# CA INTERMEDIATE

# CORPORATE AND OTHER LAWS
# GROUP – 1
# PAPER- 2

**"Every time you think of closing this book, just remember the journey which made you open the book"**

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# INDEX



***Q 3.16: What is the examination pattern in Intermediate Examination?***

***Ans: There will be 30% case scenario/ case-study based MCQs and 70% descriptive questions in all the six papers of Intermediate Examination.***

***Q 3.17: Is there negative marking in MCQ based questions in Intermediate Examination?***

***Ans: There is no negative marking in MCQ based questions in Intermediate Examination.***

# CHAPTER 1

# DEFINITIONS

## INTRODUCTION

The Companies Act, 2013 is an Act to **consolidate and amend the law relating to companies.** The legislation was necessitated to meet changes in the national and international economic environment and for expansion and growth of economy of our country.

The Companies Act, 2013 **received the assent of the Hon'ble President of India on 29th August 2013 and was notified in the Official Gazette on 30th August 2013** for public information stating that different dates may be appointed for enforcement of different provisions of the Companies Act, 2013, through notifications.

Section 1 came into force on 30th August 2013; 98 sections came into force on 12th September 2013; 143 sections were enforced from 1st April 2014 and so on.

The Companies Act, 2013 is rule based legislation with 470 sections and seven schedules. The entire Act has been divided into 29 chapters. Each chapter has at least one set of Rules. The Companies Act, 2013 aims to improve corporate governance, simplify regulations and strengthen the interests of investors. Thus, this enactment makes our corporate regulations more contemporary

**Applicability of the Act. The provisions of this Act shall apply to-**

(a) companies incorporated under this Act or under any previous company law*;

(b) insurance companies, except in so far as the said provisions are inconsistent with the provisions of the Insurance Act, 1938 or the Insurance Regulatory and Development Authority Act, 1999;

(c) banking companies, except in so far as the said provisions are inconsistent with the provisions of the Banking Regulation Act, 1949;

(d) companies engaged in the generation or supply of electricity, except in so far as the said provisions are inconsistent with the provisions of the Electricity Act, 2003;

(e) any other company governed by any special Act for the time being in force, except in so far as the said provisions are inconsistent with the provisions of such special Act, and

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

**Example:** Food Corporation of India (FCI), National Highway Authority of India (NHAI) etc.

Note: The term "except in so far as" shall mean excluding to the extent of i.e. if any provision of the Companies Act is inconsistent with any of the provisions of other Act (Insurance Act, Banking

Regulation Act, Electricity Act, etc.) to which the company is regulated than that company shall comply with the provisions of respective Act/Acts to which it is governed and regulated by.

**Example**: ABC Ltd. was incorporated on 1.1.1972 under the Companies Act,1956. So, the Companies Act, 2013 shall also be applicable on ABC Ltd.

**DEFINITONS**

**(1) Abridged prospectus:** means a **memorandum** containing such **salient features of a prospectus** as may be specified by the securities and exchange board by making regulation in this behalf.

**(2) ACCOUNTING STANDARDS:** means the standards of accounting or any addendum thereto for companies or class of companies referred to in section 133;

**Section 133 of the Act deals with the Central Government to Prescribe Accounting Standards.** As per the section, **the Central Government may prescribe the standards of accounting** or any addendum thereto, as **recommended by the ICAI**, constituted under section 3 of the Chartered Accountants Act, 1949, **in consultation with and after examination of the recommendations made by the National Financial Reporting Authority.**

Section 133 is to be read with Rule 7 of the Companies (Accounts) Rules, 2014. Accordingly,

(i) The **standards of accounting as specified under the Companies Act, 1956 shall be deemed to be the accounting standards until accounting standards are specified by the Central Government** under section 133.

(ii) **Till the NFRA* is constituted under section 132** of the Act, the Central Government may prescribe the standards of accounting or any addendum thereto, as recommended by the Institute of Chartered Accountants of India in consultation with and after examination of the recommendations made by the National Advisory Committee on Accounting Standards constituted under section 210A of the Companies Act, 1956.

***The Central Government hereby appoints the 1st October 2018 as the date of constitution of National Financial Reporting Authority.**

**(3) Alter or Alteration:** includes the making of addition , omission and substitution

**(4) Articles means:**

- The articles of association of a company as **originally** framed or
- As altered from **time to time** , or
- Applied in pursuance of any **previous company law** or
- Applied in **pursuance of this act**

**(5) 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.**

Explanation. — For the purpose of this clause, —

(a) the expression "significant influence" means control of **at least 20% of total voting power, or control of or participation** in business decisions under an agreement;

(b) 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;

Vide Circular dated 25/06/2014 it has been clarified that the shares held by a company in another company in a fiduciary capacity (a fiduciary is a person who holds a legal or ethical relationship of trust with one of more parties). Typically, a fiduciary prudently takes care of money or other assets for another person) shall not be counted for the purpose of determining the relationship of associate company

**(11) BODY CORPORATE OR CORPORATION** **includes a company incorporated outside India**, **but does not include—**

(i) a **co-operative society** registered under any law relating to co-operative societies; and

(ii) any other body corporate (not being a company as defined in this Act), which the **Central Government may, by notification, specify** in this behalf;

**(17) CHARTERED ACCOUNTANT** means a chartered accountant as defined in clause

(b) of sub-section (1) of section 2 of the Chartered Accountants Act, 1949 who holds a valid certificate of practice under sub-section (1) of section 6 of that Act

**(20) COMPANY** means a company **incorporated under this Act or under any previous company law**;

**Example:** Reliance Industries Limited incorporated in year 1973, Tata Steel Limited incorporated in year 1907, Infosys Limited incorporated in year 1981. Such companies are incorporated under Companies Act, 1956 (previous company law) are also included in the above definition for being treated as a Company.

**(27) Control** shall include

- the right to appoint majority of the directors or
- to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including

**by virtue** of

- their shareholding or
- management rights or shareholders agreements or
- voting agreements or in any other manner;

It is an inclusive definition and relevant for the provisions relating to subsidiary and holding companies

**(38) EXPERT** includes an engineer, a valuer, a Chartered Accountant, a Company Secretary, a Cost Accountant and any other person who has the power or authority to issue a certificate in pursuance of any law for the time being in force;

**(45) GOVERNMENT COMPANY** means any company in which **not less than 51% of the paid-up share capital is held by** the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, **and includes a company which is a subsidiary company of such a Government company;**

3Explanation. - For the purposes of this clause, the "**paid-up share capital" shall be construed as "total voting power"**, where shares with differential voting rights have been issued.

**Example:** X Industries Ltd. is a company in which 25% of shareholding is held by Central Government; 10% shareholding is held by Government of Maharashtra and 15% shareholding is held by Central Government and Government of Rajasthan. Here, X Industries Ltd. **is not a government company** as there is no compliance of minimum holding of paid-up share capital i.e. at least 51 % by the Central Government, or by any State Government or Governments or partly by the Central Government and partly by one or more State Government.

**(52) LISTED COMPANY**

Listed company means 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.

According to rule 2A of the Companies (Specification of definitions details) Rules, 20146, the following classes of companies shall not be considered as listed companies, namely:-

a) **Public companies which have not listed their equity shares** on a recognized stock exchange **but have listed their** –

(i) **non-convertible debt securities** issued on private placement basis; or

(ii) **non-convertible redeemable preference shares** issued on private placement basis; or

b) **Private companies** which have listed their non-convertible debt securities on private placement

c) **Public companies** which have not listed their equity shares on a recognized stock exchange but whose equity shares are listed on a stock exchange in a jurisdiction as specified in Section 23(3) of the Companies Act, 2013.(**Listed in foreign jurisdiction**)

**(54) Managing Director** means a director who, by virtue of the articles of a company or an agreement with the company or a resolution passed in its general meeting, or by its Board of Directors, is entrusted with substantial powers of management of the affairs of the company and includes a director occupying the position of managing director, by whatever name called.

Explanation.— For the purposes of this clause, the power to do administrative acts of a routine nature when so authorised by the Board such as:

• the power to affix the common seal of the company to any document or

• to draw and endorse any cheque on the account of the company in any bank or
• to draw and endorse any negotiable instrument or
• to sign any certificate of share or to direct registration of transfer of any share,

shall not be deemed to be included within the substantial powers of management;

**Explanation**.- For any individual to be called as managing director, an individual shall first be a director duly appointed by the Company under the provisions of the Companies Act, 2013. This also implies that an individual who is not a director in the company cannot be appointed as Managing Director of that company.

**(55) MEMBER**, in relation to a company, means—

(i) the **subscriber to the memorandum** of the company who shall be deemed to have agreed to become member of the company, and on its registration, shall be entered as member in its register of members;

(ii) every other **person who agrees in writing to become a member** of the company and whose name i**s entered in the register of members** of the company;

(iii) every person holding shares of the company and **whose name is entered as a beneficial owner** in the records of a depository;

**(60) OFFICER WHO IS IN DEFAULT**, for the purpose of any provision in this Act which enacts that an officer of the company who is in default shall be liable to any penalty or punishment by way of imprisonment, fine or otherwise, **means any of the following officers** of a company, namely:—

(i) whole-time director (WTD);
(ii) key managerial personnel (KMP);
(iii) where there is **no KMP, such director or directors as specified by the Board** in this behalf and **who has or have given his or their consent in writing** to the Board to such specification, **or all the directors, if no director is so specified;**
(iv) any person who, **under the immediate authority of the Board or any KMP,** is charged with any responsibility including maintenance, filing or distribution of accounts or records, authorises, actively participates in, knowingly permits, or knowingly fails to take active steps to prevent, any default;
(v) any **person in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act, other than a person who gives advice to the Board in a professional capacity;**
(vi) **every director**, in respect of a contravention of any of the provisions of this Act, **who is aware of such contravention** by **virtue of the receipt by him of any proceedings of the Board or participation in such proceedings without objecting to the same**, or **where such contravention had taken place with his consent or connivance;**
(vii) in **respect of the issue or transfer of any shares** of a company, **the share transfer agents, registrars and merchant bankers** to the issue or transfer;

**Example:** In a company, a default was committed with respect to the allotment of shares by the officers. In company there were no managing director, whole time director, a manager, secretary, a person charged by the Board with the responsibility of complying with the provisions of the Act, and

neither any director/directors specified by the board. **Therefore, in such situation, all the directors of the company may be treated as officers in default.**

**(69) Promoter** means a person—

(a) who has been named as such in a prospectus or is identified by the company in the annual return referred to in section 92, or

(b) who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or

(c) in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act:

Provided that nothing in sub-clause (c) shall apply to a person who is acting merely in a professional capacity;

**(75) REGISTRAR** means a Registrar, an Additional Registrar, a Joint Registrar, a Deputy Registrar or an Assistant Registrar, having the duty of registering companies and discharging various functions under this Act;

**(76) RELATED PARTY**, with reference to a company, means—

(i) a **director** or his relative;
(ii) a **KMP** or his relative;
(iii) a **firm**, in which a director, manager or his relative is a partner;
(iv) a private company in which a director or manager or his relative is a member or director;
(v) a **public company in which a director and manager is a director** and holds along with his relatives, more than two per cent of its paid-up share capital;
(vi) any body corporate whose Board of Directors, managing director or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager;
(vii) any person on whose advice, directions or instructions a director or manager is accustomed to act:
Provided that nothing in sub-clauses (vi) and (vii) shall apply to the advice, directions or instructions given in a professional capacity;
[4](viii) any body corporate which is-

(A) a holding, subsidiary or an associate company of such company;
(B) a subsidiary of a holding company to which it is also a subsidiary; or
(C) an investing company or the venturer of the company;

**Explanation.-** For the purpose of this clause, "the investing company or the venturer of a company" means a body corporate whose investment in the company would result in the company becoming an associate company of the body corporate.

Exemption - This Clause (viii) **shall not apply** with respect to section 188 (Related Party transactions) **to a private company** vide Notification No. G.S.R. 464(E) dated 5th June, 2015.

4 The above clause (viii) shall not apply with respect to section 188 to a Specified IFSC Public company vide Notification no. G. S.R. 08(E) dated 4th January, 2017

(ix) such other person as may be prescribed;

As per Rule 3 given in the Companies (Specification of Definitions Details) Rules, 2014, for the purposes of sub-clause (ix) of clause (76) of section 2 of the Act, a director (other than an independent director) or key managerial personnel of the holding company or his relative with reference to a company, shall be deemed to be a related party.

**Example:** XYZ Pvt. Ltd. has 2 subsidiary companies, Y Pvt. Ltd. and Z Pvt. Ltd. Here as per the section 2(76)(viii)(B), Y Pvt. Ltd and Z Pvt. Ltd. are related parties. **However, as per the Notification No. G.S.R. 464(E) dated 5th June, 2015, clause (viii) shall not apply with respect to section 188 to a private company. Therefore Y Pvt. Ltd and Z Pvt. Ltd are not related parties for the purpose of section 188.** However, if Y Pvt. Ltd and Z Pvt. Ltd. have common directors, then they will be deemed to be related parties because of section 2(76)(iv).

**Example:** Now suppose, XYZ Ltd. a public company, has two subsidiary companies, Y Pvt. Ltd and Z Pvt. Ltd. Here as per section 2(71), **a private company which is a subsidiary of a public company will be deemed to be a public company, so Y Pvt. Ltd and Z Pvt. Ltd will not be eligible to avail exemption under the Notification No. G.S.R. 464(E) dated 5th June, 2015.**

**(77) RELATIVE**, with reference to any person, means anyone who is related to another, if—

(i) they are **members of a HUF**;
(ii) they are **husband and wife**; or
(iii) one person is related to the other in such manner as may be prescribed; **Rule 4 given in the Companies (Specification of Definitions Details) Rules, 2014** provides of the List of Relatives in terms of Clause (77) of section 2. Accordingly, a person shall be deemed to be the relative of another, if he or she is related to another in the following manner, namely:-

(1) Father: Provided that the term "Father" includes step-father.
(2) Mother: Provided that the term "Mother" includes the step-mother.
(3) Son: Provided that the term "Son" includes the step-son.
(4) Son's wife.
(5) Daughter.
(6) Daughter's husband.
(7) Brother: Provided that the term "Brother" includes the step-brother;
(8) Sister: Provided that the term "Sister" includes the step-sister.

**(85) Small company** means a company, other than a public company,—

(i) **paid-up share capital** of which does not exceed four crores rupees or such higher amount as may be prescribed which shall not be more than ten crore rupees; and

(ii) **turnover** of which as per profit and loss account for the **immediately preceding financial year** does not exceed **forty crore rupees** or such higher amount as may be prescribed which shall not be more than one hundred crore rupees:

Provided that nothing in this clause shall apply to—

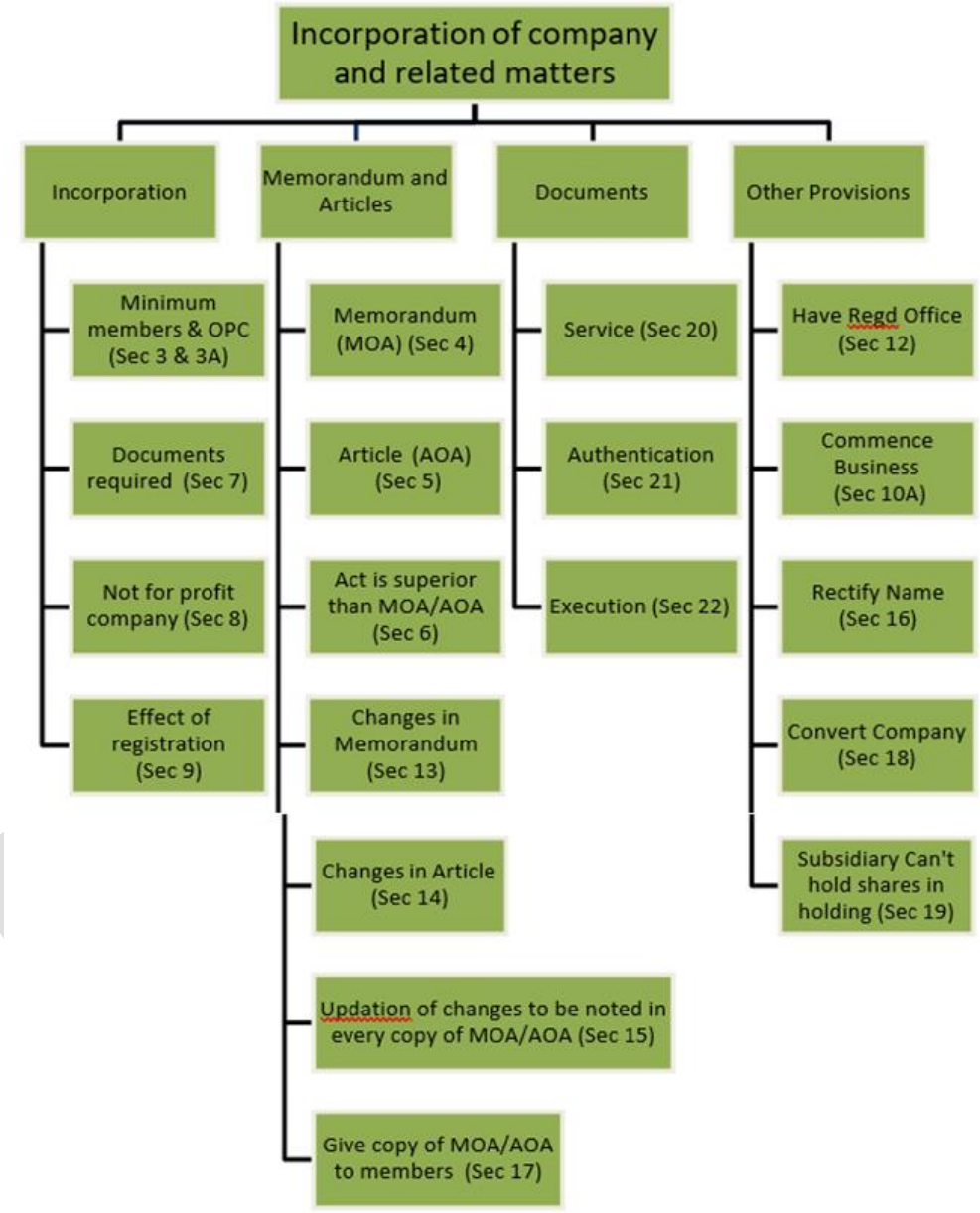
(A) a holding company or a subsidiary company;

(B) a company registered under section 8; or
(C) a company or body corporate governed by any special Act.

# Chapter 2

# INCORPORATION OF COMPANY AND MATTERS INCIDENTAL THERETO

**SECTIONS OVERVIEW**



## FORMATION OF COMPANY – SECTION 3

**(1)** A company may be formed for any lawful purpose by—

(a) **7 or more persons**, where the company to be formed is to be a **public company**;
(b) **2 or more persons**, where the company to be formed is to be a **private company**; or
(c) **1 person**, where the company to be formed is to be **One Person Company** that by **subscribing their names or his name to a memorandum** and complying with the requirements of this Act in respect of registration.

**(2)** A company formed under sub-section (1) may be either—

a) a company **limited by shares**; or
b) a company **limited by guarantee**; or
c) an **unlimited** company.

**Note**: A limited liability companies may be Companies limited by guarantee as well as shares. Specified IFSC Public or Specified IFSC Private Company shall be formed only as a company limited by shares. IFSC Company means a company licensed to set up businesses in any International Financial Services Center in India, like in Gujarat International Finance Tec-City

### DEFINITION

**1) Private Company, Section 2(68)**

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 **200**:
Provided that where 2 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;

**#Questionable point:**

Debenture holders are not included in the definition, hence it can be issued to more than 200 people

**2) Public Company: Section 2(71)**

Public company means a company which—
(a) is not a private company; and
(b) has a minimum paid-up share capital as may be prescribed*:
Provided that a company which is a subsidiary of a company, not being a private company, **shall be deemed to be public company** for the purposes of this Act even where such subsidiary company continues

to be a private company in its articles;

**#Illustration:**

**A Pvt. Ltd. is wholly owned subsidiary of AB Ltd., a public company incorporated under the Companies Act, 2013. A Pvt. Ltd. wanted to avail exemptions as provided to private companies. In this case, since A Pvt. Ltd. is subsidiary of AB Ltd., which is a public company, therefore A Pvt. Ltd. will be deemed to be a public company and will be not allowed to avail exemptions provided to a private company.**

**3) Promoter: Section 2 (69)**

(a) who has been **named as such in a prospectus** or is **identified by the company in the annual return** referred to in section 92, or

(b) **who has control over the affairs of the company**, directly or indirectly whether as a shareholder, director or otherwise; or

(c) in accordance with whose advice, directions or instructions the **Board of Directors of the company is accustomed to act:**

Provided that nothing in sub-clause (c) shall apply to a person who is acting **merely in a professional capacity;**

## INCORPORATION OF ONE PERSON COMPANY

**Law with respect to formation of OPC provides that—**

(1) Only a **natural person** who is an **Indian citizen** whether **resident in India or otherwise**

(a) shall be eligible to incorporate a One Person Company;

(b) shall be a nominee for the sole member of a One Person Company.

Explanation - For the purposes of this rule, the term "**resident in India**" means a person who has stayed in India for a **period of not less than 120 days** during the immediately preceding financial year.

**- Amended**

(2) The **MoA of OPC shall indicate the name of nominee**, who shall, in the event of the subscriber's death or his incapacity to contract, become the member.

(3) The nominee shall give his prior **written consent in prescribed form** and the same shall be filed with Registrar of companies at the time of incorporation along with other documents.

(4) Nominee has the right to **withdraw his consent**.

(5) The member may **at any time change the nominee** 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**.

**(6) A natural person shall not be a member of more than one OPC at any point of time AND the said person shall not be a nominee of more than one OPC.**

(7) Where a natural person being member in OPC becomes member in another such company by virtue of his being a nominee in that OPC, such person shall meet eligibility criteria (as given in point above) **within a period of 180 days.**

(8) **A minor shall not become member or nominee** or can hold share with beneficial interest.

(9) 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.

(10) Such Company **cannot carry out Non-Banking Financial Investment activities** including investment in securities of anybody corporate.

(11) **Conversion:** The OPC shall alter its memorandum and articles by passing a resolution in accordance with section 122(3) of the Act to give effect to the conversion and to make necessary changes. Accordingly, it shall increase the minimum number of members and directors to two or seven members and two or three directors, as the case may be

*Example: Rajesh has formed a 'One Person Company (OPC)' with his wife Roopali as nominee. For the last two years, his wife Roopali is suffering from terminal illness and due to this hard fact he wants to change her as nominee. He has a trusted and experienced friend Ramnivas who could be made nominee or his (Rajesh) son Rakshak who is of seventeen years of age. In the instant case, Rajesh can appoint his friend Ramnivas as nominee in his OPC and not Rakshak because Rakshak is a minor.*

Additional reading

**Relaxations available to an OPC** include:

- Not required to prepare a cash-flow statement with effect of section 2(40)
- The annual return to furnished under section 92 can be signed by the Director and not necessarily a Company Secretary, even abridged annual return may be prescribed.
- Further, following the similar line, section 134 provides it would suffice if one director signs the audited financial statements and abridged form of director report may be prescribed.
- Holding annual general meeting as required under section 96 is not necessary in case of OPC. Moreover, certain specific provisions related to general meetings and extraordinary general meetings, specified under sections 100 to 111 not applicable to OPC.
- Even relaxation is also there in convening board meetings section 173 requires an OPC to hold only one meeting of the Board of Directors in each half of a calendar year.
- Vide section 137, the OPC are allowed to file financial statements within six months from the close of the financial year as against 30 days.

**#Practice question:**

**Anupam got incorporated 'One Person Company' with his sister Alpana as the nominee and about three years have passed satisfactorily. From time-to-time Anupam does a number of charitable works and is associated with three NGOs. In the meantime his business under his OPC has also flourished.**

**Now he is contemplating to convert the OPC as a Section 8 company (i.e. formation of companies with charitable objects). Choose the correct option.**

(a) Since company belongs to Anupam, he has full discretion to convert the OPC either as a Section 8 company or as a private or public company

(b) Since the company was formed as a private company, the only option available with Anupam is to convert it into a public limited company.

(c) There is specific prohibition on converting OPC into a Section 8 company; otherwise it can be converted into a private or public company without any hindrance.

(d) Since Anupam does a lot of charitable works there is no prohibition to converts his OPC into a Section 8 company (companies formed with charitable objects).

**Answer:** (c) There is specific prohibition on converting OPC into a Section 8 company; otherwise it can be converted into a private or public company without any hindrance.

**#Practice Question**

**Naveen incorporated a "One Person Company" making his sister Navita as the nominee. Navita is leaving India permanently due to her marriage abroad. Due to this fact, she is withdrawing her consent of nomination in the said One Person Company. Taking into considerations the provisions of the Companies Act, 2013 answer the questions given below.**

**(A) If Navita is leaving India permanently, is it mandatory for her to withdraw her nomination in the said One Person Company?**

**(B) If Navita maintained the status of Resident of India after her marriage, then can she continue her nomination in the said One Person Company?**

**Old Answer**

As per Rule 3 & 4 of the Companies (Incorporation) Rules, 2014 following the answers:

(A) Yes, it is mandatory for Navita to withdraw her nomination in the said OPC as she is leaving India permanently as only a natural person who is an Indian citizen and resident in India shall be a nominee in OPC.

(B) Yes, Navita can continue her nomination in the said OPC, if she maintained the status of Resident of India after her marriage by staying in India for a period of not less than 120 days during the immediately preceding financial year.

**New Answer:**

Now the word Resident is replaced by Resident or otherwise. Hence Navita can continue to be a nominee

**#Practice Question:**

Mr. Varinder Singh is a philanthropist apart from being the owner of the renowned textile brand 'Paridhaan'. He is running an old age home, a shelter-home for orphans apart from a chain of art and language schools. These philanthropic initiatives and educational institutions established by him are operating under the banner of a charitable trust, in which he himself is one of the trustees. The textile business 'Paridhaan' is owned by a private limited company with paid-up share capital of INR 60 lakhs. 'Paridhaan is losing market share due to stiff competition from readymade brands resulting decline in turnover to ` 180 lakhs during the immediately preceding financial year, out of which 45% is export sales.

His son Jimmy who is also a shareholder and director in 'Paridhaan', wishes to start a new business of e-learning platform and research- based technical education. He has opted for a corporate form for this business, because this may help in reaching out to leading global universities to sign MoUs for student and faculty exchange programs, in order to establish a global brand, especially after the rollout of the new education policy. Jimmy wants to retain the entire control of education activities. Jimmy met their family friend Mr. Chawla, who is a renowned practicing Chartered Accountant. Mr. Chawla explains the various kinds of companies, including One Person Company (OPC) with the procedural requirements for each which could be considered by Jimmy for his education business. Jimmy decided to form OPC after considering the various pros and cons.

Jimmy appoints Mr. Wilson as a nominee to his OPC. Mr. Wilson who is in his 30s, is an academician and scholar, a graduate from MIT in CSE, and has done his masters with Jimmy. Mr. Wilson is from Cambridge, Massachusetts, USA and is basically a US national. But, he has been residing in India for the last couple of years. Mr. Wilson helps Jimmy in the promotion of OPC.

Mr. Chawla is an auditor of Sirmaur Pharma Limited, the AGM of which was convened on 31st August 2020. As he had already confirmed his appointment with Jimmy to meet him on that day, he asked his paid assistant, Mr. Anup, to attend the AGM on his behalf. Mr. Anup is Chartered Accountant, but in employment with Mr. Chawla's firm for the last year or so. Mr. Anup is not holding a certificate of practice. At that AGM, based upon the board's recommendation, Sirmaur Pharma Limited decided to issue fully paid-up bonus share to its members out of its reserve and surplus available with it, which are as follows:

| **Source** | **Amount in `** |
|---|---|
| Free Reserves | 1.24 Crores |
| Securities Premium Account | 0.82 Crores |
| Capital Redemption Reserve Account | 1.07 Crores |
| Capitalizing reserves created by revaluationof assets | 0.63 Crores |

**Multiple Choice Questions [2 Marks each]**

**1) Considering the validity of nominating Mr. Wilson to the One Person Company of Jimmy, out of the following, which statement holds truth?**

(a) Mr. Wilson is a valid nominee because he is a natural person.

(b) Mr. Wilson is a valid nominee because he is a natural person and resides in India.

(c) Mr. Wilson is a valid nominee because he attains the majority and also engaged in the promotion of OPC.

(d) Mr. Wilson is not a valid nominee, because he is not a citizen of India.

**2) What is the maximum amount, upto which fully paid bonus shares can be issued by Sirmaur Pharma Limited?**

(a) ` 2.06 Crores

(b) ` 3.13 Crores

(c) ` 3.76 Crores

(d) ` 2.69 Crores

**3) Mr. Varinder wants to take the benefits of relaxation available to a small company. Does Paridhaan meet the criteria to be classified as a small company?**

(a) Yes, because turnover is less than prescribed limit

(b) Yes, because both paid-up share capital and turnover are less than the prescribed limit

(c) No, because paid-up share capital is more than the prescribed limit

(d) No, because both paid-up share capital and turnover are more than the prescribed limit

**4) Jimmy is already a member of Paridhaan and has now promoted his own OPC. Is Jimmy eligible to Incorporate OPC as being an existing member and Director of 'Paridhaan', which of the following statements is correct?**

(a) Not eligible, because a person who is a member of any other company cannot incorporate an OPC.

(b) Not eligible, because a person who is director of any other company cannot incorporate an OPC as a member.

(c) Eligible, because a person can incorporate one OPC as a member despite being a member in any other form of companies, other-than OPC.

(d) Eligible, because a person can be a member of any number of companies including any number of OPCs.

**5) Mr. Chawla who is appointed as auditor of Sirmaur Pharma Limited under section 139 of Companies Act 2013, didn't attend the AGM personally. Instead of attending the general meeting personally, he has directed Mr. Anup a qualified assistant to attend the AGM as his representative. Is Mr. Chawla guilty of contravention of the provisions of section 146, under section 147 of Companies Act, 2013?**

(a) No, because attending AGM is not mandatory for auditor

(b) No, because Mr. Chawla attends the AGM through his representative (Mr. Anup)

(c) Yes, because in all circumstances; auditor (Mr. Chawla) must attend the AGM that's too in person.

(d) Yes, because representative appointed by him in this case (Mr. Anup) is not qualified to be appoint as an auditor of such a company.

**Answers to MCQs**

1) (d) Mr. Wilson is not a valid nominee, because he is not a citizen of India.

2) (b) ` 3.13 Crores

3) (c) No, because paid-up share capital is more than the prescribed limit

4) (c) Eligible, because a person can incorporate one OPC as a member despite being a member in any other form of companies, other-than OPC.

5) (d) Yes, because representative appointed by him in this case (Mr. Anup) is not qualified to be appoint as an auditor of such a company.

## Members severally liable in certain cases – section 3A

Member may have limited or unlimited liability depending upon nature of company. Generally, the members are jointly liable for the debt of company, but they shall be severally liable for the payment of the debts of the company and may be severally sued therefore; if at any time:

1. The number of members of a company is reduced **below seven (7)** and **two (2)** in case of a

public and private company, respectively; and

2. Such company carries on business for **more than six months** with reduced number of members; and
3. Every such person who carries on business after those six months is **cognizant (aware**) of the fact that business is carried reduced members

*Such members are liable for the payment of the whole debts of the company contracted during that time (after elapse of six months)*

I**llustration (True/False)**
**Statement** – Members who knowingly operating the company for more than six months with less than the minimum number of members specified in Section 3(1) are severally liable for the payment of all debts contracted by the company during the period since the number of members was first reduced**.**
**Answer** – False, refer section 3A of the Act. Such members are liable severally for the payment of the whole debts of the company contracted during that time (after elapse of six months)

**INCORPORATION OF COMPANY – SECTION -7**

**STEPS FOR INCORPORATION**

1. Determine the **nature of company** ( public or private )
2. **Reservation of name** by filing an application
3. Drafting and **signing of MOA & AOA**
4. **Submission** of MOA and AOA to ROC
5. **Consent** of person nominated as **directors**
6. **Submission of statutory declaration** of compliances
7. **Pay fees** & amount of **stamp duty**
8. Obtain **certificate of incorporation**
9. File **declaration** about **address of registered office**

**Note**: Now, it is also required to submit a declaration that all the subscribers have paid the value of shares agreed to be taken by him apart from filling of verification of registered office before the commencement of business

**FILING OF THE DOCUMENTS AND INFORMATION WITH THE REGISTRAR [SUB-SECTION 1]**

An **application** for registration of a company shall be filed, with the Registrar within whose jurisdiction the registered office of the company is proposed to be situated, **in SPICe+(**Simplified Proforma for Incorporating company Electronically Plus: INC32) **along with the fee** as provided under the Companies (Registration offices and fees) Rules, 2014 accompanied by following **documents and information;**

**The duly signed memorandum of association and articles of association**

a. Each subscriber shall add **his name, address, description & occupation**, if any, in the presence of **at least one witness** who shall attest the signature, shall sign and add his name, address, description and occupation, if any.

b. Where a subscriber is illiterate, he shall **affix his thumb impression** or mark which shall be described as such by the person, writing for him, who shall place the name of the subscriber against or below the mark and **authenticate it by his own signature** and he shall also write against the name of the subscriber, the number of shares taken by him.

**Note**: *The type written or printed particulars of the subscribers and witnesses shall be allowed as if it is written, so long as appends signature or thumb impression.*

c. Where the subscriber is **a body corporate,** the **memorandum and articles of association shall be signed** by **director, officer or employee** of the body corporate **duly authorized** in this behalf by a resolution of the board of directors.

d. Where the subscriber is a **Limited Liability Partnership**, it shall **be signed by a partner** of the Limited Liability Partnership, **duly authorized** by a resolution approved by all the partners of the Limited Liability Partnership:

**Note**: In either case c or d stated above, the person so authorized shall not, at the same time, be a subscriber to the memorandum and articles of Association

e. Where subscriber to the memorandum is a foreign national residing outside India his signatures and address on the memorandum and articles of association and proof of identity shall be **notarized by a Notary (Public)** with a certificate. Further, if such person residing in a country outside the Commonwealth or which is not a party to the Hague Apostille Convention, 1961, the certificate of the Notary (Public) shall be **authenticated by a Diplomatic or Consular Officer.**

f. Where **subscriber to the memorandum is a foreign national** residing outside India and visited in India and intended to incorporate a company, in such case the incorporation shall be allowed if, **he/she is having a valid Business Visa**. In case of Person is of Indian Origin or Overseas Citizen of India, requirement of business Visa shall not be applicable

**Declaration of Compliance by Professional & Director, Manager or Secretary of company**

A declaration that all the requirements of this Act and the rules made thereunder in respect of registration and matters precedent or incidental thereto have been complied with shall be be **filled in Form No. INC-8 by**

a. an **advocate**, a **chartered accountant**, **cost accountant** or **company secretary** in practice who is engaged in the formation of the company **and**

b. a **person named in the articles as director**, **manage**r or **secretary** of the company.

**Declaration by subscribers to the memorandum and persons named as the first directors**

A declaration in Form No. INC-9 from each of the subscribers to the memorandum and from persons named as the first directors (if any) in the articles, stating that all the documents filed with the Registrar for registration of the company contain information **that is correct and complete and true to the best of his knowledge and belief**

a. He is **not convicted** of any **offence** in connection with the promotion, formation or management of any company, or

b. He has **not been found guilty** of any **fraud or misfeasance** or of any **breach of duty** to any company under this Act or any previous company law during the last five years,

**Particulars of persons named as the first directors**

The particulars i.e name, including surname or family name, the Director Identification Number (DIN), residential address, nationality and such other particulars including proof of identity of each person mentioned in the articles as first director of the company **and his interest** in other firms or bodies corporate **along with his consent** (Form No. DIR-2) to act as director of the company shall be filed in Form No. DIR-12 along with the fee as provided in the Companies (Registration offices and fees) Rules, 2014.

**Particulars of subscribers to the memorandum**

a. Name (including surname or family name) and recent Photograph affixed

b. Father's/Mother's name

c. Nationality, Proof of nationality in case the subscriber is a foreign national

d. Date and Place of Birth (District and State)

e. Educational qualification and Occupation

f. Permanent Account Number

g. Email id and Phone number of Subscriber

h. Permanent residential address and also Present address

i. Residential proof such as Bank Statement, Electricity Bill, Telephone / Mobile Bill, provided that Bank statement Electricity bill, Telephone or Mobile bill shall not be more than two months old

j. Proof of Identity (For Indian Nationals - Voter's identity card, Passport copy, Driving License copy, Unique Identification Number (UIN) & for Foreign nationals and Non Resident Indians – Passport)

k. If the subscriber is already a director or promoter of a company(s), the particulars relating to name of the company; Corporate Identity Number; Whether interested as a director or promoter

**Where the subscriber to the memorandum is a body corporate, then the following particulars shall be filed with the Registrar**

a. The name of the body corporate and Corporate Identity Number of the Company or Registration number of the body corporate, if any

b. GLN, if any

c. The registered office address or principal place of business

d. E-mail Id

e. If the body corporate is a company, certified true copy of the board resolution specifying inter-alia the authorization to subscribe to the MOA

f. If the body corporate is a limited liability partnership or partnership firm, certified true copy of the resolution agreed to by all the partners specifying inter alia the authorization to subscribe to the MOA

g. In case of foreign bodies corporate, the details relating to the copy of certificate of incorporation of the foreign body corporate; & the registered office address.

In case any of the objects of a company **requires registration or approval from sectoral regulators** such as the RBI and SEBI, then ***such registration or approval shall be obtained*** by the proposed company before pursuing such objects and a declaration in this behalf shall be submitted at the stage of incorporation.

In case of a Company being **incorporated as a Nidhi**, the declaration by the Central Government under Section 406 of the Act **shall be obtained by the Nidhi before commencing the business** and a declaration in this behalf shall be submitted at the stage of incorporation by the Company.

**ISSUE OF CERTIFICATE OF INCORPORATION ON REGISTRATION**

The Registrar on the basis of documents and information filed, shall register all the documents and information in the register and issue a certificate of incorporation in the **Form No. INC-11** to the effect that the proposed company is incorporated under this Act. **Certificate of Incorporation shall mention permanent account number of the company where if it is issued by the Income-tax Department**

**Students are advised to take note**; The Certificate contains the name of the company, the date of its issue, CIN (Corporate Identity Number) and the signature of the Registrar with his seal. Certificate of incorporation is evidence of registration (existence of separate legal entity with perpetual succession). It effects are highlighted by section 9, explain later in this chapter. Earlier, the certificate of incorporation considered as conclusive proof, but as per the Companies Act, 2013, **certificate of Incorporation is not conclusive proof of everything prior to incorporation being in order**. Sub-section (6) and (7) of section 7 signify this understanding

**ALLOTMENT OF CORPORATE IDENTITY NUMBER (CIN)**

On and from the date mentioned in the certificate of incorporation, the Registrar shall allot to the company a corporate identity number, which shall be a distinct identity for the company and which shall also be included in the certificate of incorporation.

**CIN is a 21 alpha-numeric digit** based unique identification number, comprising data sections/elements that reveals the basis aspects about company.

**Example - Decode the CIN**
CIN of **Infosys Limited is L85110KA1981PLC013115**
The first character – **L** (reveals listing status, L for listed and U for unlisted, for instance Infosys is Listed one)
The next five digits – **85110**
The next two letters – **KA** (reveals the Indian state where the company is registered, for instance KA is for Karnataka)
The next four digits – **1981** (reveals the year of incorporation of a company)

The next three characters – **PLC** (reveals the company classification - PLC for public, PTC for private, FTC for foreign, and GOI for government)
The last six digits – **013115** (reveals registration number with concerned ROC)

**MAINTENANCE OF COPIES OF ALL DOCUMENTS AND INFORMATION**

The company shall maintain and preserve copies of all the documents and information as originally filed **at its registered office**, till its dissolution under this Act.

**FURNISHING OF FALSE OR INCORRECT INFORMATION OR SUPPRESSION OF MATERIAL FACT AT THE TIME OF INCORPORATION (I.E. DURING INCORPORATION PROCESS)**

If any person **furnishes any false** or incorrect particulars of any information or **suppresses any material information**, of **which he is aware** in any of the documents filed with the Registrar in relation to the registration of a company, he **shall be liable for action for fraud** under section 447.

**COMPANY ALREADY INCORPORATED BY FURNISHING ANY FALSE OR INCORRECT INFORMATION OR REPRESENTATION OR BY SUPPRESSING ANY MATERIAL FACT (i.e. POST INCORPORATION)**

Where, at any time after the incorporation of a company, it is proved that the company has been got incorporated by

a. furnishing any **false or incorrect information** or representation or

b. by **suppressing any material fact** or information in any of the documents or declaration filed or made for incorporating such company, or

c. by any **fraudulent action,**

Then, the **promoters**, the **persons named as the first directors** of the company and the persons making **declaration under this section shall each be liable for action for fraud** under section 447.

**ORDER OF THE TRIBUNAL**

Where a company has been got incorporated by

a. furnishing **false or incorrect information** or representation, or

b. by **suppressing any material fact** or information in any of the documents or declaration filed or made for incorporating such company or

c. by any **fraudulent action,**

Then, **the tribunal (NCLT)** on being satisfied that the situation so warrants, in response to an application made to it, may pass order as it may deem fit including;

a. **regulation of the management** of the company including changes, if any, in its memorandum and articles, in public interest or in the interest of the company and its members and creditors; or

b. direct that **liability of the members shall be unlimited**; or

c. direct **removal of the name** of the company from the register of companies; or

d. **winding up** of the company; or

**Provided that** before making any such 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

**Tribunal means the National Company Law Tribunal (NCLT**) constituted on 1st June, 2016under section 408 of the Companies Act, 2013. The NCLT is a quasi- judicial body in India that adjudicates issues relating to companies in India.

## FORMATION OF COMPANIES WITH CHARITABLE OBJECTS – SECTION -8

1) Where it is **proved to the satisfaction of the Central Government** that a person or an association of persons proposed to be registered under this Act as a limited company—
(a) has in its **objects the promotion of** commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object;
(b) intends to **apply its profits, in promoting its objects**; and
(c) intends to **prohibit the payment of any dividend** to its members,
the Central Government may, by license allow that person or association of persons to be registered as a limited company under this section **without the addition to its name** of the word **"Limited", or as the case may be, the words "Private Limited"**.
**Note:** The power of Central Government to register a Section 8 company has been delegated to ROC

2) A firm may be a member of the company registered under section 8.
3) A company registered under this section shall not alter the provisions of its memorandum or articles except with the previous approval of the Central Government
**Note: Power of approval to alteration is delegated to Regional Director.**
4) **Conversion into any other kind of Company:** A company registered under section 8 which intends to convert itself into a company of any other kind **shall pass a special resolution at a general meeting** for approving such conversion.
5) A company registered under this section shall amalgamate only with another company registered under this section and having similar objects.
6) **Revocation of license:**
   a) The Central Government (Regional Director) **may by order revoke the license of the company**
   - where the company **contravenes any of the requirements of this section** subject to which a license is issued or
   - where the affairs of the company are conducted fraudulently, or
   - affairs are conducted in violation 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, a written notice of its intention to revoke the

license and opportunity to be heard shall be given.

b) Where a license 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.

c) If on the winding up of a section 8 company **there remains, after the satisfaction of its debts and liabilities, any asset, they may be transferred to another company registered under this section and having similar objects,** subject to such conditions as the Tribunal may impose, **or** may be sold and **proceeds thereof credited to the Insolvency and Bankruptcy Fund formed under section 224** of the Insolvency and Bankruptcy Code, 2016

7) **Penalty:** The company shall, without prejudice to any other action under the provisions of this section, be punishable with fine which shall not be less than 10 lakh rupees but which may extend to one crore rupees and the directors and every officer of the company who is in default shall be punishable [~~with imprisonment for a term which may extend to three years or~~] with fine which shall not be less than 25 thousand rupees but which may extend to 25 lakh rupees

**Provided** that when it is proved that the affairs of the company were conducted fraudulently, every officer in default shall be liable for action under **section 447.**

**Additional reading Relaxations available to a Section** 8 Company include;

♦ 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.**

**#Practice Question:**

**A group of individuals intend to form a club namely 'Budding Pilots Flying Club' as limited liability company to impart class room teaching and aircraft flight training to trainee pilots. It was decided to form a limited liability company for charitable purpose under Section 8 of the Companies Act, 2013 for a period of ten years and thereafter the club will be dissolved and the surplus of assets over the liabilities, if any, will be distributed amongst the members as a usual procedure allowed under the Companies Act.**

**Examine the feasibility of the proposal and advise the promoters considering the provisions of the Companies Act, 2013.**

**Answers** – Refer to definition

In the instant case, the decision of the group of individuals to form a limited liability company for charitable purpose under section 8 for a period of 10 years and thereafter to dissolve the club and to distribute the surplus of assets over the liabilities, if any, amongst the members will not hold good, since there is a restriction as pointed out in point (b) above regarding application of its profits or other income only in promoting its objects. Further, there is restriction in the application of the surplus assets of such a company in the event of winding up or dissolution of the company as provided in sub-section (9) of Section 8 of the Companies Act, 2013. Therefore, the proposal is not feasible.

**#Practice Question:**

**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 of its objective 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? – Refer Revocation of license**

**#Practice Question:**

**Abhilasha and Amrita have incorporated a 'not for profit' private limited company which is registered under Section 8 of the Companies Act, 2013. One of their friends has informed them that their company can be categorized as a 'small company' because as per the last profit and loss account for the year ending 31st March, 2019, its turnover was less than` 2.00 crores and its paid up share capital was less than ` fifty lacs. Advise**

(a) A section 8 company, which meets the criteria of 'turnover' and 'paid- up share capital' in the last financial year, can avail the status of 'small company' only if it acquires at least 5% stake in another 'small company' within the immediately following financial year.
(b) If the acquisition of minimum 5% stake in another 'small company' materializes in the second financial year (and not in the immediately following financial year) after meeting the criteria of 'turnover' and 'paid-up share capital' then with the written permission of concerned ROC, it can acquire the status of 'small company'.
(c) The status of 'small company' cannot be bestowed upon a 'not for profit' company which is registered under Section 8 of the Companies Act, 2013.
(d) A section 8 company, if incorporated as a private limited company (and not as public limited company) can avail the status of 'small company' with the permission of concerned ROC, after it meets the criteria of 'turnover' and 'paid-up share capital'.

**Answer:**

**(c) The status of 'small company' cannot be bestowed upon a 'not for profit' company which is registered under Section 8 of the Companies Act, 2013.**

**#Practice Question:**

**Anupam got incorporated 'One Person Company' with his sister Alpana as the nominee and about three years have passed satisfactorily. From time to time Anupam does a number of charitable works and is associated with three NGOs. In the meantime his business under his OPC has also flourished. Now he is contemplating to convert the OPC either as a Section 8 company (i.e. formation of companies with charitable objects). Choose the correct option.**

(a) Since company belongs to Anupam, he has full discretion to convert the OPC either as a Section 8 company or as a private or public company
(b) Since the company was formed as a private company, the only option available with Anupam is to convert it into a public limited company.
(c) There is specific prohibition on converting OPC into a Section 8 company; otherwise it can be converted into a private or public company without any hindrance.

(d) Since Anupam does a lot of charitable works there is no prohibition to converts his OPC into a Section 8 company (companies formed with charitable objects).

**Answer:**

**(c) There is specific prohibition on converting OPC into a Section 8 company; otherwise it can be converted into a private or public company without any hindrance.**

## EFFECT OF REGISTRATION [SECTION 9]

Section 9 of the Act provides for the effect of registration of a company, it states;

From the date of incorporation specified in the certificate of incorporation, the subscribers to the memorandum and all other persons, who may become members of such company, **shall be a body corporate** by the name as contained in the memorandum

Thereafter such body corporate, by the said name; shall be capable of;

a. Exercising all the **functions of an incorporated company** under this Act and

b. Having **perpetual succession**

c. Power to **acquire, hold** and **dispose of property**, both movable and immovable, tangible and intangible,

d. To contract and **to sue and be sued**

## MEMORANDUM OF ASSOCIATION – SECTION -4

### I. Object of registering a memorandum of association:

1. 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.
2. It enables shareholders, creditors and all those who deal with company to know what its powers are and what activities it can engage in.
3. 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.
4. 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.

**The memorandum shall contains the following clauses:**

**a) NAME CLAUSE-**

The name of the company with the last word "Limited" in the case of a public limited company, or the last words "Private Limited" in the case of a private limited company.

**Exception:**

- **This clause is not applicable on the companies formed under section 8 of the Act.**
- In case of Specified IFSC Public Company and IFSC Private Company, name shall have the suffix, "International Financial Service company" or "IFSC" as a part of its name.

**Application for reserving name for proposed company [sub-section 4]**

A person may make an application **in SPICe+** (Simplified Proforma for Incorporating Company Electronically Plus: INC-32) accompanied by fee, as provided in the Companies (Registration Offices and Fees) Rules, 2014, to the Registrar for reservation of a name set out in the application as name of the proposed company.

***Resubmission shall be allowed within 15 days, for rectification of defect, if any***

**Application for reserving the name for the changing name of existing company [sub-section 4]**

A person may make an application, using **web service RUN** (Reserve Unique Name) along with fee as provided in the Companies (Registration Offices and Fees) Rules, 2014, to the Registrar for the reservation of a name set out in the application as the name to which the company proposes to change its name. Resubmission shall be allowed within 15 days, for rectification of defect, if any.

**Restriction regarding names and use of words & expressions therein [subsection 2 and 3]**

a. I**dentical** with or **resemble** too nearly to the **name of an existing company** registered under this Act or any previous company law; or

b. Such, use of which by the company will constitute an **offence** under any law for the time being in force; or

c. Such, use of which by the company is **undesirable in the opinion of the Central Government** (this power of Central Government has been delegated to ROC)

Further, sub-section 3 provides, unless the **previous approval of the Central Government** has been obtained; a company **shall not** be registered with that name;

d. Which contains any word or expression that is likely to give the **impression that the company is in any way connected with, or having the patronage** of, the Central Government, any State Government, or any local authority, corporation or body constituted by the Central Government or any State Government under any law for the time being in force; or

e. Which includes **words or expressions** namely Board; Commission; Authority; Undertaking; National; Union; Central; Federal; Republic; President; Rashtrapati; Small Scale Industries; Khadi and Village Industries Corporation; Financial Corporation and the like; Municipal;; Development Authority; Prime Minister or Chief Minister; Minister; Nation; Forest corporation; Development Scheme; Statute or Statutory; Court or Judiciary; Governor; Bureau; and the use of word Scheme with the name of Government (s), State, India, Bharat or any Government authority or in any manner resembling with the schemes launched by Central, State or local Governments and authorities.

**Reservation of name [sub-section 5]**

**Applying for name:** A person may make an application, in such form and accompanied by such fee, as may be prescribed, **to the Registrar for the reservation of a name** set out in the application as—

(i) the name of the proposed company; or
(ii) the name to which the company proposes to change its name.

**Reserving the name:** Upon receipt of an application, the Registrar may, on the basis of information and documents furnished, **reserve the name for a period of 20 days** from the date of approval.

In case of an application for change of its name by an existing company, the Registrar may **reserve the name for a period of 60 days** from the date of approval.

**Cancellation of reserved name [sub-section 5]**

**Cancelling name:** Where after reservation of name, it is found that name was applied by furnishing wrong or incorrect information, then—

(i) **if the company has not been incorporated**, the **reserved name shall be cancelled** and the person who has made the application shall be liable to a penalty which may extend to one lakh rupees;

(ii) if the **company has been incorporated**, the Registrar may, after giving the company an opportunity of being heard—

(1) either **direct the company to change its name** within a period of 3 months, after passing an ordinary resolution;

(2) take **action for striking off the name of the company** from the register of companies; or

(3) make a **petition for winding up of the company**.

*Example: Mr. Anil Desai, has applied for reservation of company name with a prefix "Sanwariya". He claimed that the Prefix "Sanwariya" is registered trademark in his name. Later on, it is found that the said prefix is not registered with Mr. Anil Desai, however, he has formed company by giving incorrect documents/information while applying the name of the company.*

*In such case, The Registrar shall take action as per the provisions of the act after giving opportunity of being heard.*

**B) REGISTERED OFFICE CLAUSE-**

the State in which the registered office of the company is to be situated.

## C) OBJECT CLAUSE-

the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof

A company can't depart away to do anything beyond or outside its objects stated in memorandum and if any act done beyond that will be **ultra vires** and **void,** same can't be ratified even by the assent of the whole body of shareholders.

### DOCTRINE WITH RESPECT TO OBJECT CLAUSE OF THE COMPANY

**1) Doctrine of Ultra Vires**

a) A **company cannot depart from the provisions contained in the MOA** 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 confessed on it by the memorandum. **If it does so, it would be ultra vires the company and void.**

b) An act which is **ultra vires does not bind the company**.

c) **Neither the company nor the contracting party can sue on it**.

d) **RATIFICATION -**

- **The company cannot make it valid, even if every member assent to it.** The general rule is that an act **which is ultra vires the company** is incapable of ratification.
- An act **which is intra vires the company** but **outside the authority of the directors MAY BE RATIFIED** by the company **(Shareholders)** in proper form **[Rajendra Nath Dutta v. Shilendra Nath Mukherjee]**

**Case Law - Ashbury Railway Carriage and Iron Co. Ltd. v. Riche**

- The memorandum of the company in the said case defined its objects as: "The objects for which the company is established are to make and sell, or lend or hire, railway plants… to carry on the business of mechanical engineers and **general contractors…** ".
- The company entered into a contract with M/s. Riche, a firm of railway contractors to finance the construction of a railway line in Belgium. On subsequent repudiation of this contract by the company on the ground of its being ultra vires, Riche brought a case for damages on the ground of breach of contract, as according to him the words "general contractors" in the objects clause gave power to the company to enter into such a contract and, therefore, it was within the powers of the company. More so because the contract was ratified by a majority of shareholders.
- **JUDGEMENT:** The House of Lords held that **the contract was ultra vires the company and, therefore, null and void.** The term "general contractor" was interpreted to indicate as the making generally of such contracts as are connected with the business of mechanical engineers. The Court held that if every shareholder of the company had been in the room and had said, "That is a contract which we desire to make, which we authorise the directors to make", still it would be ultra vires. The shareholders cannot ratify such a contract, as the contract was ultra vires the objects clause, which by Act of Parliament, they were prohibited from doing.

**2) Doctrine of Constructive Notice.**

a) Before any person **deals with a company he must inspect its documents and establish conformity with the provisions**. However, **even if a person fails to read them, the law assumes that he is aware of the contents** of the documents. Such an implied or presumed notice is called Constructive Notice.
b) In simpler words, if a person enters into a contract which is beyond the powers of a company, **then he has no right under the said contract against the company.**
c) Whereas the doctrine of constructive notice protects a company against outsiders

**Case Law: Kotla Venkataswamy Vs C Rammurthi**

- The articles of a company required that all the documents and deeds of the company shall be signed by MD, secretary and working director of the company
- A mortgage deed was signed by the secretary and a working director only

**JUDGEMENT:** It was held that the mortgage deed was invalid even though the plaintiff had acted in good faith and money was utilized for the benefit of the company.

**3) Doctrine of Indoor Management**

a) 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.
b) 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.
c) The doctrine of indoor management **protects outsiders against the actions of a company**

**Exceptions to Doctrine of Indoor Management (Applicability of doctrine of constructive notice):**

1. **Knowledge of irregularity:** In case this 'outsider' has actual knowledge of irregularity within the company, the benefit under the rule of indoor management would no longer be available.
2. **Negligence:** If, with a minimum effort, the irregularities within a company could be discovered, the benefit of the rule of indoor management would not apply.
3. **Forgery**: The rule does not apply where a person relies upon a document that turns out to be forged since nothing can validate forgery.

**Case law: Royal British Bank vs. Turquand – Not in syllabus**

- Mr. Turquand was the official manager (liquidator) of a Company, which had given a bond for £ 2,000 to the Royal British Bank.
- The bond was under the company's seal, signed by 2 directors and the secretary.
- When the company was sued, it alleged that its AOA stated that, directors only had power to borrow up to an amount authorized by a company resolution. A resolution had been passed but not specifying how much the directors could borrow.
- **JUDGEMENT-** It was Held that the **bond was valid, so Bank could enforce it**. He said the bank was deemed to be aware that the directors could borrow only up to the amount resolutions allowed. Articles of association were registered with Companies House, so there was constructive notice. But the bank could not be deemed to know which ordinary resolutions passed, because these were not registrable. **The bond was valid because there was no**

**requirement to look into the company's internal workings.**

**#Practice Question:**

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 not apply.

**#Practice Question**

**The object clause of the Memorandum of Vivek Industries Ltd., empowers it to carry on real-estate business and any other business that is allied to it. Due to a downward trend in real-estate business, the management of the company has decided to take up the business of Food processing activity. The company wants to alter its Memorandum, so as to include the Food Processing Business in its objects clause. Examine whether the company can make such change as per the provisions of the Companies Act, 2013?**

**Answer:**

The Companies Act, 2013 has made alteration of the memorandum simpler and more flexible. Under section 13(1) of the Act, a company may, by a special resolution after complying with the procedure specified in this section, alter the provisions of its Memorandum.

In the case of alteration to the objects clause, Section 13(6) requires the filing of the Special Resolution by the company with the Registrar. Section 13 (9) states that the Registrar shall register any alteration to the Memorandum with respect to the objects of the company and certify the registration within a period of thirty days from the date of filing of the special resolution by the company. Section 13 (10) further stipulates that no alteration in the Memorandum shall take effect unless it has been registered with the Registrar as above. *

Hence, the Companies Act, 2013 permits any alteration to the objects clause with ease. Vivek Industries Ltd. can make the required changes in the object clause of its Memorandum of Association.

**D) LIABILITY CLAUSE –**

The liability clause declares the liability of members of the company to be either **limited or unlimited.**

- **Company limited by shares:** The liability of its members is limited to the **amount unpaid, if any**, on the shares held by them; and
- **Company limited by guarantee:** The amount up to which each member undertakes to contribute—
  - to the assets of the company **in the event of its being wound-up** while he is a member or within one year after he ceases to be a member, for payment of the debts and liabilities of the company

**Example -** Modern Furniture limited, a company limited by shares having share capital divided into shares with face value of ` 10 each, out of which ` 8 is called up. Mr. Singh who is having 200 share paid all ` 8 on each of share he hold, while Ms. Sarla owning 100 shares paid ` 10 (Rupee 2 in

advance); whereas Mr. Sanju owning 250 shares paid ` 6 per share (` 2 in arrear per share). Liability of Mr. Singh, Ms. Sarla, and Mr. Sanju shall be maximum upto ` 400, Nil, and ` 1000 only; respectively.

### E) CAPITAL CLAUSE

The capital clause, states the company's share capital. The clause must specify the total number of **share capital with which the company must be registered**, the number of shares of each kind and the face value of each share

### F) SUBSCRIPTION CLAUSE

According to section 7(1)(a) there shall be filed with the Registrar within whose jurisdiction the registered office of a company is proposed to be situated , the MOA and AOA of the company **duly signed by all the subscribers to the memorandum.**

### G) NOMINATION CLAUSE (ONLY IN CASE OF ONE PERSON COMPANY)

Section 4 (1) (f), requires, the memorandum of a company shall state the name of the **person (nominee) who, in the event of death of the subscriber**, **shall become the member of the company**, in the case of One Person Company.

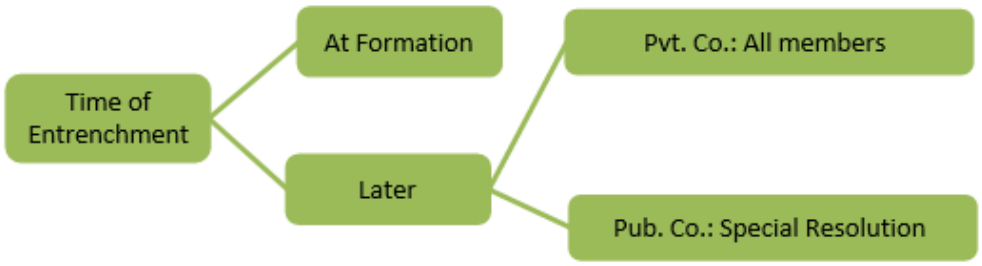
## ARTICLES OF ASSOCIATION – SECTION 5

**The section lays the following law—**

**(1)** The articles of a company shall contain the **regulations for management of the company**.

**(2) Inclusion of matters:** The articles shall also contain such matters, as are prescribed under the rules. However, a company **may also include such additional matters** in its articles as may be considered necessary for its management.

**(3) Entrenchment:** Usually **an article of association may be altered by passing special resolution** but entrenchment makes it more difficult to change it. **So, entrenchment means making something more protective.**



**Notice to the registrar of the entrenchment provision:** Where the articles contain provisions for entrenchment, whether made on formation or by amendment, the company shall give notice to the Registrar of such provisions in such form and manner as may be prescribed.

**(4) Model articles:** A company may adopt all or any of the regulations contained in the model articles applicable to such company.

**(5) Company registered after the commencement of this Act:** In case of any company, which is registered after the commencement of this Act, in so far as the registered articles of such company **do not exclude or modify the regulations** contained in the model articles applicable to such company, those regulations shall, so far as applicable, be the regulations of that company

**(6) Section not apply on company registered under any previous company law:** Nothing in this section shall apply to the articles of a company registered under any previous company law, **unless amended under this Act.**

***Example:*** *A strategic investor introduced in a company to bring a new technology or investment. Now, such strategic investor wants to protect his interest in company. Hence, he may request for the articles to be entrenched to require consent of such investor prior to passing any resolutions*

**Practice Question**

**Yadav dairy products Private limited has registered its articles along with memorandum at the time of registration of company in December, 2019. Now directors of the company are of the view that provisions of articles regarding forfeiture of shares should not be changed except by a resolution of 90% majority. While as per section 14 of the Companies Act, 2013 articles may be changed by passing a special resolution only. One of the directors said that they cannot make a provision against the Companies Act. You are required to advise the company on this matter.**

Answer:

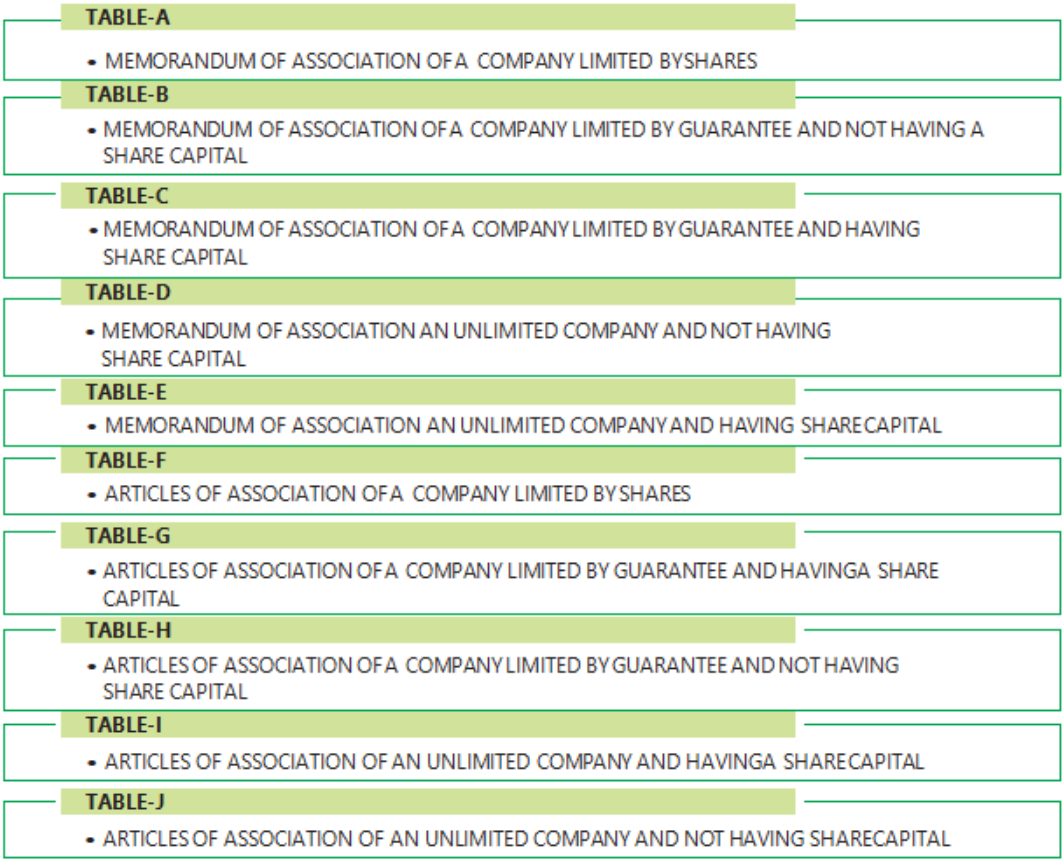
As per section 5 of the Companies Act, 2013 the article may contain provisions for entrenchment to the effect that specified provisions of the articles may be altered only if more restrictive conditions than a special resolution, are met.

The provisions for entrenchment shall only be made either on formation of a company, or by an amendment in the articles agreed to by all the members of the company in the case of a private company and by a special resolution in the case of a public company.

Where the articles contain provisions for entrenchment, whether made on formation or by amendment, the company shall give notice to the Registrar of such provisions in prescribed manner.

In the present case, Yadav dairy products Private Limited is a private company and wants to protect provisions of articles regarding forfeiture of shares. It means it wants to make entrenchment of articles, which is allowed. But the company will have to pass a resolution taking permission of all the members and it should also give notice to ROC regarding entrenchment of articles.

**THE MOA and AOA shall be in respective forms as provided in schedule 1 to the companies act 2013**




**ACT TO OVERRIDE MEMORANDUM, ARTICLES , ECT SECTION - 6**

'**Save as otherwise expressly provided** in this Act—

(a) the **provisions of this Act shall have effect notwithstanding anything** to the contrary contained in the memorandum or articles of a company, or in any agreement executed by it, or in any resolution passed by the company in general meeting or by its Board of Directors. and

any such provision contained to which it is repugnant (in conflict) to the provisions of this Act, **become or be void,** as the case may be.'

**QUESTIONABLE POINT**

The section starts with "Save as otherwise ….". It means that if **any other section of the Act says that article is superior then we will treat it accordingly**

*Example: Section 47 of the Act deals with voting power of members. And a notification dated 5th June, 2015 says that section 47 is applicable to a private company subject to its Article of Association (AOA). Now if AOA of a private company says that section 47 is not applicable to it then, in this case AOA will become superior and section 47 of the Act will not be applicable.*

## EFFECT OF MEMORANDUM AND ARTICLES [SECTION 10]

1) Subject to the provisions of this Act, the memorandum and articles shall, when registered, bind the company and the members thereof to the same extent.

   **It means that, on the basis of MOA and AOA:**

   - Company is liable to members
   - Members are liable to company
   - But normally members are not liable to each other

2) All monies payable by any member to the company under the memorandum or articles shall be a debt due from him to the company.

## ALTERATION OF MEMORANDUM – section - 13

Alteration includes the making of additions, omissions and substitutions.

**(1) Alteration by special resolution: COMPANY MAY ALTER ITS MOA BY A SPECIAL RESOLUTION.**

**(2) NAME CHANGE OF THE COMPANY:** Any **change in the name of a company** shall be effected **only with the approval of the Central Government** in writing.

**Note:**

a) No such approval shall be necessary where the change in the name is only the addition/deletion of the word "Private", on the conversion of any one class of companies to another class in accordance with the provisions of the Act.

b) **According to the Companies (Incorporation) Rules, 2014:**
   The **change of name shall not be allowed** to a company **which has not filed annual returns or financial statements** or which has failed to repay matured deposits or debentures or interest thereon.

   The change of name shall be allowed upon filing necessary documents or payment or repayment of matured deposits or debentures or interest thereon as the case may be.

**(3) Entry in register of companies:** On any change in the name of a company, **the Registrar shall enter the new name in the register of companies in place of the old name and issue a fresh certificate of incorporation** with the new name and the change in the name shall be complete and effective only on the issue of such a certificate.

## RECTIFICATION OF NAME OF COMPANY [SECTION 16]

(1) If a **company is registered by a name** which, —

(a)

- in the **OPINION OF THE CENTRAL GOVERNMENT**, **is identical with or too nearly resembles the name by which a company in existence registered**, under **this or any previous company law**,
- it **may direct the company to change its name**
- and the **company shall change its name, within 3 months** from the issue of such direction, after adopting an ordinary resolution for the purpose;

(b)

- on an **APPLICATION BY A REGISTERED PROPRIETOR OF A TRADE MARK** that the name is identical or too nearly resembles to a registered trade mark of such proprietor under the Trade Marks Act, 1999,
- **made to the Central Government within 3 years of incorporation or registration** or change of Name of the company, whether under this Act or any previous company law, **in the opinion of the Central Government**, is identical with or too nearly resembles to an existing trade mark,
- it **may direct the company to change its name and the company shall change its name** or new name, as the case may be, within a period of **3 months** (Amended) from the issue of such direction, after adopting an ordinary resolution for the purpose.

