AKG ADVISORY LLP

Corporate and Legal Consultancy Firm

Common Errors in Compliance of The Companies Act

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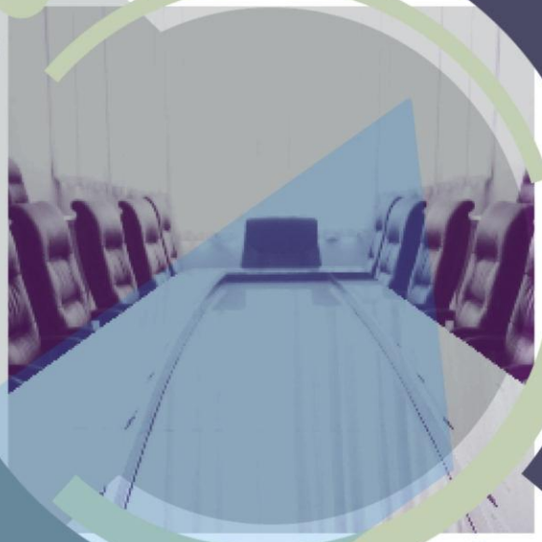

1. **Maintaining books of account at a place other than registered office and resolution by Board of Directors, in form AOC-5, is ignored or never considered.**

   Companies Act, 2013 requires, every company to maintain statutory records including books of account at the registered office of the company. Invariably registered office is like a virtual office or an address simply provided by respective chartered accountant or lawyer involved in the company formation and

accounts books are maintained at functional business address (whether factory / main or corporate office or otherwise where all Directors sit, normally). In general, only few companies pass a resolution in board meeting to this effect and as such a resolution is required to be passed and requires to be filed in 7 days thereof to the MCA. The books can be maintained at any address in India and it's not required to be in the same city where registered office of the company is situated.

Consequence - compounding of offense and filing of form with applicable filing fee. The liability will extend to company and its Directors.

2. **Maintaining registered office of over twenty companies at one address.**

   With new regulation, any address can at the best house 20 registered office addresses and not beyond. Also the office should be actual and not virtual for name sake. Earlier it was when allowed then it was a standard practice to show CA office as registered office. Hence now the company should ensure their registered office at a place where this is factual and any official communication could be sent or received there.

   Consequence - show cause notice and correction of error at the earliest. Only if it is proven that company is trying to take it leniently, then compounding of non compliance.

3. **Non-recording the RPT.**

   A related party is a party related to a body corporate in any other way other than by the companies' own transactions. It means that a special relationship

persists between the parties even before the transaction takes place, such as:

a. Director or a key Managerial person or their relatives or

b. A firm, private company in which the partner, Director/ Manager or his relative is a partner or

c. A private company or a public company in which a Director or Manager is a Director and holds along with his relatives, more than 2% of its paid-up share capital.

The definition also includes:

a. anybody corporate whose Board of Directors, Managing Director or Manager is accustomed to act in accordance with the advice, directions or instructions of a Director or Manager and

b. any person on whose advice, directions or instructions a Director or Manager is accustomed to act as related party transactions.

The provisions of related party transactions are applicable to private and public companies.

Related Party Transactions are not banned per se. They are regulated by certain conditions as provided in Section 188 of the Act, by the means of which they can be disclosed to the Board and shareholders for them to ratify. If the transactions fall within the meaning of Section 188, then these need to be disclosed in the Board Report for prior approval. A justification is required to be given in support of the transactions. If the transactions are beyond the threshold limits,

then they need to be disclosed in the General Meeting for approval by special resolution.

