REMUNERATION TO DIRECTORS

Directors are classified as follows:

- EXECUTIVE
- NON-EXECUTIVE

Remuneration to Executive Directors:

A Company can remunerate its executive directors i.e. Managing Director or Whole time Directors in the following methods:

A. Remuneration as a percentage of profits

A Company can pay a maximum of 5% of its profits in any financial year as remuneration to its Managerial personnel (Managing Director or Manager). Where there are more than one managerial personnel, the Company can pay a maximum of 10% of its profits in any financial year as remuneration to all such managerial personnel.

B. Fixed Remuneration irrespective of Profits

Companies are also allowed to pay remuneration to its managerial personnel in the years where the company has no profits or when the profits are not adequate by way of salary, dearness allowance, perquisites and any other allowances, depending on the effective capital of the Company:

Company’s effective capital has to be calculated to determine the amount that can be paid to the Managerial Personnel.

Effective Capital means the aggregate of paid-up share capital (excluding share application money or advances against shares) amount, if any, standing to the credit of share premium account, reserves and surplus excluding revaluation reserve, long term loans and deposits repayable after one year (excluding working capital loans, over drafts, interest due on loans unless funded, bank guarantee etc., and other short term arrangements) as reduced by the aggregate of any investments (except in the case of investment by an investment company whose principal business is acquisition of shares, stock, dentures or other securities) accumulated loss and preliminary expenses not written off.
Calculation of Effective Capital

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<th>Particulars</th>
<th>Amount (Rs.)</th>
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<tr>
<td>Paid-up Share Capital (Excluding Share application money or advance against shares)</td>
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<td>Share Premium</td>
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<td>Reserve &amp; Surplus (- revaluation reserve)</td>
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<td>Long term loan</td>
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<td>Deposits repayable after one year</td>
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<tr>
<td>Total</td>
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<td>Less: Investments</td>
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<td>Accumulated loss not written off</td>
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<td>preliminary expenses not written off</td>
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<tr>
<td>Effective Capital</td>
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Every managerial personnel is entitled to a remuneration not exceeding the limits specified in the tables given in Section II of Part II of Schedule XIII of the Companies Act, 1956.

In addition to the above the managerial personnel is entitled for the following perquisites which are not to be considered for the above ceiling:

(i) Contribution to provident fund, superannuation fund or annuity fund to the extent these either singly or put together are not taxable under the Income-tax Act, 1961,
(ii) Gratuity payable at a rate not exceeding half a month's salary for each completed year of service, and
(iii) Encashment of leave at the end of the tenure.

If the Company proposes a remuneration exceeding these limits the prior approval of the Central Government would be required.

Maximum remuneration to managerial personnel under Section 198 & 309 of the Companies Act, 1956.

- Each managerial personnel is entitled to a maximum remuneration which is equivalent to 5% of net profits of the Company calculated according to Section 349 & 350 of the Companies Act, 1956.
- The overall remuneration that can be paid to all the whole time directors shall not exceed 10% of net profits of the Company calculated according to Section 349 & 350 of the Companies Act, 1956.

Remuneration to Non-Executive Directors:

The Words “Remuneration of Directors” is used in Sections 198, 309, 310, 311 and Schedule XIII of the Companies Act.
What is the maximum remuneration which can be paid to all the Directors?

The maximum remuneration which can be paid to all the directors of the Company is **11%** of the net profits of the Company.

What is the maximum remuneration which can be paid to all the non-whole time Directors?

If the company has Managing Director or whole time director or a manager: - **1% of Net Profits**

If the company has no Managing Director or whole time director or a manager: - **3% of Net Profits**

Approvals Required

- In order to pay remuneration by way of commission, a special resolution is required to be passed.

- In order to pay such remuneration by way of a monthly, quarterly or annual payment the Company is required to obtain the approval of Central Government.

- In order to pay the remuneration in excess of 1% or 3% (as mentioned above) to its directors:
  - A separate approval of the Central Government is required for paying such higher remuneration.
  - Such higher remuneration is authorised by the Company in its General Meeting.

Sitting Fee

A director may receive remuneration by way of a **sitting fee** for each meeting of the Board, or a committee thereof, attended by him. By virtue of sub-section (2) of Section 198 of the Companies Act, such sitting fee paid to directors shall not be reckoned for the purpose of calculating Directors Remuneration.

What are the ceiling limits for sitting fee?

Rule 10-B of Companies (Central Governments) General Rules and Forms, 1956 provides that companies having a paid-up capital and free reserves of Rs. 10 crores or above or companies having a turnover of Rs. 50 crores or above can pay sitting fees not exceeding Rs. 20,000 and other companies can pay sitting fees up to Rs. 10,000.

Are there any other means available to pay remuneration?

Yes, the Directors can be paid remuneration for their professional services which need not be included in any of the above ceiling limits. For this purpose in the Central
Government’s opinion, the director should possess the requisite qualifications for practicing the profession.

Remuneration by way of ESOPS (Employee Stock Options)

Rule 4.3 of the Securities and Exchange Board of India (Employee Stock Option Scheme And Employee Stock Purchase Scheme) Guidelines, 1999 provides that “A director who either by himself or through his relative or through any body corporate, directly or indirectly holds more than 10% of the outstanding equity shares of the company shall not be eligible to participate in the ESOS.”

Therefore, a non-executive director is eligible for allotment of shares under the ESOPs scheme.

Moreover, the Central Board of Direct Taxes has clarified through a circular that the benefit arising out of ESOP issued to non-employees will not be liable to FBT. “However, in such cases, the taxability of such benefits in the hands of the non-employees will be determined in accordance with the existing law,” it says.

