

Remuneration of Directors (Sections 309 – 311)

Remuneration of Directors (Section 309)

Question 1

Examine whether the payment of following remuneration to Non-executive Directors (Directors who are neither in the whole-time employment of the company nor Managing Director) is in accordance with the provisions of the Companies Act, 1956:

- (i) *Sitting fee payable to Directors is increased from Rs.3,000 to Rs.6,000 per meeting by amending the Articles of Association.*
- (ii) *Commission payable to Non-executive Directors is calculated on the basis of book profits arrived at after providing for depreciation as per straight line method.*
- (iii) *Guarantee commission has been paid to one of the Non-executive Directors for having guaranteed the term loans obtained from a Financial Institution. (November, 2003)*

Answer

Non-Executive Directors Remuneration

Sitting Fees: Sitting fees are payable to directors at the rates prescribed in the Articles of Association of the company [Section 309(2) Companies Act, 1956]. No approval of the Central Government will be necessary for an increase in the amount of sitting fees so long as such increase is within the prescribed limits (Proviso 1 to Section 310) - The present prescribed limit is Rs.5,000 per meeting [Rule 10B of the Companies (Central Governments) General Rules and Forms 1956]. Since the sitting fee of Rs.6,000/- is above the prescribed limit, the amendment shall not have effect unless approved by the Central Government under Section 310.

Depreciation: Section 350, as amended by the Companies (Amendment) Act, 2000 specifies the manner of ascertainment of depreciation. The amount of depreciation to be deducted is the amount of depreciation as appearing in the books i.e. as shown in the profit and loss account of the relevant financial year, at the rates specified on Schedule XIV to the Companies Act. Schedule-XIV specifies different rates of depreciation applicable to the two methods of depreciation, namely, written-down value method and straight-line method. Thus after the Companies (Amendment) Act, 2000, depreciation as per written-down value need not be recalculated where depreciation is charged in the books as per straight-line method. Hence, the computation of commission payable is in order.

Guarantee Commission: Section 309(1) provides that the remuneration payable to any

director shall be inclusive of the remuneration payable for services rendered by him in any other capacity. The question is whether the guarantee commission is a remuneration within the meaning of Section 309. It was held in *Suessen Textile Bearings Ltd v. Union of India* [(1984) 55 (Comp. Cases 492, 496, 497)] that the guarantee commission paid to directors for giving surety against loans or credit facilities taken by the company from financial institution is not a remuneration for any professional services within the meaning of section 309 and therefore, approval of the Central Government is not necessary. The director giving guarantee does not render manual, clerical, technical supervisory or administrative service. He gets the commission for the risk which he bears and that has nothing to do with his directorship. In view of this judgement, the Department of Company Affairs has withdrawn the earlier circular dated 16.12.1969, where the department has clarified that guarantee commission is 'remuneration' within the meaning of Section 309 (Circular No.3 dated 16.2.1994). Hence the payment of guarantee commission is in order.

Question 2

Mr. Weldon was appointed as a Director of Esquire Engineering Ltd., with effect from 1st October, 2002. Since the Company, namely, Esquire Engineering Ltd. wanted to take full advantage of the wisdom and expertise of Mr. Weldon, it offered him remuneration payable on monthly basis and made an application to the Central Government for approval for payment of such remuneration. Anticipating the approval of the Central Government, Esquire Engineering Ltd. started paying such remuneration from the date of appointment and continued to do so till 31st March, 2003. The Central Government did not fully approve the remuneration proposed by the company and restricted the same to a lower amount. On scrutiny of the accounts, it was established that the company, till 31st March, 2003, has paid to Mr. Weldon a total sum of Rs.1.20 Lacs in excess of the remuneration sanctioned by the Central Government.

You are required to:

- (i) *State with reference to the provisions of the Companies Act, 1956 in respect of recovery and waiver of recovery of the excess remuneration so paid, whether Mr. Weldon can keep the excess remuneration so received and under what conditions.*
- (ii) *Draft a resolution for waiver of recovery of the excess remuneration so paid by the Company.* **(November, 2004)**

Answer

- (i) Mr. Weldon was appointed as a non-executive director. The services to be rendered by him are not stated to be of a professional nature. Hence, the provisions of Section 309 (4) are attracted in this case. According to Section 309(4) of the Companies Act, 1956 a non-executive director may be paid remuneration by way of monthly, quarterly or annual payment basis with the approval of the Central Government.

