



ERGO

Analysing developments impacting business

COMPANIES (AMENDMENT) ORDINANCE 2018 – GOVT RATIONALIZES PENALTIES

15 November 2018

Introduction

Several committees stretching back to 2002 had observed that the erstwhile Companies Act, 1956 contained penalties which were rather nominal and easily compoundable. Hence, the Companies Act, 2013 (Act) deliberately made serious offences such as fraud etc., non-compoundable. Unfortunately, in the wake of Satyam and the season of scams, lawmakers fell into the trap of ‘preventing’ scams and overcorrected.

We had written earlier how after the enactment of the Companies Act, 2013 (Act), burdensome compliance and onerous reporting requirements became the ‘new normal’ for businesses in India. The Act was [amended last year](#) to liberalise where possible and harmonise the compliance requirements with other laws. However, stakeholders felt that there was further scope for recategorization of offences such that technical defaults / procedural lapses were treated as civil liabilities. A robust in-house adjudication mechanism would also help in de-clogging the National Company Law Tribunal (NCLT) which was now swamped with more pressing matters such as administering bankruptcy laws and resolving corporate debt.

In addition to the ‘Ease of Doing Business’, the Government has professed equal enthusiasm for cracking down on ‘shell companies’ purportedly used to launder ‘black money’. To achieve these aims, the Central Government set up the Committee to Review Offences under the Companies Act, 2013 (Committee). Based on the Committee report, an ordinance to further amend the Act (Ordinance) was promulgated on 2 November 2018 to come into force at once.

The key changes brought about by the Ordinance are highlighted below.

➤ ‘De-clogging’ the NCLT

With the intent of easing the NCLT’s caseload, the Central Government has been vested with the power to authorise the following, which may be further delegated to the registrar of companies or the regional director:

- Change of financial year.
- Conversion of public limited company to private limited company and vice versa.

- Power to rectify the register of charges

Greater compounding powers

The pecuniary jurisdiction of the Regional Director for compoundable offences has been increased from INR 5 lakh to INR 25 lakh.

Earlier, the permission of the Special Court was required to compound offences where imprisonment was a discretionary component of the punishment. As punishment for many such offences has now been confined to financial penalty, Section 441(6) has been amended to clarify the principle that offences where imprisonment is a mandatory component of the punishment (with or without fine) are not compoundable.

Some of the key offences that remain not compoundable are contraventions of Section 447 (punishment for fraud); Section 8 (formation of companies with charitable objects); Section 40 (Securities to be dealt with on stock exchange); and Section 90 (register of significant beneficial owners).

➤ **Crackdown on shell companies**

Commencement of Business

Section 11 of the Act which was omitted in 2015 has been brought back as Section 10A. Henceforth, no company having a share capital can "commence any business or exercise any borrowing powers", unless:

- a director files a declaration with 6 months of incorporation stating that every subscriber to the memorandum has "*paid the value of shares to be taken by him*"; and
- a verification has been filed by the Company of its registered office within 30 days of incorporation in terms of Section 12(2) of the Act.

Where a director fails to file a declaration, the registrar, has been empowered to initiate the process for striking the name of company off the register.

Registered Office

New Section 12(9) has been inserted. Where a registrar has *reasonable cause* to believe a company is not carrying on business at its registered office, he may carry out an inspection and initiate the process for striking the name of company off the register.

➤ **Registration of Charges**

Charges created on assets of a company are to be mandatorily registered within 30 days of their creation. As per the new provisos to Section 77, for charges created and not duly registered before 2 November 2018, an additional period of six months for registering the same with additional fees is available. Also, a 60 days' additional period is made available for charges created after 2 November 2018 and not duly registered, on payment of *ad valorem* fees.

Further, Section 87 has been rewritten and the powers of the Central Government to rectify the register of charges have been restricted to situations where there is an omission or misstatement in respect of the intimation of payment or satisfaction of charge.

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As a liquidator under the IBC is only obligated to take charges duly filed by a company with the registrar into account, timely reporting will greatly assist the corporate insolvency resolution process.

➤ **Significant Beneficial Ownership**

Section 90 was revamped by an amendment to the Act last year and the new concept of 'significant beneficial owner' and related reporting requirements (by companies and shareholders) was introduced.

A duty was cast on natural persons being significant beneficial owners to disclose the nature of interest and register themselves with the company. Duty has also been cast on each company to give notice to persons whom it has reason to believe to be significant beneficial owners to come forward and register themselves. Where a response was not forthcoming, companies were empowered to apply to the NCLT, for an order seeking restrictions on transfer and suspension of all rights attached to the shares by such unregistered beneficial owners.

Aggrieved persons were given an open-ended right to approach the NCLT for relaxation or lifting of the restrictions. The Ordinance has curtailed this right. Where no person approaches the NCLT within one year, the shares will now be automatically transferred to the Investor Education & Protection Fund. In addition, non-compliance of Section 90 now carries a year's imprisonment as a discretionary component of the punishment.