Consequences of Non-Compliance:

- **Agreements voidable:** Where any contract or arrangement is entered into by a Director or any other employee, without the consent of the Board or approval by a special resolution in the general meeting and if it is not ratified by the Board or by the shareholders within three months from the date on which such contract is made, then such contract or arrangement shall be voidable at the option of the Board.
- **Indemnification:** If such a contract or arrangement is with a related party to any Director, or is authorised by any other Director, the Directors concerned shall indemnify the company against any loss incurred by it.
- The company can also proceed against such Director or any other employee who had entered into such contract or arrangement in contravention of the provisions of this section for recovery of any loss sustained by it as a result of such contract or arrangement.
- Penalties for a Director or any other employee in violation of the provisions of Section 188 of the Act:

  i. **Listed company:** Punishment of imprisonment for a term upto 1 year or with fine from INR 25,000 upto INR 5 lacs, or both.

Other companies: fine of INR 25,000 upto INR 5 lacs

4. **Maintaining minutes unsigned or compiling them at one go for a period and piling them later to sign and that too by same PEN / Color of PEN and if need arises to amend it retrospectively.**

Normally minutes for Directors meeting are expected to be drafted and sent to Chairman for its vetting and acceptance and recorded post finalization within periodical basis. These continue to be piled up in a family owned company and one day when compliances need to be completed these are put for signatures by the Chairman at one go. If any documents or more than one document are signed on different dates, it's invariable that pen ink, flow and pattern will change. However since in this case all minutes for a year or few meetings together, are given for signature, the signing person never changes the pen and signs all sheets with same pen. By doing so it is an ample proof that the papers are compiled just for compliances and not made in normal course and also there is no meeting which actually happened, but for papers formality minutes are compiled and signed. Such minutes will also be questionable in court of law. Unfortunately, such practices have initiated the wrong or week secretarial practices.

5. **Appointment of Company Secretary where capital is over 10 crores.**

In most of family owned companies, even if paid up capital of the company is over Rs 10 crores (Limit for appointing CS was revised by MCA w.e.f from 01-04-2020 and was raised from 5 crores to 10 crores), no company secretary was employed. As per the Companies Act 2013, such companies need to have a whole-time company secretary and the annual

accounts need to be signed by two Directors and company secretary on record. In most of cases, this is not followed and taken very lightly, since so far ROC has not been strict about this compliance (probably qualified company secretaries in number are not adequate).

Consequence - compounding of non-compliances including financial penalties.

6. **Stationery / name board / invoices / Letterheads etc. without CIN / phone numbers / website address.**

Under Companies Act 2013, there is a requirement of putting sign board, company number, company website, and other similar details on various media of documentation. This requirement is for public awareness and transparency. Since it is not actively verified or non-compliances are not being penalized or seek clarification, hence by ignorance, these are not adhered.

Consequence - a notice from competent authorities, to get it rectified including show cause notice.

7. **Giving leave of absence throughout year without realizing that at least one board meeting is needed to be attended to continue to be on the board.**

In earlier Companies Act, a Director could have been non present in meeting with a leave of absence applied. Hence there are instances where a Director in his stint of directorship has not attended even one board meeting. Now in the new act promulgated in 2013, the law expects all Directors to attend at least one meeting in a year and if they abstain then after one year of abstaining, it is deemed that the said Director

has vacated the seat and he is not entitled to continue as Director. Hence as a common error, most of family owned companies typically write leave of absence and assume the said leave of absence allow them to continue a part of board, which is incorrect .

Consequence - compounding of non-compliance.

8. **Holding a namesake shareholder meeting (AGM) without adequate number of shareholders, required for quorum, present in meeting.**

Most of companies which are family owned / closely held just do a namesake shareholders meeting, where they show presence of both shareholders (even if one of them is out of country). Sometime they show a proxy of the shareholder who is out of country, but with one proxy and one shareholder, it does not make a proper quorum under the Companies Act, 2013. Result is if quorum is not there, then any agenda item which needs to be passed, cannot be passed and the AGM will not amount to be held properly as per the Companies Act, 2013. Promoter Directors and management hardly care for this kind of non-compliance.

Consequence - Compounding of not holding AGM properly and decisions taken in the meeting can be challenged by outside agencies etc. if they so desire as part of natural justice.

