THE INDIAN LAW INSTITUTE, NEW DELHI

Seminar

On

Company Law

May 1970

REGULATION OF MANAGERIAL REMUNERATION UNDER THE COMPANY LAW

By

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One of the main objectives of Company Law in our country has been to promote efficient and honest management and reduce concentration of economic power. From time to time Government has sought to regulate appointment and terms and conditions of managerial personnel and their remuneration. This has been done by providing certain ceilings on remuneration payable by a company to its managerial personnel. Under the two-tier system of corporate management, a company generally has a Board of Directors which is primarily concerned with policy laying and overall supervision, and a managerial personnel who enjoy substantial powers of management in relation to company and their responsibility for execution of the policies laid down by the Board of Directors. Thus managerial services are provided by both the Directors and the managerial personnel and managerial remuneration includes payment for both type of managerial services.

In the absence of any provision in the Articles, Directors have no right to be paid for their services and cannot pay themselves or each other, or make presents to themselves, out of the company's assets, unless authorised to do so by the instruments which regulate the company or by the shareholders at a properly convened meetting. In Re. George Newman & Co.[1]

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1. (1895) I Ch. 674: C.A.

This position has recently been emphasized by Rajasthan High Court in Radhey Shyam & Others v. Official Liquidator.[2] If the Articles of a company provide for payment of remuneration, the directors can sue for it. Though a bye-law of a limited company provides that the services of a director are gratuitious, this could not prevent the director who holds the office of the secretary from claiming the benefits which are expressly conferred by another by-law on the secretary. R.Ganesh Aiyar v. Lakshmi Building Cooperative Society.[3] A director of a company in such a case enjoys a dual position i.e. (i) he is a director of the company and (ii) he is an employee of the company; and as an employee of the company he has got every right to claim remuneration for services performed. But a director is not entitled to any remuneration over and above that fixed by the Articles for doing an act which could be his duty to do and as such the director of a company formed, inter alia, with the object of promoting other companies, who was entrusted with the work of selecting directors for another country and of its registration and promotion, is not entitled to additional remuneration. Dikshit & Co. Ltd. v. Mathura Prasad.[4] It should be noted that after passing of a resolution to sell the undertaking and assets of the company, the directors' duties are diminished does not disentitle them to remuneration. In Re. Consolidated Nickel Mines Ltd.[5]

The usual method of remuneration to a director is a fee for attending meetings of the Board, but some companies remunerate their directors by a monthly salary while in still others a commission on profit in addition to the fee or the monthly salary is paid. It is for the company to decide how its directors should be remunerated but the law makers have laid down certain ceilings on remunerations of directors and other managerial personnel so that company's funds may not be watered down for the benefit of those who are at the helm of its affairs.

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2. (1969) 39 Comp. Cas. 340

3. (1937) 7 Comp. Cas. 145.

4. (1925) I.L.R. 47 All. 94.

5. (1914) 1. Ch. 883.

The regulation of managerial remuneration was first thought of in 1936 when the Companies Act 1913 was amended by adding Section 87C. Section 87c required that the remuneration of managing agent should be a sum based on a fixed percentage of the net annual profit of the company with provision for a minimum payment in the case of absence of or inadequacy of profits, together with an office allowance to be defined in the agreement of management. Payment of remuneration in any other form required sanction by a special resolution of the company. This section also provided some guidelines for the purpose of calculating net profit. In 1951 another section was added i.e. 8700 which provided that no amendment of Articles or agreement of management which purports to increase managerial remuneration would be valid unless approved by the Central Government. These provisions were not to apply to private companies which were not subsidiaries of a public company.

