

Question 1.

- (i) Explain the concept of "Dormant Company" as envisaged in the Companies Act, 2013.
- (ii) The Articles of Association of XYZ Ltd. provides that Board of Directors has authority to issue bonds provided such issue is authorized by the shareholders 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.

Ans.

- (i) Dormant Company (Section 455 of the Companies Act, 2013) Where a company is formed and registered under this Act for a future project or to hold an asset or intellectual property and has no significant accounting transaction, such a company or an inactive company may make an application to the Registrar in such manner as may be prescribed for obtaining the status of dormant company

“Inactive company” means a company which has not been carrying on any business or operation, or has not made any significant accounting transaction during the last two financial years, or has not filed financial statements and annual returns during the last two financial years.

“Significant accounting transaction” means any transaction other than

- (a) payment of fees by a company to the Registrar;
 - (b) payments made by it to fulfil the requirements of this Act or any other law;
 - (c) allotment of shares to fulfil the requirements of this Act; and
 - (d) payments for maintenance of its office and records.
- (ii) According to the Doctrine of Indoor Management, if an act is authorised by the articles or memorandum, an outsider is entitled to assume that all the detailed formalities for doing that act have been observed. 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.
- 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 2.

- (i) State whether a non-profit organization be registered as a company under the Companies Act, 2013? If so, what procedure does it have to adopt?
- (ii) When a company is registered, it is clothed with a legal personality. Explain.

Ans.

- (i) Yes, a non-profit organization be registered as a company under the Companies Act, 2013 by following the provisions of section 8 of the Companies Act, 2013. Section 8 of the Companies Act, 2013 deals with the formation of companies which are formed to promote the charitable objects of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment etc. Such company intends to apply its profit in promoting its objects and prohibiting the payment of any dividend to its members. The Central Government has the power to issue license for registering a section 8 company.
- (a) Section 8 allows the Central Government to register such person or association of persons as a company with limited liability without the addition of words 'Limited' or 'Private limited' to its name, by issuing licence on such conditions as it deems fit.
- (b) The registrar shall on application register such person or association of persons as a company under this section.
- (c) On registration the company shall enjoy same privileges and obligations as of a limited company.
- (ii) When a company is registered, it is clothed with a legal personality. It comes to have almost the same rights and powers as a human being. Its existence is distinct and separate from that of its members. A company can own property, have bank account, raise loans, incur liabilities and enter into contracts.
- (a) It is at law, a person different altogether from the subscribers to the memorandum of association. Its personality is distinct and separate from the personality of those who compose it.
- (b) Even members can contract with company, acquire right against it or incur liability to it. For the debts of the company, only its creditors can sue it and not its members.
- A company is capable of owning, enjoying and disposing of property in its own name. Although the capital and assets are contributed by the shareholders, the company becomes the owner of its capital and assets. The shareholders are not the private or joint owners of the company's property.

Question-3

- (i) ABC Pvt. Ltd., is a Private Company having five members only. All the members of the company were going by car to Mumbai in relation to some business. An accident took place and all of them died. Answer with reasons, under the Companies Act, 2013 whether existence of the company has also come to the end?
- (ii) 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?

Ans.

(i) Death of all members of a Private Limited Company, Under the Companies Act, 2013:

The most distinguishing feature of a company is its being a separate entity from the shareholders and promoters who form it. This lends stability and perpetuity to the company form of business organization. In short, a company is brought into existence by a process of law and can be terminated or wound up or brought to an end only by a process of law. Its life is not impacted by the death, insolvency or retirement of any or all shareholder(s) or director(s).

The provision for transferability or transmission of the shares helps to preserve the perpetual existence of a company by allowing the constitution and identity of shareholders to change.

In the present case, ABC Pvt. Ltd. does not cease to exist even by the death of all its shareholders. The legal process will be for the successors of the deceased shareholders to get the shares registered in their names by way of the process which is called “transmission of shares”. The company will cease to exist only when it is wound up by a due process of law.

Therefore, even with the death of all members (i.e. 5), ABC (Pvt.) Ltd. does not cease to exist. (ii)

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.

Rules regarding its membership:

- 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.
- 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.
- Such other person may be given the right to withdraw his consent
- 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.
- Any such change in the name of the person shall not be deemed to be an alteration of the memorandum.
- Only a natural person who is an Indian citizen and resident in India (person who has stayed in India for a period of not less than 182 days during the immediately preceding one calendar year)
 - No shall be eligible to incorporate a OPC;
 - No shall be a nominee for the sole member of a OPC.
- No person shall be eligible to incorporate more than one OPC or become nominee in more than one such company.

No minor shall become member or nominee of the OPC or can hold share with beneficial interest. 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.

Question 4

Flora Fauna Limited was registered as a public company. There are 230 members in the Company as noted below:

| | | |
|-----|--|-----|
| (a) | Directors and their relatives | 190 |
| (b) | Employees | 15 |
| (c) | Ex-Employees (Shares were allotted when they were employees) | 10 |
| (d) | 5 couples holding shares jointly in the name of husband and wife (5*2) | 10 |
| (e) | Others | 5 |

The Board of Directors of the company propose to convert it into a private company. Also advise whether reduction in the number of members is necessary.

Ans.

According to section 2(68) of the Companies Act, 2013, "Private company" means accompany having a minimum paid-up share capital as may be prescribed, and which by its articles, except in case of One Person Company, limits the number of its members to two hundred.

However, 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.

It is further provided 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. In the instant case, Flora Fauna Limited may be converted into a private company only if the total members of the company are limited to 200.

Total Number of members

| | | |
|-------|-------------------------------|-----|
| (i) | Directors and their relatives | 190 |
| (ii) | 5 Couples (5*1) | 5 |
| (iii) | Others | 5 |
| | Total | 200 |

Therefore, there is no need for reduction in the number of members since existing number of members are 200 which does not exceed maximum limit of 200.

Question 5

- (i) F, 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 F as a pretended loan. This way, F 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.
- (ii) Can a non-profit organization be registered as a company under the Companies Act, 2013? If so, what procedure does it have to adopt?

Ans.

- (i) 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. 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. 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.
- (1) 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. F was simply to split his income into three parts with a view to evade tax. No other business was done by the company.
 - (2) The legal personality of the three private companies may be disregarded because the companies were formed only to avoid tax liability. It carried on 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. The same was upheld in *Re Sir Dinshaw Maneckji Petit*
- (ii) Yes, a non-profit organization can be registered as a company under the Companies Act, 2013 by following the provisions of section 8 of the Companies Act, 2013. Section 8 of the Companies Act, 2013 deals with the formation of companies which are formed to
- promote the charitable objects of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment etc. Such company intends to apply its profit in
 - promoting its objects and
 - prohibiting the payment of any dividend to its members. The Central Government has the power to issue license for registering a section 8 company.
- (i) Section 8 allows the Central Government to register such person or association of persons as a company with limited liability without the addition of words 'Limited' or 'Private limited' to its name, by issuing licence on such conditions as it deems fit.
 - (ii) The registrar shall on application register such person or association of persons as a company under this section.
 - (iii) On registration the company shall enjoy same privileges and obligations as of a limited company.

Question 6

Some of the creditors of Pharmaceutical Appliances Ltd. have complained that the company was formed by the promoters only to defraud the creditors and circumvent the compliance of legal provisions of the Companies Act, 2013. In this context they seek your advice as to the meaning of corporate veil and when the promoters can be made personally liable for the debts of the company

Ans.

Corporate Veil: Corporate Veil refers to a legal concept whereby the company is identified separately from the members of the company.

The term Corporate Veil refers to the concept that members of a company are shielded from liability connected to the company's actions. If the company incurs any debts or contravenes any laws, the corporate veil concept implies that members should not be liable for those errors. In other words, they enjoy corporate insulation.

Thus, the shareholders are protected from the acts of the company.

However, under certain exceptional circumstances the courts lift or pierce the corporate veil by ignoring the separate entity of the company and the promoters and other persons who have managed and controlled the affairs of the company. Thus, when the corporate veil is lifted by the courts, the promoters and persons exercising control over the affairs of the company are held personally liable for the acts and debts of the company.