9. **Regularization of additional Director in AGM.**

In case if the company wishes to regularize the additional Director in the annual general meeting, it can do so by passing a resolution to the extent. If the shareholders approve the resolution in the annual general meeting, then the additional Director will be

appointed as normal Director and Form DIR 12 needs to be filed within 30 days from the date of annual general meeting intimating the designation change of the additional Director. However as a common error many a times the management misses to regularize the Additional Director and he/she continues to show as an additional Director on the MCA portal. In case the person is not regularized by the shareholders then also DIR-12 for her vacation of office is required to be filed.

Consequence - Penalty and non-compliance.

10. **Not recording beneficial ownership of shares in statutory registers.**

Statutory Registers are the registers which contain the specific record of the company's shareholders, Directors, beneficial owners, deposits, loan & guaranty etc. and are placed at the Registered Office of the Company. Company is required to maintain the Register and Index of Beneficial Owners in which entries shall be made for the beneficial owner of the shares of the Company where the share certificates are issued in the name of some other person. There is no format as such for Index and rest things are all similar to Register of Members. The common error is that mostly companies ignore or miss to maintain this register of beneficial ownership.

Consequence - it is always advised to maintain the Statutory Registers for good corporate governance and to avoid the penalties.

11. **Stamping of share certificates under state stamp act.**

Share certificate being an instrument requires stamping as per the Indian Stamp Act. Stamp duty

on share certificate is a state matter and delay in payment of stamp duty attracts penalty. Stamp duty is to be paid first at the time of incorporation on share certificate issued to the subscribers and thereafter on every further allotment of shares. Common error made by companies is that they either are not serious about getting the share stamping done on time or simply forgoing the procedure.

Consequence - In case of non-payment of stamp duty or evasion of payment of stamp duty on the issue of share certificate in case of allotment of share, the company shall be liable for heavy penalty under the Act, which may extend to 10 times of the duty.

12. Stamp duty on share transfers.

Whenever there is a transfer of Shares of the Company, the Company needs to register a transfer in its records based on the Share Transfer form SH-4 submitted by the Shareholder to the company. The stamp duty is applicable at 25 paise for every Rs. 100 or part thereof of the value of the share and accordingly share transfer stamps need to be affixed to the SH-4 for complete compliance. The common error that happens is that share transfer stamps are not affixed to the share transfer forms often while executing the same. Where any default is made in complying with the provisions related to transfer of shares, the company shall be punishable with fine which shall not be less than INR 25,000/- but which may extend to INR 5,00,000/- and every officer of the company who is in default shall be punishable with fine which shall not be less than INR 10,000/- but which may extend to INR 1,00,000/.

13. Signing of share certificates by less than three persons.

Pursuant to the Rule No. 5(3) of The Companies (Share Capital and Debentures) Amendment Rules, 2018 every share certificate shall be issued under the seal, if any, of the company, which shall be affixed in the presence of, and signed by two Directors duly authorized by the Board of Directors of the company for the purpose or the committee of the Board, if so authorized by the Board; and the secretary or any person authorised by the Board for the purpose. Hence the Companies should be vigilant in getting signatures of 3 persons on every share certificate signed by 2 Directors and one Authorised signatory.

14. Gap of more than 120 days between 2 board meetings.

It is mandatory for a Company to hold minimum of 4 Board Meeting every year and not more than 120 days shall intervene between two consecutive Board Meeting. Sometimes the Management misses out to hold the meetings with the given period.

Consequences - Default in holding the meeting on time calls for a major non-compliance and the company might have to go for compounding of the same.

