

**Answer -**

It is true to say that Indian Partnership Act, 1932 does not make the registration of firms compulsory nor does it impose any penalty for non-registration. Following are the consequences of Nonregistration of Partnership Firms in India: The Indian Partnership Act, 1932 does not make the registration of firms compulsory nor does it impose any penalty for non-registration. However, under Section 69 of the Indian Partnership Act, 1932, non-registration of partnership gives rise to a number of disabilities. These disabilities briefly are as follows :

1. No suit in a civil court by firm or other co-partners against third party: The firm or any other person on its behalf cannot bring an action against the third party for breach of contract entered into by the firm, unless the firm is registered and the persons suing are or have been shown in the register of firms as partners in the firm.
2. No relief to partners for set-off of claim: If an action is brought against the firm by a third party, then neither the firm nor the partner can claim any set-off, if the suit be valued for more than `100 or pursue other proceedings to enforce the rights arising from any contract.
3. Aggrieved partner cannot bring legal action against other partner or the firm: A partner of an unregistered firm (or any other person on his behalf) is precluded from bringing legal action against the firm or any person alleged to be or to have been a partner in the firm. But, such a person may sue for dissolution of the firm or for accounts and realization of his share in the firm's property where the firm is dissolved.
4. Third party can sue the firm: In case of an unregistered firm, an action can be brought against the firm by a third party.

**Question 48**

Define OPC (One Person Company) and state the rules regarding its membership. Can it be converted into a non-profit company under Section 8 or a private company?

**Answer:-**

Provision: [Section 2(62) of Companies Act, 2013]

- ✓ 1. One Person Company (OPC) [Section 2(62) of the Companies Act, 2013]: The Act defines one person company (OPC) as a company which has only one person as a member.
2. Rules regarding its membership:
- b) Only one person as member. The memorandum of OPC shall indicate the name of the other person, who shall, in the event of the subscriber's death or his incapacity to contract, become the member of the company.
  - c) The other person whose name is given in the memorandum shall give his prior written consent in prescribed form and the same shall be filed with Registrar of companies at the time of incorporation.
  - d) Such other person may be given the right to withdraw his consent.
  - e) The member of OPC may at any time change the name of such other person by giving notice to the company and the company shall intimate the same to the Registrar.
  - f) Any such change in the name of the person shall not be deemed to be an alteration of the memorandum.
  - g) Only a natural person who is an Indian citizen and resident in India or otherwise -
    - i. shall be eligible to incorporate a OPC
    - ii. shall be a nominee for the sole member of a OPC.
    - iii. who has stayed in India for a period of not less than 120 days
  - h) No person shall be eligible to incorporate more than one OPC or become nominee in more than one such company.
  - i) No minor shall become member or nominee of the OPC or can hold share with beneficial interest.
3. OPC cannot be incorporated or converted into a company under section 8 of the Act. Though it may be converted to private or public companies in certain cases.

Conclusion:

OPC = 88X  
 NBFCE  
 → convert - A

Above are rules regarding one person company. As per provisions given it is one of the main condition for OPC that it cannot be get converted into a Section 8 i.e. non-profit organization.

#### Question 49

The Articles of Association of XYZ Ltd. provides that Board of Directors have authority to issue bonds provided the shareholders authorize such issue by a necessary resolution in the general meeting of the company. The company was in dire need of funds and therefore, it issued the bonds to Mr. X without passing any such resolution in general meeting. Can Mr. X recover the money from the company. Decide referring the relevant provisions of the Companies Act, 2013.

