UNIT-1 MEANING, DEFINITION & FEATURES OF COMPANY

Structure:

1.0 OBJECTIVES

After studying this unit you will be able to know

- The meaning of Company Form of Organization
- The various features & Benefits of the company
- the doctrine of corporate veil
- the cases when corporate veil of a company may be lifted

1.1 INTRODUCTION

A company is a voluntary association of persons in business having joint capital divided into transferable shares of a fixed value, along with the features of limited liability, common seal and perpetual succession. It may be a public, private, foreign, small, associate, holding or subsidiary company. Companies may be incorporated with limited liability of its members or with unlimited liability. Liability of members may be limited by shares or by guarantee.

1.2 DEFINITIONS OF COMPANY

- According to Justice James, "A company is an association of persons united for a common object."
- According to Lord Lindley, "By a 'company' is meant an association of many persons who contribute money or money's worth to a common stock and employ it for some common purpose. The common stock so contributed is denoted in money and is the capital of the company. The persons who contribute to it or to whom it belongs are members. The proportion of capital to which each partner is entitled is his share."

- According to Kimball and Kimball, "A corporation is by nature an artificial person created or authorized by the legal statute for some specific purpose."

- According to Prof. Haney, "A company is an artificial person created by law having a separate entity with perpetual succession and a common seal."

- According to James Stephenson, "A company is an association of any persons who contribute money or money's worth to a common stock and employs it in some trade or business, and who share the profit and loss (as the case may be) arising there from."

- **The Companies Act 2013 of India defines a company as- "***A registered association which is an artificial legal person, having an independent legal entity with perpetual succession, a common seal for its signatures, a common capital comprised of transferable shares and carrying limited liability."*

Legal Person: A *legal person* could be a human or a non-human entity which is recognized by law as having legal rights and is subject to obligations.

A person or a group of persons: It is no more required to be an association of persons to form a company. A company can also be started as a single person company (one-person company).

1.3 FEATURES OF COMPANY

- **An Artificial Person Created by Law:**

In the eyes of the law, a company is an artificial legal person which has the rights to acquire or dispose of any property, to enter into contracts in its own name, and to sue and be sued by others. A company is a creation of law, and is, sometimes called an

artificial person. It does not take birth like natural person but comes into existence through law. But a company enjoys all the rights of a natural person.

- **Separate Legal Entity :**

A company has a legal entity distinct and separate from its constituent members (shareholders). It is an autonomous body, self-controlling and self-governing. It can hold and deal with any type of property of which it is the owner, in any way it likes. It can enter into contracts, open a bank account in its own name, sue and be sued by its members as well as outsiders. The rights and obligations of a company are distinct from its constituent members. "Shareholders are not, in the eyes of the law, part owners of the undertaking. The undertaking is something different from the totality of the shareholders." Shareholders cannot be held liable for the wrongs or misdeeds of the company.

- **Limited Liability:**

A company may be limited by guarantee or limited by shares. In a company limited by shares, the liability of the shareholders is limited to the unpaid value of their shares. The creditors of a company cannot get their claims satisfied beyond the assets of the company. The liability of members of a company limited by guarantee' is limited to the amount of the guarantee.

- **Perpetual Succession :**

A company has perpetual succession. It has no allotted span of life. The mode of incorporation and dissolution of a company and the right of the members to transfer shares freely guarantee the continuity of the existence of the company quite independent of the life of the members. The existence of a company can be terminated only by law. Being an artificial person it cannot die irrespective of the fact that its members, even the founders or subscribers to the Memorandum, may die or go out of it. Moreover, in spite of the changes in the membership of the company, it can perform its contracts and enter into future agreements. Thus, members may come and go but the company can go on forever.

- **Common Seal :**

Though a company has an artificial personality, it acts through human beings, who are called as directors. They act as agents to the company but not to its members. All the acts of the company are authorized by its "common seal". The "common seal" is the official signature of the company. A document not bearing the common seal of the company will not be binding on the company.

- **Transferability of Shares:**

One can sell one's share of ownership rights to an interested buyer as the shares of a company are transferable. While in case of public companies shares are freely

transferable which is provided by the law, there are some restrictions on the transferability of shares of private companies. In fact transferability of shares and limited liability are the enabling factors for the tremendous rise of companies all over the world.

- **Limitation of Work**

The field of work of a company is fixed by its charter. The Memorandum of Association. A company cannot do anything beyond the powers defined in it. Its action is, therefore, limited. In order to do the work beyond the memorandum of association, there is a need for its alteration

- **Voluntary Associations of Profit**

A company is a voluntary association of persons to earn profits. It is formed for the accomplishment of some public good and whatsoever profit is divided among its shareholders.

- **Ownership & Management**

A company is owned (de facto) by a number of shareholders which is too large a body to manage the affairs of the company. Shareholders set the objectives of the company and appoint their representatives or agents (known as directors) to manage the affairs of the company on their behalf to pursue their objectives. The directors, in turn, hire professional managers (executives) to run the day-to-day operations of the company under their supervision and control. This striking feature of separation of ownership and management has raised many issues which give rise to evolution of corporate governance as the focal point of modern corporations

- **Termination of Existence**

A company is created by law, carries on its affairs according to law and ultimately is affected by law. Generally, the existence of a company is terminated by means of winding up.

1.4 ADVANTAGES AND DISADVANTAGES OF COMPANY FORM OF ORGANISATION

The important advantages of company form of ownership are as follows:

- Limited Liability
- Perpetual Existence
- Professional Management
- Expansion Potentials
- Transferability of Shares
- Diffusion of Risk

In spite of its several advantages, the company form of ownership also suffers from some disadvantages.

- Lack of Secrecy
- Legal Restrictions

1.5 CORPORATE VEIL:

Though a company is a person created by law (legal persona) and it has a distinct entity, yet in reality it is an association of persons who are in fact the beneficial owner of all the corporate property. The people behind a company are disregarded once they have formed a company and given to their association the status of a legal entity. There are, however, certain cases when this corporate veil of company will be probed into and lifted up. The cases can be put under two categories:

(i) Cases falling under judicial interpretation.
(ii) Cases falling under express statutory provisions.

(i) Under Judicial Interpretation

'When the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons.'4 Courts have in general disregarded the concept of independent corporate personality in those cases where corporate personality has been blatantly used as a cloak for fraud or improper conduct or doing things against public policy or for evading individual responsibility. Such cases can be put as follows:

- **For determination of character of the company.** In case it is suspected that the company is owned by the enemies of the country, the courts may in their discretion disregard the corporate veil and examine the character of persons in the real control of the corporate affairs. To allow alien enemies to trade under the corporate façade is against public policy.

  The leading case is: Daimler co. Ltd. v. Continental Tyres and Rubber Co. (1916) A company was incorporated in England to sell tyres manufactured by a German company. The German company held majority of the shares in the English company and all its directors were Germans. Thus the real control of the company was in German hands. During World War I the company brought a case to recover a trade debt. The court was requested to restrain the company from doing so since it belonged to alien enemies. The company was barred from maintaining the suit. It was observed that "a company is not a natural person with mind or conscience, it cannot be loyal or disloyal, it can be neither friend nor enemy, but it may assume an

enemy character when person in de facto control of it affairs are residents in an enemy country or wherever residents, are acting under the control of enemies."

- **For the benefit of Revenues**. Courts may break brought the corporate shell of a company if it appears that the company has been formed for the only purpose of evasion of taxes or to circumvent tax obligation. Courts may refuse to identify the shareholders with the company when it is against the interest of the revenues of the government.

  The leading case is: Sir Dinshaw Maneckjee Petit (1927) Sir Dinshaw Maneckjee Petit was a wealthy man enjoying huge dividend and interest income. He formed four private companies and agreed with each to hold a block of investment as an agent for it. Income received was credited in the accounts of the company but the company handed back the amount to him as a pretended loan. This way he divided his income into four parts in a bid to reduce his tax liability. It was held that, "the company was formed by the assessee purely and simply as a means of avoiding super-tax and the company was nothing more than the assessee himself. It did no business, but was created simply as a legal entity to ostensibly receive the dividends and interests and to hand them over the assessee as pretended loans."

- **For preventing evasion of personal and statutory obligations.** Courts may disregard the separate existence of a company where it appears that company was formed for evading contractual and statutory obligations. A case in point is: Gilford Motor Co. v Horne (1933) Horne was appointed as the managing director of Gilford Motor Company on the condition that he would not solicit the customers of the company so long as he was the managing director of the company or afterwards. He attempted to evade this obligation by forming a company which undertook the soliciting. It was held that the company started by Horne was a mere cloak or sham for the purpose of enabling him to commit a breach of his agreement against solicitation, and, therefore, it was restrained from enticing away Gilford Motor Company's customers. Where a company is incorporated as a device or stratagem to conceal the identity of the proprietor of fraud, the corporate veil shall be lifted up. If an individual forms a company to avoid specific performance of his contracts, court will enforce specific performance against the company. Further, court will not permit resorting to devise of incorporation of a company to evade welfare legislation.

- *A case in point is: Workmen of Associated Rubber Industry Ltd. v. Associated Rubber Industry Ltd. In this case, a company incorporated a subsidiary company and transferred to it some of its investments and securities only for the purpose of splitting the profits into two hands and thereby to reduce the incidence of the obligation to pay bonus. The Supreme Court held that the separate existence of the*

new company would be disregarded for the purpose of working out the amount of the bonus payable to workers.