Section 309(5A) of the Companies Act, 1956 states that if any director draws or receives, directly or indirectly, by way of remuneration any sum in excess of the limits prescribed by section 309 of the Companies Act, 1956 or without the prior approval of

16.3 Corporate and Allied Laws

the Central Government, wherever required, then such director shall refund such excess remuneration to the company and until such refund is made, he shall hold such sum in trust for the company.

Section 309(5B) of the Companies Act, 1956 states that the company shall not waive the recover of any sum refundable under section 309(5A) of the Companies Act, 1956 unless permitted by the Central Government.

In light of the above mentioned provisions of the Companies Act, 1956, Mr. Weldon is under obligation to refund the excess remuneration of Rs.1.20 Lakhs received by him from the company and till the same is refunded, he shall hold the said sum in trust for the company. Similarly, the company is also not eligible to waive the recovery of such excess sum. However, the company can waive the recovery and Mr. Weldon can keep such excess sum, if the permission from the Central Government as envisaged in section 309(5B) of the Companies Act, 1956 is obtained.

- (ii) Board Resolution for waiver of recovery of excess remuneration paid to a director:

"RESOLVED that subject to the approval of the Central Government, the Board does hereby decides to waive the recovery of a sum of Rs.1.20 Lacs paid to Mr. Weldon, a director of the company during the period from 1st October, 2002 to 31st March, 2003 in excess of the remuneration sanctioned by the Central Government in terms of section 309 of the Companies Act 1956."

"RESOLVED FURTHER that an appropriate application under section 309(5B) of the Companies Act, 1956 be made to the Central Government and that Mr, the Secretary of the company be and is hereby authorized to take necessary action in this regard."

Question 3

M/s Star Health Specialities Ltd. owns a Multi-specialty Hospital in Chennai. Dr. Hamilton, a practising Heart Surgeon, has been appointed by the company as its non-executive ordinary director and it wants to pay him fee, on case to case basis, for surgery performed on the patients at the hospital. A question has arisen whether payment of such fee to him would amount to payment of managerial remuneration to a director subject to any restriction under the Companies Act, 1956.

Advise the company, which seeks to ensure that the same does not contravene any provision of the Companies Act, 1956 **(November 2006)**

Answer

Under the proviso to sub-section (1) or section 309 of the Companies Act, 1956, in case–

- (i) the services rendered are of a professional nature; and
- (ii) in the opinion of the Central Government, the director possesses the requisite qualifications for the practice of the profession,

the remuneration paid for these services shall be outside the scope of Section 309 of the Act and shall not be a part of managerial remuneration. It is then not open to the Central Government to put any restriction on the amount of remuneration payable to him for his approach work. The company is, accordingly, advised to approach the Ministry of Company Affairs to seek an affirmative expression of opinion that Dr. Hamilton who is a qualified surgeon, possesses the requisite qualification to practice the profession of surgery.

Question 4

Mr. X appointed as the Managing Director of XYZ Ltd. w.e.f. 1st October, 2006. The company made an application to the Central Government for approval, as the remuneration proposed to be paid to Mr. X was beyond the limits laid down in schedule XIII to the Companies Act, 1956. The company started paying remuneration from the date of appointment and continued to do so till 31st March, 2007. The Central Government did not approve the remuneration as proposed by the company and restricted the same to a lower amount. On scrutiny of the accounts, it was noticed that the company till 31st March, 2007 has paid to Mr. X, a total sum of ₹ 1.20 lakhs in excess of the remuneration sanctioned by the Central Government. Explain with reference to the provisions of the Act whether Mr. X can keep the excess remuneration. Draft a resolution for waiver of recovery of the excess remuneration so paid by the company.

(November 2007)

Answer

According to Section 309(5A) of the Companies Act, 1956, if any director draws any remuneration in excess of the remuneration sanctioned by the Central Government, he shall refund such excess remuneration to the company. The company shall not waive the recovery of any sum refundable to it unless permitted by the Central Government.

