Schedule XIII to the Companies Act-A Practical Approach

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< EXECUTIVE SUMMARY >

◆ Schedule XIII to the Companies Act, 1956 was put in place with the primary objective of obviating the need for seeking Central Government approval by Companies to pay remuneration to their managing or whole-time directors if they satisfied the parameters set out therein.

Schedule XIII is divided in three parts. Part I deals with 'Appointments'; Part II deals with 'Remuneration'; and Part III deals with 'Provisions applicable to Part I and Part II of this schedule'.

Author has also discussed the relevant notifications in this regard viz., Notification GSR No. 215(E) dated 02.03.2000; Notification GSR No. 36(E) dated 16.1.2002; and Notification GSR No. 565(E) dated 14.08.2002.

INTRODUCTION

Sweeping changes have been made by the Department of Company Affairs (DCA) to Schedule XIII to the Companies Act with a view to give greater freedom for the companies to acquire better managerial skills by relaxing the rules for appointing and fixing their remuneration. A balancing act was also achieved with the introduction of the concept of corporate governance.

The responsibilities expected of the accounting professionals as statutory auditors have also increased considerably in the area of managerial remuneration. Circular No. 1/CL.VII of 2000 dated 23.06.2000 requires the Auditors and Company Secretary of the company to ensure that the remuneration to the managerial personnel is not paid in excess of the limit under Schedule XIII, without Central Government approval.

The aim of this article is to make a practical approach of the Companies Act, 1956 relating to the appointment and remuneration of managerial persons, with special reference to the recent amendments to Schedule XIII.

The author is members of the Institute. The views expressed herein are the personal views of the author and do not necessarily represent the views of the Institute.

APPLICABILITY OF SCHEDULE XIII

The provisions contained in Section 198 and 269 read with Schedule XIII are applicable only to (a) a public limited company and (b) a private limited company, which is subsidiary of a public Company. The provisions of Schedule XIII are not applicable to Government Companies.

Schedule XIII is divided into three parts as detailed below:-

a) Part I- deals with the qualifications and appointment of managerial person

b) Part II- deals with the remuneration payable; and

c) Part III- deals with requirements like share holders' approval and compliance certificate to be obtained from the auditor or company secretary.

RECENT AMENDMENTS TO SCHEDULE XIII

Section II of Schedule XIII, which deals with the limits of remuneration to managerial personnel, underwent frequent amendments to facilitate fixing of liberalized remuneration limits without the approval of the Central Government. The following notifications issued by DCA in this regard are worth mentioning:-

(a) Notification GSR No.215 (E) dated 2.3.2000 (remuneration limits fixed ranging from Rs.75000/- pm. To Rs.200000/-p.m)

(b) Notification GSR No.36 (E) dated 16.1.2002 (remuneration limits fixed ranging from Rs.75000/-p.m. to Rs.400000/-p.m.)

(c) Notification GSR No.565(E) dated 14.08.2002- (enabling companies in Special Economic Zones to pay remuneration upto Rs.20,00,000 p.m)

Since the notification GSR No.36(E) of 2002 modified most of the provisions of the 2000 notification, the need for understanding the former is of practical importance. Most of the discussions in this article will focus attention on the same.

SCOPE OF NOTIFICATION GSR NO.36(E) DATED 16.1.2002

The impact of the above notification read with the earlier provisions of Schedule XIII can be summarized as follows:

a) no changes were made in Part I and Part III of the Schedule

b) as far as Part II is concerned, Section 1 (remuneration payable by companies having profits) and Section III (remuneration payable to managerial person holding position in more than one company) remain unchanged.

c) in respect of Section II of Part II

(i) new ceiling limits (which depend upon the effective caital) upto a maximum of Rs.2 Lakhs p.m. or Rs.24 Lakhs p.a., applicable to all companies having no profits or inadequate profits and the two new conditions to be satisfied were substituted for the earlier limits [Clause (A) of Para 1 of Section II)

(ii) enhanced ceiling limits (which depend upon the effective capital) upto a maximum of Rs.4 Lakhs p.m or Rs.48 Lakhs p.a., applicable in special cases together with certain new conditions and disclosure requirements, were newly introduced [Clause (B) of para 1 of Section II]

(iii) new conditions and disclosure requirements for ceiling limits (which depend upon the effective capital) exceeding Rs.4 Lakhs p.m. or Rs.48 Lakhs p.a. were newly introduced [Clause C of Para 1 of Section II]

(iv) the earlier provision as regards to contribution to Provident fund, gratuity, leave encashment and other retirement benefits is unchanged (Para 2 of Section II of Schedule XIII)

(v) the old provisions relating to payment of perquisites to an expatriate managerial person, in addition to minimum remuneration, are also unchanged (Para 3 of Section II of Schedule XIII)

(vi) three new explanations, explaining (i) Remuneration Committee, (ii) Scope of remuneration committee and (iii) negative effective capital were included in Schedule XIII. (Explanations to Section II of Schedule III)

New ceiling limits now applicable

The different situations discussed for applying different ceiling limits in Section II of the Schedule XIII may broadly be classified into:-

1) Cases where neither Central Government approval nor special resolution required.

