

ADD-ONS TO THE TERM ‘NON-EXECUTIVE DIRECTOR’

In the changing corporate-legal environment, it is important to understand the roles, responsibilities and liabilities associated with the position of a non-executive director in a private limited company, particularly when the Companies Act, 2013 (“Act”) has a sack full of punishments and penalties for both directors and companies, in case of any default.

The role of each individual on the Board has been defined and explained under the Act, be the company a small or a budding one, a medium or a large, the Act has a lot about the roles, responsibilities and liabilities of a non-executive director in a private limited company.

With this write-up here, we are trying to provide an understanding on the same. Before entering into the details of how a non-executive director functions or shall function, it is pertinent to understand the background on the non-executive chairman under the Act:

Who is a Non-Executive Director?

The Act does not specifically provide the definition of term ‘Non-Executive Director’. However, we can construe it by understanding the definition of term ‘Executive Director’ provided under Rule 2(k) of the Companies (Specification of Definition Details) Rules, 2014, which reads as follows:

“Executive Director means a whole time director as defined in clause (94) of section 2 of the Act”

To further clarify, a ‘Whole Time Director’ as defined under section 2 (94) of the Act reads as follows:

“Whole Time Director includes a director in the whole time employment of the Company”

The above definitions of executive directors will provide the understanding that a non-executive director is a director who is not a Whole-time Director i.e. a director not being in whole time employment of the company. A Non-Executive Director is the best kept secret of most successful companies. A full time fixture or in a temporary arrangement, non-executive directors contribute a wealth of knowledge, strategies, experience and contacts to the business.

Such directors are also considered to be the custodians of the governance process as they are not involved in the day-to-day running of business and monitor the executive activities.

Roles, responsibilities and liability of a Non-Executive Director:

The fact is well noted that the non-executive directors are not involved in the day to day activities of the company and hence it is all the more important to understand what exactly are the roles and responsibilities of a non-executive director and also the liabilities associated with it:

Roles and responsibilities of a Non-Executive Director –

This could be explained with a cluster of words and phrases, but nothing explains better than what is held by the Supreme Court of India, in a landmark case:

Pooja Ravinder Devidasani v/s. State of Maharashtra, [Criminal Appeal Nos. 2604-2610 of 2014 (Arising out of Special Leave Petition (Crl) Nos. 9133-9139 of 2010)]¹, where it was observed that:

“There is also no dispute that the Appellant was not the Managing Director but only a non-executive of the Company. Non-executive Director is no doubt a custodian of the governance of the Company but does not involve in the day-to-day affairs of the running of its business and only monitors the executive activity”.

Similarly, in **Chaitan M. Maniar v. State of Maharashtra 2004 ALL MR**, it was observed that for the acts of some unscrupulous persons, the non-executive directors, who are not concerned with the day to day functioning of the company cannot be held responsible *unless the active participation of the director is substantiated by concrete material or instances or particulars.*

It is important for the companies and its Board and the non-executive directors too, to understand and define the role of a non-executive director on the Board of the company in order to chalk out the responsibilities to be disposed and the liabilities to be shared with them.

In light of the various precedents laid down by courts in India, it can be understood that a non-executive director is not involved/engaged in the day-to-day affairs of the operations or running of business of a company, however still termed and viewed upon as a custodian of the governance of the company.

Liabilities of a Non-Executive Director –

As regards the liabilities of a non-executive director, it is pertinent to note that the Act or any other statute does not distinguish the liabilities of a non-executive director from that of an executive director. However, the Act provides for limitation of liabilities of a non-executive director under Section 149 (12) (ii), which states as follows:

“a non-executive director not being promoter or key managerial personnel, shall be held liable, only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently.”

In a related case of **SMS Pharmaceuticals v/s. Neeta Bhalla**, the Delhi High Court observed that the liability depends on the role that the person plays in the company and not on the designation or status. The court further concluded that the liability arises on account of conduct, act or omission on the part of a person and not merely on account of holding an office or a position in a company. The aforesaid provision read with the observations of the abovementioned case, concludes that liability of a non-executive director under the Act is limited to the extent of such contraventions / defaults, which are committed by the company with the knowledge or consent of the said non-executive director.

Despite the aforesaid principle being recognized in many cases in India, Union Carbide Corporation v/s. Union of India Etc. (*commonly known as ‘Bhopal Gas Tragedy Case’*) changed the understanding with regard to the liabilities of a non-executive director of a company. In this case a non-executive director being chairman was also convicted for the offence along with the executive directors of the company. The said conviction was based upon the contention that ‘how can a chairman without any

knowledge of the company activities, preside over the meetings of the shareholders and higher officials’.

In light of the said case, it may be concluded that a non-executive director, may not be involved / engaged in the day-to-day activities or running of business of a company, but if he is a Chairman of the Company / Board and is presiding over the meetings of the Board, he may be held responsible for the wrong doings of the company on the basis of his participation and / or involvement in the discussions held in the Board meetings of the Company as a Chairman.

If we take a close look on the definition of ‘officer in default’ provided in the Act [under Section 2(60)], it clearly indicates that not only the executive directors or Key Managerial Personnel are to be considered as officers in case of any default under the provisions of the Act, but, such other persons of a company under the immediate authority of the Board or Key Managerial Personnel; persons giving advice in professional capacity; any director who is aware of such contravention and had participated in the proceedings of the Board without objecting to the same, or where such contravention had taken place with his consent or connivance, shall also be officers in default and shall also be held liable to any penalty or punishment by way of imprisonment, fine or otherwise as prescribed under the Act. Therefore, in the event a non-executive director / chairman qualifies under the said definition, he is also liable to be penalized under the provisions of the Act.

