5,00,000 paid to Mr. Kumar, ex-MD of Shikha Super-Market Limited, shall be recovered irrespective of his retirement from the company.*
 - (c) *Only ₹ 2,50,000, being 50% of excess remuneration of ₹ 5,00,000, paid to Mr. Kumar, ex-MD of Shikha Super-Market Limited, is validly recoverable because no fraud implicating him is involved.*
 - (d) *Only ₹ 1,25,000, being 25% of excess remuneration of ₹ 5,00,000, paid to Mr. Kumar, ex-MD of Shikha Super-Market Limited, is validly recoverable because no fraud implicating him is involved.*
2. *The Board of Directors of Capable Hospitality Services Limited has entrusted Mr. Vikas, the newly appointed Managing Director (MD) of the company, with some powers. However, Mr. Vikas is not interested in discharging administrative functions as authorised by the Board of Directors, since he is of the view that he should have been entrusted with substantial powers of the management. Out of the following four options, which one is correctly applicable in relation to the functions which Mr. Vikas, the MD of Capable Hospitality Services Limited, can undertake:*
 - (a) *To draw and endorse any cheque on the account of Capable Hospitality Services Limited maintained with National Commercial Bank Limited, the main banker of the company.*
 - (b) *To sign the financial statements of Capable Hospitality Services Limited.*
 - (c) *To draw and endorse any bill of exchange when it exceeds ₹ 1,00,000.*
 - (d) *To draw and endorse any bill of exchange when it exceeds ₹ 5,00,000.*
3. *Mr. Joseph Daniel, holding the office of Whole-time Director (WTD) in Tasty Choco-Chips Limited, is desirous of appointing Mr. Vanilla Sequera, who has attained the age of 72 years, as the Managing Director (MD) of the company. However, the Board of Directors is of the opinion that no company shall appoint or continue the employment of any person as Managing Director,*

Whole-time Director or Manager who is below the age of twenty-one years or has attained the age of seventy years. From the following four options, select the one which is applicable in relation to the validity or invalidity of appointing Mr. Vanilla Sequera as the Managing Director (MD) of Tasty Choco-Chips Limited:

- (a) *In spite of the fact that Mr. Vanilla Sequera has attained the age of 72 years, he can be validly appointed as Managing Director by the Board of Directors of Tasty Choco-Chips Limited when the recommendation has been made by Mr. Joseph Daniel, the Whole-time Director.*
 - (b) *Since Mr. Vanilla Sequera has attained the age of 72 years, he cannot be validly appointed as Managing Director of Tasty Choco-Chips Limited.*
 - (c) *In spite of the fact that Mr. Vanilla Sequera has attained the age of 72 years, he can be validly appointed as Managing Director by the shareholders of Tasty Choco-Chips Limited through passing a Special Resolution in general meeting.*
 - (d) *In spite of the fact that Mr. Vanilla Sequera has attained the age of 72 years, he can be validly appointed as Managing Director of Tasty Choco-Chips Limited if an application is made to the jurisdictional National Company Law Tribunal (NCLT) and its permission is received for such appointment.*
4. *On June, 20, 2019, Mr. Anil Mehra was appointed as Manager of PQR Music Systems Limited for a period of five years. Considering his performance and dedication towards the company, the management of PQR Music Systems Limited decided to re-appoint him as Manager before the completion of his tenure. Out of the following four options, choose the one which indicates the date on which his re-appointment will be considered valid?*
- (a) *June 24, 2023*
 - (b) *February 1, 2023*
 - (c) *March 12, 2022*
 - (d) *September 10, 2022*
5. *Lockworth Safety Gears Limited which pays remuneration to its Directors on yearly basis, has Harsha as Whole-time Director (WTD). Recently, the company appointed Mr. Raviyansh as Managing Director (MD). While paying remuneration, Lockworth Safety Gears Limited needs to keep in view that the overall remuneration payable to the Directors including Managing Director, Whole-time Director and Manager shall not exceed maximum limit prescribed under the relevant provisions. After the appointment of Mr. Raviyansh as Managing Director, since the company has both Whole-time Director as well as Managing Director, select the appropriate option from those given below which indicates the maximum remuneration that is allowed in a Financial Year:*
- (a) *3% of net profits.*
 - (b) *5% of net profits.*

