

IMPLICATION OF COMPANIES ACT, 2013 ON PRIVATE LIMITED COMPANIES

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The Companies Act, 2013 is not only very complex but also very impractical. It will be very difficult for common businessmen to run their business smoothly and properly. This new Act may slow down the growth of the country. Most of the businessmen have formed private limited companies in their group and such companies will be more affected by this new act. Therefore, I have covered the issues related to private limited companies only.

PRIVATE PLACEMENT OF SHARES [SECTION 42]

Private placement means issue of shares to relatives, friends and their relatives for raising capital of the company. The private limited company could issue shares at regular interval in a year as per requirement. But now the scenario has changed. A private limited company cannot issue shares at its will. Many complexities and formalities have been imposed by the Companies Act, 2013 on issue of shares. Now, I will discuss the complexities and formalities one by one as under:-

- Private Placement can be offered to maximum 200 persons in a financial year; and to maximum fifty persons per single offer per private placement. The maximum limit of shareholders in a private limited company is 200 only.
- If a private limited company offers to more than 200 persons, than the same shall be deemed to be an offer to the public.
- Private placement can be made only 4 times in a financial year but in Companies Act, 1956 there was no such limitation for private placement to be made in a year.
- There should be a gap of 60 days between two issues and in one quarter only one issue can be made. Again there was no such restriction or limitation in previous act.
- Special resolution to be passed at a Members General Meeting for each offer; no such requirement was there in previous act. It will create difficulties as for each issue company will have to call EGM or AGM.
- Issue Price justification required in Explanatory Statement to the Notice of Meeting;
- Each share application will be minimum of the face value of Rs.20,000/-;

- Earlier we could accept fresh applications before making allotment of shares of previous applications but as per new Companies Act, 2013 fresh application for shares cannot be accepted until allotment of previous offer is made by the company;
- Share application money cannot be received in cash. In earlier act, there was no such restriction;
- Separate bank account should be opened and operated for receipt of share application money;
- Share Application money received by company cannot be utilized till allotment is made.
- Allotment to be made within 60 days of receipt of share application money, or else to be refunded within 15 days of expiry of 60 days;
- In case of delay in refund, interest @ 12% p.a. required to be paid and such non-refunded application money shall be deemed to be deposit;
- Company should record names of the persons to whom it makes offer for making application for shares prior to sending offer letters and the offer letters should contain name of the persons recorded and it should be sent in the individual name of the concerned persons;
- Offer records to be maintained in Form PAS-5 and ;
- Form PAS-4 containing offer details to be filed within 30 days of offer letter;
- Form PAS-3 for allotment to be filed within 30 days of allotment.

Any offer or invitation not in compliance of this section will attract penalty of Rs.2 crore or issue amount whichever is higher and moreover application received should also be returned within 30 days from the date of order imposing penalty.

TRANSFER OF SHARES [SECTION 56]

- No transfer of securities of a Company shall be registered unless a proper instrument of transfer, duly stamped, dated & executed by or on behalf of the transferor and the transferee; specifying the name, address, & occupation if any of the transferee; has been delivered to the company by transferor or transferee within a period of 60 days from the date of execution along with certificate related to the securities.
- Transfer Form shall be Form SH-4.
- Any allottee under a private placement offer/invitation shall not transfer his/its securities to more than 20 persons during a quarter and the company shall not register any transfer which is not in conformity with this requirement.
- If any default is made in complying to this section, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees.

The new provisions of private placement will make it difficult for those companies which are small in nature and which cannot arrange fund at one go. The penalty amount is so high that if there is any contravention of this provision due to any reason, the said private limited company will have to close its business.