(2) Where a company changes its name or obtains a new name under sub-section (1), it shall within a period of 15 days from the date of such change, give notice of the change to the Registrar along with the order of the Central Government, who shall carry out necessary changes in the certificate of incorporation and the memorandum.

**(3) If a company does not comply with any direction given under sub-section (1), the Central Government shall allot a new name to the company in such manner as may be prescribed and the Registrar shall enter the new name in the register of companies in place of the old name and issue a fresh certificate of incorporation with the new name, which the company shall use thereafter:**

**Provided that nothing in this sub-section shall prevent a company from subsequently changing its name in accordance with the provisions of section 13.**

**#Practice Question**

**Manglu and friends registered a company in the name of Taxmann advisory private limited. Taxmann is a registered trade mark. After 5 years when the owner of trade mark came to know about the same, it filed an application with relevant authority. Can the company be compelled to change its name by the owner of trade mark? Can the owner of registered trade mark request the company and then company changes its name at its discretion?**

Answer:

In the given case, owner of registered trade mark is filing objection after 5 years of registration of company with a wrong name. While it should have filed the same within 3 years. Therefore, the company cannot be compelled to change its name.

As per section 13, company can anytime change its name by passing a special resolution and taking approval of Central Government. Therefore, if owner of registered trade mark request the company for change of its name and the company accepts the same then it can change its name voluntarily by following the provisions of section 13.

**2)Change in the registered office:** Only change of registered office of from one state to another state required alteration of MOA. – **Procedure already discussed**

**3)Change in the object of the company:** A company, which has **raised money from public through prospectus** and still **has any unutilized amount out of the money so raised**, **shall not change its objects for which it raised the money through prospectus unless a special resolution through postal ballot is passed** by the company and—

- the details, in respect of such resolution shall also be published in the **newspapers** (one in English and one in vernacular language) which is in circulation at the place where the registered office of the company is situated and shall also be placed on the **website** of the company, if any, indicating there in the justification for such change;
- the **dissenting shareholders shall be given an opportunity to exit** by the promoters and shareholders having control in accordance with regulations to be specified by the Securities and Exchange Board of India.

**(3) Liability clause: Alteration if any shall be made by passing a special resolution. [Also read sec 18]**
Any alteration of the memorandum, in the case of a company limited by guarantee and not having a share capital, intending to give any person a right to participate in the divisible profits of the company otherwise than as a member, shall be void.

**#Practice Question:**

**Anushka security equipments limited is a manufacturer of CCTV cameras. It has raised ` 100 crores through public issue of its equity shares for starting one more unit of CCTV camera manufacturing. It has utilized 10 crores rupees and then it realized that its existing business has no potential for expansion because government has reduced customs duty on import of CCTV camera hence imported cameras from china are cheaper than its own manufacturing. Now it wants to utilize remaining amount in mobile app development business by adding a new object in its memorandum of association.**

**Does the Companies Act allow such change of object. If not then what advise will you give to company. If yes, then give steps to be followed.**

**Answer**:

According to section 13 of the Companies Act, 2013 a company, which has raised money from public through prospectus and still has any unutilized amount out of the money so raised, shall not change its objects for which it raised the money through prospectus unless a special resolution is passed by the company and—

(i) the details in respect of such resolution shall also be published in the newspapers (one in English and one in vernacular language) which is in circulation at the place where the registered office of the company is situated and shall also be placed on the website of the company, if any, indicating therein the justification for such change;

(ii) the dissenting shareholders shall be given an opportunity to exit by the promoters and shareholders having control in accordance with SEBI regulations.

Company will have to file copy of special resolution with ROC and he will certify the registration within a period of thirty days. Alteration will be effective only after this certificate by ROC.

Looking at the above provision we can say that company can add the object of mobile app development in its memorandum and divert public money into that business. But for that it will have to comply with above requirements.

## ALTERATION OF ARTICLES [SECTION 14]

**(1) Alteration by special resolution:** Subject to the provisions of this Act and the conditions contained in its memorandum, if any, **A COMPANY MAY, BY A SPECIAL RESOLUTION ALTER ITS ARTICLES.**

(2) Alteration to include alteration having effect of conversion of companies:—

(a) a private company into a public company; or

(b) a public company into a private company.

- Where a company being a private company alters its articles in such a manner that **they no longer include the restrictions and limitations which are required to be included (Section 2 (68)** in the articles of a private company under this Act, then such company shall, as from the date of such alteration, cease to be a private company.
- Conversion of a **public company into a private company** shall not be valid **unless it is approved by an order of the Central Government** on an application made in such form and manner as may be prescribed.

(3) **Every alteration** of the articles and a copy of the order of the Central Government approving the alteration, **shall be filed with the Registrar**, together with a printed copy of the altered articles, within a period of 15 days in such manner as may be prescribed, who shall register the same.

(4) Every alteration made in articles **shall be noted in every copy of the articles**. If a company makes any default in complying with the stated provisions, **the company and every officer who is in default shall be liable to a penalty of 1000 rupees for every copy of the articles** issued without such alteration. **[Section 15]**

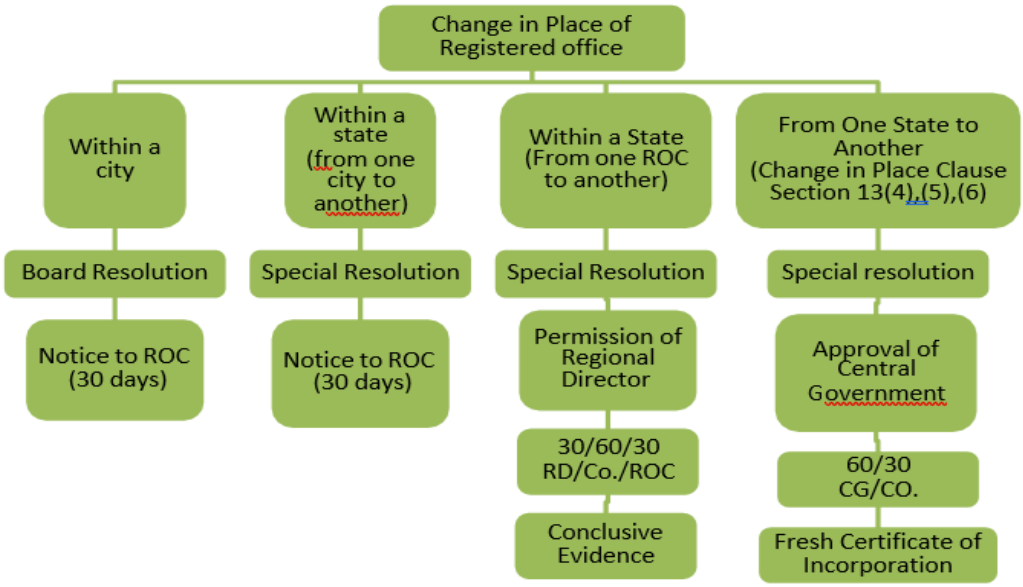
## REGISTERED OFFICE OF COMPANY [SECTION 12]

This seeks to provide for the registered office of the companies **for the communication and serving of necessary documents**, notices letters etc. The domicile and the nationality of a company is determined by the place of its registered office. This is also important for determining the jurisdiction of the court.

1. Within **30th day of its incorporation** and at all times thereafter a company shall have a registered office capable of receiving and acknowledging all communications and notices as may be addressed to it.

2. The company shall furnish to the Registrar verification of its registered office within a period of 30 days of its incorporation
3. **Labeling of company:**
    - Paint or affix its **name, and address**, outside of every office or place in which its business is carried on, in a conspicuous position, in legible letters, and if the characters employed are not those of the language/s in general use in that locality, then also in the characters of that language/s.
    - have its name engraved in legible characters on **its seal, if any**;
    - get its name, address of its registered office and the **Corporate Identity Number** along with telephone number, fax number, if any, e-mail and website addresses, if any, printed in all its business letters, billheads, letter papers and in all its notices and other official publications; and
    - have its name printed on hundies, promissory notes, bills of exchange and such other documents as may be prescribed:

    **Note:** where a **company has changed its name during the last 2 years**, it shall print along with its name, the former names so changed during the last 2 years as required under clauses.
4. **In case of OPC:** The words ''One Person Company'' shall be mentioned in brackets below the name of such company, wherever its name is printed, affixed or engraved.
5. **Shifting of registered Office:**




6. **In case of default:** The company and every officer who is in default shall be liable to a penalty of 1000 rupees for every day during which the default continues but not exceeding one lakh rupees.
7. 12(9) if the Registrar has reasonable cause to believe that the company is not carrying on any business or operations, **he may cause a physical verification of the registered office** of the company and if any

default is found to be made in complying with the requirements of sub-section (1), he may without prejudice to the provisions of sub-section (8), initiate action for the removal of the name of the company from the register of companies,

**Practice Question:**

**XY Ltd. has its registered office at Mumbai in the State of Maharashtra. For better administrative conveniences the company wants to shift its registered office from Mumbai to Pune (within the State of Maharashtra, but from Mumbai ROC to Pune ROC). What formalities the company has to comply with under the provisions of the Companies Act, 2013 for shifting its registered office as stated above? Explain.**

**Answer**

The Companies Act, 2013 under section 13 provides for the process of altering the Memorandum of a company. Since the location or Registered Office clause in the Memorandum only names the state in which its registered office is situated, a change in address from Mumbai to Pune, does not result in the alteration of the Memorandum and hence the provisions of section 13 (and its sub sections) do not apply in this case.

However, under section 12 (5) of the Act which deals with the registered office of company, the change in registered office from one town or city to another in the same state, must be approved by a special resolution of the company. Further, registered office is shifted from one ROC to another, therefore company will have to seek approval of Regional director

## COMMENCEMENT OF BUSINESS ETC. [SECTION 10A]

(1) A company incorporated after the commencement of the Companies (Amendment) Ordinance, 2019 and having a share capital shall not commence any business or exercise any borrowing powers unless—

(a) a **declaration is filed by a director within a period of 180 days** of the date of incorporation of the company in such form, with the Registrar **that every subscriber to the memorandum has paid the value of the shares agreed to be taken by him on the date of making of such declaration**; and

(b) The **company has filed with the Registrar a verification of its registered office**

(2) **If any default is made**: the company shall be liable to a penalty of 50 thousand rupees and every officer who is in default shall be liable to a penalty of one thousand rupees for each day during which such default continues but not exceeding an amount of one lakh rupees.

(3) Where no declaration has been filed **and the Registrar has reasonable cause to believe** that the company is not carrying on any business or operations, he **MAY**, without prejudice to the provisions of sub-section (2), **initiate action for the removal of the name of the company from the register of companies**

**Note:**

- The declaration by a director shall be verified by a CA or CS or CMA, in practice.
- In the case of a company pursuing objects requiring approval from any sectorial regulators such as the RBI, SEBI, etc., the approval, as the case may be from such regulator shall also be obtained and attached with the declaration.

## CONVERSION OF COMPANIES ALREADY REGISTERED [SECTION 18]

A company may convert itself into some other class of company by following the law with respect to the conversion of the companies already registered.

**1) By alteration of memorandum and articles**

2) **File an application to the Registrar**

3) Issue a certificate of incorporation: Registrar after being satisifed that the provisions have been complied with, close the former registration of the company and issue a certificate of incorporation in the same manner as its first registration.

4) The registration of a company under this section **shall not affect any debts, liabilities, obligations or contracts incurred or entered into, by or on behalf of the company before conversion** and such debts, liabilities, obligations and contracts may be enforced in the manner as if such registration had not been done.

## SUBSIDIARY COMPANY NOT TO HOLD SHARES IN ITS HOLDING COMPANY [SECTION 19]

(1) No company shall, either by itself or through its nominees, **hold any shares in its holding company and no holding company shall allot or transfer its shares to any of its subsidiary companies** and **any such allotment or transfer of shares of a company to its subsidiary company shall be void.**

**EXCEPTION**—

(a) where the subsidiary company holds such shares as the **legal representative** of a deceased member of the holding company; or

(b) where the subsidiary company holds such shares as a **trustee**; or

(c) where the **subsidiary company is a shareholder even before it became a subsidiary** company of the holding company:

**Note:** Such subsidiary company shall have a right to vote at a meeting of the holding company **only in respect of the shares held** by it **as a legal representative or as a trustee**.

**Example:** RPIP Ltd. has invested 51% in the shares of SSP Pvt. Ltd. on 31 March 2017. SSP Pvt. Ltd. have been holding 2% equity of RPIP Ltd since 2011. SSP Pvt. Ltd. cannot increase its equity beyond that 2% on or after 31 March 2017. However, it could continue to hold or reduce its initial 2% stake.

**Practice Question:**

**Shri Laxmi Electricals Ltd. (S) is a company in which Hanuman power suppliers Limited (H) is holding 60% of its paid up share capital. One of the shareholder of H made a charitable trust and donated his 10% shares in H and ` 50 crores to the trust. He appoint S as the trustee. All the assets of the trust are held in the name of S. Can a subsidiary hold shares in its holding company in this way?**

Answer:

In the given case, one of the shareholders of holding company has transferred his shares in the holding company to a trust where the shares will be held by subsidiary company. It means now subsidiary will hold shares in the holding company. But it will hold shares in the capacity of a trustee. Therefore, we can conclude that in the given situation S can hold shares in H.

## SERVICE OF DOCUMENTS [SECTION 20]

The mode in which documents may be served on the **company**, on the **members** and also on the **registrar**, is as follows;

1) **Serving of document to company:** A document may be served **to the company or the officer** at the registered office of the company by-

a) Registered/ Speed post, or

b) courier service, or

c) leaving it at its registered office, or

d) means of such **electronic** or other mode as may be prescribed:

2) **Serving of document to registrar or member:** For filing of documents with the Registrar in electronic mode, a document may be served on Registrar or any member by sending it to him by—

a) Post, or

b) Registered/ Speed post, or

c) courier, or

d) by delivering at his office or address, or

e) by such **electronic** or other mode as may be prescribed :

**Note:** However, **a member may request for delivery of any document through a particular mode**, for which **he shall pay such fees as may be determined** by the company in its AGM.

**Exemption- A Nidhi Company**, the document may be served only on members who hold shares of more than ` 1,000 in face value or more than 1%, of the total paid-up share capital of the Nidhis **whichever is less**.

For **other shareholders**, document may be served by a public notice in newspaper circulated in the district where the Registered Office of the Nidhi is situated; and publication of the same on the notice board of the Nidhi. [Notification dated 5th June, 2015.]

The term, **"electronic transmission"** means a communication that creates a record that is capable of **retention, retrieval (recovery) and review**, and which may thereafter be rendered into clearly legible tangible form. It may be made by—

a) facsimile telecommunication (fax) or E mail
b) posting of an **electronic message board** or network that the **Registrar or the member has designated for those communications**, and which transmission shall be validly delivered upon the posting, or
c) **other means of electronic communication**, in respect of which the company or the officer has put in place **reasonable systems to verify** that the sender is the person contending to send the transmission

3) In **case of delivery by post**, such **service shall be deemed to have been effected**—

(i) in the case of a **notice of a meeting**, at the **expiration of 48 hours** after the letter is posted; and

(ii) in any **other case**, at the time at which the **letter would be delivered in the ordinary course** of post.

> **Example** – Modern Furniture sent the notice of general meeting through postal mail 48 hours after the post of letter containing such notice, shall be deemed to be served. Hence, requirement of 21 clear days' notice under section 101 of the Act, if seen in this context, Modern Furniture Limited should have posted the letter containing notice 23 days prior to meeting day (48 hours of post-delivery+21 clear days).

## AUTHENTICATION OF DOCUMENTS, PROCEEDINGS AND CONTRACTS [SECTION 21]

A **document or proceeding requiring authentication by a company** or contracts made by or on behalf of a company may be signed by–

(i) any key managerial personnel, or
(ii) an officer of the company duly authorised by the Board in this behalf

**"Key managerial personnel"[KMP], in relation to a company, means— Sec - 2(51)**

(i) the Chief Executive Officer or the managing director or the manager;

(ii) the company secretary;

(iii) the whole-time director;

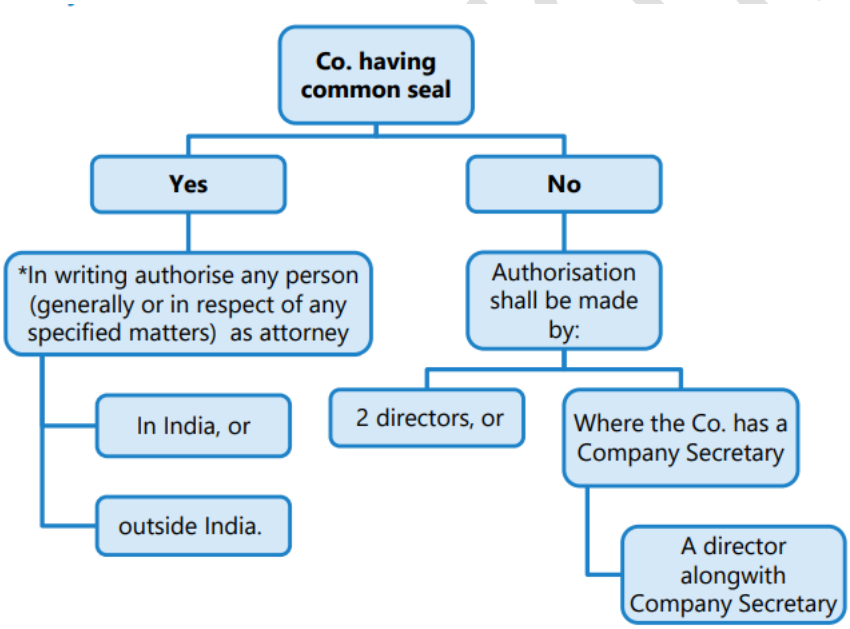
(iv) the Chief Financial Officer;

(v) such other officer, not more than **one level below the directors** who is in whole-time employment, **designated as KMP** by the Board; and

(vi) such other officer as may be prescribed]

**EXECUTION OF BILLS OF EXCHANGE, ETC. [SECTION 22]**

- A bill of exchange, hundi or promissory note shall be deemed to have been made, accepted, drawn or endorsed on behalf of a company if it is so **done by any person acting under its authority**, express or implied.
- A company **may**, by writing under its common seal, if any, authorize any person, either generally or in respect of any specified matters, as its attorney




**#Practice Question**

**Parag Constructions Limited is a leading infrastructure company. One of the directors of the company Mr. Parag has been signing all construction contracts on behalf of company for many years. All the parties who ever deal with the company know Mr. Parag very well. Company has got a very important construction contract from a renowned software company. Parag constructions will do construction for this site in partnership with a local contractor Firozbhai. Mr. Parag signed partnership deed with Firozbhai on behalf of company because he has an implied authority. Later**

**in a dispute company denied to accept liability as a partner. Can the company deny its liability as a partner?**

Answer:

In the present case company has neither given any written authority nor affixed common seal of the authority letter. It means that Mr. Parag is not legally entitled to execute deeds on behalf of the company. Therefore, deeds executed by him are not binding on the company. Therefore, company can deny its liability as a partner.

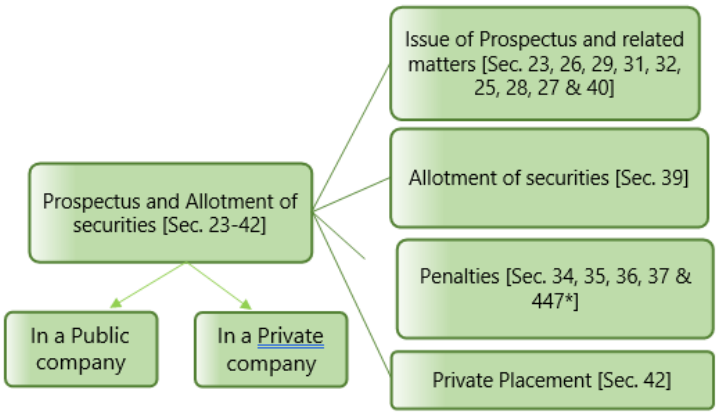
# Chapter 3

# PROSPECTUS AND ALLOTMENT OF SECURITIES

## Section overview

**Part I -** It contains provisions for the issue of securities through public offer; (sections 23 to);

**Part II -** It contains provisions for the issue of securities through private placement. Following diagram depicts the various sections: (Section 42)




## PUBLIC OFFER AND PRIVATE PLACEMENT [SECTION 23]

As per Section 23 (1), a **PUBLIC COMPANY** may issue securities—

(a) to **public through prospectus** (herein referred to as "public offer"); or
(b) through **private placement** by complying with the provisions of Part II; or
(c) through **a rights issue** or
(d) a **bonus issue** in accordance with the provisions of the Act and
in case of a listed company or intending to get listed shall also comply with the provisions of the Securities and Exchange Board of India Act, 1992 (SEBI).

**As per Section 23(2)**, a **PRIVATE COMPANY** may issue securities—

(a) by way of **rights issue** or
(b) **bonus issue** in accordance with the provisions of the Act; or
(b) through **private placement** by complying with the provisions of Part II.

"public offer" includes

- **INITIAL PUBLIC OFFER** (IPO) or
- **FURTHER PUBLIC OFFER** (FPO) of securities to the public by a company, or
- an **OFFER FOR SALE OF SECURITIES** (OFS) to the public by an existing shareholder, through issue of a prospectus.

## Meaning of Securities

As per section 2 (81), the term 'securities' means the securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 [SCRA].

As per section 2 (h) of Securities Contracts (Regulation) Act, 1956

"**Securities" include—**

(i) Shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;

(ia) derivative;

(ib) units or any other instrument issued by any collective investment scheme to the investors in such schemes;

(ic) security receipt as defined in clause (zg) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

(id) units or any other such instrument issued to the investors under any mutual fund scheme.

**Explanation:** "Securities" shall not include any unit linked **insurance policy or scrips** or any such instrument or unit, by whatever name called, which provides a combined benefit risk on the life of the persons and investment by such persons and issued by an insurer referred to in clause (9) of section 2 of the Insurance Act, 1938.

(ie) any certificate or instrument (by whatever name called), issued to an investor by any issuer being a special purpose distinct entity which possesses any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable, including mortgage debt, as the case may be;

(ii) Government securities;

(iia) such other instruments as may be declared by the Central Government to be securities; and

(iii) rights or interests in securities.

**Summary of modes (for issue of securities)**

| Mode of Issue | Public Company | Private Company |
|---|---|---|
| Public Offer (including IPO, FPO or OFS) | Yes | No |
| Private Placement | Yes | Yes |
| Rights issue / Bonus Issue | Yes | Yes |
| Compliance with SEBI rules & regulations | yes | no |

To bring ease to doing business for corporates, **Sub-section 3 and 4 to section 23 of the Act inserted vide, the Companies (Amendment) Act, 20206 (enforced w.e.f 28th September 2020)**

Prior to Amendments of 2020, Indian companies can access the overseas equity markets only through depository receipts (e.g. American Depository Receipts (ADRs) or Global Depository Receipts (GDRs) or by listing their debt securities (such as, foreign currency convertible bonds, masala bonds, etc.) on foreign markets

Since more and more businesses are going global & capital raised from across the border is cost effective, hence section 23(3) is inserted to open ways of **overseas direct listing** for notified class of public companies by allowing them to issue notified securities for the purpose of listing on permitted stock exchanges in permissible foreign jurisdictions or such other jurisdictions as may be prescribed.

**Section 23(4)** of the Act empowers the Central Government to **exempt any class or classes of public companie**s from complying with the provisions of Chapter III (Prospectus and Allotment of Securities), Chapter IV (Share Capital and Debentures), section 89 (Declaration in respect of a beneficial interest in any share), section 90 (Register of significant beneficial owners in a company) or section 127 (Punishment for failure to distribute dividends) of the Act, by issuing notification.

## REGULATION OF ISSUE AND TRANSFER OF SECURITIES ETC. [SECTION 24]

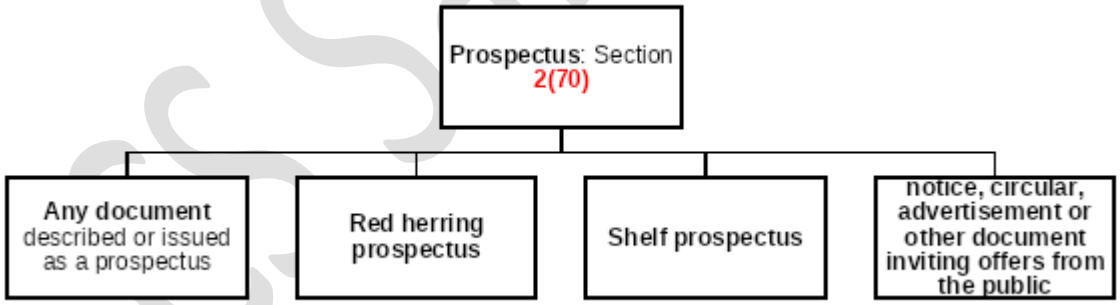
**Securities and Exchange Board of India** is empower to administer those provisions under chapter III and IV of the Act, which pertains to **issue & transfer of securities** and **non-payment of dividend**; by **listed companies** or those **companies which intend to get their securities listed on any recognised stock exchange in India,** by making regulations in this behalf.

All other matters (including matters relating to prospectus, return of allotment, redemption of preference shares) specifically provided in this Act, shall be administered by the Central Government, Tribunal or the Registrar, as the case may be.

**Illustration (True/False) Statement** – The powers to administer the matters pertaining to redemption of preference share by listed company vested with the Securities and Exchange Board of India.
**Answer –** False (Refer Section 24(1)(a)

## PROSPECTUS

In general parlance prospectus **refers to an information booklet or offer document** on the **basis of which an investor invests** in the securities of an issuer company.




## DEEMED PROSPECTUS [SECTION 25]

**(1) Documents which are deemed to be a Prospectus:**

- Where a company **allots or agrees to allot any securities of the company** with a view to all or any of those **securities being offered for sale to the public**,
- **any document by which the offer for sale to the public is made shall be deemed to be a prospectus issued by the company**;

- and **all rules of law** as to the contents of prospectus and as to liability in respect of mis-statements, in and omissions from, prospectus, or otherwise relating to prospectus, **shall apply**,
- as if **persons accepting the offer in respect of any securities were subscribers for those securities**,
- but without prejudice to the liability, if any, of the persons by whom the offer is made in respect of mis-statements contained in the document or otherwise in respect thereof. [Sub-section (1)]

**(2) Securities offered for sale to the public:** For the purposes of the Companies Act, 2013, it shall, unless the contrary is proved, be evidence that an allotment of, or an agreement to allot, securities was made with a view to the securities being offered for sale to the public if it is shown—

(a) that an **offer of the securities** for sale to the public was made **within 6 months after the allotment or agreement to allot**; or

(b) that at **the date when the offer was made**, the **whole consideration to be received by the company in respect of the securities had not been received** by it. [Sub-section (2)]

**(3) Effect of section 26:**

(i) Matters to be stated in addition to section 26 —

(a) the net amount of the consideration received or to be received by the company in respect of the securities to which the offer relates; and

(b) the time and place at which the contract where under the said securities have been or are to be allotted may be inspected;

(ii) the persons making the offer were persons named in a prospectus as directors of a company. [Sub-section (3)]

**(4) Signing of Document in case of a company or a firm:** Where a person making an offer to which this section relates is a company or a firm, it shall be sufficient if it is signed on behalf of the company or firm **by two directors of the company or by not less than one-half of the partners in the firm**.

**Illustration (True/False)**

**Statement** – The matters specified under section 25(3) need to be stated in substitution of matters stated under section 26

**Answer** – False [Section 25(3) provides three matters that need to be stated in addition to matters required to be stated in prospectus under section 26.]

**MATTERS TO BE STATED IN PROSPECTUS – SECTION -26**

**(1) Prospectus to be dated, signed and to state specified information, etc.:**

- Every prospectus issued **by or on behalf of a public company either with reference to its formation or subsequently**, or by or on behalf of any person who is or has been engaged or interested in the formation of a public company, shall be dated and signed and shall state **such information and set out such reports on financial information as may be specified by the Securities and Exchange Board** in consultation with the Central Government.
- Until **SEBI specifies the information and reports on financial information,** the regulations made by the Securities and Exchange Board under the Securities and Exchange Board of India Act, 1992, **in respect of such financial information or reports on financial information shall apply**

- Prospectus shall make a **declaration about the compliance** of the provisions of the Companies Act, 2013 and a statement to the effect that nothing in the prospectus is **contrary to the provisions of this Act, the Securities Contracts (Regulation) Act, 1956** and the **SEBI Act, 1992**

**(2)Exceptions: Nothing in sub-section (1) shall apply—**

(a) to the **issue to existing members or debenture-holders** of a company, of a prospectus or form of application relating to shares in or debentures of the company, under sub-clause (ii) of clause (a) of sub-section (1) of section 62; or
(b) to the issue of a prospectus or form of application relating to shares or debentures which are, or are to be, in all respects uniform with shares or debentures previously issued and for the time being dealt on a recognised stock exchange

**(3)The date indicated in the prospectus shall be deemed to be the date of its publication.**

**(4) Prospectus to be issued after delivery to Registrar for filing:**

No prospectus shall be issued by or on behalf of a company on or before the date of its publication, **there has been delivered to the Registrar for filing**, a copy thereof signed by every person who is named therein as a director or proposed director of the company or by his duly authorised attorney.

(5) **Prospectus not to include Experts' statement under certain circumstances:**

A prospectus **shall not include** a statement **purporting to be made by an expert unless**

- the expert is a person who is **not been, engaged or interested in the formation** or promotion or management, of the company and
- has **given his written consent to the issue of the prospectus** and

has **not withdrawn such consent** before the delivery of a copy of the prospectus to the Registrar for **filing** and

- a **statement to that effect shall be included in the prospectus**.

**Note**: As per Section 2(38) 'expert' includes an engineer, a valuer, a Chartered Accountant, a Company Secretary, a Cost Accountant and any other person who has the power or authority to issue a certificate in pursuance of any law for the time being in force

**(6)Every Prospectus to mention compliances of certain formalities on the face of it:**

(1) that a **copy has been delivered for filing to the Registrar** as per sub-section (4); and specify any **documents required by this section to be attached to the copy** so delivered or refer to statements included in the prospectus which specify these documents.

**(8)**Prospectus **shall not be valid if it is issued more than 90 days after** the date on which a copy thereof is delivered to the Registrar under sub-section (4). [Sub- section (8)]

(8) Penalty

If a prospectus is issued in contravention of the provisions of this section, the company shall be punishable with fine which shall not be less than 50 thousand rupees but which may extend to 3 lakh rupees and every person who is knowingly a party to the issue of such prospectus shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees

*Example: The Board of Directors of Dr. Sunny Pharmaceutical Limited has allotted shares to the investors at large without issuing a prospectus with the Registrar of Companies, Mumbai. In this*

*regard, it is to be noted that a public company can issue securities to the public only by issuing a prospectus (Section 23).*

*Section 26 (1) lays down the matters required to be disclosed and included in a prospectus and requires the filing of the prospectus with the Registrar before it is issued.*

*In the given case, the company has violated the above provisions of the Companies Act, 2013 and hence the allotment made by it is void. The company will have to refund the entire moneys received and will also be punishable under section 26 (9) of the Act*

**VARIATION IN TERMS OF CONTRACT OR OBJECTS STATED IN PROSPECTUS [SECTION 27]**

- Once funds are raised through a given prospectus, the principle of "doctrine of ultra vires" (mutatis mutandis) comes into play i.e., the company has to use the funds strictly in accordance with the prospectus.

**(1) Variation on approval in general meeting by passing of SR:**

- A company shall not, at any time, vary the terms of a contract referred to in the prospectus or objects for which the prospectus was issued, **except subject to the approval** by way of special resolution.
- Notice in respect of such resolution to shareholders, shall also be published in the **newspapers** (one in English and one in vernacular language) indicating clearly the justification for such variation.

**Advertisement to be in Specified Form:** The advertisement of the notice for getting the resolution passed in this regard shall be in **Form PAS-1** and such advertisement shall be published simultaneously with dispatch of Postal Ballot Notices to Shareholders. The notice shall also be placed on the **web-site of the company**, if any

It is further provided that **such company shall not use any amount raised by it through prospectus for buying, trading or otherwise dealing in equity shares of any other listed company**

**(2) The dissenting shareholders** to vary the terms of contracts or objects referred to in the prospectus, **shall be given an exit offer by promoters or controlling shareholders** at such exit price, and in such manner and conditions as may be specified by SEBI [Sub-section (2)]

**Illustration (MCQ)**

In case of variation in terms of contract or objects in prospectus, which of the followings statement are not true;

(i) Ordinary resolution shall be passed at general meeting

(ii) Notice given to shareholder shall also be published in two newspapers

(iii) Amount so raised can be invested only in equity share of prescribed class of companies.

Options

(a) (i) only

(b) Both (i) and (ii) only

(c) Both (i) and (iii) only

(d) Both (ii) and (iii) only

**Answer** – (d)

## OFFER OF SALE OF SHARES BY CERTAIN MEMBERS OF COMPANY [SECTION 28]

Sub-section 1 provides that, **member** or members of a company, in **consultation with board of directors,** may **offer whole or part** of their holding of **shares** to the **public**, in accordance with the provisions of the law for the time being in force. Further sub-section 2 provides that the document by which the offer of sale to the public is made shall be **treated as prospectus issued by company**. Hence, all provisions apply accordingly.

At last sub-section 3 highlights the members' responsibility in the matter of sale under sub-section 1. It provides, the members whether individual or bodies corporate or both, whose shares are proposed to be offered to the public, **shall collectively to authorise the company** to take all actions on their behalf for **carrying out the transaction**. They also have to **reimburse** the company for **all expenses** made by it on this matter

According to Rule 8 (1), the provisions of Part I of "Prospectus and Allotment of Securities" shall be **applicable to an offer of sale referred to in section 28 EXCEPT** for the following, namely:-

(a) the provisions relating to **minimum subscription**;
(b) the provisions for **minimum application value**;
(c) the provisions requiring any **statement to be made by the Board of directors** in respect **of the utilization of money**; and
(d) **any other** information which cannot be compiled or gathered by the offeror, with detailed justifications for not being able to comply.
**Disclosure: As per Rules 8 (2), the prospectus issued under section 28 shall disclose the name of the person or persons or entity bearing the cost of making the offer of sale along with reasons.**

## PUBLIC OFFER OF SECURITIES TO BE IN DEMATERIALISED FORM [SECTION 29]

Sub-section 1 has overriding effect to any other provision of this Act. It provides that **every company making a public offer and such other class or classes of companies as may be prescribed,** have to **issue** their securities only in dematerialised form by complying with the provisions of the Depositories Act, 199617 and regulations made under it.

Sub-section 1A inserted in 2019, provides that in case of p**rescribed class/classes of unlisted companies,** the securities shall be **held or transferred** only in dematerialised form by complying with the provisions of the Depositories Act, 199618 and regulations made under it.

Further sub-section 2 provides, **any other company** may;

a. Convert its securities into dematerialised form;

b. Issue its securities in physical form in accordance with the provisions of this Act;

c. Issue its securities in dematerialised form in accordance with the provisions of the Depositories Act, 199619 and the regulations made thereunder

## ADVERTISEMENT OF PROSPECTUS [SECTION 30]

*where an advertisement of any prospectus of a company is published in any manner, it shall be necessary to specify therein the contents of its memorandum as regards the following:*

*(i) the **objects**,*

*(ii) the **liability of members** and the amount of share capital of the company,*

*(iii) the **names of the signatories** to the memorandum,*

*(iv) the **number of shares subscribed** for by the signatories, and*

*(v) the **capital structure** of the company.*

## SHELF PROSPECTUS [SECTION 31]

**WHAT PURPOSE IT SERVES?** We may consider a situation where the issuer company issues debentures frequently and has to file a prospectus every time it issues a new series of debentures. Here, the concept of shelf prospectus comes into play. Literally, it means a prospectus with a given shelf life. Any number of issues could be made during the tenure of the shelf prospectus.

- Shelf Prospectus means a prospectus in respect of which the securities or class of securities included therein are issued for subscription in **one or more issues over a certain period without the issue of a further prospectus**. In simple terms issuer is permitted to offer and sell securities to the public **without a separate prospectus for each act of offering for a certain period.**
- Such prospectus is to be **submitted at the stage of the first offer of securities** which shall indicate a **period not exceeding one year as the period of validity of such prospectus**.
- The **validity period shall commence from** the date of opening of the first offer of securities under that prospectus.
- An **information memorandum in Form PAS-2** is required to be filed by a company filing a shelf prospectus which shall contain all material facts relating to
  - new **charges created**,
  - **changes in the financial position** of the company as have occurred between the first offer of securities or the previous offer of securities and the succeeding offer of securities and
  - such other changes as may be prescribed,

**with the Registrar** within one month, **prior to the issue of a second or subsequent offer** of securities under the shelf prospectus, According to Rule 10 of the Companies (Prospectus and Allotment of Securities) Rules, 2014.

**Benefitting provision for the investors**, where a company has **received applications for the allotment of securities along with advance payments** of subscription **before the making of any such change**, the company or other person **shall intimate the changes to such applicants** and if they express a desire

to **withdraw their application**, the company or other person shall refund all the monies received as subscription within fifteen days thereof.

**Information Memorandum together with Shelf Prospectus is deemed Prospectus [Sub-section 3]**

Where an information memorandum is filed, every time an offer of securities is made under sub-section (2), such memorandum together with the shelf prospectus shall be deemed to be a prospectus

**RED HERRING PROSPECTUS [SECTION 32]**

- **Meaning**: Red herring Prospectus means a prospectus **which does not include complete particulars of the quantum or price** of the securities included therein. Book building issue is facilitated by the concept of red herring prospectus whereby the price per security and number of securities are left open to be decided post closure of the issue.
- **It is issued prior to issue of Prospectus:** A company proposing to make an offer of securities may issue a red herring prospectus prior to the issue of a prospectus.
- **Filing with the registrar:** Such company proposing to issue a red herring prospectus shall file it with the **Registrar at least 3 days prior to the opening of the subscription list and the offer**.
- **Obligations under Red Herring Prospectus:** A red herring prospectus shall carry the same obligations as are applicable to prospectus and any **variation between the red herring prospectus and a prospectus shall be highlighted as variations in the prospectus.**
- **Filing of Red Herring Prospectus with Registrar and SEBI upon closing of Offer**: Upon the **closing of the offer of securities under this section**, the prospectus stating therein the **total capital raised**, whether by way of debt or share capital, and the **closing price of the securities** and any other details as are not included in the red herring prospectus **shall be filed with the Registrar and the Securities and Exchange Board.**

**Abridged Prospectus [Section 2(1)]**

According to it, 'Abridged Prospectus' means a memorandum containing such salient features of a prospectus as may be specified by the Securities and Exchange Board by making regulations in this behalf. In fact, 'Abridged Prospectus' is a summarised form of actual prospectus.

**MIS-STATEMENTS IN PROSPECTUS**

- Mis-statement is the act of stating something that is false or not accurate. It could either be due to commission or omission or both.
- Mis-statement of prospectus is a serious offence which attracts the provisions of section 34 **and / or** section 35. Liabilities can be classified under two headings

**1. CRIMINAL LIABILITY FOR MIS-STATEMENTS IN PROSPECTUS – Section 34**

Where a prospectus, issued, circulated or distributed under Chapter III, **includes any statement which is**
- untrue or
- misleading in form or context in which it is included or
- where any inclusion or omission of any matter is likely to mislead,

**Every person who authorises the issue** of such prospectus **shall be liable under section 447.**

**EXCEPTION**: This section **shall not apply to a person if he proves that**
- such statement or **omission was immaterial** or
- that he had reasonable grounds to believe, and did up to the time of issue of the

## 2. CIVIL LIABILITY FOR MIS-STATEMENTS IN PROSPECTUS - Section 35

**(1) Liabilities of Persons involved**:

- Where a **person has subscribed for securities of a company**
- acting on any statement included, or the inclusion or omission of any matter, in the prospectus which is misleading and
- has **sustained any loss or damage as a consequence thereof**,
- the **company** and **every person** who—

(a) is a **director** of the company at the time of the issue of the prospectus;
(b) has authorised himself to be named in the prospectus as a director, or **has agreed to become such director**, either immediately or after an interval of time;
(c) is a **promoter** of the company;
(d) has **authorised the issue** of the prospectus; and
(e) is an **expert** referred to in sub-section (5) of section 26

shall, in addition to any punishment to which any person may be liable under section 36, **be liable to pay compensation to every person who has sustained such loss or damage.**

**(2) EXCEPTIONS:**

No person shall be liable under Sub-section (1) **if he proves**—

(a) that, having consented to become a director of the company, **he withdrew his consent before the issue of the prospectus**, and that it was **issued without his consent**; or
(b) that the **prospectus was issued without his knowledge** or consent, and **on becoming aware of its issue**, he **forthwith gave a reasonable public notice** that it was issued without his knowledge or consent.
(c) that, misleading statement purported to be made by an expert or contained in a report or valuation of an expert, it was a correct and fair representation of the statement; and **he had reasonable ground to believe and did up to the time of the issue of the prospectus** believe, that the person making the statement was competent to make it and that the said person had given the consent required by sub-section (5) of section 26 to the issue of the prospectus and had not withdrawn that consent before filing of a copy of the prospectus with the Registrar] or, to the defendant's knowledge, before allotment thereunder. [Sub-section (2)]

**(3)**

- **Where it is proved that a prospectus has been issued with intent to defraud** the applicants for the securities of a company or any other person or for any fraudulent purpose,
- every person referred to in **subsection (1) shall be Unlimitedly liable**,

for all or any of the losses or damages that may have been incurred by any person who subscribed to the securities on the basis of such prospectus. [Sub-section (3)]

**#Practice Question:**
An allottee of shares in a Company brought action against a Director in respect of false statements in prospectus. The director contended that the statements were prepared by the promoters and he has relied on them and so director is not liable.

**Answer:** Yes, the Director shall be held liable for the false statements in the prospectus under sections 34 and 35 of the Companies Act, 2013. Section 34 imposes a criminal punishment on every person who authorises the issue of such prospectus, and section 35 more particularly includes a director of the company in the imposition of liability for such mis statements. Therefore, in the present case the director cannot hide behind the excuse that he had relied on the promoters for making correct statements in the prospectus.

**#Practice Question:**
**I**nformation was issued by a company. Mr. X received copy of the prospectus from the company, but did not apply for allotment of any shares. The allotment of shares to the general public was completed by the company within the stipulated period. A few months later, Mr. X bought 2000 shares through the stock exchange at a higher price which later on fell sharply. X sold these shares at a heavy loss. Mr. X claims damages from the company for the loss suffered on the ground the prospectus issued by the company contained a false statement. Referring to the provisions of the Companies Act, 2013 examine whether X's claim for damages is justified.

**Answer:** Under section 2 (70) of the Companies Act, 2013, "prospectus" means any document described or issued as a prospectus and includes a red herring prospectus referred to in section 32 or shelf prospectus referred to in section 31 or any notice, circular, advertisement or other document inviting offers from the public for the subscription or purchase of any securities of a body corporate.

A prospectus is a document inviting offers from the public. The prospectus and any statement therein has no legal binding either on the company or its directors, promoters or experts to a person who has not purchased securities in response to it.

Since X purchased shares through the stock exchange open market which cannot be said to have bought shares on the basis of prospectus. X cannot bring action for deceit against the directors. X will not succeed. It was held in the case of Peek Vs. Gurney that

**#Practice Question:**
M applies for share on the basis of a prospectus which contains mis– statement. The shares are allotted to him, who afterwards transfers them to N. Can N bring an action for a rescission on the ground of mis-statement under section 37 of the Companies Act, 2013?
**Answer**: No, N cannot bring an action for rescission of the contract to buy shares from M on the ground of mis-statement as under section 37 of the Companies Act, 2013. A suit may be filed or any other action may be taken under section 34 or section 35 or section 36 only by any person, group of persons or any association of persons affected by any misleading statement or the inclusion or omission of any matter in the prospectus

**#Practice Question**
**A prospectus issued by a company contained certain mis-statements. On becoming aware of the fact regarding mis-statements in the prospectus, one of the experts Anilesh who had earlier given his consent, forthwith gave a reasonable public notice stating that the prospectus was issued**

**without his knowledge and consent. Is it possible for Anilesh to escape liability for mis- statement in the prospectus?**

**Answer:** Section 35 (2) of the Companies Act, 2013 states that no person shall be liable under Sub-section (1) if he proves that the prospectus was issued without his knowledge or consent, and that on becoming aware of its issue, he forthwith gave a reasonable public notice that it was issued without his knowledge or consent.
The case of Anilesh is covered under the above exception provided by Sub-section (2) and therefore, he will escape liability for mis-statement in the prospectus.

## PUNISHMENT FOR FRAUDULENTLY INDUCING PERSONS TO INVEST MONEY [SECTION 36]

Any person who, either knowingly or recklessly makes any statement, promise or forecast which is false, deceptive or misleading, or deliberately conceals any material facts, **to induce another person to enter into, or to offer to enter into**,-

(a) **any agreement for**, or with a view to, **acquiring, disposing of, subscribing for, or underwriting securities**; or
(b) **any agreement**, the **purpose of which is to secure a profit to any of the parties from the yield of securities** or by reference to fluctuations in the value of securities; or
(c) **any agreement** for, or with a view to **obtaining credit facilities from any bank or financial institution**, shall be liable for action under section 447.

**Example –** A huge sums of money were collected under a document described as "project overview" by NRIs but shares not allotted in the proposed joint venture company instead the money was diverted to some off-shore companies controlled by the accused persons. Prima-facie offence under section 36 made-out.

## ACTION BY AFFECTED PERSONS [SECTION 37] – CLASS ACTION SUIT

According to Section 37, a suit may be filed or any other action may be taken under section 34, 35 or section 36 **by any person, group of persons or any association of persons affected by any misleading statement** or the inclusion or omission of any matter in the prospectus.

**Class action suit**

- The benefit of these type of suits is that **if several people have been injured by one defendant**, each of the injured person need not file a case separately **but all of the people can file one single case together against the defendant who has caused common harm.**
- In the case of class action suit, the class or the group of people filing the case need not be present in the court and can be represented by one petitioner.
    - The need for these types of suits was first felt in the context of securities market during the time of Satyam Scam, where a large group of persons was cheated and all such persons had to lose their hard-earned money invested in the stock market. During that time, it was felt that it was not at all viable and cost effective for a small stakeholder to file a case independently against the defendants. Millions of cheated investors during that time formed a large group and filed

the case against the company, but since there was no available legal remedy or law which could actually support this type of litigation initiated by a group, it became tough for those investors to take a recourse or gain advantage from the Indian Judicial System. Class action suits in India were so far filed under the guise of public interest litigations. Courts were free to dismiss them. These shareholders ran pillar to post right from the National Consumer Disputes Redressal Commission up to the extent of Supreme Court and ultimately had their claims rejected.

**EXAMPLE: M applies for equity shares of a company on the basis of a prospectus which contains mis–statement. The shares are allotted to him, who afterwards transfers them to N. Whether N can bring an action for a rescission on the ground of mis-statement under section 37 of the Companies Act, 2013?**

**Answer** – No. N cannot bring an action for rescission of the contract for buying shares from M on the ground of mis-statement made in the prospectus. Section 37 of the Companies Act, 2013 does not become applicable in such a situation. It is noteworthy that according to Section 37, a suit may be filed or any other action may be taken under section 34 or section 35 or section 36 only by any person, group of persons or any association of persons affected by any misleading statement or the inclusion or omission of any matter in the prospectus. Therefore, only M is eligible to file a suit

## PUNISHMENT FOR PERSONATION FOR ACQUISITION, ETC., OF SECURITIES [SECTION 38]

The purpose of the section is to prevent allotment of shares in fictitious names. Sub-section 1 provides, any person shall be liable for punishment under section 447, if:

a. He makes or abets the making of an application in a fictitious name to a company for acquiring, or subscribing for, its securities; or

b. He makes or abets the making of multiple applications in different names or different combinations of his name or surname for acquiring or subscribing for its securities; or

c. otherwise induces, directly or indirectly a company to allot or register any transfer of any securities to him or to any other person in a fictitious name.

Sub-section 2, provides that every company which issues a prospectus is required to reproduce prominently the provisions of the sub- section (1) in the prospectus and every form of application for securities.

Sub-section 3 provides, where a person has been convicted under the section, the court may order disgorgement of any gain made by such person. The order may also include seizure and disposal of securities which may be found in his possession.

## PUNISHMENT FOR FRAUD [SECTION 447]

## ALLOTMENT OF SECURITIES BY COMPANY [SECTION 39]

**Meaning of Allotment -** Till the allotment, as such the shares do not exist. It is on allotment that the shares come into existence.

Section 39 contains provisions in respect of **allotment of securities when there is a public offer**. Further, the Companies (Prospectus and Allotment of Securities) Rules, 2014 [PAS Rules] have also been issued.

**(1) Receipt of Minimum Amount is a must: No allotment of any securities of a company shall be made unless the amount stated in the prospectus as the minimum amount has been subscribed** and the **sums payable on application** have been paid to and received by the company by cheque or other instrument.

**(2) Quantum of Amount Payable on Application:** The **amount payable on application on every security shall not be less than 5 % of the nominal amount** of the security or **such other percentage** as may be specified by the SEBI.

**(3) Consequences if minimum amount is not subscribed:** If the stated **minimum amount has not been subscribed** and the sum payable on application is not received within a period of 30 days from the date of issue of the prospectus, or such other period as may be specified by the SEBI, the **amount received under sub-section (1) shall be returned**/ refunded **within a period of 15 days from the closure** of the issue and **if any such money is not so repaid** within such period, the directors of the company who are officers in **default shall jointly and severally be liable to repay that money with interest** at the rate of **15% per annum.**

**(4) Return of Allotment:** Whenever a company having a share capital makes any allotment of securities, it shall file with the Registrar a return of allotment **in Form PAS-3, within 30 days from allotment**.

**Documents to be attached with PAS-3 - Rule 12 of PAS Rules**

1) **A list of allottees** stating their names, address, occupation, if any, and number of securities allotted to each of the allottees and the list shall be certified by the signatory of the Form PAS-3 as being complete and correct as per the records of the company.

2) **Securities are issued for consideration other than cash:** According to Rule 12 (3), in the case of securities (not being bonus shares) **allotted as fully or partly paid up for consideration other than cash**, a **copy of the contract, duly stamped, pursuant to which the securities have been allotted** together with any contract of sale if relating to a property or an asset, or a contract for services or other consideration.

3) **Report of a Registered Valuer**

4) **Attachment of Resolution in case of Bonus Shares**

**(5) Punishment for Default:** In case of any default under sub-section (3) or sub-section (4), the company and its officer who is in default shall be liable to a penalty, for each default, of one thousand rupees for each day during which such default continues or one lakh rupees, whichever is less.

**#Practice Question**

**After having received 80% of the minimum subscription as stated in the prospectus, Raksha Detective Instruments Limited, before finalisation of the allotment, withdrew 50% of the said amount from the**

**bank for the purchase of certain assets. Thereafter, it started allotting the shares to the subscribers. Rashmi, one of the subscribers, was allotted 1000 equity shares. She, however, refused to accept the allotment on the ground that such allotment was violative of the provisions of the Companies Act, 2013.**

**Answer:** According to the above example, Raksha Detective Instruments Limited has received only 80% of the minimum subscription as stated in the prospectus. Since minimum amount has not been received in full, the allotment is in contravention of section 39 (1) of the Companies Act, 2013 which prohibits a company from making any allotment of securities until it has received the amount of minimum subscription stated in the prospectus. Further, under section 39 (3), such company is required to refund the application money received (i.e. 80% of the minimum subscription) to the applicants.

Therefore, in the present case, Rashmi is within her rights to refuse the allotment of shares which has been illegally made by the company.

## SECURITIES TO BE DEALT WITH IN STOCK EXCHANGES [SECTION 40]

(1) Every company **before making public offer** shall, make an **application to one or more recognised stock exchange** and obtain permission for the securities to be **dealt.**

(2) Where a prospectus states that an application under sub-section (1) has been made, such prospectus shall also state the names of such stock exchange

(3) All **monies received on application from the public** for subscription to the securities shall be **kept in a separate scheduled bank account** and **shall not be utilised for any purpose other than**—

(a) **for allotment** of securities; or
(b) for the **repayment of monies** within the time specified by SEBI

(4) Any **condition to waive compliance** with any of the requirements of this section **shall be void.**

(5) **Default**: **Company**: fine varying from 5 lakh rupees to 50 lakh rupees

**Officer:** punishable with ~~imprisonment upto 1 year~~, or with fine varying from 50 thousand rupees to 3 lakh rupees, ~~or with both.~~

**(6) Payment of commission**: A company may pay commission to any person in connection with the subscription to its securities, in accordance with **Rule 13 of the Companies (Prospectus and Allotment of Securities) Rules, 2014.**

**Conditions for the payment of commission:**

(a) the payment of such commission shall be **authorized in the company's AOA**

(b) the commission may be paid out of **proceeds of the issue** or the **profit of the company** or both;

(c) **Rate of commission**: The rate of commission shall not exceed,

- **IN CASE OF SHARES**, **5% of the price at which the shares** are issued **or** a rate authorised by the **articles**, **whichever is less**, and
- **IN CASE OF DEBENTURES**, **2.5 % of the price at which the debentures** are issued, or as specified in the company's **articles**, **whichever is less;**

(d) The **prospectus of the company shall disclose** the following particulars -

(i) the **name of the underwriters**;
(ii) the **rate and amount of the commission payable** to the underwriter; and
(iii) the **number of securities which is to be underwritten or subscribed by the underwriter** absolutely or conditionally.

(f) A **copy of the contract for the payment of commission is delivered to the Registrar** at the time of delivery of the prospectus for registration.

**#Practice Question:**

**The Board of Directors of a company decide to pay 5% of the issue price of shares as underwriting commission to the underwriters. However, the Articles of Association of the company permit only 3% commission. The Board of Directors further decide to pay the commission out of the proceeds of the share capital. Are the decisions taken by the Board of Directors valid under the Companies Act, 2013?**

**Answer**: Under Rule 13 of the Companies (Prospectus and Allotment of Securities) Rules, 2014 the rate of commission paid or agreed to be paid shall not exceed, in case of shares, five percent (5%) of the price at which the shares are issued or a rate authorised by the articles, whichever is less.

The same rule allows the commission to be paid out of proceeds of the issue or the profit of the company or both.

Therefore, the decision of the Board of Directors to pay 5% commission to the underwriters is invalid since the same cannot exceed the rate which is permitted by the Articles. However, the decision to pay commission out of the proceeds of the share issue is valid provided it is paid at the rate authorised by the Articles.

## GLOBAL DEPOSITORY RECEIPT [SECTION 41]

A global depository receipt is a general name for a depository receipt where a certificate issued by a depository bank, which purchases shares of foreign companies, creates a security on a local exchange backed by those shares.

GDR as per section 2(44) of this Act means any instrument in the form of a depository receipt, by whatever name called , created by a foreign depository outside India & authorized by a company making an issue of such depository receipts.

Section 41 provides, company may issue depository receipts in any foreign country after passing a **special resolution in its general meeting** and subject to such conditions as may be prescribed in the Companies (Issue of Global Depository Receipts) Rules, 2014 (as further amended in 2020).

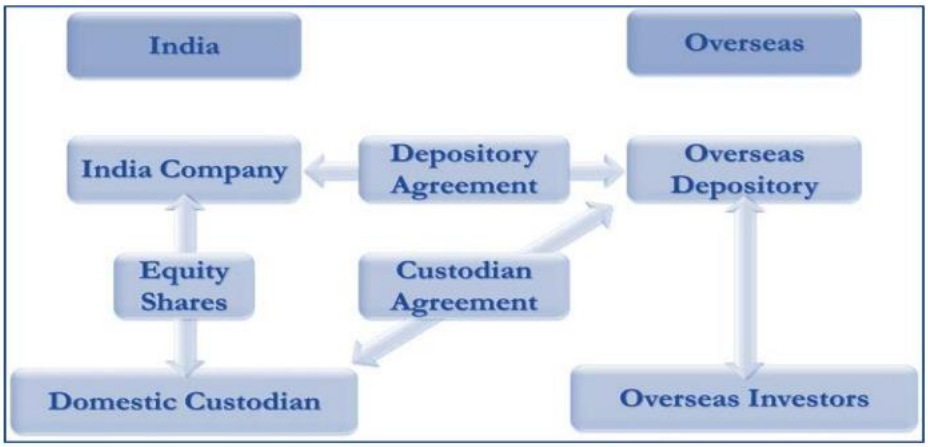
### MANNER AND FORM OF DEPOSITORY RECEIPTS

The depository receipts can be issued by way of public offering or private placement or in any other manner prevalent in the concerned jurisdiction and may be listed or traded on the listing or trading platform in the concerned jurisdiction.

The depository receipts may be issued against issue of new shares or may be sponsored against shares held by shareholders of the company in accordance with such conditions as the Central Government or Reserve Bank of India may prescribe or specify from time to time.

The underlying shares shall be allotted in the name of the overseas depository bank and against such shares, the depository receipts shall be issued by the overseas depository bank.

**HOW GDR OPERATES?**




**VOTING RIGHT**

A holder of depository receipts may become a member of the company and shall be entitled to vote as such only on conversion of the depository receipts into underlying shares after following the procedure provided in the Scheme and the provisions of this Act

Until the conversion of depository receipts, the overseas depository shall be entitled to vote on behalf of the holders of depository receipts in accordance with the provisions of the agreement entered into between the depository, holders of depository receipts and the company in this regard.

**PRIVATE PLACEMENT [SECTION 42]**

- "Private placement" means any offer of securities or invitation to subscribe securities to a **select group of persons** by a company (other than by way of public offer) through issue of a **private placement offer letter**.

**Requirements of offer or invitation for subscription of securities on private placement: [Section 42] They are also supplemented by Rule 14 the Companies (Prospectus and Allotment of Securities) Rules, 2014 [PAS Rules].**

**1) Offer to be made only to a Select Group of Persons**

- A private placement shall be made **only to a select group of persons who have been identified by the Board** (herein referred to as "identified persons"),

whose number shall not exceed **50 or such higher number as may be prescribed**, **in a financial year.** According to Rule 14 (2) of the PAS Rules, Private placement shall not be made to persons more than **200 in the aggregate in a financial year**

**#Questionable point:**

1) As the higher amount is prescribed, the limit to be followed is 200

2) Qualified institutional buyers, or employees under a scheme of employees' stock option shall not be considered while calculating the limit of two hundred persons.

3) The limit is to be considered for each individual security. (Pref, equity, debenture, etc)\

4) **Any offer or invitation not in compliance with the provisions of this section SHALL BE TREATED AS A PUBLIC OFFER** and all provisions of this Act, and the Securities Contracts (Regulation) Act, 1956 (42 of 1956) and the SEBI Act, 1992 (15 of 1992) shall be required to be complied with.

### 2)Non-applicability of Sub-rule (2):

The provisions of sub-rule (2) shall not be applicable to -

(a) non-banking financial companies (NBFCs) which are registered with the RBI; and

(b) housing finance companies (HFCs) which are registered with the National Housing Bank;

if they are complying with regulations made by the RBI or the National Housing Bank in respect of offer or invitation to be issued on private placement basis

### 2) Requirement of Special resolution: Rule 14 (1)

A company shall not make an offer or invitation to subscribe to securities through private placement **unless the proposal has been previously approved by the shareholders** of the company, by a special resolution for each of the offers or invitations.

**In the explanatory statement annexed to the notice for shareholders' approval, the following disclosure shall be made:-**

- Particulars of the offer including date of passing of Board resolution;
- kinds of securities offered and the price at which security is being offered;
- basis or justification for the price (including premium, if any) at which the offer or invitation is being made;
- name and address of valuer who performed valuation;
- amount which the company intends to raise by way of such securities;
- material terms of raising such securities, proposed time schedule, purposes or objects of offer, contribution being made by the promoters or directors either as part of the offer or separately in furtherance of objects; principle terms of assets charged as securities.

This rule shall not apply in case of offer or invitation for non-convertible debentures, where the proposed amount to be raised through such offer or invitation does not exceed the limit as specified in clause (c) of sub section (1) of section 180 and in such cases relevant Board resolution under clause (c) of sub-section (3) of section 179 would be adequate

**Questionable Point:** As per the fourth proviso to Rule 14(1), in case of offer or invitation of any securities to qualified institutional buyers, it shall be sufficient if the company **passes a previous special resolution only in a year for all the allotments to such buyers during the year**.

### 3)Private Placement Offer and Application:

A private placement offer cum application letter shall be in the form of an **application in Form PAS-4** serially numbered and addressed specifically to the person to whom the offer is made and shall be sent to him, either in writing or in electronic mode, **within 30 days of recording the name of such person** pursuant to section 42 (3).

It is provided that no person other than the person so addressed in the private placement offer cum application letter shall be allowed to apply through such application form and any application not conforming to this condition shall be treated as invalid.

**#Questionable Point:** It is provided that the private placement offer and application shall not carry any right of renunciation

**5)Maintaining of Complete Record: According to Rule 14 (4) of the PAS Rules,**

The company shall maintain a **complete record of private placement** offers in **Form PAS-5.**

**6) Timing of issue of private placement offer cum application letter:**

According to Rule 14 (8) of the PAS Rules, a company **shall issue private placement offer cum application letter only after** the relevant special resolution or Board resolution has been **filed in the Registrar**

**7)Manner of Subscribing to the Private Placement Issue:**

Every identified person willing to subscribe shall apply in the private placement and application issued to such person along with subscription money paid either **by cheque or demand draft or other banking channel** and **not by cash.**

**#Questionable Point:** It is provided that a company shall not utilise monies raised through private placement unless allotment is made and the return of allotment is filed with the Registrar in accordance with sub-section (8) of Section 42

Rule 14 (5) of the PAS Rules provides that the payment to be made for subscription to securities shall be made from the bank account of the person subscribing to such securities and the company shall keep the record of the bank account from where such payment for subscription has been received

**#Questionable Point:** In case of joint holders, it is provided that monies payable on subscription to securities to be held by joint holders shall be paid from the bank account of the person whose name appears first in the application

**Pratice Question:**

Ruhi and her younger brother Sohit were offered jointly 1000 equity shares of ` 100 each by Soumya Software Private Limited under the issue of shares on private placement basis. From whose account the company is required to take subscription money for 1000 equity shares?

**Answer:** According to the first Proviso of Rule 14 (5) of the PAS Rules, monies payable on subscription to securities to be held by joint holders shall be paid from the bank account of the person whose name appears first in the application. It is presumed that Ruhi's name appears first in the application and therefore, the subscription of ` 1,00,000 shall be payable by her from her account. It is obligatory for the company to ensure that the money is paid from her bank account and not from the bank account of her younger brother Sohit

**8)Limit on Fresh Offer:**

No fresh offer or invitation under this section shall be made **unless the allotments with respect to any offer or invitation made earlier have been completed** or that offer or invitation has been withdrawn or abandoned by the company.

**9)Time Limit for Allotment of Securities:**

- A company making an offer or invitation under this section shall **allot its securities within 60 days from the date of receipt of the application money** for such securities and

- if the company is not able to allot the securities within that period, **it shall repay the application money** to the subscribers within 15 days from the expiry of sixty days and
- if the company fails to repay the application money within the aforesaid period, it shall be **liable to repay that money with interest at the rate of 12% per annum from the expiry of the 60th day**.
- It is provided that the monies received on application under this section shall be kept in a **separate scheduled bank account** and shall not be utilised for any purpose other than—
  - for adjustment against allotment of securities; or

for the repayment of monies where the company is unable to allot securities

**10)Prohibition on Public Advertisement:**

No company issuing securities under this section shall release any public advertisements or utilise any media, marketing or distribution channels or agents to inform the public at large about such an issue.

**11)Filing of Return of Allotment:**

A company making any allotment of securities under this section, **shall file with the Registrar a return of allotment within 15 days** from the date of the allotment in **Form PAS-3.**

As regards Return of Allotment, Rule 14 (6) of the PAS Rules states that a return of allotment shall be filed along with a **complete list of all the allottees containing**-

(i) the full name, address, Permanent Account Number and E-mail ID of such security holder;

(ii) the class of security held;

(iii) the date of allotment of security;

(iv) the number of securities held, nominal value and amount paid on such securities, and particulars of consideration received if the securities were issued for consideration other than cash.

If a company defaults in filing the return of allotment within the period prescribed under sub-section (8), the company, its promoters and directors shall be liable to a penalty for each default of one thousand rupees for each day during which such default continues but not exceeding 25 lakh rupees.

**12)Punishment for Contravening the Private Placement Provisions:**

Subject to sub-section (11), if a company makes an offer or accepts monies in contravention of section 42, the company, its promoters and directors shall be liable for a penalty which **may extend to the amount raised through the private placement or two crore rupees, whichever is lower**, and the company shall also refund all monies with interest as specified in sub-section (6) to subscribers within a period of thirty days of the order imposing the penalty.

**Questions and Answer**

1. **Explain various instances which make the allotment of securities as irregular allotment under the Companies Act, 2013.**

**Answer**

Irregular allotment: The Companies Act, 2013 does not specifically provide for the term "Irregular Allotment" of securities. Hence, we have to examine the requirements of a proper issue of securities and consider the consequences of non- fulfillment of those requirements.

In broad terms an allotment of shares is deemed to be irregular when it has been made by a company in violation of Sections 23, 26, 39 or 40. Irregular allotment therefore arises in the following instances:

1. Where a company does not issue a prospectus in a public offer as required by section 23; or
2. Where the prospectus issued by the company does not include any of the matters required to be included therein under section 26 (1), or the information given is misleading, faulty and incorrect; or
3. Where the prospectus has not been filed with the Registrar for filing under section 26 (4); or
4. The minimum subscription as specified in the prospectus has not been received in terms of section 39; or
5. The minimum amount receivable on application is less than 5% of the nominal value of the securities offered or lower than the amount prescribed by SEBI in this behalf; or
6. In case of a public issue, approval for listing has not been obtained from one or more of the recognized stock exchanges under section 40 of the Companies Act, 2013.

2. **What is a Shelf-Prospectus? State the important provisions relating to the issuance of Shelf-Prospectus under the provisions of the Companies Act, 2013 and the Companies (Prospectus and Allotment of securities) Rules, 2014.**

**Answer**

Shelf prospectus – As per the Explanation given in Section 31 of the Companies Act, 2013, the expression "shelf prospectus" means a prospectus in respect of which the securities or class of securities included therein are issued for subscription in one or more issues over a certain period without the issue of a further prospectus.

Provisions relating to the issue of Shelf-prospectus are as under:

(1) Filing of shelf prospectus with the Registrar: According to section 31 (1), any class or classes of companies, as the Securities and Exchange Board may provide by regulations in this behalf, may file a shelf prospectus with the Registrar at the stage-

(i) of the first offer of securities included therein which shall indicate a period not exceeding one year as the period of validity of such prospectus which shall commence from the date of opening of the first offer of securities under that prospectus, and

(ii) in respect of a second or subsequent offer of such securities issued during the period of validity of that prospectus, no further prospectus is required.

(2) Filing of Information Memorandum with the Shelf Prospectus: According to Section 31 (2), a company filing a shelf prospectus shall be required to file an information memorandum containing all

material facts relating to new charges created, changes in the financial position of the company as have occurred between the first offer of securities or the previous offer of securities and the succeeding offer of securities and such other changes as may be prescribed, with the Registrar within the prescribed time, prior to the issue of a second or subsequent offer of securities under the shelf prospectus.

(3) Intimation of Changes: According to Proviso to Section 31 (2), where a company or any other person has received applications for the allotment of securities along with advance payments of subscription before the making of any such change, the company or other person shall intimate the changes to such applicants and if they express a desire to withdraw their application, the company or other person shall refund all the monies received as subscription within fifteen days thereof.

According to Rule 10 of the Companies (Prospectus and Allotment of securities) Rules, 2014, the information memorandum shall be prepared in Form PAS-2 and filed with the Registrar along with the fee as provided in the Companies (Registration Offices and Fees) Rules, 2014 within one month prior to the issue of a second or subsequent offer of securities under the shelf prospectus.

(4) Information Memorandum together with the Shelf Prospectus is deemed Prospectus: According to Section 31 (3), where an information memorandum is filed, every time an offer of securities is made under sub- section (2), such memorandum together with the shelf prospectus shall be deemed to be a prospectus.