In the present case Mr. X cannot keep remuneration drawn by him which is in excess of the remuneration sanctioned by the Central Government, the Central Government permit the waiver of recovery of excess remuneration, the company may waive the recover of excess remuneration, and then Mr. X will have a right to retain the excess remuneration drawn by him.

Draft resolution for waiver of recovery of the excess remuneration:

“Resolved that subject to the approval of the central Government, consent of the company be and is hereby given waiving the recovery of an amount of ₹ 120,000 paid to Mr. X the director of the company, during the period 1st October, 2006 to 31st March, 2007 being in excess of the remuneration sanctioned by the Central Government vide letter no. dated

Resolved further than an application be made to the Central Government and the company secretary be and is hereby authorized to take the necessary steps in this regard.”

Provision for increase in remuneration to require Government sanction (Section 310)

Question 5

An article of Association of a listed company has fixed payment of sitting fee for each Meeting of Directors subject to maximum of ₹ 10,000. In view of increased responsibilities of

16.5 Corporate and Allied Laws

independent directors of listed companies, the company proposes to increase the sitting fee to ₹ 25,000 per meeting. Advise the company about the requirement under Companies Act, 1956 to give effect
(May 2004, May 2007, November 2006, June 2007)

Answer

Under Section 310 of the Companies Act, 1956 approval of the Central Government shall not be required where sitting fee for each meeting of the Board of a Committee thereof does not exceed the prescribed sum under Rule 10-B of the Central Government's (General Rules & Forms, 1956) as under:

1.	Companies with paid up capital of ₹ 10 crores and above or turnover of ₹ 50 crores and above	Sitting fee not to exceed ₹ 20,000
2.	Other companies	Sitting fee not to exceed ₹ 10,000

Any increase in the sitting fee will require amendment of relevant provision of the Articles of Association. In the given case, the proposed sitting fee of ₹ 25,000 will require approval of the Central Government as the same exceeds the prescribed limits. The company can pay the sitting fee upto ₹ 20,000 depending upon the aforesaid parameters laid down in Rule 10-B.

Question 6

A company wants to include the following clause in its Articles of Association:

"Each director shall be entitled to be paid out of the funds of the company for attending meetings of the Board or a Committee thereof including adjourned meeting such sum as sitting fees as shall be determined from time to time by the Directors but not exceeding a sum of Rs.30,000 for each such meeting to be attended by the Director."

You are required to advise the company as to the validity of such a clause and the correct legal position under the provisions of the Companies Act, 1956.

(CA Final, New Course, June 2009)

Answer

The payment of sitting fee to a Director is governed by the provisions of Section 310 of the Companies Act, 1956 read with Rule 10B of the companies (Central Government's) General Rules and Forms, 1956. According to the said provisions, a Company with a paid up share capital and free reserves of Rs.10 crores and above or a turnover of Rs.50 Crores and above can pay to its director by way of sitting fee for each meeting of the board of directors or a committee thereof an amount not exceeding Rs.20,000/- and in case of other companies, the limit has been set at Rs.10,000/-.

In view of the above legal provisions, the company cannot have a clause in its Articles of Association which exceeds the limit prescribed by law. The company is advised to check whether the aggregate of its paid up capital and free reserves exceeds ₹ 10 crores or whether its turnover exceeds ₹ 50 crores and accordingly it can have a clause in its Articles of Association. In case the company keeps the clause as given in the question, it shall be ultra

vires the Companies Act, 1956 as Section 9 states that any provision contained in Memorandum of Association, Articles of Association, Agreements or Resolutions to the extent it is repugnant to the provisions of the Companies Act, 1956 shall be void.