(ii) Cases falling under express statutory provisions

The Companies Act and other statutes provide expressly the circumstances where corporate veil of a company is disregarded. Following are some of those cases:

- **Holding and Subsidiary Company Relationship:** A company is termed as a holding company when it has the power to control the composition of the board of directors of another company or holds a majority of its shares. The other company called a subsidiary of the former company has a separate legal entity. The principle of lifting the corporate veil is applicable in holding-subsidiary company relationship in two cases: (i) Section 212 of the Companies Act requires a holding company to attach to its Balance Sheet, copies of the Balance Sheet, Profit & Loss Account, Director's Report and Auditors Report of each of its subsidiaries. Further, listed companies are required, as per the Accounting Standards, to prepare Consolidated Balance Sheet to give better information about the financial position of the group as a whole to the creditors, shareholders and public. (ii) Where in spite of subsidiary companies being separate legal entities, the facts and circumstances show that they are in reality parts of one concern owned by a parent company or a group as a whole.

- **Investigation in the affairs of a company:** If an inspector is appointed under section 235 or 237 of the Companies Act to investigate the affairs of the company, he has the power to investigate also the affairs of any other related company in the same management or group (section 239). This is in complete disregard to the separate entities of the companies.

- **Investigation of ownership of a company:** Where it appears to the Central Government that there is good reason so to do, it may appoint one or more inspectors to investigate and report on the membership of any company and other matters relating to the company, for the purpose of determining the true persons - who are or have been financially interested in the success or failure, whether real or apparent, of the company & who are or have been able to control or materially to influence the policy of the company.

- **Directors with unlimited liability:** Ordinarily, the liability of a director in a limited company is the same as that of the members of the company. There is nothing in the Act, however, to prevent their liability being made unlimited by memorandum of the company or if limited by memorandum, being converted into an unlimited liability in pursuance of authority given by the articles. The same principle applies also in the case of a manager of a limited company. (Sec. 322)

- **Fraudulent conduct of business:** If in the course of the winding up of a company, it appears that any business of the company has been carried on with the intention to defraud creditors of the company or any other persons, the Tribunal, on the application of the Official Liquidator or the liquidator or on application of any other creditor or contributory of the company may, if it thinks it proper so to do, declare that any persons who were knowingly parties to the carrying on of the business in the manner above said, shall be personally responsible without any limitation of liability for all or any of the debts or other liabilities of the company as the court may direct. (Sec. 339)

- **Failure to return Application Money:** If the application money of those applicants whom no share has been allotted is not repaid up to the 45th day of the closure of the issue, then the directors of the company shall be jointly and severally liable to repay that money with interest @ 15% p.a. from the expiry of 45th day. [Sec. 39(3)]

- **Misrepresentation in the Prospectus:** In the case of misrepresentation in a prospectus, every director, promoter and every other person who authorizes the issue of such a prospectus incurs liability towards those who subscribe for shares on the faith of untrue statements contained therein. Further, they may be held criminally also (Sec. 34).

- **Mis-description of Name:** Directors and other officers of the company will be personally liable for all the contracts made by them on behalf of the company in their personal names, e.g., acceptance of a Bill of Exchange drawn upon a company by a director in his personal name or omitting to use the name of the company in the prescribed manner (for example, not using the word 'Ltd.' as a part of the company's name). (Sec. 147)

- **Non-payment of Tax:** When any private company is wound up and any tax assessed on the company whether before or in the course of or after liquidation in respect of any income of any previous year cannot be recovered, then every person who was a director of that company at any time during the relevant previous year shall be jointly and severally liable for the payment of such tax. He may, however, be exempted from this liability in case he proves that the non-payment of tax was not due to any gross negligence, misfeasance or breach of duty on his part. (Sec. 179 of the Income-tax Act)

- **Ultra vires acts:** The directors of the company will be personally liable for all those acts which they have done on behalf of the company, if they are: (i) ultra-vires the company, or (ii) ultra-vires the directors if the company does not adopt their acts.

- **Liability under other Statutes:** There are many other provisions of the company law where director(s) of a company are personally liable for the default in complying with those provisions. Some of these are: non-maintenance of proper books of accounts; default in holding of annual general meetings; default in filing the annual returns; default in paying dividends after declaration; false declaration of solvency; non-cooperation with the company auditors or with the liquidators (in the event of winding up of the company); non-compliance with the regulations of the Securities and Exchange Board of India (SEBI). Besides these, directors may be held liable under pollution laws, social security laws (eg. Minimum Wages Act, ESI, EPF, Gratuity), Competition Act, Foreign Exchange Management Act (FEMA), and taxation laws

1.6 LET US SUM UP

The company has various features like perpetual succession, a common seal, independent legal entity, artificial person , incorporated Association, transferability of shares, limited liability, separation of ownership and management. The entity of a company is separate from its members. The separate entity of a company which is also called the corporate veil may be lifted under certain situations. The situations under which corporate veil may be lifted are classified under two categories: judicial interpretation and statutory provisions.

1.7 KEYWORDS

- **Ultra Vires:** Acting or done beyond one's legal power or authority.

- **Fraudulent conduct:** Fraudulent conduct means destroying documents, bribing jurors, threatening jurors/witnesses, forging documents.

- **Corporate Veil :** A legal concept that separates the personality of a corporation from the personalities of its shareholders, and protects them from being personally liable for the company's debts and other obligations

- **Limited Liability:** The condition by which shareholders are legally responsible for the debts of a company only to the extent of the nominal value of their shares.

- **Artificial Person:** Artificial person is an entity created by law and given certain legal rights and duties of a human being. It can be real or imaginary and for the purpose of legal reasoning is treated more or less as a human being. For example, corporation, company, etc.

1.8 FURTHER READINGS

- Lobban, M. (1996). "Corporate identity and limited liability in France and England 1825-67". *Anglo-American Law Review*. 25: 397.
- Mayson, S.W; et al. (2005). *Mayson, French & Ryan on Company Law* (22nd ed.). London: Oxford University Press. ISBN 0-19-928531-4.
- Vasu, Rajkamal (November 19, 2017). The Transition to Locked-In Capital in the First Corporations: Venture Capital Financing in Early Modern Europe
- Courtney, Thomas B. *The Law of Private Companies* (2nd ed.). p. 26. ISBN 1-85475-265-0.

1.9 TERMINAL QUESTIONS

Q1 Define a Company. Explain its features.

Q2 "A Company is an artificial person created by law" Elucidate the statement with a brief overview of Companies Act 2013.

Q3 What are the benefits and limitations of company form of organization?

Q4 What is meant by "Separation between Ownership & Management?"

Q5 Write Short notes on the followings

- Limited Liability
- Transferability of Shares
- Corporate Veil

UNIT-2 THE COMPANIES ACT 2013: BROAD FEATURES

Structure

2.0 OBJECTIVES

After studying this module, you shall be able to

- Know the meaning of company
- Learn the broad features of the Companies Act 2013
- Understand how the Companies Act is implemented

2.1 INTRODUCTION

In general, company means an association of persons for a common object. The term 'company' is derived from the Latin word—com means with or together, panis means bread, and originally referred to an association of persons who take their meals together. Company as a form of business is traditionally called 'joint-stock company'. "By a company is meant an association of many persons who contribute money or money's worth to a common stock and employ it for a common purpose. The common stock so contributed is denoted in money and is the capital of the company. The persons who contribute to it or to whom it belongs are members. The proportion of capital which each member is entitled is his share. Shares are always transferable, although right to transfer them is often more or less restricted."

However, joint contribution of capital is not sufficient to describe a company. In partnership firms also, the capital is brought jointly by the partners. Company different from partnership firms, is not merely an association of persons, it is an incorporated association of persons created by law to carry on the expressly laid down objects. A company exists only in the contemplation of law. Law creates it and law alone can dissolve it. It may be formed by an Act of Parliament, or by Royal Charter, or by registration under company law.

The essential feature of the company is that it is an incorporated association created by the law. Chief Justice Marshal of U.S.A. has defined a company as "a person, artificial, invisible, intangible and existing only in the eyes of the law. Being a mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence."

Company as a form of doing business has its origin in 1600 A.D. when the East India Company was established by a Royal Charter in England. Subsequently, the legislative developments in the mid-nineteenth century in the UK give rise to the modern form of company. At present, the company has become the predominant form of doing business. This is on account of numerous advantages which a company has. Corporate laws world over have regulations regarding formation and functioning of companies. In India, the Companies Act of 2013 (known as the Indian Companies Act, 2013) contains the law relating to companies. The Companies Act being the Act of the Central Legislature (i.e. Parliament) applies to companies throughout India on a uniform basis.

2.2 HIGHLIGHTS OF INDIAN COMPANIES ACT 2013

The Companies Act, 2013 was passed to consolidate and amend the law relating to companies. The Act comprises of 7 schedules, 29 chapters and 470 sections. The Act extends to the whole of India. The Act of Parliament received the assent of the President on the 29th August, 2013.The Act shall be applicable from financial year 2014-15.

- **Immediate Changes in letterhead,** bills or other official communications, as if full name, address of its registered office, Corporate Identity Number (21 digit number allotted by Government), Telephone number, fax number, E mail id, website address if any.

- **One Person Company (OPC):** It's a Private Company having only one Member and at least One Director. No compulsion to hold AGM. Conversion of existing private Companies with paid-up capital up to Rs 50 Lacs and turnover up to Rs 2 Crores into OPC is permitted.