While we sum up the stands taken by various courts in India with respect to liability of a non-executive director (whether or not a Chairman of the board) of a company in India, we find that each case turns on its own facts.

Hence, whenever something goes beyond what the statutes have provided and the courts in its judgments have laid down for the non-executive directors, the decisions / conviction is based upon the degree of involvement of said director on the Board of the company and also on the criticality of the matter in question.

1. In this case, the court ascertained the liability of a non-executive director in respect of a cheque bounce case.

GST: A BIRD’S EYE VIEW

Highlights

- Introducing a single and transparent tax system.
- Subsuming of certain major Central and State taxes.
- Tax to be paid proportionate to value of the goods.
- Input Tax Credit across value chain and curing the cascading effect of taxes.
- Uniformity in tax rates and compliances across states.

Constitution (122nd Amendment) Bill, 2014

The tax regime in India has come a long way from being a cumbersome legislation to a more efficient system of imposing tax on value additions at every stage and reducing the overall burden of tax. The introduction of VAT in 2005 cured the cascading effect of tax by imposing tax only on the value additions within a supply chain. This made the tax structure more transparent and facilitated in reduction of price of various goods.

However, though the introduction of VAT decreased the cost of production of goods, it could not do much in case of inter-state movement of goods and also did not permit set-off of input credit across different taxes. In order to remedy these failures the Government of India recently passed the Constitution (122nd Amendment) Bill, 2014.

The Bill seeks to amend the Constitution of India and confer a simultaneous power upon the Centre and the State Legislatures to make laws governing goods and services tax. The Bill proposes to introduce Goods and Service Tax (GST), a single tax on the supply of all goods and services.

GST

The GST system will introduce a harmonised system of taxation wherein all the central and state indirect tax would be clubbed and taxed under 'one tax' code. The introduction of GST will subsume certain major taxes levied presently by the Central and State Government.

Taxes to be subsumed at Central level would include the following:

- Central Excise Duty;
- Additional Excise Duty;
- Service Tax;
- Additional Customs Duty

Similarly, taxes to be subsumed at State level would include the following:

- State Value Added Tax/Sales Tax;
- Entertainment Tax;
- Entry tax;
- Purchase Tax;
- Luxury tax

Under the GST model, tax will be levied under three components, namely, Central Goods and Service Tax (CGST), State Goods and Service Tax (SGST) and the Integrated Goods and Service Tax (IGST).

- SGST and CGST will be levied on all intra-state supply of goods and services.
- IGST will be levied on inter-state supply of goods and services.

Also on import of goods, all State taxes are being subsumed and IGST will be levied on all imports into the territory of India.

Therefore tax under GST will be levied on "supply of goods or services". Further, the term 'supply' has been given a wide connotation to include all supply of goods and/or services such as sale, transfer, barter, exchange, license, rental, lease or disposal, importation of service, whether or not

for a consideration and whether or not in the course or furtherance of business, etc. The liability to pay the tax would arise at the time of supply and the time of supply would be taken as a date earliest when the goods were either removed or made available to the recipient or date on which invoice is issued or the date on which supplier receives payment.

GST will be levied on all goods and services except alcoholic liquor for human consumption. Further, it is intended that initially, GST will not apply to certain products such as petroleum crude, high speed diesel, motor spirit, and natural gas and aviation turbine fuel, however, GST on these goods will be made applicable in a phased manner.

Input Tax Credit

A major introduction that will be brought by GST will be the availability of input tax credit at not only each stage of supply but also for inter-state transactions. Moreover, utilization of credit of CGST or SGST, respectively, between goods and services will also be allowed. Consequently, input tax credit of CGST will be made available for discharging the CGST liability on the output at each stage. Similarly, input tax credit of SGST will be made available for discharging the SGST liability at each stage of output.

Though cross utilization between CGST and SGST will not be allowed, set off of CSGT and SGST against IGST will be permitted. Therefore, with the introduction of GST, input tax credit will be available across intra-state as well as inter-state transactions.

Legal Impact

The model GST law provides for a smooth transition as far as the registration procedure is concerned. The existing dealers having a valid and subsisting VAT or service tax or central excise registration will not be required to apply for any fresh registration. Also for new dealers the registration procedure will become much easier and only a single online application for registration will be required to be filled in.

The introduction of GST will require amendments in various legislations and due consideration to the same will be required. Such as, under the present regime, the SEZ Act provides for exemption from payment of Central Sales Tax and Service Tax. The SEZ Act will now require an amendment detailing the extent of exemption from payment of CGST/SGST/IGST in SEZ units.

Also, subject to its effective date, GST may have an impact on the existing contractual agreements and clause relating to payment of taxes might be required to be reviewed as per the negative list, if any, to be introduced under GST. If there is any tax rate mentioned in any contractual agreement, the same may be required to be revisited to make it compliant with GST.

Conclusion

A brief reading of the model GST law promises a reduction in taxes at the consumer level due to availability of input tax credit at each stage. It also denotes a more sophisticated procedure for collecting tax between the Central and the State. However, there is still a long way ahead as the Constitutional Amendment Bill is yet to be passed by the States and there is presently a never

ending debate on the rate at which GST will be levied. Therefore, it needs to be seen whether GST will live upto the expectations and finally resolve the issue of cascading taxation and onerous fillings under different tax legislations, as and when it becomes effective.