The following are the cases where company law disregards the principle of corporate personality or the principle that the company is a legal entity distinct and separate from its shareholders or members:

- (i) To determine the character of the company i.e. to find out whether co -enemy or friend
- (ii) To protect revenue/tax
- (iii) To avoid a legal obligation
- (iv) Formation of subsidiaries to act as agents
- v) Company formed for fraud/improper conduct or to defeat law

Question 7

Explain clearly the doctrine of 'Indoor Management' as applicable in cases of companies registered under the Companies Act, 1956. Explain the circumstances in which an outsider dealing with the company cannot claim any relief on the ground of 'Indoor Management'.

Ans.

Doctrine of Indoor Management (Companies Act, 2013): 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. 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. The above mentioned doctrine of Indoor Management or Turquand Rule has limitations of its own. That is to say, it is inapplicable to the following cases, namely:

(a) Actual or constructive knowledge of irregularity: The rule does not protect any person when the person dealing with the company has notice, whether actual or constructive, of the irregularity.

(b) Suspicion of Irregularity: The doctrine in no way, rewards those who behave negligently. Where the person dealing with the company is put upon an inquiry, for example, where the transaction is unusual or not in the ordinary course of business, it is the duty of the outsider to make the necessary enquiry.

The protection of the “Turquand Rule” is also not available where the circumstances surrounding the contract are suspicious and therefore invite inquiry. Suspicion should arise, for example, from the fact that an officer is purporting to act in matter, which is apparently outside the scope of his authority. Where, for example, as in the case of Anand Bihari Lal vs. Dinshaw & Co. the plaintiff accepted a transfer of a company’s property from its accountant, the transfer was held void. The plaintiff could not have supposed, in absence of a power of attorney that the accountant had authority to effect transfer of the company’s property.

(c) Forgery: The doctrine of indoor management applies only to irregularities which might otherwise affect a transaction but it cannot apply to forgery which must be regarded as nullity.

Forgery may in circumstances exclude the ‘Turquand Rule’. The only clear illustration is found in the Ruben v Great Fingall Consolidated. In this case the plaintiff was the transferee of a share certificate issued under the seal of the defendant’s company. The company’s secretary, who had affixed the seal of the company and forged the signature of the two directors, issued the certificate. The plaintiff contended that whether the signature were genuine or forged was apart of the internal management, and therefore, the company should be estopped from denying genuineness of the document. But it was held, that the rule has never been extended to cover such a complete forgery.

Question 8

Examine the following whether they are correct or incorrect along with reasons:

- (a) A company being an artificial person cannot own property and cannot sue or be sued.
- (b) A private limited company must have a minimum of two members, while a public limited company must have at least seven members.

Ans.

(a) A company being an artificial person cannot own property and cannot sue or be sued
Incorrect: A company is an artificial person as it is created by a process other than natural birth. It is legal or judicial as it is created by law. It is a person since it is clothed with all the rights of an individual.

Further, the company being a separate legal entity can own property, have banking account, raise loans, incur liabilities and enter into contracts. Even members can contract with company, acquire right against it or incur liability to it. It can sue and be sued in its own name. It can do everything which any natural person can do except be sent to jail, take an oath, marry or practice a learned profession. Hence, it is a legal person in its own sense.

(b) A private limited company must have a minimum of two members, while a public limited company must have at least seven members.

Correct: Section 3 of the Companies Act, 2013 deals with the basic requirement with respect to the constitution of the company. In the case of a public company, any 7 or more persons can form a company for any lawful purpose by subscribing their names to memorandum and complying with the requirements of this Act in respect of registration. In exactly the same way, 2 or more persons can form a private company.

Question 9

ABC Limited has allotted equity shares with voting rights to XYZ Limited worth ₹ 15 Crores and issued Non-Convertible Debentures worth ₹ 40 Crores during the Financial Year 2019-20. After that total Paid-up Equity Share Capital of the company is ₹ 100 Crores and Non-Convertible Debentures stands at ₹ 120 Crores.

Define the Meaning of Associate Company and comment on whether ABC Limited and XYZ Limited would be called Associate Company as per the provisions of the Companies Act, 2013?

Ans.

As per Section 2(6) of the Companies Act, 2013, an Associate Company in relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company.

The term “significant influence” means control of at least 20% of total share capital, or control of business decisions under an agreement.

The term “Total Share Capital”, means the aggregate of the

- (a) Paid-up equity share capital; and
- (b) Convertible preference share capital. In the given case, as ABC Ltd. has allotted equity shares with voting rights to XYZ Limited of ₹ 15 cr, which is less than requisite control of 20% of total share capital (i.e 100 cr) to have a significant influence of XYZ Ltd. Since the said requirement is not complied, therefore ABC Ltd. and XYZ Ltd. are not associate companies as per the Companies Act, 2013. Holding/allotment of non-convertible debentures has no relevance for ascertaining significant influence.

Question 10

SK Infrastructure Limited has a paid up share capital divided into 6,00,000 equity shares of ₹ 100 each. 2,00,000 equity shares of the company are held by Central Government and 1,20,000 equity shares are held by Government of Maharashtra. Explain with reference to relevant provisions of the Companies Act, 2013, whether SK Infrastructure Limited can be treated as Government Company.

Ans .

Government Company [Section 2(45) of the Companies Act, 2013]: Government Company means any company in which not less than 51% of the paid-up share capital is held by

- (i) the Central Government, or
- (ii) by any State Government or Governments, or
- (iii) partly by the Central Government and partly by one or more State Governments, and the section includes a company which is a subsidiary company of such a Government company.

In the instant case, paid up share capital of SK Infrastructure Limited is 6,00,000 equity shares of ₹ 100 each. 200,000 equity shares are held by Central government and 1,20,000 equity shares are held by Government of Maharashtra. The holding of equity shares by both government is 3,20,000 which is more than 51% of total paid up equity shares. Hence, SK Infrastructure Limited is a Government company.

Question 11

Mr. Dhruv was appointed as an employee in Sunmoon Timber Private Limited on the condition that if he was to leave his employment, he will not solicit customers of the company. After some time, he was fired from company. He set up his own business under proprietorship and undercut Sunmoon Timber Private Limited's prices. On the legal advice from his legal consultant and to refrain from the provisions of breach of contract, he formed a new company under the name Seven Stars Timbers Private Limited. In this company, his wife and a friend of Mr. Dhruv were the sole shareholders and directors. They took over Dhruv's business and continued it. Sunmoon Timber Private Limited files a suit against Seven Stars Timbers Private Limited for violation of contract. Seven Stars Timbers Private Limited argued that the contract was entered between Mr. Dhruv and Sunmoon Timber Private Limited and as company has separate legal entity, Seven Stars Timbers Private Limited has not violated the terms of agreement. Explain with reasons, whether separate legal entity between Mr. Dhruv and Seven Stars Timbers Private Limited will be disregarded?

Ans.

It was decided by the court in the case of Gilford Motor Co. Vs. Horne, that if the company is formed simply as a mere device to evade legal obligations, though this is only in limited and discrete circumstances, courts can pierce the corporate veil. In other words, if the company is mere sham or cloak, the separate legal entity can be disregarded.

On considering the decision taken in Gilford Motor Co. Vs. Horne and facts of the problem given, it is very much clear that Seven Stars Timbers Private Limited was formed just to evade legal obligations of the agreement between Mr. Dhruv and Sunmoon Timber Private Limited. Hence, Seven Stars Timbers Private Limited is just a sham or cloak and separate legal entity between Mr. Dhruv and Seven Stars Timbers Private Limited should be disregarded.

Question 12

Narendra Motors Limited is a government company. Shah Auto Private Limited is a private company having share capital of ten crores in the form of ten lacs shares of ₹ 100 each. Narendra Motors Limited is holding five lacs five thousand shares in Shah Auto Private Limited. Shah Auto Private Limited claimed the status of Government Company. Advise as legal advisor, whether Shah Auto Private Limited is government company under the provisions of Companies Act, 2013?

Ans .

According to the provisions of Section 2(45) of Companies Act, 2013, Government Company means any company in which not less than 51% of the paid-up share capital is held by

(i) the Central Government, or

(ii) by any State Government or Governments, or

(iii) partly by the Central Government and partly by one or more State Governments, and

the section includes a company which is a subsidiary company of such a Government company.

According to Section 2(87), “subsidiary company” in relation to any other company (that is to say the holding company), means a company in which the holding exercises or controls more than one-half of the total voting power either at its own or together with one or more of its subsidiary companies.

