

Simplified Exit Scheme for Defunct Companies: An Analysis

Anil Khicha
.....

< E X E C U T I V E S U M M A R Y >

◆ The name of the defunct/dormant Companies are struck off from the Register of Companies without unnecessary delays/procedures. This Scheme described below is a Simplified Exit Scheme or SES. It is a short-cut route for winding up defunct

companies. The Scheme gives an opportunity to such Companies to get their name struck off from the Register of Companies in a simple way without going through the winding up procedure which is cumbersome, costly & time consuming.



It was revealed by the Department of Company Affairs that around 1.70 lacs companies out of the total 5.89 lacs companies failed to increase their capital by the cut off date of 12.12.2002 in compliance of sub section (3) & (4) to section 3 of the Companies Act which required private companies to increase their paid up capital to Rs.1.00 Lac and Public Limited Companies to Rs.5 Lacs. As per section 3(5), these companies are deemed to be defunct companies within the meaning of Section 560 and their names shall be struck off from the Register of Companies.

Apart from the companies, which could not increase their paid-up capital to the required level, there are many more dormant companies like NBFCs, which could not register with the RBI and were not allowed to do non-banking finance business. There are other companies, which could start their business and could run it for some period of time and discontinued the business subsequently due to various reasons. All such companies were feeling a need for an easy and cheaper exit route for

quite sometime as winding up procedure is cumbersome, costly & time consuming.

I. THE SCHEME

This scheme (Simplified Exit Scheme or SES) is a shortcut route for winding up of the defunct companies. The Company could be defunct either due to non-compliance of Section 3 of the Companies Act or it could be due to not taking off or for not having carried on any significant business for a significant length of time. The Scheme gives an opportunity to such companies to get their name struck off from the Register of Companies in a simple way.

II. REQUIREMENTS UNDER THE SCHEME

Any defunct and dormant company, which is willing to exit under the scheme, may apply to the Registrar in the prescribed form (Annexure 'A' of SES) along with a fee of Rs.2000/-. The Company needs to file audited accounts only for the last accounting year (not financial year) along with the Application.

However, the Company needs to comply with certain conditions:-

The author is member of the Institute. The views expressed herein are the personal views of the author and do not necessarily represent the views of the Institute.

- a) The audited accounts should not show any asset or liability.
- b) An Affidavit on a non-judicial stamp paper (Rs.20 in Tamilnadu) of at least 2 Directors, including that of a Managing/Whole-Time Director, if there is one, sworn before a Magistrate/Executive Magistrate (not a Notary) confirming that the Company has not carried on any business and has no asset or liability, must be enclosed with the Application.
- c) The Application should also be accompanied by an Indemnity Bond on a non-judicial stamp paper (Rs.40 in Tamilnadu), duly notarised, from at least two Directors, including the Managing/Whole-Time Director, if there is one, to the effect that should there be any liabilities on the Company, such liabilities will be met personally in full by them, even after the name of the Company is struck off from the Registrar of Companies.
- d) To pass a Resolution in a Board Meeting to make an Application for striking off the name u/s 560 of the Companies Act, 1956.

III. POSITIVE FEATURES OF THE SCHEME

- a) The Company needs to file audited accounts of the last accounting year alone and not for all the earlier years. The Company need not file the Annual Returns for any year and to this extent the Company can save the filing fees, additional fees in case of pending returns for earlier years and also avoid the time consuming process.
- b) The Companies, which exit under the scheme, may not be prosecuted under the Circular of 11th December 2002 for non-compliance of the requirements of Section 3 of the Companies Act, and in case, prosecution is already filed, it may be withdrawn immediately after the name of the Company is struck off.
- c) Any pending prosecutions for the non-filing of the Annual Returns and the Balance Sheets can be withdrawn. However, if there are other offences, the prosecutions can be withdrawn with the prior permission of the Department of Company Affairs.
- d) The Scheme is optional for Companies willing to exit, they may opt for the regular route if they feel that beneficial.
- e) No clearance is required from any Department including the Income Tax etc.
- f) The Scheme is applicable to all the Companies making an Application u/s 560 and is not restricted to only Companies that failed to comply with Section 3.
- g) In case any one or more of the Directors are not alive, the remaining Director(s) can also make the

Application.

IV. REASONS FOR REJECTION OF APPLICATION

As per the Scheme is introduced for the easy exit of the defaulting Companies, It may be presumed that by and large, all the Applications received under the Scheme will be accepted. However the Circular gives an impression that the acceptance of the Application and striking off under the Scheme is discretionary.

The Application may be rejected primarily on the following grounds:

- a. No fee/short fee paid for the Application.
- b. Required document(s) not enclosed with the Application.
- c. Deficiencies in the documents enclosed with the Application.
- d. Objections received from the Creditors, Public, Investors etc.

V. PERIOD OF SCHEME

The application can be made under the Scheme till 31/12/2003.