15. Gap of more than 15 months between two AGMs.

If a corporate fails to comply with the provisions of Section 96 i.e., does not hold its AGM within the prescribed time then the NCLT under Section 97 of the Act of 2013 is empowered to call or direct the calling of AGM of such company on the application of any member of the company. Where a company fails to hold its AGM within the prescribed time period or

even where an order for holding of AGM is passed by a tribunal under section 97 then the company and every other officer of the company acting on its behalf and are in default will be punishable with fine which may extend to INR 1,00,000/- and in case of continuing default with a further fine which may extend to INR 5000/- per day during the continuance of such default.

16. Non recording of start time and conclusion time of meetings in the minutes.

Whenever a company holds its Board meeting or General Meeting, it must record the start and end time of the meeting precisely in its minutes. Many a times it is noticed that companies skip to record these details in record. It is important to note the details as in case another meeting of a group company having common Directors is held on the same day then it is easy to understand at what time the meetings of both entities were held. Also it is a compulsory compliance and business ethics to record the information as per the Secretarial Standards.

17. Non-filing of form PAS-3 for conversion of Debentures into equity.

Many a times it happens that a company issues convertible Debentures which are convertible after a certain period of time. The Debenture holders automatically become shareholders of the company by virtue of the terms mentioned in the debentures. In such a scenario it is the responsibility of the company to file form PAS-3 for allotment of Equity shares. In case the company's management misses to file the form then it becomes a default under section 39(5) of the companies act.

Consequences - As per Sec 39(5) the company and its officer who is in default shall be liable to a penalty, for each default, of one thousand rupees for each day during which such default continues or one lakh rupees, whichever is less.

18. Non- appointment of First auditors within 30 days from the date of incorporation.

Once a company is incorporated, it's the responsibility of Board to appoint the First auditor within 30 days of Incorporation. In case of Board's failure, an EGM shall be called within 90 days to appoint the first auditor. The law is silent regarding from when this time limit of 90 days be reckoned, it is better to take a stricter view and interpret that the 90 days limit starts from Incorporation rather than expiry of 30 days.

Consequence - If the First Auditor is not appointed in time then the Company needs to hold an EGM within 90 days and appoint the First Auditor.

19. Non- receipt of share capital amount within 60 days from the date of incorporation.

There are many instances where the share capital money is not received within the prescribed period of 60 days. However keeping view of such non compliance the new requirement of Certificate of Commencement of Business had been introduced w.e.f where by a Company needs to file Form 20A within 180 days after incorporation to obtain Commencement of business. In order to file this form the Company needs to attach the bank statement showing the receipt of share capital from all shareholders. Non compliance in filing this form could attract heavy penalty. Hence companies should

be extra cautious with receiving the money from the shareholders in the account within the said period of 60 days.

Consequences - The penalties for non-compliance in filing the form are very high which has been done intentionally so as to curb out the number of shell companies incorporated. Following are the penalties for non-compliance:

- **Penalty to be levied on the company:** A penalty of Rs 50,000 will be levied on the company if it fails to comply with the mentioned requirement.
- **Penalty to be levied on the officers:** Every such officer in default shall be liable to a penalty of Rs 1,000 per day for each day during which the default continues subject to a maximum of Rs 1,00,000.
- **Company strike-off:** If the Registrar has reasonable grounds to believe that the company is not carrying on any business or operations even after 180 days of incorporation, the registrar may remove the name of the company from the Register of companies.

20. Use of share application amount before actual allotment of shares.

Where a company invites for subscription of shares in form of Private placement then such company pursuant to section 42(6) shall allot its securities within sixty days from the date of receipt of the application money for such securities.

Provided that monies received on application under this section shall be kept in a separate bank account in a scheduled bank and shall not be utilised for any

purpose other than—

(a) for adjustment against allotment of securities; or

(b) for the repayment of monies where the company is unable to allot securities.

Consequences - As per 42 (10) If a company makes an offer or accepts monies in contravention of this section, the company, its promoters and Directors shall be liable for a penalty which may extend to the amount involved in the offer or invitation or two crore rupees, whichever is higher, and the company shall also refund all monies to subscribers within a period of thirty days of the order imposing the penalty.