**3. The Board of Directors of Chandra Mechanical Toys Limited proposes to issue a prospectus inviting offers from the public for subscribing to the equity shares of the Company. State the reports which shall be included in the prospectus for the purposes of providing financial information under the provisions of the Companies Act, 2013.**

**Answer**

As per section 26(1) of the Companies Act, 2013, every prospectus issued by or on behalf of a public company either with reference to its formation or subsequently, or by or on behalf of any person who is or has been engaged or interested in the formation of a public company, shall be dated and signed and shall state such information and set out such reports on financial information as may be specified by the Securities and Exchange Board in consultation with the Central Government.

It is provided that until the Securities and Exchange Board specifies the information and reports on financial information under this sub-section, the regulations made by the Securities and Exchange Board under the Securities and Exchange Board of India Act, 1992, in respect of such financial information or reports on financial information shall apply.

According to clause (c) of Section 26 (1), the prospectus shall make a declaration about the compliance of the provisions of the Companies Act, 2013 and a statement to the effect that nothing in the prospectus is contrary to the provisions of this Act, the Securities Contracts (Regulation) Act, 1956 and the Securities and Exchange Board of India Act, 1992 and the rules and regulations made thereunder.

Accordingly, the Board of Directors of Chandra Mechanical Toys Limited which proposes to issue the prospectus shall provide such reports on financial information as may be specified by the Securities and Exchange Board in consultation with the Central Government to comply with the above stated provisions and make a declaration about such compliance.

**4. Unique Builders Limited decides to pay 2.5 percent of the value of debentures as underwriting commission to the underwriters but the Articles of the company authorize only 2.0 percent**

**underwriting commission on debentures. The company further decides to pay the underwriting commission in the form of flats. Examine the validity of the above arrangements under the provisions of the Companies Act, 2013.**

**Answer**

Section 40 (6) of the Companies Act 2013, provides that a company may pay commission to any person in connection with the subscription to its securities, subject to a number of conditions which are prescribed under the Companies (Prospectus and Allotment of Securities) Rules, 2014. In relation to the case given, the conditions applicable under the above Rules are as under:

(a) The payment of such commission shall be authorized in the company's articles of association;

(b) The commission may be paid out of proceeds of the issue or the profit of the company or both;

(c) The rate of commission in case of debentures, shall not exceed two and a half per cent (2.5%) of the price at which the debentures are issued, or as specified in the company's articles, whichever is less.

Thus, the underwriting commission in case of debentures is limited to 2.5%.

In view of the above, the decision of Unique Builders Limited to pay underwriting commission exceeding 2% as prescribed in the Articles is invalid.

The company may pay the underwriting commission in the form of flats as both the Companies Act and the Rules do not impose any restriction on the mode of payment though the source has been restricted to either the proceeds of the issue or profits of the company.

5. **PQR Bakers Limited wants to raise funds for its upcoming project. Accordingly, it has issued private placement offer letters for issuing equity shares to 55 persons, of which four are qualified institutional buyers and remaining are individuals. Before the completion of allotment of equity shares under this offer letter, company issued another private placement offer letter to another 155 persons in their individual names for issue of its debentures. Being a public company is it possible for PQR Bakers Limited to issue securities under a private placement offer? By doing so, whether the company is in compliance with provisions relating to private placement or should these offers be treated as public offers? What if the offer for debentures is given after allotment of equity shares but within the same financial year?**

**Answer**

According to section 42 of the Companies Act, 2013 any private or public company may make private placement through issue of a private placement offer letter.

However, the offer shall be made to the persons not exceeding fifty or such higher number as may be prescribed, in a financial year. For counting number of persons, Qualified Institutional Buyers (QIBs) and employees of the company being offered securities under a scheme of employees' stock option will not be considered.

Further, Rule 14 (2) of the Companies (Prospectus and Allotment of Securities) Rules, 2014 prescribes maximum of 200 persons who can be offered securities under the private placement in a financial year, though this limit should be counted separately for each type of security.

It is to be noted that if a company makes an offer or invitation to more than the prescribed number of persons, it shall be deemed to be an offer to the public and accordingly, it shall be governed by the provisions relating to prospectus.

Also, a company is not permitted to make fresh offer under this section if the allotment with respect to any offer made earlier has not been completed or otherwise, that offer has been withdrawn or abandoned by the company. This provision is applicable even if the issue is of different kind of security.

Any offer or invitation not in compliance with the provisions of this section shall be treated as a public offer and all provisions will apply accordingly.

In the given case PQR Bakers Limited, though a public company but the private placement provisions allow even a public company to raise funds through this route. The company has given offer to 55 persons out of which 4 are qualified institutional buyers and hence, the offer is given effectively to only 51 persons which is well within the limit of 200 persons. From this point of view, the company complies the private placement provisions.

However, as per the question, the company has given another private placement offer of debentures before completing the allotment in respect of first offer and therefore, the second offer does not comply with the provisions of section 42. Hence, the offers given by the company will be treated as public offer.

In case the company gives offer for debentures in the same financial year after allotment of equity shares is complete then both the offers can well be treated as private placement offers.

**6. How does the Companies Act, 2013 regulate and restrict the following matters in respect of a company going for public issue of shares:**

**(i) Minimum Amount stated in the Prospectus; and**

**(ii) Application Money payable on shares.**

**Answer**

The Companies Act, 2013 by virtue of the provisions as contained in Section 39 (1) and (2) regulates and restricts the minimum amount stated in the prospectus and the application money payable in a public issue of shares as under:

Minimum amount stated in a prospectus [Section 39 (1)]

No Allotment shall be made of any securities of a company offered to the public for subscription; unless; -

(i) the amount stated in the prospectus as the minimum amount has been subscribed; and

(ii) the sums payable on application for such amount has been paid to and received by the company.

Application money: Section 39 (2) provides that the amount payable on application on each security shall not be less than 5% of the nominal amount of such security or such amount as SEBI may prescribe by making any regulations in this behalf.

Further section 39 (3) provides that if the stated minimum amount is not received by the company within 30 days of the date of issue of the prospectus or such time as prescribed by SEBI, the company

will be required to refund the application money received within such time and manner as may be prescribed.

Rule 11 (1) of the Companies (Prospectus and Allotment of Securities) Rules, 2014 mentions that if the stated minimum amount has not been subscribed and the sum payable on application is not received within the period specified therein, then the application money shall be repaid within a period of fifteen days from the closure of the issue and if any such money is not so repaid within such period, the directors of the company who are officers in default shall jointly and severally be liable to repay that money with interest at the rate of fifteen percent per annum.

In case of any default, the company and its officer who is in default shall be liable to a penalty, for each default, of one thousand rupees for each day during which such default continues or one lakh rupees, whichever is less.

Section 40 (3) provides that all moneys received on application from the public for subscription to the securities shall be kept in a separate bank account maintained with a scheduled bank.

**7. The Board of Directors of Reckless Investments Limited, having registered office at Mumbai, has allotted equity shares to the 550 investors of the company without issuing a prospectus. As no prospectus was issued, nothing was delivered to the Registrar of Companies, Mumbai for filing. Explain the remedy available to the investors in this regard.**

**Answer**

According to Section 23 of the Companies Act, 2013, a public company can issue securities to the public only by issuing a prospectus. Further, where the limit crosses 200 investors the issue shall be deemed to be a public offer, as provided by Section 42. Section 26 (1) lays down the matters required to be disclosed and included in a prospectus and requires the delivery of the prospectus to the Registrar for filing before its issue.

In the given case, the company has violated the above provisions and therefore, the allotment made by it is void. The company will be required to refund the entire moneys received and will also be punishable under section 26 (9).

**8. An allottee of shares in a company brought action against a director in respect of false statements made in the prospectus. The director contended that the statements were prepared by the promoters and he simply relied on them. Is the director liable under these circumstances? Decide referring to the provisions of the Companies Act, 2013.**

**Answer**

Yes, the Director shall be held liable for the false statements made in the prospectus under sections 34 and 35 of the Companies Act, 2013. Whereas section 34 imposes a criminal punishment on every person who authorises the issue of such prospectus, section 35 more particularly includes a director of the company in the imposition of liability for such mis-statements.

The only situations when a director will not incur any liability for mis-statements in a prospectus are as under:

(a) No criminal liability under section 34 shall apply to a person if he proves that such statement or omission was immaterial or that he had reasonable grounds to believe, and did up to the time of issue of the prospectus believe, that the statement was true or the inclusion or omission was necessary.

(b) No civil liability for any mis-statement under section 35 shall apply to a person if he proves that:

(1) having consented to become a director of the company, he withdrew his consent before the issue of the prospectus, and that it was issued without his authority or consent; or

(2) the prospectus was issued without his knowledge or consent, and that on becoming aware of its issue, he forthwith gave a reasonable public notice that it was issued without his knowledge or consent.

Therefore, in the present case the director cannot escape the liability by stating that he had relied on the promoters for making correct statements in the prospectus. He will be liable for mis-statements in the prospectus.

**9. Sudarshan Exports Limited was dealing in export of rubber to specified foreign countries. The company was willing to purchase rubber trees in A.P. State. The prospectus issued by the company contained some important extracts of the expert's report and number of trees in A.P. State. The report was found untrue. Mr. Alok purchased the shares of Sudarshan Exports Limited on the basis of the expert's report published in the prospectus. Will Mr. Alok have any remedy against the company? State also the circumstances where an expert is not liable under the Companies Act, 2013.**

**Answer**

Under section 35 (1) of the Companies Act 2013, where a person has subscribed for securities of a company acting on any statement included in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, the company and every person including an expert shall be liable to pay compensation to the person who has sustained such loss or damage.

In the present case, Mr. Alok purchased the shares of Sudarshan Exports Limited on the basis of the expert's report published in the prospectus. Mr. Alok can claim compensation for any loss or damage that he might have sustained from the purchase of shares, which has not been mentioned in the given case. Further, Section 35 also mentions punishment prescribed by section 36 i.e. punishment for fraud under section 447.

Circumstances when an expert is not liable: An expert will not be liable for any mis-statement in a prospectus under the following situations:

(i) Under Section 26 (5): It states that having given his consent, the expert withdrew it in writing before delivery of the copy of prospectus for filing, or

(ii) Under section 35 (2) (b): It states that the prospectus was issued without his knowledge/consent and that on becoming aware of it, he forthwith gave a reasonable public notice that it was issued without his knowledge or consent;

(iii) An expert will not be liable in respect of any statement not made by him in the capacity of an expert and included in the prospectus as such;

(iv) Under Section 35 (2) (c): It states that, as regards every misleading statement purported to be made by an expert or contained in what purports to be a copy of or an extract from a report or valuation of an expert, it was a correct and fair representation of the statement, or a correct copy of, or a correct and fair extract from, the report or valuation; and he had reasonable ground to believe and did up to the time of the issue of the prospectus believe, that the person making the statement

was competent to make it and that the said person had given the consent required by section 26(5) to the issue of the prospectus and had not withdrawn that consent before filing of a copy of the prospectus with the Registrar or, to the defendant's knowledge, before allotment thereunder.

**10. Examine the validity of the following statement with reference to the provisions of the Companies Act, 2013.**

**"The Articles of Association of X Limited contain a provision that the underwriting commission may be paid up to 4% of the issue price of the shares. However, the Board of Directors have decided to pay the underwriting commission of 5% to Deal & Co., the underwriters."**

**Answer**

Section 40 (6) of the Companies Act 2013, provides that a company may pay commission to any person in connection with the subscription to its securities, subject to the conditions prescribed under the Companies (Prospectus and Allotment of Securities) Rules, 2014. Rule 13 states that the rate of commission paid or agreed to be paid shall not exceed, in case of shares, five percent (5%) of the price at which the shares are issued or a rate authorised by the articles, whichever is less.

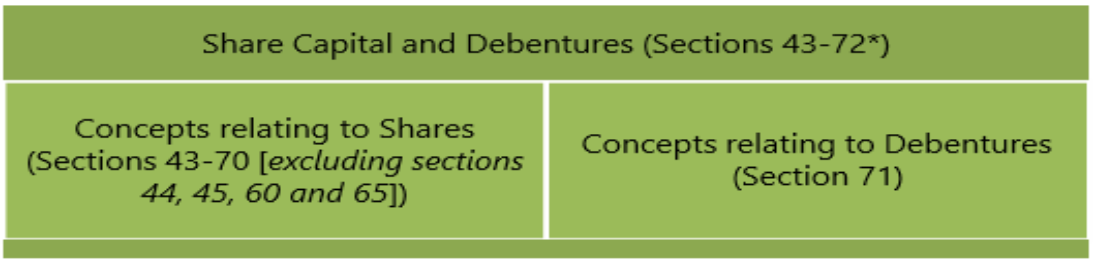
In the given problem, the articles of X Ltd. have prescribed 4% underwriting commission but the directors decided to pay 5% underwriting commission.

Therefore, the decision of the Board of Directors to pay 5% underwriting commission to the underwriters (i.e. Deal & Co.) is invalid.

# Chapter 4

# SHARE CAPITAL AND DEBENTURES

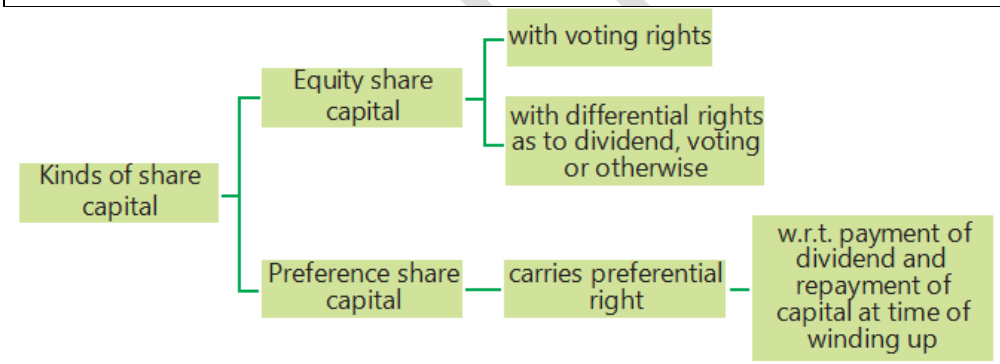
## SECTION AND OVERVIEW




Shares and debentures are financial instruments for raising funds for the company. Under the Companies Act, 2013, these are jointly referred to as "Securities".

Generally, shares depict ownership interest in a company with entrepreneurial risks and rewards whereas debentures depict lender's interest in the company with limited risks and returns.

## SHARE CAPITAL-TYPES




**(1) Definition of Share and Stock:** Section 2(84) defines share as a share in the share capital of a company and includes stock.

The share capital of a company is divided into small units having a certain face value. Each such unit is termed as **share**

**(2) Two Kinds of Share Capital**: There are **2 kinds of share capital limited by shares**:

- Equity share capital
- Preference share capital.

**1) Preferential Share capital:** The Act defines preference share capital as **instruments which have preferential right to dividend payment** and **preferential repayment during winding up of the company.** These shareholders can also participate in equity pool post the preferential entitlements.

**2) Equity Shares:** Shares which are not preference shares are termed as equity shares.

Equity shares are further classified as **plain vanilla** (same voting rights) or **differential equity shares** (differential with respect to dividend or voting rights or otherwise).

According to Section 43, the share capital of a company limited by shares shall be of **two kinds, namely: —**

**(a) equity share capital—**

(i) with voting rights; or

(ii) with differential rights as to dividend, voting; and

**# Real Life scenario:**

In Indian there are 2 companies which have issued differential voting rights shares (DVRs):

- **Tata Motors**
- **Future Retail**

**Illustration – Q&A**

**Can a company have only preference share capital?**

**Answer** – It may be noted that while a company may have only equity share capital but it cannot have only preference share capital. This is because preference shareholders have certain 'preferential rights' over the equity shareholders. Thus, in the absence of equity share capital, there cannot be preferential share capital

**Equity Share Capital [Section 43(a) read with explanation I to section 43]**

Shares capital which are not preference shares capital are termed as **equity shares capital**. Equity share capital are further classified as;

a. Equity share with **voting right (Plain vanilla**, because equitable/same voting rights) or

b. Equity share with **differential rights** with respect to dividend or voting rights or otherwise in accordance with Rule 4 of the Companies (Share capital and Debenture) Rules, 2014.

**[Rule 4 of the Companies (Share capital and Debenture) Rules, 2014]**

**(i) Conditions for the issue of equity shares with differential rights:**

A company limited by shares may issue equity shares with differential rights as to dividend, voting, **if it complies with the following conditions, namely:**

(a) **ARTICLES: The articles of the company authorizes** the issue of shares with differential rights;

(b) **ORDINARY RESOLUTION:** the issue of shares is **authorized by an ordinary resolution**.

**In case of listed company**, the issue of such shares shall be approved by the shareholders through **postal ballot**;

(c) **MAXIMUM VOTING:** The **voting power in respect of shares with differential rights**, **shall not exceed 74% of total voting power** including voting power in respect of equity shares with differential rights issued at any point of time;

d. The company has not defaulted in **filing annual accounts** and **annual returns** for the **3 financial years** preceding the year in which it was decided to issue such shares

(e) **FINANCIAL STATEMENTS and ANNUAL RETURNS**: the **company has not defaulted in filing financial statements and annual returns** for **3 financial years** immediately preceding the financial year in which it is decided to issue such shares;

(f) **NO DEFAULT:** the company has **no subsisting default in the payment of a declared dividend** to its shareholders or repayment of its **matured deposits** or redemption of its **preference shares or debentures** that have become due for redemption or **payment of interest** on such deposits or debentures or payment of dividend;

(g) the company has **not defaulted in repayment of** any term loan from a **public financial institution** or **State level financial institution** or **scheduled Bank** or **interest payable thereon** or **dues with respect to statutory payments** relating to its employees to any authority or **default in crediting the amount in Investor Education and Protection Fund** to the Central Government;

| |
|---|
| **#Questionable point:** It is provided that a company may issue equity shares with differential rights **upon expiry of 5 years** from the end of the financial Year in which such default was made good. |

(h) **NOT PENALIZED:** the **company has not been penalized by Court or Tribunal during the last 3 years** of any offence under the RBI Act, 1934, the SEBI Act, 1992, the Securities Contracts Regulation Act, 1956 (SCRA), the Foreign Exchange Management Act, 1999 (FEMA) or any other special Act, under which such companies being regulated by sectoral regulators.

(ii) **CONTENTS OF EXPLANATORY STATEMENT**: Rule 4 (2) states that the explanatory statement to shall contain various matters like particulars of the issue including its size, details of differential rights, etc.

(iii) **NO CONVERSION:** The company **shall not convert its existing equity share capital with voting rights into equity share capital carrying differential voting rights** and vice versa.

(iv) **DISCLOSURE IN THE BOARD'S REPORT**: The Board of Directors shall disclose the particulars of such in the Board's Report for the financial year.

(v) **THEY SHALL BE INCLUDED IN OTHER RIGHTS:** The holders of differential rights Equity shall **enjoy all other rights** such as bonus shares, rights shares, etc., which the holders of equity shares are entitled to.

(vi) **REGISTER OF MEMBERS**: The Register of Members maintained under section 88 shall contain all the relevant particulars of the shares so issued along with details of the shareholders.

**#Practice Question:**

Swagat Hospitality Limited defaulted in the repayment of last two instalments of term loan availed from National Commercial Bank. On 30th September, 2019, they cleared all the dues by repaying it. When can it issue equity shares with differential voting rights?

(a) Upon expiry of five years from the date on which the default was made good

(b) Upon expiry of three years from the end of the financial Year in which the default was made good

(c) Upon expiry of five years from the end of the financial Year in which the default was made good

(d) Upon expiry of seven years from the end of the financial Year in which the default was made good

**Answer:** (c) Upon expiry of five years from the end of the financial Year in which the default was made good

## CERTIFICATE OF SHARES [SECTION 46]

**PRIMA FACIE EVIDENCE OF TITLE**

**A certificate of shares is required when shares are issued in physical form.** Section 46 contains provisions which regulate certificate of shares. They are stated as under:

(1) **SIGNATURE:** 46(1) A certificate, issued under the

- **COMMON SEAL**, if any, of the company or

- signed by **2 directors** or by a **director and the CS**, if the company has appointed a CS,

**specifying the shares held by any person**, shall be prima facie evidence of the title of the person to such shares.

(2) **ISSUE OF DUPLICATE CERTIFICATE**: 46 (2) states that a duplicate certificate of shares may be issued, if such certificate —

(a) is **proved to have been lost** or destroyed; or

(b) has been **defaced, mutilated or torn and is surrendered** to the company.

(3) **MANNER OF ISSUE OF CERTIFICATES/DUPLICATE CERTIFICATES:** According to section 46 (3), notwithstanding anything contained in the articles of a company, the manner of issue of a certificate of shares or the duplicate thereof, the form of such certificate, the particulars to be entered in the register of members and other matters shall be such as may be prescribed.

(4) **SHARES HELD IN DEPOSITORY FORM:** According to Section 46 (4), where a share is held in depository form, the record of the depository is the prima facie evidence of the interest of the beneficial owner.

(5) If a **company with intent to defraud issues a duplicate certificate of shares**, the **punishment shall** be as under:

• **THE COMPANY** shall be punishable with fine which shall not be less than **5 times the face value of the shares involved in the issue** of the duplicate certificate but **which may extend to 10 times** the face value of such shares or **rupees 10 crores whichever is higher**; and

• **EVERY OFFICER** of the company who is in default shall be liable **under section 447.**

The aforesaid requirements **are not applicable in case of dematerialised shares** held in electronic form with any depository. In such a case, records of the depository will be treated as prima facie evidence of the interest of the beneficial owner.

1. **Dematerialisation (in short 'Demat') of Securities:** After the depositories started functioning in India, the listed shares are required to be held in electronic form. Even banks and financial institutions insist for demat of securities for creation of charge. Now, Rule 9A (inserted w.e.f. 2-10-2018) of the Companies (Prospectus and Allotment of Securities) Rules, 2014, requires every unlisted public company to issue the securities only in dematerialised form and also facilitate dematerialisation of all its existing securities. [**Refer Chapter 3**]
2. It is to be noted that only unlisted public companies are covered by Rule 9A and, it is not necessary for a private limited company to get its securities dematerialised.
3. At present, there are two depositories available in India i.e. NSDL and CDSL. Various depository participants (DPs) are linked to them. Dematerialised securities are held by the investors in their respective accounts with the DP which keeps a track of transfer, transmission, charge creation etc. There are necessary enabling legal enactments to facilitate all such procedures.

**PUNISHMENT FOR ISSUING DUPLICATE CERTIFICATE OF SHARES WITH INTENT TO DEFRAUD [Sub-section 5]**

| Liable | Minimum Fine | Maximum Fine |
|---|---|---|
| Company | Five times the face value of the shares involved | Higher of: Ten times the face value of such shares or Rupees ten crores |
| **And** | | |
| Every officer of the company who is in default | Liable for action under section 447<br>**Note** – Provisions of Section 447 already explained as separate topic under chapter 3 of this module | |

**Example 3** – It is observed that Golden Apple Transport Limited issued share certificates in duplicate with intend to defraud. The total shares in regard to which such certificates are issued are nearly 12,00,000. Face value of each share is ` 10. The maximum fine that can be imposed on company shall be ` 12,00,00,000

**VOTING RIGHTS [SECTION 47]**

**Section 47 governs the voting rights of the members of a company.**

**(i) Voting Rights of Members holding EQUITY SHARE CAPITAL:** Section 47 (1) states that subject to the provisions of section 43, section 50 (2) and section 188 (1)-

(a) every member of a company limited by shares and holding equity share capital therein, **shall have a right to vote on every resolution placed before the company**; and

(b) his voting **right on a poll shall be in proportion to his share** in the paid-up equity share capital of the company.

**(ii) Voting Rights of Members holding PREFERENCE SHARE CAPITAL:** In respect of such capital, have—

- a right to **vote only on resolutions which directly affect the rights** attached to his preference shares, and
- a right to vote **on any resolution for the winding up of the company**, or **for the repayment or reduction of its equity or preference share capital**.

and his voting right on a poll shall be in proportion to his share in the paid-up preference share capital of the company.

**(iii) Proportion of Voting Rights:** The proportion of the voting rights of equity shareholders to the preference shareholders shall be in the same proportion as the paid-up capital in respect of the equity shares bears to the paid-up capital in respect of the preference shares.

**(iv) Non-Payment of Preference Dividend:** where the dividend in respect of a class of preference shares **has not been paid for a period of 2 years or more**, **then such class of preference shareholders shall have a right to vote on all the resolutions placed before the company** on any resolution placed before the company i.e., in the Annual General Meeting (AGM) or Extra-ordinary General Meeting

(EGM) of the members of the company. The voting right shall be proportionate to the paid-up capital of the class of shares involved.

## VARIATION OF SHAREHOLDERS' RIGHTS [SECTION 48]

Where share capital of a company is divided into different classes of shares, it may sometimes be necessary for it to amend the rights attached to one or more classes of shares.

The Companies Act states the following laws on the variations of shareholders' right:

(1) **(1)Variation in rights of shareholders with consent:** The **rights attached to the shares of any class may be VARIED** with the **CONSENT in writing of th rae holders of not less than 3/4th of the issued shares of that class** or by means of a special resolution passed at a separate meeting of the holders of the issued shares of that class,—

(a) if provision with respect to **such variation is contained in the MOA or AOA** of the company; or
(b) in the absence of any such provision in the memorandum or articles, **if such variation is not prohibited by the terms of issue** of the shares of that class:

**#Questionable Point: If variation by one class of shareholders affects the rights of any other class of shareholders**, the **consent of 3/4th of such other class of shareholders shall also be obtained** and the provisions of this section shall apply to such variation.

(2) **Variation shall not have effect:** Where the holders of **not less than 10% of the issued shares** of a class **did not consent** to such variation or vote in favour of the special resolution for the variation, they **may apply to the Tribunal to have the variation cancelled**, the variation shall not have effect **unless and until it is confirmed by the Tribuna**l:

Provided that an application under this section shall be made **within 21 days.**

(3) **Binding decision of tribunal:** The decision of the Tribunal on any application under sub-section (2) shall be binding on the shareholders.

(4) **Filing copy of order with the Registrar:** The Company shall, within 30 days of the date of the order of the Tribunal, file a copy thereof with the Registrar.

## CALLS ON SHARE [SECTION 49 TO SECTION 51]

Calls are made by the company on security holders to pay the amount called up in respect of partly paid up securities.

**As per Section 49**, these **calls have to be uniformly made and there should be no differentiation for a given class** of security holders. The provision is not applicable in case where different amounts are paid for a same class for security.

**Call in Advance: As per Section 50**, **if authorised by the articles**, a company can keep advance subscription. However, **there would be no voting right on that advance amount** till the amount is duly called for and adjusted.

**As per Section 51,** A company may, if so authorised by its articles, **pay dividends in proportion to the amount paid- up on each share.**

**#Deeper understanding**

The shareholder who has paid calls in advance will be eligible for Dividend on such advance money paid.

In other words, advance payment will never lead to increased voting rights but delayed payment of call money could be the reason of decreased voting rights.

***Example:***

*Coriander Masale Limited has issued 10,00,000 equity shares of ` 10 each on which ` 6 per share has been called till allotment and the first and final call of ` 4 is yet to be made. Reena holds 10,000 shares on which she has paid whole of ` 10 per share. In the upcoming extra-ordinary general meeting of the company she wants to exercise her voting rights as the owner of fully paid-up shares. However, the company cannot permit her as she does not have voting right in respect of the 'advance amount' paid by her in respect of first and final call. The restriction will continue till the amount is duly called up by the company.*

**PAYMENT OF DIVIDEND IN PROPORTION TO PAID-UP AMOUNT [SECTION 51]**

The company if so authorised by article, may be permitted to pay dividends in proportion to the amount paid-up on each share.

The Board of Directors of a company may decide to pay dividends on pro rata basis if all the equity shares of the company are not equally paid-up. However, in the case of preference shares, dividend is always paid at a fixed rate.

**ISSUE OF SHARES AT PREMUIM ( SECTION – 52)**

When a security of a given face value is issued at price higher than its face value, the issue is called as issue at premium and the differential amount as premium.

Where **a company issues shares at a premium**, **a sum equal to the aggregate amount** of the premium received on those shares **shall be transferred to a securities premium account** and the provisions of this Act relating to reduction of share capital (which are very stringent) of a company shall, except as provided in this section, apply as if the securities premium account were the paid-up share capital of the company.

**Application of securities premium account: The securities premium account may be applied by the company —**

(a) as fully paid **bonus shares**;
(b) in **writing off the preliminary expenses** of the company;
(c) in writing off the **expenses of, or the commission paid or discount allowed on, any issue of shares or debentures** of the company;
(d) in providing for the **premium on the redemption of preference shares or of any debentures**; or
(e) for the **Buy back of its securities** under section 68.

**Who may apply the securities premium account:** The securities premium account may be applied by such class of companies, as may be prescribed and whose financial statement comply with the accounting standards prescribed for such class of companies under section 133.

**PROHIBITION ON ISSUE OF SHARES AT DISCOUNT ( SECTION 53)**

- A **company cannot issue shares at a discount**, **except in the case of an issue of sweat equity shares** given under section 54 of the Companies Act, 2013.
- **Any share issued by a company at a discount price shall be void**.

**Exception:** Notwithstanding anything contained in sub-sections (1) and (2), **a company may issue shares at a discount to its creditors when its debt is converted into shares** in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines specified by the RBI under the RBI Act, 1934 or the Banking (Regulation) Act, 1949.

- Where any company fails to comply with the provisions of this section, such company and every officer who is in default shall be liable to a penalty which may extend to an amount equal to the amount raised through the issue of shares at a discount or five lakh rupees, whichever is less, and the company shall also be liable to refund all monies received with interest at the rate of twelve per cent. per annum from the date of issue of such shares to the persons to whom such shares have been issued.

**Example 9** - A share having face value of ` 100 is issued at a lower price of ` 95. The differential amount of ` 5 is known as discount which is being allowed by the company.

Though title of section used the word prohibited, but indeed issue of share at discount is not fully prohibited, it is only restricted especially after the enactment of the Companies (Amendment) Act, 2017 (effective from 09th February 2018)

| Liable | Penalty |
|---|---|
| Every officer who is in default | Upto an amount equal to the amount raised through the issue of shares at a discount or five lakh rupees, **whichever is less** |
| Company | Refund all monies received with interest at the rate of twelve percent per annum from the date of issue of such shares |

**#Questionable Point:**

It is clear that these restrictions are only on issue of shares, **it could be equity or preference but not on any debt related products** like bonds or debentures.

## SWEAT EQUITY SHARES [SECTION 54]

**Purpose:** Sweat equity shares are issued to keep the employees of a company motivated by making them partner in the growth of the company.

**#Definition: As per Section 2 (88)**, the term 'sweat equity shares' means such equity shares as are **issued** by a company **to its directors or employees at a discount or for consideration, other than cash**, **for providing their**

- **know-how or**
- **making available rights in the nature of intellectual property rights or**
- **value additions**, by whatever name called.

**Conditions to issue sweat equity shares:** According to Section 54 (1), a company may issue sweat equity shares of a class of shares already issued, **if the following conditions are fulfilled, namely—**

(a) the issue is **authorised by a special resolution** passed by the company;

(b) the resolution specifies the number of shares, the current market price, consideration, if any, and the class or classes of directors or employees **to whom such equity shares are to be issued;**

(c) **In case of listed company**, the sweat equity shares are issued in accordance with the **regulations made by the Securities and Exchange Board** in this behalf and **if they are not listed**, the sweat equity shares are issued in accordance with **Rule 8 of the Companies (Share and Debentures) Rules, 2014.**

**Some of the important provisions contained in Rule 8 of the Companies (Share and Debentures) Rules, 2014, are stated as under:**

**Meaning of Employee: ''Employee'' means-**

(a) **permanent employee of the company** who has been **working in India or outside India**;or

(b) a **director of the company**, whether a **whole- time director or not**; or

(c) an employee or a director as defined in sub-clauses (a) or (b) above **of a subsidiary, in India or outside India**, or **of a holding company of the company**;

1. **Validity of Special Resolution:** The special resolution authorising the issue of sweat equity shares shall be valid for making the allotment within a period 12 months.

2. **Limit on issue of Sweat Equity Shares:** A company shall not issue sweat equity shares for more than **ONE TIME:**

   - **15% of the existing paid-up equity share capital in a year** or
   - shares of the **issue value of rupees 5 crores**, **whichever is higher.**

   **LIFE TIME:**

   - Issuance of sweat equity shares in the Company **shall not exceed 25% of the paid-up equity capital of the Company at any time**.

   **EXCEPTION:**

   In case of a **STARTUP COMPANY**, it is provided that it may issue **sweat equity shares not exceeding 50 % of its paid-up capital up to 10 years w.e.f. 05-06-2020) from the date of its incorporation.**

3. **LOCK-IN PERIOD:** The sweat equity shares issued shall be **locked in/non-transferable for a period of 3 years from the date of allotment.**

4. **VALUATION OF SWEAT EQUITY SHARES:** The sweat equity shares to be issued shall be valued at a **price determined by a registered valuer** as the fair price giving justification for such valuation.
5. **Valuation of IPR/know-how/value additions** for which sweat equity shares are to be issued, shall be **carried out by a registered valuer,** who shall **provide a proper report** addressed to the Board of directors with justification for such valuation.
6. **TREATMENT OF NON-CASH CONSIDERATION:** where the sweat equity shares are issued for a non-cash consideration on the basis of a valuation report in respect thereof obtained from the registered valuer, such non-cash consideration shall be treated in the following manner in the books of account of the company:

   (a) where the non-cash consideration takes the **form of a depreciable or amortizable asset**, it **shall be carried to the balance sheet** of the company **in accordance with the accounting standards**; or

   (b) where **clause (a) is not applicable, it shall be expensed** as provided in the accounting standards.

7. **DISCLOSURE IN THE DIRECTORS' REPORT**: The Board of Directors shall disclose in the Directors' Report for the year, the specified details of issue of sweat equity shares.
8. **MAINTENANCE OF REGISTER**: The company shall **maintain a Register of Sweat Equity Shares in Form No. SH. 3.** It shall be maintained at the registered office of the company or such other place as the Board may decide.
9. **Sweat equity shareholders to rank PARI PASSU with other equity shareholders:** According to Section 54 (2), the rights, limitations, restrictions and provisions as are applicable to equity shares shall be applicable to the sweat equity shares issued under Section 54.

## PREFERENCE SHARES – ISSUE AND REDEMPTION [SECTION 55]

| | |
|---|---|
| Cumulative Preference Shares | The **dividends are accumulated** and therefore paid before anything paid to equity shares |
| Noncumulative Preference Shares | If company does not pay dividend in current year, claim of preference shareholders is lost to that extent |
| Convertible Preference Shares | They possess an option or right to convert into an ordinary equity share at some agreed terms and conditions |
| Non-convertible Preference Shares | Shares do not have the option to convert but has all the other normal characteristics of Preference shares. |
| Participating preference shares | It has an additional benefit of participating in surplus profit or Surplus assets of the company apart from the preferential dividend. |
| Non-participating preference shares | They are not entitled to participate in the surplus profits or surplus assets of the company they are entitled to only a fixed rate of dividend |
| Redeemable preference share | Has a maturity date on which date the company will repay the capital amount to the preference shareholders the paying bank of capital is called redemption as per section 55 of the companies act 2013. Preference shares **shall be redeemed within a period not exceeding 20 years (However infrastructure companies can issue preferential shares redeemable with a period not exceeding 30 years)** |
| Irredeemable preference shares | They do not have any maturity date and are repayable only at the time of winding up of the company however as per section 55 of companies act 2013 **no company can issue irredeemable preference shares** |

1) **Company to issue only Redeemable Preference Shares**: A company limited by shares shall not issue any preference shares which are irredeemable.
2) **Time Period within which Preference Shares are to be redeemed:** A company limited by shares may, if so authorised by its articles, issue preference shares which are liable to be redeemed **within a period not exceeding 20 years from the date of their issue**.

   **Exception:**

   A company may issue preference shares for a **period exceeding 20 years (but not exceeding 30 years** for **infrastructure projects**, **subject to the redemption of 10% of such preference shares beginning 21st year onwards or earlier, on proportionate basis, at the option of such preferential shareholders.**
3) Preference Shares **shall be redeemed out of the**
   - **Profits** of the company only, which would otherwise be available for dividend or
   - Out of the **proceeds of a fresh issue** of shares

4) **Requirement of Special Resolution and Condition of no Default**: According to Rule 9 (1), the issue of preference shares has to be authorized by passing a special resolution in the general meeting of the company. Further, at the time of such issue of preference shares, the company **should not have subsisting default in the redemption of preference shares** or **in payment of dividend due on any preference shares.**
5) **Register of Member:** If a company issues preference shares, the Register of Members maintained under Section 88 shall contain the particulars in respect of such preference shareholder(s).

6) Preference shares shall not be redeemed unless they are fully paid.
7) **Transfer to CRR Account**: Where such shares are proposed to be redeemed out of the profits of the company, there shall, out of such profits, be transferred, a sum equal to the nominal amount of the shares to be redeemed, to a reserve, **to be called the Capital Redemption Reserve (CRR) Account.**

**#Practice Question:**
**During the current financial year, the Board of Directors of Vintee Lifestyles Garments Limited is to undertake redemption of 20,000 preference shares of ` 100 each at a premium of ` 20 per share. It is made out by the** Accounts Department that the profits are sufficient to meet the ensuing liability arising out of redemption of preference shares at premium.
In this case, the amount that needs to be transferred to Capital Redemption Reserve (CRR) account, if preference shares are redeemed at a premium out of profits which are otherwise available for dividend, is ` 20,00,000 being the sum equal to the nominal amount of the preference shares to be redeemed. There is no need to transfer to CRR account any amount paid towards premium.

8) **Payment of Premium in case of prescribed Class of Companies**: In case of such class of companies, as may be prescribed and whose financial statement comply with the accounting standards prescribed for such class of companies under section 133, the premium, if any, payable on redemption of any preference shares shall be provided for **out of the profits** of the company or out of the **company's securities premium account**, before such shares are redeemed.
9) According to Section 55 (3), **where a company is not in a position to redeem any preference shares or to pay dividend**, if any (such shares referred to as unredeemed preference shares), it may—
   - with the **consent of the holders of 3/4th** in value of such preference shares, **and**
   - with the **approval of the Tribunal** on a petition made by it in this behalf,

issue further redeemable preference shares **equal to the amount due, including the dividend** thereon, in respect of the unredeemed preference shares, and on the **issue of such further redeemable preference shares, the unredeemed preference shares shall be deemed to have been redeemed.**

Tribunal shall also order the redemption forthwith of preference shares held by such persons who have not consented to the issue of further redeemable preference shares.

**TRANSFER AND TRANSMISSION OF SECURITIES AND THE ALLIED PROVISIONS [SECTION 56 TO SECTION 59]**

Section 56 deals with the transfer and transmission of securities or interest of a member in the company.

1) **TRANSFER: Requirement for Registering the Transfer of Securities:** According to Section 56(1),

- a company shall not register a transfer of securities of the company, or the interest of a member in the company in the case of a company having no share capital,
- **unless a proper instrument of transfer in the prescribed form, duly stamped, dated and executed by or on behalf of the transferor and the transferee** (except where the transfer is between persons both of whose names are entered as holders of beneficial interest in the records of a depository),
- specifying the name, address and occupation, if any, of the transferee,
- has been **delivered to the company by the transferor or the transferee**
- within a period of 60 days from the date of execution,
- **along with** the certificate relating to the securities, or **if no such certificate** is in existence, **along with the letter of allotment** of securities.
- Where the instrument of transfer has been lost or the instrument of transfer has not been delivered within the prescribed period, the company may register the transfer on taking an indemnity as the Board may think fit.
- **Exception:** Requirements of transfer deed, shall not apply with respect to bonds issued by a Government company, provided that an intimation by the transferee specifying his name, address and occupation, if any, has been delivered to the company along with the certificate relating to the bond; and if no such certificate is in existence, along with the letter of allotment of the bond :
  Provided also that the provisions of this sub-section shall not apply to a Government Company in respect of securities held by nominees of the Government.

**#Forged Transfer**:

**Scenario 1):** A forged transfer is a 'nullity' and is not legally binding. Forged transfer takes place when a company effects transfer of shares on the basis of an instrument of transfer containing forged signatures of transferor. Is it possible for a transferee of 'forged transfer' to acquire ownership of shares contained in the instrument of transfer? The answer is 'NO'. At the same time, the transferor who is the real owner continues to be the shareholder and accordingly, the company can be forced by him to delete the name of the transferee and to restore his name as owner of shares in the Register of Members.

**Scenario 2):** What will happen if the transferee of 'forged transfer' transfers the shares to another buyer who does not know about the forgery and the company also registers the transfer in the name of new buyer and endorses the share certificates. In fact, the company cannot deny the ownership rights of new genuine buyer but it can also not deny the ownership rights of original shareholder because 'forged transfer' is void ab-initio and therefore, the company has to restore his name. While restoring the name of the original shareholder, the company may be asked to compensate the new genuine buyer who exercised good faith in purchasing the shares. As a remedy, the company may get itself indemnified by the first transferee who used the forged instrument of transfer to get the shares transferred in his name.

2) **TRANSMISSION:** The company is empowered to register, if it receives an **intimation of transmission o**f any right to securities **by operation of law** from any person to whom such right has been transmitted. **There is no need for submission of instrument of transfer in case of transmission of shares.**

**Cases of Transmission: In the following cases, transmission of shares shall take place:**

(a) **Death**: When a shareholder expires, his shares need to be transmitted to his legal representative.

(b) **Insolvency**: When a shareholder becomes insolvent, his shares are to be transmitted to his Official Receiver.

(c) **Lunacy**: When a shareholder becomes lunatic, his shares are to be transmitted to his administrator appointed by the Court.

3) **TRANSFER OF PARTLY PAID SHARES:** According to Section 56 (3), **where an application is made by the transferor alone** and **relates to partly paid shares**, the **transfer shall not be registered, unless the company gives the notice** in **Form No. SH-5 to the transferee** and **the transferee has given no objection to the transfer** within two weeks from the date of receipt of notice.

**EXAMPLE:**

Himanshu has received a notice from Chaitanya Progressive Books Private Limited on 7th August, 2019 intimating that Shefali has submitted a transfer deed duly signed by her for transfer of 500 partly paid shares (` 6 paid- up out of Face Value of ` 10 per share) in his name. Himanshu as transferee must raise his objection to the proposed transfer of partly paid shares latest by 21st August, 2019.

4) **TIME PERIOD FOR DELIVERY OF CERTIFICATES:**

| **Particulars** | **Time Period for delivering the Certificates of all Securities allotted, transferred or transmitted** |
|---|---|
| In the case of subscribers to the memorandum. | Within 2 months from the date of incorporation. |
| In the case of any allotment of any of its shares by a company. | Within a period of 2 months from thedate of allotment. |
| In the case of a transfer or transmission of securities. | Within a period of 1 month from the date of receipt by the company of the instrument of transfer or the intimation of transmission |
| In the case of any allotment of debenture. | Within a period of 6 months from thedate of allotment. |

5) **Transfer of Security of the Deceased Person by his Legal Representative:**

According to Section 56 (5), the transfer of any security or other interest of a deceased person in a company made by his legal representative shall, even if the legal representative is not a holder thereof, be valid as if he had been the holder at the time of the execution of the instrument of

transfer.

**Example:** Richa Daniel, after having obtained succession certificate, succeeded to 7,000 shares of ` 100 each allotted to her late father Alexender Daniel by Speed Software Limited. To pay off the debt of her cousin Stesley, she wants to transfer whole of the 7,000 shares to her on the basis of a duly stamped instrument of transfer which has been signed by her as well as Stesley. Accordingly, she has delivered the required documents to the company for transfer of shares.
In terms of Section 56 (5), the company, on receipt of duly stamped instrument of transfer along with requisite share certificates and succession certificate, shall transfer the shares in favour of Stesley. Thus, even though Richa Daniel, the legal representative of Alexender Daniel, is not a holder of 7,000 shares as per the Register of Members of the company, the transfer effected by her in favour of her cousin Stesley is a valid transfer as if she had been the holder of securities at the time of executing the transfer deed.

**Alternative**
As an alternative, Richa Daniel may choose to get herself registered as holder of the 7,000 shares in which case, she will make an application to Speed Software Limited. Such application shall be accompanied with share certificates and succession certificate. There is no need to submit instrument of transfer or transfer deed in such a case of transmission.

## PUNISHMENT FOR PERSONATION OF SHAREHOLDER [SECTION 57]

If any person deceitfully personates as—

- an owner of any security or interest in a company, or
- of any share warrant or coupon issued in pursuance of this Act, and
- thereby **obtains or attempts to obtain** any such security or interest or any such share warrant or coupon, or
- receives or attempts to receive any money due to any such owner,
  Such person shall be punishable with imprisonment for a term which shall not be less than 1 year but which may extend to 3 years and with fine which shall not be less than 1 lakh rupees but which may extend to 5 lakh rupees.

## REFUSAL OF REGISTRATION AND APPEAL AGAINST REFUSAL [SECTION 58]

It is possible that a company may refuse registration of transfer or transmission. According to Section 2 (68) (i), a private company is required to restrict the right to transfer its shares by providing so in its Articles. However, this right to prohibit transfer is not absolute but it should be reasonable so that it is in the interest of the company.

Section 58 contains the procedure which needs to be followed by a company while refusing to register the transfer of securities. It also contains

**(i) Notice of Refusal to be sent:** According to Section 58 (1), if a private company refuses to register the transfer of, or the transmission, of the right to any securities in the company, then the **company shall send notice of refusal** to the transferor and the transferee or to the person giving intimation of such transmission, **within a period of 30 days** from the date on which the instrument of transfer, or transmission, was delivered to the company.

**(ii) Securities/other interest a Public Company:** The securities or other interest of any member in a public company **are freely transferable**.

It is provided that any contract or arrangement between 2 or more persons in respect of transfer of securities shall be enforceable as a contract.

**(iii) Appeal to Tribunal against Refusal:** According to Section 58 (3), **the transferee may appeal to the Tribunal against the refusal**

- **within a period of 30 days** from the date of receipt of the notice or
- in case no notice has been sent by the company, within a period of 60 days from the date on which the instrument was delivered to the company.

**(iv) Appeal to Tribunal against Refusal by a Public Company without sufficient cause:** Section 58 (4) states that if a **public company without sufficient cause refuses to register the transfer of securities within a period of 30 days** from the date on which the instrument of transfer or the intimation of transmission, is delivered to the company, the transferee may, **within a period of 60 days of such** refusal or where no intimation has been received from the company, **within 90 days of the delivery** of the instrument of transfer or intimation of transmission, appeal to the Tribunal.

**(v) Order of Tribunal**: **The Tribunal, while dealing with an appeal may, after hearing the parties, either dismiss the appeal, or by order—**

(a) direct that the transfer or transmission shall be registered by the company and the company shall comply with such order within a period of 10 days of the receipt of the order; or

(b) direct rectification of the register and also direct the company to pay damages, if any, sustained by any party aggrieved.

**(vi) Contravention of the Order of the Tribunal:** As per Section 58 (6), if a person contravenes the order of the Tribunal, he shall be punishable with imprisonment for a term not less than one year but may extend to three years and with fine not less than one lakh rupees which may extend to five lakh rupees

**Illustration** – T&F Notice of refusal to register transfer of shares by private company shall be sent only to the transferee within 30 days, stating reasons of refusal therein.

**Answer –** False, notice of refusal shall be given to both transferee and transferor under section 58(1).

## RECTIFICATION OF REGISTER OF MEMBERS [SECTION 59]

**Section 59 provides the procedure for the rectification of register of members.**

**(i) Appeal by Aggrieved Person:** According to Section 59 (1), if the name of any person is, **without sufficient cause**,

- **entered** in the register of members of a company, or
- after having been entered in the register, is, **omitted** therefrom, or
- if a default is made, or **unnecessary delay takes place** in entering in the register, the fact of any person having become or ceased to be a member,

then the **person aggrieved**, or **any member** of the company, or **the company may appeal** in such form as may be prescribed, **to the Tribunal**, or **to a competent court outside India**, in respect of foreign members or debenture holders residing outside India, for rectification of the register.

**(ii) Order of the Tribunal:** The Tribunal may, after hearing, by order,

- either **dismiss** the appeal, or
- **direct that the transfer** or transmission to be registered by the company within a period of 10 days of the receipt of the order, or
- **direct rectification of the records** of the depository or the register and in the latter case, direct the company to pay damages, if any, sustained by the party aggrieved.

**(iii)** The provisions of Section 59 **shall not restrict the right of a holder of securities**, to transfer such securities. Further, any person acquiring such securities shall be entitled to voting rights unless the voting rights have been suspended by an order of the Tribunal.

**(iv) Transfer of Securities contravenes certain Acts:** Where **the transfer of securities is in contravention of any of the provisions of** the Securities Contracts (Regulation) Act, 1956 (SCRA), the Securities and Exchange Board of India Act, 1992 (SEBI) or the Companies Act, 2013 or any other law for the time being in force, the **Tribunal may, on an application made by the depository, company, depository participant, the holder of the securities or the SEBI**, direct any company or a depository to set right the contravention and rectify its register or records concerned.

## ALTERATION OF SHARE CAPITAL [SECTIONS 61-70]

## POWER OF LIMITED COMPANY TO ALTER ITS SHARE CAPITAL [SECTION 61]

limited company having a share capital may, if so authorised by its articles, alter its memorandum in its general meeting (Ordinary Resolution) to:

(a) **Increase its authorised share capital**

(b) **Consolidate and divide**, all or any of its existing shares into a **larger denomination** than of its existing shares e.g., by consolidating ten shares of Rs. 10/- each into one share of Rs. 100/- each.

**Note:** No consolidation and division which results in changes in the voting percentage of shareholders shall take effect **unless it is approved by the Tribunal** on an application made in the prescribed manner;

(c) **Convert** all or any of its **fully paid-up shares** into stock or reconvert that stock into fully paid-up shares of any denomination;

(d) **Sub-divide** its existing shares or any of them, into shares of **smaller amount** than is fixed by the Memorandum, so however, that in the sub-division the proportion between the amount paid and the amount, if any, unpaid on each reduced shall be the same as it was in the case of the share from which the reduced share is derived..

(e) **Cancel shares** which, at the date of the passing of the resolution in that behalf, have not been taken up or agreed to be taken by any person and diminish the amount of the share capital by the amount of the shares so cancelled.

1) However, such cancellation of shares will not be considered as reduction of share capital.

2) When a company alters it capital in any ways mentioned above or when preference shares are redeemed, the company shall file a notice in the Form SH-7 with the Registrar within a period of thirty days of such alteration or increase or redemption, as the case may be, along with an altered memorandum

| **Further issue of share capital – Section 62** | | |
|---|---|---|
| Where at any time, a company having a share capital **proposes to increase its subscribed capital** by the issue of further shares, such shares shall be offered to- | | |
| **EXISTING SHAREHOLDERS** [u/s 62(1)(a)]<br>**RIGHTS ISSUE** | **EMPLOYEES** [u/s 62(1)(b)]<br>**ESOP** | **ANY PERSONS** [u/s 62(1)(c)]<br>**PREFERENTIAL OFFER** |
| Who, at the date of the offer, are holders of equity shares of the company<br>In proportion to the paid-up share capital on those shares<br>By sending a letter of offer up share capital on those shares<br>By sending a letter of offer | Under a Scheme of Employees' Stock Option<br>Subject to special resolution passed by company (Ordinary Resolution in Private Company) | Whether or not those persons include the persons referred to in Clause (a) or (b)<br>If it is authorised by a special resolution<br>Either for cash or for a consideration other than cash, if the price of such shares is determined by the valuation report of a registered valuer |

**Right Issue - 62(1)(a)**

**The offer shall be made by notice:**

- specifying the number of shares offered and
- limiting a **time not being less than 15 days** [or such lesser number of days as may be prescribed] **and not more than 30 days** from the date of the offer within which the offer, if not accepted, shall be deemed to have been declined
- The offer shall be deemed to **include right of renunciation**, unless the articles of the company otherwise provide; and
- **The said notice shall be sent to all the existing shareholders at least 3 days before the opening of the issue.**

**NOTE:** However, **in case of a private company**, if 90% of the members give their consent the periods lesser than those above shall apply.

**Illustration– Q&A**

**What shall be length of period specified by notice of offer of further issue for giving acceptance?**

**EMPLOYEE STOCK OPTION SCHEME**

ESOP gives its employees **right to purchase, or to subscribe for, the shares of the company at a future date at a pre-determined price.**

**Who is an Employee?**

(a) a **permanent employee** of the company who has been working in India or outside India; or

(b) a **director of the company**, whether a whole-time director or not but **excluding an independent director;** or

(c) an employee as defined in clauses (a) or (b) **of a subsidiary**, in India or outside India, or of a holding company of the **company but does not include-**

(i) an **employee who is a promoter** or a person belonging to the promoter group; or

(ii) a **director** who either himself or through his relative or through any body corporate, directly or indirectly, **holds more than ten percent** of the outstanding equity shares of the company.

**NOTE: Startup company are exempted from (i) and (ii) provisions upto 10 years from date of its incorporation.**

**Rule 12 of The Companies (Share Capital and Debentures) Rules, 2014:**

- There shall be a **MINIMUM PERIOD OF ONE YEAR between the grant of options and vesting of option**. [if company gets amalgamated, such period shall get adjusted accordingly]

- The companies will have the **freedom to determine the exercise price** in conformity with the applicable accounting policies, if any.
- Company has **freedom to specify lock-in period**
- **RESTRICTIONS:**
  - Employees shall **not have right to receive any DIVIDEND or to VOTE or any benefits of a shareholder till shares are issued**
  - The option granted to employees **shall NOT BE TRANSFERABLE** to any other person.
  - The option granted to the employees **shall not be pledged, hypothecated, mortgaged** or otherwise encumbered or alienated in any other manner.
  - **No other person shall be entitled to exercise** the option.
  - In the **event of resignation or termination of employment**, all options not vested in the employee as on that day **shall expire**. **However**, the employee can exercise the options granted to him which are vested within the period specified in this behalf
- **RIGHTS:**
  - In the event of the **death of employee while in employment,** all the options granted to him till such date **shall vest in the legal heirs or nominees** of the deceased employee.
  - In case the **employee suffers a permanent incapacity while in employment**, all the options granted to him as on the date of permanent incapacitation, **shall vest in him on that day.**
- Board of directors shall **disclose in the Directors' Report for the year**, the details of the Employees Stock Option Scheme issued during the year.
- Company shall maintain a **Register of Employee Stock Options in Form No. SH.6** about option granted

(3) According to Section 62 (3), **Section 62 shall not apply** to the increase of the subscribed capital of a company caused by the **exercise of an option attached to the debentures issued or loan raised** by the company to convert such debentures or loans into shares in the company.

Provided, **such an option have been approved before the issue** of such debentures or the raising of loan by a special resolution passed by the company in general meeting.

**(4)** According to Section 62 (4),

- where any debentures have been issued, or loan has been obtained **from any Government by a company**,
- and if that **Government considers it necessary in the public interest** so to do,
- it may, by order, direct that such debentures or loans or any part thereof shall be converted into shares in the company on such terms and conditions **as appear to the Government to be reasonable**, even if terms of the issue of such debentures or the raising of such loans do not include a term for providing for an option for such conversion.
- **Term of Conversion not acceptable to the Company:** If the terms and conditions of such conversion are not acceptable to the company, **it may, within 60 days from the date of communication** of such order, **appeal to the Tribunal** which shall after hearing the company and the Government pass such order as it deems fit.

According to Section 62 (6), **where the Government has, by an order made under sub-section (4)**, directed for conversion into shares in a company and where no appeal has been preferred or such appeal has been dismissed, the MOA of such company shall, where such order has the effect of

increasing the authorised share capital of the company, stand altered and the authorised share capital of such company shall stand increased by an equivalent amount.

## BONUS SHARES – Section 63

- A company may, if its Articles provide, **capitalize its profits by issuing fully-paid bonus shares**.
- A company converts the large accumulated profits into capital and divides the capital among the existing members in proportion to their entitlements.
- Members do not have to pay any amount for such shares. They are given free.

### SOURCES FOR ISSUE OF BONUS SHARES

(i) its free reserves;

(ii) the securities premium account; or

(iii) the capital redemption reserve account.

**NOTE: Bonus shares cannot be issued by utilizing revaluation reserve account.**

**Conditions & Procedure**: Bonus shares shall not be issued, unless—

a. it is **authorised by its articles**;
b. it has, on the recommendation of the Board, been authorised in the general meeting of the company;
c. it has **not defaulted** in **payment of interest or principal** in respect of fixed deposits or debt securities issued by it;
d. it has **not defaulted** in respect of the **payment of statutory dues of the employees**, such as, contribution to provident fund, gratuity and bonus;
e. the partly paid-up shares, if any outstanding on the date of allotment, **are made fully paid-up.**
f. The **bonus shares shall not be issued in lieu of dividend**.
g. the company which has once announced the decision of its Board recommending a bonus issue, **shall not subsequently withdraw** the same.

Example: XYZ Limited declares bonus shares in the ratio of 1:5. It means an existing shareholder of the company, say Mr. 'R', will get one bonus share free of cost for every five shares already held by him.

**Illustration – True/False**

***Bonus share can be issued to partly paid shares in proportion to paid-up value.***

**Answe**r – False, Bonus shares can only be issued against fully paid, the partly paidup shares, if any outstanding on the date of allotment, are made fully paid-up.

## NOTICE TO BE GIVEN TO REGISTRAR FOR ALTERATION OF SHARE CAPITAL [SECTION 64]

**The company shall give notice to ROC in case of:-**

1) Alteration of share capital as per Sec 61,
2) Increase in authorised share capital of a company consequent to the order of the Government; or Redemption of preference shares

**Procedure to file:**

The company shall file a notice in the prescribed form **[SH-7]** with the Registrar **within a period of thirty days** of such **alteration or increase or redemption**, along with an altered memorandum.

**Penalty for Default in Filing of Notice [Sub-section 2]**

Where any company fails to file notice as manner prescribed in sub-section 1 then such company and every officer who is in default shall be liable to a penalty of five hundred rupees for each day during which such default continues, subject to a maximum of five lakh rupees in case of a company and one lakh rupees in case of an officer who is in default.

| Liable | Penalty |
|---|---|
| Company | Five hundred rupees for each day during which such default continues, subject to a maximum of five lakh rupees |
| Every officer who is in default | Five hundred rupees for each day during which such default continues, subject to a maximum of one lakh rupees |

## REDUCTION OF SHARE CAPITAL [SECTION 66]

As a principle of sound financial management, a company is required to keep its capital intact. At times, however, it may become necessary for the company to bring about a reduction in its capital.

**Need of reducing share capital:**

- Accumulated business losses,
- Assets of reduced or doubtful value
- having paid up capital in excess of wants of the company etc

**[Special resolution + Tribunal's approval required]**

**Modes of Reduction of share capital**

(1) Section 66 (1) provides that **subject to confirmation by the Tribunal** on an application by the company, a **company limited by shares or limited by guarantee** and having a share capital **may, by a special resolution, reduce the share capital** in any manner and in particular, may—

(a) **extinguish or reduce the liability** on any of its shares in respect of the **share capital not paid-up**;

***Example:*** *In respect of a share of `10, a company has called only `6 per share and the same has been paid by all the shareholders. The company decides not to call remaining `4 per share and reduces its shareholders' liability. If done, the company is said to have reduced its share of `10 to `6 as fully paid-up share.*

(b) either **with or without extinguishing or reducing liability** on any of its shares,—

(i) **cancel paid-up share capital which is lost** or is unrepresented by available assets; or

(ii) **pay off** any paid-up share capital **which is in excess** of the wants of the company,

**REDUCTION NOT PERMITTED:** No such reduction shall be made if the **company is in arrears in the repayment of any deposits** or the interest payable thereon.

(2) **Issue of Notice by the Tribunal:** The Tribunal **shall give notice** of every application made to it under sub-section (1) to

- the Central Government,

- Registrar and

- Securities and Exchange Board, in the case of listed companies, and

- creditors of the company

and **shall take into consideration the representations, if any, made** to it within a period of 3 months from the date of receipt of the notice. If no representation has been received, it shall be presumed that they have no objection to the reduction.

**(3) Order of Tribunal:** Tribunal may, if it is satisfied that the debt or claim of every creditor of the company has been discharged or determined or has been secured or his consent is obtained, make an order confirming the reduction of share capital on such terms and conditions as it deems fit.

It is provided that reduction of share capital shall not be sanctioned by the Tribunal unless the **accounting treatment, is in conformity** with the accounting standards specified in Section 133 or any other provision of this Act **and a certificate to that effect by the company's auditor has been filed with the Tribunal.**

(4) The order of confirmation of the reduction of share capital by the Tribunal shall be published by the company in such manner as the Tribunal may direct.

(5) **Delivery of Certified Copy of Order of Tribunal to Registrar:** Section 66 (5) requires that the company shall deliver a certified copy of the order of the Tribunal showing—

(a) the amount of share capital;

(b) the number of shares into which it is to be divided;

(c) the amount of each share; and

(d) the amount, if any, at the date of registration deemed to be paid-up on each share,

to the Registrar within 30 days of the receipt of the copy of the order, who shall register the same and issue a certificate to that effect.

(6) **Section 66 shall not apply to buy-back of its own securities by company under Section 68.**

(7) A member of the company, past or present, shall not be liable to any call or contribution beyond the reduced share capital amount.

(8) **Name of Creditor is excluded in the list of Creditors:** If a creditor is not entered in the list of creditors, **and after such reduction, the company commits a default**, within the meaning of section 6 of the Insolvency and Bankruptcy Code, 2016, in respect of the amount of his debt or claim-

(a) **every person, who was a member** of the company **on the date of the registration of the order for reduction by the Registrar**, shall be **liable to contribute to the payment of that debt or claim**, an **amount not exceeding his actual contribution**

(b) if the **company is wound up,** the Tribunal may, on the application of any such creditor and proof of his ignorance as aforesaid, if it thinks fit, **settle a list of persons so liable to contribute,** and make and enforce calls and orders on the contributories settled on the list, as if they were ordinary contributories in a winding up.

(9) **Liability of Officers:** Section 66 (10) deals with the liability of defaulting officers. Accordingly, if any officer of the company—

(a) **knowingly conceals the name of any creditor** entitled to object to the reduction;

(b) knowingly **misrepresents the nature or amount of the debt** or claim of any creditor; or

(c) abets or is privy [helps someone] to any such concealment or misrepresentation as aforesaid, **he shall be liable under Section 447**

**66(11) – Omitted**

**RESTRICTION ON PURCHASE BY COMPANY OR GIVING OF LOANS BY IT FOR PURCHASE OF ITS SHARES - Section 67**

As a fundamental principle, a company cannot buy its own shares because in that case it will involve reduction of share capital affecting the creditors. However, **this restriction is not absolute.** If the prescribed procedure as laid by Section 67 is followed, the company is permitted to buy its own shares and the prohibition shall not apply. **The provisions of Section 67 are mentioned below:**

1) No company limited by shares or by guarantee and having a share capital shall have power to buy its own shares unless the consequent reduction of share capital is effected. **[Meaning: It has to comply with section 66]**

2) **No public company** shall give, by means of a **loan, guarantee, or otherwise, any financial assistance for the purpose of** purchase or subscription made, by any person for any shares in the company or in its holding company.
**Exceptions:** There are, however, certain exceptions where the company may provide the financial assistance, namely:

(a)the **lending of money by a banking company** in the ordinary course of its business;

(b) the provision is made for the **purchase of, or subscription for, fully paid up shares** in the **company or its holding company**, if the purchase of, or the subscription for, **the shares held by trustees for the benefit of the employees** or such shares held by the employee of the company;

(c) the giving of **loans by a company to its employees other than its directors or key managerial personnel**, **for an amount not exceeding their salary for a period of 6 months** for enabling them to **purchase or subscribe for fully paid-up shares** in the company or its holding company.

(3) **Punishment for Contravention:**

• **Company:** It shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees;

• **Every officer of the company who is in default:** He shall be punishable with imprisonment for a term which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees

**Note:** Section 67 shall not apply to a private company— **All conditions to be satisfied**

(a) in whose share capital **no other body corporate has invested any money**;
(b) if the **borrowings of such a company** from banks or financial institutions or any body corporate **is - less than twice its paid up share capital** or

- **50 crore rupees**, whichever is lower; and

(c) such a company is **not in default in repayment of such borrowings subsisting** at the time of making transactions.

## POWER OF COMPANY TO PURCHASE ITS OWN SECURITIES [SECTION 68] - BUY BACK OF SECURITIES

Section 68 contains provisions which describe the power a company to purchase its own securities subject to the **applicable conditions.**

**(1) Sources of Funds for Buy-Back of Shares:** Section 68 (1), a company may purchase its own shares or other specified securities. The purchase should be made out of:

(i) its **free reserves**; or

(ii) the **securities premium account**; or

(iii) the **proceeds of the issue of any shares** or other specified securities.

**Note**: buy-back of securities cannot be made out of the proceeds of same kind of securities.

"Specified securities" includes employees' stock option.

**(2) Conditions for Buy-Back:** According to Section 68 (2), the company shall not purchase its own shares or other specified securities unless:

(a) the buy-back is **authorised by its articles**;

(b) **RESOLUTION AUTHORISING THE BUY-BACK** is passed

**(i) Board Resolution:** the buy-back is, **10% or less of the total paid-up equity capital** and free reserves of the company; and

**(ii) Special Resolution:** the buy-back is **25% or less of the aggregate of paid-up capital and free reserves of the company;**

(c) It is provided that **the buy-back of equity shares in ANY FINANCIAL YEAR** shall **not exceed 25% of its total paid up equity capital** in that financial year.

**Note:** The expression "free reserves" includes securities premium account.

(d) **POST BB DEBT EQUITY RATIO (2:1):** the **ratio of the aggregate debts** (secured and unsecured) owed by the company **after buy back is not more than twice the paid-up capital** and **its free reserves;**

(e) all the shares or other specified securities for buy-back are **fully paid-up**;

(f) the buy-back of listed company is in accordance with the SEBI regulations

(g) **POST BUY BACK: No buy-back, shall be made within a period of 1 year** from the date of the **closure of the preceding offer of buy-back**, if any.

**(3) PROCEDURE BEFORE BUY-BACK:** According to Section 68 (3), the notice of the meeting at which special resolution is proposed to be passed **shall be accompanied by an explanatory statement stating -**

(a) a **full and complete disclosure** of all the material facts;

(b) the **necessity** for the buy-back;

(c) the **class of shares or securities intended to be** purchased;

(d) the **amount to be invested** under the buy-back; and

(e) the **time limit for completion** of buy-back.

**(4) TIME LIMIT FOR COMPLETION OF BUY-BACK:** Section 68(4) states that **every buy-back shall be completed within 12 months from the date of passing the board/special resolution**.

**(5) Whose Securities are to be Purchased under 'Buy-Back': According to Section 68 (5), the buy-back under sub-section (1) may be—**

(a) **from the existing shareholders** or security holders on a proportionate basis; or

(b) from the **open market**; or

(c) by purchasing it **from employees** issued under ESOP or sweat equity.

**(6) DECLARATION OF SOLVENCY:** According to Section 68 (6), where a company has passed a resolution, it shall, before making such buy-back, **file with the Registrar and the SEBI (if listed), a declaration of solvency in the form SH-9** and verified by an affidavit to the effect that the Board has made a full inquiry into the affairs of the company and **that it is capable of meeting its liabilities and will not be rendered insolvent within a period of 1 year** from the date of declaration of solvency adopted by the Board. **The declaration shall be signed by at least 2 directors** of the company, one of whom shall be the managing director, if any;

**(7) Extinguishment of Securities:** Where a company buys back its securities, it shall extinguish and **physically destroy the shares** or securities so **bought-back within 7 days of the last date of completion of buy-back**.

**(8) COOLING PERIOD**:

- Where a **company completes a buy-back** under this section,

- **it shall NOT MAKE FURTHER ISSUE of same kind of securities within a period of 6 months - EXCEPT by way of bonus issue** or in the **discharge of subsisting obligations** such as conversion of **warrants,**

**stock option schemes, sweat equity or conversion of preference shares** or debentures into equity shares.

**(9) REGISTER OF BUY BACK:** Section 68 (9) requires that where a company buys- back its shares or other specified securities under this section, **it shall maintain a register to be maintained in Form No. SH-10 of the shares or securities so bought**, the consideration paid for the shares or securities bought-back, the date of cancellation of shares or securities, the date of extinguishing and physically destroying the shares or securities and such other particulars as may be prescribed.

**(10) FILING OF RETURN OF BUY-BACK:** According to Section 68 (10), a company shall, after completion of the buy-back under this section, file with the Registrar and the SEBI, **a return in Form No. SH-11** containing such particulars relating to the **buy-back within 30 days of such completion**, as may be prescribed.

