

Between the lines...

May, 2016



I. **Bombay High Court clarifies that proceedings under Section 138 of Negotiable Instruments Act, 1881 cannot be stayed under Section 446(1) of the Companies Act, 1956**

The judgment in the case of *Indorama Synthetics(India) Limited vs State of Maharashtra and Ors* in CrWP No. 1280 of 2010 arises out of a reference made to the Division Bench of the Bombay High Court to reconcile conflicting views recorded in two Single Judges' judgments on the issue "Whether the expression 'suit or other proceedings' in Section 446(1) and the expression 'suit of proceedings' in Section 442, under Chapter II of Part VII of the Companies Act, 1956 (**Companies Act**), include criminal complaints filed under Section 138 of the Negotiable Instruments Act, 1881 (**NI Act**)". Since Section 442 stood repealed pursuant to enactment of the Companies (Second Amendment) Act, 2002, the judgment restricts itself to the interpretation of the term 'suit or other proceedings' in Section 446(1) as above.

It had been held inter alia in the unreported judgment of the Single Bench of the Bombay High Court by J.H. Bhatia J. in the case of *Suresh K. Jasani vs. Mrinal Dyeing and Manufacturing Company Ltd. &Ors.* that the words "other legal proceedings" have a wide connotation and include even the criminal proceeding, which has some relevance with the functioning of the company, particularly about its civil liabilities or contractual liabilities. Further, the Judge also held that since proceedings under Section 138 of the NI Act arise out of civil liability of the company the same may be covered by the words 'other legal proceedings' within the meaning of Section 446(1) of the Companies Act.

On the other hand, in a prior judgment of the Single Bench of the Bombay High Court by F.I. Rebello J. in the case of *Firth (India) vs. Steel Company Ltd. (in liquidation)* reported in AIR 1999 Bombay 75, it had been inter alia held after considering rival submissions that the expressions 'suit or legal proceedings' and 'any suit or other legal proceedings' would not include criminal complaint under Section 138 of the NI Act.

The Division Bench observed that the scheme of Section 446 of the Companies Act made it clear that the purpose or object of the same was that in respect of a company against whom winding up proceedings had been initiated or winding up order had been passed, the Company Court would see to it that the assets of the company are not recklessly given away or frittered. The Division Bench cited judgments of the Supreme Court in *Sudarshan Chits (I) Ltd. vs. G. Sukumaran Pillai*, AIR 1984 SC 1579 and *Central Bank of India vs. M/s. Elmot Engineering Company*, AIR

1994 SC 2358, to establish that the predominant purpose of the provisions empowering the Court to stay actions against the companies in liquidation or to seek permission of the Court before proceeding with any action against a company which is already wound up is to ensure that the ultimate distribution of assets of an insolvent company is paripassu among its creditors. On the other hand the main object of Section 138 of the NI Act is to safeguard the credibility of commercial transactions and to prevent dishonour of cheques by providing a personal criminal liability against the drawer of the cheque in public interest. The Court observed that the expression “other legal proceedings” in Section 446(1) must be read ejusdem generis with the expression “Suit” and can mean only civil proceedings which have a bearing in so far as the winding up is concerned, namely realization of the assets and discharge of liabilities of the company. Since, no civil liability against the assets of the drawer of the cheque is contemplated hence provisions of Section 446(1) have no application to proceedings under Section 138 as the same are not a suit or a proceeding having a direct bearing on the proceedings for winding up of the assets of the company but are mainly dealing with the penal and personal liability of the Directors of the Company. Further, the Division Bench referred to various judgments dealing with the conflict between Section 446(1) and proceedings under various legislations such as under the Income Tax Act, the Recovery of Debts Due to Bank and Financial Institutions Act to hold that provisions of Section 138, which were introduced by way of amendment to the NI Act in 1988, being a subsequent special statute would necessarily override the provisions of a general statute such as the Companies Act.

Thus, having analyzed the spirit, purpose and object of Section 446(1) of the Companies Act, Section 138 of the NI Act along with judgments of various Indian Courts, the Division Bench answered the reference stating that “The expression “suit or other proceedings” in Section 446(1) under Chapter II of Part VII of Companies Act, 1956, does not include criminal complaints filed under Section 138 of the Negotiable Instruments Act, 1881.”

VA View

The judgment of the Division Bench in the case of *Indorama Synthetics(India) Limited vs State of Maharashtra and Ors* in CrWP No. 1280 of 2010 furthers the trend of the courts in seeking to restrict stay of proceedings by Company Courts in proceedings under special statutes. By specifically giving the principle that the Company Court can only stay proceedings having a direct bearing on the proceedings for winding up of the assets of the company, the court has further curtailed the malpractice by Indian companies in seeking stay of proceedings against them in any case where winding up proceedings are instituted. Section 138 is a special provision which is intended to buttress the reliability of cheques in commercial transactions by attaching criminal liability to dishonor of the same. Such a special provision is for public good and in general commercial interest and should not be read down or curtailed allowing defaulters to escape their liabilities by citing technicalities of other laws.