Question 7

Mr. X appointed as the Managing Director of XYZ Ltd. w.e.f. 1st October, 2006. The company made an application to the Central Government for approval, as the remuneration proposed to be paid to Mr. X was beyond the limits laid down in schedule XIII to the Companies Act, 1956. The company started paying remuneration from the date of appointment and continued to do so till 31st March, 2007. The Central Government did not approve the remuneration as proposed by the company and restricted the same to a lower amount. On scrutiny of the accounts, it was noticed that the company till 31st March, 2007 has paid to Mr. X, a total sum of ₹ 1.20 lakhs in excess of the remuneration sanctioned by the Central Government. Explain with reference to the provisions of the Act whether Mr. X can keep the excess remuneration. Draft a resolution for waiver of recovery of the excess remuneration so paid by the company.
(November 2007)

Answer

According to Section 309(5A) of the Companies Act, 1956, if any director draws any remuneration in excess of the remuneration sanctioned by the Central Government, he shall refund such excess remuneration to the company. The company shall not waive the recovery of any sum refundable to it unless permitted by the Central Government.

In the present case Mr. X cannot keep remuneration drawn by him which is in excess of the remuneration sanctioned by the Central Government, the Central Government permit the waiver of recovery of excess remuneration, the company may waive the recovery of excess remuneration, and then Mr. X will have a right to retain the excess remuneration drawn by him.

Draft resolution for waiver of recovery of the excess remuneration:

"Resolved that subject to the approval of the central Government, consent of the company be and is hereby given waiving the recovery of an amount of ₹ 120,000 paid to Mr. X the director of the company, during the period 1st October, 2006 to 31st March, 2007 being in excess of the remuneration sanctioned by the Central Government vide letter no. dated

Resolved further that an application be made to the Central Government and the company secretary be and is hereby authorized to take the necessary steps in this regard."

Question 8

Non-executive Directors of ABC Limited, who are neither in the whole time employment of the company nor Managing Directors have been given the following remuneration --

- (i) *Guarantee Commission has been paid to them for having guaranteed the term loans obtained from a financial institution.*
- (ii) *Commission payable to them is calculated on the basis of book-profits arrived at after providing for depreciation as per straight line method,*

16.7 Corporate and Allied Laws

Examine the validity of these payments in the light of the provisions of the Companies Act, 1956.
(CA, Final, New Course, May, 2010)

Answer

Remuneration to Non-Executive Directors:

- (i) **Guarantee Commission:** Section 309(i) of the Companies Act, 1956 provides that the remuneration payable to any director shall be inclusive of the remuneration payable for services rendered by him in any other capacity. The question is whether guarantee commission is remuneration within the meaning of Section 309 of the said Act. In the case of *Suesses Textile Bearings Ltd. Vs. Union of India (1984)* it has been decided that the guarantee commission paid to the directors for giving surety against loan taken by the company from financial institutions is not a remuneration for any professional services within the meaning of Section 309 and therefore approval of the Central Government is not necessary.
- (ii) **Depreciation:** Section 350 of the Companies Act, 1956 specifies the manner of ascertainment of depreciation. The amount of depreciation to be deducted is the amount of depreciation as appearing in the books i.e. as shown in the profit and loss account of the relevant financial year at the rates specified in Schedule XIV of the Companies Act, 1956. Thus, the payment of commission calculated on the basis of book profits arrived at after providing for depreciation as per straight-line method is not in order.

Question 9

Mr. Weldon was appointed as a director of Esquire Engineering Ltd. with effect from 1st October, 2008. Since the Company wanted to take full advantage of the wisdom and experience of Mr. Weldon, it offered him attractive remuneration payable on monthly basis and made an application to the Central Government for approval to pay such remuneration. Anticipating the approval of the Central Government, Esquire Engineering Ltd. started paying such remuneration from the date of appointment and continued to do so till 31st March, 2009. The Central Government did not fully approve the remuneration proposed by the Company and restricted the same to a lower amount. On scrutiny of accounts, the Company noticed that till 31st March, 2009 it has paid to Mr. Weldon a total sum of Rs.5.50 lakhs in excess of the remuneration sanctioned by the Central Government. Explain the relevant provisions of the Companies Act, 1956, in respect of recovery and waiver of recovery of the excess remuneration so paid. Draft a resolution for recovery/waiver of recovery of the excess remuneration paid by the Company.
(November 2009)

Answer

- (a) A director who is not a Managing Director or Whole Time Director can draw remuneration by way of monthly, quarterly or annual payment only if so authorized by the Central Government (Section 309). The Central Government may while sanctioning the payment of remuneration under Section 309, fix remuneration at such amount as it

may deem fit (Section 637AA). If any director draws any remuneration in excess of the remuneration sanctioned by the Central Government, he shall refund such excess remuneration to the Company. Until such excess remuneration is refunded he shall hold it in trust for the Company. The Company shall not waive the recovery of any sum refundable to it unless permitted by the Central Government.

