



Company Law Corner

ALL ABOUT MANAGERIAL REMUNERATION UNDER THE COMPANIES ACT, 2013

Just as profits drive business, incentives drive the managers of business. Not surprisingly then, in a fiercely competitive corporate environment, managerial remuneration is an important piece in the management puzzle. While it is important to incentivize the workforce performing the challenging role of managing companies, it is equally important not to go overboard with the perks and the pay.

In India, to keep a check on unnecessary profit squandering by companies and, at the same time, to ensure adequate and reasonable compensation to managerial personnel, the law intervenes to do the balancing act.

Clause 78 of Section 2 of the Companies Act, 2013 defines "Remuneration" which means any money or its equivalent given or passed to any person for services rendered by him and includes perquisites as defined under the Income-tax Act, 1961.

Though the term Managerial Remuneration is not defined anywhere in the Companies Act, 2013, the term is used interchangeably with remuneration to a managerial person.

The Nomination and Remuneration Committee formulates the criteria for determining qualifications, positive attributes and independence of a director and recommend to the Board a policy, relating to the remuneration for the directors, key managerial personnel and other employees.

While formulating the policy regarding remuneration, the NRC shall ensure that the level and composition of remuneration is reasonable and sufficient to attract, retain and motivate directors of the quality required to run the company successfully.

Relationship of remuneration to performance is clear and meets appropriate performance benchmarks; and remuneration to directors, key managerial personnel and senior management involves a balance between fixed and incentive pay reflecting short and long-term performance objectives appropriate to the working of the company and its goals.

Maximum limit of Managerial Remuneration payable by a Public Company (Section 197(1))

The total managerial remuneration payable by a public company, to its directors, including managing director and whole-time director, and its manager in respect of any financial year shall not exceed 11% of the net profits of that company for that financial year computed in the manner laid down in section 198 of the Companies Act, 2013, except that the remuneration of the directors shall not be deducted from the gross profits.

The Company may pay the remuneration to the managerial personnel exceeding total limit of 11% of net profit with the approval of members at the general meeting subject to the provisions of Schedule V of the Companies Act, 2013.

However, as per the third proviso of Section 197(1) of the Companies Act, 2013, that if the company has defaulted in the payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor, the prior approval of the bank or public financial institution concerned or the non-convertible debenture holders or other secured creditor, as the case may be, shall be obtained by the company before obtaining the approval in the general meeting.

Section 197 is applicable only on Public Limited Companies. Private Limited Companies are out of preview of this section. There is no limit on remuneration for Private Limited Companies, they can pay any amount of remuneration without complying with the provision of Section 197 and Schedule V of the Companies Act, 2013.

Remuneration should be strictly subject to the provisions of Section 197 of the Companies Act, 2013

Section 197(4) expressly requires that the remuneration payable to the directors of a company, including any managing or whole-time director or manager, shall be determined, in accordance with and subject to the provisions of Section 197 of the Companies Act, 2013. Determination of Remuneration can be done either by the articles or by a resolution or if the articles so require, by a Special Resolution passed by the company in general meeting.

The remuneration so determined to be payable is required to be inclusive of the remuneration payable to him for the services rendered by any such director in other capacity.

However, any remuneration for services rendered by any such director in other capacity shall not be so included if:-

- (a) the services rendered are of a professional nature; and
- (b) the director possesses the requisite qualification for the practice of the profession in the opinion of the Nomination and Remuneration Committee, if the company is covered under sub-section (1) of section 178, else in the opinion of the Board of Directors.

The expression “remuneration payable to the directors, including any managing or whole-time director or manager” covers all the directors on the board of the company apart from the managing or whole-time director or manager.

Prescribed individual limit for each Directors under Section 197(1) of the Companies Act, 2013

By virtue of the second proviso, within the overall limit specified under Section 197(1), the directors can be paid remuneration upto the following limits applicable individually to each director separately:

- (i) **In case of Managing Director, Whole-time Director or Manager**-upto 5% of the net profits of the company, if there is only one such director.
But if there is more than one such director, remuneration shall not exceed 10% of the net profits for all of them put together.
- (ii) **In case of directors who are neither Managing Director nor Whole-time Director**-upto 1% of the net profits, if there is a managing director or whole-time or manager.
But upto 3% of the net profits if there is no Managing Director or Whole-time Director or Manager.