- (c) 10% of net profits.
- (d) 11% of net profits.
6. Mr. Abhishek has been in full time employment at F&I Limited (a listed company) working as Chief Financial Officer (CFO). He has been given the offer to hold the office of Whole-time Director at M&N Limited whose more than 51% of the paid-up share capital is held by F&I Limited. After considering the applicable provisions, you are required to choose the correct option from the following four which indicates whether Mr. Abhishek can validly proceed or not with the offer of Whole-time Director extended by M&N Limited while also continuing as Chief Financial Officer (CFO) of F&I Limited:
- (a) Mr. Abhishek can validly proceed with the offer of Whole-time Director at M&N Limited while also continuing as Chief Financial Officer (CFO) because being a Key Managerial Personnel he shall not be disentitled from accepting the offer of Whole-time Director in any other company after obtaining the permission of Board of Directors of his parent company i.e., F&I Limited.
- (b) Mr. Abhishek will not be able to proceed with the offer of Whole-time Director at M&N Limited since a whole time Key Managerial Personnel cannot hold office in more than one company at the same time.
- (c) Mr. Abhishek can proceed with the offer of Whole-time Director at M&N Limited while also continuing as Chief Financial Officer (CFO) since M&N Limited is a subsidiary of F&I Limited.
- (d) Mr. Abhishek will not be able to proceed with the offer of Whole-time Director at M&N Limited since a whole time Key Managerial Personnel cannot hold office in more than one company at the same time including its subsidiary company.
7. Hasmukh Entertainment Limited, incorporated under the Companies Act, 2013, appointed Mr. Ram Kishore, a well-qualified and experienced person, as Whole-time Director (WTD) for a period of five years in the Annual General Meeting (AGM) held on August 28, 2019. In order that Mr. Ram Kishore continues with the company as Wholetime Director (WTD), he was re-appointed in advance as Whole-time Director (WTD) for another term of five years in the Annual General Meeting which was held on September 28, 2021. The second term of five years will start after the expiry of first term in August, 2024. From the following alternatives, choose the one which indicates the validity or otherwise of re-appointment of Mr. Ram Kishore for the second term of five years by the company:
- (a) The re-appointment of Mr. Ram Kishore in advance as Wholetime Director (WTD) for another term of five years is valid because re-appointment can be made for a period not exceeding 5 years at any time provided the Articles of Association of the company provide for such re-appointment before one year from the completion of his 'yet-to-expire' term.

- (b) *The re-appointment of Mr. Ram Kishore in advance as Wholetime Director (WTD) for another term of five years is invalid because his re-appointment as Whole-time Director (WTD) cannot be made earlier than one year before the expiry of his first term.*
- (c) *The re-appointment of Mr. Ram Kishore in advance as Wholetime Director (WTD) for another term of five years is valid provided the resolution for such re-appointment had earlier been passed with the consent of all the Directors present at the Board Meeting and thereafter, such re-appointment was taken up at the Annual General Meeting for approval.*
- (d) *The re-appointment of Mr. Ram Kishore in advance as Wholetime Director (WTD) for another term of five years is invalid because no special resolution for his re-appointment was passed at the Annual General Meeting for approval.*

