



**Arjun Chhabra Tutorial**  
Education Gives You The Wings To FLY

**What's App/Call: 62 62 62 143 8**

**Download our App from Play Store:  
Arjun Chhabra Tutorial**

**Link: <http://on-app.in/app/home?orgCode=yewkp>**

**[www.arjunchhabratutorial.com](http://www.arjunchhabratutorial.com)**

### **Important**

1. Those who have missed LIVE marathon lectures can avail those lectures from Arjun Chhabra Tutorial mobile App (Available in both android & IOS) - Links are given in the description of Contract Act LIVE Marathon video.

2. For any query regarding lectures and notes, student may whats app @ 62 62 62 143 8

## EXAM ORIENTED MARATHON NOTES

### Chapter 5: The Companies Act, 2013

#### Important Questions based on companies

**Company | Foreign Company | Private Company | Public Company  
Holding/Subsidiary Company | Government Company | Small Company | One  
Person Company | Associate Company | Section 8 Company**

#### Company Vs. Foreign Company

**Q.1** Mike Limited company incorporated in India having Liaison office at Singapore. Explain in detail meaning of Foreign Company and analysis on whether Mike Limited would be called as Foreign Company as it established a Liaison office at Singapore as per the provisions of the Companies Act, 2013? [Dec 20 - 3 Marks]

**Answers:**

Foreign company [Section 2 (42)]	Company [Section 2 (20)]
<p>Means any company or body corporate incorporated outside India which, —</p> <p>(a) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and</p> <p>(b) conducts any business activity in India in any other manner.</p>	<p>Means a company incorporated under this Act or under any previous company law.</p>

In the instant case Mike Limited incorporated in India having liaison office at Singapore.

**Conclusion:**

In the light of the above provision and facts of the case we conclude that Mike Limited cannot be called as foreign company because the basic condition to be called as foreign company is that the company must be incorporated outside India. In the present case Mike Limited is incorporated in India i.e. incorporated under this Act (Companies Act, 2013) or under any previous company law. Therefore, Mike Limited can be called as company but cannot be called as foreign company.

#### Private Company

**Q.2** Jagannath Oils Limited is a public company and having 220 members of which 25 members were employee in the company during the period 1st April, 2006 to 28th June 2016. They were allotted shares in Jagannath Oils Limited first time on 1st July, 2007 which were sold by them 1st August, 2016. After some time, on 1st December, 2016, each of those 25 members acquired shares in Jagannath Oils Limited which they are holding till date. Now company wants to convert itself into a private company. State with reasons:

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

(II) Would your answer be different if above 25 members were the employee in

Jagannath Oils Limited for the period from 1st April, 2006 to 28th June, 2017? [MTP Nov 21 - 4 Marks]

**Related Question 1:** 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. [MTP March 19, 3 Marks]  
 [RTP May 19] CS LLM Arjun Chhabra

**Related Question 2:** ABC Limited was registered as a public company. There were 245 members in the company. Their details are as follows:

Directors and their relatives	190
Employees	15
Ex — employees (shares were allotted when they were employees)	20
Others (Including 10 joint holders holding shares jointly in the name of father and son)	20

The Board of directors of the company propose to convert it into a private company. Advice whether reduction in the number of members is necessary for conversion. [Jan 21 - 4 Marks]

**Answer:**

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

- (a) 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.

(I) 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 be 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.

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

#### Related Question Answer 1:

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 (5x1)	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.

#### Related Question Answer 2:

In the instant case, ABC 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)	Others (10 joint holders holding shares in the name of father and son)	10
	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.

**Special Note: Status of private company, which is subsidiary to public company [Section 2(71)]**

A Private company, which is subsidiary of a public company shall be deemed to be public company for the purpose of this Act, even where such subsidiary company continues to be a private company in its articles.

### Holding Subsidiary & Government Company

**Q.3** 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 Rs. 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? [RTP Nov 21]

**Answer:**

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.

