ONE PERSON COMPANY – PROBLEMS AND PITFALLS

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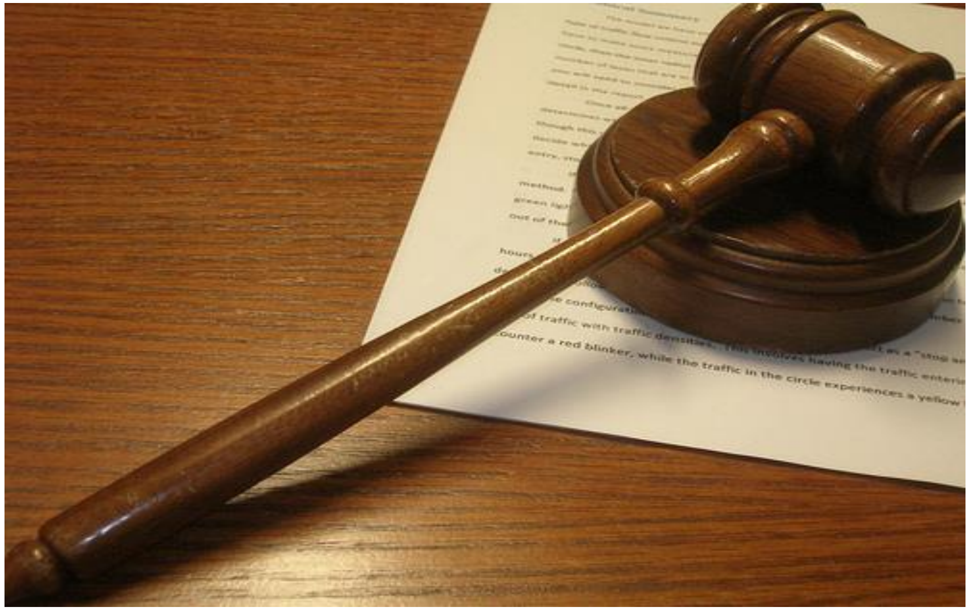
Rajani Associates

simple solutions



OPC - INTRODUCTION

- The concept of One Person Company ("***OPC***") was introduced in the Companies Act, 2013 ("***Companies Act***") and was hailed as a marque feature providing a completely new form of limited liability company. However, the concept of OPC, though well intentioned has not received much traction in the market. A total of 913 OPCs have been incorporated in India from the period of April 2014 (when the incorporation of OPCs were first allowed) to October 2014. Though the number looks large, during the same period, a total of 32,401 limited liability companies were incorporated in India. Therefore, a mere **2.8%** of the total number of limited liability companies incorporated during that period were OPCs. This Article attempts to identify the pitfalls associated with OPC in India and analyse the reasons behind the same.

The BASICS

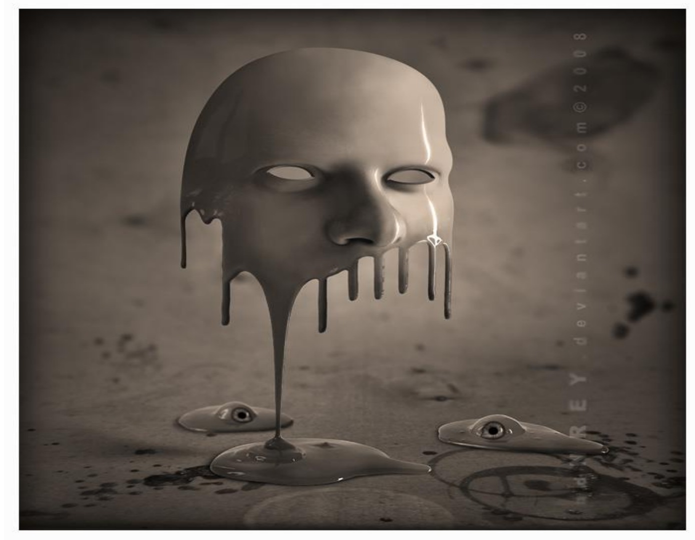
- An OPC is defined under Section 2(62) of the Companies Act as "*a company which has only one person as its member*". An OPC is a legal entity which functions on the same principles as that of a private company but has only one person as its shareholder.