ACCEPTANCE OF DEPOSITS/ LOANS/ ADVANCES [SECTION 73]

- As per Section 2(31) of the Companies Act, 2013, “Deposit” includes any receipt of money by way of deposit or loan or in any other form by a Company, but does not include such categories of amount as may be prescribed in consultation with the RBI.
- A Company cannot accept any deposits/ loans/ advances from public. A company can accept deposits/loans/advances in the following manner only:

A company can receive loan, advance or deposit from:

- ✓ Any other Company
- ✓ Director, provided the director furnishes to the Company a declaration that the amount is not being given out of funds acquired by him through borrowing. This means director can only give loan to the company to the extent of his own capital.
- ✓ Government, Local Authority, or any other Statutory Authority
- ✓ Foreign Government, International Banks, Foreign Body Corporates, Foreign Citizens, Foreign Authorities or person resident outside India subject to Foreign Exchange Management Act & Rules
- ✓ Banking Company
- ✓ Public Financial Institution
- ✓ Employee of Company not exceeding his/her annual salary, in the nature of non- interest bearing security.
- ✓ Promoter of Company in pursuance of the stipulation of any lending Financial Institution or Bank
- ✓ Amount received against issue of Commercial Paper
- ✓ Share Application money received, only if:
 - Allotment is made in 60 Days from the date of receipt or
 - In case of Non- Allotment, should be refunded within 75 Days of receipt
 - If not allotted or not refunded than it will be treated as deposit.
- ✓ Any Amount raised by issue of Bonds & Debentures
- ✓ Any non-interest bearing amount held in Trust
- ✓ Amount accepted from Nidhi Co

Any amount received for the purpose of business of the Co: but if it is received

- As an advance from customers provided such advance is appropriated against supply of goods or services within a period of 365 days from the date of receipt of such advance;
- An advance received in connection with consideration for property under an agreement provided that such advance is adjusted against the property in accordance with the terms of agreement; we have various real estate dealer client they receive advance from other company for the purpose of adjustment. They should be now careful.

- As security deposit against supply of goods or services;
- As advance received under Long Term Projects for supply of Capital Goods;
- **A Company may accept loans/deposits from its shareholders as per Prescribed Rules, subject to fulfilment of following conditions:**
 - ✓ Resolution should be passed at a General Meeting of members;
 - ✓ Issuance of Circular to members containing details about financial position of company, credit rating obtained, details of depositors, and other such details as prescribed;
 - ✓ The said circular should be filed with ROC within 30 days;
 - ✓ Depositing minimum 15% of amount of deposits maturing during a financial year, in an earmarked bank account;
 - ✓ Providing deposit insurance;
 - ✓ Such other conditions and formalities as prescribed.
- **The aforesaid conditions under which a company can accept loan or are not applicable to following companies:**
 - ✓ Banking Company
 - ✓ NBFC
 - ✓ Housing Finance Company

Outstanding loan/deposit as on 01.04.2014

I would now like to highlight the most important and dangerous provision under the new Companies Act, 2013. I have come to know that most of the companies have outstanding loan or deposit as on 01.04.2014. What the companies should do with such outstanding amount? Whether it is required to repay? Most of the companies shall face tremendous problems in respect of brought foreword amount on account of loan or deposit etc.

As per new provision, if a company has taken any loan, share application, business advance etc. which is outstanding as on 01.04.2014 from any person including share holder but other than any company, the same shall be treated as deposit under the new Company Act, 2013 and you have to either repay the same within 30.06.2014 or if you don't repay than you have to report the same with complete details with the ROC and further you have to compulsorily repay the said deposits by 31.03.2015 and if you fail to repay the said deposit by 31.03.2015 than minimum penalty of Rs.1 Crore extending to Rs.10 crore and every officer in default for imprisonment upto 7 years or with fine of Rs.25 lacs to Rs.2 crores or both. However, the reporting of such loan or deposit before ROC is very complex. It requires so many details that nothing remains hidden to outsiders. A company would not like to furnish such information to ROC.

