

Companies Act 2013

Understanding New Provisions

Dhinal Shah
Chartered Accountant

Contents

- ▶ Mergers & Amalgamations
- ▶ Foreign Companies
- ▶ Inspection, Inquiry & Investigations
- ▶ Punishments
- ▶ Dormant Companies

Mergers and amalgamations

Cross Border Mergers

Companies Act, 1956

- ▶ Permits only inbound foreign company mergers

Companies Act, 2013

- ▶ Permits outbound mergers i.e. amalgamation of Indian companies with Foreign companies
 - ▶ Tax exemption not provided for transfer
 - ▶ Company as well as shareholders
- ▶ Requirements relating to inter alia notified foreign jurisdiction and compliance with prescribed rules applicable to inbound as well as outbound merger
 - ▶ Scope of inbound mergers may get restricted to notified jurisdictions
 - ▶ FEMA regulation to be aligned
- ▶ Consideration to shareholders of merging entity could be in form of cash or depository receipts
 - ▶ Taxability aspect?

Demergers

Companies Act, 1956

- ▶ No specific definition of a demerger under the current Companies Act
- ▶ Also, no prescribed accounting treatment for recording demergers

Companies Act, 2013

- ▶ Demerger defined to mean a demerger as per Income-tax Act, 1961
- ▶ Accounting treatment for demerger also now prescribed
 - ▶ Such accounting treatment applicable till the date of notification of the relevant AS
 - ▶ *Consistency with Income tax definition?*

Both the above (ie definition and accounting treatment) captured under the Draft Rules to Cos Act, 2013

Buyback

Companies Act, 1956

- ▶ No offer of buyback shall be made within a period of 365 days reckoned from the date of the offer of buyback made pursuant to board resolutions

Companies Act, 2013

- ▶ No buyback offer shall be made within a period of one year from the date of the closure of the preceding buyback offer
 - ▶ Only one buyback per financial year
 - ▶ Amendment in the income tax law, levying buyback tax. Thus, these amendments may render buyback option as sub-optimal for repatriation of cash
- ▶ Buyback through court approved scheme also needs to comply with buyback conditions (including cooling period of one year)

Exemption from court process

Companies Act, 1956

- ▶ No provisions for exemption from court process for corporate reorganisations like amalgamation, demerger, etc

Companies Act, 2013

- ▶ Option to following companies to undertake corporate reorganisations like amalgamation, demerger, etc. without Court process
 - ▶ Between two or more small companies as defined in the Cos Act 2013
 - ▶ Between holding company and WOS
 - ▶ Other prescribed class of companies
- ▶ Procedure involves
 - ▶ Notice of the meeting to be sent to Registrar and Official Liquidators inviting suggestion / objections to scheme
 - ▶ Approval from $\geq 90\%$ shareholders and $\geq 90\%$ of creditors (value)
- ▶ Tax neutrality?

Merger of listed company with unlisted company

Companies Act, 1956

- ▶ No specific provisions governing merger of listed company with unlisted company

Companies Act, 2013

- ▶ On merger of listed company with unlisted company, the transferee company shall remain an unlisted company until it becomes a listed company
- ▶ Provision for an exit route for shareholders of the transferor company
- ▶ Payment of value of shares and other benefits in accordance with pre-determined price formula or as per prescribed valuation
 - ▶ Indirect way of minority squeeze-out / delisting?
 - ▶ Impact on tax neutrality of amalgamation if more than 25% shareholders opt for exit route?

