

# *Primer*

## A PRIMER ON MANAGERIAL REMUNERATION UNDER COMPANIES ACT, 1956

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February 19, 2013

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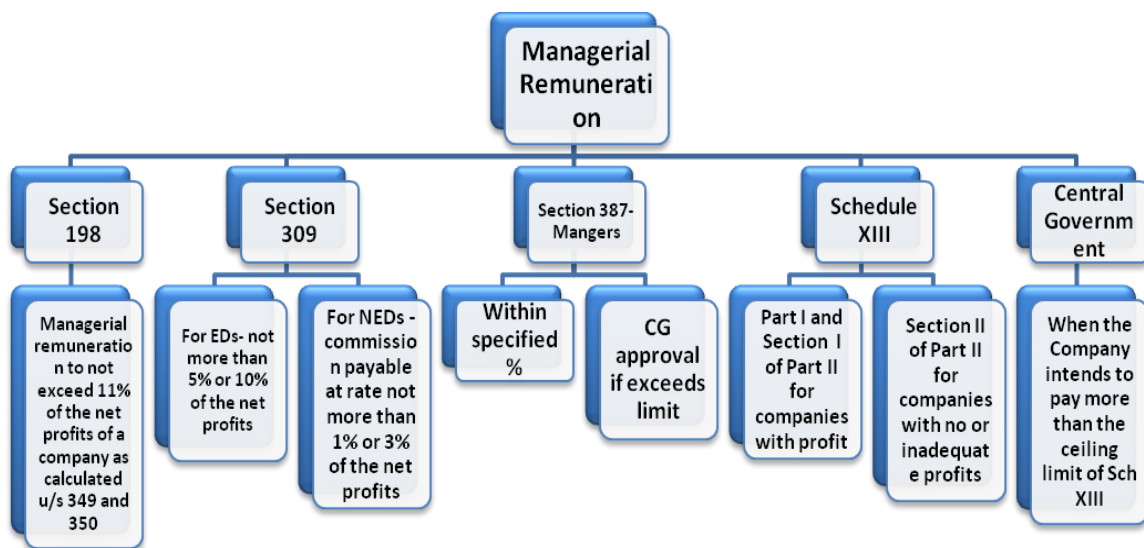
This write up is intended to initiate academic debate on a pertinent question. It is not intended to be a professional advice and should not be relied upon for real life facts.

## Primer

*This Primer also consists of questions which were discussed in the EIRC CS Study Circle meeting held on February 09, 2013 in which Mr. Vinod Kothari was invited as the speaker.*

### 1. What are the applicable legal provisions in the Companies Act, 1956 ("Act") pertaining to managerial remuneration?