Descriptive Questions

1. *Advise Super Specialities Ltd. in respect of the following proposals under consideration of its Board of Directors:*
 - (i) *Payment of commission of 4% of the net profits per annum to the directors of the company;*
 - (ii) *Payment of remuneration of rupees 40,000 per month to the whole-time director of the company which is running in loss and having an effective capital of rupees 95 lacs.*
2. *Mr. X, a Director of MJV Ltd., was appointed as Managing Director on 1st April 2017. One of the terms of appointment was that in the absence of adequacy of profits or if the company had no profits in a particular year, he will be paid remuneration in accordance with Schedule V. For the financial year ended 31st March 2019, the company suffered heavy losses. The company was not in a position to pay any remuneration but he was paid 50 lakhs for the year. The effective capital of the company is 150 crores. Referring to the provisions of the Companies Act, 2013, as contained in Schedule V, examine the validity of the above payment of remuneration to Mr. X.*
3. *Mr. Doubtful was appointed as Managing Director of Carefree Industries Ltd. for a period of five years with effect from 1.4.2016 on a salary of 12 lakhs per annum with other perquisites. The Board of Directors of the company came to know about certain questionable transactions entered into by Mr. Doubtful and therefore, terminated his services as Managing Director from 1.3.2019. Mr. Doubtful termed his removal as illegal and claimed compensation from the company. Meanwhile the company paid a sum of ₹ 5 lakhs on adhoc basis to Mr. Doubtful pending settlement of his dues. Discuss whether:*
 - (i) *The company is bound to pay compensation to Mr. Doubtful and, if so, how much.*
 - (ii) *The company can recover the amount of 5 lakhs paid on the ground that Mr. Doubtful is not entitled to any compensation, because he is guided by corrupt practices.*

4. *International Technologies Limited, a listed company, being managed by a Managing Director proposes to pay the following managerial remuneration:*

- (i) *Commission at the rate of five percent of the net profits to its Managing Director, Mr. Kamal.*
- (ii) *The directors other than the Managing Director are proposed to be paid monthly remuneration of rupees 50,000 and also commission at the rate of one percent of net profits of the company subject to the condition that overall remuneration payable to ordinary directors including monthly remuneration payable to each of them shall not exceed two percent of the net profits of the company. The commission is to be distributed equally among all the directors.*
- (iii) *The company also proposes to pay suitable additional remuneration to Mr. Bhatt, a director, for professional services rendered as software engineer, whenever such services are utilized.*

You are required to examine with reference to the provisions of the Companies Act, 2013 the validity of the above proposals.

5. *The following particulars are extracted from the statement of profit and loss of Surya Cement Limited for the year ended 31st March 2023:*

Sr. No	Particulars	Amount
1)	Gross Profit	60,00,000
2)	Profit on sale of building (Cost ₹ 10,00,000 and written down value ₹ 6,00,000)	5,00,000
3)	Salaries & wages	2,50,000
4)	Sundry Repairs to Fixed Assets	1,00,000
5)	Subsidy from the government	3,00,000
6)	Compensation for breach of contract	1,00,000
7)	Depreciation	1,40,000
8)	Loss on sale of investments	2,00,000
9)	Interest on unsecured loans	50,000
10)	Interest on debentures issued by the company	1,00,000
11)	Repair Expenses to fixed assets (Capital in nature)	2,00,000
12)	Net Profit	13,00,000

You are required to calculate the overall managerial remuneration payable under section 197 of the Companies Act, 2013 subject to the provisions under Schedule V.

6. You are provided with the relevant extract of the financials of Tribhuke Limited for the financial year ended as on 31st March 2023 as below:

Sr. No	Particulars	Amount
1	Authorised Share Capital	10,00,00,00,000
2	Issued and Paid up Share Capital	5,00,00,000
3	Share Premium Account	25,00,000
4	Reserves and Surplus (Amount of ₹ 25,00,000 is included as Revaluation Reserve)	35,00,000
5	Term loan repayable after 1 year	12,00,000
6	Current Borrowings (Cash Credit Loan from Banks)	20,00,000
7	Non-Current Investments	10,00,000
8	Accumulated Losses	5,00,000
9	Preliminary expenses not written off	3,00,000

The company has three managerial persons in its Board of Directors – Mr. A – Managing Director, Mr. B – Whole Time Director and Mr. C – Director-. According to their terms of appointment, in case the company has no or inadequate profits, the managerial remuneration payable to them shall be in accordance with Schedule V. You are required to compute the total managerial remuneration payable considering the provisions of Schedule V.