**(11) PENALTY FOR DEFAULT:** Section 68 (11) states that if a company makes default in complying with the provisions of this section or any regulations made by SEBI under clause (f) of sub-section (2), the punishment shall be as under:

• **Company:** It shall be punishable with fine which shall not be less than one lakh rupees but which may extend to 3 lakh rupees; and

• **Every officer of the company who is in default:** He shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees, or with both

**#Practice Question**

Premium Ltd. is considering buy-back of its shares without using any proceeds of shares or other specified securities. The balance sheet of Premium Ltd. shows the following status as on 31st March, 2018:

Share Capital: – 10,00,000

1,00,000 equity Shares of INR 10 each (Fully paid)

Free Reserve – 5,00,000

Unsecured Debt – 7,00,000

Secured Debt - 15,00,000

Determine the maximum Quantum of buy-back of shares with the shareholders approval as on 1st April, 2018.

**Illustration – MCQ**

Buy-back with board resolution is allowed, if amount involved is

a. Not exceeding twenty five percent of the total paid-up equity capital and free reserves of the company

b. Not exceeding twenty five percent of the total paid-up equity capital

c. Not exceeding ten percent of the total paid-up equity capital and free reserves of the company

d. Not exceeding ten percent of the total paid-up equity capital

Answer– c

## TRANSFER OF CERTAIN SUMS TO CAPITAL REDEMPTION RESERVE ACCOUNT [SECTION 69]

Section 69 requires certain **amount to be transferred to the capital redemption reserve** account in **case a company buys back its own shares**. The provisions are as under:

**(1) Amount to be transferred to CRR Account:** Section 69 (1) prescribes that where a company purchases its own shares **out of free reserves or securities premium account**, then a sum equal to the nominal value of the share so purchased **shall be transferred to the capital redemption reserve** account and details of such transfer shall be disclosed in the balance sheet.

**(2) Application of CRR Account:** Section 69 (2) states that the capital redemption reserve account may be applied by the company, in **issuing fully paid bonus shares.**

**Illustration – True/False**

**CRR can be used to issue partly paid bonus shares or finance discount portion of sweat equity shares**

**Answer** - False, the capital redemption reserve account may be applied by the company, in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

## PROHIBITION FOR BUY-BACK IN CERTAIN CIRCUMSTANCES [SECTION 70]

This section of the Companies Act, 2013 prohibits the company for buy back in the certain circumstances.

**(1) The provision says that no company shall directly or indirectly purchase its own shares or other specified securities-**

(a) **through any subsidiary company including its own subsidiary companies**; or
(b) through **any investment company** or group of investment companies; or
(c) if a **default, is made by the company**, in **repayment of deposits** or **interest**, **redemption** of **debentures or preference shares** or **payment of dividend to any shareholder or repayment of any term loan or interest payable thereon to any financial institutions or banking company**;

But **where the default is remedied** and a **period of 3 years has lapsed after such default ceased to subsist**, there such buy-back is not prohibited.

(2) No company shall directly or indirectly purchase its own shares or other specified securities in case

such company has not complied with provisions of

- Sections 92 (Annual Report),
- 123 (Declaration of dividend),
- 127 (Punishment for failure to distribute dividends), and s
- 129 (Financial Statements).

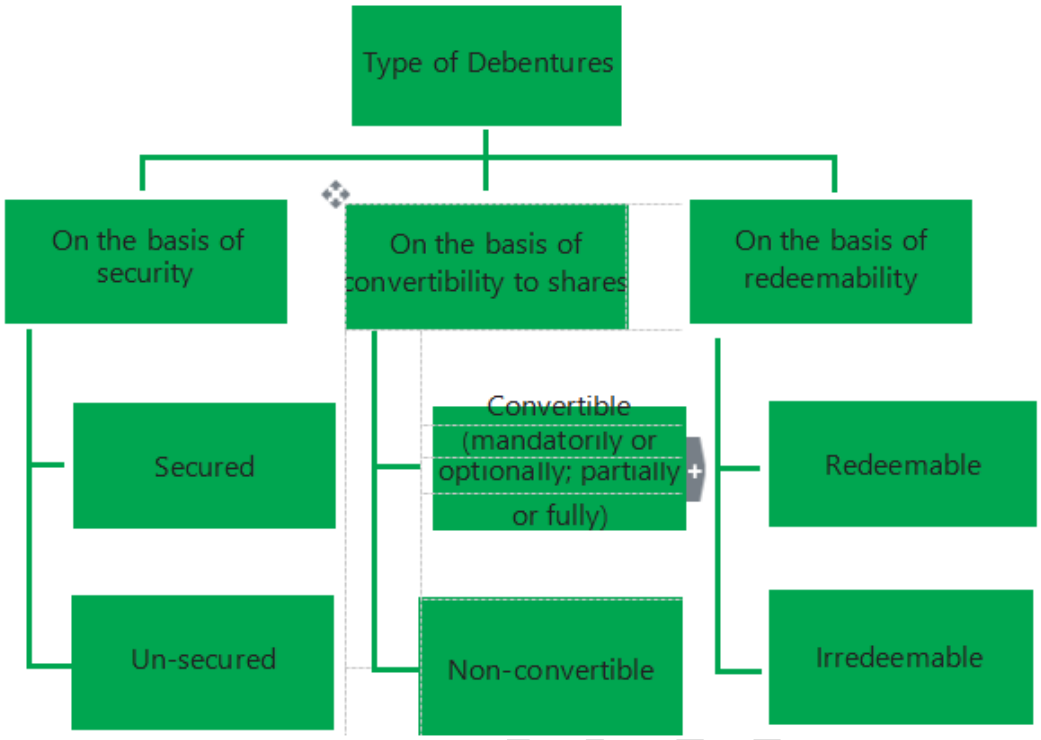
## DEBENTURE [SECTIONS 71]

### Features of Debentures

- When debentures are issued, the applicants are given certificates representing the money they have lent to the company.
- A debenture certificate is issued by the company under its common seal, if any, or under the signatures of two directors or a director and the CS, if he has been appointed.
- The company pays periodic interest on the amount raised by issuing debentures

  **Example:** The name '10% Debentures' indicates that the company shall pay interest at the rate of 10% on the outstanding amount till maturity of such debentures.
- **Voting rights are not available** in case of debentures since Section 71 (2) clearly states that no company shall issue any debentures carrying any voting rights.
- A debenture may be **secured or unsecured**. In case of secured debentures, a charge is created on the assets of the company in favour of debenture trustee.
- The issue may also **provide for conversion of debentures** at maturity into equity.
- The debenture **certificates are required to be delivered within a period of 6 months** from the date of allotment of debentures.

of issue may even allow repayment of principal amount in equal yearly instalments, in which case a portion of debentures shall be redeemed on yearly basis and the company shall be required to pay interest only on the outstanding amount. The debenture holders may also be given the option of converting their debentures into equity shares at the time of maturity




**Section 71 provides the manner in which a company may issue debentures. These provisions are stated as under:**

**(1) Issue of Debentures with an Option to Convert:** According to Section 71 (1), a company may issue debentures with an **option to convert such debentures into shares**, either wholly or partly at the time of redemption.

**Pre-condition:** it is provided that the issue of debentures with an option to convert such debentures into shares, wholly or partly, **shall be approved by a special resolution** passed at a general meeting.

**(2) No Voting Rights:** Section 71 (2) states that no company shall issue any debentures carrying any voting rights.

**(3) Issue of SECURED DEBENTURES**: According to Section 71 (3), secured debentures may be issued by a company subject to such terms and conditions as are prescribed in Rule 18 of the Companies (Share Capital and Debentures) Rules, 2014

**According to Rule 18 (1), the company issuing secured debentures shall comply with the following conditions:**

(a) **Date of redemption of secured debentures shall not exceed 10 years** from the date of issue.

(b) Following classes of companies are **permitted** to issued secured debentures for a period exceeding 10 years but not exceeding thirty years:

- Companies engaged in setting up of **infrastructure projects**;
- **Infrastructure Finance Companies**;
- **Infrastructure Debt Fund Non-Banking Financial Companies**;
- **Companies permitted** by a Ministry or Department of the Central Government or by RBI or by the National Housing Bank or by any other statutory body to issue debentures for a period

exceeding 10 tears.

**(c) Creation of Charge:** Such an issue of debentures shall be **secured by the creation of a charge on the properties or assets of the company** or its subsidiaries or its holding company or its associates companies. Such assets or properties **shall be of value which is sufficient for the due repayment** of the amount of debentures and interest thereon.

**(d) Appointment of Debenture Trustee:** The company shall **appoint a debenture trustee before the issue of prospectus or letter of offer** for subscription of its debentures. Further, **not later than 60 days after the allotment** of the debentures, it shall **execute a debenture trust deed in Form No. SH-12** to protect the interest of the debenture holders.

**(e) Security:** The security for the debentures by way of a charge or mortgage shall be created by the company **in favour of the debenture trustee.**

**(4) Creation of Debenture Redemption Reserve (DRR) Account**

**#For deeper Understanding:** Debenture Redemption Reserve (DRR) is a fund maintained by companies that have issued debentures. Its purpose is to minimise the risk of default on repayment of debentures. The DRR ensures availability of funds for meeting obligations towards debenture-holders. The DRR involves two components. The first component is setting aside a portion of the profit. The allocation of profit is done in a process known as 'earmarking of funds'. It ensures that adequate profits are available for repaying the debentures. The second component involves an investment of funds. It ensures that the company has enough liquidity to make the repayment

Section 71 (4) requires that where debentures are issued by a company under section 71, the company shall **create a debenture redemption reserve account out of the profits** of the company available for payment of dividend and the amount credited to such account shall not be utilised by the company except for the redemption of debentures. **In this respect Rule 18 (7) is relevant which is mentioned below**

(7) The company shall **comply with the requirements with regard to Debenture Redemption Reserve** (DRR) and **investment or deposit of sum in respect of debentures** maturing during the year ending on the **31st day of March of next year**, in accordance with the conditions given below:-

(a) **Debenture Redemption Reserve shall be created out of profits** of the company **available for payment of dividend;**

(b) the limits with respect to **adequacy of Debenture Redemption Reserve** and **investment or deposits,** as the case may be, shall be as under;-

| S.No. | Class of Company | Condition |
|---|---|---|
| 1 | All India Financial Institutions (AIFIs) regulated by Reserve Bank of India and Banking Companies | No DRR for debentures issued by for both public as well as privately placed debentures |
| 2 | Financial Institutions (FIs) within the meaning of clause (72) of section 2 of the Companies Act, 2013 | DRR shall be as applicable to NBFCs registered with RBI. |
| 3 | For NBFCs registered with the RBI under Section 45-IA of the RBI Act, 1934 and Housing finance companies registered with the National Housing Bank: | |
| 3A | Listed NBFCs and Housing Finance Companies | No DRR required for debentures issued for both public as well as privately placed debentures |
| 3B | Unlisted NBFCs and Housing Finance Companies | No DRR is required in case of privately placed Debentures |
| 4A | Listed Companies | No DRR required for debentures issued for both public as well as privately placed debentures |
| 4B | Unlisted companies | Adequacy of DRR shall be 10% of the value of outstanding debentures. |

**Creation of Debenture Redemption Fund (DRF)**

**Every listed company (including listed NBFCs and Housing Finance Companies) and other unlisted company (other than unlisted NBFCs and Housing Finance Companies) shall on or before the 30th day of April in each year**, in respect of debentures issued by the above mentioned companies is **required to invest or deposit at least 15 % of the amount of its debentures maturing during the year ending on 31st day of March of next year.** The company may choose any of the below given methods:

(i) in deposits with any **scheduled bank**;

(ii) in **unencumbered securities** of the Central methods of deposits or from any charge or lien; Government or any State Government;

(iii) in unencumbered securities mentioned in sub-clauses (a) to (d) and (ee) of section 20 of the Indian Trusts Act, 1882;

(iv) in unencumbered bonds issued by any other company which is notified under sub-clause (f) of section 20 of the Indian Trusts Act, 1882;

The **amount invested or deposited as above shall not be used for any purpose other than for redemption of debentures** maturing during the year referred above.

In **case of partly convertible debentures, DRR shall be created in respect of non-convertible portion** of debenture issue in accordance with this sub-rule.

**(5) Limitation on the Issue of Prospectus/Offer/Invitation to the public:** According to Section 71 (5), **no company shall issue a prospectus or make an offer** or invitation to the public or to its **members exceeding 500** for the subscription of its debentures, **unless the company has, before such issue or offer**, **appointed one or more debenture trustees** and the conditions governing the appointment of such trustees shall be such as are prescribed in Rule 18 (2) of the Companies (Share Capital and Debentures) Rules, 2014.

The provisions of Rule 18 (2) are as under:

**The company shall appoint debenture trustees under sub-section (5) of section 71, after complying with the following conditions, namely: —**

(a) the **names of the debenture trustees shall be stated in letter of offer** inviting subscription for debentures and also in all the subsequent notices or other communications sent to the debenture holders;

(b) before the appointment of debenture trustee or trustees, a **written consent shall be obtained** from such debenture trustee or trustees proposed to be appointed and a statement to that effect shall appear in the letter of offer issued for inviting the subscription of the debentures;

(c) **A person SHALL NOT BE APPOINTED as a debenture trustee, if he**—

(i) **beneficially HOLDS SHARES** in the company;

(ii) is **PROMOTER, DIRECTOR OR KMP** or any other officer or an employee of the company or its holding, subsidiary or associate company;

(iii) is **BENEFICIALLY ENTITLED to moneys** which are to be paid by the company **otherwise than as remuneration** payable to the debenture trustee;

(iv) is **INDEBTED to the company**, or its subsidiary or its holding or associate company or a subsidiary of such holding company;

(v) has **furnished any GUARANTEE** in respect of the principal debts secured by the debentures or interest thereon;

(vi)has any **PECUNIARY RELATIONSHIP** with the company amounting to

- 2% or more of its gross turnover or total income or
- 50 lakh rupees, whichever is lower,

during the 2 immediately preceding financial years or during the current financial year;

(vii) is **relative of any promoter or any person** who is in the employment of the company as a director or KMP.

(d) the **Board may fill any casual vacancy in the office of the trustee** but while any such vacancy continues, the remaining trustee or trustees, if any, may act.

Note: If such **vacancy is caused by the resignation of the debenture trustee**, the vacancy shall be filled with the **written consent of the majority of the debenture holders**.

(e) any **debenture trustee may be REMOVED** from office **before the expiry of his term** only if it is **approved by** the **holders of not less than 3/4$^{th}$ in value of the debentures outstanding**.

(6) Debenture trustee shall **take steps to protect the interests of the debenture-holders** and **redress their grievances** in accordance with such rules as may be prescribed.

In order **to protect the interest of debenture holders**, Rule 18 (4) **provides for the convening of the meeting of debenture-holders**. Accordingly, the meeting of all the debenture holders shall be convened by the debenture trustee on:

(a) **requisition in writing** signed by debenture holders holding **at least 1/10$^{th}$ in value of the debentures** for the time being outstanding;

(b) the **happening of any event**, **which constitutes a breach, default** or which in the opinion of the debenture trustees affects the interest of the debenture holders.

(7) **Liability of Debenture Trustee:** Any provision contained in a trust deed **shall be void** in so far as it would have the **effect of exempting a trustee** thereof from, or **indemnifying him against, any liability for breach of trust**, where he **fails to show the degree of care and due diligence required** of him as a trustee, having regard to the provisions of the trust deed conferring on him any power, authority or discretion.

It is provided that the **liability of the debenture trustee shall be subject to such exemptions** as may be agreed upon by debenture-holders holding not less than **3/4$^{th}$** in value of the total debentures

at a meeting held for the purpose.

**(8) To pay Interest and Redeem Debentures:** Section 71 (8) requires that a company shall pay interest and redeem the debentures in accordance with the terms and conditions of their issue.

**(9) Filing of Petition before Tribunal:** Where at any time the debenture trustee comes to a conclusion that the **assets of the company are insufficient or are likely to become insufficient** to discharge the principal amount as and when it becomes due, the debenture trustee may file a petition before the Tribunal and the Tribunal may, after hearing, by order, **impose such restrictions** on the incurring of any further liabilities by the company.

**(10) Order of Tribunal on Failure to Redeem Debentures/Pay Interest:** According to Section 71 (10), **where a company fails to redeem the debentures on the date of their maturity** or fails to pay interest, the **Tribunal may, on the application** of any or all of the debenture-holders, or debenture trustee and, after hearing the parties concerned, **direct, by order, the company to redeem the debentures forthwith** on payment of principal and interest due thereon.

**Removed**

**(12) Specific Performance of the Contract:** Section 71 (12) states that a contract with the **company to take up and pay for any debentures** of the company may be enforced by a decree for specific performance.

**(13) The Central Government may prescribe the procedure, for securing** the issue of debentures, the form of debenture trust deed, the **procedure for the debenture-holders to inspect the trust deed** and to obtain copies thereof, **quantum of debenture redemption reserve** required to be created and such other matters.

**(14) Limit on Borrowings through Debentures:** Before the issue of debentures, the Board of Directors of the company **shall obtain approval through special resolution** if the borrowings by issuing debentures together with the amount already borrowed exceed the aggregate of company's paid-up share capital, free reserves and securities premium amount. Temporary loans obtained from the company's bankers in the ordinary course of business are not to be included in the borrowings.

**(15) Return of Allotment:** If a company makes allotment of any debentures, it is required to file with the jurisdictional Registrar a **Return of Allotment (Form No. PAS-3) within 30 days of such allotment**.

**Question and Answers**

1. **VRS Company Ltd. is holding 45% of total equity shares in SV Company Ltd. The Board of Directors of SV Company Ltd. (incorporated on January 1, 2019) decided to raise the share capital by issuing further equity shares. The Board of Directors resolved not to offer any shares to VRS Company Ltd., on the ground that it was already holding a high percentage of the total number of shares issued by SV Company Ltd. The Articles of Association of SV Company Ltd. provide that the new shares should first be offered to the existing shareholders of the company. On March 1, 2019 SV Company Ltd. offered new equity shares to all the shareholders except VRS Company Ltd. Referring to the provisions of the Companies Act, 2013 examine the validity of the decision of the Board of Directors of SV Company Ltd. of not offering any further shares to VRS Company Limited.**

**Answer**

The legal issues involved herein are covered under Section 62 (1) of the Companies Act, 2013.

Section 62 (1) (a) of the Companies Act, 2013 provides that if, at any time, a company having a share capital proposes to increase its subscribed capital by issue of further shares, such shares should first be offered to the existing equity shareholders of the company as at the date of the offer, in proportion to the paid-up capital on those shares. Hence, the company cannot ignore a section of the existing shareholders and must offer the shares to the existing equity shareholders in proportion of their holdings.

As per facts of the case, the Articles of SV Company Ltd. provide that the new shares should first be offered to the existing shareholders. However, the company offered new shares to all shareholders excepting VRS Company Ltd., which held a major portion of its equity shares. It is to be noted that under the Companies Act, 2013, SV Company Ltd. did not have any legal authority to do so.

Therefore, in the given case, decision of the Board of Directors of SV Company Ltd. not to offer any further equity shares to VRS Company Ltd. on the ground that VRS Company Ltd. already held a high percentage of shareholding in SV Company Ltd. is not valid. Such a decision violates the provisions of Section 62 (1) (a) as well as Articles of the issuing company.

2. **The Directors of Mars Motors India Ltd. desire to alter Capital Clause of the Memorandum of Association of their company. Advise them about the ways in which the said clause may be altered under the provisions of the Companies Act, 2013.**

**Answer**

Alteration of Capital: Under section 61 (1) a limited company having a share capital may, if authorised by its Articles, alter its Memorandum in its general meeting to:

(i) increase its authorized share capital by such amount as it thinks expedient;

(ii) consolidate and divide all or any of its share capital into shares of a larger amount than its existing shares;

However, no consolidation and division which results in changes in the voting percentage of shareholders shall take effect unless it is approved by the Tribunal on an application made in the prescribed manner.

(iii) convert all or any of its paid- up shares into stock and reconvert that stock into fully paid shares of any denomination.

(iv) sub-divide its shares, or any of them, into shares of smaller amount than is fixed by the Memorandum;

(v) cancel shares which, at the date of the passing of the resolution in that behalf, have not been taken or agreed to be taken by any person, and diminish the amount of its share capital by the amount of the shares so cancelled.

Further, under section 64 where a company alters its share capital in any of the above-mentioned ways, the company shall file a notice in the prescribed form with the Registrar within a period of thirty days of such alteration, along with an altered memorandum. The capital clause of memorandum, if authorised by the articles, shall be altered by passing an ordinary resolution as per Section 61 (1) of the Companies Act, 2013.

**3. Ramesh, a resident of New Delhi, sent a transfer deed duly signed by him as transferee and his brother Suresh as transferor, for registration of transfer of shares to Ryan Entertainment Private Limited at its Registered Office in Mumbai. He did not receive the transferred shares certificates even after the expiry of four months from the date of dispatch of transfer deed. He lodged a criminal complaint in the Court at New Delhi. Decide, under the provisions of the Companies Act, 2013, whether the Court at New Delhi is competent to act in the said matter?**

**Answer**

Jurisdiction of Court, now Tribunal under the Companies Act, 2013: According to Section 56 (4) of the Companies Act, 2013 every company, unless prohibited by any provision of law or of any order of court, Tribunal or other authority, shall deliver the certificates of all shares transferred within a period of one month from the date of receipt by the company of the instrument of transfer.

Further, under section 56 (6), where any default is made in complying with the provisions of sub-sections (1) to (5) of Section 56 (which deal with transfer and transmission of shares), the company shall be punishable with fine which shall not be less than 25,000 rupees but which may extend to 5 lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than 10,000 rupees but which may extend to one lakh rupees.

In this case, the jurisdiction binding on the company is that of the State in which the registered office of the company is situated i.e. Mumbai. Hence, the Court at Delhi is not competent to act in the matter.

**4. Due to insufficient profits, Silver Robotics Limited is unable to redeem its existing preference**

**shares amounting to ` 10,00,000 (10,000 preference shares of ` 100 each) though as per the terms of issue they need to be redeemed within next two months. It did not, however, default in payment of dividend as and when it became due. What is the remedy available to the company in respect of outstanding preference shares as per the Companies Act, 2013?**

**Answer**

According to Section 55(3) of the Companies Act, 2013, where a company is not in a position to redeem any preference shares or to pay dividend, if any, on such shares in accordance with the terms of issue (such shares hereinafter referred to as unredeemed preference shares), it may—

- with the consent of the holders of three-fourths in value of such preference shares, and
- with the approval of the Tribunal on a petition made by it in this behalf, issue further redeemable preference shares equal to the amount due, including the dividend thereon, in respect of the unredeemed preference shares, and on the issue of such further redeemable preference shares, the unredeemed preference shares shall be deemed to have been redeemed.

  Provided that the Tribunal shall, while giving approval under this sub-section, order the redemption forthwith of preference shares held by such persons who have not consented to the issue of further redeemable preference shares.

  In view of the provisions of Section 55 (3), Silver Robotics Limited can initiate steps for the issue of further redeemable preference shares equal to the amount due i.e. ` 10,00,000. For this purpose, it shall obtain the consent of the holders of three-fourths in value of such preference shares and also seek approval of the Tribunal by making a petition. In case, there are certain preference shareholders who have not accorded their consent for the proposal of issuing further redeemable preference shares, the Tribunal may order the company to redeem forthwith such preference shares. Accordingly, Silver Robotics Limited must be ready with sufficient funds for the redemption of preference shares held by those who have not consented.

  On the issue of such further redeemable preference shares by the company, the unredeemed preference shares shall be deemed to have been redeemed.

**5. Trisha Data Security Limited was incorporated on 1st August, 2019 with a paid- up share capital of ` 200 crores. Within such a small period of about one year in operation, it has earned sizeable profits and has topped the charts for its high employee-friendly environment. The company wants to issue sweat equity to its employees. A close friend of the CEO of the company has told him that the company cannot issue sweat equity shares as minimum 2 years have not elapsed since the time company commenced its business. The CEO of the company has approached you to advise about the essential conditions to be fulfilled before the issue of sweat equity shares especially since their company is just about a year old.**

**Answer**

Sweat equity shares of a class of shares already issued.

According to section 54 of the Companies Act, 2013, a company may issue sweat equity shares of a class of shares already issued, if the following conditions are fulfilled, namely—

(i) the issue is authorised by a special resolution passed by the company;

(ii) the resolution specifies the number of shares, the current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued;

(iii) where the equity shares of the company are listed on a recognised stock exchange, the sweat equity shares are issued in accordance with the regulations made by the Securities and Exchange Board in this behalf and if they are not so listed, the sweat equity shares are issued in accordance with such rules as prescribed under Rule 8 of the Companies (Share and Debentures) Rules, 2014,

The rights, limitations, restrictions and provisions as are for the time being applicable to equity shares shall be applicable to the sweat equity shares issued under Section 54 and the holders of such shares shall rank pari passu with other equity shareholders.

Trisha Data Security Limited can issue Sweat equity shares by following the conditions as mentioned above. It does not make a difference that the company is just about a year old because no such minimum time limit of 2 years in operations is specified under Section 54.

**6. Walnut Foods Limited has an authorized share capital of 2,00,000 equity shares of ` 100 per share and an amount of ` 2 crores in its Securities Premium Account as on 31-3-2020. The Board of Directors seeks your advice about the application of securities premium account for its business purposes. Please give your advice.**

**Answer**

Amount lying to the credit of Securities Premium Account is required to be utilised for certain prescribed purposes.

According to section 52 of the Companies Act, 2013, where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium received on those shares shall be transferred to a "securities premium account" and the provisions of this Act relating to reduction of share capital of a company shall, except as provided in this Section, apply as if the securities premium account were the paid-up share capital of the company.

The securities premium account may be applied by the company—

(a) towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares;

(b) in writing off the preliminary expenses of the company;

(c) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;

(d) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or

(e) for the purchase of its own shares or other securities under section 68.

The securities premium account may be applied by such class of companies, as may be prescribed and whose financial statement comply with the accounting standards prescribed for such class of companies under section 133,—

(a) in paying up unissued equity shares of the company to be issued to members of the company as fully paid bonus shares; or

(b) in writing off the expenses of or the commission paid or discount allowed on any issue of equity shares of the company; or

(c) for the purchase of its own shares or other securities under section 68.

Keeping the above points in view Walnut Foods Limited should proceed to utilise the amount of Securities Premium Account.

7. **OLAF Limited, a subsidiary of PQR Limited, decides to give a loan of `4,00,000 to its Human Resource Manager Mr. Surya Nayan, who does not fall in the category of Key Managerial Personnel and draws a salary of `40,000 per month, to buy 500 partly paid-up equity shares of ` 1000 each in OLAF Limited. Examine the validity of company's decision under the provisions of the Companies Act, 2013.**

**Answer**

Restrictions on purchase by company or giving of loans by it for purchase of its share: As per section 67 (3) of the Companies Act, 2013 a company is allowed to give a loan to its employees subject to the following limitations:

(a) The employee must not be a director or Key Managerial Personnel;

(b) The amount of such loan shall not exceed an amount equal to six months' salary of the employee.

(c) The loan must be extended for subscribing fully paid-up shares.

In the given instance, Human Resource Manager Mr. Surya Nayan is not a Key Managerial Personnel of the OLAF Limited. Further, he is drawing a salary of

` 40,000 per month and wants to avail loan for purchasing 500 partly paid-up equity shares of ` 1000 each of OLAF Limited in which he is employed.

Keeping the above facts and legal provisions in view, the decision of OLAF Limited in granting a loan of ` 4,00,000 for purchase of its partly paid-up shares to Human Resource Manager is invalid due to the following reasons:

i. The amount of loan is more than 6 months' salary of Mr. Surya Nayan, the HR Manager. It should have been restricted to ` 2,40,000 only.

ii. The loan to be given by OLAF Limited to its HR Manager Mr. Surya Nayan is meant for purchase of partly paid shares.

8. **Shilpi Developers India Limited owed to Sunil ` 10,000. On becoming this debt payable, the company offered Sunil 100 shares of ` 100 each in full settlement of the debt. The said shares**

**were allotted to Sunil as fully paid-up in lieu of his debt. Examine the validity of this allotment in the light of the provisions of the Companies Act, 2013**

**Answer**

Under Section 62 (1) (c) of the Companies Act, 2013 where at any time, a company having a share capital proposes to increase its subscribed capital by the issue of further shares, either for cash or for a consideration other than cash, such shares may be offered to any persons, if it is authorised by a special resolution and if the price of such shares is determined by a empowered to allot the shares to Sunil in settlement of its debt to him. This valuation report of a registered valuer, subject to the compliance with the applicable provisions of Chapter III and any other conditions as may be prescribed.

In the present case, Shilpi Developers India Limited's allotment, to be classified as shares issued for consideration other than cash, must be approved by the members by a special resolution. Further, the valuation of the shares must be done by a registered valuer, subject to the compliance with the applicable provisions of Chapter III and any other conditions as may be prescribed.

**9. What are the provisions of the Companies Act, 2013 relating to the appointment of 'Debenture Trustee' by a company? Whether the following can be appointed as 'Debenture Trustee':**

**(i) A shareholder who has no beneficial interest.**

**(ii) A creditor whom the company owes ` 499 only.**

**(iii) A person who has given a guarantee for repayment of amount of debentures issued by the company?**

**Answer**

Appointment of Debenture Trustee: Under section 71 (5) of the Companies Act, 2013, no company shall issue a prospectus or make an offer or invitation to the public or to its members exceeding five hundred for the subscription of its debentures, unless the company has, before such issue or offer, appointed one or more debenture trustees and the conditions governing the appointment of such trustees shall be such as may be prescribed.

Rule 18 (2) of the Companies (Share Capital and Debentures) Rules, 2014, framed under the Companies Act for the issue of secured debentures provide that before the appointment of debenture trustee or trustees, a written consent shall be obtained from such debenture trustee or trustees proposed to be appointed and a statement to that effect shall appear in the letter of offer issued for inviting the subscription of the debentures.

Further according to the rules, no person shall be appointed as a debenture trustee, if he-

(i) beneficially holds shares in the company;

(ii) is a promoter, director or key managerial personnel or any other officer or an employee of the company or its holding, subsidiary or associate company;

(iii) is beneficially entitled to moneys which are to be paid by the company otherwise than as remuneration payable to the debenture trustee;

(iv) is indebted to the company, or its subsidiary or its holding or associate company or a subsidiary of such holding company;

(v) has furnished any guarantee in respect of the principal debts secured by the debentures or interest thereon;

(vi) Has any pecuniary relationship with the company amounting to two percent. or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;

(vii) is a relative of any promoter or any person who is in the employment of the company as a director or key managerial personnel;

Thus, based on the above provisions answers to the given questions are as follows:

(i) A shareholder who has no beneficial interest, can be appointed as a debenture trustee.

(ii) A creditor whom company owes ` 499 cannot be appointed as a debenture trustee. The amount owed is immaterial.

(iii) A person who has given guarantee for repayment of principal and interest thereon in respect of debentures also cannot be appointed as a debenture trustee.

**10. Mr. Nilesh has transferred 1000 equity shares of Perfect Vision Private Limited to his sister Ms. Mukta. The company did not register the transfer of shares and also did not send a notice of refusal to Mr. Nilesh or Ms. Mukta within the prescribed period. Discuss as per the provisions of the Companies Act, 2013, whether aggrieved party has any right(s) against the company?**

**Answer**

The problem given in the question is governed by Section 58 of the Companies Act, 2013 dealing with the refusal to register transfer and appeal against such refusal.

In the present case, the company has committed the wrongful act of not sending the notice of refusal to register the transfer of shares.

Under section 58 (1), if a private company limited by shares refuses to register the transfer of, or the transmission by operation of law of the right to any securities or interest of a member in the company, then the company shall send notice of refusal to the transferor and the transferee or to the person giving intimation of such transmission, within a period of thirty days from the date on which the instrument of transfer, or the intimation of such transmission, was delivered to the company.

According to Section 58 (3), the transferee may appeal to the Tribunal against the refusal within a period of thirty days from the date of receipt of the notice or in case no notice has been sent by the

company, within a period of sixty days from the date on which the instrument of transfer or the intimation of transmission, was delivered to the company.

In this case, as the company has not sent even a notice of refusal, Ms. Mukta being transferee can file an appeal before the Tribunal within a period of sixty days from the date on which the instrument of transfer was delivered to the company.

**11. Shankar Portland Cement Limited is engaged in the manufacture of different types of cements and has got a good brand value. Over the years, it has built a good reputation and its Balance Sheet as at March 31, 2020 showed the following position:**

**1. Authorized Share Capital (25,00,000 equity shares of `10/- each)**

**` 2,50,00,000**

**2. Issued, subscribed and paid-up Share Capital (10,00,000 equity shares of `**

**10/- each, fully paid-up) ` 1,00,00,000**

**3. Free Reserves ` 3,00,00,000**

**The Board of Directors are proposing to declare a bonus issue of 1 share for every 2 shares held by the existing shareholders. The Board wants to know the conditions and the manner of issuing bonus shares under the provisions of the Companies Act, 2013.**

Answer

According to Section 63 of the Companies Act, 2013, a company may issue fully paid-up bonus shares to its members, in any manner whatsoever, out of -

(i) its free reserves;

(ii) the securities premium account; or

(iii) the capital redemption reserve account.

Provided that no issue of bonus shares shall be made by capitalising reserves created by the revaluation of assets.

Conditions for issue of Bonus Shares: No company shall capitalise its profits or reserves for the purpose of issuing fully paid-up bonus shares, unless—

(i) it is authorised by its Articles;

(ii) it has, on the recommendation of the Board, been authorised in the general meeting of the company;

(iii) it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;

(iv) it has not defaulted in respect of payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus;

(v) the partly paid-up shares, if any, outstanding on the date of allotment, are made fully paid-up;

(vi) it complies with such conditions as are prescribed by Rule 14 of the Companies (Share Capital and debentures) Rules, 2014 which states that the company which has once announced the decision of its Board recommending a bonus issue, shall not subsequently withdraw the same.

Further, the company has to ensure that the bonus shares shall not be issued in lieu of dividend.

For the issue of bonus shares Shankar Portland Cement Limited will require reserves of ` 50,00,000 (i.e. half of ` 1,00,00,000 being the paid-up share capital), which is readily available with the company. Hence, after following the above conditions relating to the issue of bonus shares, the company may proceed for a bonus issue of 1 share for every 2 shares held by the existing shareholders.

**12. State the legal provisions in respect of 'Declaration of Solvency', which an unlisted public company needs to adhere to while taking steps to buy-back its own shares.**

**Answer**

According to Section 68 (6), where an unlisted public company has passed a special resolution under Section 68 (2) (b) or the Board has passed a resolution under item (ii) of the proviso to Section 68 (2) (b) to buy-back its own shares, it shall, before making such buy-back, file with the Registrar a 'Declaration of Solvency' in Form SH-9. The declaration shall be verified by an affidavit to the effect that the Board has made a full inquiry into the affairs of the company as a result of which they have formed an opinion that it is capable of meeting its liabilities and will not be rendered insolvent within a period of one year from the date of declaration of solvency adopted by the Board. The declaration shall be signed by at least two directors of the company, one of whom shall be the managin

# Chapter 5

# ACCEPTANCE OF DEPOSITS BY COMPANIES

**WHAT IS DEPOSIT? - Section 2(31)**

It includes any receipt of money by way of **deposit or loan** or i**n any other form**, by a company, but does not include such categories of amount as may be prescribed in consultation with the RBI.

**WHAT IS NOT DEPOSIT?**

According to the **Companies (Acceptance of Deposits) Rules, 2014**, following categories of amount may not be considered as deposit—

(i) Any **amount received** from the

- Central or state Government, or
- from any other source whose **repayment is guaranteed** by the Central or State Government, or
- any amount received from a **local authority**, or
- any amount received from a **statutory authority**

(ii) Any amount received from

- foreign Governments,
- foreign international banks,
- multilateral financial institutions etc. subject to the provisions of Foreign Exchange Management Act, 1999

(iii) **Loan received** from any **banking company**.
(iv) **Loan** or financial assistance from **Public Financial Institutions**

2(*72*) "public financial institution" means—
(*i*) the Life Insurance Corporation of India, established under section 3 of the Life Insurance Corporation Act, 1956 (31 of 1956);
(*ii*) the Infrastructure Development Finance Company Limited, referred to in clause (*vi*) of sub-section (1) of section 4A of the Companies Act, 1956 (1 of 1956) so repealed under section 465 of this Act;
(*iii*) specified company referred to in the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002 (58 of 2002);
(*iv*) institutions notified by the Central Government under sub-section (*2*) of section 4A of the Companies Act, 1956 (1 of 1956) so repealed under section 465 of this Act;
(*v*) such other institution as may be notified by the Central Government in consultation with the Reserve Bank of India:
**Provided** that no institution shall be so notified unless—
(*A*) it has been established or constituted by or under any Central or State Act; *****[14][other than this Act or the previous company law]; or

(*B*) not less than fifty-one per cent. of the paid-up share capital is held or controlled by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments;

(v) **Amount received** against issue of **commercial paper** or any other instruments issued in accordance with RBI guidelines;
(vi) Any **amount received by a company** from any **other company**;
(vii) Amount received and held towards subscription to any securities (including **share application money** or advance towards allotment of securities, pending allotment).

**Explanation:**

1. If the securities for which application money or advance for such securities was received cannot be allotted within 60 days from the date of receipt of the application money or advance for such securities and such **application money or advance is not refunded to the subscribers within 15 days from the date of completion of 60 days, such amount shall be treated as a deposit under these rules.**

2. Any adjustment of the amount for any other purpose shall not be treated as refund.

(viii) Any amount received from a **director of the company** or a relative of the director of the **Private company.**

Provided that the director or a relative of the director gives a declaration in writing to the effect that the amount is not being given out of funds acquired by him by borrowing or accepting loans or deposits from others and the company shall disclose the details of money so accepted in the Board's report;

(ix) Amount raised by the issue of bonds or secured debentures if -

- They are **secured by a first charge** or rank pari passu; and
- **Such charge is created on any assets referred to in Schedule III** of the Act **excluding intangible assets** of the company or
- bonds or debentures **compulsorily convertible into shares of the company within 10 years**; and
- the **amount of such bonds or debentures** shall **not exceed** the **market value** of such assets as assessed by a registered valuer;

(x) Any amount raised by **issue of non-convertible debenture** not constituting a charge on the assets of the company and **listed on a recognized stock exchange** as per applicable regulations made by SEBI.
(x) **Amount received from an employee** of the company **not exceeding his annual salary** under a contract of employment with the company in the **nature of non- interest bearing security deposit**;
(xi) Any **non-interest bearing amount received** or held in **trust**
(xii) any **amount received** in the course of or for the **purposes of the business** of the company:

(a) **as an advance for the supply of goods** or services, provided that **such advance is appropriated against such supply within a period of 365 days** from the date of acceptance of such advance.

**Exception of 365 days**: Advance which is subject matter of any legal proceedings before any court, the said limit shall not apply.

(b) as **advance received in connection with an immovable property**, provided that such advance is adjusted against such property in accordance with the terms of agreement or arrangement.

(c) as **security deposit for the performance of the contract** for supply of goods or services.

(d) as **advance received under long term projects** or for supply of capital goods except those covered under item (b) above.

(e) as an **advance for providing future services** in the form of a warranty or maintenance contract as per written agreement or arrangement, if the **period for providing such services does not exceed**

- the period prevalent business practice or
- **five years**, from the date of acceptance of such service **whichever is less**.

(f) as an advance received and **as allowed by any sectoral regulator**.

(g) as an advance for subscription towards publication, whether in print or in electronic to be adjusted against receipt of such publications.

**Explanation:** For the purpose of sub-clause the amount shall be deemed to be deposits on the expiry of 15 days from the date they become due for refund.

(xiii) Any **amount brought in by the promoters themselves or by their relatives of the company by way of unsecured loan** in **pursuance of the stipulation of any lending financial institution** or a bank

(xiv) Any **amount accepted by a Nidhi company**.

(xv) Amount received by way of subscription in respect of a **chit** under the Chit Fund Act, 1982

(xvi) Amount **received by the company under any collective investment scheme**

(xvii) **Convertible Note:**

- Amount of **25 lakh rupees or more**
- Received by a **start-up company**,
- by way of a **convertible note** (convertible into equity shares or repayable within a period not exceeding **10 years** from the date of issue)
- in a single tranche, from a person.

Explanation—For the purposes of this sub-clause,—

**"Start-up company"** means a private company incorporated under the Companies Act, 2013 or Companies Act, 1956 and recognized as such by the Department for Promotion of Industry and Internal Trade];

**Example 3**: Greedwood limited ('the company) which is register as start-up company register under Companies Act, 2013 has received an amount of ` 20 lacs and ` 10 lakh on different date by way of a convertible note. Though the company has received an amount of twenty-five lakh rupees or more, the

said amount will be considered as deposit since the aggregate amount has not received in single tranche in terms of the rule stated above Sub-clause (xvii)]

(xviii) **Any amount received by a company from**

- **Alternate Investment Funds**,
- **Domestic Venture Capital Funds**,
- Infrastructure Investment Trusts,
- Real Estate Investment Trusts (REIT) and
- Mutual Funds

registered with the SEBI in accordance with regulations made by it.

**#Clarification:**

Amounts received by private companies from their members, directors or their relatives before 1st April, 2014 – whether to be considered as deposits or not under the Companies Act, 2013 ?

It is clarified that such amounts received by private companies prior to 1st April, 2014 shall not be treated as 'deposits' subject to the condition that **relevant private company shall disclose** in the notes to its financial statement the figure of such amounts and the accounting head in which such amounts have been shown.

| **TEST YOUR KNOWLEDGE** | |
|---|---|
| Please check which of the following source of funds are coming under the definition of deposits in case of a company. | |
| (a) Rs.5 Crore from Government Agency, Financial institutions, Banks or by way of Commercial Paper. | |
| (b) Rs.50 Lakhs by way of Share Application money | |
| (c) Rs.50 Lakhs from one of its director by way of loan | |
| (d) Rs.50 Lakhs from issue of bonds and debentures | |
| (e) Rs.50 Lakhs by means of inter corporate deposit | |
| (f) Rs.25 Lakhs from its employees. | |
| (g) Rs.50 Lakhs as business advance from customers | |
| (h) Rs.50 Lakhs as advance against consideration for an immovable property. | |
| (i) Rs.25 Lakhs as security deposit for performance of provision of services | |
| (j) Rs.50 Lakhs from its promoter. | |

| | |
|---|---|
| (k) Rs.25 Lakhs raised by issue of non convertible debentures. These are not constituting charge on assets of the company. | |

## Summary

| | | |
|---|---|---|
| **1. Government**<br><br>- Amount received from the Central or State Government, Local and statutory authority<br>- foreign Governments | **2. Instruments**<br><br>- commercial paper<br>- Amount received and held towards subscription to any securities (Including share application [60 days])<br>- Secured Debenture and compulsorily convertible debentures<br>- non-convertible debenture by listed company<br>- Convertible Note – 25Lakh, single tranche, 10 years, startup | **3. Advances received for purpose of the business**<br><br>- as an advance – upto 365 days<br>- immovable property<br>- security deposit for the performance of the contract<br>- advance received under long term projects<br>- allowed by any sectoral regulator<br>- For providing future services<br>- Subscription towards publication |
| **4. Financial Institutions**<br><br>- foreign international banks<br>- multilateral financial institutions<br>- banking company<br>- Public Financial Institutions | **5. People**<br><br>- Amount from employee - not exceeding his annual salary, non- interest bearing<br>- amount brought in by the promoters or relatives – as a stipulation of any bank<br>- Received from a director of the company or a relative – Declaration required | **6. Others**<br><br>- amount accepted by a Nidhi company<br>- collective investment scheme<br>- Chit Fund Act<br>- Alternate Investment Funds, Domestic Venture Capital Funds and Mutual Funds |

## MEANING OF DEPOSITOR - Rule 2 (1) (d),

'Depositor'' means,

(i) **any member of the company** who has made a deposit with the company in accordance with the provisions of sub-section (2) of section 73 of the Act, or

(ii) **any person who has made a deposit with a public company** in accordance with the provisions of section 76 of the Act.

## PROHIBITIVE PROVISIONS AND EXEMPTED COMPANIES

### A. Prohibitive Provisions

According to section 73 (1) of the Act, **no company can accept or renew deposits from public unless it follows** the manner provided under **Chapter V** (contains provisions regarding acceptance of deposits by companies).

### B. Exempted Companies

According to the Proviso to Section 73 (1), the prohibition contained in sub-section (1) with respect to the acceptance or renewal of deposit from public **shall not apply** to the following types of companies:

(i) any **banking company**;
(ii) any **non-banking financial company** (NBFC) as defined in the RBI Act, 1934;
(iii) any **housing finance company** (HFC) registered with the National Housing Bank established under the National Housing Bank Act, 1987; and
(iv) **such other company** specified by Central Government, after consultation with the RBI.

## PROVISIONS REGARDING ACCEPTANCE OF DEPOSITS FROM MEMBERS 73(2)

**Any company may accept or renew deposits from its MEMBERS** by following the provisions as set out below:

(1) **Passing of a Resolution**: A company is required to pass a resolution in general meeting for acceptance of deposits from its members [Section 73 (2)].

(2) **Issuance of a Circular:** The company is required to issue a circular to its members including therein

- a statement showing the **financial position** of the company,
- the **credit rating** obtained,
- the **total number of depositors** and the amount due, in respect of any previous deposits accepted by the company and such other particulars. [Section 73 (2) (a)].
- A **certificate of the statutory auditor**, stating that the company has not committed default in the repayment of deposits or in the payment of interest. In case a company had committed a default in the repayment of deposits, a certificate of the statutory

auditor shall state that the company had made good the default and a **period of 5 years** has lapsed since the date of making good the default as the case may be.

- Further, the **circular may be published in English and vernacular newspaper** having wide circulation in the State in which the registered office of the company is situated.

According to Rule 4, the company shall issue such circular to all its members by registered post with acknowledgement due or speed post or by electronic mode **in Form DPT-1.**

**The advertisement shall remain valid till the earliest of the following dates:**

(a) **up to 6 months** from the closure of the financial year in which it is issued; or

(b) the date of Annual General Meeting (AGM), or in case no AGM has been held, the latest day on which the AGM should have been held as per the relevant statutory provisions.

A fresh circular shall be issued, in each succeeding financial year, for inviting deposits during that financial year.

**Example 4:** Ray Pharmaceuticals Limited issued a Circular inviting 'deposits' from its members on 14-02-2022. Its Annual General Meeting (AGM) was held on 07-09-2022. Since, six months from the closure of FY 2021-22 end on 30-09-2022, the Circular remains valid till 07-09-2022 only. After this date, a fresh Circular shall be issued if the company wants to invite further deposits from its members.

**(3) Filing of Circular:** The company is required to file a copy of the circular containing the statement with the **Registrar within 30 days** before the date of issue of the circular. **[Section 73 (2) (b)]**

**(4) Requirement of Deposit Repayment Reserve Account:** The company is required to deposit, **on or before 30th of April each year, at least 20% of the amount of its deposits maturing during the following financial year** and **kept in a scheduled bank in a separate bank** account to be called deposit repayment reserve account. [Section 73 (2) (c)].

It shall not be used for any other purpose other than repayment.

**Note:** Such amount shall not at any time fall below 20% of the amount of deposits maturing during the financial year.

**(5) Certification as to No default in Repayment:** The **company needs to certify that it has not committed any default** in the repayment of deposits accepted either before or after the commencement of this Act or payment of interest on such deposits.

In case a default had occurred, the company made good the default and a period of 5 years had lapsed since the date of making good the default. [Section 73 (2) (e)]

**EXEMPTION**

**1) Exemption to certain PRIVATE COMPANIES:** Clauses (a) to (e) of Section 73(2)
- issue of circular,
- filing the copy of such circular with the Registrar,
- depositing of certain amount and
- certification as to no default committed, **shall not apply to a private company**:

(A) which accepts from its **members monies not exceeding 100%** of aggregate of the **paid-up share capital, free reserves and securities premium account**; **or**

(B) **which is a start-up, for 5 years** from the date of its incorporation; **or**
(C) which **fulfils all of the following conditions**, namely:
(a) which is **not an associate or a subsidiary company of any other company**;
(b) if the **borrowings of such a company from banks or financial institutions** or any body corporate **is less than twice of its paid-up share capital** or 50 crore rupees, whichever is lower; and
(c) such a **company has not defaulted in the repayment of such borrowing**s subsisting at the time of accepting deposits under this section.
However, such a company [as referred to in clauses (A), (B) or (C)] shall file the details of monies accepted to the Registrar in the specified manner (i.e. in Form DPT-3).

**2)** Clauses (a) to (e) of section 73 (2) shall not apply to a **Specified IFSC public company which accepts from its members,** monies not exceeding 100% of aggregate of the paid-up share capital and free reserves, and such company shall file the details of monies so accepted with the Registrar in such manner as may be specified (i.e. in Form DPT-3).

**(6) Provision of Security:** The company may provide security, for the due repayment of the amount of deposit or the interest thereon. Further, if security is provided, the **company shall take steps for the creation of charge** on the property or assets of the company.

**Unsecured**: It may be noted that in case a company does not secure the deposits or secures such deposits partially, then, the deposits shall be termed as ''unsecured deposits''. Accordingly, it shall be so quoted in every circular, form, advertisement or in any document related to invitation or acceptance of deposits. [Section 73 (2) (f)]

**(7) Application to Tribunal if the Company fails to Repay: In case a company fails to repay the deposit or part** thereof or any interest thereon, the **depositor concerned may apply to the Tribunal** for an order directing the company to pay the sum due or damage incurred by him as a result of such non- payment and for such other orders as the Tribunal may deem fit. [Section 73 (4)]

**MAXIMUM AMOUNT OF DEPOSITS FROM MEMBERS**

A company is permitted to accept or renew any deposit from its members including existing deposits, **maximum up to 35% of the aggregate** of its **paid-up share capital, free reserves and securities premium account.**

**Exception**

1) A Specified **IFSC Public company and a private company** may accept from its members monies not exceeding 100% of aggregate of the paid-up share capital, free reserves and securities premium account. Further, such company shall file the details of monies so accepted with the Registrar in Form DPT-3.

2) Provided further that the maximum limit in respect of deposits to be accepted from members **shall not apply to following classes of private companies**, namely:-

(i) a **private company which is a start-up**, for **10 years** from the date of its incorporation;

(ii) a **private company which fulfils all of the following conditions**, namely:-

(a) which is **not an associate or a subsidiary company** of any other company;

(b) **Borrowings** of such company from banks or financial institutions or any body corporate is **less than twice of its paid up share capital** or 50 crore rupees, whichever is less; and

(c) such a **company has not defaulted in the repayment** of such borrowings subsisting at the time of accepting deposits under section 73:

**Note:** It may be noted that all the companies accepting deposits shall file the details of monies so accepted with the Registrar in Form DPT-3.

**PROVISIONS REGARDING ACCEPTANCE OF DEPOSITS FROM PUBLIC BY ELIGIBLE COMPANIES – Section 76**

Only **'eligible companies'** are permitted to **accept deposits from the public**, in addition to their members.

It means not all the companies can access the public at large for raising deposits though they can accept deposits from their members.

**ELIGIBLE COMPANY - Rule 2 (1) (e)**

It is a public company, having

- a **net worth** of not less than **100 crore** rupees; **OR**
- a **turnover** of not less than **500 hundred** crore rupees

**and**

which has obtained the **prior consent by means of a SPECIAL RESOLUTION** and filed it with the ROC **before making any invitation to the public** for acceptance of deposits:

**Section 76 of the Act and the Companies (Acceptance of Deposits) Rules, 2014 deal with acceptance of deposits from public by eligible companies.**

1. **Passing of Special Resolution**: The 'eligible company' is required to obtain the prior consent by means of a special resolution in general meeting and also file the said resolution with the Registrar of Companies before making any invitation to the public.

   **Exception:** However, an 'eligible company', which is accepting deposits within the limits specified under section 180 (1) (c), may accept deposits by means of an ordinary resolution.

2. **Obtaining of Credit Rating**:
   - The 'eligible company' shall be required to obtain the rating (including its net-worth, liquidity and ability to pay its deposits on due date) **from a recognised credit rating agency**.
   - The given rating which ensures adequate safety shall be **informed to the public at the time of invitation** of deposits **from the public**.
   - Further, the rating shall be **obtained every year during the tenure** of deposits and shall be sent to the ROC along with the Return of Deposits in Form DPT-3, every year.

- The credit rating **SHALL NOT BE BELOW**

  - the minimum investment grade rating or

  - other specified credit rating for fixed deposits.

  It shall be **obtained from any one of the approved credit rating agencies** as specified for NBFC.

3. **Charge Creation on Assets Necessary if the Deposits are Secured**

- Every company which accepts secured deposits from the public shall **within 30 days of such acceptance, create a charge on its assets**. The amount of charge shall not be less than the amount of deposits accepted.
- The company accepting secured deposits shall create **security on its tangible assets** only.
- The other notable points are:
  - The company **cannot create charge on intangible assets**.
  - Total **value of security should not be less** than the amount of deposits accepted and interest payable thereon.
  - The security shall be **created in favour of a trustee** for the depositors on specific movable and immovable property of the company.

4. **Appointment of Trustee for Depositors:** Following provisions are required to be observed in this respect:

- **One or more trustees for depositors** need to be appointed by the company **for creating security for the deposits.**
- A written **consent shall be obtained** from the trustees before their appointment, which shall also **appear in the circular or advertisement** with reasonable prominence.
- The company shall execute a **deposit trust deed in Form DPT-2** at least 7 days before issuing the circular or circular in the form of advertisement.
- Following people shall not be appointed as a trustee for the depositors, if the proposed trustee:

  (a) is a **director, KMP or any other officer** or **an employee** of the company or of its holding, subsidiary or associate company **or a depositor in the company**;
  (b) is **INDEBTED** to the company, or its subsidiary or its holding or associate company or a subsidiary of such holding company;
  (c) has any **material pecuniary relationship** with the company;
  (d) has entered into **any guarantee arrangement** in respect of principal debts secured by the deposits or interest thereon;
  (e) is **related to any person** specified in clause (a) above.

- The **trustee shall not be removed after the issue of circular or advertisement and before the expiry of his term** except with the **consent of all the directors present at a meeting of the board.** In case the company is required to have independent directors, at least one independent director shall be present in such meeting of the Board.

5. **Issuance of Circular in the Form of Advertisement:**

- An **'eligible company' intending to invite deposits** is required to issue a circular in the form of an advertisement in DPT-1.
- Such advertisement shall be **published** in English and vernacular newspaper.
- If the company has its **website**, the circular shall also be placed on the website.
- **Filing with the Registrar:** At **least 30 days before the issue** of the advertisement, signed by a majority of the directors or by their duly authorised agents is required to be delivered to the **Registrar of Companies** for registration.
- **The advertisement shall remain valid till the earliest of the following dates:**

(a) **up to 6 months** from the closure of the financial year in which it is issued; or

(b) the **date of Annual General Meeting (AGM)**, or in case no AGM has been held, the latest day on which the AGM should have been held as per the relevant statutory provisions.

A fresh circular shall be issued, in each succeeding financial year, for inviting deposits during that financial year.

- **Issue and Effective dates:** The date on which the advertisement appeared in the newspaper shall be taken as the date of the issue of advertisement. Further, the effective date of issue of circular shall be the date on which the circular was dispatched.

6. **Maintenance and Using the Amount of Deposit Repayment Reserve Account**: The company is required to deposit, on or before 30th of April each year, at least 20% of the amount of its deposits maturing during the following financial year and kept in a scheduled bank in a separate bank account to be called deposit repayment reserve account. [Section 73 (2) (c)]

Rule 13 states that the amount so deposited in the account shall not be used by the company for any purpose other than repayment of deposits. Further, it states that such amount shall not at any time fall below twenty percent of the amount of deposits maturing during the financial year.

## COMMON RULES APPLICABLE TO SECTION 73 AND 76

### I. TENURE FOR WHICH DEPOSITS CAN BE ACCEPTED

- **MINIMUM TENURE:** A company is not permitted to accept or renew deposits which is
  - **repayable on demand** or
  - in less than **6 months.**
- **Exception to the rule of tenure of six months:** For the purpose of meeting any of its **short-term requirements of funds**, a company may accept or renew deposits for repayment **earlier than 6 months** subject to the condition that:

(i) such deposits **shall not exceed 10%** of the aggregate of the **paid-up share capital, free reserves and securities premium account** of the company; and

(ii) such deposits are **repayable only on or after 3 months** from the date of such deposits or renewal.

- **MAXIMUM TENURE:** Further, the maximum period of acceptance of deposit **cannot exceed 36 months.**

Example 3: A, a member of the company has deposited ₹1,00,000 with his company on 1st April, 2019. The earliest repayment date in this case shall be 30th September, 2019 and the latest repayment date shall be 31st March, 2022. Thus, the tenure will range between six months and thirty-six months, as per the policy of the company.

## II. THE QUANTUM OF DEPOSITS

**The Quantum of deposits in nutshell:**

| Type of company | Members | Public |
|---|---|---|
| Eligible Company | Upto 10% of aggregate of the paid up share capital, free reserves and securities premium account | Upto 25% of aggregate of the paid up share capital, free reserves and securities premium account |
| Company referred in section 73(2) i.e. Non-eligible Companies | Upto 35% of aggregate of the paid up share capital, free reserves and securities premium account | Prohibited |
| Government Company (eligible under section 76) | – | Upto 35% of aggregate of the paid up share capital, free reserves and securities premium account |

**Refer Private company exceptions.**

## III. CEILING ON RATE OF INTEREST AND BROKERAGE PAYABLE ON DEPOSITS

1) A company is permitted to pay any rate of interest or pay any amount of brokerage **but it shall not exceed the maximum rate of interest or brokerage prescribed by the RBI in case of non-banking financial companies** (NBFCs) for acceptance of deposits.

Further, no brokerage shall be paid to any person except the person who is authorised in writing by the company to solicit deposits on its behalf and through whom deposits are actually procured.

2) **Filling of Application Form for making Deposits**: A company shall accept or renew any deposit, only when an application, as specified by the company, is submitted by the intending depositor and the **application shall contain a declaration** made by the intending depositor to the effect that the **deposit is not being made out of any money borrowed by him** from any other person.

## IV. DEPOSITS IN JOINT NAMES and NOMINATION

1) In case the depositors so desire, deposits may be accepted in **joint names not exceeding three**. A joint deposit may be accepted with or without any of the clauses, namely, "Jointly", "Either or Survivor", "First named or Survivor", "Anyone or Survivor". These clauses operate on maturity.

**Example: A, B and C have jointly deposited ` 1,00,000 in a company**.

• In case of '**Jointly'** clause the repayment of deposit on maturity shall be made to all the three together i.e. A, B and C or the survivors.

• In case of '**Either or Survivor**' clause, the repayment of deposit on maturity shall be made to either of the three i.e. either A or B or C or the survivor.

• In case of '**First named or Survivor**' clause, the repayment of deposit on maturity shall be made to the first named person i.e. A if he is the first named person or the survivor.

• In case of 'Anyone or Survivor' clause, the repayment of deposit on maturity shall be as in the case of 'Either or Survivor'.

**2) Nomination**

The nominee shall be the **person to whom his deposits shall vest in the event of his death.**

## V. DOCUMENTS AND FILING

1) **Deposit Receipt: Within 21 days from the date of receipt of money** or realization of cheque or date of renewal, the **company is required to furnish a deposit receipt** to the depositor or his agent. The receipt shall be signed by the duly authorised officer and state the date of deposit, the name and address of the depositor, the amount of deposit, the rate of interest and the maturity date.

2) Filing of Return of Deposits with the Registrar: A duly audited return of deposits in DPT-3 **and declaration to that effect shall be submitted by the auditor in Form DPT-3** (containing particulars as on 31st March of every year) shall be filed with the ROC along with requisite fee on or before the 30th June of that year.

It is clarified by way of Explanation that DPT-3 shall be used to include particulars of deposits or particulars of transactions not considered as deposits or both by every company (other than a Government company).

**3) No Right to Alter:** The **company has no right to alter any of the terms and conditions of the deposit, deposit trust deed** which may prove detrimental to the interest of the depositors after circular or circular in the form of advertisement is issued and deposits are accepted.

**4) Disclosures in Financial Statements:** A public company shall disclose in its financial statements by way of note about the money received from its directors. In case of a private company it shall disclose in its financial statements by way of note about the money received from the directors or the relatives of directors.

As a onetime measure, every company (other than a Government company) shall file a onetime return of outstanding receipt of money or loan by a company not considered as deposits from 1st April 2014 till 31st March, 2019 in Form DPT-3 with the Registrar of Companies within 90 days from 31st March, 2019 along with requisite fee.

**5) Penal Rate of Interest:** In case the company **fails to repay deposits** on maturity, after they are claimed, it shall pay **penal rate of interest of 18% per annum** for the overdue period.

**6) Punishment for Contravention:** If any company inviting deposits or any other person contravenes any of the 'deposit rules' for which no punishment is provided in the Act, the **company and every officer**-in-default shall be punishable as under:

• with fine extendable to 5000 rupees; and

• in case the contravention is a continuing one, with a further fine up to 500 hundred rupees for every day during which the contravention continues.

## VI. REGISTER OF DEPOSITS

1) Every company accepting deposits shall maintain separate registers for deposits accepted or renewed at its registered office. Following particulars shall be entered separately in the case of each depositor:

(a) name, address and **PAN** of the depositor/s;
(b) particulars of the **guardian**, in case of a minor;
(c) particulars of the **nominee**;
(d) deposit receipt number;
(e) **date and the amount** of each deposit;
(f) **duration of the deposit** and the date on which each deposit is repayable;
(g) **rate of interest** on such deposits to be payable to the depositor;
(h) **due date** for payment of interest;
(i) instructions for payment of interest and for non- deduction of tax at source, if any;
(l) particulars of **security or charge created** for repayment of deposits;
(m) any other relevant particulars.

2) The **entries shall be made within 7 days** from the date of issuance of the receipt duly authenticated by a director or secretary of the company or by any other officer authorised by the Board for this purpose.

3) The **said register shall be preserved** for a **period of not less than eight years** from the financial year in **which the latest entry is made** in the register.

## VII. PREMATURE REPAYMENT OF DEPOSITS

1. **After the expiry of 6 months but before the actual date of maturity,** if a depositor requests for premature repayment, **the rate of interest payable shall be 1% less** than the rate which would be payable for the period for which the deposit has actually run.

   It is to be noted that if the period contains any part of the year which is less than 6 months then it shall be excluded; if that **part is 6 months or more it shall be taken as one year.**

2. **Reduction of rate of interest is not applicable in the following cases:**

   - If it is prematurely **repaid to comply with Rule 3** i.e. to reduce the total amount of deposits to bring it **within the permissible limits**; or
   - If it is prematurely **repaid to provide for war risk or other related benefits to the personnel of naval, military or air forces or to their families during the period of emergency** declared under Article 352 of the constitution.

3. **Higher rate of Interest:** In case a depositor desires to avail higher rate of interest by **renewing the deposit before its actual maturity date**, the company shall pay him the higher

rate of interest **only if the deposit is renewed for a period longer than the unexpired period of deposit.**

**REPAYMENT OF DEPOSITS, ETC, ACCEPTED BEFORE COMMENCEMENT OF THIS ACT [SECTION 74]**

The provisions regarding repayment of deposits accepted before commencement of the Companies Act, 2013, has been dealt with in section 74. These provisions are explained as under:

(i) In case any deposit was accepted by a **company before the commencement of this Act** (i.e. before 1.4.2014), **and the amount of such deposit or any interest remains unpaid** as on 1.4.2014 or becomes due at any time thereafter, the company shall take the following steps:

(a) file, within a period of 3 months from such commencement or from the date on which such payments are due, with the Registrar:

• a statement of **all the deposits accepted** and **sums remaining unpaid** with the interest payable thereon **along with the arrangements made for such repayment**.

(b) **repay within 3 years from such commencement** or on or **before expiry of the period for which the deposits were accepted**, **whichever is earlier.**

(ii) **Extension of Time for Repayment of Deposits by the Tribunal**: The Tribunal may, on an application made by the company **may allow further time as considered reasonable to the company to repay the deposit.**

(iii) Punishment for Non-Repayment of Deposits: As per section 74 (3), if a company fails to repay the deposit or part thereof or any interest thereon within the time specified in section 74 (1) or such further extended time allowed by the Tribunal under section 74 (2), the company shall, in addition to the payment of the amount of deposit or part thereof and the interest due, be punishable as under:

• **Company:** with fine minimum of one crore rupees and maximum of ten crore rupees; and

• **Every officer-in-default:** with imprisonment extendable to seven years or with fine minimum of twenty-five lakh rupees and maximum of two crore rupees, or with both.

**PUNISHMENT FOR CONTRAVENTION OF SECTION 73 OR SECTION 76 [SECTION 76A]**

(a) **the company** shall, **in addition to the payment of the amount** of deposit or part thereof and the interest due, be punishable with fine which shall not be less than **one crore rupees or twice the amount of deposit accepted** by the company, **whichever is lower** rupees but which **may extend to 10 crore rupees**; and

(b) **every officer** of the company who is in default shall be **punishable with imprisonment** which may extend to **7 years and with fine** which shall not be less than **25 lakh rupees** but which may **extend to 2 crore rupees**.

Provided that if it is proved that the officer of the company who is in default, has contravened such provisions knowingly or wilfully with the intention to deceive the

company or its shareholders or depositors or creditors or tax authorities, he shall be liable for action under section 447.

**POWER OF CENTRAL GOVERNMENT TO DECIDE CERTAIN QUESTIONS**

As per Rule 18, If any question arises as to the applicability of these rules to a particular company, such question shall be decided by the Central Government in consultation with the Reserve Bank of India

**Question and Answers**

1. **Enumerate the amounts which when received by a company in the ordinary course of business are not to be considered as deposits.**

Answer

According to Rule 2 (1) (c) (xii), following amounts if received by a company in the course of, or for the purposes of, the business of the company, shall not be considered as deposits:

(a) any amount received as an advance for the supply of goods or provision of services accounted for in any manner whatsoever to be appropriated within a period of three hundred and sixty-five days from the date of acceptance of such advance:

However, in case any advance is subject matter of any legal proceedings before any court of law, the time limit of three hundred and sixty-five days shall not apply.

(b) any amount received as advance in connection with consideration for an immovable property under an agreement or arrangement. However, such advance is required to be adjusted against such property in accordance with the terms of agreement or arrangement;

(c) any amount received as security deposit for the performance of the contract for supply of goods or provision of services;

(d) any amount received as advance under long term projects for supply of capital goods except those covered under item (b) above;

(e) any amount received as an advance towards consideration for providing future services in the form of a warranty or maintenance contract as per written agreement or arrangement, if the period for providing such services does not exceed the period prevalent as per common business practice or five years, from the date of acceptance of such service whichever is less;

(f) any amount received as an advance and as allowed by any sectoral regulator or in accordance with directions of Central or State Government;

(g) any amount received as an advance for subscription towards publication, whether in print or in electronic to be adjusted against receipt of such publications;

However, if the amount received under items (a), (b) and (d) above becomes refundable (with or without interest) due to the reasons that the company accepting the money does not have necessary permission or approval, wherever required, to deal in the goods or properties or services for which the money is taken, then the amount received shall be deemed to be a deposit under these rules.

Further, for the purposes of this sub-clause the amount shall be deemed to be deposits on the expiry of fifteen days from the date they become due for refund.

**2. State the procedure to be followed by companies for acceptance of deposits from its members according to the Companies Act, 2013. What are the exemptions available to a private limited company?**

**Answer**

Acceptance of deposits by a company from its members: As per section 73 (2) of the Companies Act, 2013, a company may, subject to the passing of a resolution in general meeting and subject to such rules as may be prescribed in consultation with the Reserve Bank of India, accept deposits from its members on such terms and conditions, including the provision of security, if any, or for the repayment of such deposits with interest, as may be agreed upon between the company and its members, subject to the fulfilment of the following conditions, namely—

(a) Issuance of a circular to its members including therein a statement showing the financial position of the company, the credit rating obtained, the total number of depositors and the amount due towards deposits in respect of any previous deposits accepted by the company and such other particulars in such form and in such manner as may be prescribed;

(b) Filing a copy of the circular along with such statement with the Registrar within 30 days before the date of issue of the circular;

(c) Depositing, on or before the thirtieth day of April each year, such sum which shall not be less than twenty per cent of the amount of its deposits maturing during the following financial year and kept in a scheduled bank in a separate bank account to be called deposit repayment reserve account;

(d) Omitted

(e) Certifying that the company has not committed any default in the repayment of deposits accepted either before or after the commencement of this Act or payment of interest on such deposits and where a default had occurred, the company made good the default and a period of five years had lapsed since the date of making good the default; and

(f) Providing security, if any for the due repayment of the amount of deposit or the interest thereon including the creation of such charge on the property or assets of the company.

Every deposit accepted by a company shall be repaid with interest in accordance with the terms and conditions of the agreement. Where a company fails to repay the deposit or part thereof or any interest thereon, the depositor concerned may apply to the Tribunal for an order directing the company to pay the sum due or for any loss or damage incurred by him as a result of such non-payment and for such other orders as the Tribunal may deem fit.