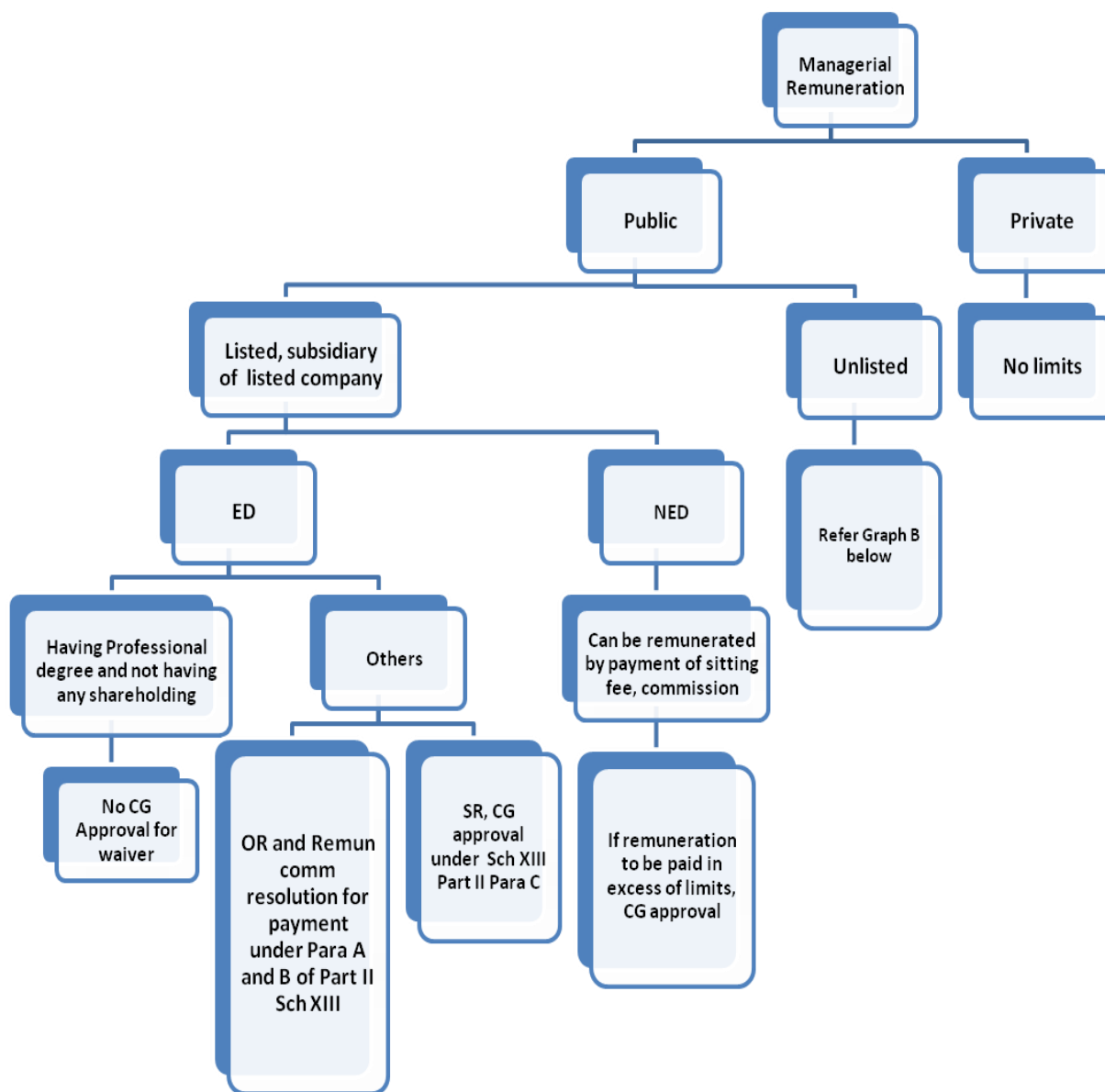
Sections 198-200, 309-311, 349-350, 387, Schedule XIII of the Act are to be borne in mind while discussing the broad topic of managerial remuneration. Note that section 269 and section 386 pertains to appointment of managerial personnel and managers, while sections 309-11 and 387 pertain to their remuneration. The graph below gives an overview of such provisions:



Below we present a broad structure of remuneration payable in different companies and compliance requirement:

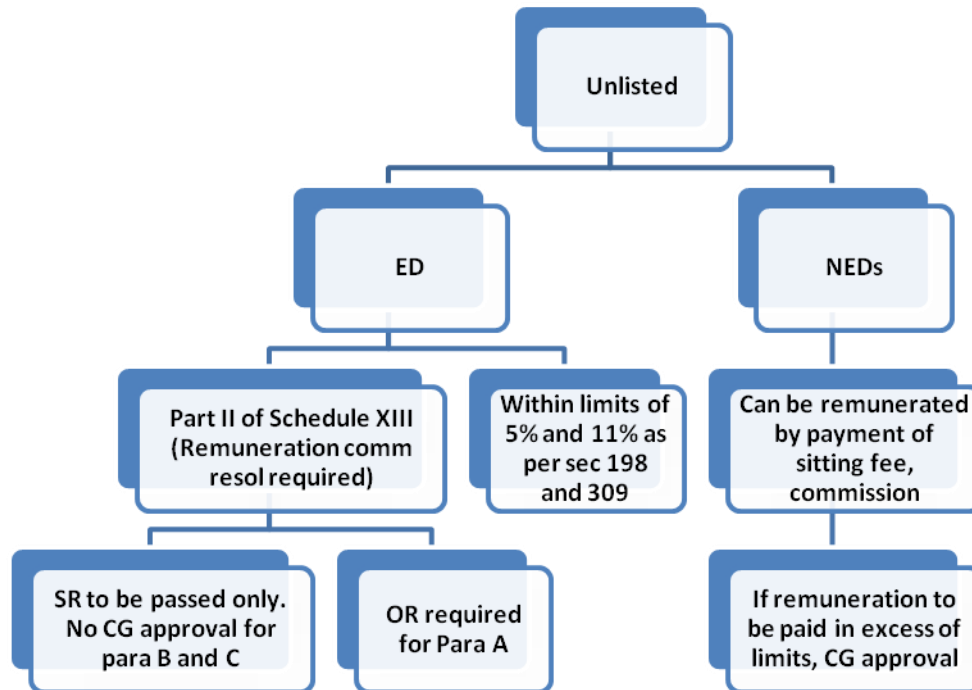
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**Graph A**