**Answer:-**

Provision: [Companies Act, 2013]

2. According to the "doctrine of indoor management" the outsiders, dealing with the company though are supposed to have satisfied themselves regarding the competence of the company to enter into the proposed contracts are also entitled to assume that as far as the internal compliance to procedures and regulations by the company is concerned, everything has been done properly. They are bound to examine the registered documents of the company and ensure that the proposed dealing is not inconsistent therewith, but they are not bound to do more.
3. They are fully entitled to presume regularity and compliance by the company with the internal procedures as required by the Memorandum and the Articles. This doctrine is a limitation of the doctrine of "constructive notice" and popularly known as the rule laid down in the celebrated case of Royal British Bank v. Turquand. Thus, the doctrine of indoor management aims to protect outsiders against the company.
4. As per the case of the Royal British Bank vs. Turquand [1856] 6E & B 327, the directors of R.B.B. Ltd. gave a bond to T. The articles empowered the directors to issue such bonds under the authority of a proper resolution. In fact, no such resolution was passed. Notwithstanding that, it was held that T could sue on the bonds on the ground that he was entitled to assume that the resolution had been duly passed. This is the doctrine of indoor management, popularly known as Turquand Rule.

Facts of case:

In given case articles of association of XYZ Ltd. Provides that BOD have authority to issue bonds provided it need to be authorized by resolution passed in general meeting by shareholders of company. Company issued bonds to Mr. X without passing any resolution in general meeting of shareholders. Answer: Since, the given question is based on the above facts, accordingly here in this case Mr. X can recover the money from the company considering that all required formalities for the passing of the resolution have been duly complied.

### Question 50

Krishna, an assessee, was a wealthy man earning huge income by way of dividend and interest. He formed three Private Companies and agreed with each to hold a bloc of investment as an agent for them. The dividend and interest income received by the companies was handed back to Krishna as a pretended loan. This way, Krishna divided his income into three parts in a bid to reduce his tax liability. Decide, for what purpose the three companies were established? Whether the legal personality of all the three companies may be disregarded.

**Answer:-**

Provision: [Companies Act, 2013]

The House of Lords in Salomon Vs. Salomon & Co. Ltd. laid down that a company is a person distinct and separate from its members, and therefore, has an independent separate legal existence from its members who have constituted the company. But under certain circumstances the separate entity of the company may be ignored by the courts.

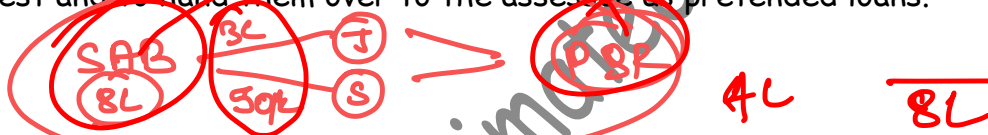
2. When that happens, the courts ignore the corporate entity of the company and look behind the corporate façade and hold the persons in control of the management of its affairs liable for the acts of the company.
3. Where a company is incorporated and formed by certain persons only for the purpose of evading taxes, the courts have discretion to disregard the corporate entity and tax the income in the hands of the appropriate assessee.
4. This is based on the concept called Lifting of Corporate Veil in which by lifting the veil court sees the persons who are actually liable for the misconduct done by such persons who acts behinds the veil of company.

Facts of case:

The problem asked in the question is based upon the aforesaid facts. The three companies were formed by the assessee purely and simply as a means of avoiding tax and the companies were nothing more than the façade of the assessee himself. Therefore, the whole idea of Mr. Krishna was simply to split his income into three parts with a view to evade tax. No other business was done by the company.

Conclusion:

The legal personality of the three private companies may be disregarded because the companies were formed only to avoid tax liability. It carried no other business, but was created simply as a legal entity to ostensibly receive the dividend and interest and to hand them over to the assessee as pretended loans.



✓ Question 51

The paid-up share capital of SAB Pvt. Ltd. is Rs. 1 crore, consisting of 8 lacs Equity Shares of Rs. 10 each, fully paid-up and 2 lacs Cumulative Preference Shares of Rs. 10 each, fully paid-up. JVN Pvt. Ltd. and SARA Pvt. Ltd. are holding 3 lacs Equity Shares and 50,000 Equity Shares respectively in SAB Pvt. Ltd. JVN Pvt. Ltd. and SARA Pvt. Ltd. are the subsidiaries of PQR Pvt. Ltd. With reference to the provisions of the Companies Act, 2013, examine whether SAB Pvt. Ltd. is a subsidiary of PQR Pvt. Ltd.? Would your answer be different if PQR Pvt. Ltd. has 8 out of 9 Directors on the Board of SAB Pvt. Ltd.?