**Related Question:** 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? [Dec 21 - 3 Marks]

**Answer:**

In the instant case, as BC private limited together with its subsidiary KL private limited holding more than one-half of the total paid up share capital (voting power) in PQ private limited i.e., 90000 equity shares are held by BC private limited plus 70000 equity shares are held by KL private limited respectively in PQ private limited amounting to 160000 equity share out of total equity shares of 300000.

In the light of the above provision and facts of the case:

1. PQ private limited is subsidiary of BC private limited.
2. In the second case also, the answer would be the same as above, i.e., PQ private limited is subsidiary of BC private limited irrespective of the fact that no shares are held by BC Private Limited in PQ Private Limited.

**Related Question:** The paid-up capital of Ram Private Limited is Rs.10 Crores in the form of 7,00,000 Equity Shares of Rs.100 each and 3,00,000 Preference Shares of Rs. 100 each. Lakhan Private Limited is holding 3,00,000 Equity Shares and 3,00,000 Preference Shares in Ram Private Limited. State with reason, Whether Ram Private Limited is subsidiary of Lakhan Private Limited? (MTP Oct 21 - 4 Marks)

**Answer:**

It is to be noted that Preference share capital will also be considered if preference shareholders have same voting rights as equity shareholders.

In the instant case, Ram Private Limited is having paid-up capital of Rs.10 Crores in the form of 7,00,000 Equity Shares of Rs.100 each and 3,00,000 Preference Shares of Rs.100 each. Lakhan Private Limited is holding 3,00,000 Equity Shares and 3,00,000 Preference Shares in Ram Private Limited.

As in the given problem it is not clear that whether Preference Shares are having voting rights or not, it can be taken that there is no voting right with these shares. On the basis of provisions of Section 2(87) and facts of the given problem, Lakhan Private Limited is holding 3,00,000 Equity Shares of total equity paid up share capital of Ram Private Limited.

Therefore, as Lakhan Private Limited does not exercises or controls more than one-half of the total voting power in Ram Private Limited, Ram Private Limited is not subsidiary of Lakhan Private Limited.

#### Associate Company

**Q.4** ABC Limited has allotted equity shares with voting rights to XYZ Limited worth Rs. 15 Crores and issued Non-Convertible Debentures worth Rs. 40 Crores during the Financial Year 2019-20. After that total Paid-up Equity Share Capital of the company is Rs. 100 Crores and Non-Convertible Debentures Stands at Rs. 120 Crores. Define the Meaning of Associate Company and comment on whether ABC Limited and XYZ Limited would be called Associate Company as per provisions of the Companies Act, 2013? [Dec 20 4 Marks] [RTP May 21]

#### Answer:

As per Sec. 2(6) of Company Act 2013 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 company having such influence and include a joint venture company.

Here the word significant influence means control of at least twenty percent of total voting power or control of or participation in business decision under an agreement.

The term Total voting power will means aggregate of-

- (a) Paid up equity share capital
- and
- (b) Convertible Preference share capital

#### Conclusion:

In the light of the above provision and facts of the case, as XYZ Ltd. hold 15 crore equity shares with voting right in total of 100 crore paid up equity of ABC Ltd. which is

only 15 percent and holding of non-convertible debenture of Rs. 40 crores in ABC Ltd. will not be taken into account for observing the relationship of associate company. Therefore, ABC Limited and XYZ Limited cannot be called Associate Company as per provisions of the Companies Act, 2013.

**Related Question:** Manicar Limited has allotted equity shares with voting rights to Nanicar Limited worth Rs. 10 Crores and issued Non-Convertible Debentures worth Rs.30 Crores during the Financial Year 2017-18. After that total Paid-up Equity Share Capital of the company is Rs.100 Crores and Non-Convertible Debentures stands at Rs.150 Crores.