- **Woman Director**: Every Listed Company /Public Company with paid up capital of Rs 100 Crores or more / Public Company with a turnover of Rs 300 Crores or more shall have at least one Woman Director.

- **Resident Director**: Every Company must have a director who stayed in India for a total period of 182 days or more in the previous calendar year.

- **Accounting Year**: Every company shall follow uniform accounting year i.e. 1 st April -31st March.

- **Loans to director –** The Company CANNOT advance any kind of loan / guarantee / security to any director, Director of holding company, his partner, his relative, Firm in which he or his relative is partner, private limited in which he is director or member or any bodies corporate whose 25% or more of total voting power or board of Directors is controlled by him.

- **Articles of Association-** In the next General Meeting, it is desirable to adopt Table F as standard set of Articles of Association of the Company with relevant changes to suit the requirements of the company. Further, every copy of Memorandum and Articles issued to members should contain a copy of all resolutions / agreements that are required to be filed with the Registrar.

- **Disqualification of director-** All existing directors must have Directors Identification Number (DIN) allotted by the central government. Directors who already have DIN need not take any action. Directors not having DIN should initiate the process of getting DIN allotted to him and inform companies. The Company, in turn, has to inform registrar.

- **Financial year-** Under the new Act, all companies have to follow a uniform Financial Year i.e. from 1st April to 31st March. Those companies which follow a different financial year have to align their accounting year to 1st April to 31st March within 2 years. It is desirable to do the same as early as possible since most the compliances are on financial year basis under the new Companies Act.

- **Appointment of Statutory Auditors**- Every Listed Company can appoint an individual auditor for 5 years and a firm of auditors for 10 years. This period of 5 / 10 years commences from the date of their appointment. Therefore, those companies have reappointed their statutory auditors for more than 5 / 10 years, have to appoint another auditor in Annual General Meeting for the year 2014.

2.2.1 Objectives of Companies Act 2013

As per the Results- Framework Document (RFD), Ministry of Corporate Affairs-(2013-2014), objectives of the Companies Act, 2013 are as follows:

- To provide simplified laws governing Corporate Sector and to facilitate effective compliances and enlightened regulatory regime.

- Online delivery of all registry related services with speed, certainty and transparency, access to public information and effectively monitoring of statutory compliance by the companies.

- Effective enforcement of `Companies Act' and other Acts coming under the domain of the Ministry of Corporate Affairs (MCA) for better Corporate Regulation and Governance.

- Protection of Investor and Promotion of Investor Education and Awareness for growth of Corporate Sector in the country.

- To develop capacity building and secure policy advisory support through Indian Institute of Corporate Affairs (IICA).

- To Promote Competition.

- To disseminate Corporate Sector Data/Official Statistics as per National Data Sharing and Accessibility Policy (NDSAP)

- Improving the functioning of Official Liquidators through application of e-Governance.

- Developing and strengthening capabilities in Serious Fraud Investigation Office (SFIO).

2.2.2 Nature & Scope

The Companies Act is an Act of the Central Legislature. So, it applies to companies throughout India on a uniform basis (except that it is applicable to the States of Jammu & Kashmir, Goa, Daman & Diu and Sikkim subject to special provisions made and notifications issued by the Central Government).

The provisions of this Act are applicable to:

- Companies incorporated under this Act or under any previous company law;
- Insurance companies, except in so far as the said provisions are inconsistent with the provisions of the Insurance Act, 1938 or the Insurance Regulatory and Development Authority Act, 1999;
- Banking companies, except in so far as the said provisions are inconsistent with the provisions of the Banking Regulation Act, 1949;
- Companies engaged in the generation or supply of electricity, except in so far as the said provisions are inconsistent with the provisions of the Electricity Act, 2003;
- Any other company governed by any special Act for the time being in force, except in so far as the said provisions are inconsistent with the provisions of such special Act; and

Such a body corporate, incorporated by any Act for the time being in force, as the Central Government may, by notification, specify in this behalf, subject to such exceptions, modifications or adaptation, as may be specified in the notification

2.3 MACHINERY OF ADMINISTRATION

The Central Government has the overall responsibility for administration and enforcement of the Companies Act. The Ministry of Corporate Affairs (MCA) of the Government of India is the nodal agency/authority given various powers under the Act. Most of the powers are vested to the authorities created under the Act.

- **National Company Law Tribunal (NCLT)**

The Companies Act, 2013 provides for the constitution of the National Company Law Tribunal (NCLT) and lays down its composition and power. Chapter XXVII (sections 407 to 434) relate to the National Company Law Tribunal (NCLT) and the National Company Law Appellate Tribunal (NCLAT). The implementation of the Amendment Act will mark the end of the High Court's jurisdiction over company matters. It will also abolish the Company Law Board (CLB) and BIFR. The NCLT will combine the work of all the Company Courts, the Company Law Board and BIFR, while NCLAT will substitute the appellate powers of the High Court. The NCLT and NCLAT have not yet been constituted. Therefore, the provisions relating to the NCLT are not applicable as of now.

The Tribunal shall consist of a President and such number of Judicial and Technical Members not exceeding sixty two, as the Central Government deems fit.

The qualifications for appointment of the President and members of the Tribunal have been laid down by the Act.

The President and every other Member of the Tribunal shall hold office for a term of three years from the date on which he enters upon his office but shall be eligible for re-appointment.

The powers of the Tribunal may be exercised by Benches, constituted by the President of the Tribunal, out of which one shall be a Judicial Member and another shall be a Technical Member. The Tribunal may, after giving the parties to any proceeding before it, an opportunity of being heard, pass such orders thereon as it thinks fit. Any person aggrieved by an order or decision of the Tribunal may prefer an appeal to the Appellate Tribunal.

The Tribunal and the Appellate Tribunal shall not be bound by the procedure laid down in the Code of Civil Procedure, 1908 , but shall be guided by the principles of natural justice. The Tribunal and the Appellate Tribunal shall have, for the purposes of discharging its functions under this Act, the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 while trying a suit in respect of the matters as laid down by the Ac Any person aggrieved by any decision or order of the Appellate Tribunal may file an appeal to the Supreme Court within sixty days from the date of communication of the decision or order of the Appellate Tribunal to him on any question of law arising out of such decision or order.

- **Regional Directors**

The Six Regional Directors are in-charge of the respective regions, each region comprising a number of States and Union Territories. They supervise the working of the offices of the Registrars of Companies and the Official Liquidators working in their regions. They also maintain liaison between the respective State Governments and the Central Government in matters relating to the administration of the Companies Act, 2013. Certain powers of the Central Government under the Companies Act have been delegated to the Regional Directors.

- **Registrar of Companies**

Registrars of Companies (ROCs) appointed under the Companies Act, 2013 covering various States and Union Territories are vested with the primary duty of registering companies floated in the respective States and the Union Territories and ensuring that such companies comply with statutory requirements under the Act. These offices function as registry of records, relating to the companies registered with them, which

are available for inspection by members of the public on payment of the prescribed fee. The Central Government exercises administrative control over these offices.

2.4 COMPANY & BODY CORPORATE

'Body corporate' or 'corporate body' refers to a body which is incorporated under a statute and has a perpetual succession with a common seal, and is a legal entity separate from the members constituting it.

The term 'body corporate' is wider than the 'company' and it includes:

- Companies registered under the Companies Act, 2013 or any former Indian Companies Act
- Foreign Companies
- Corporations formed under special Act of the Parliament or State Legislatures or of a foreign country
- Public financial institutions as defined in Section 2(72) of the Companies Act 2013
- Nationalized Banks
- Limited Liability Partnerships registered under the Limited Liability Partnership Act, 2008.

  However, 'body corporate' does not include:
- A society registered under the Societies Registration Act, 1860;
- A corporation sole;
- A co-operative society registered under any law relating to co-operative societies, and
- Any other body not being a company as defined in the Companies Act, which the Central Government may, by notification in the Official Gazette, specify in this behalf.

2.5 COMPANY AND CORPORATION

Corporation means a body or institution having an independent legal entity and enjoying perpetual succession. It may be of two types: (i) Corporation sole, and (ii) Corporation aggregate. Corporation sole refers to a single person which is constituted as a perpetual office in respect of some functions e.g., a Public Trustee, President, Governor, Minister etc. It is not taken as a body corporate for the purposes of this Act, but it is still a legal person and can be a member of a company. Corporation aggregate means a group of individuals associated as one body having perpetual succession and an independent legal entity. It may be a trading or a non-trading corporation. It includes:

- Chartered companies (created by a Royal Charter)
- Companies incorporated by special Acts of Parliament or State Legislature
- Companies registered under the Companies Act
- Municipal Corporations, District Boards, Universities etc. (non-trading corporations)

2.6 LET US SUM UP

- Company is an association created by the law.
- In India, the Indian Companies Act 2013 contains the law relating to companies.
- The Act is a Central legislature passed by the Parliament and it received the assent of the President on the 29th August, 2013.
- The Act which is replacing the five decades old Companies Act 1956 shall be applicable from financial year 2014-15.
- The objective of the Act is to provide simplified laws governing Corporate Sector and to facilitate effective compliances and enlightened regulatory regime.
- The Central Government has the overall responsibility for administration and enforcement of the Companies Act.
- The Ministry of Corporate Affairs (MCA) of the Government of India is the nodal agency/authority given various powers under the Act.
- The Companies Act, 2013 has introduced National Company Law Tribunal and National Company Law Appellate Tribunal to replace the Company Law Board and Board for Industrial and Financial Reconstruction.
- Company means a company formed and registered under the Indian Companies Act, 2013 or "an existing company". "An existing company" means a company formed and registered under any of the former Companies Act'.
- Company is a body corporate but all body corporates are not companies

2.7 KEY WORDS

- **Accounting Year:** An accounting year is a period of time, usually 12, during which businesses calculate their accounts and organize their financial activities.

