

De Jure

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Amendment to Companies (Incorporation) Rules, 2014 with respect to One Person Company



The Ministry of Corporate Affairs ("**MCA**") has recently amended the Companies (Incorporation) Rules, 2014 ("**Incorporation Rules, 2014**") by way of Companies (Incorporation) Third Amendment Rules, 2016 ("**Amended Incorporation Rules, 2016**"), *inter alia* substituting existing Rule 3(2) of the Incorporation Rules, 2014 pertaining to one person company ("**OPC**").

Rule 3(2) of the Amended Incorporation Rules, 2016 now provides "*A natural person shall not be member of more than a One Person Company at any point of time and the said person shall not be a nominee of more than a One Person Company*".

The erstwhile Rule 3(2) of the Incorporation Rules, 2014 provided that "*no person shall be eligible to incorporate more than a One Person Company or become nominee in more than one such company*".

Our View

The erstwhile Rule 3(2) imposed restriction on a person from incorporating more than one (1) OPC or becoming nominee in more than one (1) OPC. The amended Rule 3(2) now enables a natural person from being a member of one (1) OPC at any point of time and a nominee of one (1) OPC.

It is difficult to comprehend the rationale behind the aforesaid amendment made to the Incorporation Rules, 2014 by MCA, specifically the restriction imposed on a natural person to be a member of more than one (1) OPC. In the draft Rules, released by the MCA on September 07, 2013, draft Rule 2.1 (2) provided that no person shall be eligible to incorporate more than five (5) OPCs or become member in more than five (5) OPCs. In other words, a person could set up five (5) OPCs. However, the Incorporation Rules, 2014 that came into effect from March 31, 2014 did not permit incorporation of more than one (1) OPC by a person. With respect to being a member of more than one (1) OPC, the Incorporation Rules, 2014 were silent. The factors led to the aforesaid change are the reasons best known to MCA.

The United States ("**U.S.**") recognizes the concept of 'S Corporation', popularly known as 'S Corp', which essentially mean a small business corporation having (a) maximum number of shareholders up to hundred (100); (b) individuals, estate, certain trusts and organizations as shareholders; (c) individuals being U.S. resident only; and (d) issued only one (1) kind of stock. S Corp enjoys the benefits of separate legal entity, perpetual existence, pass-through status in terms of taxation and the greatest advantage being incorporation of any number of S Corps by one person, within the aforesaid limits and parameters of U.S. Code.

There are several other restrictions imposed on OPCs including in relation to increase in paid up share capital beyond Rs.50,00,000, exceeding average annual turnover beyond Rs.200,00,000, no voluntary conversion into other form of company prior to two years of incorporation, incorporation by only natural person, etc.

The aforesaid threshold limits on increase in paid up share capital and average annual turnover for an OPC are also quite small as any business doing significant progress may achieve such limits and upon achieving the same, such OPC is mandatorily required to be converted into a private or public company. A person being a sole member of OPC may not desire to share the profits or liabilities of such OPC with any other person, nevertheless such OPC shall necessarily be converted into private or public company due to the provisions of the Incorporation Rules, 2014.

Further, as of today, a person can have as many private companies as he may desire, simply by holding 99.99% of the shareholding of such company with the remaining 0.01% shareholding held by another person (his wife, father or any other person), which nominee shareholder, for all the practical purposes, may not (cannot) exercise any right(s) in such company or companies.

This leads to an anomalous situation that if a natural person wants to set up business with share capital exceeding Rs.50,00,000 or estimates his turnover to exceed Rs.200,00,000, he cannot set up an OPC (owning 100% shares), but can set up a private company (owning 99.99% legal ownership and 0.01% beneficial interest).

As such, we wonder-

- Why only natural person can incorporate (or be member of) an OPC?
- Why such a natural person can incorporate (or be member of) only one OPC, and not more than one?
- Why bodies corporate cannot incorporate an OPC, when ideally OPC would have been an ideal vehicle to form a wholly-owned subsidiary?
- Why an OPC cannot have share capital of more than Rs.50,00,000 and average annual turnover of more than Rs.200,00,000?

Taking into consideration the aforesaid circumstances and to avoid the present practise of having ineffective shareholding in the form of 0.01% shareholding, it is the need of the hour to do away with all the aforesaid restrictions imposed on OPCs and allow a person to incorporate number of entities with one/single member (being a natural person or an entity), which shall certainly flourish the idea of entrepreneurship, Start-ups and 'Make in India' vision of India.

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