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**Graph- B**



### **2. What is the meaning of “managerial remuneration”?**

Simply put, the expression means remuneration payable to managerial personnel. Managerial personnel include directors (whole time or part time), managing director and manager. Note that the word “manager” as per section 2(24) of the Companies Act includes only individuals, not being managing agents, who subject to superintendence, control and directions of Board has the management of whole or substantially the whole of the affairs of the company and includes a director or any other person occupying such position, by whatever name called.

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### 3. What constitutes remuneration?

Remuneration	
<p><b>For sections 309, 310, 311, 381 and 387</b> - Includes accomodation free of charge, expenditure of the company in providing benefits at concessional rates or free of charge, expenditure on behalf of the director, providing life insurance/gratuity/pension for the director/spouse/child. since, this is an inclusive definition, anything which is a nost to the company, shall constitute remuneration.</p>	<p><b>For Schedule XIII</b> - The following <i>shall not be considered</i> : contribution to PF/gratuity fund/ encashment of leave at tenure end.</p>

Hence, remuneration includes the entire cost to the company incurred by way of remunerating managerial personnel. Where a company pays what is otherwise the obligation of the person concerned, it is a part of remuneration. Where a company pays what is the obligation of the company in the first place it is not managerial remuneration.

### 4. Do the expressions “director in whole time employment” and “whole time director” mean the same thing?

A whole time director means someone who is devoting whole of his time to directorial functions of the company. The explanation to section 269 says that “whole-time director” includes a director in the whole-time employment of the company. So, for the purpose of the Act, both the terms would have same meaning.

### 5. Whether a whole-time employee is a whole-time director?

A ‘whole-time’ employee of a company also appointed as a director of the company can be treated as a ‘whole-time’ director. The view is equally applicable in the case of an alternate director. Accordingly, the appointment of an employee



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as an alternate director will be governed by the provisions of applicable sections of the Act. (MCA Letter No. 2/19/63-PR, dated 29-6-1964)

#### **6. What are the recent de-regulatory circulars of the MCA on managerial remuneration?**

The Ministry of Corporate Affairs (“MCA”) came up with the following de-regulatory circulars:

- i. Notification dated February 8, 2011:** With this Notification, it was prescribed that:
  - a. Prior approval of the CG under Schedule XIII, Section II, Sub-para C shall be required *only if a company is listed or its subsidiary*.
    - Hence, unlisted companies will not require any CG approval even if its paying remuneration to its managerial personnel exceeding 48 lacs (i.e. in terms of Para C)
    - Further, in terms of notifications dated May 23 and July 14, 2011, subsidiaries of listed companies will also not require CG approval, if conditions of these notifications are fulfilled. (refer point iii below)
  - b. Remuneration Committee (“RC”) be constituted with at least 3 (three) NEDs including nominee director(s). For other companies, the composition of RC has not been prescribed.
    - Hence, for companies other than listed companies, RC means a committee of its directors.
- ii. General Circular No. 4/2011 dated March 4, 2011:** Company does not require CG approval in case it pays commission in addition to sitting fees paid to its non-whole time directors. This is however, subject to ceilings prescribed in Section 309(4) of the Act.
- iii. Notification dated May 23, 2011 and July 14, 2011:** Fourth and fifth proviso inserted in section II, Para C and accordingly, no CG approval required:

