

Private companies under the Companies Act, 2013

The Companies Act, 2013 ('New Act') has received the assent of the President on 29th August, 2013 and was notified in the Gazette on 30th August, 2013. However, the Act in toto is not yet notified and only 98 sections or part thereof of the New Act have been brought into force from 12th September, 2013. Further, the Government has clarified that the relevant provisions of the Companies Act, 1956 ('existing Act') which correspond to provisions of those 98 sections of the New Act shall cease to have effect from the said date.

The New Act has made material changes to the provisions under the existing Act. In this article we have examined status under the New Act of the various privileges and exemptions which are otherwise available to a private company under the existing Act. While dealing with the subject we have considered and analysed the provisions of the New Act, irrespective of the fact whether the same are notified by the Central Government or not.

1. *Definition of Private company:*

Under the New Act a private company is defined under section 2(68) as under:

“private company” means a company having a minimum paid-up share capital of one lakh rupees or such higher paid-up share capital as may be prescribed, and which by its articles,-

(i) restricts the right to transfer its shares;

*(ii) except in case of One Person Company, **limits the number of its members to two hundred:** (emphasis supplied)*

***Provided** that where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this clause, be treated as a single member:*

***Provided further** that –*

(A) persons who are in the employment of the company; and

(B) persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased,

shall not be included in the number of members; and

*(iii) prohibits any invitation to the public to subscribe for any **securities** of the company; (emphasis supplied)*

The following material change in the definition of a private company may be noted:

- a) **Except in case of One Person Company** - maximum number of members which a private company can have is increased to 200 from the existing limit of 50;
- b) Under the existing Act a private company by its Articles is prohibited from inviting public for subscription of shares and debentures. Under the New Act the prohibition applies to securities as defined under section 2(h) of the Securities Contracts (Regulation) Act, 1956 which includes not only the shares and debentures but also other securities prescribed therein;

- c) Under the existing Act in order to form a private company it is essential that its Articles contain a clause that prohibits a company from accepting deposits from persons other than its members, directors or their relatives. The New Act does not prescribe a similar condition and thus under the New Act a private company can be formed without inserting in its Articles a clause prohibiting invitation or acceptance of deposits from persons other than its members, directors or their relatives.

2. *Restriction on commencement of business:*

As per the New Act a private company cannot commence business or exercise borrowing power:

- till every subscriber to the memorandum has paid the value of shares taken by him and the directors of the company have filed declaration to that effect; and
- the Company has filed with the Registrar a verification of its registered office.

Under the existing Act a private company can commence business or exercise borrowing power immediately on being formed / incorporated.

3. *Share Capital:*

- a) Under the existing Act - a company is prohibited from issuing classes of shares other than equity or preference shares. Further, the Act provides that the shareholder's voting rights should be in the same proportion to his share of the paid up equity capital of the company. However, these provisions do not apply to a private company which is not a subsidiary of a public company (See section 90(2) of the existing Act). Thus, under the existing Act, a private company not being a subsidiary of a public company is permitted to issue types of shares other than the equity share or the preference share. It can also issue shares with disproportionate rights in regard to dividend, participation in any surplus on liquidation and with disproportionate voting rights. However under the New Act, similar exemption is not given to a private company.
- b) Under the existing Act - a private company can issue further share capital to any person or in any manner as it thinks best in its own interest. Its Articles may or may not provide for pre-emptive rights of shareholders. Under the New Act, all companies including a private company, is required to offer shares to persons who, on the date of the offer, are holders of equity shares of the Company in proportion, as nearly as circumstances admit, to the paid up share capital on those shares.

4. *Providing financial assistance for purchase of its own / holding company' s shares:*

Under the existing Act – a public company or a private company which is a subsidiary of a public company is prohibited from giving loan, guarantee, security or any other kind of financial assistance to any person for the purpose of purchase of shares in the company or in its holding company. Under the New Act, such prohibition is restricted to public company only. Accordingly, the private companies, including the one which is a subsidiary of a public company would be able to offer financial assistance to any person for purchase of shares in the company or in its holding company.

5. *Appointment of Directors:*

a) *Where a person other than a retiring director stands for directorship:*

Under the New Act, a person who is not a retiring director and desires to stand for directorship is required to give fourteen days' notice in writing and deposit Rs. 1 lac or such higher amount as may be prescribed. The deposit amount would be refunded provided he gets elected or gets at least 25% vote. Under the existing Act, a private company is free to frame its own Rules in its Articles for the purpose.

b) *Number of directorships:*

Under section 275 of the existing Act a person cannot become a director in more than fifteen companies. For the purpose, person holding directorship in a private company which is neither a subsidiary nor a holding company of a public company is not considered. Under section 165 of the New Act the said limit is increased to twenty but it further provides that in the said limit of twenty, the number of public companies cannot exceed ten. Further it is clarified that for reckoning the limit of public companies, directorship in a private company which is either a holding or a subsidiary of a public company is to be included.