However, by passing a Special Resolution in General Meeting, a company can pay:

- (i) More than 5% or 10% of Net Profits to its Whole-time Director, Managing Director or Manager.
- (ii) More than 1% or 3% of Net Profits to its Executive Directors (including independent Director)

While calculating managerial remuneration, sitting fees have to be excluded.

Provisions for allowing payment of Remuneration to Non-Executive Directors including Independent Directors in case of No Profits or Inadequacy of Profits

Prior to the Companies (Amendment) Act, 2020, in a situation where a company has not made any profits or made inadequate profits, Managing Directors, Whole-time Directors or Managers could be paid sitting fees for attending board meetings in accordance with Section 197(5), and minimum remuneration in accordance with Section 197(3), read with Schedule V of the Companies Act, 2013. But, in the same situation, Non-Executive Directors and Independent Directors could only be paid sitting fees for attending board meetings in accordance with Section 197(5) and were not entitled to anything else.

With the advent of the Companies (Amendment) Act, 2020, amendments to Section 149 and 197 of the Companies Act, 2013 has been introduced to provide remuneration for non-executive directors, including independent directors, in case of no profit or inadequacy of profits in a manner similar to executive directors in accordance with the provisions of Schedule V of the Companies Act, 2013.

Further, On March 18 2021, the MCA also issued a notification which amended Schedule V of the Companies Act, 2013 to prescribe the remuneration limits for non-executive directors including independent directors, in situations of no profits or inadequate profits.

Limit of remuneration in case of No Profit or Inadequate Profit

Section 197(3) of the Companies Act, 2013 has been amended to provide that if in any financial year, a company has no profits or its profits are inadequate, the company shall not pay to its directors, including any managing or whole-time director or manager **or any other non-executive director, including an independent director**, by way of

remuneration any sum exclusive of any fees payable to directors hereunder except in accordance with the provisions of Schedule V of the Companies Act, 2013.

Overriding effect of Schedule V of the Companies Act, 2013

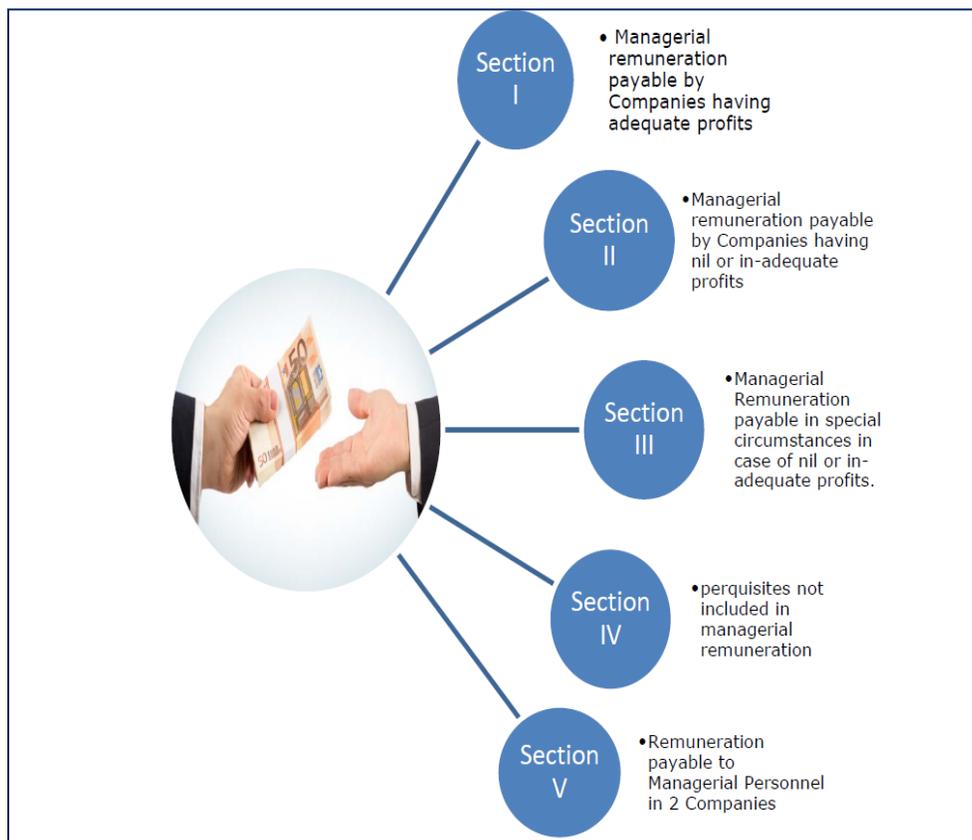
Section 197 (11) of the Companies Act, 2013 prescribes that in cases where Schedule V is applicable on grounds of no profits or inadequate profits, any provision relating to the remuneration of any director which purports to increase or has the effect of increasing the amount thereof, whether the provision be contained in the company's