Key changes to process of compromise/arrangement

- ▶ Objections to schemes can be made only by persons holding $\geq 10\%$ of shareholding or having debt outstanding of $\geq 5\%$ of total outstanding debt
 - ▶ No such limits specified under Companies Act
- ▶ Meetings of creditors may be dispensed with by NCLT if $\geq 90\%$ of creditors (value) agree and confirm by affidavit
 - ▶ No such explicit provisions under Companies Act. Though, practically meetings of creditors dispensed with by High Courts if consent letters obtained
- ▶ NCLT cannot sanction schemes unless certificate submitted from auditors stating that accounting treatment confirms with accounting standards
 - ▶ No such explicit provisions under Companies Act. However, such certificate to be submitted by listed companies as per SEBI Circular
- ▶ Notice of scheme to be sent to income tax authorities, RBI, CCI, etc for representations from them within 30 days
 - ▶ No such requirement exist under Companies Act
- ▶ Valuation report to be attached to the notice sent to creditors / members for meeting of creditors / shareholders

Protection to shareholders

Companies Act, 1956

- ▶ No specific provisions for entrenchment in AOA
- ▶ Ambiguity around enforceability of agreements between two or more persons as regards share transfers of public company

Companies Act, 2013

- ▶ Restrictive provisions may be introduced in Articles
 - ▶ Such provisions to be made at formation of company
 - ▶ If made subsequently, amendment to be agreed
 - ▶ By all members for private companies
 - ▶ By special resolution for public company
- ▶ Inter se arrangements for transfer of public company shares enforceable
 - ▶ Provision stating that any contract/ arrangement for transfer of shares between two or more persons enforceable as contract

- ▶ Investors better placed to enforce their agreed-upon rights as regards specific matters e.g. veto rights/ affirmative rights
- ▶ Right of first refusal, anti-dilution, liquidation preference, tag / drag along rights may attain better enforceability

Multi layered structure restrictions

Companies Act, 1956

- ▶ No restriction on making investments through layers

Companies Act, 2013

- ▶ Restriction on making investments through more than two layers of investment companies unless otherwise prescribed by CG
 - ▶ Investment companies defined to mean company whose principal business is acquisition of shares, debentures or other securities
- ▶ Restriction shall not apply to:
 - ▶ Outbound acquisition with this existing structure
 - ▶ Subsidiary having investment subsidiaries for meeting statutory requirements
- ▶ Whether existing structures under the Cos Act grandfathered?
- ▶ Interpretation of 'principal business' under definition of investment company

Acquisition of minority shareholding

Companies Act, 1956

- ▶ Provisions exist for acquisition of shares from dissenting shareholders
- ▶ Various conditions applicable – practically considered difficult to achieve

Companies Act, 2013

- ▶ Shareholder/s holding $\geq 90\%$ shall notify their intention to buy the remaining equity shares of minority shareholders
- ▶ Minority shareholder entitled to offer their shares suo motu
- ▶ Valuation by registered valuer in accordance with prescribed rules

- ▶ Minority squeeze-out recognised?

Sale of undertaking

Companies Act, 1956

- ▶ Sale/lease/disposal of whole / substantially the whole of undertaking possible through ordinary resolutions
- ▶ Provisions applicable only to public companies or their subsidiaries

Companies Act, 2013

- ▶ Special resolution required for sale/lease/disposal of whole or substantially the whole undertaking
- ▶ “substantially the whole of undertaking” defined as 20% or more of value of undertaking as per audited balance sheet of preceding financial year
- ▶ Undertaking defined as undertaking which
 - ▶ Has investments > 20% of networth of preceding financial year
 - ▶ Generates 20% of total income of preceding financial year

Holding Subsidiary relationship

Companies Act, 1956

- ▶ Company is considered to be a subsidiary of other company if more than half in nominal value of **equity shares** are held by such other company
- ▶ Provision treating subsidiary of a foreign company to be treated a public if the foreign company were to be a public company under the Cos Act

Companies Act, 2013

- ▶ Company is considered to be a subsidiary company of a holding company, if the holding company **exercises or controls** more than one half of the **total share capital** either on its own or together with one or more of its subsidiary companies
- ▶ Criteria changed from “holding nominal value of equity to exercising or controlling “total share capital”
- ▶ Definition of “control” similar to SEBI Takeover code
- ▶ Impact of different classes of shares, affirmative voting rights, preference shares
- ▶ Consolidated financial statements to be prepared for all subsidiaries