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- a. By a subsidiary of a listed company under Schedule XIII, Section II, Sub-para C, subject to the fulfillment of certain conditions, *inter alia*, approval is granted by RC and Board of the holding company, all members of the subsidiary are bodies corporate. (*inserted as fourth proviso*)
  - b. By all companies for payment of managerial remuneration, if the following conditions are fulfilled (*inserted as fifth proviso*):
    - He does not have any direct or indirect interest in the capital of the company or its holding company or through any other statutory structures and
    - Does not have any direct or indirect interest or related to the directors or promoters or its holding company, at any time during last two years before or on the date of appointment and
    - Has a graduate level qualification with expert and specialized knowledge in the field of his profession.
- iv. **General Circular No. 24/2012 dated August 9, 2012:** With the Finance Act, 2012, sitting fee/ commission payable to non WTDs also became liable to service tax. It was apprehended that levy of service tax on the sitting fee/ commission paid to non WTDs can exceed the ceiling prescribed u/s 309(4) of the Act and consequentially, require approval of CG. With this General Circular, it was clarified that any increase in remuneration paid to non WTDs by virtue of payment of service tax, shall not require approval of CG.
- v. **Notification dated August 16, 2012:** The provisions of the Notification dated July 14, 2012 detailed above in point (iii) above shall also be applicable to cases where any employee of the company holds shares of 0.5% of paid up capital of the company under ESOP scheme or as qualification shares.

### 7. How much sitting fee can be paid to a director?

The Act does not have any specific provision. However, Rule 10B of the Companies (Central Government's) General Rules & Forms, 1956 prescribes limits for payment of sitting fees, which is also illustrated below:

Sl. No.	Class of companies	Maximum limit (in Rs.)
(a)	Companies with a paid-up share	Sitting fees not to exceed the sum of

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	capital and free reserves of Rs.10 crore and above or turnover of Rs.50 crore and above	Rs. 20,000/- (Rupees Twenty Thousand Only)
(b)	Other companies	Sitting fees not to exceed the sum of Rs. 10,000/- (Rupees Ten Thousand Only)

However, sitting fee can be paid exceeding the above limits with approval of CG.

**8. Can a director be paid sitting fee for a meeting which could not be held in want of quorum and was adjourned?**

Section 309(2) of the Act is coded such that sitting fee is to be paid for every meeting *attended* by a director of the Board or committee. Thus, even if the meeting could not be held for want of quorum or for any other reason not within the control of the directors concerned, the directors would still be entitled to be paid sitting fee. Rule 10B of the Companies (Central Government's) General Rules & Forms, 1956 prescribes limits for payment of sitting fees.

**9. Whether sitting fee paid to directors be included in managerial remuneration?**

No, sitting fee does not form a part of remuneration when it comes to calculation of 11% of net profits per Section 198 of the Act. Even if a company has the requisite approval to pay the sitting fee in excess of prescribed limits, the same will not be considered for calculations u/s 198 of the Act.

**10. Can a *qualified* director render services to the company in professional capacity?**

Section 309(1) of the Act allows a director to render services arising out of his professional qualifications. The same shall also not be considered for the purpose of calculating limits of remuneration provided that the opinion of the CG in this regard is taken. Such an application to the CG can be made in e-form 25A.

**11. What is the meaning of 'qualification' for rendering professional services?**

The word *qualified* is wide and open for various interpretations. Generally, a director possessing necessary professional qualifications for the practice of the



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same can be taken to be qualified. Thus, an advocate, engineer, architect, chartered accountant are some of the professionals who can be taken to be qualified. However, proviso to section 309 (1) requires opinion of CG. It is pertinent to note that the expression of the opinion of the Central Government is not a ritual that is required in every case. Indeed, as the Delhi High court held in *Stup Consultants*, it is only a power exercisable in borderline cases. If it is a matter of common knowledge that the professional in question has the requisite qualification required for the job in hand, no possible purpose can be served by seeking the opinion of the Central Government on a routine basis. Hence, the qualifications which are certified by the respective professional bodies, in our view, would not require CG's opinion.