Further, the circular has given a relief to those companies which purchase securities from the market and given them to employees. The expenditure incurred by a company on purchasing shares would be allowable as a deduction in computing its taxable income. A large number of listed companies opt for this route.

But, the companies allotting shares from their own share capital will not be able to claim it as a deduction, since no expenditure has been incurred. Subsequently, if the employer recovers the FBT from the employee, it will not be treated as his income.

Remuneration Payable to Foreign Director

The legal framework for appointment and remuneration of foreign nationals still remains complex, despite the liberalization post Foreign Exchange Management Act (FEMA). The heterogeneous legal positions in different laws have to be given a careful thought before engaging the services of foreign national to facilitate repatriation and effective tax planning.

Employment of foreign nationals

Employment could be as technicians or non-executive directors or as full-time directors (called whole-time director or managing director). Technicians could be engaged for short terms by a contract. The exchange control law does not restrict the duration of such employment as long as the employee holds valid employment visa.

As for non-executive directors, the procedures prescribed under the Companies Act, 1956 alone need to be followed. These include filing forms for such appointment, consequent to the appointment by the board of directors or by the shareholders in general meeting. If the appointment is in a public limited company, the consent to act as director is to be obtained from the foreign national.
A private limited company is not subject to any restriction under the Companies Act on appointing foreign nationals in key managerial positions. Appointment of foreign nationals as whole-time director or managing director in a public limited company is subject to the provisions of Section 269 of the Companies Act read with Schedule XIII to the Act that defines qualification for appointment and ceiling limits of remuneration.

One more important aspect to be looked into is the residential status of the Director:

Residential Status is defined differently under different Laws

The acts governing Residential Status are:

- Companies Act, 1956
- Foreign Exchange Management Act, 2000
- Income Tax Act, 1961

A foreign national could have different residential status under the companies Act, FEMA and the income-tax law. The varied residential status in these laws has different legal effect concerning employment, repatriation and taxation.

Companies Act, 1956:

Only persons resident in India are eligible to receive remuneration pursuant to Schedule XIII of the Companies Act, 1956.

`Resident’ for the purposes of Part I of Schedule XIII (The Companies Act, 1956) includes a person who has been staying in India for a continuous period of not less than 12 months preceding the date of appointment as a managerial person and who has come to India (1) for taking up employment in India, or (2) for carrying on a business or vocation in India. Appointment of any person who is not a resident in India requires the approval of the Centre. Most often, appointment of a foreign national as a managerial person may require the Center’s approval either because he is not a resident or his remuneration exceeds the limits prescribed under the Schedule XIII.

Foreign Exchange Management Act, 1999

Generally, a foreign national is understood to be a non-resident. In terms of Section 2(v) of FEMA, a person will be a resident in India only if he resides in India for more than 182 days during the course of the preceding financial year.

However, exception to this general rule is made for any person who comes to India for employment or business or other reasons indicating his intention to stay in India for uncertain period. Such persons become resident immediately for the purposes of FEMA, no matter they have not stayed in India for 182 days. Thus, a foreign national seeking employment in India becomes a resident under exchange control law.
Foreign nationals thus resident could be ‘persons not permanently resident’ in India - yet another category defined under FEMA. ‘Person not permanently resident’ means a person resident in India for employment of a specified duration or for a specific job or assignment, the duration of which does not exceed three years. The significance of this category of persons is that they are not subject to restriction on remittance of exchange facilities for their relatives abroad.

It is usual practice to employ whole time director or managing director by limited companies for a term of five years. In order to avail the benefit of persons not permanently residing in India, the contract of employment/resolution of the company shall expressly state the following: (1) duration of service not exceeding 3 years, and (2) the specific job or assignment.

Repatriation facilities

Foreign nationals employed in India would like to repatriate to their family residing abroad best part of their income. Salary earned by foreign nationals being current account transaction is regulated by the Foreign Exchange Management (Current Account Transactions) Rules, 2000.

The amount that can be repatriated outside India can be classified as follows:

1. Repatriation by a foreign National (Other than citizen of Pakistan) who is a person resident in India but not permanently resident in India:

   **Up to net Salary of the Person**

   [Net salary is computed after deduction of taxes, contribution to provident fund and other deductions.]

2. Repatriation by a foreign National (Other than citizen of Pakistan) who is a person resident in India but not permanently resident in India:

   **Up to US $ 1,00,000 per year per recipient**

A national of a foreign state could continue to be an employee of foreign company and posted in Indian operations on deputation to the joint venture or branch in India. In such cases they are not employee of Indian company and are allowed to open, hold and maintain foreign currency account with bank outside India.
**Income Tax Act, 1961**

Incidence of income-tax on any person depends on the residential status of such person. Thus, the residential status of the foreign national shall be ascertained in accordance with Section 6 of the Income-Tax Act, 1961. Initially, a foreign national will be a non-resident.

Section 9(1) (ii) of Income tax law, by a legal fiction, assumes salaries earned in India by a non-resident foreign national, as accruing in India and as such, it is subject to tax.

However, this tax liability is subject to the following exemptions offered under the Act.

* Under Section 10(6)(vi): Remuneration received by foreign citizens, as an employee of foreign enterprise for services rendered by him during his stay in India are exempt subject to the following conditions. (1) The foreign employer is not engaged in any trade or business in India and (2) his stay in India does not exceed in the aggregate a period of ninety days in such previous year.

**Disclaimer:**

Although the information is provided after reviewing several relevant acts and notifications, it can be used just for quick reference only and a specialist consultant/advisor can be sought for expert opinion.

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