Exemption to certain private companies:

Clauses (a) to (c) and (e) of sub-section (2) of section 73 with respect to issue of circular, filing the copy of such circular with the Registrar, depositing of certain amount and certification as to no default committed, shall not apply to a private company:

(A) which accepts from its **members monies not exceeding 100%** of aggregate of the **paid-up share capital, free reserves and securities premium account**; **or**

(B) **which is a start-up, for 5 years** from the date of its incorporation; **or**

(C) which **fulfils all of the following conditions**, namely:

(a) which is **not an associate or a subsidiary company of any other company**;

(b) if the **borrowings of such a company from banks or financial institutions** or any body corporate **is less than twice of its paid-up share capital** or 50 crore rupees, whichever is lower; and

(c) such a **company has not defaulted in the repayment of such borrowing**s subsisting at the time of accepting deposits under this section.

However, such a company [as referred to in clauses (A), (B) or (C)] shall file the details of monies accepted to the Registrar in the specified manner (i.e. in Form DPT-3).

**3. Explain the provisions for 'Appointment of Trustee for Depositors' under the Companies Act, 2013 read with the 'Acceptance of Deposits' Rules, 2014.**

**Answer**

Appointment of Trustee for Depositors: In this respect following provisions are required to be observed as mentioned in Rule 7 of the Companies (Acceptance of Deposits) Rules, 2014:

• One or more trustees for depositors need to be appointed by the company for creating security for the deposits.

• A written consent shall be obtained from the trustees before their appointment.

• A statement shall appear in the circular or advertisement with reasonable prominence to the effect that the trustees for depositors have given their consent to the company for such appointment.

• The company shall execute a deposit trust deed in Form DPT-2 at least seven days before issuing the circular or circular in the form of advertisement.

• No person including a company that is in the business of providing trusteeship services shall be appointed as a trustee for the depositors, if the proposed trustee:

(a) is a director, key managerial personnel or any other officer or an employee of the company or of its holding, subsidiary or associate company or a depositor in the company;

(b) is indebted to the company, or its subsidiary or its holding or associate company or a subsidiary of such holding company;

(c) has any material pecuniary relationship with the company;

(d) has entered into any guarantee arrangement in respect of principal debts secured by the deposits or interest thereon;

(e) is related to any person specified in clause (a) above.

**4. What are the provisions relating to 'Credit Rating' which an 'eligible company' must follow if it wants to raise public deposits?**

Answer

The provisions relating to obtaining of 'Credit Rating' to be followed by an 'eligible company' are contained in Section 76 (1) of the Companies Act, 2013 and Rule 3 (8) of the Companies (Acceptance of Deposits) Rules, 2014 as amended from time to time. Accordingly, an 'eligible company' which desires to raise public deposits shall be required to obtain the rating (including its net-worth, liquidity and ability to pay its deposits on due date) from a recognised credit rating agency. The given rating which ensures adequate safety shall be informed to the public at the time of invitation of deposits from the public. Further, the rating shall be obtained every year during the tenure of deposits.

As per Rule 3 (8), copy of the credit rating which is being obtained at least once in a year shall be sent to the Registrar of Companies along with the Return of Deposits in Form DPT-3.

Further, the credit rating shall not be below the minimum investment grade rating or other specified credit rating for fixed deposits. It shall be obtained from any one of the approved credit rating agencies as specified for Non-Banking Financial Companies in the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998, as amended from time to time.

**5. Discuss the following situations in the light of 'deposit provisions' as contained in the Companies Act, 2013 and the Companies (Acceptance of Deposits) Rules, 2014, as amended from time to time.**

**(i) Samit, one of the directors of Zarr Technology Private Limited, a start-up company, requested his close friend Ritesh to lend to the company ₹30.00 lacs in a single tranche by way of a convertible note repayable within a period six years from the date of its issue. Advise whether it is a deposit or not.**

**(ii) Polestar Traders Limited received a loan of ₹ 30.00 lacs from Rachna who is one of its directors. Advise whether it is a deposit or not.**

**(iii) City Bakers Limited failed to repay deposits of ₹ 50.00 crores and interest due thereon even after the extended time granted by the Tribunal. Is the company or Swati, its officer-in-default, liable to any penalty?**

**(iv) Shringaar Readymade Garments Limited wants to accept deposits of ₹ 50.00 lacs from its members for a tenure which is less than six months. Is it a possibility?**

**(v) Is it in order for the Diamond Housing Finance Limited to accept and renew deposits from the public from time to time?**

**Answer**

(i) In terms of Rule 2 (1) (c) (xvii) if a start-up company receives rupees twenty- five lakh or more by way of a convertible note (convertible into equity shares or repayable within a period not exceeding ten years from the date of issue) in a single tranche, from a person, it shall not be treated as deposit.

In the given case, Zarr Technology Private Limited, a start-up company, received ₹ 30.00 lacs from Ritesh in a single tranche by way of a convertible note which is repayable within a period of six years from the date of its issue. In view of Rule 2 (1) (c) (xvii) which requires a convertible note to be repayable within a period of ten years from the date of its issue, the amount of ₹ 30.00 lacs shall not be considered as deposit.

(ii) In terms of Rule 2 (1) (c) (viii), any amount received from a person who is director of the company at the time of giving loan to the company shall not be treated as deposit if such director furnishes to the company at the time of giving money, a written declaration to the effect that the amount is not being given out of funds acquired by him by borrowing or accepting loans or deposits from others and further, the company shall disclose the details of money so accepted in the Board's report.

In the given case, it is assumed that Rachna was one of the directors of Polestar Traders Limited when the company received a loan of ₹ 30.00 lacs from her. Further, it is assumed that she had furnished to the company at time of giving money, a written declaration to the effect that the amount was not being given out of funds acquired by her by borrowing or accepting loans or deposits from others and in addition, the company had disclosed the details of money so accepted in the appropriate Board's report.

If these conditions are satisfied ₹ 30.00 lacs shall not be treated as deposit.

(iii) By not repaying the deposit of ₹ 50.00 crores and the interest due thereon even after the extended time granted by the Tribunal, City Bakers Limited has contravened the conditions prescribed under Section 73 of the Act. Accordingly, following penalty is leviable:

- Punishment for the company: City Bakers Limited shall, in addition to the payment of the amount of deposit and the interest due thereon, be punishable with fine which shall

not be less than ₹ one crore or twice the amount of deposit accepted by the company, whichever is lower but which may extend to ₹ ten crores.

- Punishment for officer-in-default: Swati, being the officer-in-default, shall be punishable with imprisonment which may extend to seven years and with fine which shall not be less than rupees twenty-five lakhs but which may extend to ₹ two crores.

Further, if it is proved that Swati had contravened such provisions knowingly or wilfully with the intention to deceive the company or its shareholders or depositors or creditors or tax authorities, she will be liable for action under section 447 (Punishment for fraud).

(iv) According to Rule 3 (1), a company is not permitted to accept or renew deposits which is repayable on demand or in less than six months. Further, the maximum period of acceptance of deposit cannot exceed 36 months.

However, as an exception to this rule, for the purpose of meeting any of its short- term requirements of funds, a company is permitted to accept or renew deposits for repayment earlier than 6 months subject to the conditions that:

(i) such deposits shall not exceed ten per cent. of the aggregate of the paid-up share capital, free reserves and securities premium account of the company; and

(ii) such deposits are repayable only on or after three months from the date of such deposits or renewal.

In the given case of Shringaar Readymade Garments Limited, it wants to accept deposits of ₹ 50.00 lacs from its members for a tenure which is less than six months. It can do so if it justifies that the deposits are required for the purpose of meeting any of its short-term requirements of funds but in no case such deposits shall exceed 10% ten per cent of the aggregate of its paid-up share capital, free reserves and securities premium account and further, such deposits shall be repayable only on or after three months from the date of such deposits.

(v) According to section 73 (1) of the Act, no company can accept or renew deposits from public unless it follows the manner provided under Chapter V of the Act (contains provisions regarding acceptance of deposits by companies) for acceptance or renewal of deposits from public. However, Proviso to Section 73 (1) states that such prohibition with respect to the acceptance or renewal of deposit from public, inter-alia, shall not apply to a housing finance company registered with the National Housing Bank established under the National Housing Bank Act, 1987.

In the given case, it is assumed that Diamond Housing Finance Limited is registered with the National Housing Bank and therefore the prohibition contained in section 73 (1) of the Act with respect to the acceptance renewal of deposit from public shall not apply to it. In other words, it being an exempted company, can accept deposits from the public from time to time without following the prescribed manner.

6. **ABC Limited having a net worth of ` 120 crores wants to accept deposit from its members. The directors of the company have approached you to advise them as to**

**what special care has to be taken while accepting such deposit from the members in case their company falls within the category of an 'eligible company'.**

Answer

According to section 76 (1) of the Act, an "eligible company" means a public company, having a net worth of not less than one hundred crore rupees or a turnover of not less than five hundred crore rupees and which has obtained the prior consent of the company in general meeting by means of a special resolution and also filed the said resolution with the Registrar of Companies before making any invitation to the public for acceptance of deposits.

However, an 'eligible company', which is accepting deposits within the limits specified under section 180 (1) (c), may accept deposits by means of an ordinary resolution.

According to Rule 4 (a), an 'eligible company' shall accept or renew any deposit from its members, if the amount of such deposit together with the amount of deposits outstanding as on the date of acceptance or renewal of such deposits from members does not exceed ten per cent. of the aggregate of the paid-up share capital, free reserves and securities premium account of the company.

ABC Limited is having a net worth of 120 crore rupees. Hence, it falls in the category of 'eligible company'.

Thus, ABC Limited has to ensure that acceptance of deposits from its members together with the amount of deposits outstanding as on the date of acceptance or renewal of such deposits from the members, in no case, exceeds 10% of the aggregate of the paid-up share capital, free reserves and securities premium account of the company.

**7. Define the term 'deposit' under the provisions of the Companies Act, 2013 and comment quoting relevant provisions whether the following amounts received by a company will be considered as deposits or not:**

**(i) ₹ 5,00,000 raised by Rishi Confectionaries Limited through issue of non-convertible debentures not constituting a charge on the assets of the company and listed on a recognised stock exchange as per the applicable regulations made by the Securities and Exchange Board of India.**

**(ii) ₹ 2,00,000 received by Raja Yarns Limited from its employee Mr. T, who draws an annual salary of ` 1,50,000, as a non-interest bearing security deposit under a contract of employment.**

**(iii) ₹ 3,00,000 received by a private company from one of the relatives of a Director. The said relative has furnished a declaration that the amount was received by him from his mother as a gift.**

Answer

Deposit: According to Section 2 (31) of the Companies Act, 2013, the term 'deposit' includes any receipt of money by way of deposit or loan or in any other form, by a company,

but does not include such categories of amount as may be prescribed in consultation with the Reserve bank of India.

Rule 2 (1) (c) of the Companies (Acceptance of Deposit) Rules, 2014 states various amounts received by a company which will not be considered as deposits. In terms of this Rule the answers to the given situations shall be as under:

(i) ₹ 5,00,000 raised by Rishi Confectionaries Limited through issue of non- convertible debentures not constituting a charge on the assets of the company and listed on recognised stock exchange as per the applicable regulations made by the SEBI, will not be considered as deposit in terms of sub-clause (ixa) of Rule 2 (1) (c).

(ii) ₹ 2,00,000 received by Raja Yarns Limited from its employee Mr. T, who draws an annual salary of ₹ 1,50,000, as a non-interest bearing security deposit under a contract of employment will be considered as deposit in terms of sub-clause (x) of Rule 2 (1) (c), for the amount received is more than his annual salary of ₹ 1,50,000.

(iii) ₹ 3,00,000 received by a private company from one of the relatives of a Director. When the relative furnishes a declaration that the said amount was received by him from his mother as a gift, then it will not be considered as deposit in terms of sub-clause (viii) of Rule 2 (1) (c). In fact, the preceding sub-clause requires that any amount given by a relative of a director of a private company shall not be considered as deposit if the relative furnishes a declaration in writing to the effect that the amount is not being given out of funds acquired by him by borrowing or accepting loans or deposits from others. Thus, the amount given to the private company out of gifted money by one of the relatives of a director is not a 'deposit'.

As an additional requirement, the company shall disclose the details of money so accepted in the Board's report.

**8. State, with reasons, whether the following statements are 'True or False'?**

(i) ABC Private Limited may accept deposits from its members to the extent of ₹ 50.00 lakhs, if the aggregate of its paid-up capital, free reserves and security premium account is ₹ 50.00 lakhs.

(ii) A Government Company, which is eligible to accept deposits under Section 76 of the Companies Act, 2013, cannot accept deposits from public exceeding 25% of the aggregate of its paid-up capital, free reserves and security premium account.

Answer

(i) As per the provisions of Section 73 (2) of the Companies Act, 2013 read with Rule 3 (3) of the Companies (Acceptance of Deposits) Rules, 2014, as amended from time to time, a company shall accept any deposit from its members, together with the amount of other deposits outstanding as on the date of acceptance of such deposits not exceeding thirty five per cent of the aggregate of the paid-up share capital, free reserves and securities premium account of the company. It is provided that a private company may accept from its members monies not exceeding one hundred per cent of aggregate of the

paid-up share capital, free reserves and securities premium account and such company shall file the details of monies so accepted to the Registrar in Form DPT-3.

Therefore, the given statement where ABC Private Limited is accepting deposits from its members to the extent of ₹ 50.00 lakh is 'true'.

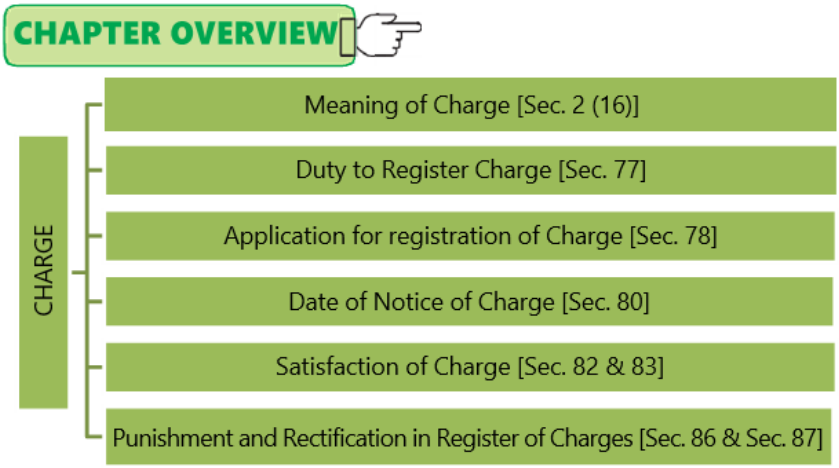
(ii) As per Rule 3 (5) of the Companies (Acceptance of Deposits) Rules 2014, a Government Company is not eligible to accept or renew deposits under section 76, if the amount of such deposits together with the amount of other deposits outstanding as on the date of acceptance or renewal exceeds thirty five per cent of the aggregate of its paid-up share capital, free reserves and securities premium account.

Therefore, the given statement where the limit of 25% has been stated for acceptance of deposits is 'false'.

# Chapter 6

# REGISTRATION OF CHARGE

## SECTION AND OVERVIEW




The law with respect to the registration of charges has been dealt in Chapter VI of the Companies Act, 2013 consisting of sections 77 to 87 as well as the Companies (Registration of Charges) Rules, 2014.

**Section 2(16), defines "charge"** as an interest or lien created on the property or assets of a company or any of its undertakings or both as security and includes a mortgage.

Whenever a company borrows money by way of loans including term loans or working capital loans from financial institutions or banks or any other persons, by offering its property or assets, as security a charge is created on such property or assets in favour of the lender. Such a charge is compulsorily registrable under the provisions of the Companies Act, 2013 in accordance with Chapter VI and the rules made in this regard.

## TYPES OF CHARGE

### 1. FIXED CHARGE:

- A 'FIXED CHARGE' is a charge on Specific assets of the borrowing company.
- These assets are of **permanent nature like land and building**, office premises, machinery installed by the company and the like.
- Further, these assets are **identified at the time of creation** of charge.
- A fixed charge is usually created by way of mortgage or deposit of title deeds.
- Once a fixed charge is created, **the borrowing company is not permitted to sell such assets though it may use them.**
- Assets under fixed charge **can be sold only with the permission or consent of the charge-holder**.
- A fixed charge ends when the money borrowed against the fixed charge is fully repaid.

**Example 1:** Pearl Electronics Limited raised a term loan ` 10 lakh from Everest Commercial Bank Limited, against the security of its office building. In this case, the company shall create a charge on specific asset i.e., its office building and such charge shall be a fixed charge. The company can sell this particular office building either by repaying the borrowed amount in full or after seeking permission from the charge-holder i.e., lender bank

## 2. FLOATING CHARGE:

- A 'Floating Charge' is created on assets which are of fluctuating nature or changing in nature
- A **floating charge is not attached to any definite property**
- **Example:** raw material, stock-in-trade, debtors, and the like.
- A floating charge is a charge which in the ordinary course of business is **changing from time to time and leaves the company free to deal with the property** as it sees fit until the holders of charge take steps to enforce their security.
- The advantage of a floating charge is that the **company may continue to deal or sell in any way** with the property which has been charged.
- When the creditor enforces the security or the company goes into liquidation, the floating charge will become a fixed charge on all the assets available on that date and which may come into existence thereafter.
- "The essence of a floating charge is that the **security remains dormant until it is fixed or crystallised**".
- On crystallisation, the security becomes fixed and is **available for realization** so that borrowed money is repaid
- **A floating charge crystallises and the security becomes fixed in the following cases:**

  (a) when the company goes into **liquidation**;
  (b) when the company **ceases to carry on its business**;
  (c) when the creditors or the debenture holders **take steps to enforce their security** e.g. by appointing receiver to take possession of the property charged;
  (d) on the **happening of the event** specified in the deed.

**Example:** A retail showroom will contain numerous articles kept for sale. The owner of the showroom might have borrowed against the security of all those goods in the showroom. But he may still sell or otherwise deal with them in the ordinary course of business. The buyer will get it free of the charge.

**Example:** In case of a company which manufactures leather goods, the raw material in the form of leather, which is subject matter of floating charge, may be used to manufacture leather goods without seeking any permission from the lender.

## DUTY TO REGISTER CHARGES, ETC. [SECTION 77]

### A. Registration of Charges

1. **Registration by the company creating a charge:** It shall be **duty of the company** creating a **charge within or outside India**, on its property or assets or any of its undertakings, whether tangible or otherwise and situated in or outside India, to register the particulars of the charge.

   The property or asset charged may be a tangible asset such as land and building. It may be otherwise, i.e. it may be a financial asset like a share or debenture which may be pledged. It may also be an intangible asset such as patent, copyright or trademark.

   **Note:** The word otherwise when used in a section would have the effect of widening the scope and operation of the provision.

2. **Registration by the charge-holder**: Section 78 (explained later) provides that in case the company creating a charge fails to register the charge within the prescribed period of 30 days, the **person in whose favour the charge is created can get the charge registered.**

3. **Registration by the purchaser:** Section 79 (explained later) covers another case of registration of charge where a company purchased some property in whose case a charge was already registered. In this case also, **the company purchasing the property shall get the charge registered** in its name in place of seller in the records of Registrar.

**#Amendment:** " Nothing contained in this rule shall apply to any charge required to be created or modified by a banking company under section 77 in favour of the RBI when any loan or advance has been made to it under sub-clause (d) of clause (4) of section 17 of the Reserve Bank of India Act, 1934 (2 of 1934)."

**B. <u>How to Register Charge</u>**

The particulars of the charge to be **filed in Form CHG-1 or Form CHG-9 (in case of debentures)** is to be filled together with a copy of the instrument, if any, creating the charge duly **signed by the company and the charge holder**, shall be filed with the **Registrar within 30 days of creation of charge** along with the prescribed fee.

**C. Verification of Instrument of Charge**

A copy of every instrument creating (or modifying) any charge and required to be filed with the Registrar, shall be verified as follows:

(a) Where the instrument **relates solely to the property situated outside India**, the copy shall be **verified by** a certificate issued either-

- under the **seal**, if any, of the company, or
- under the **hand of any director or company secretary** of the company, or an **authorised officer of the charge holder**, or
- under the **hand of some person other than** the company **who is interested in the mortgage or charge;**

(b) Where the instrument **relates to the property situated in India** (whether wholly or partly), the copy shall be verified by a certificate issued **under the hand of any director or company secretary** of the company or an **authorised officer of the charge holder**.

Thus, in case the instrument or deed relates solely to a property situated outside India, the copy may also be additionally verified by a certificate issued under the hand of some person other than the company who is interested in the mortgage or charge.

**D. Extension of Time Limit**

The original period within which a charge needs to be registered is 30 days from the date of creation of charge. **The Companies (Amendment) Second Ordinance, 2019 (w.e.f. 02-11-2018) has amended the provisions relating to extension of time limit as under:**

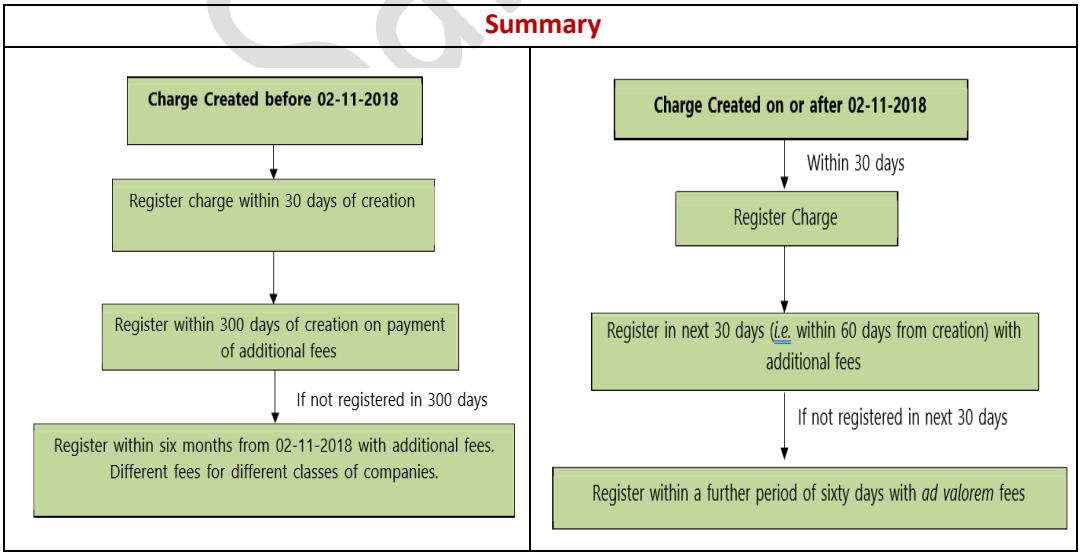
**i. Charges created before 02-11-2018**:

- where charge was created before 02-11-2018 but was not registered within the original period of 30 days, the Registrar may, on an application by the company, allow such registration to be made within a period of 300 days of such creation.
- Further, if the charge is not registered within the extended period of 300 days, it shall be done within 6 months from 02-11-2018 on payment of prescribed additional fees. It is provided that different fees may be prescribed for different classes of companies.

**ii. Charges created on or after 02-11-2018**:

- In such cases (i.e. where the **charge created but not registered within the original period of 30 days**), the Registrar may, **on an application by the company, allow such registration to be made within a period of 60 days of such creation, on payment of additional fees as prescribed.**
- If the **charge is not registered within the extended period** as above, the company shall make an application and the **Registrar is empowered to allow such registration to be made within a further period of 60 days after payment of prescribed ad valorem fees.**

**Summary**




**Procedure for Extension of Time Limit:** The company is required to make an application to the Registrar in the prescribed form for seeking extension of time. It should be supported by a declaration from the company signed by its company secretary or a director that such belated filing shall not adversely affect the rights of any other creditors of the company.

The Registrar on receiving an application for extension of time as aforesaid shall be satisfied that the company had sufficient cause for not filing instrument of charge, within the original period of 30 days. Only then shall he allow registration of charge within the extended period. Further, requisite additional fee or ad valorem fee, as applicable, must also be paid.

**iii. Issue of Certificate of Registration**

Where a charge or Modification is duly registered by the Registrar, **a certificate of Registration/ Modification shall be issued by the Registrar in the Form. CHG 2 for fresh registration and in Form No. CHG 3 for modification**. The certificate so issued by the Registrar shall be conclusive evidence that the requirements of Chapter VI of the Act and the rules made thereunder as to registration of creation of charge have been complied with.

**E. Section 77 not to apply to certain charges**

The application of Section 77 shall not be made to certain charges which are prescribed in consultation with the Reserve Bank of India.

**CONSEQUENCE OF NON-REGISTRATION OF CHARGE [SECTION 77 (3) & (4)]**

- All types of charges created by a company are to be registered by the ROC, **where they are not filed with the Registrar of Companies for registration, it shall be void as against the liquidator** appointed under the Companies Act, 2013 or the Insolvency and Bankruptcy Code, 2016 and **any other creditor of the company.**

**MEANING**:

**Void against the liquidator** means that the liquidator on winding up of the company can ignore the charge and can treat the concerned creditor as unsecured creditor. The property will be treated as free of charge i.e. the creditor cannot sell the property to recover its dues.

**Void against any creditor** of the company means that **if any subsequent charge is created on the same property and the earlier charge is not registered**, **the earlier charge would have no consequence and the latter charge if registered would enjoy priority.** In other words, the latter charge holder can have the property sold in order to recover its money.

**Note:**

- But this shall not prejudice any contract or obligation for the repayment of the money secured by a charge. This means that the debt will still remain valid and may be enforced against the company through the courts by filing a suit, but the security is lost.
- Further, it may be noted that failure to register charge shall not absolve a company from its liability in respect of any offence under this Chapter.

**Example:** Bank A has advanced Rs. One Crore to Akash Limited against the security of the company's land and building at Mulund. The charge was created by deposit of title deeds on 1st June 2019. The company did not register the charge within 30 days. Subsequently, the charge was registered on 13th August 2019 after payment of ad valorem fees and proving sufficient cause.

In the meantime, Bank B has advanced Rs. Two Crore to Akash Limited against the security of the same property on 20th June 2019. This charge was duly registered on 27th June 2019.

Subsequently, Akash Limited goes into liquidation and the property realises only Rs. Two crores.

Now, Bank B will receive its loan back fully, but Bank A will not realise anything. Because, the subsequent registration of the charge in favour of Bank A will not prejudice the right of Bank B which obtained its right before the charge in favour of Bank A was actually registered. Thus, Bank B gets priority over Bank A even though its charge was created later.

## APPLICATION FOR REGISTRATION OF CHARGE BY CHARGE-HOLDER [SECTION 78]

To avoid the consequences of non-registration on the charge holder, Section 78 of the Companies Act, 2013, empowers the charge holder to get the charge registered in case the company creating the charge on its property fails to do so.

- Accordingly, if the company fails to register the charge within 30 days [as provided in section 77 (1)], the person in whose favour the charge is created **(i.e. charge-holder) may apply to the Registrar for registration of the charge along with the instrument of charge within the prescribed time, form and manner.**
- On receipt of application from the charge-holder, the **Registrar shall give a notice to the company** and **if no objection is received**, **allow such registration within a period of 14 days after giving notice** to the company on payment of the prescribed fees.
- The Registrar shall **not allow such registration**,
  - if the **company itself registers** the charge or
  - **shows sufficient cause** why such charge should not be registered.
- **Recovery of fees:** When application is made by the charge holder, such person shall be entitled to recover from the company the amount of any fees or additional fees paid by him to the Registrar for the purpose of registration of charge.

## ACQUISITION OF PROPERTY SUBJECT TO CHARGE AND MODIFICATION OF CHARGE [SECTION 79]

**Two situations.**

**a)** **Acquisition by a company** of any property **that is already subject to charge**.

**b)** **Modification** in the terms and conditions of **any charge already registered**.

**The provisions of section 77 relating to registration of charge shall as it is apply in both the above situations.**

### A. Company acquiring any Property subject to Charge [Section 79 (a)]

In case of a property where charge is already registered and if it is sold with the permission of the holder of charge, it shall be the **duty of the company acquiring it to get the charge registered** in accordance with Section 77. In other words, the **earlier charge should get**

**vacated and, in its place, new charge should get registered** by the company which has acquired it.

**B. Modification of Charge when there is Change in Terms and Conditions, etc. [Section 79 (b)]**

Section 79 (b) requires any **modification in charge to be registered by the company in accordance with Section 77.**

**Some other examples of 'modification' are as under:**

1. Where the charge is **modified by varying any terms and conditions** of the existing charge through an agreement;

2. Where the modification is **for enhancing or decreasing the limits**;

3. Where there is **change in rate of interest** (other than bank rate);

4. Where there is **change in repayment schedule of loan**; (not applicable in case of working loans which are repayable on demand); and

5. Where there is **partial release of the charge** on a particular asset or property.

**C. Issue of Certificate of Modification**

As per Rule 6, where the particulars of modification of charge is registered under section 79, the Registrar shall issue a certificate of modification of charge in Form CHG-3.

**DATE OF NOTICE OF CHARGE [SECTION 80] / Deemed notice of charge**

Where any charge is created on a property, any person acquiring such property, assets, undertakings or part thereof or any share or interest therein s**hall be deemed to have notice of the charge** from **the date of such registration**.

All charges registered with the registrar are public documents. This means that any person who wishes to lend money to the company against the security of such property or buy it can refer to the MCA Portal and find out if there is any charge created on that asset.

In case anyone enters into the transaction without making any enquiry and later on suffers loss because of charge, he cannot claim the loss from the company for it shall be deemed that he had notice of charge.

**Example:** Vishnu Marketing Limited obtained a term loan of ` 50 lacs from Beta Commercial Bank Limited by creating a charge on one of its office buildings and the charge was duly registered. Later on, if the building is sold to Neeraj, he is deemed to have notice of such charge. In other words, it is presumed that Neeraj knew beforehand that the building was mortgaged to the bank for obtaining a loan. He cannot plead against such presumption by contending that he did not know about the charge if he suffers any loss at a later date because of the mortgage.

**COMPANY TO REPORT SATISFACTION OF CHARGE - Section 82**

**1. Intimation regarding Satisfaction of Charge**

Section 82 of the Act of 2013, requires a company to give intimation of payment or satisfaction in full of any charge earlier registered, to the **Registrar in the Form CHG-4**. The **intimation needs to be given within a period of 30 days from the date of such payment or satisfaction.**

**Extended period of intimation**: The Registrar may, on an **application by the company or the charge holder**, allow such intimation of payment or satisfaction **to be made within a period of 300 days of such payment or satisfaction** on payment of prescribed additional fees.

**2. Notice to the Holder of Charge by the Registrar**

- **On receipt of intimation**, the Registrar shall send a **notice to be sent to the holder of the charge calling upon him to show cause within 14 days, as to why payment or satisfaction in full should not be recorded.**
- **If no cause is shown by the charge-holder, the Registrar shall order entering of a memorandum of satisfaction** in the register of charges kept by him and accordingly, he shall inform the company of having done so.
- However, no notice is required to be sent, in case the intimation to the Registrar in this regard is in the specified form and signed by the holder of charge.
- **If** any cause is shown by the charge-holder, the Registrar shall record a note to that effect in the register of charges and inform the company.

**Note:** In case of a specified IFSC Public or Private company, the Registrar may, on an application by the company, allow such registration to be made **within a period of 300 days** of such creation on payment of such additional fees as may be prescribed.

**3. Issue of Certificate**

As per Rule 8 (2), in case the Registrar enters a memorandum of satisfaction of charge in full, he shall **issue a certificate of registration of satisfaction of charge in Form No. CHG-5.**

**4. Preservation of Records**

The **instrument creating a charge or modification** thereon **shall be preserved for a period of 8 years** from the date of satisfaction of charge by the company.

**POWER OF REGISTRAR TO MAKE ENTRIES OF SATISFACTION AND RELEASE IN ABSENCE OF INTIMATION FROM COMPANY [SECTION 83]**

**1)** This situation would arise where the property subject to a charge is sold to a third- party and neither the company nor the charge-holder has intimated the Registrar regarding satisfaction of the earlier charge.

**2)** Accordingly, with respect to any registered charge **if evidence is shown** to the **satisfaction of Registrar that**

- the debt secured by charge has been **paid or satisfied** wholly or in part **or**
- that the part of the property or undertaking charged has been **released from the charge** or
- has **ceased** to **form part of the company's property** or undertaking,

Then he may enter in the register of charges a memorandum of satisfaction in this regard.

This **power can be exercised by the Registrar despite the fact that no intimation has been received** by him from the company.

3) **Information to affected parties:** The Registrar shall **inform the affected parties within 30 days** of making the entry in the register of charges.

4) **Issue of Certificate:** The Registrar shall issue a certificate of registration of satisfaction of charge **in Form No. CHG-5.**

## INTIMATION OF APPOINTMENT OF RECEIVER OR MANAGER - Section 84

Section 84 of the Act of 2013 deals with the appointment of a receiver or manager and of giving intimation thereof to the company and the Registrar.

Accordingly,

• if any person **obtains an order for the appointment of a receiver** or a person to manage the property which is subject to a charge, or

• if **any person appoints such receiver** or person under any power contained in any instrument,

he **shall give notice of such appointment to the company and the Registrar** along with a copy of the order or instrument **within 30 days from the passing of the order** or making of the appointment in **Form CHG-6.**

On **ceasing to hold such appointment**, the person appointed as above shall give a notice to that effect to the company and the Registrar. In turn, the Registrar shall register such notice.

## PUNISHMENT FOR CONTRAVENTION [SECTION 86]

(1) **If any company is in default** in complying with any of the provisions of this Chapter, the company shall be liable to a **penalty of 5 lakh rupees** and **every officer** of the company who is in default shall be **liable to a penalty of 50 thousand** rupees.

(2) **If any person wilfully furnishes** any false or incorrect information or knowingly suppresses any material information, required to be registered in accordance with the provisions of section 77, he shall be liable for action under **section 447.**

## RECTIFICATION BY CENTRAL GOVERNMENT IN REGISTER OF CHARGES [SECTION 87]

1. Section 87 of the Act of 2013 and Rule 12 empowers the Central Government **to order rectification of Register of Charges in the following cases of default:**

(i) when there was **omission in giving intimation to the Registrar with respect to payment or satisfaction** of charge within the specified time;

(ii) when there was **omission or mis-statement of any particulars** in any filing previously made to the Registrar.

Such filing may relate to any charge or any modification of charge or with respect to any memorandum of satisfaction.

2. Before directing that the 'time for giving the intimation of payment or satisfaction shall be extended' or the 'omission or mis-statement shall be rectified'**, the Central Government needs to be satisfied that such default was accidental** or due to inadvertence or because of some other sufficient cause or it did not prejudice the position of creditors or shareholders.

3. **The application in Form CHG-8** shall be filed by the company or any interested person.

"According to Rule 12 of the Companies (Registration of Charges) Rules, 2014:

The Central Government may on receipt of application;

(a) **direct rectification of the omission or misstatement of any particulars, in any filing, previously recorded** with the Registrar with respect to any charge or modification thereof, or with respect to any memorandum of satisfaction or other entry made in pursuance of section 82 or section 83,

(b) **direct extension of time for satisfaction of charge**, if such filing is not made within a **period of 300 hundred days** from the date of such payment or satisfaction."

**Forms Summary**

| S.No. | E-Form | Purpose |
|---|---|---|
| 1. | CHG-1 | Creating or Modifying charge (for other than Debentures) |
| 2. | CHG-2 | Certificate of Registration of charge. |
| 3. | CHG-3 | Certificate of Modification of charge. |
| 4. | CHG-4 | Intimation of the satisfaction to the Registrar. |
| 5. | CHG-5 | Memorandum of satisfaction of charge. |
| 6. | CHG-6 | Notice of appointment or cessation or receiver or manager. |
| 7. | CHG-7 | Register of charges. |
| 8. | CHG-8 | Application for condonation of delay shall be filed the Central Government. |
| 9. | CHG-9 | Creating or modifying the charge in (for debentures including ractification) |

**Question and Answer**

1. **How will a copy of an instrument evidencing creation of charge required to be filed with the Registrar be verified?**

Answer

A copy of every instrument evidencing any creation or modification of charge and required to be filed with the Registrar shall be verified as follows:

(a) in case property is situated outside India: where the instrument or deed relates solely to the property situated outside India, the copy shall be verified by a certificate issued either under the seal, if any, of the company, or under the hand of any director or company secretary of the company or an authorised officer of the charge holder or under the hand of some person other than the company who is interested in the mortgage or charge;

(b) in case property is situated in India (whether wholly or partly): where the instrument or deed relates to the property situated in India (whether wholly or partly), the copy shall be verified by a certificate issued under the hand of any director or company secretary of the company or an authorised officer of the charge holder.

2. **Briefly explain the provisions enforced by the Companies (Amendment) Second Ordinance, 2019 when a charge created before 02-11-2018 is not registered within the prescribed period of thirty days as provided in Section 77 (1).**

Answer

As per Section 77 (1) of the Companies Act, 2013 every company creating a charge:

a. within or outside India,

b. on its property or assets or any of its undertakings,

c. whether tangible or otherwise, and

d. situated in or outside India,

is required to register the particulars of the charge with the Registrar within thirty days of its creation.

In case the charge was created before 02-11-2018 and it was not registered within the prescribed period of thirty of its creation, clause (a) of the first Proviso to Section 77 (1) states that the Registrar may, on an application by the company, allow such registration to be made within a period of 300 days of such creation.

According to clause (a) of the Second Proviso to Section 77 (1), if the registration is not made within the extended period of 300 days, it shall be made within six months from 02-11-2018 on payment of prescribed additional fees. It is provided that different fees may be prescribed for different classes of companies.

Note: The Companies (Amendment) Second Ordinance, 2019 stands enforced w.e.f. 02-11-2018.

3. **Define the term "charge" and also explain what is the punishment for default with respect to registration of charge as per the provisions of the Companies Act, 2013.**

Answer

The term charge has been defined in section 2 (16) of the Companies Act, 2013 as 'an interest or lien created on the property or assets of a company or any of its undertakings or both as security and includes a mortgage'.

Punishment for contravention – According to section 86 of the Companies Act, 2013,

(1) **If any company is in default** in complying with any of the provisions of this Chapter, the company shall be liable to a **penalty of 5 lakh rupees** and **every officer** of the company who is in default shall be **liable to a penalty of 50 thousand** rupees.

(2) **If any person wilfully furnishes** any false or incorrect information or knowingly suppresses any material information, required to be registered in accordance with the provisions of section 77, he shall be liable for action under **section 447.**

4. **Renuka Soaps and Detergents Limited realised on 2nd May, 2019 that particulars of charge created on 12th March, 2019 in favour of a Bank were not registered with the Registrar of Companies. What procedure should the company follow to get the charge registered? Would the procedure be different if the company realised its mistake of not registering the charge on 7th June, 2019 instead of 2nd May, 2019? Explain with reference to the relevant provisions of the Companies Act, 2013.**

Answer

The charge in the present case was created after 02-11-2018 (i.e. the date of commencement of the Companies (Amendment) Second Ordinance, 2019) to which another set of provisions is applicable. These provisions are different from a case where the charge was created before 02-11-2018.

Initially, the prescribed particulars of the charge together with the instrument, if any, by which the charge is created or evidenced, or a copy thereof, duly verified by a certificate, are to be filed with the Registrar within 30 days of its creation. [Section 77 (1)]. In this case particulars of charge were not filed within the prescribed period of 30 days.

However, the Registrar is empowered under clause (b) of first proviso to section 77

(1) to extend the period of 30 days by another 30 days (i.e. sixty days from the date of creation) on payment of prescribed additional fee. Taking advantage of this provision, Renuka Soaps and Detergents Limited should immediately file the particulars of charge with the Registrar after satisfying him through making an application that it had sufficient cause for not filing the particulars of charge within 30 days of its creation.

If the company realises its mistake of not registering the charge on 7th June, 2019 instead of 2nd May, 2019, it shall be noted that a period of sixty days has already expired from the date of creation of charge. However, Clause (b) of Second Proviso to Section 77 (1) provides another opportunity for registration of charge by granting a further period of sixty days but the company is required to pay ad valorem fees. Since the first sixty days from creation of charge

have expired on 11th May, 2019, Renuka Soaps and Detergents Limited can still get the charge registered within a further period of sixty days from 11th May, 2019 after paying the prescribed ad valorem fees. The company is required to make an application to the Registrar in this respect giving sufficient cause for non-registration of charge.

5. **Mr. Antriksh purchased a commercial property in Delhi belonging to NRT Limited after entering into an agreement with the company. At the time of registration, Mr. Antriksh comes to know that the title deed of the company is not free and the company expresses its inability to get the title deed transferred in his name contending that he ought to have the knowledge of charge created on the property of the company. Explain, whether the contention of NRT Limited is correct?**

Answer

According to section 80 of the Companies Act, 2013, where any charge on any property or assets of a company or any of its undertakings is registered under section 77 of the Companies Act, 2013, any person acquiring such property, assets, undertakings or part thereof or any share or interest therein shall be deemed to have notice of the charge from the date of such registration.

Thus, Section 80 clarifies that if any person acquires a property, assets or undertaking in respect of which a charge is already registered, it would be deemed that he has complete knowledge of charge from the date of its registration. Mr. Antriksh, therefore, ought to have been careful while purchasing property and should have verified beforehand that NRT Limited had already created a charge on the property.

In view of above, the contention of NRT Limited is correct.

6. **ABC Limited created a charge in favour of OK Bank. The charge was duly registered. Later, the Bank enhanced the facility by another Rs. 20 crores. Due to inadvertence this modification in the original charge was not registered. Advise the company as to the course of action to be pursued in this regard.**

**Answer**

The company is advised to immediately file an application for rectification of the Register of Charges in Form No CHG- 8 to the Central Government under Section 87 of the Companies Act, 2013.

Section 87 of the Act of 2013 and Rule 12 empowers the Central Government to order rectification of Register of Charges in the following cases of default:

(i) when there was omission in giving intimation to the Registrar with respect to payment or satisfaction of charge within the specified time;

(ii) when there was omission or mis-statement of any particulars in any filing previously made to the Registrar. Such filing may relate to any charge or any modification of charge or with respect to any memorandum of satisfaction or other entry made under Section 82 (Company to report satisfaction of charge) or Section 83 (Power of Registrar to make entries of satisfaction and release).

Before directing that the 'time for giving the intimation of payment or satisfaction shall be extended' or the 'omission or mis-statement shall be rectified', the Central Government needs to be satisfied that such default was accidental or due to inadvertence or because of some other sufficient cause or it did not prejudice the position of creditors or shareholders.

The application in Form CHG-8 shall be filed by the company or any interested person. Therefore, OK Bank can also proceed under Section 87 as aforesaid.

The order of rectification shall be made by the Central Government on such terms and conditions as it deems just and expedient.

7. **Ranjit acquired a property from ABC Limited which was mortgaged to OK Bank. He settled the dues to Ok Bank in full and the same was registered with the sub-registrar who has noted that the mortgage has been settled. But neither the company nor OK Bank has filed particulars of satisfaction of charge with the Registrar of Companies. Can Mr. Ranjit approach the Registrar and seek any relief in this regard? Discuss this matter in the light of provisions of the Companies Act, 2013.**

Answer

Section 83 of the Act of 2013 empowers the Registrar to make entries with respect to the satisfaction and release of charges even if no intimation has been received by him from the company. Accordingly, with respect to any registered charge if an evidence is shown to the satisfaction of Registrar that the debt secured by charge has been paid or satisfied in whole or in part or that the part of the property or undertaking charged has been released from the charge or has ceased to form part of the company's property or undertaking, then he may enter in the register of charges a memorandum of satisfaction that:

- the debt has been satisfied in whole or in part; or
- the part of the property or undertaking has been released from the charge or has ceased to form part of the company's property or undertaking.

This power can be exercised by the Registrar despite the fact that no intimation has been received by him from the company.

Information to affected parties: The Registrar shall inform the affected parties within 30 days of making the entry in the register of charges.

Issue of Certificate: As per Rule 8 (2), in case the Registrar enters a memorandum of satisfaction of charge in full, he shall issue a certificate of registration of satisfaction of charge in Form No. CHG-5.

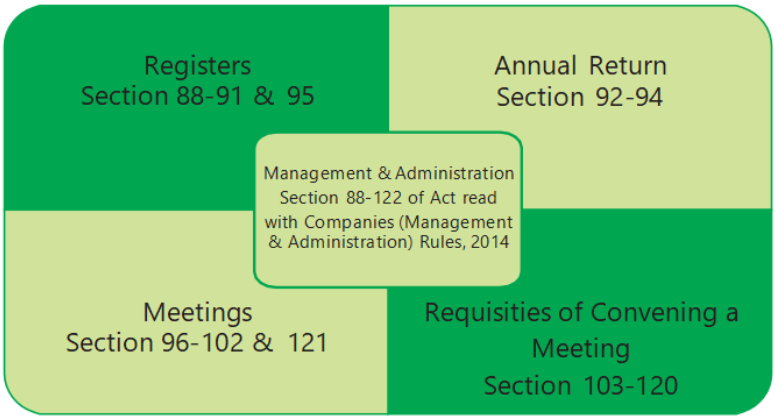
Therefore, Ranjit can approach the Registrar and show evidence to his satisfaction that the charge has been duly settled and satisfied and request the Registrar to enter a memorandum of satisfaction noting the release of charge.

# Chapter 7

# MANAGEMENT & ADMINISTRATION

## INTRODUCTION and Sections Overview

A company is an artificial legal entity distinct from its members, thus, the affairs of the company are managed by the members and Director through resolutions passed at validly held Meetings. The Board of Directors in carrying out the day-to- day affairs of the company has to perform the role within the power which is granted to them. Certain powers can be exercised by the board on their own and some with the consent of the company at the general meeting. The shareholders as owners of the company ratify the actions of the board at the general meetings of the company. The meetings of the shareholders serve as the focal point for the shareholders to converge and give their decisions on the actions taken by the directors.




This Chapter applies to all the companies, public and private and has special provisions applicable to One Person Company, which are detailed out in section 122 of the Act and is discussed later in the Chapter.

## REGISTERS

## REGISTER OF MEMBERS, ETC. - Section 88

Section 88(1) of the Companies Act, 2013 seeks to provide that every company shall keep and maintain the register of members, register of debenture-holders (DH) and register of any other security holders (OSH).

1) **Register of members:** Section 88(1)(a) requires a register of members to be maintained and that the holding of **each class of equity and preference shares** by each member **residing in or outside India will** have to be shown separately in the register of members.

**Particulars in register**: Rule 3 provides that every company limited by shares, shall, **from the date of its registration**, **maintain a register of its members in Form MGT–1**. In case of a **company not having share capital**, the register shall contain the following particulars, in respect of each member–

- Name of the member, address; email address; Permanent Account Number or Corporate Identity Number ('CIN'); Nationality; in case member is a minor – name of his guardian and the date of birth of the member, name and address of the nominee;
- Date of becoming the member;
- Date of cessation;
- Amount of guarantee, if any;
- Any other interest, if any; and
- **Instructions, if any, given by the member** with regard to sending of notices, etc.

2) **Register of debenture holders (DH)**: Section 88(1) (b), which corresponds to Rule 4 states that **every company which issues or allots debentures or any other security** shall maintain **a separate register for debenture holder or security** holder in **Form MGT-2.**

3) **Maintenance of Registers – RULE 5**

- **Time period for entries in register:** Entries have to be made in the Registers **within 7 days of the date of approval** by the Board or Committee thereof by **approving the allotment or transfer** of shares, debentures or any other securities, as the case may be.
- **Place where register shall be maintained**: The registers shall be maintained at the **registered office of the company** unless **a special resolution is passed**
  - **authorising the keeping of the register AT ANY OTHER PLACE WITHIN THE CITY, TOWN OR VILLAGE in which the registered office is situated** or
  - any **OTHER PLACE IN INDIA IN WHICH MORE THAN 1/10TH OF THE TOTAL MEMBERS** entered in the register of members reside.
- **Other information also to be referred in register:**
  - Any **order passed by the competent authority** attaching the shares or relating to dividends is also required to be referred in the register of members.
  - The **particulars of any charge, lien, pledge or hypothecation** of any securities of the company is also required to be entered in the register of members.

- **Updating of change in status of members:** If any change occurs in the status of a member or debenture-holder or any other security holder whether due to death or insolvency or change of name or due to transfer to Investor Education Protection Fund (IEPF) or due to any other reason, entries thereof explaining the change shall be made in the respective registers.

4) **Index of names:** Section 88(2) provides that every register maintained under section 88(1) **shall include an index of names included therein.** However, according to Rule 6 **the maintenance of index is not necessary where the number of members is less than 50**. The company shall make the necessary entries in the index simultaneously with the entry for allotment or transfer of any security in such Register.

5) **Register and index of beneficial owner to be maintained of a depository:** Section 88(3) is an enabling provision, which sets out that the register and index of beneficial owners **maintained by a depository** under section 11 of the Depositories Act, 1996, shall be deemed to be the corresponding register and index for the purposes of this Act.

6) **Details of Nominations in the register:** It is important to note here that Form MGT – 1 and MGT – 2 **require details of nomination as referred to in section 72.**

7) Authentication of entries:

- The entries in the registers maintained under section 88 and index included therein **shall be authenticated by the CS** of the company or by **any other person authorised by the Board** for the purpose, and the date of the board resolution authorising the same shall be mentioned.
- The entries in the foreign register shall be authenticated by the company secretary of the company or person authorised by the Board by appending his signature to each entry.

8) **Preserved for**

- **Register of members** along with the index shall be **preserved permanently** and shall be kept in the custody of CS of the company or any other person authorised by the Board for such purpose
- **Foreign Register** shall be **preserved permanently**, **unless it is discontinued** and all the entries are transferred to the principal register.
- **Foreign register or debenture-holder or any other security** holder shall be **preserved for a period of 8 years from the date of redemption** of debenture or securities.

**FOREIGN REGISTER – Section 88(4) read with Rule 7:**

1) **Maintenance of foreign register:** A company which has share capital or which has issued debentures or any other security **MAY**, **if so authorised by its articles**, **keep in any country outside India, a part of the register of members**, **of debenture holders or of any other security holders** or of beneficial owners, **resident in that country**. The register may be referred as "Foreign Register".

2) **Compliances**: **The Foreign Register is optional**. Once company decides to keep, it shall comply to the following–

- 
  - The company shall, **within 30 days from the date of the opening of any foreign register**, **file with the Registrar of Companies** ('RoC')
  - **notice of the situation of the office in the prescribed Form No. MGT – 3** along with the fee **where such register is kept**; and
  - **in the event of any change in the situation of such office or of its discontinuance, shall, within 30 days** from the date of such change or discontinuance, as the case may be, **file notice in Form No. MGT.3** with the RoC of such change or discontinuance.
- A foreign register shall be deemed to be part of the company's register ('principal register'). It shall be maintained in the **same format as the principal register**.
- A foreign register **shall be open to inspection** and may be closed, and extracts may be taken therefrom and copies thereof may be required, in the same manner, as is applicable to the principal register, except that the newspapers advertisement shall be given in the place wherein the foreign register is kept.
- If a foreign register is kept by a company in any country outside India, the **decision of the appropriate competent authority** in regard to the rectification of the register shall be binding.
- Entries in the foreign register maintained under section 88(4) shall be made after the Board of Directors or its duly constituted committee approves the allotment or transfer of shares, debentures or any other securities, as the case may be.
- **The company shall** –

- **Transmit to its registered office in India**, a copy of every entry in any foreign register **within 15 days after the entry** is made; and
- Keep at such office a **duplicate register of every foreign register** duly updated from time to time and it shall be deemed to part of the principal register.

- The **company may discontinue the keeping of any foreign register,** and thereupon all entries in that register shall be transferred to some other foreign register kept by the company outside India or to the principal register.

**Penalty: The company** shall be liable to a penalty **of 3 lakh rupees** and
**every officer** of the company who is in default shall be liable to a **penalty of 50 thousand rupees**

**– Amended**

**#Practice Question**
**Mr. Zoey purchased the shares of Luxy Hairstyles Private Limited, at market price, in the name of his daughter, Mila, who is 4 years old. Mr. Joe, the Director of the Company, has approached you to advise him on the updation of said change in the register of members, since Mila, being a minor is incompetent to contract in her capacity.**

**Answer**: Since, the minors are not competent to enter into any contract, thus their names cannot be entered in the register of members. Therefore, Mr. Joe is advised that while filing MGT – 1 and MGT – 2, the names of the minor can only be entered only if the details of the guardian are present. Thus, Zoey's name shall appear in the register of members of Luxy Hairstyles Private Limited since Mila is a minor.

**#Practice Question**

**Mrs. And Mr. Taneja, recently got married and jointly purchased the shares of New Hopes India Private Limited on 14th August 2018. Mr. Taneja intimated the company that only the name of his wife should appear in the records of the company, for the shares purchased by them. The secretary of the company is not sure whether this is possible, given that the shares are held in the names of both the persons.**

**Answer:** Joint holders of shares may request the company to enter their names on the register in a certain order, or execute transfers to have their holding split, with the result that part of the holding is entered showing the name of one holder and part showing the name of another. **However, the condition of Mr. Taneja that only the name of his wife should appear in the register as a member cannot be catered to**, although the names can be entered in the order such that the name of his wife appears first. The reason for this is that the articles of most companies provide that, in the case of exclusion of the other joint holders, and for this purpose, seniority shall be determined by the order in which the names stand in the register of members.

**POWER TO CLOSE REGISTER OF MEMBERS OR DEBENTURE- HOLDERS OR OTHER SECURITY HOLDERS - Section 91**

1) **Notice to be given:** A company **may close the register of members, debenture-holders and other security holders by giving minimum 7 days' notice or such lesser period as specified by Securities Exchange Board of India** ('SEBI').

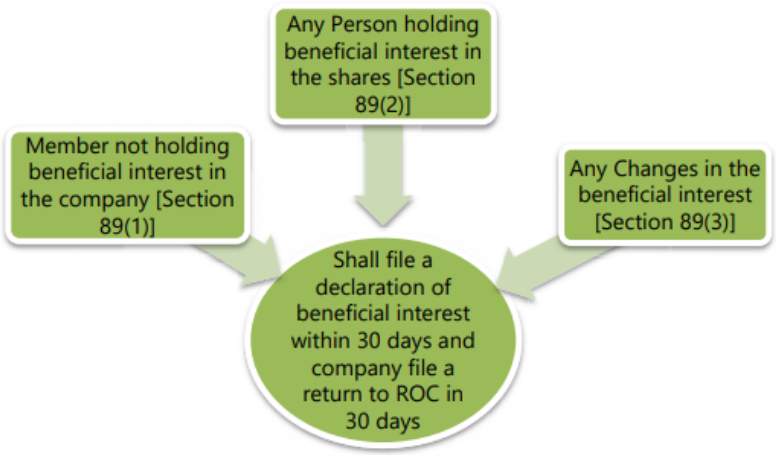
- According to Rule 10 of the Companies (Management & Administration) Rules, 2014, A company closing the register of members or debenture holders or other security holders shall give at least 7 days previous notice,
- if such **company is a LISTED COMPANY OR INTENDS TO GET ITS SECURITIES LISTED**, by
  - **newspaper** advertisement [principal vernacular language and English newspaper] having circulation in the place of registered office and
  - publish the notice on the **website** as notified by the Central Government and
  - on the **website, if any, of the Company**. [Sub rule (1)]

**Exemption:** The private companies have been exempted from issuing public notice in newspapers, provided it issues 7 days' notice to its members before closure of the registers

2) **Maximum closure**: Registers may be closed for any period **not exceeding 30 days at any one time** and for an **aggregate period of 45 days in one year**.

3) **Default:** The company and every officer of the company who is in default shall be liable to a penalty of 5,000 per day subject to a maximum of `1,00,000 during which the register is kept closed. However, the offence is a compoundable offence under section 441 of the Companies Act, 2013.

## DECLARATION IN RESPECT OF BENEFICIAL INTEREST IN ANY SHARE - Section 89




1) **Declaration by REGISTERED HOLDER of shares:** A person **whose name is entered in the register of members** of a company as the holder of shares in that company **but who does not hold the beneficial interest** in such shares (hereinafter referred to as "the registered owner"), shall **file with the company, a declaration to that effect in Form No. MGT. 4**, **specifying the name and other particulars of the person who holds the beneficial interest** in such shares, within a period of 30 days from the date on which his name is entered in the register of members of such company.

2) **Declaration by person HOLDING BENEFICIAL INTEREST in shares:** Every person who holds or acquires a **beneficial interest in share of a company** shall make **a declaration to the company in form MGT-5, within 30 days** after acquiring such beneficial interest, specifying the nature of his interest, particulars of the person in whose name the shares stand registered in the books of the company and such other particulars as may be prescribed.

3) **Declaration in case of change in beneficial interest:** Where any **change occurs in the beneficial interest** in any shares in respect of which a declaration has been filed u/s 89 (1) and (2), then, within 30 days of such change, a declaration is to be made to the company.

4) **Filling of return by the company with the registrar:** Where any declaration under this section is made to a company, the company shall make a **note of such declaration in the register concerned** and shall file, within 30 days from the date of receipt of declaration by it, **a return in Form No. MGT.6** with the ROC in respect of such declaration with fee.

5) **Consequence of non-filling of declaration:** where a declaration required u/s 89 **is not filed by the beneficial owner**, then, any **right with respect to such shares shall not be enforceable** by the beneficial owner or by any person claiming through him.

   **Exemption:** Trust which is created, to set up a Mutual Fund or Venture Capital Fund or such other fund as may be approved by SEBI. These entities need not file the declarations as envisaged under this section.

6) **Meaning of beneficial interest:** For the purposes of this section and section 90, beneficial interest in a share includes, **directly or indirectly**, through any contract, arrangement or

otherwise, the **right or entitlement of a person** alone or together with any other person to—

(i) **exercise** any or all of the **rights attached to such share**; or

(ii) **receive or participate** in any **dividend** or other distribution in respect of such share. [Section 89(10)]

**7) Penalty for default under section 89(5) & 89(7) –**

- **PERSON 89(5):** If any person fails to make a declaration as required under sub-section (1),(2) or (3), he shall be liable to a penalty of **50 thousand rupees** and in case of continuing failure, **2 hundred rupees for each day** after the first during which such failure continues, subject to a **maximum of 5 lakh rupees.**
- **Related to company [Section 89(7)]**- If a company, fails file the return before the expiry of the time specified, the **company and every officer** of the company who is in default shall be liable to a penalty of **1 thousand rupees for each day** during which such failure continues, subject to a **maximum of five lakh rupees** in the case of a company and **2 lakh rupees in case of an officer** who is in default.

**8) Exemption to Government Company- In case of Government Company - Section 89 shall not apply - Notification dated 5th June, 2015.**

**#Practice Question:**

**Ms. Emma gifted the shares purchased by her of the Company Bio-Optics Limited, to her sister Cathy. Emma had purchased these shares on the occasion of her birthday in February 2019. However, neither Emma nor Cathy were aware that they had to intimate about the transaction of transfer of such shares as a gift, to the company. Discuss the same in light of the provisions of section 89 of the Act.**

**Answer:** The provisions of the section 89 of the Act, dealing with declaration of beneficial interest in shares by a person to the company does not apply in a civil suit where the title of the shares is in a dispute. In Khajamiya Miransaheb Mujahid Vs. Peerapasha Miransaheb Mujahid (1987) (Kar.), where the shares are gifted away, they become the property of the donee. Hence, the provisions relating to declaration of beneficial interest are not applicable.

## REGISTER OF SIGNIFICANT BENEFICIAL OWNERS IN A COMPANY – Section 90

As per Section 90 of the Act, **every Significant Beneficial Owner "SBO" is required to disclose the nature of his interest** and other particulars within the prescribed period of time **to the Company**, which in **turn will inform the same to the Registrar of Companies**. In the said connection, MCA has issued Companies (Significant Beneficial Owners) Rules, 2018 ("SBO"), which deals with identification and reporting in connection with SBO.

**Definition:**

**Significant Beneficial Owner:** The term 'significant beneficial owner' "SBO" has been defined in section 90 of the Act as **Every individual**, who acting alone or together, or through one or more persons or trust, including a trust and persons resident outside

India, **holds beneficial interests, of not less than 25%** or such other percentage as may be prescribed, in shares of a company or the right to exercise, or the actual exercising of significant influence or control, over the company (herein referred to as "significant beneficial owner").

**Amended Definition:** However, Companies (Significant Beneficial Owners) Amendment Rules, 2019 ("Amendment Rules") **has amended the definition of the term SBO.**
In terms of Rule 2(1) (h) of the SBO Rules, the term **'Significant Beneficial Owner' (SBO) is defined as an individual who—**
i. acting alone or together, or
ii. through one or more persons or trust,

**Possess one or more of the following rights** or entitlements in the Reporting Company (i.e. the company in respect of which SBO declaration is required to be filed)—:
i. holds indirectly, or together with any direct holdings, **not less than 10% of the shares**;
ii. holds indirectly, or together with any direct holdings, **not less than 10% of the voting rights** in the shares;
iii. has the **right to receive or participate in not less than 10% of the total distributable dividend**, or any other distribution, in a financial year through indirect holdings alone, or together with any direct holdings;
iv. Has the right to exercise, **significant influence or control**, in any manner other than through direct holdings alone.

**Significant influence:** It means the power to participate, directly or indirectly, in the **financial and operating policy decisions** of the reporting company but is not control or joint control of those policies.

**Majority stake:** The Amendment Rules inserted a new term, "Majority Stake," which means
i. holding more than one-half of the equity share capital in the body corporate; or
ii. holding more than one-half of the voting rights in the body corporate; or
iii. Having the right to receive or participate in more than one-half of the distributable dividend or any other distribution by the body corporate.

**Direct and Indirect shareholding:** when an individual holds any rights or entitlement **directly in the reporting company, the said individual shall not be considered as SBO**. An individual will be considered to hold a right or entitlement directly in the Relevant Company, if he satisfies any of the following criteria:
a. the shares in the Relevant Company representing such right or entitlement are held in the name of such individual;
b. the individual holds or acquires a beneficial interest in the shares of the Relevant Company under section 89(2) of the CA 2013, and has made a declaration in this regard to the Relevant Company.

**Indirect shareholding**: is, when a shareholder is a (a) Body corporate; (b) Hindu Undivided Family(c) Partnership (d) Trust (e) Pooled investment vehicle.

**NON-APPLICABILITY**

The amended Rules will not be applicable where the shares of the **Relevant Company are held by:**
(a) the Investor Education and Protection Fund Authority;

| |
|---|
| (b) its **holding company which has complied with section 90**, provided that the details of such holding company are reported in Form BEN-2;<br>(c) the **Central, any State Government** or any local authority;<br>(d) an **entity/ body corporate controlled wholly or partly by the Central Government** and/ or State Government(s);<br>(e) investment vehicles such as mutual funds, alternative investment funds (AIFs), Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InVITs) registered with and regulated by the Securities and Exchange Board of India; and<br>(f) investment vehicles regulated by the RBI, IRDA or Pension Fund Regulatory and Development Authority. |
| **Refer the Notes for Provisions** |

**ANNUAL RETURN - Section 92**

**1) Contents of Annual return—**

(a) its **registered office**, **principal business** activities, particulars of its **holding, subsidiary and associate** companies;
(b) its **shares, debentures and other securities** and shareholding pattern;
(d) its **members and debenture-holders** along with changes therein since the close of the previous financial year;
(e) its **promoters, directors, KMP along with changes**, since the close of the previous financial year;
(f) **meetings of members or a class thereof, Board** and its various committees along with **attendance details**;
(g) **remuneration** of directors and key managerial personnel;]
(h) **penalty or punishment imposed** on the company, its directors or officers and details of compounding of offences and appeals made against such penalty or punishment;
(i) matters relating to certification of compliances, disclosures as may be prescribed;
(j) Details in respect of shares held by or on behalf of the **Foreign Institutional Investors** including their names, addresses, countries of incorporation, registration and percentage of shareholding held by them
(k) **Its indebtedness**

**2) Signature:**

The **Annual return has to be signed by**

- a director of the company and
- the company secretary; and
- in case, there is no company secretary, by a company secretary in practice.

**Exemption:** Provided that in relation to OPC, small company and private company (if such private company is a start-up), the annual return shall be signed by the company secretary, or where there is no company secretary, by the director of the company.".

3) **Form:** Every company shall file its annual return in **Form No.MGT-7.**

One Person Company (OPC) and Small Company. One Person Company and Small Company shall file annual return **from the financial year 2020-2021** onwards in **Form No.MGT-7A**

4) **Additional compliance:** The annual return, filed by

- a **listed company** or
- a **company having**
  - **paid-up share capital of ` 10 crore or more;** or
  - a **turnover of ` 50 crore or more**,

shall be certified by a **PCS and the certificate shall be in Form MGT – 8**. It must state that the annual return discloses the facts correctly and adequately and that the company has complied with all the provisions of the Act.

5) **Time Line:** A copy of annual return shall be filed with the **RoC within 60 days** from the date on which the Annual General Meeting ('AGM') is held or where no annual general meeting is held in any year within 60 days from the date on which the annual general meeting should have been held, along with the reasons for not holding the AGM.

6) **Default**:

- If any company fails to file its annual return, **such company and its every officer who is in default shall be liable to a penalty of 10 thousand rupees** and **in case of continuing failure**, with further penalty of **100 rupees for each day** during which such failure continues, subject to a **maximum of 2 lakh rupees** in case of a company and **50 thousand rupees in case of an officer** who is in default].
- If a CS in practice **certifies the annual return** otherwise than in conformity with the requirements of this section or the rules made thereunder, he shall be liable to a penalty of 2 lakh rupees.

**#Practice Question:**

**Big Fox Private Limited called it's Annual General Meeting on 30th September, 2018 for laying down the financial statement for approval of its shareholders' for the financial year ended 31st March 2018. However, due to want of quorum, the meeting could not take place and was cancelled. The company has not filed the annual financial statements or the annual return for the year ending March 2018, with the RoC till date. The director is of the view that since the annual general meeting did not take place, the period of 60 days for filing of annual return is not applicable and thus, there is no contravention of section 92. Discuss**.

**Answer**: The director is incorrect in holding that there no contravention of the provisions of the Companies Act, 2013. Section 92 states that every company has to file an annual return with the RoC in Form MGT – 7 within 60 days of date on which annual general meeting was held or the date when it must have been held. In the above case, the annual general meeting of Big Fox Private Limited should have been held by 30th September 2018, but it did not take place. Thus, the company has contravened the provisions of section 92 of the Companies Act, 2013 and shall be liable for a penalty as specified in Section 92(5) of the Act.

**PLACE OF KEEPING AND INSPECTION OF REGISTERS, RETURNS, etc. - Section 94**

(1) The registers required to be kept and maintained by a company under section 88 and copies of the annual return filed under section 92 shall be kept at

- the registered office of the company: or
- may also be kept at any **other place in India- Provided**

a) More than 10% of the total number of members entered in the register of members reside; **and**
b) approved by a special resolution

(2) The **registers, indices, and returns shall be open for inspection**

- by any **member, debenture-holder, other security holder** or **beneficial owner**,
- during business hours **without payment of any fees;** and
- by **any other person** on payment of such fees not exceeding **Rupees 50**.
- Time period of inspection shall not less than **two hours** on every working day.

(3) Any such member, debenture-holder, other security holder or beneficial owner or any other person may—

(a) **take extracts from any register**, or index or return **without payment of any fee**; or
(b) **require a copy of any such register** or entries therein or return **on payment of fees not exceeding rupees 10** for each page.

(4) Default: the **company** and **every officer** of the company who is in default shall be liable, for each such default, to a **penalty of one thousand rupees** for every day subject to a maximum of **one lakh rupees** during which the refusal or default continues.

"(3) Notwithstanding anything contained in sub-rules (1) and (2), the following particulars of the register or index or return in respect of the members of a company shall not be made available for any inspection under sub-section (2) or for taking extracts or copies under sub-section (3) of section 94, namely: —

(i) address or registered address (in case of a body corporate);
(ii) e-mail ID
(iii) Unique Identification Number
(iv) PAN Number

**Rule 15 Preservation of Register of Members etc. and Annual Return**

(1) **Period of retention:**

a) The register of members along with the index shall be preserved **permanently** and **Custody:** CS of the company or **any other person authorized by the Board**
b) The **foreign register of members** shall be **preserved permanently**, **unless it is discontinued** and all the entries are transferred to any other foreign register or to the principal register.
c) **Foreign register of debenture holders** or any other security holders shall be preserved for a **period of eight years** from the date of redemption of such debentures or securities.