Answer-

Provision: [Section 2(87) of Companies Act, 2013]

1. Holding and Subsidiary Companies are relative terms. A company is a holding company of another only if the other is its subsidiary.
2. Section 2 (87) of the Companies Act 2013 lays down the circumstances under which a company becomes a subsidiary company of another company which becomes its holding company. These circumstances are as under:
  - a) When the holding company controls the composition of Board of Directors of the subsidiary company or companies, or

- b) When the holding company exercises or controls more than one half of the total voting power either on its own or together with one or more of its subsidiary companies, or
3. Where a company is the holding company of the company which fulfils any of the above conditions, e.g., if A Ltd. is the holding company of B Ltd., but C Ltd. is the holding company of A Ltd., then B Ltd. will automatically become a subsidiary of C Ltd.

Facts of case:

The paid-up share capital of SAB Private Limited is Rs. 1 crore, consisting of 8 lacs Equity Shares of Rs. 10 each, fully paid-up and 2 lacs Cumulative Preference Shares of Rs. 10 each, fully paid-up. JVN Private Limited and SARA Private Limited are holding 3 lacs Equity Shares and 50,000 Equity Shares respectively in SAB Private Limited. JVN Private Limited and SARA Private Limited are the subsidiaries of PQR Private Limited

Conclusion:

In the first case, the SAB Pvt. Ltd. will not be the subsidiary of the PQR Pvt. Ltd. as JVN Pvt. Ltd. and SARA Pvt. Ltd. are the subsidiaries of PQR Pvt. Ltd. but they do not hold more than one-half of the share capital of SAB Pvt. Ltd. Hence, SAB Pvt. Ltd. is the holding company of JVN Pvt. Ltd. and SARA Pvt. Ltd. but not a subsidiary of PQR Pvt. Ltd.

If, PQR Pvt. Ltd. has 8 out of 9 Directors on the Board of SAB Pvt. Ltd., so, it implies that the PQR Pvt. Ltd. controls the composition of the Board of Directors of SAB Pvt. Ltd. and hence be the holding company of the SAB Pvt. Ltd.

Question 52

*Jnc*

✓ The K Ltd. was in the process of incorporation. The Promoters of the company signed an agreement for the purchase of certain furniture for the company and payment was to be made to the suppliers of furniture by the company after incorporation. The company was incorporated and the furniture was received and used by it. Shortly after incorporation, the company went into liquidation and the debt could not be paid by the company for the purchase of above furniture. As a result, supplier sued the promoters of the company for the recovery of money.

Examine whether promoters can be held liable for the payment under the following situations:

- ✓ a) When the company has already adopted the contract after incorporation?
- ✓ b) When the company makes a fresh contract with the suppliers in substitution of pre incorporation contract ✓

**Answer:-**

Provision: [Companies Act, 2013]

1. Pre-incorporation contracts are those contracts which are entered into, by the promoters on behalf of a prospective company, before it has come into existence e.g. with the proprietor of business to sell it to the prospective company.
3. Under section 9 of the Companies Act, 2013 a company comes into existence from the date of its incorporation, it follows that any act purporting to be performed by it prior to that date is of no effect so far as the company is concerned. The right to enter into contracts, sue or get sued arises only on the incorporation of the company as stated in section 9. Before its incorporation a company does not exist.
4. Being nonexistent, it can neither act in its own behalf nor expressly or implicitly appoint agents to act on its behalf.
5. Further, under the principle of constructive notice, every person entering into a contract with a company is presumed to have knowledge of its documents such as the Memorandum, Articles and resolutions passed by members as these are public documents available for scrutiny at the registered office of a company.
6. Hence, a person who enters into a pre incorporation contract with the promoters does so at his own peril.