LOANS TO DIRECTORS [SECTION 185]

- **RESTRICTIONS**

No Company shall directly or indirectly advance any loan, including any loan represented by a book debt with effect from 12th September, 2014, to any of its Director or to any other person in whom the Director is interested, or give any guarantee or provide any security in connection with loan taken by Director or such other person:

The phrase 'including any loan represented by a book debt' is a very smart move by the law makers to ensure that the directors and/or any other person in whom the director is interested do not circumvent the law by juggling with the words. To elaborate this with an example: Say a Company manufactures air-conditioners. One of the director of the Company is setting up an hotel for which he will also need to buy air-conditioners. The director in the erstwhile situation (when section 185 was not applicable) could have taken a loan from the Company for buying the same. But in the present situation, since he is not able to take that loan, he asks the Company to give him 100 air-conditioners for a long credit period. If the credit period extended by the Company is as per the normal period and in the normal terms and conditions, as extended to its other buyers, then there is no problem but as soon as it is biased and tilted to give undue benefit to the director and/or other person in whom the director is interested, then such transaction will be considered to be loan.

Thus a Company (**hereinafter referred to as 'Lending Company'**) cannot advance a loan to:

- > Any Director;
- > Any Director of Holding company of the Lending company;
- > Any Partner or Relative of any such Directors mentioned above;

Relative as per Companies Act, 2013 means anyone who is related to another, if:

- They are members of HUF
 - Spouse
 - Father/ Step-father
 - Mother/ Step-mother
 - Son/Step-son
 - Son's wife
 - Daughter
 - Daughter's Husband
 - Brother/ Step-brother
 - Sister/ Step-sister
- > Any Firm in which any such Director or Relative is partner;
 - > **Any Private Company** of which any such Director is a Director or Member of Lending Company;

Let us take another example: ABC Private Limited having Mr. R as a Director decides to give loan to XYZ Private Limited in which Mr. R is not a Director but a shareholder, then it will not be able to give loan to XYZ Private Limited (even if Mr. R is holding a single share).

Another situation: ABC Private Limited and XYZ Private Limited does not have a single common director. In ABC Private Limited, Mr. R is a Director and in XYZ Private Limited, the wife of Mr. R is a Director. In such a situation, the loan can be given by ABC Private Limited to XYZ Private Limited. One should not get confused between loan transactions taking place with an individual per-se and between entities. For example, one may think in the immediate example given here that section 185 does not permit giving loans to wife of such director. Then how is it that in the said example such loan is permissible. It is true that a company cannot give loan to the wife of such director, because wife falls under the definition of a relative. But in this example, loan is not being given to the wife but to the Company, ABC Private Limited in which the wife is a director.

Another situation: ABC Private Limited and XYZ Private Limited does not have any common directors. ABC Private Limited has Mr. M as a shareholder and even XYZ Private Limited has Mr. M as a shareholder. ABC Private Limited wants to give loan to XYZ Private Limited. Yes, it can.

- Any company or LLP whose 25% voting rights in AGM are exercised by one or two directors of lending company;
- Any Body Corporate, the Board of Directors of which is controlled by the any Director(s) of Lending Company.

The restrictions which i have just discussed in the above paras are not applicable to:

- ✓ Giving of any loan to the Managing or Whole-time Director –
 - (i) As a part of the conditions of service extended by the company to all its employees;
 - (ii) Pursuant to any scheme approved by members vide special resolution
- ✓ A Company which provides loans in the ordinary course of its business and interest in respect of such loans is charged at a rate not less than Bank rate declared by RBI
- ✓ The above restrictions do not apply to loans given by Holding company to its Subsidiary.

Will it be applicable for all kinds of NBFC? Clearly not. If suppose this Company in question is an Investment NBFC. Then surely giving of loans for it will not classify in its ordinary course of business. Many a times, a question has been posed that what if the Company includes loans business in its main object clause and hence qualify under the phrase-'ordinary course of businesses. This is also not going to help, unless the other special acts e.g. the Nidhi Benefit Companies etc. allows such activities and the Company has all proper registrations for being called so.

If any loan is advanced or a guarantee or security is given or provided in contravention of the provisions of sub section (1), the company shall be punishable

with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees.

If any loan is advanced or a guarantee or security is given or provided in contravention of the provisions of sub –section (1), the director or the other person to whom any loan is advanced or guarantee or security is given or provided in connection with any loan taken by him or the other person, shall be punishable with imprisonment which may extend to six months or with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees, or with both.