2) Cases where Government approval is not required, but payment of remuneration requires approval through special resolution; and

3) Cases where the approval of the Central Government as well as approval through a special resolution are required.

For better and easy understanding of the new amendments, a schematic representation is shown in Figure-1.

Situation 1- Cases where neither the Government approval nor the Special Resolution required

Under the amended provisions of Section II, where a company has no profits or inadequate profits the maximum remuneration payable depending upon the effective capital shall not exceed Rs.2 Lakhs per month or Rs.24 Lakhs per annum.

The following table shows the comparison of the amended notification with that of the old:

Effective Capital of the Company is	Monthly Remuneration New limits as per Notification GSR No. 36(E) dated 16.1.2002`	Monthly Remuneration Old Limits Vide Notifiction GSR No.215(E) dated 2.3.2000
Less than Rs.1 Crore	75,000	75,000
Rs.1 Crore or more but less than Rs.5 Crores	1,00,000	1,00,000
Rs.5 Crore or more but less than Rs.25 Crores	1,25,000	1,25,000
Rs.25 Crore or more but less than Rs.50 Crores	1,50,000	1,50,000
Rs.50 Crores or more but less than Rs.100 Crores	1,75,000	1,50,000
Rs.100 Crores and more	2,00,000	2,00,000

From the above table, it is observed that, but for the introduction of an extra slab for companies having effective capital between Rs.50 Crores and Rs.100 Crores, no other changes were made in the first situation.

However, the amended notification has introduced the following two new conditions for payment of managerial remuneration on the above lines:-

(a) The Remuneration Committee of the Company should approve the remuneration by a resolution.

(b) There should not be any default in repayment of any of its debts (Including public deposits) or debentures or interest payable thereon for a continuous period of thirty days in the preceding financial year before the date of appointment of such managerial person.

Situation 2- Cases where special resolution is required but Government approval is not required

The notification has introduced a new situation where an eligible company can fix remuneration at higher ceiling limits. It may be noted that no such enhanced limits are available under the old provisions.

Effective Capital of the Company	Monthly remuneration payable shall not exceed
Less than Rupees 1 Crore	1,50,000
Rupees 1 crores or more but Less than Rupees 5 Crores	2,00,000
Rupees 5 Crores or more but Less than Rupees 25 Crores	2,50,000
Rupees 25 Crores or more but less than Rupees 50 Crores	3,00,000
Rupees 50 Crores or more but Less than Rupees 100 Crores	3,50,000
Rupees 100 Crores or more	4,00,000

On one hand the DCA allows payment of remuneration at enhanced limits and on the other, to ensure stringent control over corporate governance, it imposes certain additional conditions to be fullfiled to avail the enhanced limits. These conditions are in addition to conditions (a) and (b) discussed in situation 1.

(a) A special resolution has to be passed at the General Meeting for the payment of remuneration for a period not exceeding three years.

(b) A statement containing the following information should be given along with the notice calling for the General Meeting to every shareholder.

1) General Information about the industry and the company on prescribed lines
2) Information about the appointee, including background, past remuneration etc.,
3) Other information, pertaining to reasons for loss or inadequate profit, steps taken or proposed to be taken for improvement, expected increase in productivity and profits in measurable terms etc..
4) Disclosure requirement in the Directors' report under the heading "Corporate Governance", if any, attached to the annual report regarding all elements of remuneration package such as salary, benefits, bonuses, stock options, pension etc.

Situation 3- Cases where special resolution and Central Government Approval are required

In the following cases, the company is not only required to fulfill all the conditions listed in Situation 1 and 2 but also required to obtain the prior approval of the Central Government:-

a) where the effective capital of the company is negative

b) where the remuneration is more than the ceiling limits (depending upon the effective capital) of Rs.48,00,000 per annum or Rs.4,00,000 per month

However, in respect of companies in Special Economic Zones (SEZ) Notification GSR No.565 (E) dated 14.08.2002 is applicable.

Scope of Notification GSR No.565 (E) dated 14.08.2002

A new clause (D) in Para 1 of Section II of Part II of Schedule XIII was inserted by the DCA through Notification GSR No.565 (E) empowering companies in SEZ, notified by the Department of Commerce, to pay managerial remuneration not exceeding Rs.240 Lakhs per annum or Rs.20 Lakhs per month. No prior approval of the Central Government is required in this regard.

