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### AMENDMENT TO S. 197 OF COMPANIES ACT, 2013 NOTIFIED: GOVERNMENT APPROVAL NO LONGER REQUIRED FOR ENHANCEMENT OF MANAGERIAL REMUNERATION

19 October 2018

#### Introduction

In a long awaited move, the Ministry of Corporate Affairs (MCA) has notified the provisions of the Companies (Amendment) Act, 2017 (CA Amendment Act), relating to managerial remuneration, which are now in force with effect from 12 September 2018. By way of a notification, the amendments to Section 197 and Schedule V of the Companies Act, 2013 (CA 2013) have been brought into effect. More importantly, the requirement of seeking approval of the Central Government for the payment of managerial remuneration in excess of limits stipulated for public companies has now been removed. The MCA has also made appropriate changes to the Companies (Appointment and Remuneration of Managerial Personnel) Amendment Rules, 2018.

The changes to Section 197 and Schedule V of the Companies Act, 2013 follow the recommendations made by the Company Law Committee in its report dated 1 February 2016 (CLC Report), wherein they had observed that the requirement of obtaining a Central Government approval was stringent, time consuming and not in line with international practices. Accordingly, in light of the recommendations under the CLC Report, the CA Amendment Act had sought to amend relevant sub-sections of Section 197 of CA 2013. Accordingly, public companies are now free to appropriately compensate their managerial personnel in excess of the limits prescribed under the CA 2013 only subject to shareholder's consent by means of a special resolution.

#### Key Highlights

##### Limits of managerial remuneration

Section 197 of CA 2013 prescribes a ceiling on the total managerial remuneration payable by a public company to its directors (including managing or wholetime directors) and manager at 11% of the net profits of the company. Further, the remuneration payable to any one managing or wholetime director or manager cannot exceed 5% of the net profits of the company and 10% if there were more than one such director. The remuneration payable to non-executive directors is also capped at 1% of the net profits if such public company has appointed a managing or wholetime director or manager. In absence of such executive directors (a managing or wholetime director or manager), the limit of remuneration is fixed at 3% of net profits of the company. Prior to the amendment, payment of remuneration in excess of these limits required both shareholders' approval and approval from the Central Government. Further, if in any financial year, a public company had no profits or inadequate profits,

such company was not permitted to pay to its directors and managerial personnel, any remuneration except in accordance with the provisions of Schedule V of CA 2013.

If a public company is desirous of paying remuneration in excess of the above limits, such company may now do so after obtaining approval of the shareholders of company by means of a special resolution. The additional requirement of obtaining central government approval has been done away with.

Further, if a public company defaults in payment of dues to any bank / public financial institution / non-convertible debenture holders / any other secured creditor, such company would be required to obtain prior approval of such bank / public financial institution / non-convertible debenture holders / any other secured creditor, as the case may be, before obtaining the shareholders' approval.

Any remuneration received by any director / managerial personnel in excess of the statutory limits without obtaining the approval from the shareholders, must be refunded to the company, within two years or such lesser period as may be allowed by the company, and until such sum is refunded, such director / managerial personnel would continue to hold it in trust for the company. Any waiver of such refund must be approved by the shareholders by a special resolution within two years from the date the sum becomes refundable. The requirement of obtaining approval from the central government in such cases has also been done away with.

Similarly, public companies with inadequate or no profits, desirous of paying remuneration to its directors and managerial personnel in excess of the limits prescribed in Schedule V of CA 2013 may now do so after obtaining approval of the shareholders by a special resolution.

On and from the commencement of the CA Amendment Act, any prior application made to the Central Government under the provisions of erstwhile Section 197 which is pending with the Central Government will abate. The company would be required to obtain a shareholder's approval in respect of such excess remuneration within a year from the commencement of the CA Amendment Act.

Part I of Schedule V prescribes that persons who are sentenced to imprisonment for any period or are subject to a fine exceeding Rs 1,000 under certain laws, are disqualified from being appointed as managing or wholetime director or manager. By virtue of the CA Amendment Act, the list of laws has been expanded to include the Insolvency & Bankruptcy Code, 2016, the Goods & Services Tax Act, 2017 and the Fugitive Economic Offenders Act, 2018.

### Comments

The fifth anniversary of the first notification of CA 2013 marks a new beginning by implementing a liberalised regime for compensating directors and managerial personnel of public companies. The removal of the requirement of obtaining a Central Government approval has simplified compliances for public companies. However, shareholders have simultaneously lost the protection of an additional layer of scrutiny by the Central Government. This imposes a higher responsibility on nomination and remuneration committees and boards of directors to justify managerial remuneration levels. The stakeholders' say on managerial remuneration is gaining momentum and is fortified by the current amendment of CA 2013. In light of the requirement of obtaining shareholder's consent by a special resolution, companies will now be required to ensure greater transparency and rationale while drafting explanatory statements to be shared with the shareholders, for resolutions seeking approval for enhanced remuneration. Further, in case of listed companies, the proxy advisory firms will continue to play a major role by offering research-based analysis and comparisons with peers, insofar as

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the fairness of remuneration is concerned, thereby influencing the opinions of major institutional stakeholders.

- *Sharad Abhyankar (Partner), Atul Pandey (Partner) & HIRAK Mukhopadhyay (Associate)*

For any queries please contact: [editors@khaitanco.com](mailto:editors@khaitanco.com)

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**Mumbai**

One Indiabulls Centre, 13<sup>th</sup> Floor  
Tower 1841, Senapati Bapat Marg  
Mumbai 400 013, India

T: +91 22 6636 5000  
E: [mumbai@khaitanco.com](mailto:mumbai@khaitanco.com)

**New Delhi**

Ashoka Estate, 12th Floor  
24 Barakhamba Road  
New Delhi 110 001, India

T: +91 11 4151 5454  
E: [delhi@khaitanco.com](mailto:delhi@khaitanco.com)

**Bengaluru**

Simal, 2nd Floor  
7/1, Ulsoor Road  
Bengaluru 560 042, India

T: +91 80 4339 7000  
E: [bengaluru@khaitanco.com](mailto:bengaluru@khaitanco.com)

**Kolkata**

Emerald House  
1 B Old Post Office Street  
Kolkata 700 001, India

T: +91 33 2248 7000  
E: [kolkata@khaitanco.com](mailto:kolkata@khaitanco.com)