➤ **Practical Omissions?**

Remuneration of Independent Directors (IDs)

As per Section 149(6)(c) of the Act, an ID's entire remuneration (including sitting fees, expenses and commission) are excluded from the ambit of pecuniary relationships. The Committee observed that the proportion of pecuniary rewards in an ID's overall annual income could compromise his independence and that only sitting fees and expenses incurred should be exempted. The Committee also had recommended that the pecuniary relationship limit of an ID with the company be hiked to 20% of his total annual income with a sub-limit of 10% for professional fees received.

➤ **Recategorization of miscellaneous reporting offences**

Please refer to the table below for a list of offences that have been recategorized as civil liability only and are within the purview of the compounding procedure.

Table of miscellaneous reporting offences

SECTION	NEW LIABILITY	CHANGE
Section 53(3) - Prohibition on issue of shares at a discount	The company and every officer in default faces a penalty equal to the amount raised through the issue or INR 5 lakh whichever is less. In addition, company is required to refund all monies with a penal interest of 12%	Imprisonment dropped

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Section 92(5) - Failure to file Annual Return within 60 days of AGM	The company and every officer in default faces a penalty of INR 50,000 and INR 100 for each day of continuing failure subject to a cap of INR 5 lakh	Imprisonment dropped
Section 102(5) - Failure to annex statement of 'material facts' to notice of general meeting	Every promoter, director, manager or other key managerial personnel is liable for INR 50,000 or five times the amount of benefit and INR 100 for each day of continuing failure subject to a cap of INR 5 lakh accruing to the aforesaid persons or their relatives whichever is higher.	INR 100 penalty for continuing failure added
Section 105 - Proxies	Officers in default are liable for a fixed penalty of INR 5,000	Classification from 'fine' to penalty'
Section 117 - Not filing shareholders' resolutions with registrar	Fixed penalty of INR 1 lakh subject to a maximum of INR 25 lakh for companies. Similarly, fixed penalty of INR 50,000 subject to a maximum of INR 5 lakh for officers in default.	INR 500, subject to maximum of IN 5 lakh penalty for continuing failure added for both companies' officers and liquidator, if any.
Section 121(3) - Not filing report on AGM by listed companies	Fixed penalty of INR 1 lakh subject to a maximum of INR 5 lakh for companies. A penalty of at least INR 25,000 subject to a maximum of INR 1 lakh for each officer in default.	INR 500 penalty for continuing failure added for both companies and officers
Section 137(3) - Not filing financial statement with registrar	The MD and CFO and in their absence the responsible director or in his absence the entire board is liable for INR 1 lakh and INR 100 for each day of continuing failure subject to a cap of INR 5 lakh.	Imprisonment dropped
Section 140 - Failure by auditor to intimate registrar of resignation	A penalty equal to the remuneration of the auditor or INR 50,000 whichever is less and INR 100 for each day of continuing failure subject to a cap of INR 5 lakh.	INR 100 penalty for continuing failure added
Section 157 - Not filing Director Identification Number (DIN) with the registrar	The company and every officer in default faces a penalty of INR 25,000 and INR 100 for each day of continuing failure subject to a cap of INR 1 lakh	INR 100 penalty for continuing failure added

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Section 159 – Failure by director to comply with DIN requirements	A penalty of INR 50,000 and INR 500 for each day of continuing failure	Imprisonment dropped
Section 164 – Disqualification for director	Failure to comply with the provisions relating to number of directorships in Section 165	A new ground for disqualification
Section 165 – Number of directorships	A fixed penalty of INR 5,000 for each day of contravention	Classification from ‘fine’ to penalty’
Section 191 – Payment to directors for loss of office etc.	A fixed penalty on INR 1 lakh for director of a company.	Classification from ‘fine’ to penalty’. Also, quantum has been enhanced from the range of INR 25,000 to INR 1 lakh to a fixed penalty.
Section 197– Managerial remuneration	A fixed penalty on INR 1 lakh for default for any defaulting persons.	Companies also liable for a fixed penalty of INR 5 lakh
Section 203 – Non compliance of KMP provisions	Fixed penalty of INR 5 lakh for companies. A penalty of INR 50,000 and INR 1,000 for each day of continuing failure subject to a cap of INR 5 lakh for each officer in default	INR 1,000 penalty for continuing failure added for officers
Section 238 – Failure to register offer to compulsorily acquire shares from dissenters in scheme of arrangement	Directors who issue circular are liable for a fixed penalty on INR 1 lakh	Classification from ‘fine’ to penalty’. Also, quantum has been enhanced from the range of INR 25,000 to INR 1 lakh
Section 446B – Lesser penalties for One Person Companies or small companies.	Non-compliance pertaining to filing annual returns (Section 92); shareholders’ resolutions (Section 117); and financial statements (Section 137) attracts a liability of up to half the penalty in specified sections	Imprisonment dropped

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Section 454A– Penalty for repeated default	Where a company or an officer repeats a default within three years of an order imposing a penalty for such default, the penal rate shall be double.	This is a new provision to disincentivise repeat offences.
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Comment

Policy mechanisms that seek to increase reporting and disclosure on the one hand and those that seek to improve judicial efficiency or deregulate businesses can run counter to each other.

Hot on the heels of India's leap to 77th position in the World Bank's 'Ease of Doing Business' rankings, the Ordinance is an honest effort at striking the right balance between these competing aims.

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