c) *Appointment of directors to be voted on individually:*

Under section 162 of the New Act where a company including a private company, desires to appoint two or more persons as directors by a single resolution, it is necessary first to pass a resolution authorising their appointment in that manner without even one dissentient vote being cast against such resolution. Under the existing Act a private company which is not a subsidiary of a public company is permitted to appoint two or more persons as directors by a single resolution with no pre-conditions attached to it.

d) *Consent to act as a director:*

Under section 152 of the New Act where a person is proposed to be appointed as a director by a company including a private company, he is required to furnish a declaration that he is not disqualified to become a director under the Act. It is further provided that a person appointed as a director shall not act as a director unless he gives his consent to hold the office as director and such consent has been filed with the Registrar. Similar provision under the existing Act is not applicable to a private company which is not a subsidiary of a public company.

6. *Appointment of Managerial Personnel:*

a) As per section 269 of the existing Act, every public company or a private company which is a subsidiary of a public company having a paid up share capital of Rs. 5 crore is required to have a managing or whole time director or manager. As per section 203 of the New Act every company belonging to such class or classes of companies (which could also include a private company), as may be prescribed by the Central Government is required to have the following whole-time key managerial personnel:

- Managing director or Chief Executive Officer or Manager or Whole-time director;
- Company secretary; and
- Chief financial officer.

- b) It is further specified that a person who is the Managing director or Chief Executive Officer cannot be appointed as the Chairperson of the company unless Articles of such company provide for the same or the company carries on multiple businesses.
- c) A whole-time key managerial personnel cannot hold office in more than one company except in its subsidiary company, though he can be a director of any company with the permission of the Board. Under the existing Act a person can be appointed as a managing director in two companies and for the purpose, managing directorships in a private company which is not a subsidiary of public company is not considered;
- d) As per Section 196(3) of the New Act, which applies to all types of companies, a person cannot be appointed to the post of managerial personnel who is below the age of 21 years or has attained the age of 70 years. Under the existing Act no such age criteria were prescribed in relation to a private company.
- e) Under the existing Act a private company not being a subsidiary of a public company is not prohibited from appointing a managing director or a manager for a term which may exceed five years at a time. Under the New Act, all types of companies, including a private company, are prohibited from appointing managing director or whole time director or manager for a term exceeding five years at a time.

7. *Restrictions on Powers of Board:*

As per the New Act, the Board of a company, including of a private company can exercise the following powers only with the **consent of the company by a special resolution**:

- a) Sale, lease or otherwise disposal of the whole or substantially the whole undertaking. The term 'substantial' means where not less than 20% of the value of the undertaking is being disposed off;
- b) To invest otherwise in trust securities the amount of compensation received by it as a result of any merger / amalgamation;
- c) To borrow money, where the money to be borrowed, together with the money already borrowed exceed the aggregate of its paid up share capital and free reserves;
- d) To remit, or give time for the re-payment of, any debt due from a director;

8. *Loans and investments by a company:*

The New Act provides for the manner in which and the limits up to which a company, including a private company can give loan or give guarantee or provide security in connection with a loan to any other body corporate or person or acquire any securities of any other body corporate. As per section 186 of the Act, unless authorised by a special resolution passed at a general meeting, such loans, investments, etc. made by any company cannot exceed 60% of its paid up share capital, free reserves and securities premium account or 100% of free reserves and securities premium account, whichever is lower. It further provides that the loan cannot be given at a rate of interest lower than the prevailing yield of one year, three year, five year or ten year Government security closest to the tenor of the loan. It also empowers the Central government to prescribe limits up to which the companies registered under section 12 of the Securities and Exchange Board of India Act, 1992 can take inter-corporate loan or deposit.

Section 372A of the existing Act also restricts loans and investments by the company. However, the provisions under the New Act are more stringent and restrictive. The material differences between the two provisions are as under:

- a) Section 372A is not applicable to a private company not being a subsidiary of a public company while section 186 applies to private companies also;
- b) New section not only covers inter-corporate loans and investment but also to loans and investment given to non-corporates;
- c) As per section 372A - loan cannot be made at the rate of interest lower than the prevailing bank rate made public under section 49 of the Reserve Bank of India Act, 1934. While under section 186 the rate of interest is linked to the prevailing yield of Government securities;
- d) Following transactions not covered (or exempted) under the provisions of section 372A of the existing Act gets covered under section 186 of the New Act:
 - Investments in right issue of shares made in pursuant of section 81(1)(a);
 - Loan by a holding company to its wholly owned subsidiary;
 - Guarantee given or security provided by a holding company in respect of loan to its wholly owned subsidiary;
 - Acquisition of securities by a holding company of its wholly owned subsidiary;
- e) A new provision is inserted to prohibit investment through more than two layers of investment companies.