- **Statutory Auditors :** A statutory auditor is an external or outside service supplier who has the responsibility to certify the financial statements

- **Ministry of Corporate Affairs:** The Ministry of Corporate Affairs is an Indian government ministry. It is primarily concerned with administration of the Companies Act 2013

- **Corporation:** A corporation is an organization—usually a group of people or a company—authorized by the state to act as a single entity and recognized as such in law for certain purposes.

2.8 FURTHER READINGS

- A Compendium of Companies Act 2013, along with Rules, by Taxmann Publications.
- Corporate Law, Gupta,Garg,Dhingra, Kalyani Publication
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- Kumar, R., Legal Aspects of Business, Cengage Learning
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- Gogna, P.P.S – Company Law, S. Chand
- MC KuchhalCorporate Laws, Shri Mahavir Book Depot. (Publishers).
- GK Kapoor& Sanjay Dhamija, Company Law, Bharat Law House.

2.9 TERMINAL QUESTIONS

Q 1 What are the major highlights of Indian Companies Act 2013?

Q 2 Discuss in detail about "Machinery for Administration"

Q 3 Distinguish between Company & Body Corporate.

Q 4 The provisions of the Indian companies Act 2013 is applicable to which categories of companies?

Q 5 Write the difference between the followings.

a) Disqualification of Director
b) Registrar of Companies
c) Body Corporate
d) NCLT

UNIT-3 KINDS OF COMPANIES

Structure

3.0 OBJECTIVES

After studying this module, you shall be able to

- Know the various types of company
- Learn the various features of public company and private company
- Identify the holding and subsidiary company
- Understand concept of a foreign company

3.1 INTRODUCTION

The companies can be divided into different types based on parameters such as Size of company, a number of its members, Control of ownership, Liability to shareholders, need of capital from public & On the basis of the manner in which capital can be accessed. A company is popularly referred to as a group of people coming together

with resources in terms of capital, manpower, and skills for the common objective of making profits.

3.2 STATUTORY COMPANY

A company formed by a special Act passed either by the Central or State Legislature is called a Statutory Company. Such companies are governed by their respective Acts. Although statutory companies are governed by the provisions of their special Acts, the provisions of the Companies Act, 2013 which are not inconsistent with the special Acts apply to these companies.

These companies are usually formed to carry out some special public undertakings requiring extraordinary powers and privileges. The object of such companies is not so much to earn profit but to serve people. Though the liability of the members of such companies is limited, yet in most of the cases, they may not be required to use the word 'limited' as part of their names. Annual Report on the working of each such company is required to be placed on the table of the Legislature (Parliament or State Legislative Assembly as the case may be). The audit of such companies is conducted under the supervision, control and guidance of the Comptroller and Auditor General of India. Some of the important statutory companies are Reserve Bank of India, State Bank of India, Life Insurance Corporation of India, Industrial Finance Corporation, etc.

3.3 REGISTERED COMPANY

Companies registered under the Indian Companies Act are known as Registered Companies. These companies are governed and regulated by the provisions of the Companies Act, Memorandum of Association and Articles of Association. These companies may be limited by shares or limited by guarantee or unlimited companies.

Companies Limited by Shares. A company having the liability of its members limited by the amount, if any, unpaid on the shares respectively held by them, is called as a company limited by shares [Sec.2 (22)]. For example if AB.Ltd. has a share capital of 10,000 shares of Rs. 10 each, and A has purchased 100 shares on which he has paid so far Rs. 6 per share, the maximum liability of A is only Rs. 4 per share (the unpaid amount). Also known as 'Limited Liability Company', a large majority of companies registered in India belongs to this category.

Companies Limited by Guarantee Company limited by guarantee, also called Guarantee Company is a company in which the liability of each member is limited to such amount as the members may voluntarily undertake under the memorandum of association to contribute to meet out the deficiency of the assets of the company in the event of its being wound up. The guaranteed amount may differ from member to

member [Sec.2 (21)]. The amount guaranteed by each member is in the nature of a reserve capital. It cannot be called up except in the case of winding up of the affairs of the company. No charge can be created on the guarantee of the members.

These companies may or may not have share capital. If the company has a share capital, liability of members shall be two-fold, firstly liable to pay the amount which remains unpaid on their shares plus the amount payable under the guarantee. The guarantee undertaken by the members would be payable only in the event of winding up of the company. Also referred as non-trading companies, the objective of these companies is not to earn profits. These companies are usually formed for the promotion of educational or scientific research or for any other kind of social or charitable purposes. Sports club, trade associations, NGOs are usually registered as guarantee companies.

Unlimited Companies. A company not having any limit on the liability of its members is termed as an unlimited company [Sec. 2 (92)]. In the case of an unlimited company, the liability of each member extends to the whole amount of the company's debts and liabilities. An unlimited company may or may not have any share capital. In case it has any share capital, it can increase or reduce its share capital without any restriction. Such type of companies, though permitted by the Companies Act, is very few in the country.

3.4 PUBLIC COMPANY AND PRIVATE COMPANY

The registered companies (whether limited or unlimited) may be either private or public companies.

Private Company

Private company as defined by Sec. 2 (68), means a company which has a minimum paid up capital of Rs 1 lakh or such higher paid-up capital as may be prescribed, and whose articles of association contains the following restrictions:

(a) Restricts the right of members to transfer its shares;

(b) Limits the number of its members to 200 (except in case of One Person Company) exclusive of members who are or were in the employment of the company (i.e. past or present employees of the company who are members in the company will not be counted for the limit of 200 members);

(c) Prohibits any invitation to the public to subscribe for any securities of the company. A private limited company may be registered with only two members. A private limited company is required to add the words 'private' (or pvt.) as part of its name.

Public Company [Sec. 2 (71)]
Public company as defined by Sec. 2 (71) means a company which

(a) is not a private company ;

(b) has a minimum paid-up capital of Rs 5 lakh or such higher paid-up capital as may be prescribed ;

(c) is a private company which is a subsidiary of a company which is not a private company (i.e. subsidiary of a public company whether constituted as a private company or public company shall be regarded as a public company).

A public company must have a minimum of 7 members. The articles of association of public company does not contain the restrictions applicable to a private company. That is: shares of a public company are freely transferable: there is no restriction on the maximum number of members; a public company may invite the public to subscribe for its securities - shares, or debentures. However, a public company is under no legal binding to invite the public to subscribe to its shares or debentures.

3.4.1 Distinction between a Private and a Public Company

Following are the main points of distinction between a private and a public company:

- **Minimum number of members:** The minimum number of members required to form a private company is 2, whereas for a public company at least 7 members are needed.

- **Maximum number of members:** The maximum number of members in a public company is unlimited. But a private company cannot have more than 200 members excluding the past and present employees of the company.

- **Minimum paid up capital:** A private company must have a minimum paid up capital of Rs. 1 lakh whereas the minimum paid up capital prescribed for a public company is Rs 5 lakh.

- **Invitation to public:** A private company is prohibited to invite public to subscribe to its share capital. It need not issue a prospectus. But a public company can invite the public to subscribe to its shares or purchase its shares.

- **Deposits from public:** A private company cannot accept deposit from the public i.e. other than its shareholders, directors and their relatives. But a public can invite and/or accept deposits from the public.

- **Transferability of shares:** Articles of Association of a private company imposes restrictions on the transfer of shares. But the shares of a public company are freely transferable.

- **Directors:** A public company is required to have at least three directors while a private company may have only two. Directors of a private company need not retire by rotation. They may be appointed on a permanent basis for life. Unlike the public companies, the directors of a private company may be appointed en bloc by a single resolution.

- **Restrictions regarding managerial remuneration:** Restrictions with regard to the payment of managerial remuneration do not apply to private companies. Unlike the public companies which cannot pay more than 11% of the net profits by way of managerial remuneration, private companies are free to spend any amount on its management. Besides these points of distinction, a private limited company enjoys a large number of legal exemptions and privileges which are not available to public limited companies.

3.4.2 Conversion of a Private Company into a Public Company

Section 14 of the Company Act lay down the following modes in which a private company can become a public company. A private company may get itself converted into a public company by its own choice. In such a case it must–

(i) Pass a special resolution for amending is articles so as to delete the restrictive clauses applicable to a private company.
(ii) Increase the paid up capital to at least Rs 5 lakh if it is less than that.
(iii) Increase the number of members to 7 if it is less than 7.
(iv) Increase the number of directors to 3, if it is less than 3.
(v) File within 15 days a copy of the special resolution for altering the articles.

The company shall cease to be a private limited company from the date of the alteration of the Articles and will become a public company.

A public company can also be converted into a private company by taking the following steps:

- The Articles of the company should be altered by passing a special resolution so as to include the restrictions, limitations and prohibitions imposed by the Act on private companies.

- The consent of the Tribunal must be obtained.
- The company must file with the Registrar a printed copy of the Articles as altered within 15 days of the receipt of the approval of the Tribunal.