The 1956 Act places further restrictions on manaterial remuneration. It prescribes an overall limit for managerial remuneration which, according to section 198, should not exceed 11% of the net profit of a company and in case of inadequacy of profits it can go up to Rs.50,000/- This does not include any remuneration payable to directors for the services rendered which are of professional nature and the director, in the opinion of the Central Government, possesses the requisite qualifications for the practice of the profession; and fees for attending meetings of the Board or a committee thereof. Where remuneration is paid on the basis of monthly salary and the Central Government is satisfied that for the efficient conduct of a company, minimum remuneration of Rs.50,000/- per annum is insufficient, it may, by order, sanction an increase to such sums, for such period and subject to such conditions, if any, as may be specified in the order. Upto 1960, it was not very clear whether the remuneration included perquisites This lacuna of Company law was subject to adverse comment in a Bombay High Court judgement i.e. Remaben A. Thanawala v. Jyoti Ltd.[6] According to the learned court, provisions of the act governing managerial remuneration were badly drawn up. This question was studied by the Companies Act Amendment Committee(1957) according to which "these perquisities undoubtedly have a money value and in some cases might be converted into their money equivalent.

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6. A.I.R. 1958 Bom. 214.

From the point of view of the company, perquisites allowed to directors are part of the consideration paid by the company for their services and the cost of providing them has an effect on a company's profits exactly similar to the payment of the monthly cash salary. On the other hand, from the point of view of the recipient, they formed part of the consideration for his services and the position is more advantageous to him than if the money equivalent of the perquisites had been paid in cash and expended by him for the various amenities provided. The existing provisions are, capable of being construed as referring to cash payment alone. In our view, there is no reason in principle for ignoring these perquisites for evaluating the remuneration."[7] Accordingly, an explanation to Section 198 was added which provides that remuneration shall include:-

a) Any expenditure incurred by the company in providing rent free accommodation, or any other benefit or amenity in respect of accommodation free of charge;

b) Any expenditure incurred by the company in providing any other benefit or amenity, free of charge, or at a concessional rate;

c) Any expenditure incurred by the company in respect of obligation or service which, but for such expenditure by company, would have been incurred by the managerial personnel; and

d) Any expenditure incurred by the company to effect any insurance on the life of, or to provide any pension, annuity or gratuity for, any of the managerial personnel or his spouse or child.

It may be noted that provisions regarding managerial remuneration are applicable only in case of a public company or a private company which is a subsidiary of a public company the same position as was there in 1913 Act.

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7. Page 67 of the Report.

Subject to the overall limits prescribed by section 198, the remuneration of directors should not exceed 1% of the net profits of a company, if the company has a managerial personnel; and 3% of the net profits if there is no such managerial personnel. Section 309 which regulates remunerations of a director also provides that for professionally qualified directors, if they provide professional services to the company, additional remuneration can be paid which will be free from all the legislative ceilings. The remuneration of a director who is either in the whole-time employment of a company or a managing director can go up to 5% of the net profits for one such director, and if there is more than one such director 10% for all of them together; this limit can be exceeded with the approval of the Central Government. Such a director may be remunerated either by way of a monthly salary or a specified percentage of the net profits of the company, or parity by one way and partly by the other. Sub-section (iv) of Section 309 provides that a director who is neither in the whole-time employment of the company nor a managing director may be remunerated either (a) by way of a monthly, quarterly or annual payment with the approval of the Central Government, or (b) by way of commission if the company by a special resolution[8] authorises such payment. The limits to remuneration of director (i.e. 1% or 3% as the case may be) can be exceeded by company in General Meeting by the approval of the Central Government. If a director receives remuneration in excess of these limits, he is bound to refund such sums to the company and until such sum is refunded, he holds it in trust for the company. The company is not allowed to waive the recovery of any such refundable sum. Sub-section (6) disallows payment from a subsidiary of a company to a director who is in receipt of any commission from the company and who is either in the whole-time employment of the company or managing director..

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8. According to sub-section(7) this resolution shall not remain in force for more than 5 years; but may be renewed from time to time, by a special resolution for further period of not more than 5 years at a time; but the renewal should not be effected earlier than one year from the date on which it is to come into effect.

The question whether remuneration of the director include remuneration payable for other services as well has now been settled with the amendment of Section 309 and has been brought in tune with Bombay High Court decision in Ramaben A. Thanawala v. Jyoti Ltd.[9] which has taken the view that Section 198 and 309 cover only remunerations for managerial service and as such the remuneration received in technical capacity is not to be included in the managerial remuneration for the purpose of these ceilings.