II. Indian Accounting Standards

This financial year was marked with the implementation of new Indian Accounting Standards (**Ind-AS**) with effect from April 1, 2016, in phases, with the intention to bring the current Indian Accounting Standards at par with the International Financial Reporting Standards (IFRS). All Indian companies having a net worth exceeding INR 5 billion or whose equity and/or debt securities are listed/in the process of listing in any stock exchange in or outside India (including the holding, subsidiary or joint venture company thereof) are required to mandatorily adopt the new accounting norms for the financial year 2016-17, as a part of the mandatory phase I adoption of Ind-AS. Some of these companies were following the Indian Generally Accepted Accounting Principles (GAAP) till now. Whereas, entities having a net worth of less than INR 5 billion but are listed or in the process of getting listed will have to compulsorily follow the new norms from April 1, 2017.

However, companies whose securities are listed or in the process of listing on SME exchanges shall not be required to apply Ind AS. Such companies shall continue to comply with the existing Accounting Standards unless they choose otherwise.

The implementation date for financial service sector companies including banks and insurance companies to comply with Ind AS will be from April 1, 2018 as per the road-map drawn up for implementation of Ind-AS by Ministry of Corporate Affairs. It is pertinent to note that scheduled commercial banks are not permitted to voluntarily adopt Ind AS, if they do not meet the specified criteria of having a net worth exceeding INR 5 billion. NBFCs having net worth of INR 5 billion crore or more will require to prepare Ind AS for accounting periods beginning from April 1, 2018. But the implementation for NBFCs whose equity and/or debt securities are listed/in the process of listing in any stock exchange in or outside India having net worth less than INR 5 billion has been deferred to April 1, 2019 onwards. The press note has further clarified that NBFCs having net worth below INR 2.5 billion are not covered within this scheme and hence may continue to apply accounting standards as specified in Companies (Accounting Standards) Rules, 2006.

Adoption of Ind-AS would bring about significant change in revenue recognition, employee stock options, foreign currency transactions, accounting for mergers and acquisition and will also have an impact on net worth, return ratios and earnings of Indian companies.

A striking feature of Ind-AS is the fair value basis accounting of financial instruments. Under the old accounting standards, companies were taking into account the cost price of assets, including foreign exchange, securities, debentures or shares held by them. However fair value basis of accounting of such assets implies that in every financial year companies will need to value assets by the most recent market value and account for the gains, if any, in the profit and loss statement, consequently the book profits will increase thereby increasing tax liability under Minimum Alternate Tax (MAT). Further, non-amortisation of goodwill will also increase reported income.

However, the overall impact may be balanced because of the counter weighing adjustments proposed. One such example could be that, Ind AS provides that preference share capital and related dividend is to be treated as debt and interest expenditure thereby will have the effect of consequent reduction of share capital and net income as per the profit and loss account. However, the Companies Act, 2013 treats the preference share capital as part of share capital of a company and a clarification from the government to resolve this conflict is needed.

Post-implementation of Ind-AS by companies, there will be a considerable bearing on the profits/revenues of various Indian companies owing to changes in principles of accounting. Corporates are required to prepare and present an opening balance sheet on the transition day, recognizing assets and liabilities in accordance with Ind AS and adjusting the difference on migration through reserves. Furthermore, the obligatory requirement of accounting for ESOP on fair valuation basis will have a direct implication of increased employee cost. Contrary to this, earlier regime offered flexibility of choice between adopting either the intrinsic value or the fair value methods.

VA View

Ind-AS is an 'Indianized' version of the IFRS in an attempt to merge international principles of financial reporting within the Indian regulatory framework. As the Ind-AS is more so at par with the IFRS, it would definitely provide a higher comfort level to prospective foreign investors. This would be a welcome change impacting more Indian companies at a global forum and attract more foreign investment in Indian companies. Thus, the application of Ind-AS will have far reaching impact on the financial statements of the companies since Ind-AS are comparatively more intricate in many aspects and prescribes stringent norms as compared to the current Indian GAAP.



Disclaimer:

While every care has been taken in the preparation of this Between the Lines to ensure its accuracy at the time of publication, Vaish Associates, Advocates assumes no responsibility for any errors which despite all precautions, may be found therein. Neither this bulletin nor the information contained herein constitutes a contract or will form the basis of a contract. The material contained in this document does not constitute/substitute professional advice that may be required before acting on any matter. All logos and trade marks appearing in the newsletter are property of their respective owners.

© 2016, Vaish Associates Advocates
All rights reserved.

Contact Details :

www.vaishlaw.com

NEW DELHI

1st, 9th & 11th Floor
Mohan Dev Bldg. 13 Tolstoy Marg
New Delhi - 110001, India
Phone: +91-11-4249 2525
Fax: +91-11-23320484
delhi@vaishlaw.com

MUMBAI

106, Peninsula Centre
Dr. S. S. Rao Road, Parel
Mumbai - 400012, India
Phone: +91-22-4213 4101
Fax: +91-22-4213 4102
mumbai@vaishlaw.com

BENGALURU

Unit No. 305, 3rd Floor
Prestige Meridian-II, Building No. 30
M.G. Road, Bengaluru - 560001, India
Phone: +91-80-40903581/ 88 /89
Fax: +91-80-40903584
bangalore@vaishlaw.com