By virtue of provisions of Section 2(87) of Companies Act, 2013, Shah Auto Private Limited is a subsidiary company of Narendra Motors Limited because Narendra Motors Limited is holding more than one-half of the total voting power in Shah Auto Private Limited. Further as per Section 2(45), a subsidiary company of Government Company is also termed as Government Company. Hence, Shah Auto Private Limited being subsidiary of Narendra Motors Limited will also be considered as Government Company.

Question 13

Jagannath Oils Limited is a public company and having 220 members. Of which 25 members were employee in the company during the period 1 st April 2006 to 28 th June 2016. They were allotted shares in Jagannath Oils Limited first time on 1 st July 2007 which were sold by them on 1 st August 2016. After some time, on 1 st 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:

(a) Whether Jagannath Oils Limited is required to reduce the number of members.

(b) Would your answer be different if above 25 members were the employee in Jagannath Oils Limited for the period from 1 st April 2006 to 28 th June 2017?

Ans.

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,

- (i) restricts the right to transfer its shares;
- (ii) 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
- (iii) prohibits any invitation to the public to subscribe for any securities of the company;
 - (a) 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.
 - (b) On the other hand, if those 25 members were ceased to be employee on 28 th 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.

Question 14

A, B and C has decided to set up a new club with name of ABC club having objects to promote welfare of Christian society. They planned to do charitable work or social activity for promoting the art work of economically weaker section of Christian society. The company obtained the status of section 8 company and started operating from 1 st April, 2017 onwards.

However, on 30 th September 2019, it was observed that ABC club was violating the objects of its objective clause due to which it was granted the status of section 8 Company under the Companies Act 2013.

Discuss what powers can be exercised by the central government against ABC club, in such a case?

Ans.

Section 8 of the Companies Act, 2013 deals with the formation of companies which are formed to promote the charitable objects of commerce, art, science, education, sports etc. Such company intends to apply its profit in promoting its objects. Section 8 companies are registered by the Registrar only when a license is issued by the Central Government to them.

Since ABC Club was a Section 8 company and it was observed on 30 th September, 2019 that it had started violating the objects of its objective clause. Hence in such a situation the following powers can be exercised by the Central Government:

- (i) The Central Government may by order revoke the licence of the company where the company contravenes any of the requirements or the conditions of this sections subject to which a licence is issued or where the affairs of the company are conducted fraudulently, or violative of the objects of the company or prejudicial to public interest, and on revocation the Registrar shall put 'Limited' or 'Private Limited' against the company's name in the register. But before such revocation, the Central Government must give it a written notice of its intention to revoke the licence and opportunity to be heard in the matter.
- (ii) Where a licence is revoked, the Central Government may, by order, if it is satisfied that it is essential in the public interest, direct that the company be wound up under this Act or amalgamated with another company registered under this section. However, no such order shall be made unless the company is given a reasonable opportunity of being heard.
- (iii) Where a licence is revoked and where the Central Government is satisfied that it is essential in the public interest that the company registered under this section should be amalgamated with another company registered under this section and having similar objects, then, notwithstanding anything to the contrary contained in this Act, the Central Government may, by order, provide for such amalgamation to form a single company with such constitution, properties, powers, rights, interest, authorities and privileges and with such liabilities, duties and obligations as may be specified in the order.

Question 15

An employee Mr. Karan signed a contract with his employer company ABC Limited that he will not solicit the customers after leaving the employment from the company. But after Mr. Karan left ABC Limited, he started up his own company PQR Limited and he started soliciting the customers of ABC Limited for his own business purposes.

ABC Limited filed a case against Mr. Karan for breach of the employment contract and for soliciting their customers for own business. Mr. Karan contended that there is corporate veil between him, and his company and he should not be personally held liable for this. In this context, the company ABC Limited seek your advice as to the meaning of corporate veil and when the veil can be lifted to make the owners liable for the acts done by a company?

Ans.

Corporate Veil: Corporate Veil refers to a legal concept whereby the company is identified separately from the members of the company.

The term Corporate Veil refers to the concept that members of a company are shielded from liability connected to the company's actions. If the company incurs any debts or contravenes any laws, the corporate veil concept implies that members should not be liable for those errors. In other words, they enjoy corporate insulation.

Thus, the shareholders are protected from the acts of the company. However, under certain exceptional circumstances the courts lift or pierce the corporate veil by ignoring the separate entity of the company and the promoters and other persons who have managed and controlled the affairs of the company. Thus, when the corporate veil is lifted by the courts, the promoters and persons exercising control over the affairs of the company are held personally liable for the acts and debts of the company.

The following are the cases where company law disregards the principle of corporate personality or the principle that the company is a legal entity distinct and separate from its shareholders or members:

- (i) To determine the character of the company i.e. to find out whether co-enemy or friend.
- (ii) To protect revenue/tax
- (iii) To avoid a legal obligation
- (iv) Formation of subsidiaries to act as agents

Question 16

A transport company wanted to obtain licences for its vehicles but could not obtain licences if applied in its own name. It, therefore, formed a subsidiary company and the application for licence was made in the name of the subsidiary company. The vehicles were to be transferred to the subsidiary company. Will the parent and the subsidiary company be treated as separate commercial units? Explain in the light of the provisions of the Companies Act, 2013.

Ans .

If the subsidiary is formed to act as agent of the Principal Company, it may be deemed to have lost its individuality in favour of its principal. The veil of Corporate Personality is lifted and the principal will be held liable for the acts of subsidiary company.

The facts of the case are similar to the case of *Merchandise Transport Limited vs. British Transport Commission (1982)*, wherein a transport company wanted to obtain licences for its vehicles but could not do so, if applied in its own name. It, therefore, formed a subsidiary company, and the application for the licence was made in the name of the subsidiary. The vehicles were to be transferred to the subsidiary company. Held, the parent and the subsidiary were held to be one commercial unit and the application for licences was rejected.

Hence, in this case the parent and the subsidiary company shall not be treated as separate commercial units

Question 17

ABC Pvt Ltd, has been overstating expenditures in their Profit & Loss account for the past few years. On Inquiry, it was found that the mere purpose was to avoid tax. However, there was no fraudulent intentions. Should the corporate veil of the company be lifted? Kindly justify.

Ans .

Corporate veil refers to the concept that members of a company are shielded from liability connected to the company's action. It is the legal concept whereby the company is identified separately from the members of the company. However, under the below circumstances, the company law disregards the principle of corporate personality.

- To determine the character of the company
- To protect revenue/tax - To avoid a legal obligation
- Formation of subsidiaries to act as agents
- Company formed for fraud/improper conduct.

In the given scenario, though the intention of the company was not fraudulent to defeat law, it had the intention of avoiding taxes and protecting revenue.

Hence, corporate veil should be lifted and the principles of corporate personality will be disregarded.

Question 18

A Company registered under Section 8 of the Companies Act, 2013, has been consistently making profits for the past 5 years after a major change in the management structure. Few members contented that they are entitled to receive dividends. Can the company distribute dividend? If yes, what is the maximum percentage of dividend that can be distributed as per provisions of the Companies Act, 2013? Also, to discuss this along with other regular matters, the company kept a general meeting by giving only 14 days' notice. Is this valid?

Ans.

A company registered under Section 8 of the Companies Act, 2013 is prohibited from the payment of any dividends to its members.

Hence in the given case, the contention of the members to distribute dividend from the profits earned is wrong.

Also, Section 8 company is allowed to call a general meeting by giving 14 days instead of 21 days.

Question 19

Nolimit Private Company is incorporated as unlimited company having share capital of ₹ 10,00,000. One of its creditors, Mr. Samuel filed a suit against a shareholder Mr. Innocent for recovery of his debt against Nolimit Private Company. Mr. Innocent has given his plea in the court that he is not liable as he is just a shareholder. Explain, whether Mr. Samuel will be successful in recovering his dues from Mr. Innocent?

Ans.

Section 2(92) of Companies Act, 2013, provides that an unlimited company means a company not having any limit on the liability of its members. The liability of each member extends to the whole amount of the company's debts and liabilities, but he will be entitled to claim contribution from other members. In case the company has share capital, the Articles of Association must state the amount of share capital and the amount of each share. So long as the company is a going concern the liability on the shares is the only liability which can be enforced by the company. The creditors can institute proceedings for winding up of the company for their claims. The official liquidator may call the members for their contribution towards the liabilities and debts of the company, which can be unlimited. On the basis of above, it can be said that Mr. Samuel cannot directly claim his dues against the company from Mr. Innocent, the shareholder of the company even the company is an unlimited company. Mr. Innocent is liable upto his share capital. His unlimited liability will arise when official liquidator calls the members for their contribution towards the liabilities and debts of the company at the time of winding up of company.