Section 310 requires that every increase in remuneration of directors (including managing or whole-time directors) must be approved by the Central Government; but such approval is not needed for increasing the sitting fees of the Board or a committee thereof provided the amount of such fee after such increase does not exceed Rs.250/-

Certain companies may increase the remuneration of managing directors on re-appointment. Such increases also require Central Government sanction under Section 311.

Remuneration of managing agent and secretaries and treasurers (which now stand abolished) were governed by Sections 348 and 381 respectively. With the overall limits prescribed in Section 198, the remunerations could go up to 10% of the net profits increase of managing agents and up to 7½% in the case of secretaries and treasurers with a provision for Rs.50,000/- minimum in case of inadequacy of profits.

Section 349 prescribes guidelines for determining net profits for computing the managerial remuneration. Profits by way of premium on shares and debentures, profits on sale of forfeited shares, profits of capital nature and profits from sale of immovable property are not regarded as profits of the company for this purpose. Bounties and subsidy received from any Government or any public authority are deemed to be items of profits. The various sums deductable from profits are mentioned in sub-section (4) of section 349 and section 350 provides that depreciation should be charged as allowed under the Income-Tax Act 1961.

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9. (1957) 27 Comp. Cas. 105; A.I.R. 1958 Bomb. 214

According to Section 351 where there is an arrangement between two of more companies to share their profits and not less than two of those companies have the same managing agent, any profits paid in pursuance of the arrangement by any of the companies having that managing agent to any other or others of them shall-

a) be excluded from the net profits of the company making such payment; and

b) by included in the net profits of the company receiving such payments or where more than one company receives such payment, be included in the net profits of each of the receiving companies, to the extent of the payment received by it.

Since there is no mention of common managing/whole-time director, this section has lost its significance with the abolition of managing agency system.

In the administration of Company Law, the Central Government has been assisted by an Advisory Commission which was constituted in terms of Section 410 of the Companies Act 1956. This Advisory Commission was abolished in 1965 and replaced by an Advisory Committee for advising the Central Government relating to fixation of remuneration for managing directors, whole-time directors and managers. The Commission laid down the following principles in the year 1956-57:-

a) For fixing the remuneration of such managerial personnel, regard should be had generally to the financial resources of the company, its dividends recorded, turn-over, size of the unit and the nature of the business. The extent of of the managing directors' interest in the company and the responsibilities shouldered by them should also be taken into consideration.

b) Proposals for increase in sitting fees of directors or fixed conveyance or other allowances should be considered on merit of each case. In such cases, ordinarily, the judgement of the shareholders is the guiding factor except where the increase proposed is prima facie grossly excessive having regard to the previous scales of fees and allowances.

c) Proposals involving payments to managing directors in excess of the statutory limits laid down by Section 198, in cases of absence or inadequacy of profits, should be considered after taking into consideration the following factors:-

i) The multitude of the company;

ii) The nature and extent of its operations;

iii) The number of managing directors and power assigned to them;

iv) Whether the remuneration proposed is necessary for the efficient managing of the company having regard to the considerations enumerated above; and

v) Such other factors as would make it inequitable to apply the limit of Rs.50,000/- in the particular case.

d) Directors of a company who are also directors or partners of the managing agent should not ordinarily be permitted to receive any separate remuneration from the managed companies by way of stipulated commission on net profits or otherwise.

e) The Commission did not object to payment of commission on net profits to non-working directors in accordance with Section 309(4) of the Act provided that the directors have been getting such a commission before or the commission is satisfied about the responsibilities shouldered by the directors that payment of such a commission is only fair and equitable. The Commission, however, stipulated that the commission so paid should be divided equally between all the directors or in such proportion as the directors may unanimously decide in each case.

f) Managing directors, who were in receipt of monthly salaries and commission on net profits should not be allowed to draw any additional guaranteed minimum remuneration besides their monthly salaries in the event of absence or inadequacy of profits. Similarly, the commission on net profits payable to the ordinary directors should not be subject to any stipulated minimum remuneration.