Define the Meaning of Associate Company and comment on whether Manicar Limited and Nanicar Limited would be called Associate Company as per the provisions of the Companies Act, 2013? [MTP Nov 21 - 3 Marks]

**Answer:**

In the given case, as Manicar Ltd. has allotted equity shares with voting rights to Nanicar Limited of Rs. 10 crores, which is less than requisite control of 20% of total share capital (i.e. 100 crore) to have a significant influence of Nanicar Ltd. Since the said requirement is not complied, therefore Manicar Ltd. and Nanicar Ltd. are not associate companies as per the Companies Act, 2013.

Further holding/allotment of non-convertible debentures has no relevance for ascertaining significant influence. Hence the issue of non-convertible debentures will not make both the companies Associate Company.

**Q.5** Explain the classification of the companies on the basis of control as per The Companies Act, 2013? [July 21 - 6 Marks]

### **One Person Company**

**Q.6** 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? [RTP Nov 18] [May 18, 6 Marks] [MTP Oct 19, 6 Marks] [RTP Nov 20] CS LLM Arjun Chhabra

**Answer:**

**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 **WHETHER RESIDENT IN INDIA** (person who stayed in India for a period of not less than 120 days during immediately preceding financial year) **OR OTHERWISE**
  - shall be eligible to incorporate a OPC;
  - 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.

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

(i) Is Mr. A eligible to be incorporated as a One Person Company (OPC). If yes, can he give the name of Mr. B in the memorandum of Association as his nominee to become the member after Mr. A's incapacity to become a member.

(ii) If Mr. A has contravened any of the provisions of the Act, what are the consequences? [RTP Nov 21]

**Answer:**

As per the provisions of the Companies Act, 2013, Only a natural person who is an Indian citizen **WHETHER RESIDENT IN INDIA** (person who stayed in India for a period of not less than 120 days during immediately preceding financial year) **OR OTHERWISE**

- shall be eligible to incorporate a OPC;
- shall be a nominee for the sole member of a OPC.

(i) In the given case, Mr. A being a natural person and Indian citizen is eligible to incorporate OPC even though he is not resident in India during immediately preceding

financial year because now it is not mandatory for nominee or sole member to be resident in India in order to become nominee or sole member of OPC.

Mr. A cannot give the name of Mr. B in the memorandum of Association as his nominee to become the member after Mr. A's incapacity to become a member because Mr. B is a foreign citizen and not an Indian citizen. Hence B's name cannot be given as nominee in the memorandum.

(ii) If Mr. A has contravened any of the provisions of the Act, following are the consequences:

- He shall be punishable with fine which may extend to ten thousand rupees and
- with a further fine which may extend to One thousand rupees every day after the first during which such contravention occurs.

### Section 8 Company

**Q.7** What do you mean by "Companies with charitable purpose" (section 8) under the Companies Act, 2013? Mention the conditions of the issue and revocation of the licence of such company by the government. [May 19, 6 Marks]

**Related Question:** 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? [RTP May 18] [RTP May 19] CS LLM Arjun Chhabra

**Answer:** Same Answer for both the Questions

**Formation of companies with charitable purpose etc. (Section 8 company):**

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.

**Examples** of section 8 companies are FICCI, ASSOCHAM, National Sports Club of India, CII etc.

**Power of Central government to issue the license-**

- (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.

**Revocation of license:** 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.

**Related Question:** What are the significant points of Section 8 Company which are not applicable for other companies? Briefly explain with reference to provisions of the Companies Act, 2013. [Dec-20, 6 Marks]

#### Section 8 Company- Significant points

- Formed for the promotion of commerce, art, science, religion, charity, protection environment, sports, etc.
- Requirement of minimum share capital does not apply.
- Uses its profits for the promotion of the objective for which formed.
- Does not declare dividend to members.
- Operates under a special licence from Central Government.
- Need not use the word Ltd./ Pvt. Ltd. in its name and adopt a more suitable name such as club, chambers of commerce etc.
- Licence revoked if conditions contravened.
- On revocation, Central Government may direct it to
  - Converts its status and change its name
  - Wind - up
  - Amalgamate with another company having similar object.
- Can call its general meeting by giving a clear 14 days' notice instead of 21 days.
- Requirement of minimum number of directors, independent directors etc. does not apply.
- Need not constitute Nomination and Remuneration Committee and Shareholders Relationship Committee.
- A partnership firm can be a member of Section 8 company.