Question 20

In the Flower Fans Private Limited, there are only 5 members. All of them go in a boat on a pleasure trip into an open sea. The boat capsizes and all of them died being drowned. Explain with reference to the provisions of Companies Act, 2013:

(i) Is Flower Fans Private Limited no longer in existence?

(ii) Further is it correct to say that a company being an artificial person cannot own property and cannot sue or be sued?

Ans.

- (i) Perpetual Succession – A company on incorporation becomes a separate legal entity. It is an artificial legal person and have perpetual succession which means even if all the members of a company die, the company still continues to exist. It has permanent existence. The existence of a company is independent of the lives of its members. It has a perpetual succession. In this problem, the company will continue as a legal entity. The company's existence is in no way affected by the death of all its members.
- (ii) The statement given is incorrect. A company is an artificial person as it is created by a process other than natural birth. It is legal or judicial as it is created by law. It is a person since it is clothed with all the rights of an individual. Further, the company being a separate legal entity can own property, have banking account, raise loans, incur liabilities and enter into contracts. Even members can contract with company, acquire right against it or incur liability to it. It can sue and be sued in its own name. It can do everything which any natural person can do except be sent to jail, take an oath, marry or practice a learned profession. Hence, it is a legal person in its own sense.

Question 21

ABC Limited was into sale and purchase of iron rods. This was the main object of the company mentioned in the Memorandum of Association. The company entered into a contract with Mr. John for some finance related work. Later on, the company repudiated the contract as being ultra vires.

With reference to the same, briefly explain the doctrine of “ultravires” under the Companies Act, 2013. What are the consequences of ultravires acts of the company?

Ans.

Doctrine of ultra vires: The meaning of the term ultra vires is simply “beyond (their) powers”. The legal phrase “ultra vires” is applicable only to acts done in excess of the legal powers of the doers. This presupposes that the powers in their nature are limited. It is a fundamental rule of Company Law that the objects of a company as stated in its memorandum can be departed from only to the extent permitted by the Act, thus far and no further. In consequence, any act done or a contract made by the company which travels beyond the powers not only of the directors but also of the company is wholly void and inoperative in law and is therefore not binding on the company. On this account, a company can be restrained from employing its fund for purposes other than those sanctioned by the memorandum. Likewise, it can be restrained from carrying on a trade different from the one it is authorised to carry on.

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. Since the memorandum is a “public document”, it is open to public inspection. Therefore, when one deals with a company one is deemed to know about the powers of the company. If in spite of this you enter into a transaction which is ultra vires the company, you cannot enforce it against the company.

An act which is ultra vires the company being void, cannot be ratified even by the unanimous consent of all the shareholders of the company.

Hence in the given case, ABC Limited cannot enter into a contract outside the purview of its object clause of Memorandum of Association as it becomes ultra vires and thus null and void.

Question 22

Articles of Association of XYZ Private Limited provides that Board of Directors (BOD) can take the loan upto ₹ 5,00,000 for Company by passing the board resolution. In that case, the loan amount is in excess of the limit, special resolution is required to be passed in general meeting. Due to urgent needs of funds, BOD applied for loan in a reputed bank for ₹ 10,00,000 without passing the resolution in the general meeting. BOD gave an undertaking to bank that Special Resolution has been passed for such loan. The bank on believing on such undertaking lend the money. On demanding the repayment of loan, company denied the payment as act was ultra vires to company. Kindly, advise.

Ans.

According to doctrine of Indoor Management, persons dealing with the Company are presumed to have read the registered documents and to see that the proposed dealing is not inconsistent therewith, but they are not bound to do more; they need not enquire into the regularity of internal proceedings as required by Memorandum and Articles. This was also decided in case of Royal British Bank Vs. Turquand.

In the instant case, XYZ Private Limited have taken loan from reputed bank for ₹ 10,00,000 by passing Board Resolution while Special Resolution was necessary for such amount. BOD gave an undertaking to bank that Special Resolution has been passed for such loan. The bank on believing on such undertaking lends the money. On demanding the repayment of loan, company denied the payment as act was ultra vires to company. On the basis of provisions of doctrine of indoor management, the bank can claim the amount of his loan from the company. The bank can believe on the undertaking given by board and no need to enquire further.

Question 23.

Explain the classification of the companies on the basis of control as per the Companies Act, 2013.

Ans.

In line with the Companies Act, 2013, following are the classification of the Companies on the basis of control:

- (a) Holding and subsidiary companies: 'Holding and subsidiary' companies are relative terms. A company is a holding company in relation to one or more other companies, means a company of which such companies are subsidiary companies. [Section 2(46)] For the purposes of this clause, the expression "company" includes any body corporate. Whereas section 2(87) defines "subsidiary company" in relation to any other company (that is to say the holding company), means a company in which the holding company (i) controls the composition of the Board of Directors; or (ii) exercises or controls more than one-half of the total voting power either at its own or together with one or more of its subsidiary companies: Provided that such class or classes of holding companies as may be prescribed shall not have layers of subsidiaries beyond such numbers as may be prescribed.
- (b) Associate company [Section 2(6)]: In relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company.
- Explanation. – For the purpose of this clause
- (i) the expression "significant influence" means control of at least twenty per cent of total voting power, or control of or participation in business decisions under an agreement;
 - (ii) the expression "joint venture" means a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.
- The term "Total Share Capital", means the aggregate of the
- (1) Paid-up equity share capital; and
 - (2) Convertible preference share capital.

Question 24

BC Private Limited and its subsidiary KL Private Limited are holding 90,000 and 70,000 shares respectively in PQ Private Limited. The paid-up share capital of PQ Private Limited is ₹ 30 Lakhs (3 Lakhs equity shares of ₹ 10 each fully paid). Analyse with reference to provisions of the Companies Act, 2013 whether PQ Private Limited is a subsidiary of BC Private Limited. What would be your answer if KL Private Limited is holding 1,60,000 shares in PQ Private Limited and no shares are held by BC Private Limited in PQ Private Limited

Ans.

Section 2(87) of the Companies Act, 2013 defines “subsidiary company” in relation to any other company (that is to say the holding company), means a company in which the holding company

- (i) controls the composition of the Board of Directors; or
- (ii) exercises or controls more than one-half of the total voting power either at its own or together with one or more of its subsidiary companies:

For the purposes of this section

- (I) a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (ii) is of another subsidiary company of the holding company;
 - (II) “layer” in relation to a holding company means its subsidiary or subsidiaries. In the instant case, BC Private Limited together with its subsidiary KL Private Limited is holding 1,60,000 shares (90,000+70,000 respectively) which is more than one half in nominal value of the Equity Share Capital of PQ Private Limited. Hence, PQ Private Limited is subsidiary of BC Private Limited.
- (ii) In the second case, the answer will remain the same. KL Private Limited is a holding 1,60,000 shares i.e., more than one half in nominal value of the Equity Share Capital of PQ Private Limited (i.e., holding more than one half of voting power). Hence, KL Private Limited is holding company of PQ Private Company and BC Private Limited is a holding company of KL Private Limited.

Hence, by virtue of Chain relationship, BC Private Limited becomes the holding company of PQ Private Limited.

Question 25

AK Private Limited has borrowed ₹ 36 crore from BK Finance Limited. However, as per memorandum of AK Private Limited, the maximum borrowing power of the company is ₹ 30 crore. Examine whether AK Private Limited is liable to pay this debt? State the remedy, if any available to BK Finance Limited.

Ans.

This case is governed by the 'Doctrine of Ultra Vires'. According to this doctrine, any act done, or a contract made by the company which travels beyond the powers of the company conferred upon it by its Memorandum of Association is wholly void and inoperative in law and is therefore not binding on the company. This is because the Memorandum of Association of the company is, in fact, its charter; it defines its constitution and the scope of the powers of the company. Hence, a company cannot depart from the provisions contained in the memorandum however imperative may be the necessity for the departure. Hence, any agreement ultra vires the company shall be null and void.

(i) Whether AK Private Limited is liable to pay the debt?

As per the facts given, AK Private Limited borrowed ₹ 36 crore from BK Finance Limited which is beyond its borrowing power of ₹ 30 crore.

Hence, contract for borrowing of ₹ 36 crore, being ultra vires the Memorandum of Association and thereby is void. AK Private Limited is not, therefore, liable to pay the debt.