Voting rights – for Preference Shares

Companies Act, 1956

- ▶ Preference share holders can vote:
 - ▶ on resolution which directly affect rights attached to preference shares
 - ▶ based on dividend remaining unpaid for different periods
- ▶ Aforesaid provisions applicable only to public companies and its subsidiaries
 - ▶ Voting rights of preference shares of private companies governed by AoA

Companies Act, 2013

- ▶ Preference shareholders may acquire general voting rights at par with equity shareholders on account of unpaid dividends for 2 years
- ▶ No specific exemption to private companies
 - ▶ Company Act may override provisions of AoA
 - ▶ Structuring options may be explored considering deal parameters

Preferential Allotment

Companies Act, 1956

- ▶ Special resolution required
- ▶ No requirement of determination of price by registered valuer

Companies Act, 2013

- ▶ Special resolution as well as determination of price by Registered Valuer required
- ▶ Additional conditions may also be prescribed

Likely impact

- ▶ Valuation of shares also prescribed in following regulations:
 - ▶ Income-tax Act – Section 56(2)(vii-a)/ (vii-b) – Issue of shares without adequate consideration;
 - ▶ Exchange control – transfer of shares between Non-resident to resident and vice versa
- ▶ Possible tax implications in case of deviations between the valuation arrived as per method prescribed for tax purposes vis-à-vis other regulations
- ▶ Manner of appointment and methodology to be adopted by the Valuer not prescribed

Foreign Companies

Foreign company registration in India

Overview and key changes

- ▶ Foreign company defined to mean company/body corporate incorporated outside India having, inter alia,
 - ▶ Place of business through agent or electronic mode and
 - ▶ Conducting business activity in India in any other manner
- ▶ Electronic mode defined in Rules very widely to include any electronic based activity (email, cloud computing, mobile etc.) whether or not server installed in India
- ▶ Foreign company having 'place of business' in India triggers registration and India centric financials
- ▶ Likely retroactive applicability of provisions to existing companies

Foreign company definition

- ▶ Rule 2(h) of the Companies (Specification of definitions details) Rules, 2014 defines “electronic mode” for the purposes of s. 2(42) of the Cos Act 2013 to mean

carrying out electronically based, whether main server is installed in India or not, including, but not limited to-

(i) business to business and business to consumer transactions, data interchange and other digital supply transactions;

(ii) offering to accept deposits or inviting deposits or accepting deposits or subscriptions in securities, in India or from citizens of India;

(iii) financial settlements, web based marketing, advisory and transactional services, database services and products, supply chain management;

(iv) online services such as telemarketing, telecommuting, telemedicine, education and information

research; and

(v) all related data communication services

Explore : E-learning, online travel, hotel booking, e-purchase, IBFD database access, etc

Foreign company definition - Challenges

Section / Rule No	Requirements under the Act/Rules/Forms	Ambiguity on compliance in context of electronic presence
380	<p>(1) Every foreign company shall, within thirty days of the establishment of its place of business in India, deliver to the Registrar for registration</p> <p>(a)....</p> <p>(b)....</p> <p>....</p> <p>(d) the name and address or the names and addresses of one or more persons resident in India authorised to accept on behalf of the company service of process and any notices or other documents required to be served on the company</p> <p>(e) the full address of the office of the company in India which is deemed to be its principal place of business in India</p>	<ul style="list-style-type: none"> Unless the references to 'place of business' or 'address of office' are understood as physical locations, foreign companies having merely virtual presence may find it difficult to comply with these provisions.
382	<p>Display of name, etc, of foreign company</p> <p>Every foreign company shall—</p> <p>(a) conspicuously exhibit on the outside of every office or place where it carries on business in India, the name of the company and the country in which it is incorporated, in letters easily legible in English characters, and also in the characters of the language or one of the languages in general use in the locality in which the office or place is situate.</p>	<ul style="list-style-type: none"> This requirement also pre-supposes the existence of a physical presence of the foreign company in India. In absence of physical presence, foreign company cannot display the name of the company outside its office in India.