**Q.8** A company registered under section 8 of the Companies Act, 2013, earned huge profit during the financial year ended on 31st March, 2018 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. Examine the relevant provisions of the Companies Act, 2013 and advise the members accordingly. [Nov 18, 4 Marks] [MTP Oct 19, 4 Marks] CS LLM Arjun Chhabra

**Answer:** Take points of answers no.4 upto 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.

**Q.9** Explain the meaning of Guarantee Company? State the similarities and dissimilarities between a 'Guarantee Company' and 'Company Limited by Shares'. [MTP March 18, 6 Marks] [MTP April 19, 6 Marks] [July 21 - 3 Marks]

**Answer:**

**Meaning of Guarantee Company:** Section 2(21) of the Companies Act, 2013 defines a Company Limited by Guarantee as a company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake to contribute to the assets of the company in the event of its being wound up. Thus, the liability of the members of a guarantee company is limited to a stipulated amount in terms of individual guarantees given by members and mentioned in the memorandum. The members cannot be called upon to contribute more than such stipulated amount for which each member has given a guarantee in the memorandum of association.

**Similarities and dis-similarities between the Guarantee Company and the Company limited by shares:** The common features between a "guarantee company" and the "company limited share" are legal entity and limited liability. In case of a company limited by shares, the liability of its members is limited to the amount remaining unpaid on the shares held by them. Both these types of companies have to state this fact in their memorandum that the members' liability is limited.

**However, the dissimilarities between a 'guarantee company' and 'company limited by shares' is** that in the former case the members will be called upon to discharge their liability only after commencement of the winding up of the company and only to the extent of amounts guaranteed by them respectively; whereas in the case of a company limited by shares, the members may be called upon to discharge their liability at any time, either during the life of the company or during the course of its winding up.

### Corporate veil

**Q.10** There are cases where company law disregards the principle of corporate personality or the principle that the company is a legal entity distinct from its shareholders or members. Elucidate. [Nov 18, 6 Marks]

**Answer:**

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

However, this veil can be lifted which means looking behind the company as a legal person, i.e., disregarding the corporate entity and paying regard, instead, to the realities behind the legal facade. Where the Courts ignore the company, and concern themselves directly with the members or managers, the corporate veil may be said to have been lifted. Only in appropriate circumstances, the Courts are willing to lift the corporate veil and that too, when questions of control are involved rather than merely a question of ownership.

#### 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:

- **Trading with enemy:** If the public interest is likely to be in jeopardy, the Court may be willing to crack the corporate shell
- Where **corporate entity is used to evade or circumvent tax**, the corporate veil may be lifted
- Where companies form other companies as their **subsidiaries to act as their agent**
- Company is **formed to circumvent welfare of employees**
- **Where the device of incorporation is adopted for some illegal or improper purpose:** 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.

**Q.11** A, an assessee, had large income in the form of dividend and interest. In order to reduce his tax liability, he formed four private limited company and transferred his investments to them in exchange of their shares. The income earned by the companies was taken back by him as pretended loan. Can A be regarded as separate from the private limited company he formed? [Nov19, 3 Marks]

**Related Question:** Krishna, an assessee, was a wealthy man earning huge income by way of dividend and interest. He formed three Private Companies and agreed with each to hold a bloc of investment as an agent for them. The dividend and interest income received by the companies was handed back to Krishna as a pretended loan. This way, Krishna divided his income into three parts in a bid to reduce his tax liability.