- a. Memorandum of Association (MoA) or
- b. Articles of Association (AoA) or
- c. Agreement entered in with by Company or
- d. Resolution passed in General meeting or its Board Meeting,

shall not have any effect unless such increase is in accordance with the conditions specified in Schedule V.

Schedule V have an overriding effect over MoA, AoA, agreement and general meeting resolution. Hence, if Company is unable to comply with provisions of Schedule V, then no remuneration can be paid to Managerial Personnel except sitting fees.

Part II of Schedule V of the Companies Act, 2013 confers with Managerial Remuneration



Section I - Remuneration payable by companies having profits:

Subject to the provisions of section 197, a company having profits in a financial year may pay remuneration to a managerial person or persons or other director or directors not exceeding the limits specified in such section.

Section II - Managerial Remuneration payable by the Companies having Nil or Inadequate profits

Where in any financial year during the currency of tenure of a managerial person or other director, a company has no profits or its profits are inadequate, it may, pay remuneration to the managerial person or other director not exceeding, the limits under (A) and (B) given below:-

(A):

(1)		(2)	(3)
Sl. No.	Where the effective capital (in rupees) is	Limit of yearly remuneration payable shall not exceed (in rupees) in case of a managerial person	Limit of yearly remuneration payable shall not exceed (in rupees) in case of other director
(i)	Negative or less than 5 crores.	60 lakhs	12 lakhs
(ii)	5 crores and above but less than 100 crores.	84 lakhs	17 lakhs
(iii)	100 crores and above but less than 250 crores.	120 lakhs	24 lakhs
(iv)	250 crores and above.	120 lakhs plus 0.01% of the effective capital in excess of Rs.250 crores	24 Lakhs plus 0.01% of the effective capital in excess of Rs.250 crores

If Company wants to make payment of remuneration more than above mentioned limit than company can do the same by passing of "Special Resolution" in General Meeting of the Company.

Explanation.- It is hereby clarified that for a period less than one year, the limits shall be pro-rated.

(B) In case of a managerial person or other director who is functioning in a professional capacity:

If a managerial personnel or other director is functioning in professional capacity, remuneration as per item (A) may be paid, if the following conditions is satisfied:

- (i) they are not having any interest in the capital of the company or its holding company or any of its subsidiaries directly or indirectly or through any other statutory structures;
- (ii) not having any, direct or indirect interest or related to the directors or promoters of the company or its holding company or any of its subsidiaries at any time during the last two years before or on or after the date of appointment; and
- (iii) possesses graduate level qualification with expertise and specialised knowledge in the field in which the company operates.

Any employee of the company will not be deemed to be a person having interest in the capital of the company in the following circumstances:

- (i) If he holds shares of the company not exceeding 0.5% of its paid-up share capital under any scheme formulated for allotment of shares to such employees including Employees Stock Option Plan; or
- (ii) by way of qualification shares.

The benefits of the limits specified under items (A) and (B) can be availed if the following further conditions are satisfied-

- (i) payment of remuneration is approved by a resolution passed by the Board and, in the case of a company covered under section 178(1) also by the Nomination and Remuneration Committee;
- (ii) the company has not committed any default in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor, and in case of default, the prior approval of the bank or public financial institution concerned or the non-convertible debenture holders or other secured creditor, as the case may be, has been obtained by the company before obtaining the approval in the general meeting;
- (iii) an ordinary resolution or a special resolution, as the case may be, has been passed for payment of remuneration as per the limits laid down in item (A) or a special resolution has been passed for payment of remuneration as per item (B), at the general meeting of the company for a period not exceeding three years;
- (iv) a statement along with a notice calling the general meeting referred to in clause (iii) is given to the shareholders containing the information specified for this purpose.