### **12. Can travelling allowance be taken to be a part of the remuneration of the director?**

In case, the travelling allowance is claimed only as reimbursement of actual expenses, then the same shall not be considered to be a part of remuneration. Travelling allowance will be forming part of managerial remuneration while travelling reimbursement not.

### **13. What is the concept of "minimum remuneration"?**

The relevant sections do not have any concept of 'minimum remuneration', but Schedule XIII Section II of the Act allows remuneration to be paid to a managerial person in case a company has no or inadequate profits depending upon the effective capital of the Company.

### **14. What if a company proposes to pay its ED in excess of the limits prescribed u/s 309(3)?**

In case, of payment of remuneration to EDs, Section 269 also needs to be considered which prescribes the following:

- a. In case of payment of remuneration to directors Part I and Section I of Part II of Schedule XIII to be followed, if a company has adequate profits.
- b. In case a company does not have enough profits, then Section II (para A, B C, depending upon the remuneration payable and effective capital of the Company) of Part II of Schedule XIII to be followed. Para D of Section II of Part II of the Schedule is applicable in case company's registered office is in SEZ.



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**15. What if a company wants to pay above the prescribed ceiling mentioned in Part III of Schedule XIII?**

The Company needs to apply for CG approval in e-form 25A within 90 (ninety) days of appointment.

**16. What if a company desires to remunerate within the prescribed ceilings of Schedule XIII?**

The Company needs to obtain members' approval along with compliance with other formalities mentioned in Part A and B of Section II of Schedule XIII to the Act.

**17. What if a company pays within the limit prescribed in section 198 read with section 309 of the Act?**

The Company has to file e-form 25C within 90(ninety) days from the date of such appointment.

**18. What if a company appoints a managerial person but does not intend to pay any remuneration?**

Even if a Company is not paying any remuneration, Form 25C has to be filed within 90 days of appointment as the form is for intimation of appointment. However, no general meeting resolution will be required for this.

**19. If a company is not paying remuneration to managerial personnel, are the conditions of Part I of Schedule XIII, which read as *Appointment*, still applicable?**

Yes. Section 269(2) of the Act prohibits appointment of any managerial person unless Part I and Part II of Schedule XIII is complied with. Thus, clauses (a) to (e) of Part I of Schedule XIII shall have to be adhered to in case of every appointment of a managerial person.

**20. What if an ED draws remuneration from two companies?**

Schedule XIII Part III Section III prescribes that an ED can draw remuneration from one or both companies, provided the total remuneration drawn from the

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companies does not exceed the higher maximum limits admissible from any one of the companies of which he is an ED.

**21. Is it lawful for Mr. X, ED of a company and drawing commission from a company to also draw remuneration from its subsidiary company?**

No. Section 309(6) prohibits such an arrangement. In fact, it prohibits drawing of commission or *any other remuneration* from a subsidiary company.

**22. Is it lawful for Mr. X, ED of a company and drawing commission from a company to also draw remuneration from any other company not being subsidiary?**

Schedule XIII Part III Section III prescribes that an ED can draw remuneration from one or more companies provided the total remuneration drawn from the companies does not exceed the higher maximum limits admissible from any one of the companies of which he is an ED.

**23. What if my company has a foreign director? How should he be remunerated?**

Schedule XIII Part I allows a non-resident Indian to be also appointed as a director subject to certain compliances. Surely, he is also entitled to remuneration per the provisions of the Act. Although, the Act does not have anything to the contrary, logically speaking, it is obvious that a foreign director shall not be entitled to any remuneration in case an alternate director has been appointed in his place. This is unless he renders any service to the company outside India. However, should an expatriate be a director in any company and remuneration in excess of the ceiling in Schedule XIII Part III Para C is proposed to be paid, then the Schedule excludes certain perquisites from the calculation of limits. Innocent

**24. What are the forms to be filed for appointment of managerial personnel?**

**In case of private companies:** Form 23 and 32 (within 30 days of appointment)

**In case of others:**

**If appointment is in accordance with limits provided in sections:** Form 23 (within 30 days of passing of resolution) and Form 25C (within 90 days of appointment)



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**If appointment requires CG approval:** Form 23 (within 30 days of passing of resolution), Form 25A (within 90 days of appointment)

#### **25. Is there any age limit on appointment of managerial person?**

Schedule XIII Part I of the Act prescribes that the managerial person should have attained 25 years and not crossed 70 years at the time appointment.