- (b) In the present case, Mr. Weldon cannot keep remuneration drawn by him which is in excess of the remuneration sanctioned by the Central Government. Accordingly he shall refund to the Company Rs.5.50 lakhs. Until such refund is made he shall hold the excess amount in trust for the Company. Further the Company cannot waive the recovery of excess remuneration.

However, if on an application made to the Central Government, the Central Government may permit, the waiver of recovery of excess remuneration. The Company can waive the recovery of excess remuneration and then Mr. Weldon shall have a right to retain the excess remuneration drawn by him. For recovery of the excess remuneration paid to Mr. Weldon, there is no need to pass any resolution. However, for waiver of recovery a resolution is required to be passed by the Company in a general meeting and approval of the Central Government in necessary.

Resolution

- (c) "Resolved that subject to the approval of the Central Government, consent of the Company be and is hereby given waiving the recovery of an amount of Rs.5.50 lakhs paid to Mr. Weldon, the director of the Company, during the period 1st October, 2008 to 31st march 2009 being in excess of the remuneration sanctioned by the Central Government vide letter no date
- (d) Resolved further that an application to be made to the Central Government and the Company Secretary be and is here by authorized to take the necessary steps in this regard."

Question 10

Advise M/s Super Specialities Ltd. in respect of the following proposals under consideration of its Board of Directors:

- (i) *Appointment of Managing Director who is more than 70 years of age;*
- (ii) *Payment of commission of 4% of the net profits per annum to the ordinary directors of the company;*
- (iii) *Payment of remuneration to an ordinary director for rendering professional services; and*
- (iv) *Payment of remuneration of Rs.40,000 per month to the whole time director of the company running in loss and having an effective capital of Rs.95.00 lacs. (May 2005)*

16.9 Corporate and Allied Laws

Answer

- (i) Under Schedule XIII, Part I, Paragraph (c) of the Companies Act, 1956, a person shall be eligible for appointment as Managing Director who has attained the age of 70 years where his appointment is approved by a Special resolution passed by the company in the general meeting. In that case, approval of the Central Government is not required.
- (ii) Under Section 309(4)(b) of the Companies Act, 1956 ordinary directors may be paid commission if the company by special resolution authorise such payment not exceeding 1% of net profit, if the company has MD/WTD/Manager or upto 3% of the net profits in any other case. Further, under section 309(7) of the Act, Special resolution shall not remain in force for a period of more than 5 years at a time.

Second proviso to section 309(4) states that a company in general meeting may, with the approval of the Central Government, authorise the payment of such remuneration at a rate exceeding one per cent or, as the case may be, three per cent of its net profits.

Thus, in the present case, commission of 4% of net profits of the company per annum can only be paid to the ordinary directors with the approval of the Central Government

- (iii) Under proviso to section 309(1) of the Act, any remuneration for services rendered to any director in any other capacity shall not be so included if-
 - (a) the services rendered are of a professional nature, and
 - (b) in the opinion of the Central Government, the director possesses the requisite qualification for the practice of the profession.

In that case, approval of the Central Government will not be required for payment of any remuneration to the concerned director.

- (iv) In terms of section II of Part II of Schedule XIII of the Act, approval of the Central Government is not required for payment of monthly remuneration upto Rs.75,000/- in case of a company with effective capital of less than Rs.1 crore and having no profit or its profits are inadequate, to its managerial persons, provided -
 - (1) the payment of remuneration is approved by the Remuneration Committee;
 - (2) the company has not defaulted in repayment of its debts, including public deposits or debentures or interest payable thereon for a continuous period of 30 days in the preceding year before the date of such appointment.

Thus, in the given case, the company may pay the remuneration of Rs.40,000 P.M. to its WTD without approval of the Central Government subject to the above restrictions.