Some further guidelines were laid down by the Commission in 1957-58 which allowed payment of bonus to directors and managers of a company if it is on the same rate as allowed to other employees of the company. The interest of the company continued to be the main guiding factor, and each proposal was judged by the Commission from the point of view of whether or not its acceptance would leave sufficient incentive with the person concerned for the better working of the company.

These guidelines were further revised by the Advisory Commission in 1958-59. It was laid down that the remuneration by way of salary and commission payable to managing/whole-time director or manager should not ordinarily exceed Rs.1,20,000/- per annum. Even if the total managerial remuneration was well within the ceiling of 11% of the net profits of the company as laid down in Section 198 or 5% as allowed under Section 309, normally, fixed monthly payments should not be allowed to directors nor are rendering any specific service to the company.

In 1959-60, payment of fixed amount as travelling and halting allowances was discontinued and the Commission recommended reimbursement of actual expenses instead. In 1960-61, guaranteed commission payable to managerial personnel was also brought within the regulatory framework of the company law and ceilings were laid down for such payments. For Foreign nationals appointed as managing/whole-time directors or managers of public companies, some guidelines were laid down for the first time. In cases of this type where due to dearth of adequately qualified people in this country or for other valid reasons it was absolutely essential for the company to appoint a foreigner to be in charge of the management of the company, the Commission considered it necessary to deviate from the pattern of remuneration allowed in respect of the companies of comparable size not involving foreign collaboration or foreign participation. The criteria for determining the amount of remuneration in such cases were:-

i) Qualifications and business experience of the foreign national in question;

ii) The size of the company;

iii) The anticipated profit-earning capacity of the company;

iv) The status and position of the person under his previous employer;

v) The net remuneration earned by him in his previous position; and

vi) The standard of living and the average level of income in the country of origin.

In 1963-64, the Commission felt that in the light of restrictions being gradually imposed on the remuneration payable to the managing/whole-time directors or managers, in the context of socio-economic policy of the Government, it was desirable to impose some restrictions on the perquisites which were allowed to such personnel. The Commission did not favour the practice of varying pattern of remuneration during mid-term and discouraged this practice.

The ceiling of Rs. 1,20,000/- for remuneration of managing/whole-time directors and managers was raised to Rs.1,70,000/-in the year 1964-65.

In the year 1965-66, in consultation with the Company Law Advisory Committee set up under the 1965 Amendment Act, the Central Government decided that the ceiling should ordinarily be Rs. 1,80,000/- per annum in respect of remuneration (excluding perquisites) drawn by an individual managing/whole-time director or manager from any one company and Rs.2,70,000/- per annum in case such remuneration is drawn from more than one company in such managerial capacity.

Devaluation of Rupee and Managerial Remuneration

At the time of devaluation of our rupee in June 1966, a good number of foreigners were occupying managerial positions in various public companies and as a result of the devaluation, the equivalent of their remuneration in the relevant foreign currency became considerably

reduced and accordingly proposals for sanction of corresponding increase in their remuneration were received by the Company Law Board (constituted by the Amendment Act of 1963 for performing most of the functions assigned to the Central Government under the Companies Act) from the various companies employing such expatriates.

After a careful consideration of the whole matter from the foreign exchange, taxation, company law and other aspects, it was decided as a matter of policy that, as the devaluation could be regarded to have affected mostly the home remittance of these foreign nationals, there was a need to compensate them to the extent of such increase in their existing remuneration as would be just sufficient to enable them to maintain these remittances at the pre-devaluation level even if the resultant increased remuneration exceeds the statutory limits imposed by the Companies Act.

Current Position

As mentioned earlier, the Central Government, first on the recommendations of the Advisory Commission and now on its own, has been following a policy of laying down administrative ceilings on managerial remune ration from 1959 which have been revised from time to time, and the administrative ceiling was last fixed in 1965 at Rs.1,80,000/- per annum for salary, commission and fixed allowances but exclusive or perquisites.