However, any director who has attained majority but is not 25 years of age *or* has attained 70 years, may still be appointed as a director, provided the same is approved by a SR. No approval of the CG is required for this.

#### **26. Can the company pay remuneration to its managerial personnel pending approval of CG or in excess of limits provided in the Act?**

Generally companies do and remuneration can be paid within limits during such time. However, in terms of section 309 (5A), full remuneration, exceeding the limits, paid without CG approval is deemed to be in trust for the company by such managerial personnel until CG approval is taken. (With approval of CG, the Company can also waive such excess remuneration or remuneration already paid without CG approval in terms of Section 309 (5B) of the Act.)

However, in case companies pay the remuneration pending approval of CG, they should ensure that the approval is taken within same financial year to escape the adverse remark of their auditors.

#### **27. What if the remuneration sought to be paid does not get fully approved by the CG and the company has already paid such remuneration to the director?**

Section 309(5A) envisages such a situation and requires such excess money to be refunded to the company and till such time, to hold it in trust.

#### **28. Can a CEO, who is not the director of the company, be said to be manager?**

Given the definition of the term “manager” in the Act, a CEO can be taken to be a manager. If the CEO have been entrusted with responsibility of managing the affairs of a company, he will be a manager. However, if the company has not treated the person as such, and has not done the relevant filing of e-forms, then it remains a facts and circumstances question as to whether the person can be said to be manager.

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**29.If an MD is a person having substantial powers of management over the whole of the affairs of the company, can a company have two managing directors?**

The Act does not have any specific restriction on appointment of more than one MD in the same company. In its clarification F. No. 8/16(1)/61-PR, the MCA viewed that appointment of more than one MD in the same company is allowed. The Clarification placed specific reference to the definition of *manager* (Section 2(24)) and *managing director* (2(26)) of the Act. The major point of difference between the two sub-sections, is the use of the word *whole* in the definition of *manager*. Since, the definition of *managing director* refers to the nature of the powers and not the quantum thereof, it is possible for a company to have more than one MDs, as according to the definition of *manager*, manager may be entrusted with substantial power of management but not necessarily of the whole or substantially the whole of the affairs of a company.

Further, an “office in default” as per Section 5 (a) of the Act consists of managing director or managing director(s). Thus, the Act discreetly allows appointment of more than one MD.

**30.Can a person be appointed both, a director and a CS to fulfill the requirements of sections 269 and 383A of the Act?**

No, an individual cannot be appointed as a whole time director and whole time secretary of the company at the same time. However, the Department of Company Affairs has clarified that the whole-time company secretary can be appointed as part-time director and will not require the approval of the CG under section 269 of the Act, so long as substantial powers of management of the affairs of the company are not vested in him.

**31.Will the Company require CG approval again even if the MD is to be re-elected as director?**

A managing director's office as managing director does not suffer any break, if he retires as a director under section 255 and is re-elected as a director in the same meeting. Hence, in such a case, the approval of the CG would not be necessary for five years where the term of appointment of managing director has already been approved by CG for that period.



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#### **32.What are the consequences if CG approval not obtained within prescribed time?**

In such case, the company can either apply in form 65 for condoning the delay, apply for approval by filing form 25A at the same time or apply for waiver of excess remuneration paid under section 309(5B) of the Act.

#### **33.Whether removal of managerial persons appointed with CG approval would require CG approval again?**

No, the Act requires CG approval at the time of appointment and payment of remuneration only. Hence, such managerial persons can be removed in compliance with the Act without CG approval.

#### **34.What can be the maximum tenure for appointment of managerial personnel?**

Para (B) and (C) of Section II of Part II of Schedule XIII state that the special resolution can approve payment of remuneration for a period of three years at a time. However, if not appointed in terms of said para of Schedule XIII, the appointment can be for any period. However, section 317 restricts the tenure of MD up to a period of 5 years at a time.