Fact of case:

K Ltd. was in the process of incorporation. The Promoters of the company signed an agreement for the purchase of certain furniture for the company and payment was to be made to the suppliers of furniture by the company after incorporation. The company was incorporated and the furniture was received and used by it. Shortly after incorporation, the company went into liquidation and the debt could

not be paid by the company for the purchase of above furniture. As a result, supplier sued the promoters of the company for the recovery of money.

Conclusion:

- a) If there was already a contract between the suppliers and promoters even after incorporation, the promoters shall be personally liable for the failure of payment to the suppliers. Company will not be held liable.
- b) If the company makes a fresh contract with the suppliers in substitution of pre- incorporation contract, the liability of the promoters will come to an end and the company shall be liable to pay to the suppliers.

Question 53

The principal business of XYZ Company Ltd. was the acquisition of vacant plots of land and to erect the houses. In the course of transacting the business, the chairman of the Company acquired the knowledge of arranging finance for the development land. The XYZ Company introduced a financier to another company ABC Ltd. and received an agreed fee of Rs. 2 lakhs for arranging the finance. The Memorandum of Association of the company authorises the company to carry on any other trade or business which can, in the opinion of the board of directors, be advantageously carried on by the company in connection with the company's general business. Referring to the provisions of the Companies Act, 1956 examine the validity of the contract carried out by XYZ Company Ltd. with ABC Ltd.

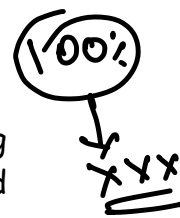
**Answer: -**

Provision: [Companies Act, 2013]

1. As per the provisions of the Companies Act, 2013, the meaning of the term 'ultra vires' is simply "beyond powers". The acts done by the company beyond its object clause of the Memorandum of Association are void.
2. The impact of the doctrine of ultra vires is that a company can neither be sued on an ultra vires transaction nor can it sue on it.
3. In the leading case law of Ashbury Railway Carriage and Iron Company Limited V. Riche, the main business of the company was to make, sell or lend on hire,



railway carriages or wagon and to carry on the business of mechanical engineers and general contractors.



- ✓ 4. The directors of the company entered into a contract with Riche for financing the construction of a railway line in Belgium and the company further ratified this act of the directors by passing a special resolution.
5. Riche, however, repudiated the contract as being ultra vires and the company brought an action for damages for breach of contract. Its contention was that the contract was well within the meaning of the word 'general contractors' and hence within its powers.
6. The court decided that the term 'general contractors' was associated with mechanical engineers, i.e. it had to be read in connection with the company's main business. If the term 'general contractors' was not so interpreted, it would authorize the making of contracts of any kind and every description

Fact of case:

The principal business of XYZ Company Ltd. was the acquisition of vacant plots of land and to erect the houses. In the course of transacting the business, the chairman of the Company acquired the knowledge of arranging finance for the development land. The XYZ Company introduced a financier to another company ABC Ltd. and received an agreed fee of Rs. 2 lakhs for arranging the finance. The Memorandum of Association of the company authorizes the company to carry on any other trade or business, which can, in the opinion of the board of directors, be advantageously carried on, by the company in connection with the company's general business.

Conclusion:

Here, arranging finance or financier is an ultra vires act since it falls outside the object clause of memorandum. An object contained in the object clause is not valid if it authorizes the company to carry on any other trade or business which can be advantageously carried on by the company.

- a) The company has no power to arrange finance or financier.
- b) The Board cannot take the defence that the memorandum authorizes the company to carry on any business which can be advantageously carried on in

connection with company's present business because it is a specified purpose for alternation of object clause.