ANSWERS

Answer to Multiple Choice Questions

1.	b	2.	b	3.	c	4.	a	5.	c
6.	c	7.	b						

Answer to Descriptive Questions

1. (i) Under section 197 (1) the limit of total managerial remuneration payable by a public company, to its directors, including managing director and whole-time director, and its manager in respect of any financial year shall not exceed eleven per cent of the net profits of that company for that financial year computed in the manner laid down in section 198. Further, the third proviso to section 197 (1) provides that except with the approval of the company in general meeting by a special resolution, the remuneration payable to directors who are neither managing directors nor whole-time directors shall not exceed one per cent. of the net profits of the company, if there is a managing or whole-time director or manager. Whereas in any other case, the remuneration payable to directors shall not exceed three per cent of the net profits.

Therefore, in the given case, the commission of 4% is beyond the limit specified, and the same should be approved by the members by passing a special resolution.

- (ii) As per section 197(3) of the Companies Act, 2013, if, in any financial year, a company has no profits or its profits are inadequate, the company shall not pay to its directors, including managing or whole time director or manager or any other non-executive director, including an independent director, any remuneration exclusive of any fees payable to directors except in accordance with the provisions of Schedule V. Section II of Part II of Schedule V provides that where in any financial year during the currency of tenure of a managerial person or other director, a company has no profits or its profits are inadequate, it may pay remuneration to the managerial person not exceeding 60 lakhs for the year if the effective capital of the company is negative or upto 5 crore.

In the given situation, the proposed remuneration of 40,000 rupees per month (*i.e.* 4,80,000 rupees per annum) can be paid to the whole-time director of the company which is running in loss because the remuneration is within the permissible limit of 60 lakhs.

2. Under Section II of Part II of Schedule V to the Companies Act, 2013, the remuneration payable to managerial personnel is linked to the effective capital of the company. Schedule V states that where in any financial year during the currency of tenure of a managerial person or other director, a company has no profits or its profits are inadequate, it may pay remuneration to the managerial person not exceeding 120 Lakhs in the year in case the effective capital of the company is between 100 crores and 250 crores. However, the remuneration in excess of 120 Lakh may be paid if the resolution passed by the shareholders is a special resolution.

From the foregoing provisions as contained in Schedule V, the payment of 50 lakh in the year of loss as remuneration to Mr. X is less than 120 lakhs which is otherwise permissible when the effective capital of the company is between 100 crores and 250 crores. Thus, payment of 50 lakhs being made to Mr. X is within the prescribed limit and can be validly made to him.

3. According to Section 202 of the Companies Act, 2013, compensation can be paid only to a Managing Director, Whole-time Director or Manager. The amount of compensation cannot exceed the remuneration which he would have earned if he would have been in the office for the unexpired term of his office or for 3 years whichever is shorter. No compensation shall be paid, if the director has been found guilty of fraud or breach of trust or gross negligence in the conduct of the affairs of the company.

In light of the above provisions of law, the company is not liable to pay any compensation to Mr. Doubtful, if he has been found guilty of fraud or breach of trust or gross negligence in the conduct of affairs of the company. But it is not proper on the part of the company to withhold the payment of compensation on the basis of mere allegations. The compensation payable by the company to Mr. Doubtful would be 25 Lakhs calculated at the rate of 12 Lakhs per annum for unexpired term of 25 months.