This information is required to be given under four heads (i) General Information of the Company (ii) Information about the appointee (iii) Other information like reasons of loss or inadequate profits, steps taken or proposed to be taken for improvement, expected increase in productivity and profits in measurable terms etc. (iv) Disclosures in the Board's report.

Section III - Remuneration payable by companies having no profit or inadequate profit in certain special circumstances

Section III of Part II of Schedule V envisages further special circumstances where remuneration can be payable to a managerial person or other director in excess of the amounts provided in Section II above. These circumstances are enumerated as below:

- a. Where the remuneration in excess of the limits specified in Section I or Section II is paid by any other company and that other company is either:
 - Foreign Company or
 - has got the approval of its shareholders in general meeting to make such payment, and treats this amount as managerial remuneration for the purpose of section 197 and the total managerial remuneration payable by such other company to its managerial persons or other directors including such amount or amounts is within permissible limits under section 197.
- b. Managerial remuneration up to any amount permissible under Section II can be paid to the managerial persons or other directors of the following class of Companies :
 - Newly incorporated company, for a period of seven years from the date of its incorporation, or
 - Sick company, for which a scheme of revival or rehabilitation has been ordered by the Board for Industrial and Financial Reconstruction (BIFR) for a period of five years from the date of sanction of scheme of revival, or
 - Company in relation to which resolution plan has been approved by NCLT under Insolvency and Bankruptcy Code, 2016 for a period of 5 years from such approval.
- c. Where remuneration of a managerial person or other director exceeds the limits in Section II but the remuneration has been fixed by the BIFR or the NCLT, provided that the limits under this section shall be applicable subject to meeting of all the conditions specified under Section II and the following additional conditions:—
 - (i) except as provided in para (a) of this Section, the managerial person is not receiving remuneration from any other company;
 - (ii) the auditor or Company Secretary of the company or where the company has not appointed a Secretary, a Secretary in whole-time practice, certifies that all secured creditors and term lenders have stated in writing that they have no objection for the appointment of the managerial person or other director as well as the quantum of remuneration and such certificate is filed along with the return as prescribed under Section 196(4).
 - (iii) the auditor or Company Secretary or where the company has not appointed a secretary, a secretary in whole-time practice certifies that there is no default on payments to any creditors, and all dues to deposit holders are being settled on time.

For the purposes of Section I, Section II and Section III, the term or other director shall mean a non-executive director or an independent director.

Section IV - Perquisites not included in managerial remuneration

Section V - Remuneration payable to a managerial person in two companies:

Subject to the provisions of sections I to IV, a managerial person shall draw remuneration from one or both companies, provided that the total remuneration drawn from the companies does not exceed the higher maximum limit admissible from any one of the companies of which he is a managerial person.

Sitting Fees to Directors for Attending the Meetings [Section 197(5)]

A director may receive remuneration by way of fee for attending the Board/Committee meetings or for any other purpose as may be decided by the Board. However, the amount of such fees shall not exceed the amount as may be prescribed.

The Central Government through Rule 4 of the Companies (Appointment & Remuneration of Managerial Personnel) Rules, 2014 has prescribed that a company may pay a sitting fee to a director for attending meetings of the Board or committees and such sum as may be decided by the Board of directors shall not exceed one lakh rupees per meeting of the Board or committee thereof.

Sitting fees of Independent and Women Directors shall not be less than the sitting fees payable to other Directors.

Monthly Remuneration to Director or Manager

Permissible forms of Remuneration

A director or manager may be paid remuneration either by way of a monthly payment or at a specified percentage of the net profits of the company or partly by one way and partly by the other. [Section 197 (6)]

Commission or remuneration from holding or subsidiary company

Any director who is in receipt of any commission from the company and who is a managing or whole-time director of the company shall not be disqualified from receiving any remuneration or commission from any holding company or subsidiary company of such company.

However, the company is required to disclose this fact in the Board's report. [Section 197 (14)].