LOANS AND INVESTMENT BY COMPANIES [SECTION 186]

As regards loans to be given by the company, there are again certain conditions which should be followed by every company before giving loans. The said conditions as prescribed by the Companies Act, 2013 are as under -

- No Loans/Acquisition of securities of any body corporate can be made in excess of:
 - 60% of (paid up capital + free reserves + security premium); or
 - 100% of (free reserves + security premium), whichever is higher.
 - For example : ABC private limited company have paid up capital of Rs.200 and free reserves of Rs.50 and security premium of Rs.150. 60% of (200+50+150) = Rs.240 or 100% of (50 +150) = Rs.200 whichever is higher i.e, Rs.240 is higher and this mount can be invested by ABC private limited in loans or investments of securities.
- Consent of all directors present at the meeting is required before advancement.
- Special resolution required for loans/ investment in excess of aforesaid limit (except loans/investment by Holding companies in its Subsidiary);
- Disclosure of loans/ investment and purpose of recipient required to be disclosed in financial statements;
- No loan can be given at a rate of interest lower than Govt. security closest to the tenor of loan;
- The aforesaid restrictions are not be applicable to NBFC Companies;
- Loan/ Investment register to be maintained in Form MBP-2;
- In case the existing Loans/ Investments of companies as on 1st April, 2014 exceed the aforesaid specified limits, special resolution to be passed at any time before 31st March, 2015
- Contraventions of any provision of this section Company – Penalty not less than Rs25000 to Rs5 lakh. Officer – imprisonment upto 2 years, or penalty Rs. 25000 to Rs1 lakh

RELATED PARTY TRANSACTIONS [SECTION 188]

If any company enters into a transaction with another company or a person who as per Companies Act, 2013, is a related party, following guidelines have to be followed as per the new act.

- Prior consent of Board required for each contract or arrangement with related party
- Prior approval required by SR, before any transactions by
 - company having paid up share capital – Rs. 10 crore or more
 - other companies, where transactions to be entered into exceeds the limits as given below
 - sale, purchase or supply of goods or materials directly or through agent - 25% of annual turnover
 - selling or buying of property of any worth kind directly or through agent - 10% of net worth
 - leasing of property - 10% of net worth or turnover
 - availing or rendering of services directly or through agent - 10% of net worth.
 - appointment of relative in office or place of profit in company , subsidiary or associate company - Monthly remuneration of Rs 2.5 lac
- any director interested in the contract not to participate in the board meeting
- What are related party transactions
 - sale, purchase or supply of goods or materials
 - selling or buying of property of any kind
 - leasing of property
 - availing or rendering of services
 - appointment of any agent for any of above transactions
 - appointment of relative in office or place of profit in company, subsidiary or associate company
 - underwriting the subscription of securities or derivatives
- The aforesaid provisions not applicable in case of transactions entered into by a company with a related party in its ordinary course of business on arm's length basis;
- Board of Directors' Report should contain details about such related party contracts/ arrangements.

PUNISHMENT FOR FRAUD [SECTION 447]

One of the most frequently quoted sections in the 2013 Act is the Section 447 dealing with "Punishment for fraud". The term fraud is a commonly used one, but the new law for company has a clear explanation for the term "fraud", which is explained below:

"fraud" in relation to affairs of a company or anybody 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."

Interestingly the law also explains the terms “any wrongful gain or wrongful loss”, which runs as under:

“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.

Thus, as per Section 447, any person who is found to be guilty of fraud, shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud. Where the fraud in question involves public interest, the term of imprisonment shall not be less than three years.

CONCLUSION

The private limited companies should be very very careful in respect of the provisions of Companies Act, 2013. For every transaction entered into by the private limited companies, the correct interpretation of the law should be made and statutory compliances should also be made properly because if there is any lapses heavy penalty may be imposed on the company. The private limited companies and the directors should not take the provisions of the new Companies Act, 2013 lightly. The auditors will also not come to the rescue of defaulting company because the auditors will also face litigation, penalty proceedings if they miss anything during auditing of accounts either for helping the companies or out of there negligence.