Foreign company definition - Challenges

Section / Rule No	Requirements under the Act/Rules/Forms	Ambiguity on compliance in context of electronic presence
Rule 3	<p>(1)Every foreign company shall, <u>within thirty days of establishment of its place of business in India</u>, in addition to the particulars specified in sub-section (1) of section 380 of the Act, also deliver to the Registrar for registration, a list of directors and Secretary of such company.....</p> <p>(2)...</p> <p>(3)A foreign company shall, within a period of thirty days of <u>the establishment of its place of business in India</u>, file with the registrar Form FC-1 with such fee as provided in Companies.....</p>	<ul style="list-style-type: none"> Determination of date of establishment of virtual presence will become a very cumbersome exercise and consequently counting of thirty days time limit will pose significant practical difficulties.
Form FC-1	<p>This form requires a foreign company to list all principle places of business in India and requires the company to provide an address to the place of business. This form pre-supposes designated place to be a physical location in India having Telephone number, Pin code, City, State, etc.</p>	<ul style="list-style-type: none"> The particulars required in this form can be filled up only if a physical location in India is identified which is impossible in context of electronic presence.
Rule 2(b)/(c)	<p>Financial statements of foreign company need to be accompanied by, inter alia, statement of repatriation of funds and statement of transfer of funds between place of business of foreign company in India and any other related party of the foreign company outside India including its holding , subsidiary and associate company</p>	<ul style="list-style-type: none"> Such statements can be provided only if bank accounts of foreign companies are opened in India. Foreign companies doing business in electronic mode are unlikely to have bank accounts in India.

Inspection, Inquiry & Investigation

Inspection, Inquiry & Investigation

- ▶ Power to call for information, inspect books & conduct inquiries (Sec. 206 to 208)
- ▶ Search & Seizure (Sec. 209)
- ▶ Investigation into affairs of Company (Sec. 210)
 - ▶ (a) on the receipt of a report of the Registrar or inspector under section 208;
 - ▶ (b) on intimation of a special resolution passed by a company that the affairs of the company ought to be investigated; or
 - ▶ (c) in public interest,

Inspection, Inquiry & Investigation

- ▶ Serious Fraud Investigation Office (SFIO)
 - ▶ Central Government (CG) to establish SFIO to investigate frauds relating to a company as assigned to it by CG order
 - ▶ No government investigating agency can investigate or proceed with cases assigned to SFIO
 - ▶ SFIO empowered to arrest offenders in certain cases who may be released on bail only upon fulfillment of specified conditions
 - ▶ Certain offences which are treated as fraud under section 447 shall be non cognizable & will be released on bail on following of special conditions
 - ▶ False or incorrect particulars or suppression material information or wrong declaration (CA/CS/ICWA/Advocate) for incorporation (Sec.7)
 - ▶ Misstatement in prospectus (Sec. 34)
 - ▶ Fraudulently inducing persons to invest money (Sec. 36)
 - ▶ Personation for acquisition of securities (Sec. 38)
 - ▶ Issue of duplicate shares with an intent to defraud (Sec. 46(5))
 - ▶ Transfer of shares by depository with an intent to defraud (Sec. 56(7))
 - ▶ Furnishing false statement, mutilation or destruction of documents (Sec. 229)

Inspection, Inquiry & Investigation

- ▶ SFIO to submit its investigation report to CG
- ▶ SFIO to initiate prosecution against the company, its employees or **any other person connected with the company's affairs, directly or indirectly**, as directed by CG
- ▶ SFIO report for framing charges would be treated as a police report under Code of Criminal Procedure, 1973
- ▶ SFIO may also appoint experts in the field of Cyber forensic, financial accounting, management accounting, cost accounting or other fields (Sec. 211(4) r.w. Rule 3)
- ▶ Power to Arrest
- ▶ Furnishing of information by other investing agency, state government, police authority, income tax authorities to SFIO.

Inspection, Inquiry & Investigation

▶ Investigation into ownership of Company (Sec. 216)

▶ For determining true person

(a) who are or have been financially interested in the success or failure, whether real or apparent, of the company; or

(b) who are or have been able to control or to materially influence the policy of the company.