However the following conditions are to be satisfied:-

(a) the company should not have raised any money by public issue of shares or debentures; and

(b) the company should not have committed any default in India in repayment of it debts or debentures or interest payable thereon for a continuous period of 30 days in any financial year.

Further as per Notification GSR No.670(E) dated 30.09.2002, which brought in a modification to GSR No.565(E), no non-resident can be appointed as managerial personnel, unless he holds a proper employment visa from the concerned Indian mission abroad.

KEYWORDS OF SECTION II OF PART II OF SCHEDULE XIII EXPLAINED

(a) Effective capital

The different ceiling limits provided in Schedule XIII are based on the effective capital of the company, making it necessary to understand the meaning of the same.

Explanation I of Section II of Schedule XIII define effective capital as the aggregate of

a) paid-up capital
b) reserves and surplus (excluding revaluation reserve)
c) long term loans and
d) deposits repayable after one year

as reduced by

a) any investments
b) accumulated losses and
c) preliminary expenses not written off

According to Explanation II, the effective capital is to be calculated

a) where the appointment was made in the year of incorporation of the Company, as on the date of appointment; and
b) in all other cases as on the last date of the financial year immediately preceding the financial year in which the appointment is made.

(b) Remuneration Committee

Under the amended rules it is mandatory to constitute a remuneration committee consisting of atleast three non-executive independent directors, including nominee director or nominee directors, if any.

(c) Independent Directors

The term "independent director" is not defined anywhere in the Companies Act, 1956. Hence it is to be presumed that this provision would adopt the definition given in Clause 49 of the Listing Agreement.

Remuneration Committee- Comparative Analysis of Clause 49 of the Listing Agreement And Schedule XIII of the Companies Act

Schedule XIII (as amended) as well as Clause 49 of the listing agreement deal with the concept of remuneration committee, but from different perspective. The comparative analysis of the same is given below:-

Particulars	Clause 49	Schedule XIII
Companies to which applicable	Only listed companies, but a Non-mandatory requirement	Mandatory in the case of companies with paid-up capital of Rs.5 Crores or more and where minimum Remuneration is payable in case of absence of profits or In adequate profits.
Minimum number of members in the Committee	3 Non-Executive Directors	3 Non-Executive Independent Directors
Chairman of the Committee	An independent Director to be the Chairman	Not defined
Quorum for the Committee	All members of the Committee to be present	Not defined
Annual General Meeting and the remuneration committee	Chairman to be present at the AGM to answer	Not defined

PRACTICAL ISSUES IN THE APPLICATION OF SCHEDULE XIII

Some of the practical issues pertaining to the applicability of Schedule XIII are discussed below:

(a) Remuneration is fixed by a profit making company but in later years it incurred loss

In the case of a profit making company the provisions of Section 1 of Part II of the Schedule is applicable. Accordingly the company can pay managerial remuneration upto 5% of net profits to one such managerial person and if there is more than one person, 10% of the net profits for all of them put together.

However, if the company incurred losses or earned inadequate net profits in any subsequent financial year, then Section II of Part II will apply automatically.

Accordingly, the company has to either

a) re-fix the remuneration within the applicable ceiling limits specified in Section II of Part II.

or

b) obtain the approval of the Central Government for payment in excess of the Schedule XIII limits

(b) Reduction in effective capital after remuneration is fixed according to Schedule XIII

Where section II of Part II is applicable, but effective capital was reduced in any subsequent financial year then, as in the earlier instance, the remuneration package has to be scaled down or the approval of the Central Government has to be obtained.

Note: In both the above cases, If none of the above options are exercised, then the appointment and remuneration shall be deemed to be in contravention to Schedule XIII.

(c) Payment of fees for professional services to a Director- Whether to be included for Schedule XIII calculations

Any remuneration paid for professional services rendered by any director shall not be included in calculating the managerial remuneration under Schedule XIII, if he has the requisite qualification for the practice of the profession. [Proviso to Section 309(1)]

(d) Non-competing fees paid to ex-managing director

Consideration paid to ex-managing director under an agreement to restrain him from competing with the company for a reasonable period after cessation will not be considered as remuneration to such director and hence Schedule XIII is not applicable.

(e) Managerial remuneration from two companies
Procedure for appointment

(i) specific notice has to be given to all the Directors of the Company regarding the meeting and the proposed resolution relating to the appointment.
(ii) the appointment should be approved by a resolution of the Board with the consent of all the Directors present at the meeting.
(iii) the managerial person shall not hold office in more than two companies, except with the approval of the Central Government.