#### Question 54

Mr. A is an Indian citizen and his stay in India during immediately preceding financial year is for 115 days. He appoints Mr. B as his nominee who is a foreign citizen but has stayed in India for 130 days during immediately preceding financial year.

- 1/ ✓ Is Mr. A eligible to be incorporated as a One Person Company (OPC). If yes, can he give the name of Mr. B in the memorandum of Association as his nominee to become the member after Mr. A's incapacity to become a member.
- ✓ 2. If Mr. A has contravened any of the provisions of the Act, what are the consequences?

#### Answer

As per the provisions of the Companies Act, 2013, only a natural person who is an Indian citizen and resident in India (person who stayed in India for a period of not less than 120 days during immediately preceding financial year) - - Shall be eligible to incorporate an OPC - Shall be a nominee for the sole member.

- (i) In the given case, though Mr. A is an Indian citizen, his stay in India during the immediately preceding previous year is only 115 days which is below the requirement of 120 days. Hence Mr. A is not eligible to incorporate an OPC. Also, even though Mr. B's name is mentioned in the memorandum of Association as nominee and his stay in India during the immediately preceding financial year is more than 120 days, he is a foreign citizen and not an Indian citizen. Hence B's name cannot be given as nominee in the memorandum.

Since Mr. A is not eligible to incorporate a One Person Company (OPC), he will be contravening the provisions, if he incorporates one. He shall be punishable with fine which may extent to ten thousand rupees and with a further fine which may extent to One thousand rupees every day after the first during which such contravention occurs.

Penalty

## ✓ Question 55

1/4/2006

28/6/2016

7/7

1/12/16

1/12/16

✓ Jagannath Oils Limited is a public company and having ~~220~~ members. Of which 25 members were employee in the company during the period 1st April 2006 to 28th June 2016. They were allotted shares in Jagannath Oils Limited first time on 1st July 2007 which were sold by them on 1st August 2016. After some time, on 1st December 2016, each of those 25 members acquired shares in Jagannath Oils Limited which they are holding till date. Now company wants to convert itself into a private company. State with reasons:

- Whether Jagannath Oils Limited is required to reduce the number of members.
- Would your answer be different if above 25 members were the employee in Jagannath Oils Limited for the period from 1st April 2006 to 28th June 2017?

Answer

**Answer**

According to Section 2(68) of Companies Act, 2013, "Private company" means a company having a minimum paid-up share capital as may be prescribed, and which by its articles,—

- restricts the right to transfer its shares;
- except in case of One Person Company, limits the number of its members to two hundred Provided that where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this clause, be treated as a single member: Provided further that— (A) persons who are in the employment of the company; and (B) persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased, shall not be included in the number of members; and
- prohibits any invitation to the public to subscribe for any securities of the company;

Following the provisions of Section 2(68), 25 members were employees of the company but not during present membership which was started from 1st December 2016 i.e. after the date on which these 25 members were ceased to the employee in Jagannath Oils Limited. Hence, they will be considered as members for the purpose of the limit of 200 members. The company is required to reduce the number of members before converting it into a private company

On the other hand, if those 25 members were ceased to be employee on 28th June 2017, they were employee at the time of getting present membership. Hence, they will not be counted as members for the purpose of the limit of 200 members and the total number of members for the purpose of this sub-section will be 195. Therefore, Jagannath Oils Limited is not required to reduce the number of members before converting it into a private company.

### Negotiable Instrument Act

#### Question 56

What are the essential characteristics of Negotiable Instruments?

**Answer:**

Essential Characteristics of Negotiable Instruments

1. It is necessarily in writing.
2. It should be signed.
3. It is freely transferable from one person to another.
4. Holder's title is free from defects.
5. It can be transferred any number of times till its satisfaction.
6. Every negotiable instrument must contain an unconditional promise or order to pay money. The promise or order to pay must consist of money only.
7. The sum payable, the time of payment, the payee, must be certain.
8. The instrument should be delivered. Mere drawing of instrument does not create liability.

#### Question 57