Regarding *ad-hoc* payment of 5 Lakhs, it will not be possible for the company to recover the amount from Mr. Doubtful in view of the decision in case of *Bell vs. Lever Bros. (1932) AC 161* where it was observed that a director was not legally bound to disclose any breach of his fiduciary obligations so as to give the company an opportunity to dismiss him. In that case the Managing Director was initially removed by paying him compensation and later on it was discovered that he had been guilty of breaches of duty and corrupt practices and that he could have been removed without compensation.

4. International Technologies Limited, a listed company, being managed by a Managing Director proposes to pay the following managerial remuneration:

- (i) **Commission at the rate of 5% of the net profits to its Managing Director, Mr. Kamal:** Part (i) of the Second Proviso to Section 197(1), provides that except with the approval of the company in general meeting by a special resolution, the remuneration payable to any one managing director or whole time director or manager shall not exceed 5% of the net profits of the company and if there is more than one such director then remuneration shall not exceed 10% of the net profits to all such directors and manager taken together.

In the present case, since the International Technologies Limited is being managed by a Managing Director, the commission at the rate of 5% of the net profit to Mr. Kamal, the Managing Director is allowed and no approval of company in general meeting is required.

- (ii) The directors other than the Managing Director are proposed to be paid monthly remuneration of rupees 50,000 and also commission at the rate of 1 % of net profits of the company subject to the condition that overall remuneration payable to ordinary directors including monthly remuneration payable to each of them shall not exceed 2 % of the net profits of the company: Part (ii) of the Second Proviso to Section 197(1) provides that except with the approval of the company in general meeting by a special resolution, the remuneration payable to directors who are neither managing directors nor whole time directors shall not exceed-

- (A) 1% of the net profits of the company, if there is a managing or whole-time director or manager;
- (B) 3% of the net profits in any other case.

In the present case, the maximum remuneration allowed to directors other than managing or whole-time director is 1% of the net profits of the company because the company is managed by a managing director. Hence, if the company wants to fix directors' remuneration at not more than 2% of the net profits of the company, the approval of the company in general meeting is required by passing a special resolution.

- (iii) The company also proposes to pay suitable additional remuneration to Mr. Bhatt, a director, for professional services to be rendered by him as software engineer, whenever such services are utilized by the company:
- (1) According to section 197(4), 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 this section, either
 - (i) by the articles of the company, or
 - (ii) by a resolution or,
 - (iii) if the articles so require, by a special resolution, passed by the company in general meeting, and
 - (2) 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.
 - (3) Any remuneration for services rendered by any such director in other capacity shall not be so included if—
 - (i) the services rendered are of a professional nature; and
 - (ii) 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.

Hence, in the present case, the additional remuneration payable to Mr. Bhatt, a director, for professional services rendered by him as software engineer will not be included in the maximum managerial remuneration. Accordingly, such additional remuneration shall be allowed but opinion of Nomination and Remuneration Committee needs to be obtained.

Also, the International Technologies Limited (a listed company) shall disclose in the Board's report, the ratio of the remuneration of each director to the median employee's remuneration and such other details as are prescribed under Rule 5 of the Companies (Appointment and Remuneration of Managerial personnel) Rules, 2014.

5. The managerial remuneration shall be computed in accordance with the provisions laid down in section 198 of the Companies Act 2013

Particulars	Amount
Net profit	13,00,000
Less: Capital profits on sale of building (Note 1)	1,00,000
Salaries & Wages (Note 2)	-
Sundry repairs to fixed Assets (Note 2)	-
Subsidy from the government (Note 3)	-
Compensation from breach of contract (Note 2)	-
Depreciation (Note 2)	-
Loss on Sale of Investments (Note 4)	-
Interest on unsecured loans (Note 2)	-
Interest on debentures (Note 2)	-
Add: Repair expenses to fixed assets (Capital in Nature) (Note 5)	2,00,000
Net profits as per section 198	14,00,000

Therefore, the overall maximum managerial remuneration shall be 11% of the Net profits computed in accordance with section 198 i.e. $11\% \times 14,00,000 = ₹ 1,54,000$. It is assumed that the net profit given in the question is arrived after giving effect to all the line items given therein.