As a measure of socio-economic policy with particular reference to the Directive Principles of State Policy in our Constitution (which lays down that the ownership and control of material resources of the community are so distributed as best to subserve the common good and that the operation of the economic system does not result in the concentration of wealth and means of consumption to the common detriment), the Central Government feel that very high incomes are not in accordance with the spirit of those principles. There is also at present a great disparity between the remunerations drawn by managerial personnel in the private sector and those drawn by their counterparts in the public sector. It is also felt that a reasonable limitation on the level of remuneration of managerial personnel is expected also

to have a salutary effect on the salaries paid to the executives employed by companies which are beyond the regulatory provisions of the Companies Act. Keeping in view these things, the Central Government announced the following revised guidelines for dealing with the question of managerial remuneration:-

i) The maximum remuneration, within the statutory limits laid down by the Act, payable to managing whole-time or part-time paid director/manager in a public limited company has been fixed as under

   a) There will be a ceiling of Rs.90,000/-per annum i.e. Rs.7500/-per month on salary including dearness allowance and all other fixed allowances.

   b) A commission on net profits upto 1% of the net profit may be allowed in addition to the salary as an incentive for efficient and sound management, but this should be subject to a maximum ceiling of 50% of the approved salary i.e. an absolute ceiling of Rs.45,000/- per annum.

   c) Where a company proposes to pay remuneration in the form of commission on net profits alone, this shall be subject to a maximum administrative limit of Rs.1.35 lacs per annum.

   d) At present there is no overall ceiling for the value of perquisites apart from limits on certain individual items like housing or medical benefits. In future, perquisites to be allowed in addition to salary and/or commission will be restricted to an overall limit of one-third of the salary/ emoluments or Rs.30,000/- per annum (Rs.2500/-per month). whichever is less. Rs.30,000/-per annum only will thus be admissible to those having salary/emoluments of Rs.90,000/- per annum or above. within this overall limit a company will be free to choose whatever perquisites it wants to allow. But this ceiling of one-third of salary will not include the employer's

contribution to provident/superannuation fund to the extent these are not taxable under the the Income-tax Act (the present position being that provident fund contribution not exceeding 10% of the salary and superannuation fund contribution, does not exceed 25% of the salary are not taxable). Similarly, the reimbursement of medical expenses actually incurred subject to the present ceiling of Rs.5,000/-per annum or one month's salary, whichever is less, reasonable intervals say, once a year, will be excluded from the aforesaid ceiling on perquisites. Leave salary for leave admissible within1/11 of duty periods will also not be counted for this purpose.

ii) The above ceilings will be followed as a rule subject to exceptions in some deserving cases depending on the merits thereof, for example where higher remunerations have already been drawn in public limited companies or in the case of expatriate directors in Indian Subsidiaries of foreign companies or in Indian companies having foreign collaboration arrangements provided the appointment is justified and the expatriate Director concerned has previously been drawing higher emoluments.

These revised guidelines are important in view of the fact that the systems of managing agents and secretaries and treasurers have been abolished from April 1970 and now the entire burden of corporate management falls on the Board of Directors or managing/whole-time directors and managers.

These guidelines have been criticised by the representatives of business house, Chambers of Commerce etc. on various grounds. The scaling down of managerial remuneration, it is felt, is not in the larger interests or the country; it might have serious repurcussions on the development of a top managerial cadre and might also

undermine the urge towards better and efficient management which in turn may retard efficiency and productivity which is absolutely essential for obtaining the take-off stage for a developing economy. These administrative ceilings would preclude a company from paying to managing whole-time director or manager according to his worth and usefulness to the company. Large business enterprises require highly qualified, experienced and intelligent top managerial personnel and if the salaries paid to them are not commensurate with qualifications, experience and expertise, it might become difficult to infuse new blood in the top management cadre and professionalise company management. In the context of the prevailing high rates of personal income-tax, the imposition of an administrative ceiling does not appear to be at all necessary; it will only affect the marginal incentive to work and invok innovate on the top managerial personnel.