Decide, for what purpose the three companies were established? Whether the legal personality of all the three companies may be disregarded. [March 18, 4 Marks] [MTP October 18, 4 Marks] [MTP March 19, 6 Marks] [MTP April 19, 4 Marks] [RTP May 19] CS LLM Arjun Chhabra

**Answer:** Same answer for both the question

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.

In *Dinshaw Maneckjee Petit case* it was held that the company was not a genuine company at all but merely the assessee himself disguised that the legal entity of a limited company. The assessee earned huge income by way of dividends and interest. So, he opened some companies and purchased their shares in exchange of his income by way of dividend and interest. This income was transferred back to assessee by way of loan. The court decided that the private companies were a sham and the corporate veil was lifted to decide the real owner of the income.

In the instant case, the four private limited companies were formed by A, 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. A was simply to split his income into four parts with a view to evade tax. No other business was done by the company.

Hence, A cannot be regarded as separate from the private limited companies he formed.

**Related Question:** 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? [RTP Nov 21]

**Answer:**

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.

#### Memorandum & Doctrines

**Q.12** "The Memorandum of Association is a charter of a company". Discuss. Also explain in brief the contents of Memorandum of Association. [Nov 19, 6 Marks] [MTP Oct 21 - 6 Marks] CS LLM Arjun Chhabra

**Answer:**

The Memorandum of Association of company is in fact its charter; it defines its constitution and the scope of the powers of the company with which it has been established under the Act. It is the very foundation on which the whole edifice of the company is built.

**Object of registering a memorandum of association:**

- It contains the object for which the company is formed and therefore identifies the possible scope of its operations beyond which its actions cannot go.
- It enables shareholders, creditors and all those who deal with company to know what its powers are and what activities it can engage in.

A memorandum is a public document under Section 399 of the Companies Act, 2013. Consequently, every person entering into a contract with the company is presumed to have the knowledge of the conditions contained therein.

- The shareholders must know the purposes for which his money can be used by the company and what risks he is taking in making the investment.

A company cannot depart from the provisions contained in the memorandum however imperative may be the necessity for the departure. It cannot enter into a contract or engage in any trade or business, which is beyond the power conferred on it by the

memorandum. If it does so, it would be *ultra vires* the company and void.

**Contents of the memorandum:** The memorandum of a company shall state—

- (a) the name of the company (Name Clause) with the last word "Limited" in the case of public limited company, or the last words "Private Limited" in the case of a private limited company. This clause is not applicable on the companies formed under section 8 of the Act.
- (b) the State in which the registered office of the company (Registered Office clause) is to be situated;
- (c) the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof (Object clause);
- (d) the liability of members of the company (Liability clause), whether limited or unlimited
- (e) the amount of authorized capital (Capital Clause) divided into share of fixed amounts and the number of shares with the subscribers to the memorandum have agreed to take, indicated opposite their names, which shall not be less than one share. A company not having share capital need not have this clause.
- (f) the desire of the subscribers to be formed into a company. The Memorandum shall conclude with the association clause. Every subscriber to the Memorandum shall take at least one share, and shall write against his name, the number of shares taken by him. (Association Clause)

### Doctrines

#### Doctrine of ultra vires

**Q.13** Briefly explain the doctrine of "ultravires" under the Companies Act, 2013. What are the consequences of ultravires acts of the company? [RTP Nov 18] [MTP Oct 18, 6 Marks] [RTP May 20] [MTP Nov 21 - 6 Marks]

**Related Question:** The Object Clause of Memorandum of Association of ABC Pvt. Ltd. authorized 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. Advise them. [MTP Aug 18, 4 Marks]

**Answer:**

#### Doctrine of ultra vires

1. 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.

2. 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.
3. 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.
4. 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.
5. 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.
6. 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.
7. An act which is *ultra vires* the company being void, cannot be ratified by the shareholders of the company. Sometimes, act which is *ultra vires* can be regularized by ratifying it subsequently.