Notes:

- As per section 198(3), credit shall not be given for profits from the sale of any immovable property or fixed assets of a capital nature comprised in the undertaking or any of the undertakings of the company, unless the business of the company consists, whether wholly or partly, of buying and selling any such property or assets; provided that where the amount for which any fixed asset is sold exceeds the written-down value thereof, credit shall be given for so much of the excess as is not higher than the difference between the original cost of that fixed asset and its written-down value.

Accordingly, the calculation of capital profit is computed as under:

Profit = Selling Price – Written down value

$5,00,000 = \text{Selling Price} - 6,00,000$. Therefore, Selling Price = $11,00,000$. Capital profit = $11,00,000 - 10,00,000$ (original cost) = $1,00,000$

- 2) According to section 198 (4), the following sums shall be deducted:
- a) All the usual working charges – salaries and wages are considered as usual working charges
 - b) expenses on repairs, whether to immovable or to movable property, provided the repairs are not of a capital nature
 - c) any compensation or damages to be paid in virtue of any legal liability including a liability arising from a breach of contract
 - d) interest on debentures issued by the company
 - e) interest on unsecured loans and advances
 - f) depreciation to the extent specified in section 123

Since all of the above charges are already deducted while arriving at net profit, no effect will be given.

- 3) According to section 198 (1), credit shall be given for bounties and subsidies received from any government, or any public authority constituted or authorised in this behalf, by any government, unless and except in so far as the Central Government otherwise directs.
- 4) According to section 198(5), Loss of a capital nature including loss on sale of the undertaking or any of the undertakings of the company or any part thereof shall not be deducted. In the given question, in the absence of the specific information about the nature of investments, the said investments are considered as current investments and revenue in nature and accordingly no effect is given as it is already deducted while arriving at net profit.
- 5) According to section 198(4), expenses on repairs, whether to immovable or to movable property is deducted only for repairs which are not capital in nature. Accordingly, we have added back to the net profit.
6. Section II of Part II of Schedule V states the provisions applicable for the payment of managerial remuneration in case where the company has no profits or its profits are inadequate. In such a case, managerial remuneration is payable on the basis of the effective capital as on the last date of the financial year for which the remuneration is payable. Accordingly, to compute the total managerial remuneration payable, effective capital is calculated as:

Particulars	Amount
Issued and Paid up Capital	5,00,00,000
Add: Share Premium Account	25,00,000

Add: Reserves and surplus excluding revaluation reserve	10,00,000
Add: Term Loan repayable after 1 year (excluding working capital loans)	12,00,000
Less: Non-Current Investments	10,00,000
Less: Accumulated Losses	5,00,000
Less: Preliminary Expenses	3,00,000
Effective Capital	5,29,00,000

Explanation 1 to Section II of Part II of Schedule V states effective capital means the aggregate of the paid-up share capital (excluding share application money or advances against shares); amount, if any, for the time being standing to the credit of share premium account; reserves and surplus (excluding revaluation reserve); long-term loans and deposits repayable after one year (excluding working capital loans, over drafts, interest due on loans unless funded, bank guarantee, etc., and other short-term arrangements) as reduced by the aggregate of any investments (except in case of investment by an investment company whose principal business is acquisition of shares, stock, debentures or other securities), accumulated losses and preliminary expenses not written off.

Section II of Part II of Schedule V states that where the effective capital is 5 crores and above but less than 100 crores, the remuneration payable shall not exceed Rs. 84 lakhs. Accordingly, the total managerial remuneration payable by the Companies to three managerial personnel for the year ended 31st March, 2023 shall not exceed ₹ 252 lakhs (₹ 84 lakhs x 3 managerial personnel).

Note: As nothing is specified about Mr. C, whether he is part-time or non-executive or Independent director, he may be considered as director in whole time employment.