It might be argued that the revised guidelines regarding administrative ceilings are in furtherance of the socio-economic objectives of the state policy like reduction in disparities in income and wealth, checking concentration of economic power etc. Those objectives can better be achieved by broadening the opportunities for increased incomes at lower levels through various incentives to small self-employed persons and reducing inequities by further increasing the exemption limit of income tax for individuals and providing low interest, capital funds and other incentives for improving their productivity, efficiency and profitability rather than fixing administrative ceilings on top managerial remuneration which, in fact, channelise individual initiative and ability. With the rising price levels because of the stresses and strains of development, the value of rupee is fast eroding in our country. The ceiling on managerial remuneration has lowered the maximum admissible to managerial personnel at a very steep rate.

In view of the express provisions made by the Parliament, the legal validity of administrative ceilings is doubtful. In fact these administrative ceilings have nullified the express provisions of Companies Act which permit remuneration to managing/whole-time directors or managers up to 5% of the net profit for one such managerial personnel and upto 10% for more than one managerial personnel in a company. Whether the Central Government

can over ride the statutory ceilings and fix any administrative ceilings, is a high question. A detailed study of the provisions of Companies Act 1956 regarding managerial remuneration will reveal that there does not seem to be any residuary or other power left to be exercised by the Central Government or the Company Law Board which could enable them to fix a ceiling on the remuneration which is lower than the limits expressly set out in the Act. The argument that the Central Government or the Company Law Board are authorised under Section 637A to impose administrative ceilings on remuneration at the time of approving the appointment or or re-appointment is open to question. Section 269 which requires Government approval for appointment or re-appointment of managing or whole-time directors, does not mention the word 'remuneration' at all and Section 309 which deals with remuneration of directors also does not require any approval of the Central Government except when such remuneration exceeds 5% of the net profit for one managing or whole-time director and if there is more than one such director, 10% for all of them together. Of course, remuneration for services which are of professional nature requires approval if in the opinion of the Central Government, the director concerned possesses the requisite qualifications for the practice of the profession. Section 310 no doubt requires Government sanction for increase in remuneration of any director including a managing or whole-time director. Similarly, Section 311 requires Government approval for increase in remuneration to managing or whole-time directors on re-appointment of the same man or appointment of some one else. Thus, nowhere in the Companies Act the Central Government has power to regulate managerial remuneration through administrative guidelines at the time of appointment or re-appointment of managing/whole-time directors except where it is a case of increase in remuneration of such director. The Central Government has power to sanction an increase in minimum remuneration under Section 198 but it has no authority to decrease it.

To strengthen the above argument regarding illegality of the Central Government power to fix administrative ceilings on remuneration it would be pertinent to refer here to the concept of "Subordinate Legislation". Legislature does not have enough time to deliberate upon, discuss and approve regulatory measures and the law making has now become a complicated and technical matter; thus Parliament quite often lays down broad principles of any legislation on hand, leaving it to the Executive to frame, in

conformity with those principles, formal and procedural details of that measure. In case of managerial remuneration, the detailed guidelines have been laid down by the Parliament and the provisions in the Companies Act are very specific in this regard, as such the Executive (i.e. the Central Government or the Company Law Board) has no power to make them ineffective by prescribing 'ceilings within ceilings.'

It is another thing that Government has been prescribing administrative ceilings for a fairly long time, but it cannot be said that this practice has been in conformity with the express provisions of the Company Law and intensions of the Legislature. Since no one has challenged the competency of the Central Government in this regard in a court of law, an impression is created that Central Government has been doing it in a perfectly legal manner. One fails to understand why the Companies and their managerial personnel seek the approval of the Central Government in such matter. In fact, as pointed out earlier, no approval of the Central Government is required for payment of managerial remuneration unless it "purports to increase or has the effect of increasing, whether directly or indirectly"; the remineration of directors and other managerial personnel.