(2) **Period of retention:** The register of debenture holders or any other security holders - **period of 8 years** from the **date of redemption of debentures or securities**,

**Custody:** CS of the company or **any other person authorized by the Board**

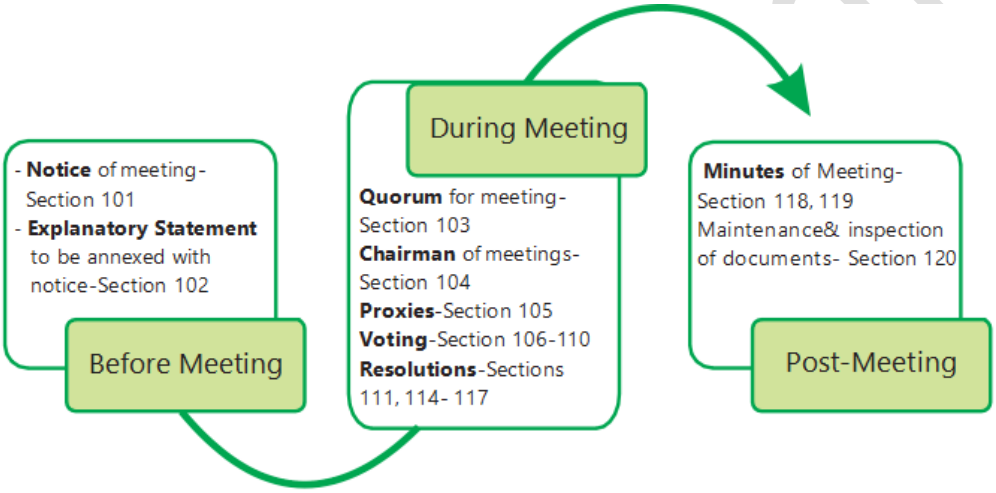
(3) **Copies of all annual returns - preserved for a period of eight years** from the date of filing with the Registrar.

**Registers, etc., to be Evidence - Section 95**

The registers, their indices and copies of annual returns maintained under sections 88 and 94 shall be prima facie evidence of any matter directed or authorised to be inserted therein by or under this Act.

## GENERAL MEETINGS

**PRE-REQUISITES OF A MEETING**




**NOTICE OF MEETING - Section 101**

**When to give Notice?**

A general meeting of a company may be **called by giving not less than 21 days clear notice**
**Medium of Notice:** In writing or through electronic mode in such manner as may be prescribed

**Note:**
1) clear days mean that the date on which notice is served and the date of meeting are excluded for sending the notice.
2) Where a notice of general meeting is sent by post, it shall be deemed to be served at the expiration of 48 hours after the letter containing the same is posted. **Hence, 48 hours to be added to 21 days to give a valid notice.**
3) In case of section 8 company, in clause (1) of Sub-section (1) of Section 101 for the words "21 days", the words "14 days"

**#Practice Question:**
**Illustration**

**Question: ABC Ltd. issued a notice on 1st August, 2019 to hold its AGM on 24th August, 2019. Check the validity of the notice referring to the provisions of the relevant act, in case it is sent by post.**

**Answer:** Date of holding AGM: 24th August, 2019

Date of dispatch of notice: 1st August, 2019

Days to be excluded:

(a) Day of holding AGM i.e 24th August, 2019

(b) Day of dispatch of notice i.e. 1st August, 2019

(c) 2 additional days for service of notice i.e 2nd& 3rd August, 2019 (SS-2 Para 1.2.6)

Number of days notice given: 20 days Number of days notice required under section 101 of the Act is 21 days. Therefore it is not a case of valid notice. However, shortfall of 1 day can be condoned if consent is given for such shorter notice by at least 95% of the members entitled to vote at such AGM.

**Mode of sending the notice:**

**Rule 18 - Notice of the Meeting**

(1) A company **may give notice through electronic mode.**

''electronic mode'' shall mean any communication sent by a **company through its authorized and secured computer programme** which is **capable of producing confirmation and keeping record of such communication** addressed to the person entitled to receive such communication at the last electronic mail address provided by the member.

(2) The said rule mentions that a notice may be **sent through e-mail** as a–

- Text; or
- As an attachment to e-mail; or
- As a notification providing electronic link; or
- Uniform Resource Locator for accessing such notice.

(3) (i) The e-mail shall be **addressed to the person entitled to receive** such e-mail as per the records of the company or as provided by the depository:

(ii) The **subject line in e-mail** shall state the

- name of the company,
- notice of the type of meeting,
- place and the date on which the meeting is scheduled.

(iv) To whom the notice has been sent and copy of such record and any notices of any failed transmissions and subsequent re-sending shall be retained by or on behalf of the company as ''proof of sending''.

(v) The **company's obligation shall be satisfied when it transmits** the e-mail and the **company shall not be held responsible for a failure in transmission beyond its control**

(vi) **If a member entitled to receive notice fails** to provide or **update relevant e-mail address to the company**, or to the depository participant as the case may be, **the company shall not be in default for not delivering notice via e-mail.**

(ix) The notice of the general meeting of the company shall be simultaneously placed on the website of the company if any and on the website as may be notified by the Central Government.

**PERSONS ENTITLED TO RECEIVE NOTICE ?**

In terms of Section 101(3), notice of every meeting of the company must be given to:

(a) every member of the company,
(b) legal representative of any deceased member or
(c) the assignee of an insolvent member;
(d) the auditor or auditors of the company; and
(e) every director of the company.

**#Questionable Point:**

1) Any **accidental omission to give notice** to or the non- receipt of such notice by, any member or other person who is entitled to such notice for any meeting **shall not invalidate the proceedings of the meeting.** The **onus is on the company to prove** that the omission was not deliberate.

2) **Preference Shareholders are Members of the company**, notice of general meetings should also be given to them.

**#Practice Question:**

Mr. Abeer filed a complaint against the company, Elixir Private Limited since it did not serve the notice to him for attending the annual general meeting. The company, in turn, provided the proof that they had sent the notice, by way of an email to Mr. Abeer, inviting him to attend the annual general meeting of the company. Abeer alleges that he never received the email. State whether the company is liable as guilty for contravening the provisions of section 101 of the Companies Act, 2013 read with rules.

**Answer:** As per Rule 18(3) of the Companies (Management & Administration) Rules, 2014, the company's obligation shall be satisfied when it transmits the e-mail and the company shall not be held responsible for a failure in transmission beyond its control. Also, if the member entitled to receive the notice fails to provide or update relevant e-mail address to the company, or to the depository participant as the case may be, the company shall not be in default for not delivering notice via e-mail.

**Can a Meeting be held at shorter notice?**

A general meeting may be called after giving shorter notice than that specified in this sub-section **if consent, in writing or by electronic mode, is given by**—

(i) in the case of an **AGM**, by not less than 95% of the **members entitled to vote** thereat; and

(ii) in the case of **any other general meeting**, by members of the company—

(a) holding, **company having share capital,** majority in number of members entitled to vote and **who represent not less than 95% of such part of the paid-up share capital**; or

(b) having, **if the company has no share capital,** not less than **95% of the total voting power** exercisable at that meeting.

**Authority to call a General Meeting**

A general meeting (AGM or EGM) has to be called by **the Board of Directors**. An individual **director does not have the authority to call a General Meeting**. Any notice of General Meeting given without the sanction of the Board is invalid; however, the same can be ratified by the Board. For calling a General Meeting, the Board passes a Board Resolution.

**EXPLANATORY STATEMENT TO BE ANNEXED TO NOTICE - Section 102**

1. **consideration of financial statements** and the reports of board of directors and auditors.
2. **Declaration of any dividend**
3. **Appointment** of **directors** in place of those retiring
4. **Appointment** of and **fixing** of the **remuneration of the auditor**

**Rest all Business = Special Business**

**#Deeper Understanding:**

**1) Ordinary business shall be held only in AGM.**
**2) Any other business apart from those mentioned above shall be deemed to be special business and can be discussed AGM or EGM.**
**3) All the matters held in EGM shall be deemed to be Special business.**
**4) Explanatory statement is not required for transacting OB.**

**Contents to be disclosed in Explanatory Statement:**

Section 102 of the Companies Act, 2013 mentions that where any special business is to be transacted at the company's general meeting, then an 'Explanatory Statement' should be annexed to the notice, **which must specify**

1)
(a) the **nature of concern or interest**, financial or otherwise, if any, in respect of each items of—

(i) every director and the manager, if any;
(ii) every other key managerial personnel; and
(iii) relatives of the persons mentioned in sub-clauses (i) and (ii);

(b) any **other information and facts that may enable members to understand** the meaning, scope and implications of the items of business and to take decision thereon.

2) If special business to be transacted at a meeting of the company **relates to any other company**, in which extent of shareholding of every promoter, director, manager, KMP shall be disclosed, if **shareholding is 2% or more of that other company.**

3) Where as a **result of the non-disclosure or insufficient disclosure** by a promoter, director, manager, KMP, any benefit which accrues **to them or their relatives**, they, shall hold such

benefit in **trust for the company**, and shall, be **liable to compensate the company to the extent of the benefit received by him**.

(d) **Default**: In addition to (3), Every promoter, director, manager or other KMP of the company who is in default shall be liable to a penalty of 50,000 rupees or **five** times the amount of benefit accruing to the promoter, director, manager or other key managerial personnel or any of his relatives, **whichever is higher.**

## QUORUM FOR MEETINGS - Section 103

1) **Quorum means the minimum number of members who must be present in order to constitute a valid meeting.** Section 103 of the Act states that **unless the articles of the company provide for a larger number**, the quorum for the meeting shall be as follows–

Let us remember the concept through a table:

(a) in case of a public company,—

| Quorum for the meeting | Number of members |
|---|---|
| 5 members personally present | Not more than one thousand |
| 15 members personally present | More than one thousand but upto five thousand |
| 30 members personally present | Exceeds five thousand |

(b) In the case of a private company, two members personally present, shall be the quorum for a meeting of the company.

**1)** Where the Quorum provided in the **Articles is higher than that provided under the Act**, the Quorum shall **conform to such higher requirement**.

**2)** Members need to be **personally present at a Meeting to constitute the Quorum**. Proxies shall be excluded for determining the Quorum.

**#Questionable Point:**

- Duly **authorized representative of a body corporate or President of India or the Governor of a State** is deemed to be a Member personally present and enjoys all the rights of a Member present in person.
- **One person can be an authorized representative of more than one body corporate**. In **such a case, he is treated as more than one-member present in person for the purpose of quorum**. However, to constitute a meeting, at least two individuals shall be present in person.

  **Illustration**: Thus, in case of a public company having not more than 1000 members with a quorum requirement of five members, an authorized representative of five bodies corporate cannot form a quorum by himself but can do so if at least one more member is personally present.
- Quorum must be present **throughout the meeting.**

**3)** **CONSEQUENCES OF NO QUORUM**- If the quorum is not present **within half-an-hour from the time appointed for holding a meeting** of the company—

(a) the meeting **shall stand adjourned to the same day in the next week at the same time and place**, or to such other date as the Board may determine; or

(b) **the meeting, if called by requisitionists (under section 100), shall stand cancelled**

**Adjourned Meeting:** Provided that **in case of an adjourned meeting** or of a change of day, time or place of meeting under clause (a), **the company shall give not less than 3 days' notice** to the members **either individually or by publishing an advertisement in the newspapers** (English and vernacular language) which is in circulation at the place where the registered office of the company is situated.

Where quorum is not present in the adjourned meeting also within half an hour, **then the members present shall form the quorum.**

**#Practice Question:**

Abbey Limited has 2300 members and the annual general meeting of the company is to be held on 23rd February 2019 at 10.30 a.m. On the day of the meeting, 18 members were personally present by 11.00 a.m. and the Chairman proceeded to initiate the chronicles of the meeting. There were 5 special businesses to be discussed at the said meeting and by 2.30 p.m. Agenda 1 to 3 had been discussed and appropriate resolutions were passed. However, due to some emergency, 4 of the members had to leave around 3 p.m. The Chairman granted them the permission and proceeded to discuss Agenda 4 & 5 and accordingly passed resolution as per the consent of the remaining members. Comment whether the meeting is a properly convened meeting as per the provisions of section 103 of the Companies Act, 2013.

**Answer:** In the above case, while the appropriate quorum was present at the time when the meeting started as per section 103 of the Companies Act, 2013, the quorum was not present at the time of deciding Agenda 4 & 5. It has been held that where at the time of transacting business, the number of members is less than the quorum fixed for the meeting, the business cannot be transacted and shall be a nullity.

**REPRESENTATION OF THE PRESIDENT & GOVERNORS IN MEETING OF COMPANIES TO WHICH THEY ARE MEMBER - Section 112**

The President of India or the Governor of a State, if he is a member of a company, **may appoint such person as he thinks fit to act as his representative** at any meeting and **such other person shall be entitled to exercise the same rights** and powers including the right to vote to proxy and postal ballot, as the President or, as the case may be, the Governor could exercise as a member of the company.

**REPRESENTATIONS OF CORPORATIONS MEETING OF COMPANIES AND CREDITORS - Section 113**

Where a **body corporate is a member or a creditor including a holder of debentures of the company** and it authorises any person as its representative at any meeting of the company or any class of members of the company or at any meeting of creditors of the company, such **representative shall be entitled to exercise the same rights** and powers including right to vote by proxy and by postal ballot on behalf of the body corporate which he represents.

**CHAIRMAN OF MEETINGS - Section 104**

(1) **Election of chairman by members:** Unless the articles of the company otherwise provide, **the members personally present at the meeting shall elect one of themselves to be the Chairman** thereof **on a show of hands**.

(2) **If a poll is demanded on the election of the Chairman**, it shall be taken forthwith and; the Chairman elected on a show of hands shall continue to be the Chairman of the meeting until some other person is elected as Chairman as a result of the poll, and such other person shall be the Chairman for the rest of the meeting.

(3) **Right to cast casting vote:** The Chairman has a casting vote in Board Meetings and general meetings, **if specifically empowered by the articles** of the Company. A casting vote means that in event of the **equality of vote on a particular business** being transacted at the meeting, the Chairman of the meeting shall have a **right to cast a second vote.**

**PROXIES - Section 105**

1) Any **member of a company who is entitled to attend and vote at a meeting of the company shall be entitled to appoint another person as a proxy** to attend and vote at the meeting on his behalf.

   **Exemption:** Applicability of the sub-section (1) - Unless the articles of a company otherwise provide, this sub-section shall not apply to a company not having a share capital. CG may also prescribe a class or classes of companies whose members shall not be entitled to appoint another person as a proxy.

2) A **member of a section 8 Company** shall not be entitled to appoint any other person as his proxy **unless such other person is also a member** of such company.

3) A Proxy **can act on behalf of Members not exceeding fifty (if more than 50 appointed only the first fifty proxies shall be valid)** and **holding in the aggregate not more than ten percent of the total share capital of the company** carrying Voting Rights.
   **NOTE**: A **Member holding more than 10% of the total share capital** of the company carrying Voting Rights may appoint a single person as Proxy for his entire shareholding and **such person shall not act as a Proxy for another person or shareholder.**
4) The instrument **appointing a proxy must be in Form No. MGT - 11**. It needs to be in writing and signed by the appointer or his attorney duly authorised in writing. If the appointer is a body corporate, the instrument should be under its seal or be signed by an officer or an attorney duly authorised by the body corporate.
5) As a compliance requirement, every notice calling a meeting, which has a share capital, there shall appear with reasonable prominence a statement that a member entitled to attend and vote is entitled to appoint a proxy and that a proxy need not be a member.
6) A **proxy received 48 hours before the meeting will be valid even if the articles provide for a longer period.**
7) In listed companies, the **notice of the meeting shall clearly state that** the members who **have cast their vote by remote e-voting prior to the meeting may also attend the meeting but shall not be entitled to cast their vote again.**
8) Every **member entitled to vote** at a meeting of the company, or on any resolution to be moved thereat, shall be **entitled during the period beginning 24 hours before commencement of the meeting** and ending with the conclusion of the meeting, to **inspect the proxies lodged,** at any time during the business hours of the company, provided **not less than 3 days' notice in writing of the intention so to inspect is given** to the company.
9) **DISABILITIES OF PROXY:**
   a) A proxy shall **not have the right to speak at the meeting**.
   b) A proxy **cannot vote on a show of hands**.

c) A proxy is **not counted for the purpose of quorum**.

10) **Rights of proxy**:

a) A proxy has the **right to attend the meeting**.

b) A proxy has the **right to vote only on a poll**.

c) A proxy, if eligible under section 109, has the **right to demand a poll**.

**#Practice Questions**

1. **Question: Annual General Meeting of a Public Company was scheduled to be held on 15.12.2015. Mr. A, a shareholder, issued two Proxies in respect of the shares held by him in favor of Mr. 'X' and Mr. 'Y'. The proxy in favor of 'Y' was lodged on 12.12.2015 and the one in favor of Mr. X was lodged on 15.12.2015. The company rejected the proxy in favor of Mr. Y as the proxy in favor of Mr. Y was of dated 12.12.2015 and in favor of Mr. X was of dated15.12.2015. Is the rejection by the company in order?**

   **Answer:** As per Section 105 of the Companies Act, 2013 a proxy should be deposited 48 hours before the time of the meeting. In the given case, the proxies should have, therefore, been deposited on or before 13.12.2015 (the date of the meeting being 15.12.2015). X deposited the proxy on 15.12.2015.

   Therefore, proxy in favour of Mr. X has become invalid. Thus, rejecting the proxy in favour of Mr. Y is unsustainable. Proxy in favor of Y is valid since it is deposited in time.

2. **Question: The Chairman of the meeting of a public company received a Proxy 54 hours before the time fixed for the start of the meeting. He refused to accept the Proxy on the ground that the Articles of the company provided that a Proxy must be filed 60 hours before the start of the meeting. Decide, under the provisions of the Companies Act, 2013 whether the Proxy holder can compel the Chairman to admit the Proxy?**

   **Answer:** As per Section 105 of the Companies Act, 2013 proxy shall be deposited with the company within 48 hours before the meeting.

   Any provisions contained in the Articles of a company that requires a longer period than 48 hours before a meeting of the company for depositing a proxy shall be void. Thus, contention of Mr X is valid.

3. **Question: Mr. A, a member of XYZ Limited, appoints Mr. B as his proxy to attend the general meeting of the company. Later he (Mr. A) also attends the meeting. Both Mr. A (the member) and Mr. B (the proxy) voted on a particular resolution in the meeting. Mr. A's vote was declared invalid by the chairman stating that since he has appointed the proxy and Mr. B's vote has been considered as valid. Mr. A objects to the decision of the Chairman. Decide, under the provisions of the Companies Act, 2013 whether Mr. A's objection shall be taxable.**

**Answer:** Decision by Chairman is invalid. Since Mr. A i.e. a member himself attended a meeting and voted on resolution; it will amount to revocation of proxy. Thus, any vote put by Mr. B i.e. proxy shall be invalid.

## ANNUAL GENERAL MEETING - Section 96

**#Definition:**

Section 2 (41): Financial year, means the **period ending on the 31st day of March every year**, and where **it has been incorporated on or after the 1st day of January of a year**, **the period ending on the 31st day of March of the following year**, in respect whereof financial statement of the company or body corporate is made up

Provided that where a company or body corporate, which is a **holding company or a subsidiary or associate company of a company incorporated outside India** and is required to follow a different financial year for consolidation of its accounts outside India, **the Central Government may, on an application made by that company** or body corporate, **allow any period as its financial year, whether or not that period is a year.**

1) Annual general meeting should **be held once in each calendar year**.
2) First annual general meeting of the company should be held **within 9 months from the closing of the first financial year**. Hence it shall not be necessary for the company to hold any annual general meeting in the year of its incorporation.
3) Subsequent annual general meeting of the company should be held **within 6 months from the date of closing of the relevant financial year**.
4) The **gap between two annual general meetings shall not exceed 15 months**.
5) **Extension**: In case, it is not possible for a company to hold an annual general meeting within the prescribed time, the Registrar may, for any special reason, extend the time within which any annual general meeting shall be held. Such extension can be for a period **not exceeding 3 months**. **No such extension of time can be granted by the Registrar for the holding of the first annual general meeting.**
6) **Time and place for holding an annual general meeting:** Section 96(2) states that every AGM shall be **called during business hours, that is, between 9 a.m. and 6 p.m.** on any day **that is not a National Holiday** and **shall be held either at the registered office of the company** or **at some other place within the city, town or village** in which the registered office of the company is situated.

   Provided that **AGM of an unlisted company** may be held **at any place in India if consent is given in writing** or by electronic mode **by all the members** in advance.

"National Holiday means Republic Day i.e. 26th January, Independence Day i.e. 15th August, Gandhi Jayanti i.e. 2nd October and such other day as may be declared as National Holiday by the Central Government."

## POWER OF TRIBUNAL TO CALL ANNUAL GENERAL MEETING - Section 97

(1) If any default is made in holding the AGM of a company under section 96, **the Tribunal may,** notwithstanding anything contained in this Act or the articles of the company, **on the application of any member** of the company, call, or direct the calling of, an annual general meeting of the company and give such ancillary or consequential directions as the Tribunal thinks expedient:

Provided that such directions may include a direction that one member of the company present in person or by proxy shall be deemed to constitute a meeting.

(2) A general meeting held in pursuance of sub-section (1) shall, subject to any directions of the Tribunal, be deemed to be an annual general meeting of the company under this Act.

**POWER OF TRIBUNAL TO CALL MEETINGS OF MEMBERS, etc - Section - 98**

(1) If for any reason it is impracticable to call a meeting of a company, **other than an AGM, the Tribunal may**,

- either suomotu or
- on the application of any director or
- member of the company who would be entitled to vote at the meeting,—

(a) **order a meeting of the company to be called**, held and conducted in such manner as the Tribunal thinks fit; and

(b) give such ancillary or consequential directions as the Tribunal thinks expedient, including directions modifying or supplementing in relation to the calling, holding and conducting of the meeting, the operation of the provisions of this Act or articles of the company:

Provided that such directions may include a direction that one member of the company present in person or by proxy shall be deemed to constitute a meeting.

(2) Any meeting called, held and conducted in accordance with any order made under sub-section (1) shall, for all purposes, be deemed to be a meeting of the company duly called, held and conducted.

**Section 99 - PUNISHMENT FOR DEFAULT IN COMPLYING WITH PROVISIONS OF Sections 96 - 98**

If any default in section 96 or section 97 or section 98 or in complying with any directions of the Tribunal, the **company** and every **officer** of the company who is in default shall be punishable with **fine** which may extend to **1 lakh rupees** and in the case of a continuing default, with a further fine which may extend to **5 thousand rupees for every day** during which such default continues.

**EXTRA-ORDINARY GENERAL MEETINGS – Section 100**

1) The Board may, whenever it deems fit, call an EGM of the company.
Provided that an EGM of the company, other than of the wholly owned subsidiary of a company incorporated outside India, **shall be held at a place within India.**

(2) The Board shall, at the requisition made by,—

(a) **Company having a share capital**: Members who hold **not less than one-tenth of such of the paid-up share capital** of the company as on that date carries the right of voting;

(b) **Company not having a share capital**: Members who have not less than **one-tenth of the total voting power of all the members** having on the said date a right to vote,
call an EGM of the company within the period specified in sub-section (4).

(3) The requisition made under sub-section (2) shall set out the matters for the consideration of which the meeting is to be called and shall be signed by the requisitionists and sent to the registered office of the company.

(4) If the **Board does not**, within 21 days from the date of receipt of a valid requisition in regard to any matter, proceed to call a meeting for the consideration of that matter on a day **not later than 45 days from the date of receipt of such requisition**, the **meeting may be called and held by the requisitonists themselves within a period of 3 months from the date of the requisition.**

(5) Any **reasonable expenses incurred by the requisitionists** in calling a meeting under sub-section (4) shall be **reimbursed to the requisitionists by the company** and the **sums so paid shall be deducted from any fee or other remuneration under section 197 payable to such of the directors** who were in default in calling the meeting.

**Rule 17 of the Companies (Management and Administration) Rules, 2014 provides as under with regard to calling of EGM by requisitionists**

- The **notice shall specify the place, date, day and hour of the meeting** and shall contain the business to be transacted at the meeting.-
- Explanation.- The requistionists should convene meeting at **Registered office or in the same city or town** where Registered office is situated and such meeting should be convened on any day except national holiday.
- Where the meeting is not convened, the **requistionists shall have a right to receive list of members together with their registered address and number of shares held** and the company concerned is bound to give a list of members together with their registered address made as on twenty first day from the date of receipt of valid requisition together with such changes, if any, before the expiry of the forty-five days from the date of receipt of a valid requisition.
- The notice of the meeting shall be given by speed post or registered post or through electronic mode. Any accidental omission to give notice to, or the non-receipt of such notice by, any member shall not invalidate the proceedings of the meeting.

**#Practice Questions:**

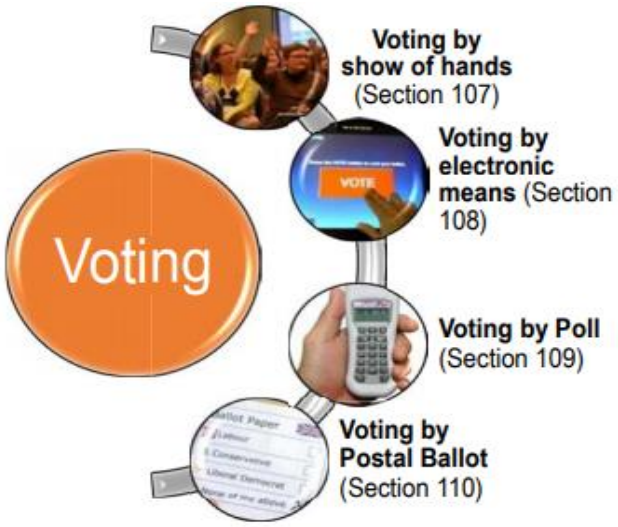
1) The Board of directors of Illusions Private Limited, a company registered in New Delhi, has decided to call an EGM in Madrid, Spain on 2nd October 2018. Discuss whether the general meeting can be convened on the said date.

No, the meeting cannot be convened in the manner as stated in the facts of the question. As per Rule 17(2) of the Companies (Management and Administration) Rules, 2014, the

requisitionists should hold the meeting in the registered office of the company or in the same city or town in which the registered office is situated and it should be a working day.

2) The members of the Blumove Peacocks Private Limited, holding 1/10th voting power of the company, requisitioned a meeting on 14th August, 2018 to the Board of Directors. However, the directors did not pay any heed to such a requisition and did not call an extra-ordinary meeting. Discuss the consequences of the contravention of the same in accordance with the Companies Act, 2013.
Where the Board, after the receipt of the requisition, does not within 21 days call for a meeting within 45 days of the date of requisition, then the requisitionists may themselves call and convene the meeting.

**VOTING [SECTION 106-109]**




The votes cast by the shareholders play significant role in the General Meetings. An equity shareholder has the right to vote for every motion. However, as per the Section 47 of the Companies Act, 2013 preference shareholder is entitled to vote only for a resolution pertaining to his rights. The companies Act provides for various modes through which a shareholder can cast his vote.

**Restriction on Voting Rights - Section 106**

1. **The articles of a company may provide that, no member shall exercise any voting right** in respect of any share registered in his name **on which any amount is due from him on calls or any other sums payable to the company**, or in regard to which the company has exercised the right of lien.
2. **A company shall not prohibit any member** from exercising **his voting rights on any other ground** except the grounds mentioned in (1).
3. **On a poll taken at a meeting of a company**, A member entitled to more than one vote need not use all his votes or cast his votes in the same way – all the votes he uses.
   The right to vote is a personal right of a shareholder and he may use it as he likes it. He may split its vote for and against the resolution.

**#Questionable Point:**
1) Where the **articles of the company do not contain any provision** restricting the exercise of voting right of member, **a member cannot be prevented from voting**, even though, calls or

other sum payable by him have not been paid or the company has exercised any right of lien over his shares.

2) Consider a situation where **directors are also the shareholders of the company**.
Directors, who are also the shareholders of the company, stand in a fiduciary relationship with the company in their capacity as directors. However, a director should vote as a common shareholder would vote in a general meeting, and need not be influenced by the fact of his being a director.

**3) Can an insolvent shareholder vote at the meeting?**
Yes. Notwithstanding that he has no longer any beneficial interest in the shares and the dividends are payable only to his trustee in bankruptcy, an insolvent shareholder so long as he remains in the register of the company as a member, is entitled to exercise his votes which are attributed to his status as member.

**#Practice Question:**
Mr. & Mrs. Iyer are joint shareholders of Goal Private Limited and they hold 500 shares of the company. Regarding a particular, Mr. Iyer is in the favour of the decision, whereas Mrs. Iyer is against the resolution. Decide how should the vote be casted in case of this situation?

**Answer:** Join shareholders **must be of the same opinion** in voting unless the articles provide to the contrary. The voting in case of joint shareholders is done in the order of seniority, which is determined on the basis of the order in which their names appear in the register of members/ shareholders.

**Voting by show of hands - Section 107**

1. **Unless the voting is demanded by way of poll** or by electronic means, the voting should be by way of show of hands in the first instance.
2. The **declaration by the Chairman of the meeting** in the minutes books shall be the **conclusive evidence that the resolution is passed**.
3. Proof of number of vote cast in favour of and against the resolution is not required.

**Question**: Can an insolvent shareholder vote at the general meeting by show of hands?

**DEMAND FOR POLL - Section 109**

1. Section 109 provides that **before or on declaration of result** of the voting on any resolution **by a show of hands**, the **Chairman of the meeting on his own, or on demand made by the 'specified' members** in that behalf order for a poll.
2. **Members who can demand for poll –**
   - **Company having a share capital**, **by the members present in person or proxy**, and **having not less than 1/10th of the total voting power** or **holding shares on which an aggregate sum of not less than ` 5,00,000** has been paid – up.
   - **Any other company,** by **any member or members present in person or by proxy,** where allowed, and **having not less than 1/10th of the total voting power.**

3. The demand for poll may be **withdrawn by the persons who made the demand**, at any time.

4. A **poll demanded for ADJOURNMENT OF THE MEETING OR APPOINTMENT OF CHAIRMAN** of the meeting **shall be taken forthwith**.

   A poll demanded for any other reason shall be taken at such time, **not being later than 48 hours from the time when the demand was made**, as the Chairman of the meeting may direct.

**5. The Chairman of a meeting shall ensure that-**

(a) The **Scrutinizers are provided with the Register of Members, specimen signatures of the members, Attendance Register and Register of Proxies**.

(b) The **Scrutinizers are provided with all the documents** received by the Company pursuant to sections 105, 112 and section 113.

(c) The **Scrutinizers shall arrange for Polling papers and distribute them to the members and proxies present at the meeting; in case of joint shareholders, the polling paper shall be given to the first named holder** and the **Polling paper shall be in Form No. MGT.12.**

(d) The **Scrutinizers shall keep a record of the polling papers received** in response to poll, by initialing it.

(e) The **Scrutinizers shall lock and seal an empty polling box in the presence of the members** and proxies.

(f) The **Scrutinizers shall open the Polling box in the presence of two persons as witnesses** after the voting process is over.

(g) In **case of ambiguity** about the validity of a proxy, the Scrutinizers shall decide the validity in **consultation with the Chairman.**

(h) The **Scrutinizers shall ensure** that if a member has voted in person, the **proxy's vote shall be disregarded.**

(i) The Scrutinizers shall count the votes cast on poll and **prepare a report** thereon addressed to the Chairman.

(j) Where **voting is conducted by electronic means under the provisions of section 108** and rules made thereunder, the company shall provide all the necessary support, technical and otherwise, to the Scrutinizers in orderly conduct of the voting and counting the result thereof.

(k) The **Scrutinizers' report shall state total votes cast, valid votes, votes in favour and against the resolution including the details of invalid polling papers and votes comprised therein.**

(l) The Scrutinizers shall **submit the Report to the Chairman** who shall counter-sign the same.

(m) The Chairman shall **declare the result of Voting on poll**.

**(3)** The scrutinizers appointed for the poll, shall submit a report to the Chairman of the meeting **in Form No. MGT.13** and the report shall be signed by the scrutinizer and, in case there is more than one scrutinizer by all the scrutinizers, and the **same shall be submitted by them to the Chairman of the meeting within 7 days from the date the poll is taken.**

**EXEMPTION**

**Applicability of section 101 to 107 and 109 to Private companies- Section 101 to 107 and 109 shall apply unless otherwise specified in respective sections or the articles of the company provide otherwise. Notification dated 5th June, 2015.**

**This exception shall be applicable to a private company which has not committed a default in filing its financial statements under section 137 or annual return under section 92 of the Act, with the Registrar. Notification dated 13th June 2017.**

## VOTING THROUGH ELECTRONIC MEANS - Section 108

E- Voting has been introduced under Section 108 read with the Rule 20 of Companies (Management and Administration) Rules, 2014 and provides that a member in the prescribed class of companies may exercise his right to vote by electronic means.

**#Deeper Understanding:**

- General meetings of companies are held at their registered offices and **it is not possible for every member specially members holding minor shares to travel up to the registered office of the company and participate in the general meetings of the company.**
- **A member can cast his vote through one mode only.**
- **However**, A member after casting his vote through e-voting can go and attend the general meeting but cannot cast vote in that general meeting.

**1) APPLICABILITY:** Section 108 of the Act shall apply to-
(i) ***Equtiy Listed Companies*** on recognised stock exchanges; and
(ii) All companies ***having 1000 or more members***.

**2) NON-APPLICABILITY: 108 shall not apply to; -**

**1. Nidhi**
**2. An enterprise or institutional investor** referred to in SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009

**Procedure:** A company which provides the facility to its members to exercise voting by electronic means shall comply with the following procedure, namely:-

**3) NOTICE OF MEETING**

**i) Notice Shall be sent to and by:** It shall be sent to all the members, directors and auditors of the company either-
(a) by registered post or speed post; or
(b) through electronic means, namely, registered e-mail ID of the recipient; or
(c) by courier service;

**ii) Notice to be hosted on website:** the notice shall also be placed on the website, if any, of the company and of the agency forthwith after it is sent to the members;

iii) **The notice of the meeting shall clearly state** -

(a) that the **company is providing facility for voting by electronic means**

(b) that the facility for voting, either through electronic voting system or ballot or polling paper **shall also be made available at the meeting** and **members attending the meeting who have not already cast their vote by remote e-voting shall be able to exercise their right at the meeting;**

(c) that the members who have cast their vote by remote e-voting prior to the meeting may **also attend the meeting but shall not vote again**;

(d) indicate the **process and manner for voting** by electronic means;

(e) The **time period** during which the votes may be cast by remote e-voting;

(f) provide the details about the **login ID and password**

iv) **Publication of notice:** On completion of dispatch of notices for the meeting, at least 21 days before the date of general meeting, publish a notice in newspaper [Vernacular (regional) +English (Country vide circulation) and specifying the following matters, namely:-

(a) statement that the business may be transacted through voting by electronic means;

(b) the date and **time of commencement** of remote e-voting;

(c) the date and **time of end** of remote e-voting;

(d) **cut-off date**;

(e) website address of the company, if any, and of the agency where notice of the meeting is displayed; and

(f) **name, designation, address, email id and phone number** of the person responsible to **address the grievances connected** with facility for voting by electronic means

**4) TIME FOR OPENING OF E-VOTING:**

The facility for remote e-voting shall remain open for **not less than 3 days** and **shall close at 5.00 p.m.** on the **date preceding the date of the general meeting**;

**5) OPTION FOR REMOTE E-VOTING:**

- The members of the company, holding shares **either in physical form or in dematerialized form**, as on the cut-off date, **may opt** for remote e-voting.
- Provided that **once the vote on a resolution is cast by the member, he shall not be allowed to change it subsequently** or cast the vote again:
- A **member may participate** in the general meeting even after exercising his right to vote through remote e-voting **but shall not be allowed to vote again**;

**6) AT THE END OF THE REMOTE E-VOTING PERIOD, THE FACILITY SHALL BE BLOCKED:**

Provided that if a company opts to provide the same electronic voting system as used during remote e-voting during the general meeting, the said facility shall be in operation till all the resolutions are considered and voted upon in the meeting and may be used for voting only by the members attending the meeting and who have not exercised their right to vote through remote e- voting.

**7) APPOINTMENT OF SCRUTINIZER**:

- The Board of Directors shall appoint **one or more scrutinizer**, **who may be PCA, PCS, PCMA or an Advocate**, or **any other person who is not in employment** of the company and is a person of repute who, in the opinion of the Board can scrutinize the voting and remote e-voting process in a fair and transparent manner.
- Provided that the **scrutinizer may take assistance of a person who is not in employment of the company** and who is well-versed with the electronic voting system;
- **FUNCTION OF SCRUTINIZER:** The scrutinizer shall be willing to be appointed and be available for the purpose of ascertaining the requisite majority;

- **ACCESS TO DETAILS:**
  Scrutinizer shall have access to details relating to members, such as their names, folios, number of shares held and such other information, to decide who have cast votes through remote e-voting and attending the meeting.

**8) COUNTING OF VOTES**:

The scrutinizer shall, immediately **after the conclusion of voting** at the general meeting, **first count the votes cast at the meeting**, thereafter **unblock the votes cast through remote e-voting in the presence of at least 2 witnesses** not in the employment of the company and make, **not later than 3 days of conclusion of the meeting, a consolidated SCRUTINIZER'S REPORT** of the total votes cast in favour or against, if any, to the Chairman or a person authorized by him in writing who shall countersign the same:
**Provided that the Chairman or a person authorized by him in writing shall declare the result of the voting forthwith;**
**Explanation**: It is hereby clarified that the manner in which members have cast their votes, that is, affirming or negating the resolution, shall remain secret and not available to the Chairman, Scrutinizer or any other person till the votes are cast in the meeting.

**9) MAINTENANCE OF REGISTER:**

- The **scrutinizer shall maintain a register either manually or electronically** to record the **assent or dissent received**, mentioning the particulars of name, address, folio number or client ID of the members, number of shares held by them, nominal value of such shares and whether the shares have differential voting rights;
- **Safe Custody of register**: The register and all other papers relating to voting by electronic means shall remain in the safe custody of the scrutinizer until the Chairman considers, approves and signs the minutes and thereafter, the scrutinizer shall hand over the register and other related papers to the company.

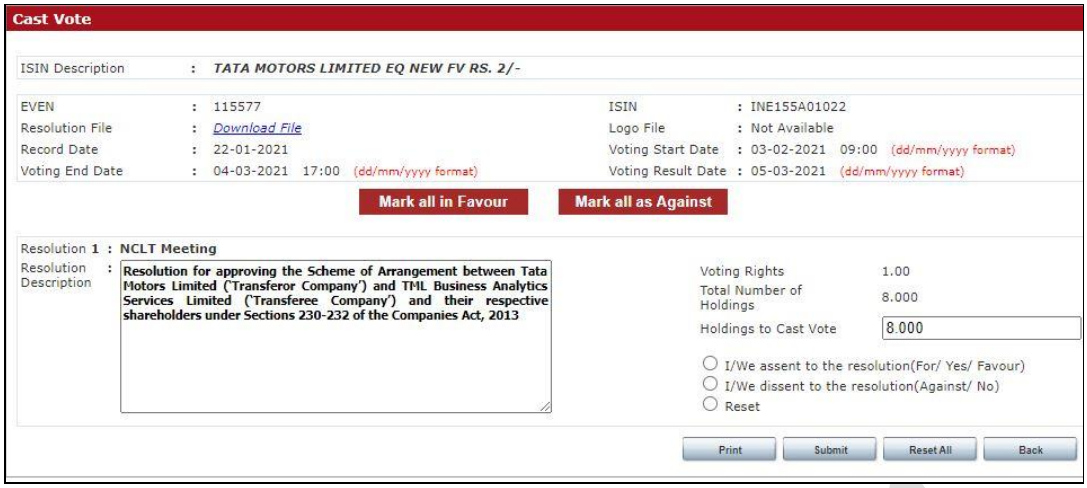
**10) RESULT ON WEBSITES:**

- The results declared along with the report of the scrutinizer shall be **placed on the website of the company**, if any, and on the **website of the agency immediately after the result is declared** by the Chairman:
- In case of Listed companies, it shall, simultaneously, forward the results to the concerned stock exchange **to place the results on its or their website.**

**11) Passing of date of resolution:**

Subject to receipt of requisite number of votes, the resolution shall be deemed to be passed **on the date of the relevant general meeting**.

**#Questionable point:**
**A resolution proposed to be considered through voting by electronic means shall not be withdrawn.**




## POSTAL BALLOT - Section 110

Meaning of postal ballot: As per section 2(65) "postal ballot" means voting by post or through any electronic mode. It includes voting by shareholders by postal or electronic mode instead of voting personally for transacting businesses in a general meeting of the company.

**A company may use postal ballot for transacting any item of business, other than**

(i) **Ordinary business** and
(ii) Any business in respect of which **directors or auditors have a right to be heard** at any meeting.

**Procedure in short**: A company shall send a notice and draft resolution by registered post or speed post, or by courier or by e-mail or by any other electronic means to all shareholders explaining the reasons and requesting them to send their assent or dissent in writing on a postal ballot. If a resolution is assented to by the requisite majority of the shareholders by means of postal ballot, it shall be deemed to have been duly passed at a general meeting convened in that behalf.

**Following companies are not required to transact any business through postal ballot.**

**(i) One person company**
**(ii) All other companies having members up to 200.**

**The following items of business shall be transacted only by means of voting through postal ballot:**

(a) Alteration of the **objects clause** of the memorandum
(b) Alteration of articles of association in relation to **insertion or removal of provisions defining a private company.**
(c) **Change in place of registered office outside the local limits** of any city, town or village.
(d) **Change in objects for which a company has raised money from public through prospectus and still has any unutilized amount** out of the money so raised.
(e) Issue of shares with **differential voting rights.**
(f) **Variation in the rights attached to a class of shares** or debentures or other securities.
(g) **Buy-back** of shares by a company.

(h) **Election of a 'small shareholders'** director.
(i) **Sale of the whole or substantially the whole** of an undertaking of a company.
(j) **Giving loans or extending guarantee or providing security exceeding** 60% of its paid up share capital, free reserves and securities premium account or 100% of its free reserves and securities premium account.
(k) any other resolution prescribed under any applicable law, rules or regulations.

*Any item of business required to be transacted by means of postal ballot (as stated above), **may** be transacted at a general meeting by a company which is required to provide the facility to members to vote by electronic means under section 108, in the manner provided in that section.*

**Rule 22 of the Companies (Management and Administration) Rules, 2014 lay down the procedure to be followed for conducting business through postal ballot.**

**(1) Notice to all shareholders:** The company shall send a notice to all the shareholders, along with a draft resolution explaining the reasons therefore and requesting them to send their assent or dissent **within a period of thirty days from the date of dispatch of the notice.**

**(2) Mode of sending documents:** The notice shall be sent

(a) By Registered Post or speed post, or
(b) Through electronic means like registered e-mail id or
(c) Through courier service

**Appointment of scrutinizer:** The Board of directors shall appoint one scrutinizer, who is not in employment of the company and who, in the opinion of the Board can conduct the postal ballot voting process in a fair and transparent manner.

- The scrutinizer may be a **CS, CA, CA in Practice, an Advocate** or any other person of repute who is not in the employment of the company and, who can in the opinion of the Board, scrutinise the postal ballot process in a fair and transparent manner.
- The scrutinizer shall however **not be an officer or employee** of the company.
- The scrutinizer so appointed may **take assistance of a person who is not in employment** of the company and who is well-versed with the e-voting system
- **Submission of report of the scrutinizer**: The scrutinizer shall submit his report as soon as possible after the last date of receipt of postal ballots **but not later than seven days thereof**.
- **Preservation of postal ballots:** The postal ballot and all other papers relating to postal ballot including voting by electronic means, shall be under the safe custody of the scrutinizer till the chairman considers, approves and signs the minutes and thereafter, the scrutinizer shall return the ballot papers and other related papers or register to the company who shall preserve such ballot papers and other related papers or register safely.
- **Declaration of result:** The results shall be declared by placing it, along with the scrutinizer's report, on the website of the company.

**#Extra Gyaan**

**A postal ballot form shall be considered invalid if:**

(a) A **different form** other than issued by the company is used;
(b) It has **not been signed**;
(c) **Signature on the postal ballot form doesn't match the specimen signatures**
(e) **Neither assent nor dissent is mentioned**;
(f) Any competent authority has directed the company to **freeze the Voting Rights of the Member**;
(g) The **envelope is received after the last date** prescribed; i.e., **30 days from** the date of issue of notice shall be treated as if reply from the member has not been received.
(i) It is received from a Member **who is in arrears of payment of calls**;
(j) It is **defaced or mutilated** in such a way that its identity as a genuine form cannot be established;
(k) **Member has made any amendment** to the Resolution or **imposed any condition** while exercising his vote.

**Sample Postal Ballot Form**

**(On the letterhead of the Company)**

1. Name and Registered Address of the: sole / first named Member

2. Name(s) of Joint-Holder(s), if any :

3. Registered Folio No. /DP ID No.* : /Client ID No.* (*Applicable to Members holding shares in dematerialized form)

4. Number of equity shares held :

5. I/We hereby exercise my / our vote in respect of the under mentioned resolutions to be passed through Postal Ballot as stated in the Notice dated February 20, 20.... of the Company by sending my / our assent or dissent to the said Resolution by placing the tick (√) mark in the appropriate box below:

| Item No. | Brief Particulars of the Resolution | No. of Shares | I / We assent to the Resolution (FOR) | I / We dissent to the Resolution (AGAINST) |
|---|---|---|---|---|
| | | | | |
| | | | | |
| | | | | |

Place:

Date: .....

Signature of Shareholder

## CIRCULATION OF MEMBER'S RESOLUTIONS - Section 111

**(1) Circulation of members' resolution and statements:** While the board enjoys the primacy in setting the agenda of the meetings, the **members are given a right under section 111 to propose resolutions for consideration at the general meetings.** The number of members required to make a requisition under sub-section (1) of this section are as required to requisition a general meeting in sub-section (2) of section 100.

**(2) Eligible members:**

- **Company having share cap:** members holding more than 10% paid up equity share cap
- **Company not having share cap**: members holding more than 10% of total voting power

**(3) Legal requirements:**

(a) a copy of the requisition **signed by the requisitionists is deposited at the registered office of the company**,-

(i) **Where requisition is to propose a resolution: not less than 6 weeks before the meeting**;

(ii) **In any other case including circulation of a statement**: **not less than 2 weeks before the meeting**; and

**Note:** Where however, after a copy of a requisition requiring notice of a resolution has been deposited at the registered office of the company, an **AGM is called on a date within 6 weeks after the copy has been deposited,** the copy, although not deposited within the time required by this subsection, shall be deemed to have been properly deposited for the purposes thereof.

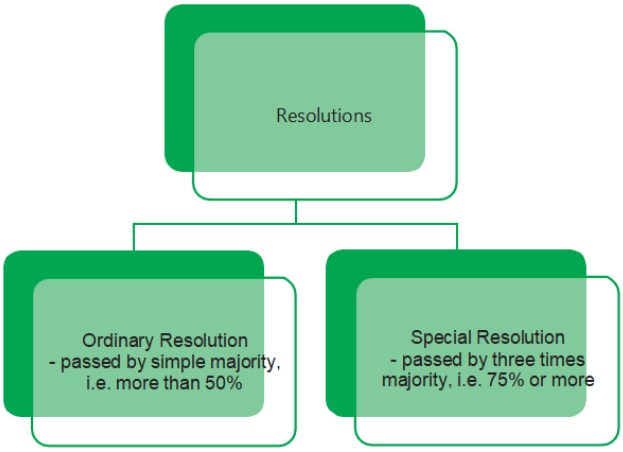
(b) A **sum reasonably sufficient** to meet the company's **expenses is also deposited**

**(4) Exception from circulation of any statement:** The company shall not circulate any statement, **if on the application by any person who claims to be aggrieved**, then the Central Government, declares that the rights conferred are being abused **to secure needless publicity for defamatory matter**.

**(5) Default**: the company and every officer of the company who is in default shall be liable to a penalty o**f twenty-five thousand rupees.**

## ORDINARY & SPECIAL RESOLUTION - Section 114

A resolution is the **formal decision** of company while transacting a business at a meeting.

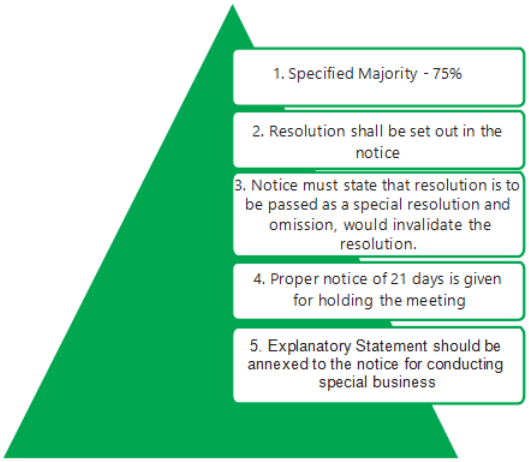



**Ordinary Resolution—**

It states that a resolution shall be ordinary resolution, if the notice has been given and it is required to be passed by the votes cast as the case may be, in favour of the resolution, including the vote of the Chairman, if any, exceed the votes, if any cast against the resolution by members, so entitled and voting.

Simply put, the votes cast in the favour of the resolution, by any mode of voting should exceed the votes cast against it.

**Characteristics of Special Resolution—**




**#Practice Question:**

1) At a General meeting of a company, a matter was to be passed by a special resolution. Out of 40 members present, 20 voted in favour of the resolution, 5 voted against it and 5 votes were found invalid. The remaining 10 members abstained from voting. Is it a valid special resolution?

Answer: Yes, as the number of Votes cast for the resolution is 3 times the number of votes against resolution.

**2) In the annual general meeting of Black Mango Limited, the notice contained the agenda for 8 special businesses to be transacted. The Chairman decided to move all the resolutions at one time in order to save time of the members present at the meeting. Discuss whether two or more resolutions can be moved together as per the provisions of the Companies Act, 2013.**

For the sake of avoiding confusion and mixing up, the resolutions are moved separately. However, there is nothing illegal if the Chairman of the meeting desires that two or more resolutions should be moved together, unless any member requires that each resolution should be put to vote separately or unless a poll is demanded in respect of any.

The only case where a resolution should be moved separately is the one which requires that as regards the appointment of directors at a general meeting of a public or private company, where two or more directors may not be appointed as directors by a single resolution.

**RESOLUTIONS REQUIRING SPECIAL NOTICE - Section 115**

Where any **provision of this Act specifically requires or Articles of Association** of a company so require that a special notice is required for passing any resolution, then the notice of the intention to move such resolution shall be given to the company

**As per section 115 of the Act, special notice is required in the following cases –**

a) Resolution for **appointment of an auditors other the retiring auditor** at an annual general meeting [Section 140(4)].
b) Resolution at an AGM to provide that a **retiring auditor shall not be re-appointed** [Section 140].
c) Resolution to **remove a director before the expiry of his tenure** [Section 169(2)]

d) Resolution to **appoint another director** in **place of the removed director** [(Section 169(5)]

**Procedure for special notice:**

**(A) Signing of special notice:** – A special notice required to be given to the company shall be signed, either **individually or collectively by such number of members**

- holding **not less than 1% of total voting power or**
- **holding shares on which an aggregate sum of not less than 5 lakh rupees** has been paid up on the date of the notice.

**(B) Sending of notice to the company:** – Such **notice shall be sent by members to the company not earlier than 3 months but at least 14 days before the date of the meeting** at which the resolution is to be moved, exclusive of the day on which the notice is given and the day of the meeting.

**(C) On receipt of notice by the company**: – The **company shall immediately after receipt of the notice, give its members notice of the resolution at least 7 days before the meeting**, exclusive of the day of dispatch of notice and day of the meeting, in the same manner as it gives notice of any general meetings.

**(D) Publication of notice:** – Where it is **not practicable to give the notice in the same manner as it gives** notice of any general meetings, the notice shall be published in English language in English newspaper and in vernacular language in a vernacular newspaper. Such notice shall also be posted on the website, if any, of the Company. Such notice shall be published at least 7 days before the meeting, exclusive of the day of publication of the notice and day of the meeting.

**RESOLUTIONS PASSED AT ADJOURNED MEETING - Section 116**

As per Section 116 where a resolution is passed at an adjourned meeting of a company; or the holders of any class of shares in a company; or the Board of Directors, **the resolution shall be treated as passed on the day it was actually passed and not on any earlier date.**

**#Practice Question:**
The EGM of the company, Purple Banana Private Limited was due to be held on 23rd September 2019. However, due to want of quorum, the meeting was adjourned to a later date on 1st October 2019 and two resolutions were passed on that date. Now, as per section 116 of the Companies Act, 2013, the said two resolutions shall be deemed to have been passed on the original date of meeting, i.e. 1st October 2019 and not on the earlier date.

**RESOLUTIONS AND AGREEMENTS TO BE FILED - Section - 117**

Section 117 provides that a copy of every resolution and an agreement in respect of matters specified therein **together with the explanatory statement shall be filed in Form No. MGT.14 with the Registrar,** within thirty days of its passing or making thereof.

**Resolutions and agreements to be filed with the Registrar are as under**:

(a) **special resolutions**;

(b) resolutions **which have been agreed by all the members** of a company, but which, if not so agreed to, would not have been effective for their purpose **unless they had been passed as special resolutions**;

(c) any **resolution of the Board of Directors** of a company, **relating to the appointment, re-appointment or renewal of the appointment, or variation of the terms of appointment, of a managing director;**

(d) resolutions agreed **by any class of members** but which, if not so agreed to, would not have been effective for their purpose unless they had been passed by **a specified majority**

(e) **resolutions requiring a company to be wound up voluntarily** passed in pursuance of section 59 of the Insolvency and Bankruptcy Code 2016;

(f) **resolutions passed in pursuance of sub-section (3) of section 179.** [Powers of Board]

(g) any **other resolution or agreement as may be prescribed** and placed in the public domain.

**MINUTES OF MEETING - Section 118**

(1) Every company shall cause minutes of the proceedings of:

- every **general meeting** of any class of shareholders or creditors, and
- every **resolution passed by postal ballot** and
- every **meeting of its Board of Directors** or of
- every committee of the Board, **to be prepared, signed** and kept **within 30 days** of the **conclusion of every such meeting,** with their pages consecutively numbered.

(2) In the case of a Board meeting or of a committee of the Board, the **minutes shall also contain—**

(a) the names of the **directors present** and
(b) in the case of each resolution, the **names of the directors, if any, dissenting from** resolution.

(3) **Matters to be excluded from the minutes** which, in the opinion of the Chairman of the meeting, —

(a) is **defamatory** of any person; or
(b) is **irrelevant or immaterial** to the proceedings; or
(c) is **detrimental to the interests** of the company.

(4) The minutes kept in accordance with the provisions of this section shall be evidence of the proceedings recorded therein.

(5) Where the minutes have been kept in accordance with sub-section (1) then, until the contrary is proved, the meeting shall be deemed to have been duly called and held, and all proceedings thereat to have duly taken place, and the resolutions passed by postal ballot to have been duly passed and in particular, all appointments of directors, key managerial personnel, auditors or company secretary in practice, shall be deemed to be valid.

(6) Every company shall observe **secretarial standards** with respect to general and Board meetings.

(7) **Signing provisions: Each page** of every such book **shall be initialed or signed** and the **last page** in such books shall be dated and signed –

(i) in the case of Board or its committee minutes, **by the chairman of the said meeting or the chairman of the next succeeding meeting**;

(ii) in the case of minutes of general meeting, by the **chairman of the same meeting within the aforesaid period of 30 days** or in the event of the **death or inability of that chairman within that period, by a director duly authorised by the Board for the purpose**;

(iii) In case of every resolution passed by postal ballot, **by the chairman of the Board within the aforesaid period of 30 days or in the event of there being no chairman of the Board or the death or inability of that chairman within that period, by a director duly authorized by the Board for the purpose.**

(8) If any **default** is made in complying with the provisions of this section in respect of any meeting, the company shall be liable to a penalty of 25 thousand rupees and every officer of the company who is in default shall be liable to a penalty of 5 thousand rupees.

(9) If a person is found guilty of tampering with the minutes of the proceedings of meeting, he shall be punishable with imprisonment for a term which may extend to 2 years and with fine which shall not be less than 25 thousand rupees but which may extend to 1 lakh rupees.

## INSPECTION OF MINUTE-BOOKS OF GENERAL MEETING - Section 119

(1) The **minutes of the proceedings of any general meeting** of a company or of a resolution passed by postal ballot, shall—

(a) be **kept at the registered office** of the company; and

(b) be **open, during business hours, to the inspection** by any member **without charge**, subject to such reasonable restrictions as the company may, by its articles impose that **not less than two hours in each business day are allowed for inspection.**

(2) Any member shall be entitled to be furnished, **within seven working days after he has made a request in that behalf to the company, and on payment of such fees as may be prescribed, with a copy of any minutes** referred to in sub-section (1).

**Default:**

(3) If any inspection under sub-section (1) is refused, or if any copy required under sub-section (2) is not furnished within the time specified therein, the company shall be liable to a penalty of twenty-five thousand rupees and every officer of the company who is in default shall be liable to a penalty of five thousand rupees for each such refusal or default, as the case may be.

(4) In the case of any such **refusal or default, the Tribunal may**, in addition to (3), by order, **direct an immediate inspection** of the minute-books or direct that the copy required shall forthwith be sent to the person requiring it.

## MAINTENANCE AND INSPECTION OF DOCUMENTS IN ELECTRONIC FORM - Section 120

Any document, record, register, minutes, etc.,—

(a) required to be kept by a company; or

(b) allowed to be inspected or copies to be given to any person by a company under this Act, may be kept or inspected or copies given, as the case may be, in electronic form in such form and manner as specified in rule 27

**Rule 27**

(1) **Every listed company** or **a company having not less than 1000 shareholders**, debenture holders and other security holders, **MAY** maintain its records in electronic form.

(2) The records in electronic form shall be maintained in such manner as the Board of directors of the company may think fit,

Provided that -

(a) the **records are maintained in the same formats** as provided in the Act
(b) the information as required should be **adequately recorded** for future reference;
(c) the records must be capable of being **readable, retrievable and reproducible** in printed form;
(d) the **records are capable of being dated and signed digitally** wherever it is required
(e) the records, **once dated and signed digitally**, shall **not be capable of being altered**;
(f) the records shall be capable of being updated, and the date of updating shall be capable of being recorded on every updating.

Explanation: - For the purpose of this rule, the term "records" means any register, index, agreement, memorandum, minutes or any other document required by the Act or the rules made there under to be kept by a company.

**REPORT ON ANNUAL GENERAL MEETING - Section - 121**

(1) Every **listed public company** shall **prepare a report on each AGM** including the **confirmation to the effect that the meeting was convened**, held and conducted as per the provisions of this Act and the rules made thereunder.
(2) The **company shall file with the Registrar a copy of the report** referred to in sub-section (1) **within 30 days of the conclusion** of the annual general meeting

**Contents of the report**

(i) the **day, date, hour and venue of the AGM**;
(ii) **confirmation with respect to appointment** of Chairman of the meeting;
(iii) number of **members attending the meeting**;
(iv) confirmation of **quorum**;
(v) **confirmation with respect to compliance of the Act** and the Rules, secretarial standards made there under with respect to calling, convening and conducting the meeting;
(vi) **business transacted at the meeting** and result thereof;
(vii) particulars with respect to any **adjournment of meeting, change in venue**; and
(viii) any other points relevant for inclusion in the report.

**APPLICABILITY OF THIS CHAPTER TO ONE PERSON COMPANY - Section 122**

(1) The section states that the provisions of **section 98 and section 100 to 111 shall not apply to One Person Company.**

(2) For the purposes of section 114, any business which is required to be transacted at an general meeting of a company by means of an ordinary or special resolution, it shall be sufficient if, in case of OPC, the **resolution is communicated by the member to the company and entered in the minutes-book** required to be maintained under section 118 and signed and dated by the member and such date shall be deemed to be the date of the meeting for all the purposes under this Act.

(3) Notwithstanding anything in this Act, where **there is only one director on the Board of Director** of a OPC, any business which is required to be transacted at the meeting of the Board of Directors of a company, it shall be sufficient if, in case of such One Person Company, the resolution by such director is entered in the minutes book required to be maintained under section 118 and signed and dated by such director and such date shall be deemed to be the date of the meeting of the Board of Directors for all the purposes under this Act.

**Questions and Answer**

1. **In a General meeting of Alpha Limited, the chairman directed to exclude certain matters detrimental to the interest of the company from the minutes, Mukesh, a shareholder contended that the minutes of the meeting must contain fair and correct summary of the proceedings thereat. Decide, whether the contention of Mukesh is maintainable under the provisions of the Companies Act, 2013?**

**Answer**

Under Section 118 (5) of the Companies Act, 2013, there shall not be included in the Minutes of a meeting, any matter which, in the opinion of the Chairman of the meeting:

(i) is or could reasonably be regarded as defamatory of any person;
(ii) is irrelevant or immaterial to the proceeding; or
(iii) is detrimental to the interests of the company;

Further, under section 118(6) the chairman shall exercise absolute discretion in regard to the inclusion or non-inclusion of any matter in the Minutes on the grounds specified in sub-section (5) above.

Hence, in view of the above, the contention of Mukesh, a shareholder of Alpha Limited is not valid because the Chairman has absolute discretion on the inclusion or exclusion of any matter in the minutes for aforesaid reasons.

2. **A General Meeting was scheduled to be held on 15th April, 2019 at 3.00 P.M. As per the notice the members who are unable to attend a meeting in person can appoint a proxy and the proxy forms duly filled should be sent to the company so as to reach at least 48 hours before the meeting. Mr. X, a member of the company appoints Mr. Y as his proxy and the proxy form dated 10-04-2019 was deposited by Mr. Y with the company at its registered Office on 11-04-2019. Similarly, another member Mr. W also gives two separate proxies to two individuals named Mr. M and Mr. N. In the case of Mr. M, the proxy dated 12-04-2019 was deposited with the company on the same day and the proxy form in favour of Mr. N was deposited on 14-04-2019. All the proxies viz., Y, M and N were present before the meeting.**

   **According to the provisions of the Companies Act, 2013, who would be the persons allowed to represent at proxies for members X and W respectively?**

**Answer**

A Proxy is an instrument in writing executed by a shareholder authorizing another person to attend a meeting and to vote thereat on his behalf and in his absence. As per the provisions of Section 105 of the Companies Act, 2013, every shareholder who is entitled to attend and vote has a statutory right to appoint another person as his proxy. It is not necessary that the proxy be a member of the company. Further, any provision in the articles of association of the company requiring instrument of proxy to be lodged with the company more than 48 hours before a meeting shall have effect as if 48 hours had been specified therein. The members

have a right to revoke the proxy's authority by voting himself before the proxy has voted but once the proxy has voted the member cannot retract his authority.

Where two proxy instruments by the same shareholder are lodged of in such a manner that one is lodged before and the other after the expiry of the date fixed for lodging proxies, the former will be counted.

Thus, in case of member X, the proxy Y will be permitted to vote on his behalf as form for appointing proxy was submitted within the permitted time.

However, in the case of Member W, the proxy M (and not Proxy N) will be permitted to vote as the proxy authorizing N to vote was deposited in less than 48 hours before the meeting.

3. **M. H. Company Limited served a notice of general meeting upon its shareholders. The notice stated that the issue of sweat equity shares would be considered at such meeting. Mr. 'A', a shareholder of the M. H. Company Limited complains that the issue of sweat equity shares was not specified fully in the notice. Is the notice issued by M. H. Company Limited regarding issue of sweat equity shares valid according to the provisions of the Companies Act, 2013? Explain in detail.**

**Answer**

Under section 102 (2) (b) of the Companies Act, 2013, in the case of any meeting other than an Annual General Meeting, all business transacted thereat shall be deemed to be special business.

Further under section 102 (1) a statement setting out the following material facts concerning each item of special business to be transacted at a general meeting, shall be annexed to the notice calling such meeting:

(a) the nature of concern or interest, financial or otherwise, if any, in respect of each items, of every director and the manager, if any or every other key managerial personnel and relatives of such persons; and

(b) any other information and facts that may enable members to understand the meaning, scope and implications of the items of business and to take decision thereon.

Thus, the objection of the member is valid since the complete details about the issue of sweat equity should be sent with the notice. The notice is, therefore, not a valid notice under Section 102 of the Companies Act, 2013.

4. **Tulip Ltd. maintains its Register of Members at its registered office in Mumbai. A group of members residing in Kolkata want to keep the register of members at Kolkata.**

   **(i) Explain with provisions of Companies Act, 2013, whether the company can keep the Registers and Returns at Kolkata.**

   **(ii) Does Mr. Rich, holding 400 shares of total worth ` 4000 only, has the right to inspect the Register of Members?**

Answer

(i) Maintenance of the Register of Members etc.: As per section 94(1) of the Companies Act, 2013, the registers required to be kept and maintained by a company under section 88

and copies of the annual return filed under section 92 shall be kept at the registered office of the company:

Provided that such registers or copies of return may also be kept at any other place in India in which more than one-tenth of the total number of members entered in the register of members reside, if approved by a special resolution passed at a general meeting of the company.

So, Tulip Ltd. can also keep the registers and returns at Kolkata after compliance with the above provisions, provided more than one-tenth of the total number of members entered in the register of members reside in Kolkata.

(ii) As per section 94(2) of the Companies Act, the registers and their indices, except when they are closed under the provisions of this Act, and the copies of all the returns shall be open for inspection by any member, debenture- holder, other security holder or beneficial owner, during business hours without payment of any fees and by any other person on payment of such fees as may be prescribed.

Accordingly, a director Mr. Rich, who is a shareholder of the company, has a right to inspect the Register of Members during business hours without payment of any fees, as per the provisions of this section.

**5. Examine the validity of the following with reference to the relevant provisions of the Companies Act, 2013:**

**The Board of Directors of Shrey Ltd. called an extraordinary general meeting upon the requisition of members. However, the meeting was adjourned on the ground that the quorum was not present at the meeting. Advise the company.**

**Answer**

According to section 100 (2) of the Companies Act 2013, the Board of directors must convene a general meeting upon requisition by the stipulated minimum number of members.

As per Section 103 (2) (b) of the Companies Act, 2013, if the quorum is not present within half an hour from the appointed time for holding a meeting of the company, the meeting, if called on the requisition of members, shall stand cancelled. Therefore, the meeting stands cancelled and the stand taken by the Board of Directors to adjourn it, is not proper.

**6. Zorab Limited served a notice of General Meeting upon its members. The notice stated that a resolution to increase the share capital of the Company would be considered at such meeting. A shareholder complained that the amount of the proposed increase was not specified in the notice. Is the notice valid?**

**Answer**

Under section 102(2)(b) in the case of any meeting other than an AGM, all business transacted thereat shall be deemed to be special business.

Further under section 102 (1), a statement setting out the following material facts concerning each item of special business to be transacted at a general meeting, shall be annexed to the notice calling such meeting.

Thus, the objection of the shareholder is valid since the details on the item to be considered are lacking. The information about the amount is a material fact with reference to the proposed increase of share capital. The notice is, therefore, not a valid notice under Section 102 of the Companies Act, 2013.

**7. Examine the validity of the following decisions of the Board of Directors with reference of the provisions of the Companies Act, 2013.**

**(i) In an Annual General Meeting of a company having share capital, 80 members present in person or by proxy holding more than 1/10th of the total voting power, demanded for poll. The chairman of the meeting rejected the request on the ground that only the members present in person can demand for poll.**

**(ii) In an annual general meeting, during the process of poll, the members who earlier demanded for poll want to withdraw it. The chairman of the meeting rejected the request on the ground that once poll started, it cannot be withdrawn.**

**Answer**

Section 109 of the Companies Act, 2013 provides for the demand of poll before or on the declaration of the result of the voting on any resolution on show of hands. Accordingly, law says that:-

Before or on the declaration of the result of the voting on any resolution on show of hands, a poll may be ordered to be taken by the Chairman of the meeting on his own motion, and shall be ordered to be taken by him on a demand made in that behalf:-

(a) In the case a company having a share capital, by the members present in person or by proxy, where allowed, and having not less than one-tenth of the total voting power or holding shares on which an aggregate sum of not less than five lakh rupees or such higher amount as may be prescribed has been paid-up; and

(b) in the case of any other company, by any member or members present in person or by proxy, where allowed, and having not less than one tenth of the total voting power.

Withdrawal of the demand: The demand for a poll may be withdrawn at any time by the persons who made the demand.

Hence, on the basis on the above provisions of the Companies Act, 2013:

(i) The chairman cannot reject the demand for poll subject to provision in the articles of company.

(ii) The chairman cannot reject the request of the members for withdrawing the demand of the Poll.

**8. Sirhj, a shareholder, gives a notice for inspecting proxies, five days before the meeting is scheduled and approaches the company two days before the scheduled meeting for inspecting the same. What is the legal position relating to his actions as per the provisions of the Companies Act, 2013?**

**Answer**

Under section 105 (8) of the Companies Act, 2013 every member entitled to vote at a meeting of the company, or on any resolution to be moved thereat, shall be entitled during the period beginning 24 hours before the time fixed for the commencement of the meeting and ending with the conclusion of the meeting, to inspect the proxies lodged, at any time during the business hours of the company, provided not less than 3 days' notice in writing of the intention so to inspect is given to the company.