Such conversion of a private company into a public company or vice versa does not bring into existence a new company. Therefore, the conversion does not affect the legal personality of the company which continues to remain the same, in spite of the conversion.

3.5 HOLDING COMPANY AND SUBSIDIARY COMPNAY

A company which controls another company is known as Holding company, and the company so controlled is termed as Subsidiary company. As per section 2 (87), a company shall be deemed to control another company in each of the following cases:

- If it controls the majority composition of the board of directors of another company. The composition of other company's board of directors shall be deemed to be controlled if it can, at its direction without the consent or concurrence of any other person, appoint or remove the holders of all or a majority of the directorships.

- If it holds the majority of the shares of another company. For the purpose of control the company should hold more than half in nominal value of the equity shares of another company.

- A company shall be deemed to be the holding company of another company if another company is a subsidiary of the first mentioned company's subsidiary (i.e. subsidiary of the subsidiary).

Illustration: Company B is a subsidiary of company A, and company C is a subsidiary of company B. Company C would be regarded as a subsidiary of company A. By virtue of the above provision, if company D is subsidiary of company C, company D will be a subsidiary of company B and consequently also of company A.
A private company which is a subsidiary of a public company is regarded as a public company. A subsidiary company cannot be a member of its holding company and any allotment or transfer of shares in the holding company to its subsidiary will be void.
Section 129(3) of the Companies Act requires a holding company to attach to its Balance-Sheet, copies of the Balance Sheet, Profit & Loss Account, Director's Report and Auditors Report of each of its subsidiaries. Further, listed companies are required, as per the Accounting Standards, to prepare Consolidated Balance Sheet to give better information about the financial position of the group as a whole to the creditors, shareholders and public.

3.6 ONE PERSON COMPANY

Under Section 2(62) "One Person Company" means a company which has only one person as a member.

(a) OPC may be registered as a private company with one member and at least one director [Sec3 (1)(c)].
(b) One Person Company shall indicate the name of the other person, with his prior written consent in the prescribed form, who shall, in the event of the subscriber's death or his incapacity to contract become the member of the company and the written consent of such person shall also be filed with the Registrar at the time of incorporation of the One Person Company along with its memorandum and articles [Sec 3].
(c) A One Person Company may be either:
    - A company limited by shares; or
    - A company limited by guarantee; or
    - An unlimited company.

3.7 GOVERNMENT COMPANY

Government Company means a company in which not less than 51 percent of the paid-up share capital is held by: -the Central Government, or - Any State Government or Governments, or -partly by the Central Government and partly by one or more State Governments. Government Company includes a company which is a subsidiary of a Government company Government Company is a company in which at least 51% of the paid-up capital is held by the Government. Holding of shares by municipal and other local authorities or statutory corporations (which are the government bodies) is not to be taken into consideration for this purpose. A Government company may be a private company or public company. A Government private company is not required to add the word 'private' as part of its name. A Government company is not an agent of the government as it is a juristic person different from its members (the government).

Specific Provision regarding government companies:

(a) The auditor of a government company is appointed or re-appointed by the Comptroller and Auditor General of India. The Comptroller and Auditor General of India has the power to direct the manner in which the company's accounts are to be audited by the auditor and give such other instructions regarding any matter relating to the performance of his functions as such. He can also conduct a supplementary test audit of the company's accounts by

officers appointed by him. The auditor must submit a copy of his report to the Comptroller and Auditor-General and such report, with his comments thereon, shall be placed before the annual general meeting of the company.

(b) Where the Central Government is a member of a Government company, it shall prepare an annual report on the working and affairs of the company within three months of the annual general meeting and place it along with the audit report and comments thereon before both Houses of Parliament. Where a State Government is a member of a Government Company, it shall present the annual report on the working of the company along with the audit report and comment thereon before the House(s) of the State Legislature.

(c) The Central Government may, by notification in the Official Gazette, direct that any of the provisions of this Act specified in the notification: shall not apply to any Government company; or shall apply to any Government company, only with such exceptions, modifications and adaptations, as may be specified in the notification.

3.8 FOREIGN COMPANY

Foreign companies are companies incorporated outside India but (a) have established a place of business in India, or (b) had established a place of business in India prior to the commencement of the Companies Act, 1956 and continue to have the same. However, where not less than 50 per cent of the paid-up share capital of a company incorporated outside India and having an established place of business in India, is held by one or more citizens of India or by one or more bodies corporate incorporated in India, or by one or more citizens of India and one or more bodies corporate incorporated in India, whether singly or in the aggregate, such company shall comply with such of the provisions of this Act as if it were a company incorporated in India. Foreign company is a company incorporated outside India but having a place of business in India.

Obligations of a Foreign Company

Document to be submitted: Within 30 days of the establishment of the place of business, a foreign company is required to deliver the following documents to the Registrar for registration -

- A certified copy of the charter, statutes, or memorandum and articles of the company or other instrument constituting or defining the constitution of the company; and, if the instrument is not in the English language, a certified translation thereof;

- The full address of the registered or principal office of the company;
- A list of the directors and secretary of the company, containing the particulars of their names, usual residential addresses, nationality, business occupations, and other directorships held;

- The name and address or the names and addresses of some one or more persons resident in India, authorised to accept on behalf of the company service of process and any notices or other documents required to be served on the company ; and

- The full address of the office of the company in India which is to be deemed its principal place of business in India.

3.9 SMALL COMPANY

The concept of "Small Company" has been introduced for the first time by the Companies Act, 2013. The Act identifies some companies as small companies based on their capital and turnover position for the purpose of providing certain relief/exemptions to these companies. Small company is defined under section 2(85) of the Companies Act, 2013. As per this section Small Company means a company, other than a public company,- Paid up share capital of which does not exceed 50 lakhs rupees or such higher amount as may be prescribed which shall not be more than 5 crore rupees.

Salient Features:

- Only a private company can be classified as a small company.
- Holding company, subsidiary company, charitable company and company governed by any Special Act cannot be classified as a small company.
- For a small company, either the paid up capital should not exceed Rupees fifty lakhs or the turnover as per last statement of profit & loss should not exceed rupees two crores.
- The status of a company as "Small Company" may change from year to year. Thus the benefits which are available during a particular year may stand withdrawn in the next year and become available again in the subsequent year.

Provisions and Exemptions available to a Small Company

- The annual return of a Small Company can be signed by the company secretary alone, or where there is no company secretary, by a single director of the company.

- A small company may hold only two board meetings in a year, i.e. one Board Meeting in each half of the calendar year with a minimum gap of ninety days between the two meetings.
- A small company need not include Cash Flow Statement as part of its financial statement.
- Provision regarding mandatory rotation of auditor/maximum term of auditor being 5 years in case of an individual and 10 years in case of a firm of auditors is not applicable to an OPC.

3.10 LET US SUM UP

Statutory company is formed by special act passed by central or state legislature. Companies registered under the Indian companies act are known as registered companies. There are various privileges enjoyed by a private company over a public company. One person company is a company which has only one person as a member. Government Company is a company in which at least 51% of the paid-up capital is held by the Government. Foreign company is a company incorporated outside India but having a place of business in India.

3.11 KEY WORDS

- **Small Company :** Small companies as defined by the Ministry of Corporate Affairs in the Company Amendment Act 2017 means: Any company other than a public company whose paid-up share capital does not exceed 50 lakhs rupees or such higher amount as may be prescribed which shall not be more than 10 crore rupees.

- **Dormant Company:** A dormant company is one that has been registered with Companies House but is not carrying on any kind of business activity or receiving any form of income.

- **Listed Company:** A listed company is a company whose shares are quoted on a stock exchange. Some of the largest listed companies are expected to announce huge interim earnings this week.

- **Associate Company:** "Associate Company", in relation to another Company, means a company in which another company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company.

3.12 FURTHER READINGS

- A Compendium of Companies Act 2013, along with Rules, by Taxmann Publications.
- Corporate Law, Gupta, Garg, Dhingra, Kalyani Publication
- Company Law: Roy & Das, Oxford University Press.
- Kumar, R., Legal Aspects of Business, Cengage Learning
- Corporate Law– S K Matta, Geetika Matta, Vrinda Publications (P) Ltd
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- Gogna, P.P.S – Company Law, S. Chand
- MC KuchhalCorporate Laws, Shri Mahavir Book Depot. (Publishers).
- GK Kapoor& Sanjay Dhamija, Company Law, Bharat Law House.

3.13 TERMINAL QUESTIONS

Q1: How do you distinguish a Private Company and a Public Company? What are the circumstances under which a private company can be converted into a public company?

Q2: Differentiate between Holding Company & Subsidiary Company.

Q3: What do you mean by a small company? What are the provisions and exemptions in case of a small company?

Q4: Write Short Notes on the followings

- Listed Company
- Dormant Company
- Statutory Company
- One Person Company

Q5: Explain the obligations of a foreign company.

UNIT-4 FORMATION OF A COMPANY

Structure

4.0 INTRODUCTION

Company formation is the process of registering a business as a limited company at Companies House. As a result, the business becomes a distinct legal entity. The process is also referred to as 'company incorporation' and 'company registration'. Section 3 of the Companies Act, 2013, details the basic requirements of forming a company as follows: Formation of a public company involves 7 or more people who subscribe their names to the memorandum and register the company for any lawful purpose. One person can form a One-person company. The company must subscribe their names into a memorandum and must comply with all the registration requirements under the Companies Act, 2013.