(ii) Remedy available to BK Finance Limited:

In light of the legal position explained above, BK Finance Limited cannot enforce the said transaction and thus has no remedy against the company for recovery of the money lent. BK Finance limited may take action against the directors of AK Private Limited as it is the personal liability of its directors to restore the borrowed funds. Besides, BK Finance Limited may take recourse to the remedy by means of 'Injunction', if feasible.

Question 26

Mike LLC incorporated in Singapore having an office in Pune, India. Analyze whether Mike LLC would be called a foreign company as per the provisions of the Companies Act, 2013? Also explain the meaning of foreign company.

- Ans .
- Foreign Company [Section 2(42) of the Companies Act, 2013]: It means any company or body corporate incorporated outside India which
- (i) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and
 - (ii) conducts any business activity in India in any other manner. As Mike LLC is incorporated in Singapore and having a place of business in Pune, India, it is a foreign Company.

Question 27

Explain the classification of the companies on the basis of control as per the Companies Act, 2013. (6 Marks)

Ans. In line with the Companies Act, 2013, following are the classification of the Companies on the basis of control:

(a) **Holding and subsidiary companies:** 'Holding and subsidiary' companies are relative terms.

A company is a holding company in relation to one or more other companies, means a company of which such companies are subsidiary companies. [Section 2(46)] For the purposes of this clause, the expression "company" includes anybody corporate.

Whereas section 2(87) defines "subsidiary company" in relation to any other company (that is to say the holding company), means a company in which the holding company

- (i) controls the composition of the Board of Directors; or
- (ii) exercises or controls more than one-half of the total voting power either at its own or together with one or more of its subsidiary companies:

Provided that such class or classes of holding companies as may be prescribed shall not have layers of subsidiaries beyond such numbers as may be prescribed. For the purposes of this section

- (I) a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (ii) is of another subsidiary company of the holding company;
- (II) the composition of a company's Board of Directors shall be deemed to be controlled by another company if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors;
- (III) the expression "company" includes anybody corporate;
- (IV) "layer" in relation to a holding company means its subsidiary or subsidiaries.

(b) **Associate company [Section 2(6)]:** In relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company. Explanation. – For the purpose of this clause

- (i) the expression "significant influence" means control of at least twenty per cent of total voting power, or control of or participation in business decisions under an agreement;
- (ii) the expression "joint venture" means a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

The term "Total Share Capital", means the aggregate of the

- (1) Paid-up equity share capital; and
- (2) Convertible preference share capital.

Question 28

What is the main difference between a Guarantee Company and a Company having Share capital?
(3 Marks)

Ans. **Difference between Guarantee Company [Section 2(21) of the Companies Act, 2013] and a Company having share capital [Section 2(22)].**

In case of guarantee company, the members may be called upon to discharge their liability only after commencement of the winding up and only subject to certain conditions; whereas in the case of company having share capital, members may be called upon to discharge their liability at any time, either during the company's life -time or during its winding up.

It is clear from the definition of the guarantee company that it does not raise its initial working funds from its members. Therefore, such a company may be useful only where no working funds are needed or where these funds can be held from other sources like endowment, fees, charges, donations, etc.

In **Narendra Kumar Agarwal vs. Saroj Maloo**, the Supreme Court has laid down that the right of a guarantee company to refuse to accept the transfer by a member of his interest in the company is on a different footing than that of a company limited by shares. The membership of a guarantee company may carry privileges much different from those of ordinary shareholders.

Question 29

What do you mean by the term Capital? Describe its classification in the domain of Company Law.
(1 + 5 = 6 Marks)

Ans .

- (i) Meaning of capital: The term capital has variety of meanings. But in relation to a company limited by shares, the term 'capital' means 'share capital'. Share capital means capital of the company expressed in terms of rupees divided into shares of fixed amount.
- (ii) Classification of capital: In the domain of Company Law, the term capital can be classified as follows:
 - (a) Nominal or authorised or registered capital:
This expression means such capital as is authorised by memorandum of a company to be the maximum amount of share capital of the company.
 - (b) Issued capital: It means such capital as the company issues from time to time for subscription.
 - (c) Subscribed capital: As such part of the capital which is for the time being subscribed by the members of a company.
 - (d) Called up capital: As such part of the capital which has been called for payment. It is the total amount called up on the shares issued.
 - (e) Paid-up capital: It is the total amount paid or credited as paid up on shares issued. It is equal to called up capital less calls in arrears.

Question 30

The Articles of Association of Aarna Limited empowers its managing agents to borrow loans on behalf of the company. Ms. Anika, the director of the company, borrowed ₹ 18 Lakhs in name of the company from Quick Finance Limited, a non-banking finance company. Later on, Aarna Limited refused to repay the money borrowed on the pretext that no resolution authorizing such loan have been actually passed by the company and therefore the company is not liable to pay such loan.

Decide whether the contention of Aarna Limited is correct in accordance with the provisions of the Companies Act, 2013? (4 Marks)

Ans.

Doctrine of Indoor Management

According to this doctrine, persons dealing with the company need not inquire whether internal proceedings relating to the contract are followed correctly, once they are satisfied that the transaction is in accordance with the memorandum and articles of association.

Stakeholders need not enquire whether the necessary meeting was convened and held properly or whether necessary resolution was passed properly. They are entitled to take it for granted that the company had gone through all these proceedings in a regular manner.

The doctrine helps to protect the external members from the company and states that the people are entitled to presume that internal proceedings are as per documents submitted with the Registrar of Companies.

Thus,

1. What happens internal to a company is not a matter of public knowledge. An outsider can only presume the intentions of a company, but do not know the information he/she is not privy to.
2. If not for the doctrine, the company could escape creditors by denying the authority of officials to act on its behalf.

In the given question, Quick Finance Limited being external to the company, need not enquire whether the necessary resolution was passed properly. Even if Aarna Limited claims that no resolution authorizing the loan was passed, Aarna Limited is bound to repay the loan to Quick Finance Limited.

Question 31

Explain the 'Doctrine of ultra vires under the Companies Act, 2013. What are the consequences of 'ultra vires' acts of the company? (6 Marks)

Ans.

Doctrine of ultra vires:

The meaning of the term ultra vires is simply “beyond (their) powers”. The legal phrase “ultra vires” is applicable only to acts done in excess of the legal powers of the doers. This presupposes that the powers in their nature are limited. To an ordinary citizen, the law permits whatever does the law not expressly forbid. It is a fundamental rule of Company Law that the objects of a company as stated in its memorandum can be departed from only to the extent permitted by the Act, thus far and no further [Ashbury Railway Company Ltd. vs. Riche]. In consequence, any act done or a contract made by the company which travels beyond the powers not only of the directors but also of the company is wholly void and inoperative in law and is therefore not binding on the company. On this account, a company can be restrained from employing its fund for purposes other than those sanctioned by the memorandum. Likewise, it can be restrained from carrying on a trade different from the one it is authorised to carry on. Consequences of ‘ultra vires’ acts of the company:

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. Since the memorandum is a “public document”, it is open to public inspection. Therefore, when one deals with a company one is deemed to know about the powers of the company. If in spite of this one enters into a transaction which is ultra vires the company, he/she cannot enforce it against the company. An act which is ultra vires the company being void, cannot be ratified by the shareholders of the company. However, some ultra vires act can be regularised by ratifying them subsequently. For instance, if the act is ultra vires the power of the directors, the shareholders can ratify it; if it is ultra vires the articles of the company, the company can alter the articles; if the act is within the power of the company but is done irregularly, shareholders can validate such acts.

Question 32

Mr. R is an Indian citizen, and his stay in India during the immediately preceding financial year is for 130 days. He appoints Mr. S, a foreign citizen, as his nominee, who has stayed in India for 125 days during the immediately preceding financial year. Is Mr. R eligible to be incorporated as a One-Person Company (OPC)? If yes, can he give the name of Mr. S in the Memorandum of Association as his nominee? Justify your answers with relevant provisions of the Companies Act, 2013. (3 Marks)

Ans.

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.

In the given case, Mr. R is an Indian citizen and his stay in India during the immediately preceding financial year is 130 days which is above the requirement of 120 days. Hence, Mr. R is eligible to incorporate an OPC.

Also, even though Mr. S'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, S's name cannot be given as nominee in the memorandum.