21. Non- issue of shares within 60 days from the date of receipt of share application money.

Pursuant to Sections 62 & 42 and Rule 13 of Companies (Share Capital and Debentures) Rules, 2014 any company making an offer or invitation, shall allot its securities within 60 days of the receipt of application money and if the company is not able to allot the securities within that period, it shall repay the application money to the subscribers within 15 days from the date of completion of 60 days and if the company fails to repay the application money within the 15 days, it will have to repay that money with interest at the rate of 12% per annum from the expiry of the 60th day.

Consequences - If the shares are not allotted within the prescribed period then the company becomes liable to repay the money back to the investors and is not returned within the prescribed period, it shall be liable to pay an interest of 12% on such amount of refund.

22. Share certificates to be issued within 60 days from the date of allotment.

Unless prohibited by any provision of law or any order of Court, Tribunal or other authority, every company shall deliver the certificates of all securities within following timelines:

(i) To subscribers of memorandum of association—within 2 months from the date of incorporation,

(ii) To allotees (shares)—within 2 months from the date of allotment,

(iii) To transferee—within 1 month from the date of receipt of instrument of transfer or intimation of transmission,

(iv) To allotees (debentures)—within 6 months from the date of allotment.

If the securities are dealt with in a depository, the company shall intimate the details of allotment of securities to depository immediately on its allotment [Section 56(4) of the Act].

Consequences - Where a company makes any default in complying with provisions relating to issue of share certificates, such company would be punishable with a fine that wouldn't be less than INR 25,000 but could extend to INR 5,00,000 and every defaulting officer of such company would be punishable with a fine that wouldn't be less than INR 10,000 but could extend to INR 1,00,000.

23. Donation- no resolution is passed in the general meeting if the donation is more than 5% of the net profit.

Any private limited company may contribute in form of Donation to charitable trust of funds. However many a times companies miss to pass an ordinary resolution in a General meeting approving such donations. Pursuant to section 181 of the Companies Act, 2013 the Board of Directors of a company may contribute to bona fide charitable and other funds provided that prior permission of the company in general meeting shall be required for such contribution in case any amount the aggregate of which, in any financial year, exceed five per cent (5%) of its average net profits for the three immediately preceding financial years.

24. CSR applicability.

Corporate Social Responsibility (CSR) - A company becomes liable for CSR where the Company's net worth is Rs.500 Cr or more, or turnover is Rs.1000 Cr or more or a net profit is Rs. 5 Cr or more during the immediately preceding financial year.

Once a company is covered under the ambit of the CSR, it shall be required to comply with the provisions of the CSR -Section 135(1), required to do the following activities-

- Constitute CSR Committee
- Board's report shall disclose the compositions of the CSR Committee
- Spend 2% of Average Net Profits of the last 3 years on CSR activities

Section 135 does not lay down any penal provision in case a company fails to spend towards CSR activities. However, Section 135(5) provides that in case the company fails to spend such amount, the Board shall specify in its report reason for not spending the amount under Section 134(3)(o).

Consequence - A company is mandatorily required to mention the reason for non spending of amount as applicable for CSR in the Board's report which in itself proves to be non-compliance and the.

25. Commencement of business to be filed within 180 days.

"Commencement of Business" is a Declaration to be issued by the Directors within 180 days of incorporation of company stating that the subscribers to the Memorandum of the company has paid the value of shares so agreed by them, along with a verification of registered office address of the company. This declaration need to be filed along with proof of subscription money received by the company in form 20A with the Registrar of Companies.

Consequences - Any company which defaults in filing the commencement of business form within time shall be liable to penalty as follows:

- 50,000/- for Company
- 1000/- per day for defaulting Directors (maximum Rs. 1,00,000/-)
- Registrar can remove the name of the company

Compiled By:

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It is our constant endeavour
to create effective and useful awareness.

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