- The Company (Incorporation) Rules, 2014 ("***Rules***") state that only a natural individual, who is an Indian citizen and an Indian resident in the current financial year, shall be eligible to incorporate an OPC ("***Member***"). The Member is further required to nominate another natural Indian citizen and resident (with their prior written consent) ("***Nominee***") who shall become the member in the event of the death or incapacity of the Member.

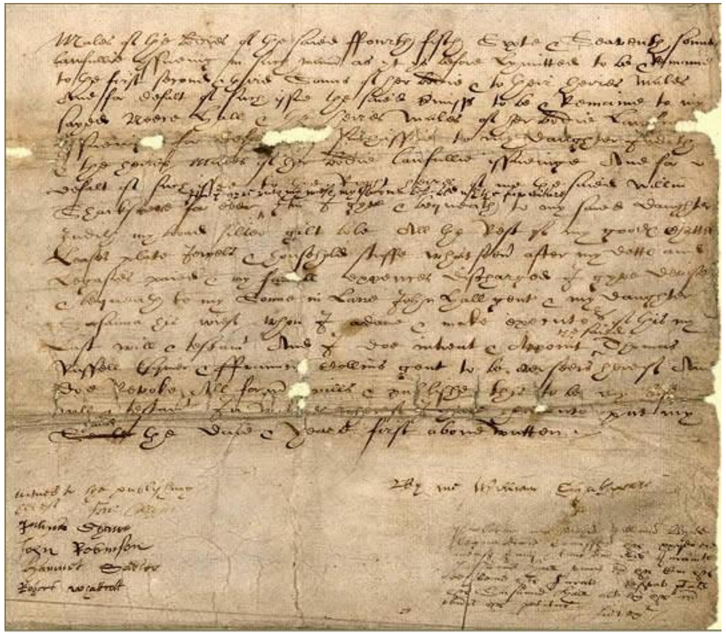
- The minimum paid up share capital of an OPC is Rs.1,00,000 (Rupees one lakh only). The Companies Act grants certain benefits to an OPC vis-à - visa private limited company, including, waiver of requirement of annual general meetings; waiver from creation of cash flow statement; waiver for having quorum of meetings and notice of meetings; exemption from circulation of members resolutions, etc.

- The Major pitfalls associated with OPCs are as follows:

ONLY NATURAL INDIVIDUAL



The main concern with the OPC is the restriction on membership to natural persons. Under the Companies Act, a "person" may incorporate an OPC. The definition of person includes a duly incorporated company. The Rules however have restricted this right only to an Indian citizen currently residing in India. As such, in the event a company desires to form an OPC as a wholly owned subsidiary, it simply cannot do so. If companies were to be allowed to set up wholly owned OPC, it would with its limited procedure allow for easier diversification and greater control over the management of such fledging ventures. One still does not know, nor can fathom, why this restriction on a company setting up an OPC has been imposed under the Act.



Mandatory Nomination

The concept of OPC is centred on the ability of an individual to enter into a business with limited liability without a partner. This entire objective has been overshadowed due to the requirement of a Nominee, who in the event of death or incapacity of the Member shall become the sole member of the OPC. The prior permission of the Nominee is required for this appointment and the Nominee may resign from this position at any time, requiring the Member to identify a new nominee within fifteen days. Though, the concept of Nominee has a rationale objective (*to ensure continual existence of the OPC*), at a practical level it mars the entire objective of the concept through its procedural complications. The concept of Nominee further raises the question of inheritance, would the Nominee inherit the OPC? Or will the inheritance of the OPC follow the personal laws of the Member?