Question 33

Mr. R, a manufacturer of toys approached MNO Private Limited for supply of raw material worth ₹ 1,50,000/-. Mr. R was offered a credit period of one month. Mr. R went to the company prior to the due date and met Mr. C, an employee at the billing counter, who convinced the former that the payment can be made to him as the billing-cashier is on leave. Mr. R paid the money and was issued a signed and sealed receipt by Mr. C. After the lapse of due date, Mr. R received a recovery notice from the company for the payment of ₹ 1,50,000/-. Mr. R informed the company that he has already paid the above amount and being an outsider had genuine reasons to trust Mr. C who claimed to be an employee and had issued him a receipt. The Company filed a suit against Mr. R for non-payment of dues. Discuss the fate of the suit and the liability of Mr. R towards company as on current date in consonance with the provision of the Companies Act 2013? Would your answer be different if a receipt under the company seal was not issued by Mr. C after receiving payment? (4 Marks)

Ans.

(i) Fate of the suit and the liability of Mr. R towards the company:

Doctrine of the Indoor Management

According to the Doctrine of the Indoor Management, the outsiders are not deemed to have notice of the internal affairs of the company. They are entitled to assume that the acts of the directors or other officers of the company are validly performed, if they are within the scope of their apparent authority. So long as an act is valid under the articles, if done in a particular manner, an outsider dealing with the company is entitled to assume that it has been done in the manner required. This is the indoor management rule, that the company's indoor affairs are the company's problem. This rule has been laid down in the landmark case-the Royal British Bank vs. Turquand. (Known as "Turquand Rule")

In the instant case, Mr. R is not liable to pay the amount of ₹ 1,50,000 to MNO Private Limited as he had genuine reasons to trust Mr. C, an employee of the company who had issued him a signed and sealed receipt.

(ii) Liability of Mr. R in case no receipt is issued by Mr. C:

Exceptions to doctrine of indoor management: Suspicion of irregularity is an exception to the doctrine of indoor management. The doctrine of indoor management, in no way, rewards those who behave negligently. It is the duty of the outsider to make necessary enquiry, if the transaction is not in the ordinary course of business.

If a receipt under the company seal was not issued by Mr. C after receiving payment, Mr. R is liable to pay the said amount as this will be deemed to be a negligence on the part of Mr. R and it is his duty to make the necessary enquiry to check that whether Mr. C is eligible to take the payment or not

Question 34

- (i) Mr. Anil formed a One Person Company (OPC) on 16 April, 2018 for manufacturing electric cars. The turnover of the OPC for the financial year ended 31 March, 2019 was about ₹ 2.25 crores. His friend Sunil wanted to invest in his One Person Company (OPC), so they decided to convert it voluntarily into a private limited company. Can Anil do so, as per the provisions of the Companies Act, 2013? (4 Marks)
- (ii) Explain listed company and unlisted company as per the provisions of the Companies Act, 2013. (2 Marks)

Ans.

Section 2(62) of the Companies Act, 2013 defines one person company as a company which has only one person as a member. However, a private company shall have minimum 2 members without any restriction on the share capital or turnover. If OPC is converted into private company Mr. Anil and Mr. Sunil both can be the members of the company and investment from Mr. Sunil can be accepted. A One Person Company can voluntarily convert itself into a private company by following the compliances given under the Companies Act, 2013.

In the instant case, OPC formed by Mr. Anil can be voluntarily converted into a private company by following the compliances given under the Companies Act, 2013. Here, the information given relating to turnover for the financial year ended 31 st March, 2019 is immaterial.

Listed company: As per the definition given in the section 2(52) of the Companies Act, 2013, it is a company which has any of its securities listed on any recognised stock exchange.

Provided that such class of companies, which have listed or intend to list such class of securities, as may be prescribed in consultation with the Securities and Exchange Board, shall not be considered as listed companies.

Whereas the word securities as per the section 2(81) of the Companies Act, 2013 has been assigned the same meaning as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956.

Unlisted company means company other than listed company.

Question 35

Explain the concept of 'Corporate Veil'. Briefly state the circumstances when the corporate veil can be lifted as per the provisions of the Companies Act, 2013. (6 Marks)

Ans.

Corporate Veil: Corporate Veil refers to a legal concept whereby the company is identified separately from the members of the company. Due to this, members of a company are shielded from liability connected to the company's actions.

Lifting of Corporate Veil: The following are the cases where company law disregards the principle of corporate personality or the principle that the company is a legal entity distinct and separate from its shareholders or members:

- (1) **To determine the character of the company i.e. to find out whether co-enemy or friend:** It is true that, unlike a natural person, a company does not have mind or conscience; therefore, it cannot be a friend or foe. It may, however, be characterised as an enemy company, if its affairs are under the control of people of an enemy country. For this purpose, the Court may examine the character of the persons who are really at the helm of affairs of the company.
- (2) **To protect revenue/tax:** In certain matters concerning the law of taxes, duties and stamps particularly where question of the controlling interest is in issue. Where corporate entity is used to evade or circumvent tax, the Court can disregard the corporate identity.
- (3) **To avoid a legal obligation:** Where it was found that the sole purpose for the formation of the company was to use it as a device to reduce the amount to be paid by way of bonus to workmen, the Supreme Court upheld the piercing of the veil to look at the real transaction.
- (4) **Formation of subsidiaries to act as agents:** A company may sometimes be regarded as an agent or trustee of its members, or of another company, and may therefore be deemed to have lost its individuality in favour of its principal. Here the principal will be held liable for the acts of that company.
- (5) **Company formed for fraud/improper conduct or to defeat law:** Where the device of incorporation is adopted for some illegal or improper purpose, e.g., to defeat or circumvent law, to defraud creditors or to avoid legal obligations

Question 36

ABC Private Limited is a registered company under the Companies Act, 2013 with paid up capital of ₹ 35 lakhs and turnover of ₹ 2.5 crores. Whether the ABC Private Limited can avail the status of a Small Company in accordance with the provisions of the Companies Act, 2013? Also discuss the meaning of a Small Company. (3 Marks)

Ans.

Small Company: Small Company as defined under Section 2(85) of the Companies Act, 2013 means a company, other than a public company

- (i) paid-up share capital of which does not exceed ₹ 4 crore or such higher amount as may be prescribed which shall not be more than ₹ 10 crore; and
- (ii) turnover of which as per profit and loss account for the immediately preceding financial year does not exceed ₹ 40 Crore or such higher amount as may be prescribed which shall not be more than ₹ 100 crore: Exceptions: This clause shall not apply to:
 - (A) a holding company or a subsidiary company;
 - (B) a company registered under section 8; or
 - (C) a company or body corporate governed by any special Act. In the instant case, since the paid-up capital of ABC Private Limited is ₹ 35 Lakhs and turnover is ₹ 2.5 crore, it can avail the status of a small company as both the requirements with regard to paid-up share capital as well as turnover are fulfilled by the Company.

Question 37

The State Government of X, a state in the country is holding 48 lakh shares of Y Limited. The paid up capital of Y Limited is ₹ 9.5 crore (95 lakh shares of ₹ 10 each). Y Limited directly holds 2,50,600 shares of Z Private Limited which is having share capital of ₹ 5 crore in the form of 5 lakh shares of ₹ 100 each. Z Private Limited claimed the status of a subsidiary company of ₹ 100 each. Z Private Limited claimed the status of a subsidiary company of Y Limited as well as a Government company. Advise as a legal advisor, whether Z Private Limited is a subsidiary company of Y Limited as well as a Government company under the provisions of the Companies Act, 2013? (4 Marks)

Ans.

According to Section 2(45) of the Companies Act, 2013, Government Company means any company in which not less than 51% of the paid-up share capital is held by

- (i) the Central Government, or
- (ii) by any State Government or Governments, or
- (iii) partly by the Central Government and partly by one or more State Governments, and the section includes a company which is a subsidiary company of such a Government company. As per Section 2(87) of the Companies Act, 2013, “subsidiary company” in relation to any other company (that is to say the holding company), means a company in which the holding company—
 - (i) controls the composition of the Board of Directors; or
 - (ii) exercises or controls more than one-half of the total voting power either at its own or together with one or more of its subsidiary companies.

In the instant case, the State Government of X, a state in the country is holding 48 Lakh shares in Y Limited which is below 51% of the paid up share capital of Y Limited i.e. 48.45 Lakh shares (51% of 95 Lakh shares). Hence Y Limited is not a Government Company.