9. *Interested director not to participate or vote in Board's proceedings:*

As per the New Act every director of a company, including of a private company, who is concerned or interested in a contract or arrangement entered into or proposed to be entered into is required to disclose the nature of his concern or interest at the meeting of the Board and he cannot participate in proceedings of such meeting. The provisions under the existing Act were not applicable to a private company.

10. *Loan to directors:*

As per the New Act no company, including a private company, can advance any loan to any of its directors or to any other persons in whom the director is interested or give guarantee or provide any security in connection with any loan taken by him or such other person. The provisions under the existing Act are not applicable to a private company which is not a subsidiary of a public company.

11. *Administration related:*

a) *Time and Place of Annual General Meeting:*

Under the existing Act - a private company has the option to fix the time for its annual general meeting by its Articles or by a resolution passed in one annual general meeting wherein time for holding subsequent meeting is fixed / decided. In case of a private company which is not a subsidiary of a public company it also has the option of fixing the place of its annual general meeting in the like manner. The New Act does not provide for similar options and as provided in section 96(2), all companies, including a private company, is required to held its annual general meeting between 9 a.m. and 6 p.m. on a day that is not a National holiday, at the registered

office of the company or at some other place within the city, town or village in which the registered office of the company is situated.

b) *Meetings and Proceedings:*

By virtue of the provisions of section 170 of the existing Act, a private company by its Articles can frame its own Rules as regards the length of notice for calling meeting, contents and manner of service of notice and person on whom it is to be served, Explanatory statement to be annexed to notice, Quorum for meeting, Chairman of meeting, Proxies and manner of Voting on resolutions. The New Act does not grant similar exemptions hence, a private company is required to follow the same rules and procedures as are applicable to a public company as provided in the New Act.

c) *Filing of Financial Statements with the Registrar:*

Proviso to section 220 of the existing Act permits a private company to file copy of Statement of Profit and Loss separately with the Registrar and the same is not available to general public for inspection. Under the New Act no such exemption is available to a private company and the Financial Statements filed under section 137 which also includes Statement of Profit and Loss, would be available to general public for inspection.

d) *Register of directors:*

Under the existing Act all companies other than a private company which is not a subsidiary of a public company are required to enter date of birth of a director in the Register maintained. The exemption granted to a private company has been withdrawn under the New Act, and accordingly, the Register maintained even by a private company shall contain information about the date of birth of a director.

12. *Following exemptions and privileges available under the existing Act also available under the New Act:*

(A) In case of all types of private companies:

- Filing of statement in lieu of prospectus before allotment of shares is not required;
- A private company need not have more than two directors;

(B) In case of a private company not being a subsidiary of a public company:

- Provisions relating to the managerial remuneration like extent and manner of payment, fixing of overall maximum remuneration, limit of minimum managerial remuneration in the event of no profits or inadequate profits, etc. are not applicable and such company can remunerate its managerial personnel by such higher percentage of profits or in any manner as it may think fit;
- The provisions relating to the appointment, retirement, re-appointment, etc. of directors who are to retire by rotation and the procedure relating thereto are not applicable and the company can frame its own Rules for the purpose in the Articles;
- The provisions relating to the manner of filling up casual vacancy among directors are not applicable and the company can frame its own Rules for the purpose in the Articles;
- The company can by its Articles, provide for any disqualification for appointment as a director in addition to those specified in the Act;

- The company may provide any other ground for the vacation of the office of a director in addition to those specified in the Act;

13. One Person Company (OPC):

A concept of One Person Company has been introduced under the New Act. Section 2(62) of the Act defines OPC to mean a company which has only one person as a member and as per section 3, a company formed by one person would be a private limited company. Thus OPC would enjoy all the exemptions and privileges enjoyed by any private company. In addition, OPC enjoys following exemptions and privileges:

- a) It is not mandatory for OPC to prepare cash flow statement;
- b) In the absence of company secretary, the Annual Return filed under section 92 can be signed by the director;
- c) OPC is not required to hold Annual general meeting;
- d) The provisions of section 100 to 111 which provides for matter regarding extra-ordinary general meeting, length of notice for calling general meeting, contents and manner of service of notice and person on whom it is to be served, Explanatory statement to be annexed to notice, Quorum for meeting, Chairman of meeting, Proxies and manner of Voting on resolutions, etc. do not apply to OPC;
- e) The financial statement need not be signed amongst others, by Chief Financial Officer and the Company secretary. It is sufficient compliance if the same is signed by one director;
- f) It is sufficient compliance if OPC has only one director instead of minimum two required in the case of a private limited company;
- g) In case of OPC it is sufficient if at least one meeting of the Board of Directors is held in each half of a calendar year.

The full impact of the New Act would become clearer once the necessary Rules are notified. However, the New Act has taken significant steps in strengthening corporate governance by introducing and modifying provisions relating to duties and responsibilities of directors and key managerial personnel. Each company would be required to revisit the procedures followed by them with respect to those act which has direct impact on the governance. In few cases, the Articles may also have to be amended.