4.1 STEPS IN FORMATION OF A COMPANY

The procedure for the formation of a company, from the time the idea of forming a company is first conceived till the company is actually formed and commences business, may be divided into three principal stages:

- Promotion
- Incorporation
- Commencement of business

4.2 PROMOTION STAGE

Company promotion is the first stage of the formation of the company. It involves identifying the opportunity, study its feasibility, assembling the requirements, and finance the proposition. The promoter takes various responsibilities to perform the above stages of promotion. Following are the steps in promotion

- Identification if business opportunity
- Minuet Investigation
- Name Approval
- Signatories to Memorandum
- Appointment of Professionals
- Preparing necessary Documents

4.2.1 Meaning of Promoter:

Promoter is a person who conceives the idea of starting a business, plans the formation of a company and actually brings it into existence. He may be said to be "the father of the company who sees the prospects of gain in a business which he wishes to set up, and believes that the can persuade others too to think as he does." A promoter is 'one who undertakes to form a company with reference to a given object and to set it going and who takes the necessary steps to accomplish that purpose. Palmer has defined company promoter as "a person who originates a scheme for the formation of the company, has the Memorandum and the Articles prepared, executed and registered, and finds the first directors, settles the terms of preliminary contracts and prospects (if any) and makes arrangements for advertising and circulating the prospectus and placing the capital."

Thus, a promoter discovers, formulates and assembles a business proposition and brings about a company into existence for its development. They plan and decide upon the nature, scope and the extent of the business of the proposed company. They provide or secure the initial capital of the company, negotiate for the purchase of an existing

business, instruct and direct the lawyers to prepare the necessary documents, select and arrange with persons to become directors, have the prospectus issued and approved, induce persons to buy shares, find funds for the registration fees and execute a score of other things involved in the formulation of a company.

4.2.2 Functions of a Promoter:

- The main functions of a promoter are as follows:
- To conceive an idea of starting a business and explore its possibilities.
- To undertake detailed technical, economic and commercial feasibility of the business propositions. Help of experts may be taken for that.
- To conduct negotiations for the purchase of a business in case it is intended to purchase an existing business.
- To collect the requisite number of persons i.e. 2 in the case of a private company and 7 in the case of a public company, who can sign the memorandum and articles of the company and also agree to act as the first directors of the company.
- To decide the following:
    - The nature of the company
    - The location of its registered office
    - The amount and form of its capital
    - The underwriters of brokers for capital issue, if necessary
    - The bankers
    - The auditors
    - The legal advisers.
- To get the memorandum of association and articles of association drafted and printed. To enter into preliminary contracts with vendors, under writers etc.
- To arrange for the preparation of prospectus, its filing, advertisement and issue of capital.
- To pay preliminary expenses. To arrange funds required by the company including loans.

4.2.3 Duties & Liabilities of Promoter

A promoter cannot an agent nor a trustee of a company which has not come into existence. The reason is that there was no principal or trust in existence for whom or for whose benefit the promoter has acted. But promoter has wide powers relating to the formation of the company. Law has put the relationship of the promoters with the company they bring into existence as well as with those whom they induce to become shareholders in it, as that of a fiduciary nature, the relationship based on utmost faith and confidence. “Those who accept and use such extensive powers are not entitled to disregard the interests of the corporation altogether. They must make a reasonable use of the powers which they accept from the legislature; and consequently they do stand,

with regard to the corporation, when formed, in what is commonly called a fiduciary relation to some extent

This fiduciary relationship imposes an obligation on the promoters to disclose fully all material facts relating to the formation of the company. Though the fiduciary relationship really begins when the company is formed, the fiduciary obligation of a promoter beings as soon as he sets out to act for or promoter the company. Promotes should not make any secret profits at the cost of the company without its knowledge and consent. The disclosure of all material facts, regarding contracts made and the profits earned by them from the formation of the company, should be made to an independent and competent board of directors. If the promoters fail to disclose complete facts, company may set aside the transaction and recover the benefit earned by them.

Thus, it is the duty of the promoters to provide the company with an independent board. However, if the board of directors is not independent from the company, as generally is the case, the disclosure to be effective must be to the would-be shareholders as a whole. The disclosure can be made to the members of the purchasing company by its articles or prospectus or any other method. If this has been done, the absence of an independent board of directors will not invalidate the agreement. Secret profits or undisclosed benefits of any type received by the promoters can be recovered from them by the company. Company can proceed against the promoters for any damage caused to it on account of their fraud or breach of duty. The estate of deceased promoter shall remain liable in an action by a company for deceit or breach of trust if any benefit has accrued to the estate. A promoter can also be liable for any omission of fact (section 56) or false statement in the prospectus (section 62).

4.3 REGISTRATION OR INCORPORATION STAGE

Incorporation is the legal process used to form a corporate entity or company. A corporation is the resulting legal entity that separates the firm's assets and income from its owners and investors. It is the process of legally declaring a corporate entity as separate from its owners. Incorporation brings a company into existence as a separate corporate entity. The promoter has to take the following steps in this connection:

Steps to be taken to incorporate a new company

Select, in order of preference, at least one suitable name upto a maximum of six names, indicative of the main objects of the company. Ensure that the name does not resemble the name of any other already registered company and also does not violate the provisions of emblems and names (Prevention of Improper Use Act, 1950) by availing the services of checking name availability on the portal.

- Apply to the concerned Registrar of Companies (RoC) to ascertain the availability of name in e-Form 1A by logging in to the portal. A fee of Rs. 500/- has to be paid alongside and the digital signature of the applicant proposing the company has to be attached in the form. If proposed name is not available, the user has to apply for a fresh name on the same application.

- After the name approval the applicant can apply for registration of the new company by filing the required forms (Form 1, 18 and 32) within 60 days of name approval.

- Arrange for the drafting of the memorandum and articles of association by the solicitors, vetting of the same by RoC and printing of the same.

- Arrange for stamping of the memorandum and articles of association with the appropriate stamp duty.

- Get the Memorandum and Articles signed by at least 7 subscribers (2 in case of a private company) in his/her own hand, his/her father's name, occupation, address and the number of shares subscribed for and witnessed by at least one person.

- Ensure that the Memorandum and Article is dated on a date after the date of stamping.

- Login to the portal and fill the following forms and attach the mandatory documents listed in the eForm

- Submit the eForms after attaching the digital signature, pay the requisite filing and registration fees and send the physical copy of Memorandum and Articles of Association to the RoC. After processing of the Form is complete and Corporate Identity is generated and the Certificate of Incorporation would be issued by the Registrar of Company.

Documents and Forms to be submitted for Incorporation/Registration of a Company

The promoter has to file the following documents with the required fees to the Registrar of Companies of the State in which the registered office of the company is to be situated:

(a) the memorandum and articles of the company duly signed by all the subscribers to the memorandum in such manner as may be prescribed;

(b) a declaration in the prescribed form by an advocate, a chartered accountant, cost accountant or company secretary in practice, who is engaged in the formation of the company, and by a person named in the articles as a director, manager or secretary of the company, that all the requirements of this Act and the rules made thereunder in respect of registration and matters precedent or incidental thereto have been complied with;

(c) an affidavit from each of the subscribers to the memorandum and from persons named as the first directors, if any, in the articles that he is not convicted of any offence in connection with the promotion, formation or management of any company, or that he has not been found guilty of any fraud or misfeasance or of any breach of duty to any company under this Act or any previous company law during the preceding five years and that all the documents filed with the Registrar for registration of the company contain information that is correct and complete and true to the best of his knowledge and belief;

(d) the address for correspondence till its registered office is established;

(e) the particulars of name, including surname or family name, residential address, nationality and such other particulars of every subscriber to the memorandum along with proof of identity, as may be prescribed, and in the case of a subscriber being a body corporate, such particulars as may be prescribed;

(f) the particulars of the persons mentioned in the articles as the first directors of the company, their names, including surnames or family names, the Director Identification Number, residential address, nationality and such other particulars including proof of identity as may be prescribed; and

(g) the particulars of the interests of the persons mentioned in the articles as the first directors of the company in other firms or bodies corporate along with their consent to act as directors of the company in such form and manner as may be prescribed.

Upon receipt of these documents and the requisite fees, the Registrar will examine them and satisfying himself that the requirement of the Companies Act are met, issue a certificate of incorporation in the prescribed form to the effect that the proposed company is incorporated under this Act. On and from the date mentioned in the certificate of incorporation, the Registrar shall allot to the company a corporate identity number, which shall be a distinct identity for the company and which shall also be included in the certificate. If any person furnishes any false or incorrect particulars of any information or suppresses any material information, of which he is aware in any of

the documents filed with the Registrar in relation to the registration of a company, he shall be liable for action under section 447.

4.3.1 Memorandum of Association

A Memorandum of Association (MOA) is a legal document prepared in the formation and registration process of a limited liability company to define its relationship with shareholders. Memorandum of association is the main document of a company which defines its objects. It lays down the fundamental conditions upon which alone the company is allowed to be formed. It may be termed as the charter or the constitution of the company since it governs the relationship of the company with the outside world.

Memorandum of association must have the following clauses:

- **Name Clause**

A Company is a legal entity and it must have a name to establish its identity. Name Clause in the Memorandum of Association confers protection against subsequent company registration in the same or closely similar name, it secures to the company de facto monopoly of corporate trading under a particular name.