In the given case, Sirhj has given proper notice.

However, such inspection can be undertaken only during the period beginning 24 hours before the time fixed for the commencement of the meeting and ending with the conclusion of the meeting. So, Sirhj can undertake the inspection only during the above mentioned period and not two days prior to the meeting.

9. **Miraj Limited held its Annual General Meeting on September 15, 2019. The meeting was presided over by Mr. Venkat, the Chairman of the Company's Board of Directors. On September 17, 2019, Mr. Venkat, the Chairman, without signing the minutes of the meeting, left India to look after his father who fell sick in London. Referring to the provisions of the Companies Act, 2013, examine the manner in which the minutes of the above meeting are to be signed in the absence of Mr. Venkat and by whom.**

Answer

Section 118 of the Companies Act, 2013 provides that every company shall prepare, sign and keep minutes of proceedings of every general meeting, including the meeting called by the requisitionists and all proceedings of meeting of any class of shareholders or creditors or Board of Directors or committee of the Board and also resolution passed by postal ballot within thirty days of the conclusion of every such meeting concerned. Minutes kept shall be evidence of the proceedings recorded in a meeting.

By virtue of Rule 25 of the Companies (Management and Administration ) Rules 2014 read with section 118 of the Companies Act, 2013 each page of every such book shall be initialled or signed and the last page of the record of proceedings of each meeting or each report in such books shall be dated and signed by, in the case of minutes of proceedings of a general meeting, by the chairman of the same meeting within the aforesaid period of thirty days or in the event of the death or inability of that chairman within that period, by a director duly authorized by the Board for the purpose.

Therefore, the minutes of the meeting referred to in the case given above can be signed in the absence of Mr Venkat, by any director who is authorized by the Board.

10. **Infotech Ltd. was incorporated on 1.4.2016. No General Meeting of the company has been held till 30.4.2018. Discuss the provisions of the Companies Act, 2013 regarding the time limit for holding the first annual general meeting of the Company and the power of the Registrar to grant extension of time for the First Annual General Meeting.**

Answer

According to Section 96 of the Companies Act, 2013, every company shall be required to hold its first annual general meeting within a period of 9 months from the date of closing of its first financial year.

The first financial year of Infotech Ltd is for the period 1st April 2016 to 31st March 2017, the first annual general meeting (AGM) of the company should be held on or before 31st December, 2017.

The section further provides that the Registrar may, for any special reason, extend the time within which any annual general meeting, other than the first annual general meeting, shall be held, by a period not exceeding three months.

Thus, the first AGM of Infotech should have been held on or before 31st December, 2017. Further, the Registrar does not have the power to grant extension to time limit

**11. The Articles of Association of DJA Ltd. require the personal presence of 7 members to constitute quorum of General Meetings. The company has 965 members as on the date of meeting. The following persons were present in the extra-ordinary meeting to consider the appointment of Managing Director:**

**(i) A, the representative of Governor of Uttar Pradesh.**

**(ii) B and C, shareholders of preference shares,**

**(iii) D, representing Y Ltd. and Z Ltd.**

**(iv) E, F, G and H as proxies of shareholders.**

**Can it be said that the quorum was present in the meeting?**

Answer

According to section 103 of the Companies Act, 2013, unless the articles of the company provide for a larger number in case of a public company, five members personally present if the number of members as on the date of meeting is not more than one thousand, shall be the quorum.

In this case the quorum for holding a general meeting is 7 members to be personally present (higher of 5 or 7). For the purpose of quorum, only those members are counted who are entitled to vote on resolution proposed to be passed in the meeting.

Again, only members present in person and not by proxy are to be counted. Hence, proxies whether they are members or not will have to be excluded for the purposes of quorum.

If a company is a member of another company, it may authorize a person by resolution to act as its representative at a meeting of the latter company, then such a person shall be deemed to be a member present in person and counted for the purpose of quorum Where two or more companies which are members of another company, appoint a single person as their representative then each such company will be counted as quorum at a meeting of the latter company.

Further the President of India or Governor of a State, if he is a member of a company, may appoint such a person as he thinks fit, to act as his representative at any meeting of the company. A person so appointed shall be deemed to be a member of such a company and thus considered as member personally present.

In view of the above there are only three members personally present.

'A' will be included for the purpose of quorum. B & C have to be excluded for the purpose of quorum because they represent the preference shares and since the agenda being the appointment of Managing Director, their rights cannot be said to be directly affected and therefore, they shall not have voting rights. D will have two votes for the purpose of quorum as he represents two companies 'Y Ltd.' and 'Z Ltd.' E, F, G and H are not to be included as they are not members but representing as proxies for the members.

Thus, it can be said that the requirements of quorum has not been met and it shall not constitute a valid quorum for the meeting.

**12. What do you mean by Proxy? Explain the provisions relating to appointment of proxy under the Companies Act, 2013.**

Answer

A proxy is an instrument in writing executed by a share holder authorising another person to attend a meeting and to vote thereat on his behalf and in his absence. The term also applies to the person so appointed in such case a proxy is a person appointed by a member of a company, to attend a meeting of the company and vote thereat on his behalf.

The various provisions relating to the appointment of a proxy is contained in section 105 of the Companies Act, 2013 are as under:

1. Under section 105 (1) any member of a company entitled to attend and vote at a meeting of the company shall be entitled to appoint another person as a proxy to attend and vote at the meeting on his behalf.
2. A proxy shall not have the right to speak at such meeting and shall not be entitled to vote except on a poll. This means that a proxy cannot vote on a resolution by a show of hands.
3. The Central Government may prescribe a class or classes of companies whose members shall not be entitled to appoint another person as a proxy.
4. Under section 105 (6) the instrument appointing a proxy shall be in writing; and be signed by the appointer or his attorney duly authorised in writing or, if the appointer is a body corporate, be under its seal or be signed by an officer or an attorney duly authorised by it.
5. Under section 105 (7) an instrument appointing a proxy, if in the form as may be prescribed, shall not be questioned on the ground that it fails to comply with any special requirements specified for such instrument by the articles of a company.

**13. Bazaar Limited called its AGM in order to lay down the financial statements for Shareholders' approval. Due to want of Quorum, the meeting was cancelled. The directors did not file the annual returns with the Registrar. The directors were of the idea that the time for filing of returns within 60 days from the date of AGM would not apply, as AGM was cancelled. Has the company contravened the provisions of Companies Act, 2013? If the company has contravened the provisions of the Act, how will it be penalized?**

Answer

According to section 92(4) of the Companies Act, 2013, every company shall file with the Registrar a copy of the annual return, within sixty days from the date on which the annual general meeting is held or where no annual general meeting is held in any year within sixty days from the date on which the annual general meeting should have been held together with the statement specifying the reasons for not holding the annual general meeting.

Sub-section (5) of Section 92 also states that if any company fails to file its annual return under sub-section (4), before the expiry of the period specified therein, such company and its every officer who is in default shall be liable to a penalty of fifty thousand rupees and in case of continuing failure, with further penalty of one hundred rupees for each day during which such failure continues, subject to a maximum of five lakh rupees.

In the instant case, the idea of the directors that since the AGM was cancelled, the provisions requiring the company to file annual returns within 60 days from the date of AGM would not apply, is incorrect.

In the above case, the annual general meeting of Bazaar Limited should have been held within a period of six months, from the date of closing of the financial year but it did not take place. Thus, the company has contravened the provisions of section 92 of the Companies Act, 2013 for not filing the annual returns and shall attract the penal provisions along with every officer of the company who is in default as specified in Section 92(5) of the Act.

**14. Madurai Ltd. issued a notice for holding of its Annual general meeting on 7th November 2019. The notice was posted to the members on 16th October 2019. Some members of the company allege that the company had not complied with the provisions of the Companies Act, 2013 with regard to the period of notice and as such the meeting was valid. Referring to the provisions of the Act, decide:**

**(i) Whether the meeting has been validly called?**

**(ii) If there is a shortfall, state and explain by how many days does the notice fall short of the statutory requirement?**

**(iii) Can the delay in giving notice be condoned?**

**Answer**

According to section 101(1) of the Companies Act, 2013, a general meeting of a company may be called by giving not less than clear twenty-one days' notice either in writing or through electronic mode in such manner as may be prescribed.

Also, it is to be noted that 21 clear days mean that the date on which notice is served and the date of meeting are excluded for sending the notice.

Further, Rule 35(6) of the Companies (Incorporation) Rules, 2014, provides that in case of delivery by post, such service shall be deemed to have been effected - in the case of a notice of a meeting, at the expiration of forty eight hours after the letter containing the same is posted.

Hence, in the given question:

(i) A 21 days' clear notice must be given. In the given question, only 19 clear days' notice is served (after excluding 48 hours from the time of its posting and the day of sending and date of meeting). Therefore, the meeting was not validly called.

(ii) As explained in (i) above, notice falls short by 2 days.

(iii) The Companies Act, 2013 does not provide anything specific regarding the condonation of delay in giving of notice. Hence, the delay in giving the notice calling the meeting cannot be condoned.

**15. KMN Ltd. scheduled its Annual General Meeting to be held on 11th March, 2019 at 11:00 A.M. The company has 900 members. On 11th March, 2019 following persons were present by 11:30 A.M.**

**1. P1, P2 & P3 shareholders**

**2. P4 representing ABC Ltd.**

**3. P5 representing DEF Ltd.**

**4. P6 & P7 as proxies of the shareholders**

**(i) Examine with reference to relevant provisions of the Companies Act, 2013, whether quorum was present in the meeting.**

**(ii) What will be your answer if P4 representing ABC Ltd., reached in the meeting after 11:30 A.M.?**

**(iii) In case lack of Quorum, discuss the provisions as applicable for an adjourned meeting in terms of date, time & place.**

**(iv) What happens if there is no Quorum in the Adjourned meeting?**

**Answer**

According to section 103 of the Companies Act, 2013, unless the articles of the company provide for a larger number, the quorum for the meeting of a Public Limited Company shall be 5 members personally present, if number of members is not more than 1000.

(i) (1) P1, P2 and P3 will be counted as three members.

(2) If a company is a member of another company, it may authorize a person by resolution to act as its representative at a meeting of the latter company, then such a person shall be deemed to be a member present in person and counted for the purpose of quorum. Hence, P4 and P5 representing ABC Ltd. and DEF Ltd. respectively will be counted as two members.

(3) Only members present in person and not by proxy are to be counted. Hence, proxies whether they are members or not will have to be excluded for the purposes of quorum. Thus, P6 and P7 shall not be counted in quorum.

In the light of the provision of the Act and the facts of the question, it can be concluded that the quorum for Annual General Meeting of KMN Ltd. is 5 members personally present. Total 5 members (P1, P2, P3, P4 and P5) were present. Hence, the requirement of quorum is fulfilled.

(ii) The section further states that, if the required quorum is not present within half an hour, the meeting shall stand adjourned for the next week at the same time and place or such other time and place as decided by the Board of Directors.

Since, P4 is an essential part for meeting the quorum requirement, and he reaches after 11:30 AM (i.e. half an hour after the starting of the meeting), the meeting will be adjourned

(iii) In case of lack of quorum, the meeting will be adjourned as provided in section 103.

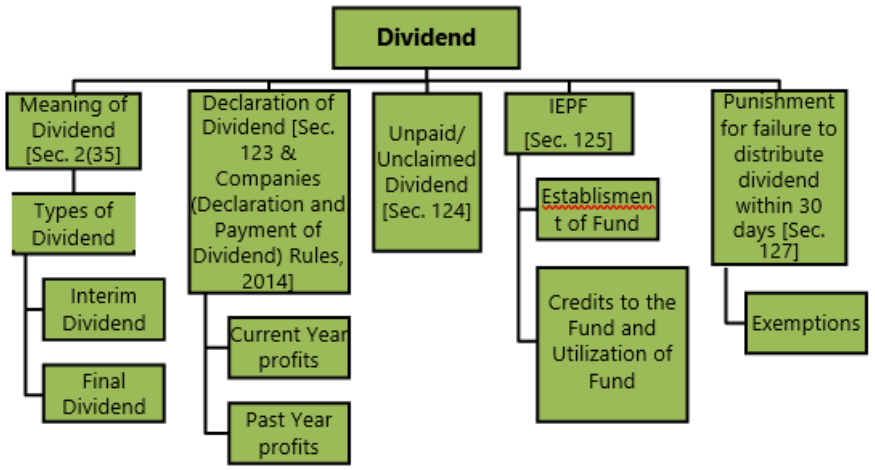
In case of the adjourned meeting or change of day, time or place of meeting, the company shall give not less than 3 days' notice to the members either individually or by publishing an advertisement in the newspaper.

(iv) Where quorum is not present in the adjourned meeting also within half an hour, then the members present shall form the quorum.

# Chapter 8

# DECLARATION AND PAYMENT OF DIVIDEND

**Section Overview**




**MEANING OF DIVIDEND - Section 2(35)**

1) **Definition:** As per section 2(35) Dividend simply states that "dividend" includes any interim dividend.
2) Dividend is the shareholders return on their investment / capital in the company.
3) The **company in general meeting may declare dividends**, but no dividend shall exceed the amount recommended by the Board.
4) **Dividend is recommended by Board of Directors** in the Board's Report and **approved by Shareholders at the Annual General Meeting**.
5) **Dividend is not a liability unless it is declared by the shareholders** at a validly constituted general meeting **by passing an ordinary resolution at the rates recommended by the Board or such lower rates as they may decide.**

**#Questionable point:**

1) Dividend by the company **at a rate higher than the rate recommended by the Board is not permitted.**
2) Dividend is Declared **as a proportion of Nominal or Face Value** of a share.

**Example: AB Ltd. has issued equity shares having face value of ` 10 per share. The shares are currently quoting on the NSE at ` 250/- per share. The Company at its AGM held on 27.7.20 has declared a dividend of 20%. Mr. Shekar owns 1000 shares which he purchased at ` 300/- per share. What is the amount of dividend he will receive**?

The dividend is to be calculated on Face Value i.e. ` 10/-. So dividend per share is 20% of ` 10/- = ` 2/- per share. So Mr. Shekar will receive ` 2 * 1000 shares = ` 2000/-.

**Example:** The shareholders at an annual general meeting unanimously passed a resolution for payment of dividend at a rate higher than that recommended by the directors. Discuss the validity of the resolution.

Articles of Association companies usually contain provisions with regard to declaration of dividend on the pattern of regulations 80 to 85 of Table F to Schedule I of the Companies Act, 2013. Under regulation 80, the power to declare a dividend vests with the general meeting, But not even all the shareholders have the power to declare a dividend exceeding the amount recommended by the Board of Directors.

## TYPES OF DIVIDEND

### I. Classification based on time i.e. when declared

#### 1) Interim Dividend

Section 123 (3) and also section 123 (4) contain provisions regarding interim dividend. Following points are noteworthy:

- Interim dividend **may be declared by the Board of Directors**.
- The declaration of interim dividend is done out of profits before the final adoption of the accounts by the shareholders and therefore, **interim dividend is said to be declared and paid between two AGMs.**
- The **SOURCES FOR DECLARING INTERIM DIVIDEND** include:
  - **Surplus** in the profit and loss account; or
  - **Profits of the financial year** in which such dividend is sought to be declared; or
  - **Profits generated in the financial year till the quarter** preceding the date of declaration of the interim dividend.
- Declaration of interim dividend shall be ratified at the ensuing AGM by the members.
- If the **company has incurred loss during the current financial year** up to the end of the quarter immediately preceding the date of declaration of interim dividend, **such interim dividend shall not be declared at a rate higher than the average (rate of) dividend declared by the company during the immediately preceding 3 financial years**.

**Example:** If a company declared dividend at the rate of 16% during the immediately preceding three financial years, then in case the company incurs loss in the current financial year, it is permitted to declare interim dividend at a rate which is not higher than 16%.

**Note: All provisions which are applicable to the payment of dividend shall also apply in case of interim dividend.**

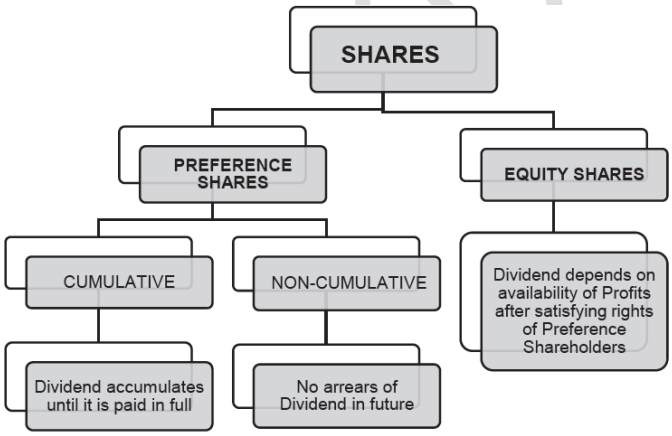
#### 2) Final Dividend

- When the **dividend is declared at the AGM** of the company, it is known as **'final dividend'**.
- The rate of dividend recommended by the Board cannot be increased by the members.

**The table given below provides a quick summary of the above concepts of Interim Dividend and Final Dividend.**

| BASIS FOR COMPARISON | INTERIM DIVIDEND | FINAL DIVIDEND |
|---|---|---|
| **Definition** | Interim dividend is declared and paid during an accounting year, i.e. before the finalization of accounts for the year. | Final dividend is the dividend recommended by the board of directors, and approved by shareholders at the company's Annual General Meeting, after the close of financial year. |
| **Announcement** | Announced by Board of Directors. | Recommended by Board of Directors and approved by shareholders. |
| **Time of Declaration** | Before preparation of financial statements. | After preparation of financial statements. |
| **Revocation** | It can be revoked with the consent of all shareholders. | It cannot be revoked. |
| **Provision in Articles of Association** | It is declared only when the articles specifically permits the declaration. | It does not require any specific provision in the articles. |

**II. Classification based on Nature of Shares does not require any specific provision in the articles.**




## DECLARATION OF DIVIDEND [SECTION 123]

### A. SOURCES FOR DECLARATION OF DIVIDEND

According to Section 123 (1), the dividend for any financial year shall be declared or paid from the following sources:

**(a) Profits of the CURRENT FINANCIAL YEAR**- Profits arrived at after providing for depreciation.

**(b) Profits of any PREVIOUS FINANCIAL YEAR OR YEARS-** Profits of any previous financial year(s) arrived at **after providing for depreciation**. i.e. credit balance in profit and loss account and free reserves.

**#Questionable Point:**

**It is to be noted that only free reserves and no other reserves are to be used for declaration or payment of dividend. i.e. statutory reserves (DRR, CRR) or revaluation reserve cannot be used.**

**(c) Both (a) and (b).**

**(d) Money provided by the Central Government or a State Government** for the payment of dividend.

**Note:**
**1)** Before declaration of any dividend, carried over (previous years) previous losses and depreciation are required to be set off against profit of the company for the current year.
**2)** In computing profits any amount representing unrealised, notional gains or revaluation of assets shall be excluded.
**3)** Capital profits are not same as distributable profits; and therefore, normally not available for distribution as dividend.

**Example**: Shreyas Mechanics Limited owns a plot of land which was purchased long before. As the property rates are going up, it is decided to revalue the plot at fair value which is moderately ten times the original price, thus resulting in a revaluation profit of ` 20,00,000. The Board of Directors is keen to utilize this ` 20,00,000 along with free reserves of ` 24,00,000 for declaration of dividend at the forthcoming Annual General Meeting (AGM) to be held on 28th September, 2019. But according to Proviso to Section 123 (1) (a), the amount of ` 20,00,000 cannot be considered as it does not form part of Free Reserves as the same cannot be utilized towards declaration of dividend.

**B. <u>TRANSFER TO RESERVES IS NOT MANDATORY</u>**

Transfer of profits to reserves for any financial year has been left to the discretion of the company. Therefore, a company is free to transfer any portion of its profit to reserves as it may deem fit. **It may also decide not to transfer any amount to reserves.**

**Example:** For the current year, Alma Watches Limited proposes to transfer more than 10% of its profits to the reserves before declaration of dividend at the rate of 12%. Can the company do so?
**Answer:** The amount to be transferred to reserves out of profits for any financial year before the declaration of dividend has been left to the discretion of the company. Therefore, Alma Watches Limited is free to transfer any part of its profits to reserves as it may deem fit.

## C. DECLARATION OF DIVIDEND WHEN THERE IS INADEQUACY OR ABSENCE OF PROFITS (Second Proviso to Sec. 123)

Where in any year there are no adequate profits for declaring dividend, the company may declare dividend out of the profits of any previous year transferred by it to the free reserves only in accordance with the procedure laid down in **Rule 3 of the Companies (Declaration and Payment of Dividend) Rules, 2014.**

| CONDITION I | CONDITION II | CONDITION III |
|---|---|---|
| The rate of dividend declared **shall not exceed the average** of the rates at which dividend was declared by the company in the immediately **preceding 3 years.** | The **total amount to be drawn** from such accumulated profits shall not exceed = 10% of (paid up share capital + free reserves). As per latest audited financial statement | **The balance of reserves** after such withdrawal shall not fall below = 15 % of paid up share capital. As per latest audited financial statement. |
| **Note:** However, this condition shall not apply if the company has not declared any dividend in each of the three preceding financial year. | **Note**: The amount so drawn shall 1st be u5tilized to set off the losses incurred in the financial year in which dividend is declared. | |
| **Note: 1)** It may be noted that **all the above 3 conditions have to be satisfied**. **2)** These conditions are not applicable to a Government company in which the entire paid up share capital is held by the Central Government, or by any Stale Government or together | | |

**#Practice Question:**

Capricorn Industries Limited has a paid-up capital of ` 200 lakhs and accumulated Reserves of ` 240 lakhs. Loss for the year ending 31st March 2020 is ` 30 Lakhs. Dividend was immediately preceding. declared at the following rates during the 3 years

Year 1 = 9% || Year 2 = 10% || Year 3 = 12%

What is the maximum rate at which the company can declare dividend for the current year.

**Answer:** In the given case, Capricorn Industries Limited has not made adequate profits during the current year ending on 31st March, 2020, but it still wants to declare dividend. Let us apply the conditions:

**Condition I:**

9+10+12 Average rate = 10.3%
3

Therefore, the rate of dividend shall not exceed 10.3% Paid up Capital i.e. `200 lakhs = ` 20.6 lakhs

**Condition II:**

| | |
|---|---|
| Paid-up capital + Free reserves = ` (200+240) Lakhs | = 440 Lakhs |
| 10% thereof | = 44 Lakhs |
| **Less:** loss for the year | = ` 30 Lakhs |
| **Amount available** | = ` 14 Lakhs |

Hence the quantum of dividend is further restricted to ` 14 lakhs.

**Condition III:**

| | |
|---|---|
| Accumulated Reserves | = ` 240 Lakhs |
| Proposed withdrawal declaration of dividend | = ` 14 Lakhs |
| Balance of Reserves | =` 226 Lakhs |

**This is more than 15% of paid-up capital (i.e 15% of ` 200 Lakhs) i.e. ` 30 lakhs.**

**Conclusion:** Thus, the company can declare a dividend of ` **14 lakhs i.e. at a rate of 7%** on its paid-up capital of ` 200 lakhs.

**D. DEPOSITING OF AMOUNT OF DIVIDEND**

In terms of section 123(4), the amount of the dividend (including interim dividend), **shall be deposited in a separate account maintained with a scheduled bank**. This is to be done **within 5 days from the date of declaration** of dividend

Example 9: A company declared a dividend at its (AGM) held on 24th September, 2019, the company declared a dividend of ` 2 per share. The amount of dividend must be deposited in a scheduled bank in a separate account latest by **29th September, 2019.**

**E. PAYMENT OF DIVIDEND**

**(a) Dividend shall be payable only to the registered shareholder or to his order or to his banker.**

- A purchaser of shares **whose name is not entered in the Register of Members cannot claim payment of dividend** to him though he might have made full payment to the seller of shares.
- Dividend will be kept in abeyance pending registration of transfer of shares, unless the registered holder has authorized the company to pay the dividend to the purchaser.
- Note: In terms of Section 51, a company may, if so authorised by its articles, pay dividend in proportion to the amount paid-up on each share. Suppose, some of the shareholders have paid only ` 5 (face value ` 10) on each share held by them. In case of declaration of dividend at the rate of ` 5 per share, the company, if authorised by its articles, shall be justified in paying dividend of ` 2.50 per share in respect of such partly paid shares.

**(b) Dividends are payable in cash and not in kind. Dividends that are payable to the shareholders in cash may also be paid by cheque or dividend warrant or through any electronic mode.**

Section 127 requires that the declared dividend must be paid to the entitled shareholders within the prescribed time limit of thirty days from the date of declaration of dividend.

**F. PROHIBITION ON DECLARATION OF DIVIDEND in following cases:**

(i) A company **which fails to comply with the provisions of section 73** (Prohibition on acceptance of deposits from public) **and section 74** (Repayment of deposits, etc., accepted before the commencement of this Act of 2013) **shall not declare until such failure continues**.

(ii) **Prohibition in case of Section 8 Companies:** Its profits are intended to be applied only in promoting the objects for which it is formed.

**UNPAID DIVIDEND ACCOUNT [SECTION 124]/ Time line**

**(i) Unpaid or Unclaimed Dividend to be transferred to the Unpaid Dividend Account**- Where a dividend has been declared by a company **but has not been claimed within 30 days** from the date of declaration, the company shall, **within 7 days from the expiry of such 30 days**, transfer the total amount of unpaid or unclaimed dividend to a special account called the Unpaid Dividend Account (UDA). The UDA shall be opened by the company in any scheduled bank.

**(ii) Preparing of Statement of the Unpaid Dividend**- **Within 90 days** of transferring any amount to the Unpaid Dividend Account, the company shall prepare a statement containing

- the names,
- last known addresses and

- the amount of unpaid dividend to be paid to each person

and **place such statement on its web-site**, if any, and also on any other web-site approved by the Central Government for this purpose.

(iii) **Payment of Interest if default is made in transferring the Amount-** If any default is made in transferring the unpaid dividend amount, the company shall pay, **from the date of such default, interest at the rate of 12% per annum**. The interest accruing on such amount shall be available to the benefit of the members of the company in proportion to the amount remaining unpaid to them.

(iv) **Apply to unpaid amount-** Any person entitled to any money transferred to the Unpaid Dividend Account **may apply to the company concerned for payment of the money** so claimed.

(v) **Transfer to IEPF**- Any money transferred **to the Unpaid Dividend Account** which **remains unpaid or unclaimed for 7 years** from the date of such transfer

**- Such unpaid money**
**- Interest accrued there on**
**- All shares in respect of which dividend has not been paid**
**shall be transferred by the company to the Investor Education and Protection Fund.**

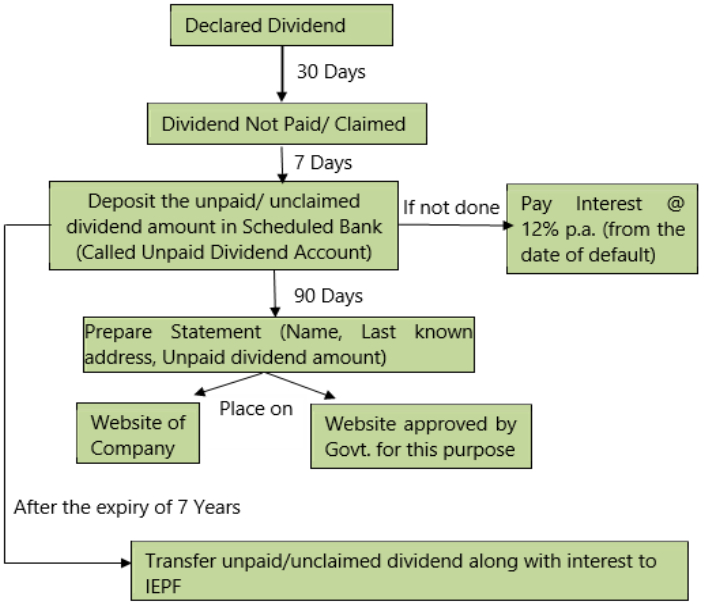
Further, the company shall send a prescribed statement containing the details of such transfer to the IEPF Authority and in turn, the Authority shall issue a receipt to the company as evidence of such transfer.

**Note:** In case **any dividend is paid or claimed for any year during the said period of 7 consecutive years**, the share **shall not be transferred** to Investor Education and Protection Fund.

(vii) **Right of Owner of 'transferred shares' to Reclaim**- Any claimant of shares so transferred to IEPF shall be entitled to reclaim the 'transferred shares' **from Investor Education and Protection Fund in accordance with the prescribed procedure** and on submission of prescribed documents.

(viii) **Punishment for Contravention-** If a company fails to comply with any of the requirements relating to unpaid dividend account, it shall be punishable with minimum fine of ` five lakhs which may extend to ` twenty-five lakhs.

Further, every officer of the company who is in default shall be punishable with minimum fine of ` one lakh which may extend to ` five lakhs.




## INVESTOR EDUCATION AND PROTECTION FUND [SECTION 125]

- Section 125 of the Act along with various Rules framed from time to time including IEPF Authority (Accounting, Audit, Transfer and Refund) Rules, 2016 deal with the Investor Education and Protection Fund (IEPF).
- This fund, **being established by the Central Government.**

**The relevant provisions are discussed below:**

**1. Credit of Specified Amounts to the Fund:**

**(a) Amount given by Central Government** by way of **GRANTS** after appropriation made by Parliament;
**(b) DONATIONS by the Central Government, State Governments, companies** or any other institution
**(c) Amount lying in UNPAID DIVIDEND ACCOUNT** and transferred to the Fund under section 124(5);
**(d) Amount in the GENERAL REVENUE ACCOUNT of the Central Government-**
**(e) Amount in IEPF-** The **AMOUNT LYING IN THE IEPF** under section 205C of the Companies Act, 1956;
**(f) INTEREST OR OTHER INCOME** received out of investments made from the Fund;
**(fa) all shares held by the Authority in accordance with proviso of subsection (9) of section 90 of the Companies Act, 2013 and all the resultant benefits arising out of such shares, without any restrictions;"**
**(g)** Amount received through **DISGORGEMENT** or disposal of Securities

Disgorgement is the legally enforced repayment of ill-gotten gains imposed on wrongdoers by the courts. Funds that were received through illegal or unethical business transactions are disgorged, or paid back, often with interest and/or penalties to those affected by the action.

**(h)** The **APPLICATION MONEY RECEIVED** by companies for allotment of any securities and due for refund (only if such amount has remained unclaimed and unpaid for a period of 7 years.
**(i) MATURED DEPOSITS** with companies other than banking companies (only if such amount has remained unclaimed and unpaid for a period of 7 years from the date it became due for payment);

**(j) MATURED DEBENTURES** with companies (only if such amount has remained unclaimed and unpaid for a period of 7 years from the date it became due for payment);
**Note:** In case of Deposits and Debentures, due unpaid or unclaimed interest shall be transferred to the Fund **along with the transfer of the matured amount** of such deposits & debentures.

**(k) INTEREST ACCRUED** on the amounts referred to in clauses (h) to (j);
**(l)** Amount received from **SALE PROCEEDS OF FRACTIONAL SHARES** arising out of issuance of bonus shares, merger and amalgamation for seven or more years;
**(m)** Redemption amount of **PREFERENCE SHARES** remaining unpaid or unclaimed for 7 or more years;
**(n) Other Amounts-** Such other amounts as prescribed in Rule 3 of the Investor Education and Protection Fund Authority (Accounting, Audit, Transfer and Refund) Rules, 2016. They are as under:

a) **ALL SHARES** in whose case dividends have not been claimed for 7 consecutive years or more;
b) all the **RESULTANT BENEFITS ARISING OUT OF SHARES** held by the Authority under clause (a) above;
c) all income earned by the Authority in any year;

**2. Utilization of the Fund: According to section 125 (3) the Fund shall be utilized for:**

(a) **REFUND** of unclaimed dividends, matured deposits, matured debentures, the application money due for refund and interest thereon;
(b) **PROMOTION** of investors' education, awareness and protection;
(c) **distribution of any DISGORGED AMOUNT** among eligible and identifiable applicants for shares or debentures, shareholders, debenture-holders or depositors **who have suffered losses due to wrong actions by any person**,
(d) **reimbursement of legal expenses incurred in pursuing class action suits** under sections 37 and 245 by members, debenture-holders or depositors as may be sanctioned by the Tribunal; and
(e) any other purpose

**3. Application to the Authority for payment:** According to section 125 (4), any person claiming to be entitled to the amount referred in section 125 (2) may apply to the Authority constituted under section 125 (5) for the payment of the money claimed.

**4. Other Provisions governing the IEPF**

**(i) Constitution of the Authority for Administration of Fund-** MCA has notified **that an Authority is being constituted for the administration and maintenance of accounts** as well as other relevant records of the Fund.

**Composition: The Secretary, MCA shall be the ex-officio Chairperson of the Authority**. In addition, there shall be 6 members (maximum limit seven) and a CEO who shall be the convenor of the Authority.

**(ii)** The **Authority shall administer the Fund and maintain separate accounts** and other relevant records in relation to the Fund in such form after consultation with the **Comptroller and Auditor-General of India.**

**(iv) Spending of Money**- The Authority shall be competent to spend money out of the Fund for carrying out the objects specified in section 125 (3) i.e. purposes for which the fund shall be utilized.

**(v) Audit of the Fund**- The accounts of the Fund shall be audited by the Comptroller and Auditor-General of India at such intervals as may be specified by him. Such audited accounts together with the audit report thereon shall be **forwarded annually by the Authority to the Central Government.**

(vi) The Authority shall prepare a **ANNUAL REPORT** giving full account of its activities during the financial year and forward a copy thereof to the CG. In turn, the CG shall cause the annual report and the audit report given by the CAG of India **to be laid before each House of Parliament.**

## RIGHT OF DIVIDEND, RIGHTS SHARES AND BONUS SHARES TO BE HELD IN ABEYANCE PENDING REGISTRATION OF TRANSFER OF SHARES – Section 126

According to Section 126, in case any instrument of transfer of shares has been delivered by a shareholder for registration and the transfer of such shares has not been registered by the company, such company shall take the following steps:

(a) Transfer the dividend in relation to such shares to the Unpaid Dividend Account unless it is authorised by the registered holder of such share in writing to pay such dividend to the transferee specified in the instrument of transfer; and

(b) Keep in abeyance in relation to such shares any offer of rights shares under section 62 (1) (a) and any issue of fully paid-up bonus shares in pursuance of first proviso to section 123 (5).

## PUNISHMENT FOR FAILURE TO DISTRIBUTE DIVIDENDS WITHIN 30 DAYS – Section 127

### A. Time Limit for Distribution of Dividends

Where a company declares dividend, it must be **paid or the dividend warrant thereof must be posted within 30 days from the date of declaration of dividend** to the shareholders entitled to the same.

### B. Punishment for Failure

In case a **company fails to pay declared dividends or fails to post dividend warrants within 30 days** of declaration, following punishments are applicable:

(i) **Every director** of the company shall be **punishable with imprisonment of up to 2 years**, if he is **knowingly a party to the default**. And, he shall also be liable to pay minimum fine of ` 1,000 for every day during which such default continues.

(ii) The company shall be liable to pay simple interest at the rate of 18% p.a. during the period for which such default continues.

### C. Exemption from Punishment

Under the following cases, where the company has failed to pay declared dividend within 30 days of declaration, no offence shall be deemed to have been committed and therefore, no punishment is attracted:

(a) where the dividend could not be paid by reason of the **operation of any law**;
(b) where a shareholder has given directions to the company regarding the payment of the dividend and those **directions cannot be complied** with and the same has been communicated to him;
(c) where there is a **dispute regarding the right** to receive the dividend;
(d) where the dividend has been **lawfully adjusted by the company against any sum due** to it from the shareholder;
(e) where, for any other reason, the failure to pay the dividend or to post the warrant within the prescribed period of 30 days **was not due to any default on the part of the company.**

**Question and Answers**

1. **The AGM of ABC Bakers Limited held on 30th May, 2019, declared a dividend at the rate of 30% payable on its paid-up equity share capital as recommended by Board of Directors. However, the Company was unable to post the dividend warrant to Mr. Ranjan, an equity shareholder, up to 25th July, 2019. Mr. Ranjan filed a suit against the Company for the payment of dividend along with interest at the rate of 20 percent per annum for the period of default. Decide in the light of provisions of the Companies Act, 2013, whether Mr. Ranjan would succeed? Also, state the directors' liability in this regard under the Act.**

**Answer**

Section 127 of the Companies Act, 2013 lays down the penalty for non-payment of dividend within the prescribed time period of 30 days. According to this section where a dividend has been declared by a company but has not been paid or the warrant in respect thereof has not been posted within 30 days from the date of declaration of dividend to any shareholder entitled to the payment of dividend:

(a) every director of the company shall, if he is knowingly a party to the default, be punishable with imprisonment maximum up to two years and with minimum fine of rupees one thousand for every day during which such default continues; and

(b) the company shall be liable to pay simple interest at the rate of 18% per annum during the period for which such default continues.

Therefore, in the given case Mr. Ranjan will not succeed if he claims interest at 20% interest as the limit under section 127 is 18% per annum.

2. **The Board of Directors of Future Fashions Limited at its meeting recommended a dividend on its paid-up equity share capital which was later on approved by the shareholders at the AGM. Thereafter, the directors at another meeting of the Board passed a board resolution for diverting the total dividend to be paid to the shareholders for purchase of certain short-term investments in the name of the company. As a result, dividend was paid to shareholders after 45 days.**
   **Examining the provisions of the Companies Act, 2013, state whether the act of directors is in violation of the provisions of the Act and if so, state the consequences that shall follow for the above violative act.**

**Answer**

According to section 127 of the Companies Act, 2013, where a dividend has been declared by a company but has not been paid or the warrant in respect thereof has not been posted within 30 days from the date of declaration to any entitled shareholder, every director of the company shall, if he is knowingly a party to the default, be liable for punishment.

In the present case, the Board of Directors of Future Fashions Limited at its meeting recommended a dividend on its paid-up equity share capital which was later on approved by the shareholders at the

Annual General Meeting., Thereafter, the directors at another meeting of the Board decided by passing a board resolution for diverting the total dividend to be paid to the shareholders for purchase of certain short-term investments in the name of the company. As a result, dividend was paid to shareholders after 45 days.

1. Since, declared dividend has not been paid within 30 days from the date of the declaration to any shareholder entitled to the payment of dividend, the company shall, within 7 days from the date of expiry of the said period of 30 days, transfer the total amount of dividend which remains unpaid or unclaimed to a special account to be opened by the company in any scheduled bank to be called the Unpaid Dividend Account.

2. The Board of Directors of Future Fashions Limited has violated section 127 of the Companies Act, 2013 as it failed to pay dividend to shareholders within 30 days due to its decision to divert the total dividend to be paid to shareholders for purchase of certain short-term investments in the name of the company.

**Consequences:** The following are the consequences for violation of the above provisions:

(a) Every director of the company shall, if he is knowingly a party to the default, be punishable with maximum imprisonment of two years and shall also be liable for a minimum fine rupees one thousand for every day during which such default continues.

(b) The company shall also be liable to pay simple interest at the rate of 18% p.a. during the period for which such default continues.

3. **Referring to the provisions of the Companies Act, 2013, examine the validity of the following:**

**The Board of Directors of ABC Tractors Limited proposes to declare dividend at the rate of 20% to the equity shareholders, despite the fact that the company has defaulted in repayment of public deposits accepted before the commencement of this Act.**

Answer

Section 123(6) of the Companies Act, 2013, specifically provides that a company which fails to comply with the provisions of section 73 (Prohibition of acceptance of deposits from public) and section 74 (Repayment of deposits, etc., accepted before the commencement of this Act) shall not, so long as such failure continues, declare any dividend on its equity shares.

In the given instance, the Board of Directors of ABC Tractors Limited proposes to declare dividend at the rate of 20% to the equity shareholders, in spite of the fact that the company has defaulted in repayment of public deposits accepted before the commencement of the Companies Act, 2013. Hence, according to the above provision, declaration of dividend by the ABC Tractors Limited is not valid.

4. **Star Computers Limited declared and paid dividend in time to all its equity holders for the financial year 2018-19, except in the following two cases:**

**(i) Mrs. Sheela Bhatt, holding 250 shares had mandated the company to directly deposit the dividend amount in her bank account. The company, accordingly remitted the dividend but the bank returned the payment on the ground that there was difference in surname of the payee in the bank records. The company, however, did not inform Mrs. Sheela Bhatt about this discrepancy.**

**(ii) Dividend amount of ` 50,000 was not paid to the successor of Late Mr. Mohan, in view of the court order restraining the payment due to family dispute about succession.**

**You are required to analyse these cases with reference to provisions of the Companies Act, 2013 regarding failure to distribute dividends.**

**Answer**

(i) Section 127 of the Companies Act, 2013 provides for punishment for failure to distribute dividend on time. One of such situations is where a shareholder has given directions to the company regarding the payment of the dividend and those directions could not be complied with but the non- compliance was not communicated to him.

In the given situation, the company has failed to communicate to the shareholder Mrs. Sheela Bhatt about non-compliance of her direction regarding payment of dividend. Hence, the penal provisions under section 127 will be applicable.

(ii) Section 127, inter-alia, provides that no offence shall be deemed to have been committed where the dividend could not be paid by reason of operation of law.

In the present case, the dividend could not be paid because it was not allowed to be paid by the court until the matter was resolved about succession. Hence, there will not be any liability on the company and its directors, etc.

5. **Alpha Herbals, a Section 8 company is planning to declare dividend in the Annual General Meeting for the Financial Year ended 31-03-2019. Mr. Chopra is holding 800 equity shares as on date. State whether the act of the company is according to the provisions of the Companies Act, 2013.**

Answer

According to Section 8(1) of the Companies Act, 2013, the companies licenced under Section 8 of the Act (Formation of companies with Charitable Objects, etc.) are prohibited from paying any dividend to their members. Their profits are intended to be applied only in promoting the objects for which they are formed.

Hence, in the instant case, the proposed act of Alpha Herbals, a company licenced under Section 8 of the Companies Act, 2013, which is planning to declare dividend, is not according to the provisions of the Companies Act, 2013.

6.

**(i) YZ Medical Instruments Limited is a manufacturing company & has proposed a dividend @ 10% for the year 2018-19 out of the profits of current year. The company has earned a profit of ` 910 crores during 2018-19. The company does not intend to transfer any amount to the general reserves out of the profits. Is YZ Medical Instruments Limited allowed to do so? Comment.**

**(ii) Karan, holder of 5000 equity shares of ` 100 each of M/s. Rachit Leather Shoes Limited did not pay final call of ` 10 per share. M/s. Rachit Leather Shoes Limited declared dividend of 10%. Examine with reference to relevant provisions of the Companies Act, 2013, the amount of dividend Karan should receive.**

**Answer**

(i) According to section 123 of the Companies Act, 2013 a company may, before the declaration of any dividend in any financial year, transfer such percentage of its profits for that financial year as it may consider appropriate to the reserves of the company. Such transfer is not mandatory and the percentage to be transferred to reserves is at the discretion of the company.

As per the given facts, YZ Medical Instruments Limited has earned a profit of ` 910 crores for the financial year 2018-19. It has proposed a dividend @ 10%. However, it does not intend to transfer any amount to the reserves of the company out of the profits of current year.

As per the provisions stated above, the amount to be transferred to reserves out of profits for any financial year is at the discretion of the company acting through its Board of Directors. Therefore, at its discretion, if YZ Medical Instruments Limited decides not to transfer any profit to reserves before the declaration of dividend at 10%, it is legally allowed to do so.

(ii) As per the proviso to section 127 of the Companies Act, 2013, no offence will be deemed to have been committed by a director for adjusting the calls in arrears remaining unpaid or any other sum due from a member against the dividend declared by the company.

Thus, as per the given facts, M/s. Rachit Leather Shoes Limited can adjust the unpaid call money of ` 50,000 against the declared dividend of 10%, i.e. 5,00,000 x 10/100 = 50,000. Hence, call money of ` 50,000 not paid by Karan can be adjusted fully from the entitled dividend amount of ` 50,000 payable to him.

7. **PQ Ltd. declared and paid 10% dividend to all its shareholders except Mr. Kumar, holding 500 equity shares, who instructed the company to deposit the dividend amount directly in his bank account. The company accordingly remitted the dividend, but the bank returned the payment on the ground that the account number as given by Mr. Kumar doesn't tally with the records of the bank. The company, however, did not inform Mr. Kumar about this discrepancy. ·Comment on this issue with reference to the provisions of the Companies Act, 2013 regarding failure to distribute dividend.**

**Answer**

Section 127 of the Companies Act, 2013 provides for punishment for failure to distribute dividend on time. One of such situations is where a shareholder has given directions to the company regarding the payment of the dividend and those directions cannot be complied with and the same has not been communicated to the shareholder.

In the instant case, PQ Ltd. has failed to communicate to the shareholder Mr. Kumar about non-compliance of his direction regarding payment of dividend. Hence, the penal provisions under section 127 will be attracted.

8. **Alex limited is facing loss in business during the financial year 2018-2019. In the immediate preceding three financial years, the company had declared dividend at the rate of 7%, 11% and 12% respectively. The Board of Directors has decided to declare 12% interim dividend for the current financial year atleast to be in par with the immediate preceding year. Is the act of the Board of Directors valid ?**

Answer

As per Section 123(3) of the Companies Act, 2013, the Board of Directors of a company may declare interim dividend during any financial year out of the surplus in the profit and loss account and out of profits of the financial year in which such interim dividend is sought to be declared.

Provided that in case the company has incurred loss during the current financial year up to the end of the quarter immediately preceding the date of declaration of interim dividend, such interim dividend shall not be declared at a rate higher than the average dividends declared by the company during the immediately preceding three financial years.

According to the given facts, Alex Ltd. is facing loss in business during the financial year 2018-2019. In the immediate preceding three financial years, the company declared dividend at the rate of 7%, 11% and 12% respectively. Accordingly, the rate of dividend declared shall not exceed 10%, the average of the rates (7+11+12=30/3) at which dividend was declared by it during the immediately preceding three financial years.

Therefore, the act of the Board of Directors as to declaration of interim dividend at the rate of 12% during the F.Y 2018-2019 is not valid.

# Chapter 9
# Accounts of Companies
### Rules: The Companies (Accounts) Rules, 2014

## INTRODUCTION

There is a need for disclosing the Annual information to the shareholders by the directors about the working and financial position of the company, so that the shareholders are aware of the affairs of the company.

## BOOKS OF ACCOUNT, ETC., TO BE KEPT BY COMPANY - SECTION 128

### A. GENERAL REQUIREMENT

- Every company **SHALL PREPARE books of accounts and other relevant books and records and financial statement** for every financial year.
- These **books of accounts should give a TRUE AND FAIR VIEW** of the state of the **affairs of the company, including that of its branch office(s)** and explain the transactions effected both at the registered office and its branches.
- These books of accounts must be kept on **ACCRUAL BASIS** and according to the **DOUBLE ENTRY SYSTEM** of accounting.

**#Meaning:**

**ACCRUAL BASIS**

Accrual involves recording income and expenses as they accrue; distinct from when they are received or paid.

**DOUBLE ENTRY BOOK-KEEPING** is a method of recording any transaction of a business in a set of accounts, in which every transaction has a dual aspect of debit and credit.

**#Definition**

1) **"Books of account"** as per Section 2(13) includes records maintained in respect of—
   - all **sums of money received and expended by a company**
   - all **sales and purchases of goods and services** by the company;
   - the **assets and liabilities** of the company; and
   - the items of cost as may be prescribed under section 148 (Cost Audit)

2) **"Book and paper" and "book or paper"** as defined in Section 2(12) include books of account, deeds, vouchers, writings, documents, minutes and registers maintained on paper or in electronic form;

### B. PLACE OF KEEPING BOOKS OF ACCOUNT

Section 128(1) requires every company to prepare and keep the books of account and other relevant books and papers and financial statements **at its registered office.**

**#Questionable point:**

- Provided all or any of the books of accounts **may be kept at such other place in India as the Board of directors may decide**.
- The Board shall **within 7 days** of decision file with the registrar a notice in writing in **form AOC-5** giving full address of that other place.

## C. MANNER OF BOOKS OF ACCOUNT TO BE KEPT IN ELECTRONIC MODE - Rule 3

(1) The books of account and other relevant books and papers **shall remain accessible in India, at all times for subsequent reference.**

(2) The books of account and other relevant books and papers shall be **retained completely in the original format** or in a **format which shall present accurately the information generated, sent or received** and **remain unaltered.**

### Audit trail and edit log [Proviso to Rule 3(1)]

In order to ensure audit trial, in case of company which uses accounting software for maintaining its books of account, the proviso to rule 3(1) requires that:

a. For the **financial year** commencing on or after the **1st day of April, 2023,**

b. Every such company (which uses accounting software) shall use only such accounting software,

c. Which has a feature of **recording audit trail** of each and every transaction,

d. Creating an **edit log** of each change made in books of account along with the date when such changes were made and

e. Ensuring that the **audit trail cannot be disabled.**

### Retain in original or accurate form [Rule 3(2) and Rule 3(3)]

Sub-rule 2 requires the books of account and other relevant books and papers referred to in sub-rule (1) shall be **retained completely in the format** in which they were **originally generated, sent or received**, or in a format which shall present **accurately** the information generated, sent or received and the information contained in the electronic records shall remain complete and unaltered

Further sub-rule 3 requires **the information received from branch offices** shall not be altered and shall be kept in a manner where it shall depict what was **originally received** from the branches

### Proper storage, retrieval and legible display [Rule 3(4) and Rule 3(5)]

Sub-rule 4 requires the information in the electronic record of the document shall be capable of being **displayed in a legible form**

Further sub-rule 5 requires there shall be a proper system for **storage, retrieval, display** or **printout** of the electronic records as the Audit Committee, if any, or the

Board may deem appropriate and such records shall not be disposed of or rendered unusable, unless permitted by law.

Proviso to sub-rule 5 requires the **back-up** of the books of account and other books and papers of the company **maintained in electronic mode**, including at a **place outside India,** if any, shall be kept in servers physically located in India on a **daily basis.**

**Intimation to Registrar – Information of Service Provider [Rule 3(6)]**

The company shall intimate to the Registrar on an annual basis at the time of filing of financial statement following relevant information related to service provider:

a. The name of the service provider;

b. The internet protocol (IP) address of service provider;

c. The location of the service provider (wherever applicable);

d. Where the books of account and other books and papers are maintained on cloud, such address as provided by the service provider.

e. Where the service provider is located outside India, the name and address of the person in control of the books of account and other books and papers in India.

**D. BOOKS OF ACCOUNT - BRANCH OFFICE**

- Where a company has a **branch office in or outside India**, it shall be deemed to have complied with the provisions of sub-section (1), if proper books of account relating to the transactions effected **at the branch office are kept at that office.**
- The **summarised returns** of the books kept and maintained outside India **shall be sent to the registered office at quarterly intervals**, which shall be kept and maintained at the registered office of the company and **kept open to directors for inspection.**

**E. INSPECTION BY DIRECTORS**

- **Any director** [nominee, independent, promoter or whole time] can inspect the books of account and other books and papers of the company **during business hours**.
- A person can **inspect the books of account of the subsidiary**, **only on authorisation** by way of the resolution of Board of Directors.
- The officers and other employees of the company shall give to the person making such inspection all **assistance in connection with the inspection**.

**F. OTHER FINANCIAL INFORMATION:**

- Where any other **financial information MAINTAINED OUTSIDE THE COUNTRY is required by a director**, the director shall furnish a request to the company asking for details of the financial information sought, the period for which such information is sought.
- The company shall produce it to the director **within 15 days of receipt request**.
- The Director can seek the information only individually and not by or through his attorney holder or agent or representative.

## G. PERIOD FOR PRESERVATION OF BOOKS [SECTION 128(5)]

- The books of accounts, together with vouchers, are required to be preserved in good order for a **period of not less than 8 years immediately** preceding financial year.
- In case of a **company incorporated less than 8 years before** the financial year, it shall be preserved accordingly.
- Where an investigation has been ordered in respect of a company, the CG may direct that the **books of account may be kept for such period longer than 8 years.**

## H. PERSONS RESPONSIBLE AND PENALTY

The **person responsible for the maintenance of books** of account etc. shall be:

(i) Managing Director,

(ii) Whole-Time Director, in charge of finance

(iii) Chief Financial Officer

(iv) Any other person of a company charged by the Board with duty of complying with provisions of section 128.

## I. PENALTY FOR CONTRAVENTION

If the managing director, the whole-time director in charge of finance, the Chief Financial Officer or any other person of a company charged by the Board with the duty of complying with the provisions of this section, contravenes such provisions, such managing director, whole-time director in charge of finance, Chief Financial officer or such other person of the company shall be punishable [~~with imprisonment for a term which may extend to one year or~~] with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees [~~or with both~~]

### Illustration 1- True false

**Statement** – Vouchers need not to be preserved as part of requirement of preserving books for period of 8 years

**Answer** False

**Reason** – As per section 128(5) of the Companies Act 2013, the books of account, together with vouchers relevant to any entry in such books, are required to be preserved in good order by the company for a period of not less than eight years immediately preceding the relevant financial year.

**Example 1: XYZ Ltd. wants to maintain its books of account on cash basis. Is this a valid act of XYZ Ltd?**

**Answer:** The Companies Act 2013 vide section 128(1) requires every company to prepare books of account and other relevant books and papers and financial statement for every financial year on accrual basis and double entry system of accounting. No exception has been given by the Act to any class or classes of companies from the above requirement. Hence XYZ

Ltd. cannot maintain its books of accounts on cash basis.

## FINANCIAL STATEMENT [SECTION 129]

**# Definition**

**1) Financial statement: 2 (40)**, in relation to a company, includes—

(i) a balance sheet as at the end of the financial year;
(ii) a profit and loss account, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year;
(iii) cash flow statement for the financial year;
(iv) a statement of changes in equity, if applicable; and
(v) any explanatory note annexed to, or forming part of, any document referred to in sub-clause (i) to sub-clause (iv):

Exception

a) Provided that the financial statement, with respect to One Person Company, small company and dormant company and a startup Private company, **may not include the cash flow statement**;]

**2) Sec 2(41) - "financial year"**

"**financial year**", in relation to any company or body corporate, means the period ending on the 31st day of March every year, and where it has been incorporated on or after the 1st day of January of a year, the period ending on the 31st day of March of the following year, in respect whereof financial statement of the company or body corporate is made up: Provided that where a company or body corporate, which is a holding company or a subsidiary or associate company of a company incorporated outside India and is required to follow a different financial year for consolidation of its accounts outside India, the Central Government may, on an application made by that company or body corporate in such form and manner as may be prescribed, allow any period as its financial year, whether or not that period is a year.

**Example:** Mahindra and Mahindra Company Limited was incorporated as a company on 22nd February 2014. Now for the purpose of the first financial statements, the period ending shall be 31st March of the following year i.e. 31st March 2015.
Provided that where a company or body corporate, which is a holding company or a subsidiary or associate company of a company incorporated outside India and is required to follow a different financial year for consolidation of its accounts outside India, the Central Government may, on an application made by that company or body corporate in such form and manner as may be prescribed, allow any period as its financial year, whether or not that period is a year.

**1) TRUE AND FAIR VIEW**

- The financial statements shall give a **true and fair view** of the state of affairs of the company
- It shall **comply with the accounting standards** notified under section 133 and
- It shall be in the form as provided under **Schedule III**.

**2) NON-APPLICABILITY**

Provided further that nothing contained in this sub-section shall apply to:

- Insurance company
- Banking company
- Company engaged in generation or supply the of electricity
- Company governed by any other law

**3) LAYING OF FINANCIAL STATEMENTS [SECTION 129(2)]**

At every AGM of a company, the Board of Directors of the company shall lay before such meeting financial statements for the financial year.

**4) CONSOLIDATION OF FINANCIAL STATEMENTS [SECTION 129(3)]**

a) Where a **company has one or more subsidiaries or associate companies**, **it shall, in addition to financial statements**, **prepare a consolidated financial statement (CFS) of the company and of all the subsidiaries and associate companies**, **which shall also be laid before the AGM of the company** along with the laying of its financial statement under sub-section (2).

b) **EXEMPTIONS FROM PREPARATION OF CFS:** As per Companies (Accounts) Amendment Rules, 2016, preparation of CFS by a company is not required if it meets the following conditions:
(i) it is a **wholly-owned subsidiary, or is a partially-owned subsidiary of another company** and **all its other members**, **including those not otherwise entitled to vote**, have been intimated and **they do not object to the company** not presenting CFS;
(ii) **Unlisted company** or **are not in the process of listing** on any stock exchange, **whether in or outside India**; and
(iii) its **ultimate or any intermediate holding company files CFS** with the Registrar which are in compliance with the applicable Accounting Standards.
Exception: This rule shall not apply in respect of CFS by a company having subsidiary or **subsidiaries incorporated outside India** commencing on or after 1st April 2014.

c) **DISCLOSURE OF DEVIATION:** Where the **financial statements of a company do not comply with the accounting standards** referred to in sub- section (1), the company **shall disclose** in its financial statements, the **deviation from the accounting standards**, the reasons for such deviation and the financial effects, if any, arising out of such deviation [Section 129(5)].

5) The Central Government may, on its own or on an application, **exempt any class or classes of companies from complying with any of the requirements of this section** or, if it is considered necessary to grant such exemption **in the public interest** and any such exemption may be granted either unconditionally or subject to such conditions as may be specified. [Section 129(6)].

**6) PENAL PROVISIONS [SECTION 129(7)]**

If a company contravenes the provisions of this section, **the managing director, the whole-time director in charge of finance, the Chief Financial Officer or any other person charged by the Board with the duty of complying with the requirements** of this section and in the absence of any of the officers mentioned above, all the directors shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than 50 thousand rupees but which may extend to 5 lakh rupees, or with both.

## RE-OPENING OF ACCOUNTS ON COURT'S OR TRIBUNAL ORDERS [SECTION 130]

**(1) Apply to court for re-opening of accounts**—A **company shall not re-open its books of account and not recast its financial statements**, unless an **application in this regard** is made by-

(a) the Central Government,
(b) the Income-tax authorities,
(c) the Securities and Exchange Board of India (SEBI),
(d) any other statutory regulatory body or authority or any person concerned

and an order is **made by a court of competent jurisdiction or the Tribunal** to the effect that—

(i) the relevant earlier **accounts were prepared in a fraudulent manner**; or
(ii) the affairs of the company **were mismanaged during the relevant period**,

casting a doubt on the reliability of financial statements:

**Serving of notice:** Provided that the Court or the Tribunal, as the case may be, shall give notice to

(a) the Central Government,
(b) the Income-tax authorities,
(c) the Securities and Exchange Board of India (SEBI),
(d) any other statutory regulatory body or authority or any person concerned

and shall **take into consideration the representations**, if any, made before passing any order

**(2)** The accounts so revised or re-casted, shall be final.

**(3) Time Limit in respect of re-opening of books of account:** No order shall be made under sub-section (1) in respect of re-opening of books of account relating **to a period earlier than 8 financial years** immediately preceding the current financial year:
Provided that where a direction has been issued by the Central Government under the proviso

to sub-section (5) of section 128 for keeping of books of account for a period longer than 8 years, the books of account may be ordered to be re- opened within such longer period.

## VOLUNTARY REVISION OF FINANCIAL STATEMENTS OR BOARD'S REPORT [SECTION 131]

1) **Preparation of revised financial statement or revised report on the approval of Tribunal: If it appears to the directors of a company that—**

(a) the financial statement of the company; or

(b) the report of the Board,

**do not comply with the provisions of section 129 or section 134, they may prepare revised financial statement** or **a revised report** in respect of **any of the 3 preceding financial years after obtaining approval of the Tribunal** on an application made by the company and a copy of the order passed by the Tribunal shall be filed with the Registrar.

a) **Tribunal shall give notice to:**

- to the Central Government and
- the Income tax authorities

and shall take into consideration the representations, if any, made by that Government or the authorities before passing any order under this section.

b) **Number of times of revision and recast:**

Provided further that such revised financial statement or report shall not be prepared or filed more than once in a financial year.

c) **Reason for revision to be disclosed:**

Provided also that the detailed reasons for revision shall also be **disclosed in the Board's report** in the relevant financial year in which such revision is being made

### SCOPE OF REVISIONS [SUB-SECTION 2]

a. **Correction** in respect of which the previous financial statement does not **comply with** the provisions of section 129; and

b. **Correction** in respect of which the previous board report does not comply with the provisions of section 134; and

c. Making of any **necessary consequential alternation.**

2) **Limits of revisions:**

Where copies of the previous financial statement or report have been

- sent out to members or
- delivered to the Registrar or
- laid before the company in general meeting,

**the revisions must be confined to—**

(a) the correction in respect of which the previous financial statement or report do not comply with the provisions of section 129 or section 134; and

(b) the making of any necessary consequential alternation.

**CONSTITUTION OF NATIONAL FINANCIAL REPORTING AUTHORITY - Section 132**

(1) The Central Government may, by notification, constitute the NFRA to provide **for matters relating to accounting and auditing standards** under this Act.

The Central Government hereby appoints the 1st October 2018 as the date of constitution of National Financial Reporting Authority

**(2) FUNCTIONS:** Notwithstanding anything contained in any other law for the time being in force, the **NFRA shall**—

(a) **make recommendations to the Central Government on the formulation and laying down of ACCOUNTING AND AUDITING POLICIES AND STANDARDS** for adoption by companies or class of companies or their auditors, as the case may be;

(b) **monitor and enforce the compliance** with accounting and auditing standard;

(c) **oversee the quality of service of the professions** associated with ensuring compliance with such standards, and suggest measures required for improvement in quality of service and such other related matters as may be prescribed; and

(d) perform such other functions relating to (a), (b) and (c) as may be prescribed.

**(3) COMPOSITION:** The NFRA shall consist of

- **a chairperson**, who shall be a person of eminence and having expertise in accountancy, auditing, finance or law **to be appointed by the Central Government** and
- **such other members** not exceeding 15 consisting of part- time and full-time members

(3A) Each division of the National Financial Reporting Authority shall be presided over by the Chairperson or a full-time Member authorised by the Chairperson.

**Note:**

- Provided that the **chairperson and members shall make a declaration** to the Central Government in the prescribed form regarding **no conflict of interest or lack of independence in respect of his or their appointment**.
- The chairperson and members, who are **in full-time employment with NFRA shall not be associated with any audit firm** (including related consultancy firms) **during the course of their appointment and 2 years after ceasing to hold such appointment.**

(4) Notwithstanding anything contained in any other law for the time being in force, the **NFRA shall—**

(a) have the **power to investigate**, either suo moto or on application by the Central Government, into the **matters of professional or other misconduct committed by any member or firm of chartered accountants**, registered under the Chartered Accountants Act, 1949.

**Note:** Provided that no other institute or body shall initiate or continue any proceedings in

such matters of misconduct where the NFRA has initiated an investigation.

(b) have the **same powers as are vested in a civil court** under the Code of Civil Procedure, 1908, while trying a suit, in respect of the following matters, namely:—

(i) **discovery and production of books** of account and other documents, at such place and at such time as may be specified by the NFRA;

(ii) **summoning and enforcing the attendance** of persons and examining them on oath;

(iii) **inspection of any books, registers and other documents** of any person referred to in clause (b) at any place;

(iv) issuing **commissions for examination of witnesses** or documents;

(c) where **professional or other misconduct is proved**, the NFRA shall have the power to make order for—

**(A) IMPOSING PENALTY OF—**

(I) **IN CASE OF INDIVIDUALS: not less than 1 lakh rupees**, but which may **extend to 5 times** of the fees received; and

(II) **IN CASE OF FIRMS:** not less than **5 lakh rupees**, but which may **extend to 10 times** of the fees received;

**(B) DEBARRING THE MEMBER OR THE FIRM FROM -**

(I) being **appointed as an auditor or internal auditor** or **undertaking any audit** in respect of financial statements or internal audit of the functions and activities of any company or body corporate; or

(II) performing **any valuation** as provided under section 247,

**for a minimum period of 6 months or such higher period not exceeding 10 years as may be determined by the NFRA.**

**Appeal against orders of NFRA**

**Any person aggrieved** by any order of the NFRA issued under clause (c) of sub-section (4), **may prefer an appeal before the Appellate Tribunal** on payment of fees as prescribed.

**Meetings of NFRA**

The NFRA shall meet at such times, places and shall observe such rules as may be prescribed.

**Secretary and other employees**

The Central Government may appoint a secretary and such other employees as it may consider necessary for the efficient performance of functions by the NFRA.

**Head office of NFRA**

The head office of the NFRA shall be at New Delhi and it may, meet at such other places in India as it deems fit.

**Maintenance of books by NFRA**

The NFRA shall maintain such books of account and other books as the Central Government may, in consultation with the **Comptroller and Auditor-General of India prescribe**.

**Audit of account of NFRA**

The accounts of the NFRA shall be audited by the **Comptroller and Auditor-General of India** at such intervals as may be specified by him and certified accounts together with the audit report thereon shall be forwarded annually to the Central Government.

**Annual Report on working of NFRA**

The NFRA shall prepare in such form and at such time for each financial year as may be prescribed its **annual report giving a full account of its activities** during the financial year and forward a copy thereof to the Central Government and the Central Government shall cause the annual report and the audit report given by the Comptroller and Auditor-General of India to be **laid before each House of Parliament.**

**The Central Government has made the National Financial Reporting Authority Rules, 2018 (NFRA Rules).**

As per NFRA rules, NFRA shall have **power to monitor and enforce compliance with accounting standards and auditing standards**, oversee the quality of service under sub-section (2) of section 132 or undertake investigation under sub-section (4) of such section of the auditors.

**Rule 3 provides for the classes of companies and bodies corporate governed by the NFRA.**

**Rule 3: These include:**

a) companies whose securities are **listed on any stock exchange in India or outside India**;

b) **unlisted public companies**

- having **paid-up capital** of **not less than rupees 500 crores** or
- having **annual turnover** of not less than rupees **1000 crores** or
- having, in **aggregate, outstanding loans, debentures and deposits** of not less than rupees **500 crores** as on the 31st March of immediately preceding financial year;

c) insurance companies, banking companies, companies engaged in the generation or supply of electricity, companies governed by any special Act for the time being in force

d) any body corporate or company or person, or any class of bodies corporate or companies or persons, on a r**eference made to the NFRA by the Central Government in public interest**; and

e) a body corporate incorporated or **registered outside India**, which is a **subsidiary or associate company of any company or body corporate incorporated or registered in India as referred to in clauses (a) to (d) above**,

if the **income or networth of such subsidiary or associate company exceeds 20% of the consolidated income or consolidated networth of such company** or the body corporate, as the case may be, referred to in clauses (a) to (d) above.

**Every existing body corporate other than a company** governed by these rules, shall inform the **NFRA within 30 days of the commencement of NFRA rules**, **in Form NFRA-1**, **the particulars of the auditor** as on the date of commencement of these rules.[1st July 2019]

A company or a body corporate other than a company governed under NFRA Rules **shall continue to be governed by the NFRA for a period of 3 years** after it ceases to be listed or its paid-up capital or turnover or aggregate of loans, debentures and deposits falls below the limit stated therein[i.e. mentioned in points (a) to (e) above].

**Punishment in case of non-compliance** - If a company or any officer of a company or an auditor or any other person contravenes any of the provisions of NFRA Rules, the company and every officer of the company who is in default or the auditor or such other person shall be punishable as per the provisions of section 450 of the Act.

## CENTRAL GOVERNMENT TO PRESCRIBE ACCOUNTING STANDARDS - Section 133

- Section 133 of the Companies Act, 2013 deals with the power of the Central Government to prescribe the accounting standards.
- The Central Government may prescribe the standards of accounting or any addendum thereto, as recommended by the ICAI in consultation with and after examination of the recommendations made by the NFRA.
- Provided that until the NFRA is constituted under section 132 of the Companies Act, 2013, the Central Government may prescribe the standards of accounting or any addendum thereto, as recommended by the ICAI in consultation with and after examination of the recommendations made by the National Advisory Committee on Accounting Standards (NACAS) constituted under the previous company law.

## FINANCIAL STATEMENT, BOARD'S REPORT, ETC. - Section 134

Section 134 provides that the financial statement including consolidated financial statements should be approved by the Board of Directors before they are signed and submitted to auditors for their report. The auditor's report is to be attached to every financial statement. A report by the Board of Directors containing details on the matters specified including Director's responsibility statement shall be attached to every financial statement laid before the company. The Board's report and every annexure has to be duly signed. A signed copy of every financial statement shall be circulated, issued or published along with all notes or documents, the auditor's report and Board's report. The clause also provides for penal provisions for the company and every officer of the company in case of any contravention.