Further, Y Limited directly holds 2,50,600 shares in Z Private Limited, which is more than one-half of the total shares of Z Limited i.e. 2,50,000 shares (50% of 5 Lakh shares). Thus, the Company controls more than one-half of the total voting power of Z Limited. Hence Z Private Limited is a subsidiary of Y Limited. Therefore, we can conclude that Z Private Limited is a subsidiary of Y Limited but not a Government Company since Y Limited is not a Government Company.

Question 38

Explain the kinds of share capital as per the Companies Act, 2013. Also explain when the capital shall be deemed to be preference capital. (6 Marks)

Ans.

Kinds of share capital: Section 43 of the Companies Act, 2013 provides the kinds of share capital. According to the said provision, the share capital of a company limited by shares shall be of two kinds, namely:

1. “Equity share capital”, with reference to any company limited by shares, means all share capital which is not preference share capital;
Equity share capital– can be
 - (i) with voting rights; or
 - (ii) with differential rights as to dividend, voting or otherwise in accordance with such rules as may be prescribed;
2. “Preference share capital”, with reference to any company limited by shares, means that part of the issued share capital of the company which carries or would carry a preferential right with respect to
 - (a) payment of dividend, either as a fixed amount or an amount calculated at a fixed rate, which may either be free of or subject to income-tax; and
 - (b) repayment, in the case of a winding up or repayment of capital, of the amount of the share capital paid-up or deemed to have been paid-up, whether or not, there is a preferential right to the payment of any fixed premium or premium on any fixed scale, specified in the memorandum or articles of the company; Capital shall be deemed to be preference capital, despite that it is entitled to either or both of the following rights, namely:
 - (a) that in respect of dividends, in addition to the preferential rights to the amounts specified as above, it has a right to participate, whether fully or to a limited extent, with capital not entitled to the preferential right aforesaid;
 - (b) that in respect of capital, in addition to the preferential right to the repayment, on a winding up, of the amounts specified above, it has a right to participate, whether fully or to a limited extent, with capital not entitled to that preferential right in any surplus which may remain after the entire capital has been repaid.

Question 39

MTK Private Limited is a company registered under the Companies Act, 2013 on 5 th January, 2021. The company has not started its business till now. On 7 th April, 2023, a notice has been received from ROC for non-filing of FORM No-INC-20A. Identify under which category MTK Private Limited company is classified. Explain the definition of the category of the company in detail. (3 Marks)

Ans.

“Inactive company” means a company which has not been carrying on any business or operation, or has not made any significant accounting transaction during the last two financial years, or has not filed financial statements and annual returns during the last two financial years. [Explanation (i) to Section 455 of the Companies Act, 2013] “Significant accounting transaction” means any transaction other than

- (a) payment of fees by a company to the Registrar;
- (b) payments made by it to fulfil the requirements of this Act or any other law;
- (c) allotment of shares to fulfil the requirements of this Act; and
- (d) payments for maintenance of its office and records.

[Explanation (ii) to Section 455 of the Companies Act, 2013]

In the instant case, MTK Private Limited was registered on 5 th January, 2021 and has not started its business till now. On 7 th April, 2023, a notice has been received from ROC for non-filing of Form No. INC-20A. Since the Company has not started its business and a period of more than two years have already elapsed, it will be treated as an inactive company.

Question 40

The Object Clause of Memorandum of Association of ABC Pvt. Ltd. authorised the company to carry on the business of trading in Fruits and Vegetables. The Directors of the company in recently concluded Board Meeting decided and accordingly, the company ordered for fish for the purpose of trading. FSH Limited supplied fish to ABC Pvt. Ltd. worth Rs. 36 Lakhs. The members of the company convened an extraordinary general meeting and negated the proposal of the Board of Directors on the ground of ultra vires acts. FSH Limited being aggrieved of the said decision of ABC Pvt Ltd. seeks your advice. Advice them. (4 Marks)

Ans.

Doctrine of ultra vires: The meaning of the term ultra vires is simply "beyond (their) powers". The legal phrase "ultra vires" is applicable only to acts done in excess of the legal powers of the doers. This presupposes that the powers in their nature are limited. It is a fundamental rule of Company Law that the objects of a company as stated in its memorandum can be departed from only to the extent permitted by the Act, thus far and no further. In consequence, any act done or a contract made by the company which travels beyond the powers not only of the directors but also of the company is wholly void and inoperative in law and is therefore not binding on the company.

On this account, a company can be restrained from employing its fund for purposes other than those sanctioned by the memorandum. Likewise, it can be restrained from carrying on a trade different from the one it is authorized to carry on. 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. Since the memorandum is a "public document", it is open to public inspection. Therefore, when one deals with a company one is deemed to know about the powers of the company. If in spite of this you enter into a transaction which is ultra vires the company, you cannot enforce it against the company.

Therefore, the resolution passed by the Board of Director ABC Pvt. Limited for an ultra vires transaction is invalid. As a result of this, the transaction entered into the supply of fish with FSH Limited is not legal and is void.

Question 41

What is the meaning of “Certificate of Incorporation” under the provisions of the Companies Act, 2013?
What are the effects of registration of a company? (6 Marks)

Ans.

Under section 7(2) the Registrar shall on the basis of documents and information filed for the formation of a company, shall register all the documents and information and issue a certificate that the company is incorporated in the prescribed form to the effect that the proposed company is incorporated under this Act. The company becomes a legal entity from the date mentioned in the certificate of incorporation and continues to be so till it is wound up.

Effects of registration of a company

Section 9 of the Companies Act, 2013 provides that, from the date of incorporation mentioned in the certificate of incorporation, such of the subscribers to the Memorandum and all other persons, as may from time to time become members of the company, shall be a body corporate by the name contained in the memorandum, capable forthwith of exercising all the functions of an incorporated company under this Act and having perpetual succession with power to acquire, hold and dispose of property, both movable and immovable, tangible and intangible, to contract and to sue and be sued by the said name. Accordingly, when a company is registered and a certificate of incorporation is issued by the Registrar, three important consequences follow:

- (a) the company becomes a distinct legal entity. Its life commences from the date mentioned in the certificate of incorporation capable of entering into contracts in its own name, acquiring, holding and disposing of property of any nature whatsoever and capable of suing and being sued in its own name.
- (b) it acquires a life of perpetual existence by the doctrine of succession. The members may come and go, but it goes on forever, unless it is wound up.
- (c) Its property is not the property of the shareholders. The shareholders have a right to share in the profits of the company as and when declared either as dividend or as bonus shares. Likewise any liability of the company is not the liability of the individual shareholders.

Question 42

FAREB Limited was incorporated by acquisition of FAREB & Co., a partnership firm, which was earlier involved in many illegal activities. The promoters furnished some false information and also suppressed some material facts at the time of incorporation of the company. Some members of the public (not being directors or promoters of the company) approached the National Company Law Tribunal (NCLT) against the incorporation status of FAREB Limited. NCLT is about to pass the order by directing that the liability of the members of the company shall be unlimited.

Given the above, advice on whether the above order will be legal and mention the precaution to be taken by NCLT before passing order in respect of the above as per the provisions of the Companies Act, 2013. (3 Marks)

Ans.

As per section 7(7) of the Companies Act, 2013, where a company has been got incorporated by furnishing false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporating such company or by any fraudulent action, the Tribunal may, on an application made to it, on being satisfied that the situation so warrants, direct that liability of the members shall be unlimited. Hence, the order of NCLT will be legal.

Precautions: Before making any order,

- (a) the company shall be given a reasonable opportunity of being heard in the matter; and
- (b) the Tribunal shall take into consideration the transactions entered into by the company, including the obligations, if any, contracted or payment of any liability.

Question 43

Examine with reasons whether the following statement is correct or incorrect:

- (i) A private limited company must have a minimum of two members, while a public limited company must have at least seven members.
- (ii) Affixing of Common seal on company's documents is compulsory. (3 Marks)

Ans.

- i) Correct: Section 3 of the Companies Act, 2013 deals with the basic requirement with respect to the constitution of the company. In the case of a public company, any 7 or more persons can form a company for any lawful purpose by subscribing their names to memorandum and complying with the requirements of this Act in respect of registration. In exactly the same way, 2 or more persons can form a private company.
- (ii) Incorrect: The common seal is a seal used by a corporation as the symbol of its incorporation. The Companies (Amendment) Act, 2015 has made the common seal optional by omitting the words “and a common seal” from Section 9 so as to provide an alternative mode of authorization for companies who opt not to have a common seal. This amendment provides that the documents which need to be authenticated by a common seal will be required to be so done, only if the company opts to have a common seal. In case a company does not have a common seal, the authorization shall be made by two directors or by a director and the Company Secretary, wherever the company has appointed a Company Secretary.