VI. Consequences of Non-utilizing of the Scheme

Those companies which have not complied with the requirements of Section 3 of the Companies Act and don't exit under the Scheme shall be prosecuted under the 11th December 2002 Circular vigorously. How far this will be true is to be seen as the similar statements were made under the Company Law Settlement Scheme 2000. However no action was taken against those defaulting Companies, which did not respond to the directions under the Scheme.

VII. ISSUES/ APPREHENSIONS

- a. Regarding non-prosecution and withdrawal of prosecutions, words used are 'may' and 'can be' and not 'shall'. However, in jurisprudence, the word 'may' shall mean 'shall' according to May's Parliamentary Practices.
- b. A sworn Affidavit before a Magistrate/Executive Magistrate should not be insisted upon as this complicates the Simplified Scheme. This complicates further when the Magistrate/ Executive Magistrate is not aware about the Scheme. The earlier 'Fast Track Section 560 Scheme, 2000' too started with such stipulations but later during the period of Scheme accepted the notarised Affidavit.
 - a. It hardly makes any difference if there is a small

amount of loans from the Directors, some Cash or Bank Balance in the Balance Sheet. It may prompt Companies to resort to some avoidable ways to fulfill this condition. Small amounts of liabilities in the form of unsecured loans from the directors and small amounts of assets in the form of Cash & Bank Balances should not be a hurdle as long as there are no Statutory or Public Dues, as accepted under the 'Fast Track Section 560 Scheme 2000'.

- b. The Affidavit requires confirming that the Company has not carried on any business whereas the Circular refers about the Companies who had not done significant business for a significant period, both appears contradictory. The meaning of 'Significant Business for a Significant period' is not clear. Even if the Companies have done business for some period of time earlier, but are presently not engaged in any business, shall be allowed to take benefit of the Scheme as the intention of not doing business in future is more important.
- c. Reasons for which an application under the scheme may be rejected, are not clearly specified.
- d. In case the audited accounts pertain to a period which is more than 3 months prior, the date of filing the Application, a statement should be sufficient in the Affidavit confirming that no transaction had taken place from the end of the last accounting year till the date of the Application, instead of insisting for another audited account.
- e. Wherever there is a Declaration that there had been no transaction, and that there is no asset or liability, it does not serve any purpose of filing an audited Balance Sheet and Audited Annual Accounts. Even so, a simple Certificate from an Auditor to this effect may serve the purpose?

Clarifications beyond doubt shall be issued at the earliest regarding all these issues.

VIII. RESTORATION OF NAME

If a Company or any Member or Creditor thereof, applies to the Court, to order the name of the Company to be restored to the Register, the Court may make an order for restoration under Section 560(6), if it is satisfied that:

- a. The Company is solvent.
- b. On the date of striking off, the Company was carrying on business.
- c. It is in the interest of justice that the order of restoration should be made.

- d. Period of 20 years has not expired.
- e. The Applicant is an "aggrieved" person.

The effect of an Order under this Section is that the Company is to be deemed to have continued in existence "as if its name had not been struck off". The object is to put both the Company and the parties in the same position, as they would have occupied if the dissolution of the Company had not taken place. The restoration produces "as you were" position.

IX. REFERENCES

Reference may be made to the following Circulars of The Government of India, Ministry of Finance & Company Affairs, Department of Company Affairs.

- a) General Circular No. 13/2003 dt. 25/03/2003.
- b) General Circular No. 15/2003 dt. 09/04/2003.
- c) General Circular No. 16/2003 dt. 17/04/2003
- d) General Circular No.17/2003 dt. 22/04/2003
- e) Circular No.09/07/83- CL (III) dt. 17/02/87.
- f) Circular No.01/03/91- CL (V) dt. 05/04/91. CL (III) dt. 19/02/91

X. CONCLUSION

It was always felt that the names of the defunct/ dormant Companies are struck off from the Register of Companies without unnecessary delays/ procedures and the present scheme serves this purpose. The Scheme is simple and cost effective. It however needs to be reviewed at the earliest to remove the ambiguities so that the targeted Companies can decide soon to take its benefits.

The CLSS 2000 was a mandatory Scheme in that the filing of returns was compulsory under the Act unlike the present case of defunct Companies, opting for Winding Up or striking off from the Register under Section 560 of the Act. Yet even in fulfilling the mandatory duties, the defaulters despite a concessional Scheme having been made available were let off the hook just like that making those who complied with the provisions by opting to file the returns under the CLSS to feel that they have succumbed to empty threats. This past experience might make the present offer under Sec 560 not very appealing. However, the large number of Companies and the lack of adequate "Government machinery" make it rather difficult for the DCA to go after all the defaulting companies.

In fact Section 560 casts a duty on the Registrar and not on the Companies. This Scheme has been devised to fulfill the duties of the Registrar by the Companies themselves. ■