Additional compliances for payment of Managerial Remuneration in case of No Profits/ Profits are Inadequate

As per Section 200, in respect of cases where the company has inadequate or no profits, a company may fix the remuneration within the limits specified in the Companies Act, 2013, at such amount or percentage of profits of the company, as it may deem fit and while doing so, the company shall have regard to —

- (a) the financial position of the company;
- (b) the remuneration or commission drawn by the individual concerned in any other capacity;
- (c) the remuneration or commission drawn by him from any other company;

- (d) professional qualifications and experience of the individual concerned;
- (e) such other matters as may be prescribed.

As per Rule 6 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 for the purpose of item (e) of section 200, the company shall have regard to the following matters while granting approval:

Parameters for consideration of remuneration

The company shall have regard to the following matters, namely:-

- (1) the Financial and operating performance of the company during the three preceding financial years.
- (2) the relationship between remuneration and performance.
- (3) the principle of proportionality of remuneration within the company, ideally by a rating methodology which compares the remuneration of directors to that of other directors on the board who receives remuneration and employees or executives of the company.
- (4) whether remuneration policy for directors differs from remuneration policy for other employees and if so, an explanation for the difference.
- (5) the securities held by the director, including options and details of the shares pledged as at the end of the preceding financial year.

Disclosures

Disclosure in Board's Report regarding remuneration to Directors

Section 197(12) provides that every listed company shall disclose in the Board's report, the ratio of the remuneration of each director to the median employee's remuneration and such other details as may be prescribed.

According to Rule 5 of the Companies (Appointment and Remuneration of Managerial Personnel) Rule, 2014, every listed company shall disclose in the Board's report-

- the ratio of the remuneration of each director to the median remuneration of the employees of the company for the financial year;
- the percentage increase in remuneration of each director, Chief Financial Officer, Chief Executive Officer, Company Secretary or Manager, if any, in the financial year;
- the percentage increase in the median remuneration of employees in the financial year;
- the number of permanent employees on the rolls of company;
- average percentile increase already made in the salaries of employees other than the managerial personnel in the last financial year and its comparison with the percentile increase in the managerial remuneration and justification thereof and point out if there are any exceptional circumstances for increase in the managerial remuneration;
- affirmation that the remuneration is as per the remuneration policy of the company.

Explanation.- For the purposes of this rule.- (i) the expression “median” means the numerical value separating the higher half of a population from the lower half and the median of a finite list of numbers may be found by arranging all the observations from lowest value to highest value and picking the middle one; (ii) if there is an even number of observations, the median shall be the average of the two middle values.

The board’s report shall include a statement showing the names of the top ten employees in terms of remuneration drawn and the name of every employee, who-

- if employed throughout the financial year, was in receipt of remuneration for that year which, in the aggregate, was not less than one crore and two lakh rupees;
- if employed for a part of the financial year, was in receipt of remuneration for any part of that year, at a rate which, in the aggregate, was not less than eight lakh and fifty thousand rupees per month;
- if employed throughout the financial year or part thereof, was in receipt of remuneration in that year which, in the aggregate, or as the case may be, at a rate which, in the aggregate, is in excess of that drawn by the managing director or whole-time director or manager and holds by himself or along with his spouse and dependent children, not less than two percent of the equity shares of the company.

The statement referred above shall also indicate -

- (i) designation of the employee;
- (ii) remuneration received;
- (iii) nature of employment, whether contractual or otherwise;
- (iv) qualifications and experience of the employee;
- (v) date of commencement of employment;
- (vi) the age of such employee;
- (vii) the last employment held by such employee before joining the company;
- (viii) the percentage of equity shares held by the employee in the company within the meaning of clause (iii) of sub-rule (2) above; and
- (ix) whether any such employee is a relative of any director or manager of the company and if so, name of such director or manager:

Provided that the particulars of employees posted and working in a country outside India, not being directors or their relatives, drawing more than sixty lakh rupees per financial year or five lakh rupees per month, as the case may be, as may be decided by the Board, shall not be circulated to the members in the Board’s report, but such particulars shall be filed with the Registrar of Companies while filing the financial statement and Board Reports:

Provided further that such particulars shall be made available to any shareholder on a specific request made by him in writing before the date of such Annual General Meeting wherein financial statements for the relevant financial year are proposed to be adopted by shareholders and such particulars shall be made available by the company within three days from the date of receipt of such request from shareholders:

Provided also that in case of request received even after the date of completion of Annual General Meeting, such particulars shall be made available to the shareholders within seven days from the date of receipt of such request.