Question 44

Mr. X had purchased some goods from M/s ABC Limited on credit. A credit period of one month was allowed to Mr. X. Before the due date Mr. X went to the company and wanted to repay the amount due from him. He found only Mr. Z there, who was the factory supervisor of the company. Mr. Z told Mr. X that the accountant and the cashier were on leave, he is in-charge of receiving money and he may pay the amount to him. Mr. Z issued a money receipt under his signature. After two months M/s ABC Limited issued a notice to Mr. X for non-payment of the dues within the stipulated period. Mr. X informed the company that he had already cleared the dues and he is no more responsible for the same. He also contended that Mr. Z is an employee of the company whom he had made the payment and being an outsider, he trusted the words of Mr. Z as duty distribution is a job of the internal management of the company.

Analyse the situation and decide whether Mr. X is free from his liability.

Ans.

Doctrine of Indoor Management: The Doctrine of Indoor Management is the exception to the doctrine of constructive notice. The doctrine of constructive notice does not mean that outsiders are deemed to have notice of the internal affairs of the company. For instance, if an act is authorised by the articles or memorandum, an outsider is entitled to assume that all the detailed formalities for doing that act have been observed.

The doctrine of Indoor Management is important to persons dealing with a company through its directors or other persons. They are entitled to assume that the acts of the directors or other officers of the company are validly performed, if they are within the scope of their apparent authority. So long as an act is valid under the articles, if done in a particular manner, an outsider dealing with the company is entitled to assume that it has been done in the manner required.

In the given question, Mr. X has made payment to Mr. Z and he (Mr. Z) gave to receipt of the same to Mr. X. Thus, it will be rightful on part of Mr. X to assume that Mr. Z was also authorised to receive money on behalf of the company. Hence, Mr. X will be free from liability for payment of goods purchased from M/s ABC Limited, as he has paid amount due to an employee of the company.

Question 45

A company registered under section 8 of the Companies Act, 2013, earned huge profit during the financial year ended on 31st March, 2019 due to some favorable policies declared by the Government of India and implemented by the company. Considering the development, some members of the company wanted the company to distribute dividends to the members of the company. They approached you to advise them about the maximum amount of dividend that can be declared by the company as per the provisions of the Companies Act, 2013. (4 Marks)

Ans.

Section 8 of the Companies Act, 2013 deals with the formation of companies which are formed to promote the charitable objects of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment etc. Such company intends to apply its profit in promoting its objects and prohibiting the payment of any dividend to its members. Hence, a company that is registered under section 8 of the Companies Act, 2013, is prohibited from the payment of any dividend to its members. In the present case, the company in question is a section 8 company and hence it cannot declare dividend. Thus, the contention of members is incorrect.

Question 46

Mr. X had purchased some goods from M/s ABC Limited on credit. A credit period of one month was allowed to Mr. X. Before the due date Mr. X went to the company and wanted to repay the amount due from him. He found only Mr. Z there, who was the factory supervisor of the company. Mr. Z told Mr. X that the accountant and the cashier were on leave, he is in-charge of receiving money and he may pay the amount to him. Mr. Z issued a money receipt under his signature. After two months M/s ABC Limited issued a notice to Mr. X for non-payment of the dues within the stipulated period. Mr. X informed the company that he had already cleared the dues and he is no more responsible for the same. He also contended that Mr. Z is an employee of the company to whom he had made the payment and being an outsider, he trusted the words of Mr. Z as duty distribution is a job of the internal management of the company.

Analyse the situation and decide whether Mr. X is free from his liability. (3 Marks)

Ans.

Doctrine of Indoor Management: The Doctrine of Indoor Management is the exception to the doctrine of constructive notice. The doctrine of constructive notice does not mean that outsiders are deemed to have notice of the internal affairs of the company. For instance, if an act is authorised by the articles or memorandum, an outsider is entitled to assume that all the detailed formalities for doing that act have been observed.

The doctrine of Indoor Management is important to persons dealing with a company through its directors or other persons. They are entitled to assume that the acts of the directors or other officers of the company are validly performed, if they are within the scope of their apparent authority. So long as an act is valid under the articles, if done in a particular manner, an outsider dealing with the company is entitled to assume that it has been done in the manner required.

In the given question, Mr. X has made payment to Mr. Z and he (Mr. Z) gave to receipt of the same to Mr. X. Thus, it will be rightful on part of Mr. X to assume that Mr. Z was also authorised to receive money on behalf of the company. Hence, Mr. X will be free from liability for payment of goods purchased from M/s ABC Limited, as he has paid amount due to an employee of the company.

Question 47

The persons (not being members) dealing with the company are always protected by the doctrine of indoor management. Explain. Also, explain when doctrine of Constructive Notice will apply. (6 Marks)

Ans.

Doctrine of Indoor Management: According to this doctrine, persons dealing with the company need not inquire whether internal proceedings relating to the contract are followed correctly, once they are satisfied that the transaction is in accordance with the memorandum and articles of association. Stakeholders need not enquire whether the necessary meeting was convened and held properly or whether necessary resolution was passed properly. They are entitled to take it for granted that the company had gone through all these proceedings in a regular manner.

The doctrine helps to protect external members from the company and states that the people are entitled to presume that internal proceedings are as per documents submitted with the Registrar of Companies.

The doctrine of indoor management is opposite to the doctrine of constructive notice. Whereas the doctrine of constructive notice protects a company against outsiders, the doctrine of indoor management protects outsiders against the actions of a company. This doctrine also is a safeguard against the possibility of abusing the doctrine of constructive notice. Exceptions to Doctrine of Indoor Management (Applicability of doctrine of constructive notice)

- (i) **Knowledge of irregularity:** In case an 'outsider' has actual knowledge of irregularity within the company, the benefit under the rule of indoor management would no longer be available. In fact, he/she may well be considered part of the irregularity.
- (ii) **Negligence:** If, with a minimum of effort, the irregularities within a company could be discovered, the benefit of the rule of indoor management would not apply. The protection of the rule is also not available where the circumstances surrounding the contract are so suspicious as to invite inquiry, and the outsider dealing with the company does not make proper inquiry.
- (iii) **Forgery:** The rule does not apply where a person relies upon a document that turns out to be forged since nothing can validate forgery. A company can never be held bound for forgeries committed by its officers.

Question 48

Alfa School started imparting education on 1st April, 2010, with the sole objective of providing education to children of weaker society either free of cost or at a very nominal fee depending upon the financial condition of their parents. However, on 30th March 2018, it came to the knowledge of the Central Government that the said school was operating by violating the objects clause due to which it was granted the status of a section 8 company under the Companies Act, 2013. Describe what powers can be exercised by the Central Government against the Alfa School, in such a case?

(3 Marks)

Ans.

Section 8 of the Companies Act, 2013 deals with the formation of companies which are formed to promote the charitable objects of commerce, art, science, education, sports etc. Such company intends to apply its profit in promoting its objects. Section 8 companies are registered by the Registrar only when a license is issued by the Central Government to them. Since, Alfa School was a Section 8 company and it had started violating the objects clause, hence in such a situation the following powers can be exercised by the Central Government:

- (i) The Central Government may by order revoke the licence of the company where the company contravenes any of the requirements or the conditions of this sections subject to which a licence is issued or where the affairs of the company are conducted fraudulently, or violative of the objects of the company or prejudicial to public interest, and on revocation the Registrar shall put 'Limited' or 'Private Limited' against the company's name in the register. But before such revocation, the Central Government must give it a written notice of its intention to revoke the licence and opportunity to be heard in the matter.
- (ii) Where a licence is revoked, the Central Government may, by order, if it is satisfied that it is essential in the public interest, direct that the company be wound up under this Act or amalgamated with another company registered under this section. However, no such order shall be made unless the company is given a reasonable opportunity of being heard.
- (iii) Where a licence is revoked and where the Central Government is satisfied that it is essential in the public interest that the company registered under this section should be amalgamated with another company registered under this section and having similar objects, then, notwithstanding anything to the contrary contained in this Act, the Central Government may, by order, provide for such amalgamation to form a single company with such constitution, properties, powers, rights, interest, authorities and privileges and with such liabilities, duties and obligations as may be specified in the order.