### Conclusion

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.**

**Q.14** Ravi Private Limited has borrowed Rs. 5 crores from Mudra Finance Ltd. This debt is ultra vires to the company. Examine, whether the company is liable to pay this debt? State the remedy if any available to Mudra Finance Ltd.? [May 18, 4 Marks] CS LLM Arjun Chhabra

**Answer:**

**As per the facts given**, Ravi Private Limited borrowed ` 5 crore from Mudra Finance Ltd. This debt is ultra vires to the company, which signifies that Ravi Private Limited has borrowed the amount beyond the expressed limit prescribed in its memorandum. This act of the company can be said to be null and void.

**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.

So is being the act void in nature, there being no existence of the contract between the Ravi Private Ltd. and Mudra Finance Ltd. Therefore, the company Ravi Private Ltd. is liable to pay this debt amount upto the limit prescribed in the memorandum.

**Remedy available to the Mudra Finance Ltd.:** 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, a company which deals with the other, is deemed to know about the powers of the company.

So, Mudra Finance Ltd. can claim for the amount within the expressed limit prescribed in its memorandum.

**Related Question:** AK Private Limited has borrowed 36 crores from BK Finance Limited. However, as per the memorandum of AK Private Limited, the maximum borrowing power of the company is ₹30 crores. Examine whether AK Private Limited is liable to pay this debt? State the remedy, if any, available to BK Finance Limited. [Dec 21, 4 Marks] CS LLM Arjun Chhabra

**Answer:**

As per the facts given, AK Private Limited has borrowed 36 crores from BK Finance Limited. This debt is ultra vires to the company, because the maximum borrowing power of the company as per memorandum is ₹30 crores which signifies that AK Private Limited has borrowed the amount beyond the expressed limit prescribed in its memorandum. This act of the company can be said to be null and void.

In consequence, any act done or a contract made by the company which travels beyond the powers of the company is wholly void and inoperative in law and is therefore not binding on the company.

So is being the act void in nature, there being no existence of the contract between the AK Private Limited and BK Finance Limited. Therefore, the company AK Private Limited. is liable to pay this debt amount upto the limit prescribed in the memorandum.

**Remedy available to the BK Finance Limited:** 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, a company which deals with the other, is deemed to know about the powers of the company.

So, BK Finance Limited can claim for the amount within the expressed limit prescribed in its memorandum. i.e., ₹30 crores only.

### Doctrine of Indoor Management

**Q.15** Sound Syndicate Ltd., a public company, its articles of association empowers the managing agents to borrow both short and long term loans on behalf of the company, Mr. Liddle, the director of the company, approached Easy Finance Ltd., a non-banking finance company for a loan of ` 25,00,000 in name of the company.

The Lender agreed and provided the above said loan. Later on, Sound Syndicate Ltd. refused to repay the money borrowed on the pretext that no resolution authorizing such loan have been actually passed by the company and the lender should have enquired about the same prior providing such loan hence company not liable to pay such loan.

Analyse the above situation in terms of the provisions of Doctrine of Indoor Management under the Companies Act, 2013 and examine whether the contention of Sound Syndicate Ltd. is correct or not? [May 19, 4 Marks] [MTP Oct 20 - 6 Marks]

**Related Question:** 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. [RTP May 18] CS LLM Arjun Chhabra

**Answer:**

#### Doctrine of Indoor Management

1. 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.
2. 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.
3. The doctrine helps 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.

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

Easy Finance Ltd. being external to the company, need not enquire whether the necessary

resolution was passed properly. Even if the company claim that no resolution authorizing the loan was passed, the company is bound to pay the loan to Easy Finance Ltd.

**Related Question Answer:**

1. 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.
2. 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.
3. 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

**Related Question:** 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. [Nov 18, 3 Marks] [MTP March 19, 4 Marks] [MTP Oct 19, 3 Marks] CS LLM Arjun Chhabra

**Answer:**

**Doctrine of Indoor Management:**

1. 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.
2. 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 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.