- **Situation Clause**

Memorandum of Association must state the name of the State in which the registered office of the company is to be situated. It will fix up the domicile of the company. Registered office of a company is the place of its residence for the purposes of delivering or addressing any communications, service of any notice or process of Court of Law and for determining the question of jurisdiction in any action against the company. It is the place where all the statutory books, records and registers of the company shall be maintained.

- **Objects Clause**

It is the most important clause in the Memorandum of Association. It defines and limits the scope of the operations of the company. It explains to the members the scope of the activity of the company where their capital will be employed. It gives protection to the shareholders by ensuring that the funds raised for specified businesses are not going to be risked in another. The outside public dealing with the company is informed of the extent of the powers of the company.

- **Liability Clause**

Liability clause mentions the liability of members of the company. In case of a company limited by shares, Memorandum of Association must have a clause to the effect that the liability of the members is limited to the extent of the amount of the unpaid portion of the shares held by him.

- **Capital Clause:**

Memorandum of Association of a limited company having a share capital must state the amount of the share capital with which the company is to be registered which is usually called authorized or nominal capital. Further, division of registered share capital into shares of a fixed amount is also required to be given in the memorandum. Each subscriber must take at least one share and write opposite his name the number of shares he takes.

- **Association Clause:**

This clause states that the persons subscribing their signatures at the end of the Memorandum are desirous of forming themselves into an association in pursuance of the Memorandum. Memorandum of Association must be signed by seven or more persons in the case of a public company and by two or more persons in the case of a private company. Signatures shall be attested by witnesses. There may be one witness for all signatures but one subscriber cannot be a witness to the signatures of another. Full description, address, occupation, etc. of the subscribers and witnesses must be written

4.3.1.1 Alteration of Memorandum:

Memorandum of association can be altered only to the extent to which such alteration is necessary and in accordance with the provisions of the Companies Act (Section13).

Alteration in the Name Clause [Sec. 13 (2)]

Alteration in the name clause can be effected in the following ways:

i) A company can change its name at any time in the course of its business by (a) passing a special resolution, and (b) obtaining the approval of the Central Government in writing to the change. However,

ii) No approval from the Central Government is required where the only change in the name of a company is the addition thereto or, as the case may be the deletion there from, of the word “Private”, consequent on the conversion of a public company into a private company or vice versa.

iii) If, by inadvertence, or otherwise a company on its first registration or on its registration by a new name, has been registered by a name identical with or too resembling with the name of another company previously registered it may, by ordinary resolution and with the previous approval of the Central Government, in writing, change its name.

Alteration in the Situation Clause.

Change in the registered office of a company can be effected in the following ways:

(i) Change of registered office outside the local limits the city, town or village where such office is situated. This can be done by passing special resolution by the company and a notice of the change in the registered office in the prescribed form is to be given to the Registrar within 15 days of passing of the resolution. (Sec. 13)

(j) Change of registered office from one city, town or village to another, within the same State. The procedure is passing of a special resolution of the members of the company in the general meeting. Confirmation of the Regional Director however is required where the change is from the jurisdiction of one Registrar of Companies to the jurisdiction of another Registrar of Companies.

Alteration in the Objects Clause.

In case of companies which have not raised money through prospectus, objects can be changed any time by passing of special resolution. A company, which has raised money from public through prospectus and has any un-utilized amount out of the money so raised, shall not change its objects for which it raised the money through prospectus unless a special resolution is passed by the company through postal ballot and the notice in respect of the resolution for altering the objects shall contain the following particulars:

The total money received

- The total money utilized for the objects stated in the prospectus;
- The unutilized amount out of the money so raised through prospectus,
- The particulars of the proposed alteration or change in the objects;
- The justification for the alteration or change in the objects;
- The amount proposed to be utilized for the new objects;
- The estimated financial impact of the proposed alteration on the earnings and cash flow of the company;
- The other relevant information which is necessary for the members to take an informed decision on the proposed resolution;
- The place from where any interested person may obtain a copy of the notice of resolution to be passed.

The details, as may be prescribed, in respect of such resolution shall also be published in the newspapers (one in English and one in vernacular language) which is in circulation at the place where the registered office of the company is situated and shall

also be placed on the website of the company, if any, indicating there in the justification for such change;

The dissenting shareholders shall be given an opportunity to exit by the promoters and shareholders having control in accordance with regulations to be specified by the Securities and Exchange Board.

The Registrar shall register any alteration of the memorandum with respect to the objects of the company and certify the registration within a period of thirty days from the date of filing of the special resolution.

Alteration in the Liability Clause.

Ordinarily it cannot be altered so as to make the liability of the members unlimited. However, with the authority of the Articles of Association, a company may pass special resolution altering liability clause of the Memorandum of Association so as to make the liability of directors or of any one director or manager unlimited. But, in such a case any person holds office as director or manager before such alteration shall not be liable until the expiry of his present term or unless he has accorded his consent to his liability becoming unlimited. Alterations, which are likely to impose additional liability on a member or which are likely to compel a member to buy additional shares of the company after the date on which he became a member, not be made except with the consent of the member concerned in writing. However, in case a company happens to be a club or any other association and the alteration requires the member to pay recurring or periodical subscriptions or charges at a higher rate, the member will be bound by the alteration although he does not agree in writing to be bound by the alteration.

Alteration of the Capital Clause.

Alterations in the capital clause of the Memorandum of Association may be of the following type:

Alteration of the share capital. (Sec. 61)
Reduction of share capital. (Sec.66)

Alteration of the share capital. A limited company having a share capital may, alter its share capital as follows-

(a) increase its share capital by the issue of new shares;
(b) consolidate or sub- divide its share capital into shares of larger or smaller denominations;

(c) convert its fully paid - up shares into stock, and re-convert that stock into fully paid - up shares of any denomination;
(d) cancel shares which have not been taken or agreed to be taken by any person, and diminish the amount of its share capital by the amount of the shares so cancelled.

A company can make these alterations by passing an ordinary resolution if it is authorized by the Articles of Association to do so. Such alterations must be notified and a copy of the resolution filed with the Registrar within 15 days of the date of the passing of the resolution. Reduction of Share Capital. To provide protection to interests of the investors especially creditors of companies, reduction of share capital is permissible with strict stipulation of the law.
A company limited by shares or a company limited by guarantee and having a share capital, may, reduce its share capital by adopting any of the following methods of reduction:

(a) extinguish or reduce the liability on any of its shares in respect of share capital not paid-up;
(b) either with or without extinguishing or reducing liability on any of its shares, cancel any paid-up share capital which is lost, or is unrepresented by available assets ; or
(c) either with or without extinguishing or reducing liability on any of its shares, pay off any paid-up share capital which is in excess of the wants of the company ;

4.3.2 Articles of Association

Articles of Association is an important document of a company. It contains rules, regulations and bye-laws for the internal administration of the company. Articles regulate the internal management of the company and also govern the relationship between the company and its constituent members by prescribing their rights and obligations.

4.3.2.1 Contents of Articles

The Articles of Association of a company usually deal with the following matters:

i) Definition of important terms and phrases.
ii) Share capital and the rights attached to different classes of shares.
iii) Procedure as to the making of calls and forfeiture of shares.
iv) Appointment of managerial personnel e.g., directors, managing directors etc., their rotation, powers and duties.
v) Rules as to

(a) Transfer and transmission of shares
(b) General meetings
(c) Common seal of the company
(d) Dividend, reserves and capitalization of profits
(e) Accounts and audit
(f) Lien on shares
(g) Remuneration of managerial personnel
(h) Issue of redeemable preference shares
(i) Winding up of the company

Regulations contained in the Articles of Association must not go beyond the powers of the company as laid down by the Memorandum of Association nor violate any of the requirements of the Companies Act. All clauses in the Articles ultra-Vires the Memorandum or the Act shall be null and void.

4.3.2.2 Alteration of Articles:

A company has an inherent power to alter its articles. Section 14 of the Companies Act conferred the power of alteration to the company which states that a company may alter its articles by passing a special resolution to this effect. A company may even change its Articles with retrospective effect. Any provision making Articles unalterable is regarded as bad in law. Company cannot deprive itself, by an express provision in the Articles or independent contract, of the power to alter its articles. However, there are certain limitations or restrictions on the power of the company to alter its articles of association. These are as follows–

- Articles can be altered only by a special resolution. Articles can never be altered by an ordinary resolution even if they provide for such a procedure.

- Alteration can neither be beyond the provisions of the Companies Act nor the memorandum of association. Articles may, however, be altered to explain ambiguous portions or to supplement the memorandum with regard to those things upon which it is silent.
- Alteration of articles seeking to take away the company's power to alter its articles, would be void as being contrary to the provisions of the Act. But an Article prescribing a special method for passing the special resolution for altering the Articles will be valid.

- Alternation seeking to impose an additional liability on a member of the company after the date on which he became a member, to take shares more than what he has already taken or to pay any more money than what he is liable to pay on his shares shall not be binding upon him unless he agrees in writing to

such an alteration except in case where the company is a club or any other association and the alteration of Articles provides for increase in the rate of subscription by the members.

- Alteration should not be illegal or against public policy besides not being contrary to any other statute in force.

- The power to alter the Articles must be exercised by the shareholders in good faith for the benefit of the company as a whole.2 Alterations made bona fide and in the interests of the company shall be valid even if they are likely to affect adversely the personal interests of some of the members of the company. Alteration of Articles so as to give power to the directors to require any shareholder who competed with the company's business to transfer his shares at full value is valid and binding upon the members of the company for it will be beneficial to and in the interest of the whole company.