<u>**Ceiling on remuneration**</u>

If a person is appointed as managerial person in more than one company, no Central Government approval is necessary, provided the total remuneration from both the companies does not exceed the higher of the maximum managerial remuneration computed in accordance with Schedule XIII for each company. For example, if the remuneration payable by Company A as per Schedule XIII is Rs.75,000/- per month and Company B is Rs.1,00,000/- per month, then the total remuneration received by the managerial person from both the companies shall not exceed Rs.1,00,000/- per month [Clause (d) of Part I and III of Part II of Schedule XIII)

(f) Section 314 Vs Schedule XIII

Section 314 of the Act requires the approval of the Central Government for appointing relatives of a Director to hold office of profits in excess of certain limits.

However, if a relative of a Director is appointed as a whole-time director and the remuneration fixed is within the limits laid down in Schedule XIII, then no approval of the Central Government is required [DCA letter No.3/36/87-CL-V dated 29.5.1989]

(g) Section 10(10CC) of the Income Tax Act Vs Section 200 of the Companies Act

Section 200 of the Companies Act provides that no Company shall pay to any officer or employee thereof, remuneration free of any tax. However, Section 10(10CC) of the Income Tax Act provides that not withstanding anything contained in Section 200 of the Companies Act, 1956, the employer can opt to bear the tax burden on non-monetary perquisite given to its employees within the meaning of Section 17(2) of the

Income Tax Act.

In case a company opts to pay perquisite to its managerial personnel free of income tax, shall it be construed as a violation under sec 200 of the Companies Act. Unfortunately, the answer is in the affirmative, as there is no corresponding amendment to Section 200 of the Companies Act to empower companies to pay tax-free remuneration.

(h) Managerial Remuneration to Non Whole-Time Directors

As per section 198 of the Companies Act, the maximum managerial remuneration permissible is 11% of the net profits. If we practically analyse that 11%, first 5% percent is for the managing or whole-time directors, next 5% is for the second managing director, if there is any and only the balance 1% is left for the non whole-time directors.

SEBI's requirement for listed companies to have independent directors in the Board imposes much more obligation on the non whole-time directors. Adequate compensation is absolutely essential to motivate the independent directors and to ensure their greater involvement in the company. The limits fixed under schedule XIII may require further revision in respect of the non whole-time directors.

(i) Schedule XIII and sitting fees to Managing and Whole-time directors

By virtue of the explanation given by the DCA, payment of sitting fees to managerial personnel is also treated as part of remuneration and in the case of Schedule XIII appointments, no sitting fees is payable unless specific provision is made in the appointment.

(j) Effect of appointment in contravention of Schedule XIII

Appointment in contravention to Schedule XIII, when so declared by the Company Law Board has the following effects:-

a) The appointee is liable to refund the entire amount received as salaries, commission and perquisites received or enjoyed by him. The company can not waive the recovery unless approved by the Central Government u/s 309(5b).
b) Every officer in default and the appointee are liable for imprisonment upto 3 years and also fine of Rs.500/- for every day of default.
c) The offence is not compoundable under Section 621A.

(k) Validity of appointment in case resolution authorizing the remuneration was not passed within 90 days of appointment by the shareholders

DCA had clarified that if the Board resolution, in respect of the remuneration package, was already filed along with Form No.25C with the concerned ROC and the shareholders subsequently ratified the same, then

a) the resolution in the AGM/EGM, approving the appointment and/or remuneration, can be passed even after the expiry of 90 days from the date of appointment by the Board
b) the same is not required to be filed with the ROC
c) the appointment is valid and the company can make payment of remuneration

CONCLUSION

The changes made by the new amendements not only aims at giving greater freedom to Companies with regard to managerial remuneration, but also aims at arresting the flight of managerial talent from India to other countries. With enhanced limits, a new path has been paved for the professional executives to accept board-level managerial assignment and to turnaround the corporate sector in the context of globalisation of economy.

Ashok Chandak Elected President of SAFA

Mr. Ashok Chandak, President of The Institute of Chartered Accountants of India (ICAI) has been elected President of South Asian Federation of Accountants (SAFA) at the 48th Assembly Meeting of the Federation held in New Delhi.

The South Asian Federation of Accountants (SAFA), is a forum of professional accountancy bodies in the SAARC countries and is committed to positioning, maintaining and developing the profession in its member-countries and ensuring its continued eminence in the world of accountancy. In the year 1998, SAFA became a recognized body of SAARC. At the last (22nd) meeting of the Council of Ministers of SAARC at Kathmandu, SAFA has been elevated to the status of SAARC Apex Body.

Figure-1 Applicablity of Schedule XIII