**Related Question:** Explain clearly the doctrine of 'Indoor Management' as applicable in cases of companies registered under the Companies Act, 2013. Explain the circumstances in which an outsider dealing with the company cannot claim any relief on the ground of 'Indoor Management'. [RTP Nov 20] [Jan 21- 6 Marks]

**Answer:** Doctrine of Indoor Management (the 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 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:

The doctrine of Indoor Management has limitations of its own. That is to say, it is inapplicable to the following cases, namely:

- (i) **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.
- (ii) **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.

<p>(iii) <b>Forgery:</b> 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.</p>
<b>Miscellaneous</b>
<p><b>Q.16</b> Explain the concept of "Dormant Company" as envisaged in the Companies Act, 2013. [RTP May 18]</p>
<p><b>Q.17</b> When a company is registered, it is clothed with a legal personality. Explain. [RTP May 18]</p>
<p><b>Q.18</b> 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? [RTP Nov 18]</p>
<p><b>Q.19</b> Examine the following whether they are correct or incorrect along with reasons:</p> <ul style="list-style-type: none"><li>(a) A company being an artificial person cannot own property and cannot sue or be sued.</li><li>(b) A private limited company must have a minimum of two members, while a public limited company must have at least seven members. [RTP Nov 18] [MTP Oct 20 - 3 Marks]</li></ul>
<p><b>Q.20</b> Examine with reasons whether the following statement is correct or incorrect:</p> <ul style="list-style-type: none"><li>(i) A private limited company must have a minimum of two members, while a public limited company must have at least seven members.</li><li>(ii) Affixing of Common seal on company's documents is compulsory. [MTP March 18, 3 Marks] [MTP Oct 18, 3 Marks] [MTP April 19, 3 Marks] CS LLM Arjun Chhabra</li></ul>
<p><b>Q.21</b> FAREB Limited was incorporated by acquisition of FAREB &amp; 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. [MTP Aug 18, 3 Marks] CS LLM Arjun Chhabra</p>
<p><b>Q.22</b> What do you mean by the term capital? Describe its classification in the domain of Company Law. [Dec 21 - 6 Marks]</p>
<p><b>Answer:</b></p> <p>The term capital has a variety of meanings. In relation to a company limited by shares, the word capital means <b>share capital</b>, i.e., the capital or figure in terms of so many rupees</p>

divided into shares of a fixed amount.

In other words, the contributions of persons to the common stock of the company form the capital of the company. The proportion of the capital to which each member is entitled is his share. A share is not a sum of money; it is rather an interest measured by a sum of money and made up of various rights contained in the contract.

In the domain of Company Law, the term 'capital' is used in the following senses:

**1) "Authorised capital" or "Nominal capital":** It means the Capital as is authorized by the MOA of a Company to be the maximum amount of Share Capital of the Company. [Sec.2(8)]

It is also known as **registered capital of company** upon which it pays the stamp duty.

It is usually fixed at the amount, which, it is estimated, the company will need, including the working capital and reserve capital, if any.

**2) Issued capital:** It means such Capital as the Company issues from time to time for subscription. [Sec.2(50)]. Issued Capital also includes Shares allotted for consideration other than cash.

It is that part of authorised capital which is offered by the company for subscription.

**3) Subscribed capital:** It means that part of the capital, which is for the time being subscribed by the members of a company.

It is the nominal amount of shares taken up by the public. Where any notice, advertisement or other social communication or any business letter, billhead or letter paper of a company states the authorised capital, the subscribed and paid-up capital must also be stated in equally conspicuous characters.

Default in this regard will make the company and every officer who is in default liable to pay the penalty extending ₹10,000 and ₹5,000, respectively.

**4) Called-up capital:** It means the capital that has been called for payment. It is the total amount called upon the shares issued.

**5) Paid-up capital:** Paid-up capital is the total amount paid or credited as paid up on shares issued. It is equal to called up capital less calls in arrears.