Question 11

EF Chemicals Ltd. proposes to appoint one whole-time technical Director on a consolidated monthly remuneration of ₹ 30,000 and one whole-time Marketing Director on a consolidated salary of ₹ 25,000 per month for a period for three years with effect from 1st September, 2005. The company has got a Managing Director and he is getting ₹ 40,000 per month. Explain the

Remuneration of Directors (Sections 309 – 311) 16.10

requirements under the Companies Act to be complied with by the company in connection with the proposed appointment of whole-time Directors taking into account the following data collected from the Balance Sheet of the company as on 31st March, 2005:

		₹
1.	Paid-up Share Capital	80,00,000
2.	Debentures redeemable after three years	90,00,000
3.	Investments	20,00,000
4.	Accumulated Loss	70,00,000
5.	Preliminary Expenses not written off	15,00,000

(May 2006)

Answer

Appointment of whole time directors: In the given case two whole time directors are proposed to be appointed with effect from 1st September, 2005. The remuneration payable to these directors depends on the effective capital of the company on the last day of the preceding financial year i.e. 31.3.2005. The effective capital is ₹ 65 lakhs (₹ 80 lakhs + 90 lakhs - ₹ 20 lakhs - ₹ 70 lakhs - ₹ 15 lakhs) on 31.3.2005.

The ceiling on minimum remuneration has been prescribed in Part II of Schedule XIII of the Companies Act, 1956. Here the Managing Director is already getting a minimum monthly remuneration of ₹ 40,000. The proposed minimum remuneration to the whole-time technical director is ₹ 30,000 p.m. and to the whole time marketing director is ₹ 25,000 p.m. If a company has more than one managing director and / or whole-time director, the company may pay to each of them minimum remuneration within the prescribed ceiling. As the effective capital is less than Rs.1crore, the company may pay to each of the Managing Director/whole time director minimum remuneration upto ₹ 75,000 p.m. Hence the proposed minimum remuneration is within the prescribed limits.

The remuneration payable to the whole-time directors must be approved by Remuneration Committee of the Board of Directors, and thereafter the appointments of the Technical Director and Marketing Director shall be approved at a Board meeting.

Abstract of terms of appointment of whole-time directors must be sent to every member within 21 days as required under section 302(2). Nature of concern or interest of each director must be disclosed.

Copy of Board resolution, Form No. 32 must be filed with the Registrar of Companies.

Return in Form No. 25C must also be filed within 90 days from appointment as required under section 269(2). The return must contain a certificate from the auditor or the Secretary of the company or a Secretary in Whole-Time Practice that the requirements under Schedule XIII have been complied with Part III of Schedule XIII – Para 2)

The appointment and remuneration of the whole-time marketing and technical directors must

16.11 Corporate and Allied Laws

be approved in next annual general meeting by ordinary resolution (Section 305(1) and part III of Schedule XIII).

The company has to comply with the above requirements under the Companies Act, 1956 with regard to the proposed appointment of two whole-time directors.

Question 12

X, a Director of MJV Ltd., was appointed on 1st April, 2009, 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 XIII. For the financial year ended 31st March, 2010, the company suffered heavy losses. The company was not in a position to pay any remuneration but he was paid ₹ 50 lacs for the year, as paid to other directors. The effective capital of the company is ₹ 150 crores. Referring to the provisions of Companies Act, 1956, as contained in Schedule XIII, examine the validity of the above payment of remuneration to X.

(CA Final, New Course, November, 2010)

Answer

Where in any financial year during the currency of tenure of the managerial person, a company has no profits or its profits are inadequate, it may pay remuneration to a managerial person, by way of salary, dearness allowance, perquisites and any other allowance, not exceeding ceiling limit of ₹ 24,00,000 per annum or ₹ 2 lacs per month calculated on the scale as given in Schedule XIII of the Companies Act, 1956.

In the given case, the effective capital of the company is ₹ 150 crores. As per the scale given in the Schedule XIII monthly remuneration payable should not exceed ₹ 2,00,000 (for effective Capital ₹ 100 crores or more). The remuneration given to X is ₹ 50 lacs for the whole Year, which is more than the ceiling. Therefore, payment of ₹ 50 lacs is not in order.