- Certain provisions of the Articles cannot be altered except with the prior approval of the Central Government. These include conversion of a public company into a private company.

- A company can alter its articles even if it causes a breach of an agreement with the outsider. It cannot be prevented by injunction from altering its articles which constitute a breach of contract, although it may be able to pay damages, if it acts upon them. The remedy of the outsider depends on this fact whether his contract is purely on the terms in the articles or it is an independent contract. In the former case, the alteration will be operative and outsider will have no remedy against the company. While in the latter case, the company can repudiate the contract by altering its articles, but will be liable for the damages caused to the third party on account of such breach. This is because "a company cannot by altering articles cause a breach of contract."

4.3.3 Prospectus

According to Section 2 (70), prospectus means "any document described or issued as a prospectus and includes any notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any shares in, or debentures of a body corporate." Thus, prospectus is a document inviting general public to subscribe to the share capital of a public company. Any document which has the object of securing the required capital or public deposits for a company comes within the definition of prospectus. Invitation to Public. The term 'public' includes any section of the public howsoever selected. It connotes persons not personally known to the promoter as distinguished from his own friends, relatives,

connections and acquaintances. Even an offer to a limited class of people shall be an offer to the public.

Legal Requirements of a valid Prospectus :

- **Obligations of SEBI:** (Issue of Capital and Disclosure Requirements) Regulations, 2009. These regulations inter-alia deal with the appointment of Lead Merchant Banker, Bankers to the issue, Registrar to the issue, filing of various documents along with a draft prospectus, pricing of the securities, promoters contribution, minimum public offer, and disclosure in the offer document. The company is required to file a draft offer document through the lead merchant banker, at least 30 days prior to registering the prospectus with the Registrar of Companies.

- **It must be dated:** Every prospectus must be dated. The date given in the prospectus shall be taken to be the date of its publication unless proved to the contrary. Date of filing of the prospectus with the Registrar is taken to be the date of its issue. Date of issue of the prospectus may, however, be different from the date of its publication.

- **It must be registered:** A copy of every prospectus must be signed by every director or proposed director and filed with the Registrar for registration before it is issued to the public. Subsequent issues of copies of the prospectus must state on their face that a copy has been so filed. This copy must be accompanied with the following documents:

  (a) if the report of an expert of an expert is to be published, his written consent to such publication;
  (b) Written consent of all those persons whose names are mentioned in the prospectus as auditors, legal advisors, solicitors, bankers, etc.
  (c) A copy of every contract relating to appointment and remuneration of managerial personnel and their consent to act as such;
  (d) A copy of every material contract unless entered into in the ordinary course of business or two years before the date of the issue of the prospectus;
  (e) Where the persons making any report required by Section 26 have made any adjustments as regards the "figures of profits or losses or assets and liabilities dealt with by the report", without giving the reasons, a written statement signed by those persons setting out the adjustments and giving the reasons therefore.

The prospectus must be issued within 90 days after the date on which a copy thereof has been delivered for registration. If a prospectus is issued subsequently after the expiry of this period, it shall be deemed to be a prospectus a copy of which has not been delivered to the Registrar for registration. This default will make liable, the company,

and every person who is knowingly a party to such an issue of prospectus, to a fine which may extend to Rs 3 Lakhs.

- **Expert to be unconnected with the formation or management of the company:** A prospectus must not include a statement purporting to be made by an expert such as an engineer, accountant, etc. unless the expert is a person who has never been engaged or interested in the formation or promotion or in the management of the company. [Sec. 26(5)]

- **Expert's consent to be obtained:** If the prospectus includes a statement purporting to be made by an expert, it must not be issued, unless the expert was an independent person competent to make such reports and had given his written consent to the issue thereof and has not withdrawn such consent before the delivery of a copy of the prospectus for registration and a statement to that effect appears in the prospectus.

- **Terms of the contract not to be varied:** The terms of any contract stated in the prospectus cannot be varied after registration of the prospectus except with the approval of the members in general meeting.

- **Every application form to be accompanied with a copy of prospectus or abridged prospectus:** Every form of application for subscribing to the shares or debentures of a company shall not be issued unless it is accompanied by a prospectus or an abridged prospectus, unless the offer or invitation has not been made to the public.

- **Consequences of applying for shares in fictitious names to be prominently displayed:** The following provisions of section38 must be prominently reproduced in every prospectus and every application form issued by the company to any person: "Any person who— (a) makes in a fictitious name an application to a company for acquiring, or subscribing for, any shares therein, or (b) otherwise induces a company to allot, register any transfer of shares therein to him, or any other person in a fictitious name shall be liable for action under section 447.

- **Disclosure Requirement and Contents as per Section 26:** Every prospectus issued by a company must state the matters and contain reports specified in Section 26 of the Act.

4.4 SUBSCRIPTION STAGE

After getting the certificate of incorporation the very next stage is to raise funds. A Public company cannot commence business unless the minimum amount of subscription mentioned in the prospectus has been subscribed. The following steps are required to raise funds from the public.

- SEBI approval: The first step is to take the approval from the regulatory authority i.e., SEBI. The company has to follow its rules and guidelines.
- Filing of prospectus: Prospectus is a statement containing all the required information regarding the state of affairs of the company as well as the future prospects of the company.
- Appointment of bankers, brokers' and underwriters: The banker is appointed to collect the money coming from the applications. A broker is appointed to induce the public, by creating an image in the public's mind for the purchase of the shares and debentures. An underwriter is appointed to ensure that the issue is subscribed fully.
- Minimum subscription: Minimum subscription means the minimum amount which should be subscribed by the public. According to the guidelines of SEBI, minimum subscription is 90% of the entire issue.
- Listing of shares: The Company will make its shares listed to at least one stock exchange for the purchase of the shares.
- Allotment of shares: Allotment letters are issued to the qualified applicants.

4.5 COMMENCEMENT OF BUSINESS

As soon as a private company gets the certification of incorporation it can start its business. If all the legal formalities are done then the registrar issues a certificate known as 'certificate of commencement of business'. This is conclusive evidence for the commencement of business for the public company.

As per section 11 of the Companies Act, 2013, now all newly incorporated Public and Private Companies having Share Capital would be required to obtain a certificate of commencement of business from concerned Registrar of Companies before commencing the business or exercise borrowing powers. A Company will file the following documents with the registrar.

- A Declaration that a prospectus has been filed with the registrar of the company.
- List of members of the company with their shareholdings
- List of Directors, Manager, Secretary, Auditors and changes among them, if any

- Consent of the Auditors to include their name in the Prospectus/Statement in lieu of Prospectus
- Printed and certified copy of the Memorandum and Articles of Association of the company.
- Certified copy of the resolution passed by the Board for approval of prospectus /statement in lieu of prospectus for filing with the Registrar.
- Details of the preliminary expenses incurred by the company

4.6 LET US SUM UP

Promotion is the stage of conceiving an idea of forming a company to do business and working on that idea. Promoters stand in a fiduciary relationship with the company promoted by them. Preliminary contracts may be adopted by a company under the Specific Relief Act. Incorporation of a company requires certain documents to be filed with the Registrar of Companies. Incorporation brings a company into existence. Commencement of business by a company requires filing of a prescribed declaration and verification of registered office of the company

4.7 KEY WORDS

- **Registrar of Companies:** The Registrar of Companies is an office under the Indian Ministry of Corporate Affairs that deals with administration of the Companies Act 1956 and Companies Act, 2013. These officers are from Indian Corporate Law Service cadre.

- **Subscription:** Subscribed share capital is that part of issued share capital for which company has positively received subscription from investors. In simple words, when a company issues shares to raise fund, it may or may not find the investors for all of its shares**.**

- **SEBI:** The Securities and Exchange Board of India is the Regulator for the Securities market in India owned by Government of India. SEBI acts as a watchdog for all the capital market participants and its main purpose is to provide such an environment for the financial market enthusiasts that facilitate efficient and smooth working of the securities market.

- **Commencement:** It is a Declaration to be issued by the directors within 180 days of incorporation of the company stating that the subscribers to the Memorandum of the company has paid the value of shares so agreed by them, along with a verification of registered office address of the company.

- **Incorporation:** The process of constituting a company, city, or other organization as a legal corporation.

4.8 FURTHER READINGS

- A Compendium of Companies Act 2013, along with Rules, by Taxmann Publications.
- Corporate Law, Gupta,Garg,Dhingra, Kalyani Publication
- Company Law: Roy & Das, Oxford University Press.
- Kumar, R., Legal Aspects of Business, Cengage Learning
- Corporate Law– S K Matta, Geetika Matta, Vrinda Publications (P) Ltd
- Arora & Banshal, Corporate Law – Vikas Publication
- Gogna, P.P.S – Company Law, S. Chand
- MC Kuchhal Corporate Laws, Shri Mahavir Book Depot. (Publishers).
- GK Kapoor& Sanjay Dhamija, Company Law, Bharat Law House.

4.9 TERMINAL QUESTIONS

Q1 What is meant by company incorporation? Give stages of company promotion.

Q2 What is memorandum of association? Describe various clauses of Memorandum.

Q3 What do you mean by the Articles of Association? Give various contents of Articles.

Q4 What is meant by Prospectus? Is it compulsory to issue? What are the legal requirements of a valid prospectus?

Q5 What are the duties and liabilities of a Promoter?