▶ Punishment for fraud (Sec. 447)

▶ “fraud” in relation to affairs of a company or any body corporate, includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss;

▶ “wrongful gain” means the gain by unlawful means of property to which the person gaining is not legally entitled;

▶ “wrongful loss” means the loss by unlawful means of property to which the person losing is legally entitled.

▶ Punishment up to 10 imprisonment & fine up to three times of fraud amount.

▶ Punishment for false statement to be treated as fraud (sec. 448)

Prohibition of association or partnership of persons exceeding certain numbers (Sec. 464)

ACTIVITY OF PARTNERSHIP OR ASSOCIATION	MAXIMUM NUMBER OF PARTNERS OR MEMBERS PERMITTED UNDER SECTION 464 OF THE 2013 ACT	MAXIMUM NUMBER OF PARTNERS OR MEMBERS PERMITTED UNDER SECTION 11 OF THE 1956 ACT
Professionals who are governed by special Acts (presumably partnership of CAs/ICWAs/CSs/ Doctors/Architects/ Lawyers etc.)	No limit	20
Association or partnership (other than that of professionals as above – Rule 10 of Miscellaneous Rules)	Prescribed number of persons (number prescribed cannot exceed 50)	20 for non-banking 10 for banking

**Dormant Company
(Sec. 455 read with Misc. Rules)**

Dormant Company

Dormant company means,

- ▶ Formed for future project
- ▶ Holding an asset or intangible property and
- ▶ No significant accounting transaction - It means any transaction other than—
 - (a) payment of fees by a company to the Registrar;
 - (b) payments made by it to fulfil the requirements of this Act or any other law;
 - (c) allotment of shares to fulfil the requirements of this Act; and
 - (d) payments for maintenance of its office and records
- ▶ Inactive Company - It means a company which has not been carrying on any business or operation, or has not made any significant accounting transaction during the last two financial years, or has not filed financial statements and annual returns during the last two financial years;

Dormant Company

- ▶ Eligibility (as per Rule 3)
 - ▶ no inspection, inquiry or investigation has been ordered or taken up or carried out against the company;
 - ▶ no prosecution has been initiated and pending against the company under any law;
 - ▶ the company is neither having any public deposits which are outstanding nor the company is in default in payment thereof or interest thereon;
 - ▶ the company is not having any outstanding loan, whether secured or unsecured: Provided that if there is any outstanding unsecured loan, the company may apply under this rule after obtaining concurrence of the lender and enclosing the same with Form MSC-1 ;
 - ▶ there is no dispute in the management or ownership of the company and a certificate in this regard is enclosed with Form MSC-1;
 - ▶ the company does not have any outstanding statutory taxes, dues, duties etc. payable to the Central Government or any State Government or local authorities etc.;
 - ▶ the company has not defaulted in the payment of workmen's dues;
 - ▶ the securities of the company are not listed on any stock exchange within or outside India.

Dormant Company

Section / Rule	Particulars	Description
Section 2(40)	Financial statement – Cash Flow Statement not required	The financial statement, with respect to one person company, small company and dormant company may not include the cash flow statement
Section 173(5)	Frequency of Board Meeting in a calendar year	A one person company, small company and dormant company shall be deemed to have complied with the provisions of this section if at least one meeting of the Board of Directors has been conducted in each half of the calendar year and the gap between the two meeting is not less than ninety days:
Rule 29.B	Minimum number of directors for dormant company	A dormant company shall have a minimum number of three directors in case of a public company, two directors in case of a private company and one director in case of a one person company.

Dormant Company

Section / Rule	Particulars	Description
Rule 29.B (Proviso)	Retirement of directors by rotation	The provisions of the Act in relation to the rotation of directors shall not apply on dormant companies.
Rule 29.9	Return of dormant companies	A dormant company shall file a declaration annually in Form No. 29.4 along with such annual fee as provided with in thirty days from the end of each financial year.
Proviso to Rule 29.9	No relaxation in filling return of allotment	The dormant company shall continue to file the return(s) of allotment in the manner and within the time specified in the Act whenever the company allots any security to any person.

Thank You