NUMBER OF OPCs

A Member is restricted from incorporating more than one OPC. A restriction which is unique to OPC, i.e. a person may incorporate an infinite number of sole proprietorship concerns, partnerships and companies but only one OPC. This unnecessary restriction imposes an additional burden on the state to track not only the Member of an OPC but also the Nominee, to ensure that a person may not incorporate more than one OPC. The Rules further, do not deal with the status of an OPC incorporated in contravention of this limit. Whether such OPC will have to be dissolved or lose its corporate personality or treated as a sole proprietorship has not been clarified. The question therefore arises as to why there exists a limit to the number of OPCs. There is therefore an additional restriction on the Member forcing him/her to incorporate additional private limited companies with majority shareholding to circumnavigate the problem.

INCOME TAX ON OPC

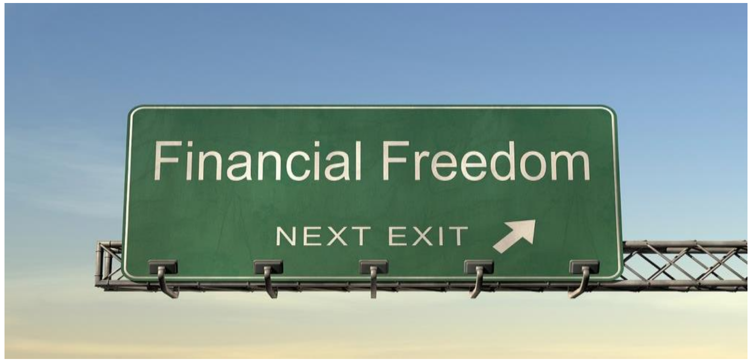
The concept of OPC is not yet recognized under Income Tax Act, 1961 ("***IT Act***") and may be put in the same tax slab as other private companies, making it liable for several additional taxes including the dividend distribution tax. As per the IT Act, private companies have been placed under the tax bracket of flat 30% taxation on the total income. On the other hand, sole proprietors are taxed at the rates applicable to individuals, which means that different tax rates are applicable for different income slabs. Sole proprietors also benefit from exemptions available to individuals under the IT Act. It is unclear if the IT Act would be amended to include such exemptions to OPC, as per the present date, the concept of OPC is in limbo under applicable taxation laws.

NO ECB

The OPC is not a recognised concept under the External Commercial Borrowing and Trade Credits dated July 1, 2014 ("***ECB Policy***"). An OPC therefore cannot obtain funding from foreign recognised lenders as per the extant ECB Policy.

RESTRICTIONS ON CONVERSION OF OPC

- An OPC must compulsorily convert into a private limited company within six months of either its paid up share capital exceeding Rs.50,00,000 (*Rupees fifty lakhs*) or its average annual turnover exceeding Rs 2,00,00,000 (*Rupees two crores*). These additional restrictions are also unique to OPC and the rationale behind the same eludes the authors. It also causes an absurd situation wherein an OPC set up with the very intention of avoiding the additional paperwork and bureaucracy of a private limited company is punished for its very success. The reasons for the imposition of the limit is unclear, it appears that it's a limit on the prosperity of the OPC.



- The Rules are characteristically ambiguous as to the event if an OPC fails to find a partner willing to sign on to a private limited company with the Member. The Rule is also silent on the implication of the failure of the OPC to complete such a conversion. There is also ambiguity as to the status of the OPC between the point it exceeds of the turnover restriction and its eventual conversion as per the Rules. Would the OPC be treated as a private limited company or continue as an OPC?

OUR VIEW

To conclude, it is evident that OPC is a promising concept, but it is still in it's of infancy and there still exist many unsolved questions pertaining to its existence and continuation. It further has more restrictions than a private limited company and must also ensure compliance with a set of new regulations. The various other acts of India also may or may not accept an OPC and require suitable amendments. The silver lining of OPC however is that the majority of restrictive clauses exist not in the Companies Act but the Rules, allowing for the possibility of quick amendments from the government. Though it seems that OPCs have started off on the wrong foot, with suitable modification to the Rules, the concept may still be capable of having several commercial applications.

Contributed by:
Prem Rajani
Kapish Mandhyan

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