The auditor of the company shall, in his report under section 143, make a statement as to whether:

- (i) the remuneration paid by the company to its directors is in accordance with the provisions of Section 197.
- (ii) whether remuneration paid to any director is in excess of the limit laid down under this section and give such other details as may be prescribed.

The following disclosures is required to be mentioned in the Board of Director's report under the heading "Corporate Governance", if any, attached to the Financial statement as per Schedule V of the Companies Act, 2013:

- (i) all elements of remuneration package such as salary, benefits, bonuses, stock options, pension, etc., of all the directors;
- (ii) details of fixed component. and performance linked incentives along with the performance criteria;
- (iii) service contracts, notice period, severance fees; and
- (iv) stock option details, if any, and whether the same has been issued at a discount as well as the period over which accrued and over which exercisable.

Disclosure of Remuneration in terms of SEBI (LODR) Regulations, 2015

Regulation 17(6)(ca) - Remuneration payable to a single Non-Executive Director

The approval of shareholders by special resolution shall be obtained every year, in which the annual remuneration payable to a single non-executive director exceeds fifty per cent of the total annual remuneration payable to all non-executive directors, giving details of the remuneration thereof.

Regulation 17(6)(e) - Remuneration payable to Executive Directors who are promoters or members of the promoter group

Requires the listed entity to obtain the approval of the shareholders by special resolution in general meeting, if-

- (i) the annual remuneration payable to such executive director exceeds rupees 5 crore or 2.5 per cent of the net profits of the listed entity, whichever is higher; or
- (ii) where there is more than one such director, the aggregate annual remuneration to such directors exceeds 5 per cent of the net profits of the listed entity: Provided that the approval of the shareholders under this provision shall be valid only till the expiry of the term of such director.

Explanation: For the purposes of this clause, net profits shall be calculated as per section 198 of the Companies Act, 2013.

Insurance Premium not part of Remuneration

Where any insurance is taken by a company on behalf of its managing director, whole-time director, manager, Chief Executive Officer, Chief Financial Officer or Company Secretary for indemnifying any of them against any liability in respect of any negligence, default, misfeasance, breach of duty or breach of trust for which they may be guilty in relation to the company, the premium paid on such insurance shall not be treated as part of the remuneration payable to any such personnel.

However, if such person is proved to be guilty, the premium paid on such insurance shall be treated as part of the remuneration. [Section 197(13)].

Penalty for Contravention

If any person makes any default in complying with the provisions of this section, he shall be liable to a penalty of one lakh rupees and where any default has been made by a company, the company shall be liable to a penalty of five lakh rupees.

Refund of Remuneration in certain cases

Section 197(9) stipulates that if any director draws or receives, directly or indirectly, by way of remuneration any such sums in excess of the limit prescribed or without approval required under this section, he shall refund such sums to the company, within two years or such lesser period as may be allowed by the company, and until such sum is refunded, hold it in trust for the company.

Further Section 197(10), restricts the company from waiving off the recovery of any sum refundable to it under sub-section (9). However, waiver can be done by the company within 2 years from the date the sum becomes refundable, after obtaining approval of shareholders by special resolution.

Where the company has defaulted in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor, the prior approval of the bank or public financial institution concerned or the non-convertible debenture holders or other secured creditor, as the case may be, shall be obtained by the company before obtaining approval of such waiver.

Recovery of Managerial Remuneration in Certain Cases

Section 199 of the Companies Act, 2013 provides for recovery of remuneration including stock options received by the specified Managerial Personnel, where the benefits given to them are found to be in excess of what is reflected in the restated financial statements.

It states that without prejudice to any liability incurred under the provisions of the Companies Act, 2013 or any other law for the time being in force, where a company is required to re-state its financial statements due to fraud or non-compliance with any requirement under the Companies Act, 2013 and the rules made there under, the company shall recover from any past or present managing director or whole-time director or manager or Chief Executive Officer (by whatever name called) who, during the period for which the financial statements are required to be re-stated, received the remuneration (including stock option) in excess of what would have been payable to him as per restatement of financial statements.