**(I) AUTHENTICATION OF FINANCIAL STATEMENTS [Section 134(1), (2) & (7)]:**

(a) The financial statement, including consolidated financial statement, if any, **shall be approved by the Board of Directors** before **they are signed** on behalf of the Board

- **CHAIRPERSON**, if authorised by the Board **OR**

- by **2 DIRECTORS** out of which one shall be **MANAGING DIRECTOR**, if any, and
- the **CEO, the CFO and CS** of the company, **wherever they are appointed**, or
- in the **case of OPC**, only by **ONE DIRECTOR**, for submission to the auditor for his report thereon.

(b) A **signed copy of every financial statement**, including consolidated financial statement, if any, **shall be issued, circulated or published along with a copy** of [Section 134(7)] —

(1) **Any notes annexed** to or forming part of such financial statement;

(2) The **auditor's report**; and

(3) The **Board's report** referred to in sub section 3.

**Example**: The Board of Directors of ABC Ltd. wants to circulate **unaudited accounts before the AGM** of the shareholders of the Company. Whether such an act of ABC Ltd. is tenable?

**Answer:** Section 129(2) of the Companies Act, 2013 provides that at every AGM of a company, the Board of Directors of the company shall lay before such meeting financial statements for the financial year. Further section 134(7) provides that signed copy of every financial statement, including consolidated financial statement, if any, shall be issued, circulated or published along with a copy each of:

(a) any notes annexed to or forming part of such financial statement;

(b) the auditor's report; and

(c) the Board's report.

It, therefore, follows that unaudited accounts cannot be sent to members or unaudited accounts cannot be filed with the Registrar of Companies. So, such an act of ABC Ltd, is not tenable.

**(II) BOARD'S REPORT [SECTION 134(3) & (4) READ WITH RULE 8 OF THE COMPANIES (ACCOUNTS) RULES, 2014]:**

**(1)** According to Rule 8 of the Companies (Accounts) Rules, 2014, the Board's Report shall be prepared based on the standalone financial statement of the company and shall report on the highlights of performance of subsidiaries, associates and joint venture companies and their contribution to the overall performance of the company during the period under report.

**(2) Section 134(3)** read with **Rule 8** prescribes the **following CONTENTS OF THE BOARD'S REPORT:**

(a) the **web address**, if any, where **ANNUAL RETURN** has been placed;

(b) **number of meetings** of the Board;

(c) **directors' responsibility statement**;

(ca) **details in respect of frauds reported by auditors** under 143(12)

(d) a statement on **declaration given by independent directors** under sub- section 149(6)

(e) If a company covered under Section 178 (1) (Nomination and Remuneration Committee and Stakeholders Relationship Committee), company's policy on directors' appointment and remuneration including criteria for determining qualifications, positive attributes, independence of a director and other matters provided under sub-section (3) of section 178;

Note: The above clause (e) shall not apply in the case of a government company.

(f) **explanations or comments by the Board on every qualification**, reservation or adverse remark or disclaimer made—

(i) by the **auditor** in his report; and

(ii) by the **CS in his secretarial audit** report;

(g) **particulars** of **loans, guarantees or investments** under section 186;

(h) particulars of **contracts or arrangements with related parties** as per **188 (1) in the form AOC-2;**

(i) the **state of the company's affairs**;

(j) the amount, **proposed to carry to any reserves**;

(k) the amount, **recommended to be paid by way of dividend**;

(l) the **conservation of energy, technology absorption, foreign exchange earnings and outgo, in such manner as may be prescribed**; However, the Govt. companies engaged in producing defense equipment is exempted from disclosure under this clause.

(n) a **statement indicating development and implementation of a risk management policy** for the company including identification therein of elements of risk, if any, which in the opinion of the Board may threaten the existence of the company;

(o) the **CSR policy** and initiatives taken during the year

(p) According to Rule 8(4),

- Every listed company and
- Every other public company having a **paid up share capital of 25 crore rupees** or more, a statement indicating the manner in which **formal annual evaluation has been made** by the **Board of its own performance** and **committees and individual directors.**
- **Exemption to Government company**- 134 (3) (p) 134 shall not apply, in case the **directors are evaluated by the Ministry or Department of the Central/ State Government** which is in charge of the company.

(q) such other matters as may be prescribed [See **].

****According to Rule 8 of the Companies (Accounts) Rules, 2014, the report of the Board shall also contain–**

(i) the **financial summary** or highlights;

(ii) the **change in the nature of business**, if any;

(iii) the details of **directors or KMP** who were **appointed or resigned** during the year;

(iiia) a statement **regarding opinion of the Board** with **regard to integrity, expertise and experience (including the proficiency) of the independent directors** appointed during the year.

Explanation.-For the purposes of this clause, the expression "proficiency" means the proficiency of the independent director as ascertained from the online proficiency self-assessment test conducted by the institute notified under sub-section (1) of section 150 (Manner of selection of Independent Directors and maintenance of databank of independent directors).

(iv) the names of companies which have become or ceased to be its subsidiaries, joint ventures or associate companies during the year;

(v) the details **relating to deposits** like-

(a) accepted during the year;

(b) remained unpaid or unclaimed as at the end of the year;

(c) whether there has been any default in repayment of deposits or payment of interest thereon during the year and if so, number of such cases and the total amount involved-

(1) at the beginning of the year;

(2) maximum during the year;

(3) at the end of the year;

(vi) the **details of deposits**, not in compliance with the requirements of Chapter V (Acceptance of Deposits by Companies) of the Act;

(vii) the details of **significant orders passed by the regulators or courts or tribunals** impacting the going concern status and company's operations in future;

(viii) the details in respect of **adequacy of internal financial controls** with reference to the Financial Statements.

(ix) a statement that the **company has complied with provisions relating to** the constitution of Internal Complaints Committee under the **Sexual Harassment of Women at Workplace** (Prevention, Prohibition and Redressal) Act, 2013.

**Non- applicability of Rule 8 of Companies (Accounts) Rules, 2014: This rule shall not apply to One Person Company or Small Company.**

**(4) Board's Report in case of OPC [Section 134(4)]:** In case of a OPC, the report of the Board of Directors to be attached to the financial statement under this section shall, mean a report containing explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made by the auditor in his report.

**(III) DIRECTORS' RESPONSIBILITY STATEMENT [SECTION 134(5)]:**

**The Directors' Responsibility Statement referred to in 134(3)(c) shall state that—**

(1) in the preparation of the **annual accounts**, the applicable **ACCOUNTING STANDARDS** had been followed **along with explanation relating to material departures**;

(2) the directors had selected such **ACCOUNTING POLICIES** and applied them consistently and **made judgments and estimates that are reasonable** and prudent so as **to give a true and fair view** of the state of affairs of the company at the end of the financial year and of the profit and loss of the company for that period;

(3) the directors had taken proper and sufficient care for the **maintenance of adequate ACCOUNTING RECORDS** in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;

(4) the directors had prepared the **annual accounts on a GOING CONCERN BASIS**; and

(5) the directors, in the case of a **listed company,** had laid down **INTERNAL FINANCIAL CONTROLS** to be followed and they were adequate and operating effectively.

**"internal financial controls"** means the policies and procedures adopted by the company for, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information;

(6) the directors had devised **proper systems to ensure compliance** with the provisions of all **applicable laws** and that such systems were adequate and operating effectively.

**SIGNING OF BOARD'S REPORT**

The Board's report and any annexures thereto shall be signed by
a. **Chairperson** of the company if he is **authorised by the Board** and
b. Where he is not so authorised, shall be signed by
i. **At least two directors**, one of whom shall be a **managing director**, or
ii. The director where there is one director.

**(IV) PENALTY:** If a **company is in default** in complying with the provisions of this section, the company shall be liable to a penalty of **3 lakh rupees** and **every officer** of the company who is in default shall be liable to a penalty of **50 thousand rupees**.

**Example:** ABC Company is a **OPC and has only one director.** Who shall authenticate the balance sheet and statement of profit & loss and the Board's report?

**Answer:** In case of a OPC, the financial statements shall be signed by only one director, for submission to the auditor for his report thereon. So, the financial statements signed by one director shall be considered in order.

**CORPORATE SOCIAL RESPONSIBILITY - Section 135 - (CSR Policy) Rules, 2014**

- The Companies Act, 2013 lays down the provisions requiring corporates to mandatorily spend a prescribed percentage of their profits on certain specified areas of social upliftment in discharge of their social responsibilities.
- The Companies CSR Rule 2(1)(c)] provides the exhaustive definition of CSR which provides that the **CSR means and includes but is not limited to:**
  Projects or programs relating to activities undertaken by the board of directors of a company on recommendations of the **CSR Committee with respect to areas specified in Schedule VII of the Act.**
  **Explanation:** Schedule VII of the Act provides for the list of activities which may be included by Companies in their CSR Policies.
- According to section 135 of the Companies Act, 2013 read with the Companies (Corporate Social Responsibility) Rules, 2014

**1) DEFINITIONS:**

a) "**CSR Policy**" means a statement containing the approach and direction given by the board of a company, taking into account the recommendations of its CSR Committee, and includes guiding principles for selection, implementation and monitoring of activities as well as formulation of the annual action plan;
b) **"Administrative overheads"** means the **expenses incurred by the company for 'general management and administration'** of CSR functions in the company but shall not include the expenses directly incurred for the designing, implementation, monitoring, and evaluation of a particular CSR project or programme;
c) "**Ongoing Project**" means a **multi-year project** undertaken by a Company in fulfilment of its CSR obligation **having timelines not exceeding three years excluding the**

**financial year** in which it was commenced, and shall include such project that was initially not approved as a multi-year project but whose duration has been extended beyond one year by the board based on reasonable justification; [Rule 2(i)]

## 2) APPLICABILITY

According to section 135(1), every company having
(1) **net worth of rupees 500** crore or more, or
(2) **turnover of rupees 1000 crore** or more or
(3) a **net profit of rupees 5 crore** or more
during the immediately preceding financial year shall constitute a Corporate Social Responsibility Committee.

**Note:** Every company including its holding or subsidiary, and a foreign company defined under clause (42) of section 2 of the Act having its branch office or project office in India, which fulfills the criteria specified in sub-section (I) of section 135 of the Act shall comply with the provisions of section 135 of the Act and these rules.

**#Definition**
**"Net worth" [As per Section 2(57)]** means
paid-up share capital
**+** all reserves created out of the profits and
**+ S**ecurities premium account and
**+/-** debit or credit balance of the profit and loss account,
**--** accumulated losses,
**--** deferred expenditure and
**--** miscellaneous expenditure not written off,
but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation.

"**Net profit**" means the net profit of a company as per its financial statement prepared in accordance with the applicable provisions of the Act, **but shall not include the following**, namely: –
(i) any profit arising from any overseas branch or branches of the company, whether operated as a separate company or otherwise; and
(ii) any dividend received from other companies in India, which are covered under and complying with the provisions of section 135 of the Act:

Provided that in case of a foreign company covered under these rules, net profit means the net profit of such company as per profit and loss account prepared in terms of clause (a) of sub-section (1) of section 381, read with section 198 of the Act;

**Example: The statutory auditors of a company were required to issue a certificate on the net worth of the company as per the requirement of the management as on 30th September 2018 computed as per the provision of section 2(57) of the Companies Act, 2013.**

**The company had fair valued its property, plant and equipment in the current year which was mistakenly taken into retained earnings of the company in its books of accounts. Please advise whether this fair valuation would be covered in the net worth of the company as per the legal requirements.**

**Answer:** As per sec 2(57) of the Companies Act 2013, any reserves created out of revaluation of assets doesn't form part of net worth. The company fair valued its property, plant and equipment and took that to retained earnings.
Even if the company has taken the fair valuation to the retained earnings in its books of accounts, the resultant credit in reserves (by whatever name called) would be in the category of 'reserves created out of revaluation of assets' which is specifically excluded in the definition of 'net worth' in section 2 (57) and hence should be excluded by the company.
Further the auditors should also consider the matter related to accounting of this reserve separately at the time of audit of books of accounts of the company.

**Example: ABC Ltd is a company with a turnover of more than Rs.1000 crores and having incurred a loss in one of the preceding three financial years. Will it be required to comply with CSR?**

**Answer:** As per section 135(1) of the Act, if any one of the three criteria (whether net worth, or turnover or net profit) gets satisfied then the company is mandatorily required to comply with the CSR provisions. Hence ABC Ltd. will be required to comply with CSR based on its turnover. The mere fact that company has incurred loss in one of the preceding three financial years will not be considered for determining the applicability of CSR to the companies.

### 3) COMPOSITION OF CSR COMMITTEE:

(1) The CSR Committee of the Board shall be **consisting of 3 or more directors**, out of which **at least one shall be an independent director**.

**#Questionable point:**
Provided that where a company is not required to appoint an independent director under sub-section (4) of section 149, it shall have in its Corporate Social Responsibility Committee two or more directors.

(2) The companies **mentioned in the rule 3 shall constitute CSR Committee as under**.-

(i) an **unlisted public company or a private company** covered under subsection (1) of section 135 which is not required to appoint an independent director, shall have its CSR Committee without such director;
(ii) a **private company** having only 2 directors on its Board shall constitute its CSR Committee with 2 such directors;
(iii) a **foreign company**, the CSR Committee shall comprise of at least 2 persons of which **one shall be Indian resident.**

(3) The Board's report under sub-section (3) of section 134 shall disclose the composition of the CSR Committee[Section 135(2)]

**EXCEPTION**

*Where the amount to be spent by a company under Section 135(5) of the Companies Act, 2013* ***does not exceed Rs. 50 Lakh****, the* ***requirement for constitution of the CSR Committee shall not be applicable*** *and the functions of such Committee provided under this section shall, in such cases, be discharged by the Board of Directors of such company.*

## 4) EXCLUSION OF COMPANIES [RULE 3(2) OF THE COMPANIES (CSR) RULES, 2014]

Every company which ceases to be a company covered under subsection (1) of section 135 of the Act for **3 consecutive financial years shall not be required to** constitute a **CSR Committee**; till such time it meets the criteria specified in sub-section (1) of section 135.

## 5) CSR EXPENDITURE

a) The Board of every company shall ensure that the company spends, in every financial year, at least **2 % of the average net profits of the company made during the three immediately preceding financial years** [or where the company has not completed the period of three financial years since its incorporation, during such immediately preceding financial years. 135(5)

b) If the company **fails to spend such amount,** the Board shall**, in its report specify the reasons for not spending the amount** [and unless the unspent amount relates to any ongoing project referred to in sub- section (6) of Section 135 of Companies Act, 2013, **transfer such unspent amount to a Fund specified in Schedule VII, within a period of 6 months** of the expiry of the financial year-Inserted by The Companies (Amendment) Act,2019.

c) Any **amount remaining unspent** under sub-section (5) of Section 135 of Companies Act, 2013, pursuant to any ongoing project, fulfilling such conditions as may be prescribed, undertaken by a company in pursuance of its CSR Policy, **shall be transferred by the company within a period of 30 days from the end of the financial year to a special account to be called the Unspent Corporate Social Responsibility Account**, and such amount shall be spent by the company in pursuance of its obligation towards the Corporate Social Responsibility Policy **within a period of 3 financial years from the date of such transfer**, **failing which, the company shall transfer the same to a Fund specified in Schedule VII, within a period of 30 days** from the date of completion of the third financial year - Inserted by the Companies (Amendment) Act,2019.

d) If the company **spends an amount in excess of the requirements**, such **company may set off such excess amount** against the requirement to spend for such number of succeeding financial years.

e) Expenditure incurred on **specified activities that are carried out in India only will qualify** as CSR expenditure.

f) Expenditure incurred in undertaking normal course of business will not form a part of

the CSR expenditure.

**Note:** Provided by the CSR activities does not include the activities undertaken in pursuance of normal course of business of a company ***[Omitted by the Companies (Corporate Social Responsibility Policy) Amendment Rules, 2020, dated 24th August, 2020]**

g) Any surplus arising out of CSR activities will not be considered as business profit.

h) **Expenditure incurred by foreign holding company** for CSR activities in India will qualify as CSR **spend of the Indian subsidiary** if, the CSR expenditures are routed through Indian subsidiaries and if the Indian subsidiary is required to do so as per section 135 of the Act.

## 6) DUTIES OF CSR COMMITTEE [Section 135(3)]:

**The CSR Committee shall-**

(a) formulate and recommend to the Board, **a CSR Policy** which shall indicate the **activities to be undertaken** by the company in areas or subject, **specified in Schedule VII**;

(b) **recommend the amount of expenditure** to be incurred on the activities referred to in clause (a); and

(c) **monitor the CSR Policy** of the company from time to time.

## 7) IMPLEMENTATION OF CSR

The Board of a company may decide to undertake its CSR activities approved by the CSR Committee, **through**

(a) a company established under section 8 of the Act, or a registered public trust or a registered society, **exempted under sub-clauses (iv), (v), (vi) or (via) of clause (23C) of section 10** or registered under section 12A and approved under 80 G of the Income Tax Act, 1961 (43 of 1961), established by the company, either singly or along with any other company; or

(b) a company established under section 8 of the Act or a registered trust ora registered society, established by the Central Government or State Government; or

(c) any entity established under an Act of Parliament or a State legislature; or

(d) a company established under section 8 of the Act, or a registered public trust or a registered society, exempted under sub-clauses (iv), (v), (vi) or (via) of clause (23C) of section 10 or registered under section 12A and approved under 80 G of the Income Tax Act, 1961, and having an established track record of at least three years in undertaking similar activities.

**#Not in Syllabus: Meaning:** Sub-clauses (iv), (v), (vi) and (via) of clause (23C) of said section covers fund or trust or institution or university or other educational institutions or hospital or other institutions which may be approved by a prescribed authority.

**Note:**

1) A company may also **collaborate with other companies** for undertaking CSR activities in such manner that the CSR Committees of **respective companies are in a position to report separately** on such projects or programs in accordance with these rules.

***Registration:***

- *Every entity, covered under sub-rule (1), who intends to undertake any CSR activity, shall register itself with the Central Government* ***by filing the form CSR-1*** *electronically with the Registrar, with effect from the 01st day of April 2021:*
- ***Unique Registration Number:*** *On the submission of the Form CSR-1 on the portal, a* ***unique CSR Registration Number shall be generated*** *by the system automatically*

## 8) ACTIVITIES SPECIFIED UNDER SCHEDULE VII

(1) **eradicating hunger, poverty and malnutrition**, promoting health care including preventive health care and sanitation including contribution to the Swach Bharat Kosh set-up by the Central Government for the promotion of sanitation and making available safe drinking water;
(2) **promoting education**, including special education and employment enhancing vocation skills especially among children, women, elderly, and the differently abled and livelihood enhancement projects;
(3) **promoting gender equality**, empowering women, **setting up homes and hostels for women and orphans; setting up old age homes**, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups;
(4) **ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare**, agro forestry, conservation of natural resources and maintaining quality of soil, air and water **including contribution to the Clean Ganga Fund** set up by the Central Government for rejuvenation of river Ganga;
(5**) protection of national heritage, art and culture including restoration of building**s and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional arts and handicrafts;
(6) measures for the **benefit of armed forces veterans, war widows and their dependents Central Armed Police Forces (CAPF) and Central Para Military Forces (CPMF) veterans, and their dependents including widows;**
(7**) training to promote rural sport**s, nationally recognised sports, **paralympic sports** and Olympic sports;
(8**) contribution to the Prime Minister's National Relief Fund** or **Prime Minister's Citizen Assistance and Relief in Emergency Situations Fund (PM Cares Fund)** or any other -fund set up by the Central Government for socio-economic development and relief and welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women;
**(9)**

**(a) Contribution to incubators or research and development projects in the field of science, technology, engineering and medicine, funded by the Central Government or State Government or Public Sector Undertaking or any agency of the Central Government or State Government; and**

**(b) Contributions to public funded Universities; Indian Institute of Technology (IITs); National Laboratories and autonomous bodies established under Department of Atomic Energy (DAE); Department of Biotechnology (DBT); Department of Science and**

**Technology (DST); Department of Pharmaceuticals; Ministry of Ayurveda, Yoga and Naturopathy, Unani, Siddha and Homoeopathy (AYUSH); Ministry of Electronics and Information Technology and other bodies, namely Defence Research and Development Organisation (DRDO); Indian Council of Agricultural Research (ICAR); Indian Council of Medical Research (ICMR) and Council of Scientific and Industrial Research (CSIR), engaged in conducting research in science, technology, engineering and medicine aimed at promoting Sustainable Development Goals (SDGs)".**

(10) **rural development projects;**
(11) **slum area development**. [For the purposes of this item, the term 'slum area' shall mean any area declared as such by the Central Government or any State Government or any other competent authority under any law for the time being in force.]
(12) Disaster management, including relief, rehabilitation and reconstruction activities.

**Note:**

1. MCA has **issued clarification on spending of CSR funds for COVID-19**, dated 23.03.2020 and **confirmed that spending of CSR funds for COVID-19 is eligible CSR activity**.
   Funds may be spent for various activities related to COVID-19 under item no.s (i) and (xii) of Schedule VII relating to promotion of health care including preventive health care and sanitation and disaster management.

2. **Provided that any company engaged in research and development activity of new vaccine, drugs and medical devices in their normal course of business may undertake research and development activity of new vaccine, drugs and medical devices related to COVID-19 for financial years 2020-21, 2021-22 and 2022-23 subject to the conditions that-**
   (i) such research and development activities shall be carried out in collaboration with any of the institutes or organisations mentioned in item (ix) of Schedule VII to the Act.
   (ii) details of such activity shall be disclosed separately in the Annual Report on CSR included in the Board's Report. [Inserted by the Companies (Corporate Social Responsibility Policy) Amendment Rules, 2020, dated 24th August, 2020]}*

**Note:** Further as per general circular no. 21/2014 dated 18.06.2014, items in Schedule VII are broad based and may be interpreted liberally for this purpose.

3. **General Circular 13/2021 dated 30th July, 2021**

   The MCA vide General Circular 10/2020 dated 23.03.2020 clarified that spending of CSR funds for COVID- 19 is an eligible CSR activity. In continuation to the said circular, it is further clarified that spending of CSR funds of COVID- 19 **vaccination for persons other than the employees and their families, is an eligible CSR activity** under item no. (i) of Schedule VII of the Companies Act, 2013 relating to promotion of health care including preventive health care and item no. (xii) relating to disaster management

4. **`Har Ghar Tiranga',** a campaign under the aegis of Azadi Ka Amrit Mahotsav, is aimed to invoke the feeling of patriotism in the hearts of the people and to promote awareness about the Indian National Flag. In this regard, it is clarified that spending of CSR funds for the activities related to this campaign, such as mass scale production and supply of the

National Flag, outreach and amplification efforts and other related activities, are eligible CSR activities under item no. (ii) of Schedule VII of the Companies Act, 2013 pertaining to promotion of education relating to culture. The companies may undertake the aforesaid activities, subject to fulfilment of the Companies (CSR Policy) Rules, 2014 and related circulars/ clarifications issued by the Ministry thereof, from time to time.

**Brief Analysis:**

The Ministry of Corporate Affairs has issued clarification on spending of CSR funds for Har Ghar Trianga on 26th July, 2022. As per the clarification issued, spending of CSR funds for activities related to it like mass scale production and supply of the National Flag, outreach and amplification efforts and other related activities will be eligible as CSR activities of Schedule VII of the Companies Act, 2013 pertaining to promotion of education relating to culture.

## 9) ACTIVITIES NOT CONSIDERED AS CSR

(i) Activities undertaken in **pursuance of normal course of business** of the company.

*Provided that any **company engaged in research and development** activity **of new vaccine**, **drugs and medical devices in their normal course of business** may undertake research and development activity of new vaccine, drugs and medical devices related to COVID-19 for financial years 2020- 21, 2021-22, 2022-23 subject to the conditions that-*

*(a) such research and development activities shall be carried out in collaboration with any of the institutesor organisations mentioned in item (ix) of Schedule VII to the Act;*

*(b) details of such activity shall be disclosed separately in the Annual report on CSR included in the Board's Report;*

(ii) any activity undertaken by the company **outside India except for training of Indian sports personnel** representing any State or Union territory at national level or India at international level;

(iii) contribution of any **amount to any political party** under section 182

(iv) activities **benefitting employees of the company**

(v) activities supported by the companies on sponsorship basis for **deriving marketing benefits** for its products or services;

(vi) activities carried out for **fulfilment of any other statutory obligations** under any law in force in India;

**Note:**

1) **Salaries paid by the companies** to regular CSR staff as well as to volunteers of the companies (in proportion to company's time/hours spent specifically on CSR) can be factored into CSR project cost as part of the CSR expenditure.

## 10) NON-COMPLIANCE

- **IF A COMPANY IS IN DEFAULT** in complying with the provisions of sub-section (5) or (6), the **company shall be liable** to a penalty of
  - **twice the amount required to be transferred** by the company **to the Fund specified in Schedule VII or the Unspent Corporate Social Responsibility Account,** or
  - **1 crore rupees**, whichever is less,
- and **EVERY OFFICER** of the company who is in default shall be liable to a penalty of
  - **1/10$^{th}$ of the amount** required **to be transferred by the company to such Fund specified in Schedule VII**, or
  - the **Unspent Corporate Social Responsibility Account**, as the case may be, or
  - **2 lakh rupees**, whichever is less.

**Example: ADV Ltd. is engaged in the business of construction and has various projects which are under execution in Delhi-NCR region. The company is also looking for new projects, particularly in Southern part of India based on an understanding that the margins are very high over there.**
**During the year ended 31st March 2018, the company got covered within the requirements of CSR. Considering the nature of its business, company has a large employee base and it decided to spend CSR on some activity related to construction which would benefit its employees and would indirectly also help the business of the company. Please advise on this.**

Answer: As per the requirements of CSR, the projects or programs or activities that benefit only the employees of the company and their families shall not be considered as CSR activities in accordance with section 135 of the Act. Accordingly, in the given case, the activity planned by the company is related to its business only and that too only for the benefit of its employees would not be considered as part of CSR requirements.

## 11) CSR REPORTING - Impact Assessment

- Every company having average CSR obligation of **10 crore rupees or more** in pursuance of subsection (5) of section 135 of the Act, in the 3 immediately preceding financial years, shall **undertake impact assessment**, **through an independent agency**, of their CSR projects **having outlays of one crore rupees or more**, and which have been completed not less than one year before undertaking the impact study.
- The impact assessment reports shall be placed before the Board and shall be annexed to the annual report on CSR.
- A Company undertaking impact assessment may book the expenditure towards CSR for that financial year, which shall not exceed ~~5%~~ 2% of the total CSR expenditure for that financial year or 50 lakh rupees, whichever is less.

**#Amendment Dec 2022:**

"(1B) Every company covered under the provisions of sub-section (1) to section 135 shall furnish a report on Corporate Social Responsibility in Form CSR-2 to the Registrar for the preceding financial year (2020-2021) and onwards as an addendum to Form AOC-4 or AOC-4 XBRL or AOC-4 NBFC (Ind AS), as the case may be:

Provided that for the preceding financial year (2020-2021), Form CSR-2 shall be filed separately on or before 31st March 20221, after filing Form AOC-4 or AOC-4 XBRL or AOC-4 NBFC (Ind AS), as the case may be."

**RIGHT OF MEMBERS TO COPIES OF AUDITED FINANCIAL STATEMENT - Section 136**

1) **WHAT TO BE SENT?**

A copy of the **financial statements, including consolidated financial statements, if any, auditor's report** and every other document required by law to be annexed or attached to the financial statements,

2) **WHOM SHALL IT BE SENT TO?** It shall be sent to **every member**, to **every trustee for the debenture-holder** of any debentures, and **to all other persons** so entitled,

3) **TIMELINES: not less than 21 days before the date of the meeting,** provided that if the copies of the **documents are sent less than 21 days before** the date of the meeting, **they shall, be deemed to have been duly sent if it is so agreed by members—**

(a) holding, if the **COMPANY HAS A SHARE CAPITAL**, majority in number **entitled to vote and who represent not less than 95 %** of such part of the paid-up share capital

(b) having, if the **COMPANY HAS NO SHARE CAPITAL**, **not less than 95% of the total voting power** exercisable at the meeting:

4) **LISTED COMPANY**:

- That a listed company shall also place its financial statements including CFS, if any, and all other documents required to be attached thereto, **on its website**, which is maintained by or on behalf of the company:
- Provided also that every listed company having a subsidiary or subsidiaries shall place separate **audited accounts in respect of each of subsidiary on its website**, if any: Provided also that a **listed company which has a subsidiary incorporated outside India** (herein referred to as "foreign subsidiary")—
  (a) where such **foreign subsidiary is statutorily required to prepare CFS** under any law of the country of its incorporation, the requirement of this proviso shall be met **if CFS of such foreign subsidiary is placed on the website of the listed company**;
  (b) where such **foreign subsidiary is not required to get its financial statement audited** under any law of the country of its incorporation and **which does not get such financial statement audited**, the holding Indian listed company may place such unaudited financial statement on its website and where such financial statement is in a language other than English, **a translated copy of the financial statement in English** shall also be placed on

the website.]

**5) INSPECTION:**

A company shall allow **every member** or **trustee of the holder of any debentures** issued by the company to inspect the documents stated under sub-section (1) at its registered office during business hours.

7[Provided that every company having a subsidiary or subsidiaries shall provide a copy of separate audited or unaudited financial statements, as the case may be, as prepared in respect of each of its subsidiary to any member of the company who asks for it.]

**6) MANNER OF CIRCULATION OF FINANCIAL STATEMENTS IN CERTAIN CASES:**

In case of **all listed companies and such public companies** which have

- a net worth of more **than 1 crore rupees and**
- turnover of more **than 10 crore rupees**, the **financial statements may be sent** [Rule 11 of the Companies (Accounts) Rules, 2014]-

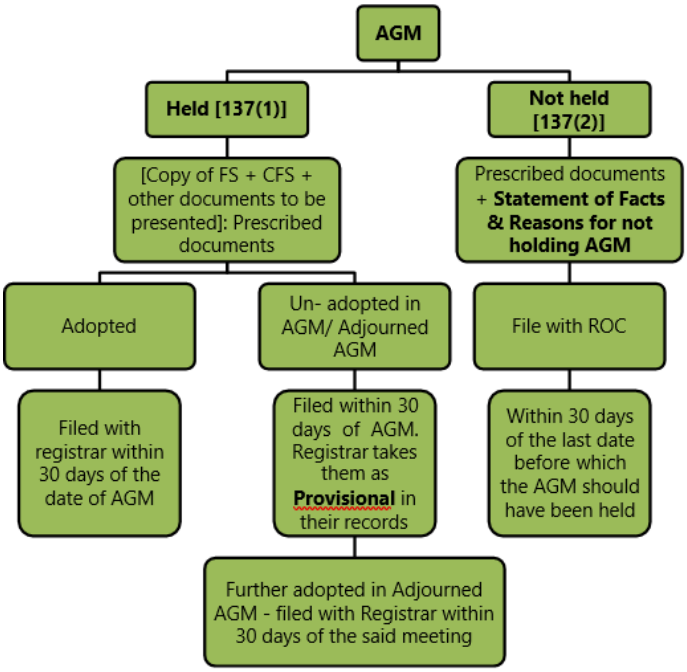
(1) **by electronic mode** to such members **whose shareholding is in dematerialized format**.
(2) where shareholding is held **otherwise than by dematerialized format**, to such members **who have positively consented in writing for receiving by electronic mode** (this may not be relevant considering that shareholding is not held otherwise than by dematerialized form anymore); and
(3) by **dispatch of physical copies** through any recognised mode of delivery, **in all other cases.**

**7) NON-COMPLIANCE**

If any default is made in complying with the provisions of this section, the company shall be liable to a penalty of 25 thousand rupees and every officer of the company who is in default shall be liable to a penalty of 5 thousand rupees.

| **COPY OF FINANCIAL STATEMENT TO BE FILED WITH REGISTRAR - Section 137** |
|---|

This section provides that copies of financial statement including CFS, if any, along with all the documents annexed to financial statement and adopted at AGM shall be filed with Registrar.




**Filing of financial statements [Section 137(1)]**

**1) FINANCIAL STATEMENTS DULY ADOPTED AT AGM**

a) Section 137 read with Rule 12 of the Companies (Account Rules), 2014 states that - A copy of the **financial statements with form AOC-4**, including **CFS with form AOC-4 CFS**, along with all the documents, **duly adopted at the AGM of the company,** shall be filed with the Registrar **within 30 days of the date of AGM.**

**b)** Every Non-Banking Financial Company that is required to comply with Indian Accounting Standards (Ind AS) shall file the financial statements with Registrar together with **FORM AOC-4 NBFC (Ind AS)** and the **CFS, with FORM AOC-4 CFS NBFC (Ind AS)**

The following class of companies shall file their financial statements with the Registrar in **e-form AOC- 4 XBRL** as per Annexure-I:

(i) **companies listed** with stock exchanges **in India** and **their Indian subsidiaries**;
(ii) companies having **paid up capital of 5 crore rupees** or above;
(iii) companies having **turnover of 100 crore rupees** or above;
(iv) all companies which are required to prepare their financial statements in accordance with Companies (Indian Accounting Standards) Rules, 2015.

**Provided further that NBFC, housing finance companies and companies engaged in the business of banking and insurance sector** are **exempted from filing of financial statements under these rules**.

**ONCE XBRL ALWAYS XBRL:** The companies which have filed their financial statements under sub-rule (1) and erstwhile rules shall continue to file their financial statements and other documents though they may not fall under the class of companies specified therein in succeeding years.

2) **If the FINANCIAL STATEMENTS ARE NOT ADOPTED**:

(a) Where the financial statements are not adopted at **AGM or adjourned AGM**, such **unadopted financial statements** along with the required documents **shall be filed with the Registrar within 30 days** of the date of AGM.

(b) The **Registrar shall take them in his records as provisional till the financial statements are filed with him after their adoption** in the adjourned AGM for that purpose.

(c) If the **financial statements are adopted in the adjourned AGM**, **then they shall be filed with the Registrar within 30 days** of the date of such adjourned AGM with such fees or such additional fees as may be prescribed.

**3) Annual General meeting not held [Section 137(2)]:**

Where the AGM of a company for any year has **not been held**, **the financial statements along with the documents required to be attached**, duly signed along with the statement of **facts and reasons for not holding the AGM shall be filed** with the Registrar **within 30 days** of the last date before which the AGM should have been held and in such manner, with such fees or additional fees as may be prescribed.

**4) Filing by One Person Company [Section 137(1)]:**

A OPC shall file a copy of the financial statements duly adopted by its member, along with all the documents which are required to be attached to such financial statements, **within 180 days from the closure of the financial year.**

**5) Company having subsidiaries [Section 137(1)]:**

A company shall, along with its financial statements to be filed with the Registrar, **attach the accounts of its subsidiary or subsidiaries** incorporated outside India. ("foreign subsidiary"),

Provided also that in the case of a "foreign subsidiary", which is **not required to get its financial statement audited** under any law of the country of its incorporation and which does not get such financial statement audited, the requirements of the fourth proviso shall be met if the **holding Indian company files such unaudited financial statement along with a declaration to this effect and where such financial statement is in a language other than English, along with a translated copy of the financial statement in English.**

**#Question**

**The AGM of R Ltd., for laying the Annual Accounts there at for the year ended 31 March 2018 was not held. What remedy is available with the company regarding compliance of the provisions of section 137 of the Companies Act, 2013 for filing of copies of financial statements with the Registrar of Companies?**

**Answer**: In the present case, though AGM was not held, it ought to be held by 30 September 2018 under sections 96 of the Companies Act, 2013.

Therefore, under the provisions of section 137(2), the financial statements along with the documents required to be attached under this Act, duly signed along with the statement

of facts and reasons for not holding the AGM shall be filed with the Registrar within thirty days of the last date before which the AGM should have been held i.e. by 30 October 2018 along with such fees or additional fees as may be prescribed.

**Example: Will it make any difference in case the Annual Accounts were duly laid before the AGM held on 27 September 2018 but the same were not adopted by the shareholders?**

**Answer**: Since the AGM has been held in time on 27 September 2018, the un-adopted financial statements along with the required documents under sub-section (1) of section 137 shall be filed with the Registrar within thirty days of the date of AGM and the Registrar shall take them in his records as provisional till the financial statements are filed with him after its adoption in the adjourned AGM for that purpose.

## INTERNAL AUDIT [SECTION 138]

Rule 13 of the Companies (Accounts) rules, 2014 states that:

**Classes of companies requiring Internal Audit:**

| 1. All Listed Company | 2. Unlisted Public Company with | | | | 3. Private Company with | |
|---|---|---|---|---|---|---|
| | Paid up share capital | Turnover | Outstanding loans or borrowings | Outstanding deposits | Turnover | Outstanding loans or borrowings |
| | 50 Cr or more or | 200 Cr or more or | 100 Cr or more or | 25 Cr or more | 200 Cr or more or | 100 Cr or more. |

**Who can be an Internal Auditor?**

(a) A Chartered Accountant or;

(b) A Cost Accountant or;

(c) Such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the Company.

## MANNER AND INTERVAL OF INTERNAL AUDIT [SUB-SECTION 2 READ WITH RULE 13(2) OF COMPANIES (ACCOUNTS) RULES, 2014]

Sub-section2 to section 138 empowers central government to draw rules, to prescribe the manner and the intervals in which the internal audit shall be conducted and reported to the Board. In this regard, Rule 13(2) of the Companies (Accounts) Rules, 2014 states the Audit Committee of the company or the Board shall, in consultation with the Internal Auditor, formulate the scope, functioning, periodicity and methodology for conducting the internal audit

**Questions and Answers**

1) **The registered office of the Bharat Ltd. is situated in a classified backward area of Maharashtra. The Board wants to keep its books of account at its corporate office in Mumbai which is conveniently located. The Board seeks your advice about the feasibility of maintaining the accounting records at a place other than the registered office of the company. Please advise.**

**Answer**

According to section 128(1) of the Companies Act, 2013, every company is required to prepare and keep the books of accounts and other relevant books and papers and financial statement for every financial year which give a true and fair view of the state of the affairs of the company, including that of its branch office or offices, if any, and explain the transactions effected both at the registered office and its branches and such books shall be kept on accrual basis and according to the double entry system of accounting.

The proviso to section 128(1) further provides that all or any of the books of account aforesaid and other relevant papers may be kept at such other place in India as the Board of Directors may decide and where such a decision is taken, the company shall, within seven days thereof, file with the Registrar a notice in writing giving the full address of that other place. Further company may keep such books of accounts or other relevant papers in electronic mode as per the Rule 3 of the Companies (Accounts) Rules, 2014.

Therefore, the Board of Bharat Ltd. can keep its books of account at its corporate office in Mumbai by following the abovementioned procedure.

2) **The Board of Directors of Vishwakarma Electronics Limited consists of Mr. Ghanshyam (Director), Mr. Hyder (Director) and Mr. Indersen (Managing Director). The company has also employed a full time Secretary.**

**The Profit and Loss Account and Balance Sheet of the company were signed by Mr. Ghanshyam and Mr. Hyder. Examine whether the authentication of financial statements of the company was in accordance with the provisions of the Companies Act, 2013?**

Answer

According to section 134(1) of the Companies Act, 2013, the financial statement, including consolidated financial statement, if any, shall be approved by the Board of Directors before they are signed on behalf of the Board by the chairperson of the company where he is authorised by the Board or by two directors out of which one shall be managing director, if any, and the Chief Executive Officer, the Chief Financial Officer and the company secretary of the company, wherever they are appointed, or in the case of One Person Company, only by one director, for submission to the auditor for his report thereon.

In the instant case, the Balance Sheet and Profit and Loss Account have been signed only by Mr. Ghanshyam and Mr. Hyder, the directors. In view of Section 134(1) of the

Companies Act, 2013, Mr. Indersen, the Managing Director should be one of the two signing directors. Since, the company has also employed a full- time Secretary, he should also sign the Balance Sheet and Profit and Loss Account.

3) A Housing Finance Ltd. is a housing finance company having a paid up share capital of ₹ 11 crores and a turnover of ₹ 145 crores during the financial year 2017-18. Explain with reference to the relevant provisions and rules, whether it is necessary for A Housing Finance Ltd. to file its financial statements in XBRL mode.

Answer

Filing of financial statements in XBRL Mode

As per Rule 1 of the Companies (Filing of Documents and forms in Extensible Business Reporting Language) Rules, 2015, following class of companies shall file their financial statements and other documents under section 137 of the Act with the Registrar in e-form AOC-4 XBRL as per Annexure-I:

(i) companies listed with stock exchanges in India and their Indian subsidiaries;
(ii) companies having paid up capital of five crore rupees or above;
(iii) companies having turnover of one hundred crore rupees or above;
(iv) all companies which are required to prepare their financial statements in accordance with Companies (Indian Accounting Standards) Rules, 2015.

Provided further that non-banking financial companies, housing finance companies and companies engaged in the business of banking and insurance sector are exempted from filing of financial statements under these rules.

Hence A housing Finance Ltd., being a housing finance company, is exempted from filing its financial statement in XBRL mode.

**4) Herry Limited is a company registered in Thailand. SKP Limited (Registered in India), a wholly owned subsidiary company of Herry Limited decided to follow different financial year for consolidation of its accounts outside India. State the procedure to be followed in this regard.**

Answer

Where a company or body corporate, which is a holding company or a subsidiary or associate company of a company incorporated outside India and is required to follow a different financial year for consolidation of its accounts outside India, the Central Government may, on an application made by that company or body corporate in such form and manner as may be prescribed, allow any period as its financial year, whether or not that period is a year. Any application pending before the Tribunal as on the date of commencement of the Companies (Amendment) Ordinance, 2018, shall be disposed of by the Tribunal in accordance with the provisions applicable to it before such commencement. Also, a company or body corporate, existing on the commencement of this Act, shall, within a period of two years from such commencement, align its financial year as per the provisions of this clause. SKP Limited is advised to follow the above procedure accordingly.

**5)**

**(i) Ravi Limited maintained its books of accounts under Single Entry System of Accounting.**

**Is it permitted under the provisions of the Companies Act, 2013?**

**(ii) State the persons responsible for complying with the provisions regarding maintenance of Books of Accounts of a Company.**

**(iii) Whether a Company can keep books of Accounts in electronic mode accessible only outside India?**

Answer

(i) According to Section 128(1) of the Companies Act, 2013, every company shall prepare "books of account" and other relevant books and papers and financial statement for every financial year. These books of account should give a true and fair view of the state of the affairs of the company, including that of its branch office(s). These books of account must be kept on accrual basis and according to the double entry system of accounting. Hence, maintenance of books of account under Singly Entry System of Accounting by Ravi Limited is not permitted.

(ii) Persons responsible to maintain books: As per Section 128 (6) of the Companies Act, 2013, the person responsible to take all reasonable steps to secure compliance by the company with the requirement of maintenance of books of account etc. shall be:

(a) Managing Director,

(b) Whole-Time Director, in charge of finance

(c) Chief Financial Officer

(d) Any other person of a company charged by the Board with duty of complying with provisions of section 128.

(iii) A Company has the option of keeping such books of account or other relevant papers in electronic mode as per Rule 3 of the Companies (Accounts) Rules, 2014. According to such Rule,

(a) such books of accounts or other relevant books or papers maintained in electronic mode shall remain accessible in India so as to be usable for subsequent reference.

(b) There shall be a proper system for storage, retrieval, display or printout of the electronic records as the Audit Committee, if any, or the Board may deem appropriate and such records shall not be disposed of or rendered unusable, unless permitted by law.

(c) The back-up of the books of account and other books and papers of the company maintained in electronic mode, including at a place outside India, if any, shall be kept in servers physically located in India on a periodic basis.

Hence, a company cannot keep books of Account in electronic mode accessible only outside India.

**6) The Government of India is holding 51% of the paid-up equity share capital of Sun Ltd. The Audited financial statements of Sun Ltd. for the financial year 2017-18 were placed at its annual general meeting held on 31st August, 2018. However, pending the comments of the Comptroller and Auditor General of India (CAG) on the said accounts the meeting was adjourned without adoption of the accounts. On receipt of CAG comments on the accounts, the adjourned annual general meeting was held on 15th October, 2018 whereat the accounts were adopted. Thereafter, Sun Ltd. filed its financial statements relevant to the financial year 2017-18 with the Registrar of Companies on 12th November, 2018. Examine, with reference to the applicable provisions of the Companies Act, 2013, whether Sun Ltd. has complied with the statutory requirement**

**regarding filing of accounts with the Registrar?**

**Answer**

According to first proviso to section 137(1) of the Companies Act, 2013, where the financial statements are not adopted at annual general meeting or adjourned annual general meeting, such unadopted financial statements along with the required documents shall be filed with the Registrar within thirty days of the date of annual general meeting and the Registrar shall take them in his records as provisional till the financial statements are filed with him after their adoption in the adjourned annual general meeting for that purpose.

According to second proviso to section 137(1) of the Companies Act, 2013, financial statements adopted in the adjourned AGM shall be filed with the Registrar within thirty days of the date of such adjourned AGM with such fees or such additional fees as may be prescribed. In the instant case, the accounts of Sun Ltd. were adopted at the adjourned AGM held on 15th October, 2018 and filing of financial statements with Registrar was done on 12th November, 2018 i.e. within 30 days of the date of adjourned AGM But Sun Ltd. has not filed its unadopted financial statements within 30 days of the date of the annual general meeting held on 31st August 2018.

Hence, Sun Ltd. has not complied with the statutory requirement regarding filing of unadopted accounts with the Registrar, but has certainly complied with the provisions by filing of adopted accounts within the due date with the Registrar.

**7) The Income Tax Authorities in the current financial year 2019-20 observed, during the assessment proceedings, a need to re-open the accounts of Chetan Ltd. for the financial year 2008-09 and, therefore, filed an application before the National Company Law Tribunal (NCLT) to issue the order to Chetan Ltd. for re-opening of its accounts and recasting the financial statements for the financial year 2008-09. Examine the validity of the application filed by the Income Tax Authorities to NCLT.**

**Answer**

As per section 130 of the Companies Act, 2013, a company shall not re-open its books of account and not recast its financial statements, unless an application in this regard is made by the Central Government, the Income-tax authorities, the Securities and Exchange Board, any other statutory body or authority or any person concerned and an order is made by a court of competent jurisdiction or the Tribunal to the effect that—

(i) the relevant earlier accounts were prepared in a fraudulent manner; or

(ii) the affairs of the company were mismanaged during the relevant period, casting a doubt on the reliability of financial statements:

However, no order shall be made in respect of re-opening of books of account relating to a period earlier than eight financial years immediately preceding the current financial year.

In the given instance, an application was filed for re-opening and re-casting of the financial statements of Chetan Ltd. for the financial year 2008-2009 which is beyond 8 financial years immediately preceding the current financial year.

Though application filed by the Income Tax Authorities to NCLT is valid, its recommendation for reopening and recasting of financial statements for the period earlier than eight financial years immediately preceding the current financial year

i.e. 2019-2020, is invalid.

# Chapter 10

# Audit and Auditors

## INTRODUCTION

- Large business corporations are managed by the directors who represent the members who are the real owners of the company.
- In the absence of any check the directors may mismanage the finances of the organisation. Thus, members appoint auditor to look into the true and fair view of the financial affairs of the company.

**#Definition – Section 2(45) - Government company**

It means any company in which **not less than 51 % of the paid-up share capital** is held by the CG, or by any SG or SG's, or partly by the CG and partly by one or more SG's, and **includes a company which is a subsidiary company of such a Government company**;

## APPOINTMENT OF AUDITORS - Section 139

### 1) Appointment of auditor [Section 139(1)]:

(a) Every company **shall** appoint an individual or **a firm as an auditor of the company at the 1st annual general meeting (AGM).**

**Example:** Rashail Techlabs Private Limited incorporated during the financial year 2019-20. 1st AGM of the company held on 30.09.2020. The company appointed M/s. Rams & Associates, Chartered Accountant firm for the period of 5 Years as a subsequent statutory auditor.

(b) The auditor shall hold office from the conclusion of **1st AGM till the conclusion of its 6th AGM** and thereafter till the conclusion of every sixth AGM. The manner and procedure of selection of auditors by the members of the company at AGM has been prescribed under the Companies (Audit and Auditors) Rules, 2014.

(c) Manner and procedure of selection and appointment of auditors:

(i) It competent authority shall take into consideration the **qualifications and experience** of the individual or the firm proposed to be considered for appointment as auditor.

(ii) It shall have regard to any order or pending proceeding relating to professional matters of conduct against the proposed auditor before the Institute of Chartered Accountants of India (ICAI) or any competent authority or any Court.

(iii) It may call for such other information from the proposed auditor as it may deem fit.

**IF COMPNAY HAS AN AUDIT COMMITTEE:**

- The **committee shall recommend** the name of an individual or a firm as auditor to the Board for consideration.

- If the **BOARD AGREES** with the recommendation of the Audit Committee, **it shall further recommend him** to the members in the AGM.
- If the **BOARD DISAGREES** with the recommendation of the Audit Committee, **it shall refer back the recommendation to the committee** for **reconsideration** citing reasons for such disagreement.
- If the Audit Committee, **decides not to reconsider** its original recommendation, **the Board shall record reasons for its disagreement** with the committee and **send its own recommendation for consideration of the members** in the AGM; and if the Board agrees with the recommendations of the Audit Committee, it shall place the matter for consideration by members in the AGM.

**IF COMPANY HAS NO AUDIT COMMITTEE**

- the Board shall consider and recommend an individual or a firm as auditor to the members in the AGM for appointment.

2) **Conditions for appointment and notice to the Registrar:** Along with the written consent. The auditor appointed shall submit a certificate that–

(A) the individual or the firm is **eligible for appointment and is not disqualified** for appointment under the Chartered Accountants Act, 1949

(B) the proposed appointment **is as per the term provided** under the Act;

(C) the proposed appointment **is within the limits** laid down by or under the authority of the Act;

(D) the **list of proceedings against the auditor or audit firm** or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct.

(E) The certificate shall also indicate whether the auditor satisfies the criteria provided in section 141 [Section 141 provides provisions on eligibility, qualification and disqualification of Auditor which will be discussed later] of the Companies Act, 2013

(F) **Communication to Auditor and Intimate to ROC**: Further the company shall inform the concerned auditor of his or its appointment, and also file a notice (in the **Form ADT-1) of such appointment with the Registrar within 15 days** of the meeting in which the auditor is appointed.

(G) Every existing body corporate other than a company governed by NFRA rules, shall inform the National Financial Reporting Authority (NFRA) within 15 days of appointment of an auditor under sub-section (1) of section 139, inform the NFRA **in Form NFRA- 1**, the particulars of the auditor

Here, "appointment" includes re-appointment.

3) **TERM OF AUDITOR [SECTION 139(2)]:**

I. **APPLICABILITY**

(a) The listed companies and

(b) all **unlisted public companies** having paid up share capital of rupees 10 crores or more;

(c) all **private limited companies** having paid up share capital of rupees 50 crore or more;

(d) **all companies**, but having public borrowings from financial institutions, banks or public deposits of rupees 50 crores or more.

**The above mentioned companies shall not appoint or re-appoint—**

(1) an individual as auditor for more than **ONE TERM** of **5 consecutive years**; and
(2) an audit firm as auditor for more than **TWO TERMS** of **5 consecutive years**.

## II. COOLING PERIOD/ ROATATION OF AUDITORS

**(1)** An individual auditor who has completed his term (i.e. one term of five consecutive years) shall **not be eligible for re-appointment** as auditor in the same company **for 5 years from the completion of his term;**

**(2)** An audit firm which has completed its term (i.e. two terms of five consecutive years) shall **not be eligible for re- appointment** as auditor in the same company **for 5 years from the completion of such term.**

**Example**: XYZ Ltd. which is a listed company appoints individual **Mr. Raghav** as an auditor in its AGM dated 29th September, 2016. Mr. Raghav will hold office of Auditor from the conclusion of this meeting upto conclusion of sixth AGM i.e. AGM to be held in the year 2021. Now as per sub-section (2), Mr. Raghav shall not be re-appointed as Auditor in XYZ Ltd. for further term of five years i.e. he cannot be appointed as Auditor in XYZ Ltd. upto year 2026.

**Example**: XYZ Ltd. which is a listed company **appoints M/s Raghav & Associates** as an audit firm in its AGM dated 29th September, 2016. M/s Raghav & Associates will hold office from the conclusion of this meeting upto conclusion of sixth AGM to be held in the year 2021. Now as per sub-section (2), M/s Raghav & Associates can be appointed or re- appointed as auditor for one more term of five years i.e. upto year 2026. It shall not be re-appointed as Audit firm in XYZ Ltd. for further term of five years after year 2026 to year 2031.

## III. COMMON PARTNER:

As on the date of appointment, **no audit firm** having a common partner or partners to the other audit firm, **whose tenure has expired** in a company immediately preceding the financial year, **shall be appointed as auditor** of the same company for a period of 5 years.

## IV. Manner of rotation in case of joint auditors [Rule 6(4)]

Where a company has appointed two or more individuals or firms or a combination thereof as joint auditors, the **company may follow the rotation of auditors** in such a manner that **both or all of the joint auditors**, as the case may be, **do not complete their term in the same year**

**Example:** M/s Krishna & Associates is an audit firm having 2 partners namely Mr. Krishna and Mr. Shyam. Mr. Shyam is also a partner of another audit firm named M/s Kukreja & Associates. M/s Krishna & Associates was appointed as the auditors in the company Golden Smith Ltd. for two consecutive periods of 5 years i.e. from year 2016 to year 2026. Now, if Golden Smith Ltd. wants to appoint M/s Kukreja & Associates as its audit firm, it cannot do so because Mr. Shyam is the common partner between both the Audit firms. This prohibition is only for 5 years i.e. upto year 2031. After 5 years, Golden Smith Ltd. may appoint M/s Kukreja & Associates or M/s. Krishna & Associates as its auditors.

(4) **TRANSITIONAL PERIOD**: Every company, existing on or before the commencement of this Act which is required to comply with the provisions as mentioned in above mentioned points, shall comply with those provisions **within a period 3 years from the date of commencement of this Act**."

**Note:** It is also provided that nothing contained in above mentioned points shall prejudice the right of the company to remove an auditor or the right of the auditor to resign.

| Number of consecutive years for which an individual auditor has been functioning as auditor in the same company [in the first AGM held after the commencement of provisions of section 139(2)] | Maximum number of consecutive years for which he may be appointed in the same company (including transitional period) | Aggregate period which the auditor would complete in the same company in view of column I and II |
|---|---|---|
| I | II | III |
| 5 years (or more than 5 years) | 3 years | 8 years or more |
| 4 years | 3 years | 7 years |
| 3 years | 3 years | 6 years |
| 2 years | 3 years | 5 years |
| 1 year | 4 years | 5 years |

## V. FIRST AUDITORS - Section 139(6):

(a) Notwithstanding anything contained in sub-section (1) of Section 139 i.e. point 2(i) mentioned above, the first auditor of a company, other than a Government Company, shall be appointed by the Board of directors within 30 days of the date of registration of the company and the auditor so appointed shall hold office until the conclusion of the first AGM.

(b) If the Board fails to exercise its powers i.e. appointment of first auditor, it shall inform the members of the company and the company may appoint the first auditor within 90 days at an extra ordinary general meeting (EGM) and such auditor shall hold office till the conclusion of the first AGM.

**Example: Unicorn Steel Private Limited is incorporated as on 02.06.2020, board of directors of the company held board meeting as on 15.06.2020 to appoint Jain Ajmera & Associates as a first auditor of the company for a term of 5 years. As per section 139(6) of the companies act, 2013, the board shall appoint first director within 30 days from the date of registration of the company. State the validity of the aforesaid situation.**

(a) Invalid
(b) Valid
(c) Valid after approval of shareholder in General Meeting
(d) Valid only after approval of Central Government

**Answer:**

(a) The given situation is Invalid i.e., option (a)

**Example: Managing Director of PQR Ltd. himself wants to appoint Shri Ganpati, a practicing Chartered Accountant, as first auditor of the company. Comment on the proposed action of the Managing Director.**

**Answer:** Provisions and Explanation: Section 139(6) of the Companies Act, 2013 provides that "the first auditor or auditors of a company shall be appointed by the Board of directors within 30 days from the date of registration of the company". In the instant case, the appointment of Shri Ganapati, a practicing Chartered Accountant as first auditors by the Managing Director of PQR Ltd by himself is in violation of Section 139(6) of the Companies Act, 2013, which requires the Board of Directors to appoint the first auditor of the company.

**Conclusion:** In view of the above, the Managing Director of PQR Ltd. cannot appoint the first auditor of the company himself.

## VI. FILLING UP CASUAL VACANCY - Section 139(8)]:

(a) The Board may fill any casual vacancy in the office of an auditor within 30 days but where such vacancy is caused by the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within 3 months of the recommendation of the Board.

(b) Any auditor appointed in a casual vacancy shall hold office until the conclusion of the next AGM.

**Example**: Prakash Carriers Limited appointed Mr. Raman as its auditor in the Annual General Meeting held on 30th September, 2019. Initially, he accepted the appointment. But he resigned from his office on 31st October, 2019 for personal reasons. The Board of directors seeks advice for filling up the vacancy by appointment of Mr. Albert as auditor.

In the present case, as the auditor has resigned, the casual vacancy so created can be filled up by the Board appointing Mr. Albert. However, the appointment of Mr. Albert must be approved by the company by passing of an ordinary resolution at a general meeting of the company which must be convened by the Board within 3 months of the recommendation of the Board. Mr. Albert will be entitled to hold office till the conclusion of the next Annual General Meeting.

## VII. APPOINTMENT OF AUDITORS IN CASE OF GOVERNMENT COMPANY [Section 139(5), (7) & (8)]

(1) **CAG:** In the **case of a Government company**, the 1st auditor shall be **appointed by the CAG within 60 days** from the date of registration of the company.

(2) **BOD:** In case the **CAG does not appoint 1st auditor** within the said period, **THE BOARD OF DIRECTORS** of the company shall appoint such **auditor within the next 30 days.**

(3) **MEMBERS:** Further, in the case of failure of the Board to appoint such auditor within the next 30 days, it shall inform the members of the company who shall appoint such auditor within the 60 days at an EGM, who shall hold office till the conclusion of the first annual general meeting.

(4) **CASUAL VACANCY:** Company whose accounts are subject to audit by an auditor appointed by the CAG, casual vacancy of an auditor shall be filled by the **CAG within 30 days**.

If CAG fails, the **Board of Directors shall fill the vacancy** within next 30 days.

## VIII. RE-APPOINTMENT OF RETIRING AUDITOR - Section 139(9), (10) And (11)

**(a) A retiring auditor may be re-appointed at an AGM if—**

(1) he is **not disqualified** for re-appointment;
(2) he has **not given a notice of unwillingness in writing to the company**; and
(3) a **Special resolution** has not been passed at that meeting appointing some other auditor or providing expressly that he shall not be re-appointed.

(b) Where at any AGM, **no auditor is appointed or re-appointed**, the existing auditor shall continue to be the auditor of the company.

**Note** Even in case of continuation of auditor due to deeming provision of sub-section 10, the conditions specified under sub-section 9 shall be checked.

**AUDIT COMMITTEE'S RECOMMENDATION [SUB-SECTION 11]**

Sub-section 11 prescribes the confirming provision, that where a company is required to constitute an Audit Committee under section 177, all appointments, including the filling of a casual vacancy of an auditor under this section shall be made after taking into account the recommendations of such committee

**As per NFRA Rules, following provisions are relevant for the understanding of the students:**

**Monitoring and enforcing compliance with auditing standards -**

(1) For the **purpose of monitoring and enforcing compliance** with auditing standards (SA) under the Act by a company or a body corporate governed under rule 3, the NFRA may:

(i) **review working papers** and communications related to the audit;

(ii) **evaluate the sufficiency of the quality control system** of the auditor and the manner of documentation of the system by the auditor; and

(iii) perform such other **testing of the audit, supervisory, and quality control procedures of the auditor** as may be considered necessary or appropriate.

(2) The **NFRA may require an auditor to report on its governance practices** and internal processes designed to promote audit quality, protect its reputation and reduce risks including risk **of failure of the auditor and may take such action on the report as may be necessary.**

(3) The **NFRA may seek additional information** or **may require the personal presence** in connection with the conduct of an audit.

(4) The **NFRA shall publish its findings relating to non-compliances on its website** and in such other manner as it considers fit,

The NFRA **shall not publish proprietary or confidential information**, unless it has reasons to do so in the public interest and it records the reasons in writing.

(7) The NFRA may send a **separate report containing proprietary or confidential information** to the **Central Government** for its information.

(8) Where the **NFRA finds or has reason to believe that any** law or professional or other standard has or **may have been violated by an auditor**, it may decide on the further course of investigation or enforcement action through its concerned Division.

## REMOVAL, RESIGNATION OF AUDITOR AND GIVING OF SPECIAL NOTICE - Section 140

Section 140 of the Companies Act, 2013 provides for removal, resignation of auditor and giving of **SPECIAL NOTICE (Section 115)**. According to this section:

### I. REMOVAL OF AUDITOR BEFORE THE EXPIRY OF HIS TERM [Section 140(1)]:

(a) The auditor appointed under section 139 may be removed from his office before the expiry of his term **only by**

- the **approval of the Central Government** by making an application in **Form ADT-2 within 30 days** of the resolution passed by the Board.
- Hold the **general meeting within 60 days** of receipt of approval of the Central Government **for passing the special resolution**.

(b) **Giving opportunity of being heard** (Audi Alteram Partem) shall be given to the auditor before taking in decision.

**Example:** Mr. Suresh, a CA, was appointed by the Board of Directors of AB Limited as the First Auditor. The company in General Meeting removed Mr. Suresh without seeking the approval of the Central Government and appointed Mr. Gupta as an auditor in his place. The first auditor appointed by the Board of Directors can be removed in accordance with the provision of Section 140(1) of the Companies Act, 2013. Hence, the removal of the first auditor in this case is invalid. The company contravened the provision of the Act.

### II. RESIGNATION BY AUDITOR - Section 140(2) & (3)]

(a) If the Auditor has resigned from the company, he shall file a statement in the **form ADT-3 with the company** and the Registrar **within 30 days from the date of resignation.**

(b) The auditor shall indicate the **reasons and other facts** for his resignation, in the statement.

**Statement to CAG in case of Government Company [Sub-section 2]**

The auditor shall file such statement with the Comptroller and Auditor-General of India (CAG) along with the company and the Registrar indicating the reasons and other facts as may be relevant with regard to his resignation, in case if he is auditor of:

i. A Government company or

ii. Any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments.

### III. PENALTY FOR CONTRAVENTION:

If the auditor does not comply with the provisions of sub-section (2), he or it shall be liable to a penalty of 50 thousand rupees or an amount equal to the remuneration of the auditor, whichever is less, and in case of continuing failure, with further penalty of 500 rupees for each day after the first during which such failure continues, subject to a maximum of 2 lakh rupees.

### IV. APPOINTING AUDITOR OTHER THAN THE RETIRING AUDITOR [SECTION 140(4)]

(a) If the retiring auditor has not completed a consecutive tenure of 5 years or 10 years, as the case may be, a **special notice shall be required for a resolution at an AGM appointing as auditor a person other than a retiring auditor**, or providing expressly that a retiring auditor shall not be re- appointed.

(b) On receipt of special notice, the company shall **send a copy to the retiring auditor**.

(c) Where notice is given and the retiring auditor makes a representation in writing to the company and **requests its notification to be sent to the members** the company shall Send a copy of the representation to every member of the company to whom notice of the meeting is sent, whether before or after the receipt of the representation by the company.

(d) If a copy of the **representation is not sent** as aforesaid because it was received too late or because of the company's default, the **auditor may require that the representation shall be read out at the meetin**g.

(e) If the **Tribunal is satisfied on an application** either of the company or of any other aggrieved person that the rights conferred by this sub-section are being abused by the auditor, then the copy of the representation may not be sent and the representation need not be read out at the meeting.

### V. AUDITOR ACTS IN A FRAUDULENT MANNER OR ABETTED OR COLLUDED IN ANY FRAUD [SECTION 140(5)]

(a) The Tribunal either—

- suo motu; or

- on an application made to it by the Central Government; or
- by any person concerned,

if it is satisfied that the auditor of a company has, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers, i**t may, by order, direct the company to change its auditors**.

(b) **Requirement for change of auditor:** If the application is made by the Central Government and the Tribunal is satisfied that any change of the auditor is required, it shall **within 15 days of receipt of such application**, **make an order that he shall not function as an auditor** and the Central Government **may appoint another auditor in his place**.

(c) **Ineligibility of auditor to be appointed:** An auditor, against whom **final order has been passed by the Tribunal under this section shall not be eligible to be appointed as an auditor** of **any company for a period of 5 years from the date of passing of the order** and the auditor shall also be liable for action under section 447

**NOTE:** It is hereby clarified that the **case of a firm, the liability shall be of the firm and that of every partner** or partners who acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its director or officers.

**Example: FLP Ltd, engaged in the business of real estate and energy, defaulted on its borrowings which amounted to thousands of crores. During the year ended 31st March 2019, a fraud was uncovered in respect of various transactions of the company and it was observed by the Central Government that the auditors of the company were involved in such fraud. Please suggest what can be the course of action in this case.**

**Answer:** The Central Government may apply to the Tribunal in respect of such matter highlighting that the auditors miserably failed to fulfill their duties as auditors of the company. If the Tribunal is satisfied that the auditors were involved in the fraud with the company, the Tribunal may direct the company to change its auditors and those auditors shall not be eligible to be appointed as auditor of any company for 5 years and also liable for action under section 447 of the Companies Act 2013.

## ELIGIBILITY, QUALIFICATIONS AND DISQUALIFICATIONS OF AUDITORS - Section 141

Section 141 of the Companies Act, 2013 provides for eligibility, qualifications and disqualifications of auditors. This section deals with:

### i. Qualifications of an auditor [Section 141(1) & (2)]:

(a) He **should be Chartered Accountant** as per Chartered Accountants Act, 1949.

(b) A **firm whereof majority of partners practicing in India are qualified** as CA **may be appointed by its firm name** to be auditor of a company.

**Note:** Where a **firm including a LLP** is appointed as an auditor of a company, only the partners who are CA's shall be **authorized to act and sign on behalf of the firm.**

### ii. Disqualifications – Section 141 (3)

**The following persons shall not be eligible for appointment as an auditor of a company, namely:—**

(a) a **body corporate** other than a limited liability partnership
(b) an **officer or employee of the company**;
(c) a **person who is a partner, or who is in the employment**, of an officer or employee of the company;
(d) a person **who, or his relative or partner**—
(i) is **holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company**:
Provided that the **relative may hold security or interest in the company of face value not exceeding 1,00,000 rupees**
(ii) is **indebted to the company, or its subsidiary, or its holding or associate company** or a subsidiary of such holding company, in excess of **rupees 5 Lakh**; or
(iii) has **given a guarantee or provided any security in connection with the indebtedness of any third person to the company**, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in **excess of ₹ 1 Lac.**
(e) a **person or a firm** who, whether directly or indirectly, **has business relationship** with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company.
"business relationship" shall be construed as any transaction entered into for a commercial purpose, except–
(A) commercial transactions **in the nature of professional services** permitted to be rendered by an auditor or audit firm under the Act and the Chartered Accountants Act
(B) commercial transactions which are in the **ordinary course of business of the company at arm's length price** like sale of products or services to the auditor as customer by the companies engaged in the business of telecommunications, airlines, hospitals, hotels and such other similar businesses.
(f) a **person whose relative is a director or is in the employment of the company as a director or KMP;**
(g) if such **persons or partner** is at the date of such appointment or reappointment **holding appointment as auditor of more than 20 companies.**
**Note:**
1) Limit **does not include** Dormant company, OPC, small companies and private companies having paid-up share capital less than 100 crores rupees.
2) As per section 141 (3)(g), this limit of 20 company audits is per person. In the case of an audit firm having 3 partners, the overall ceiling will be 3 × 20 = 60 companies audit.
(h) a person **who has been convicted by a court of an offence involving fraud and a period of 10 years has not elapsed** from the date of such conviction;
(i) a p**erson who, directly or indirectly, renders any service referred to in section 144** to the company or its holding company or its subsidiary company.

Where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in sub-section (3) after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor.

**Illustrations:**

**1) Mr. Anil, a Chartered accountant, is a partner of a firm and has been appointed as an auditor of Laxman Ltd. in the Annual General Meeting of the company held in September 2018 in which he accepted the assignment. Subsequently, in January 2019, he offered Bharat, another Chartered Accountant, who is the Manager Finance of Laxman Ltd., to join the firm of Anil as a partner.**

**Answer:** Provisions and Explanation: Section 141(3)(c) of the Companies Act, 2013 prescribes that any person who is a partner or in employment of an officer or employee of the company will be disqualified to act as an auditor of a company. Sub-section (4) of Section 141 provides that an auditor who becomes subject, after his appointment, to any of the disqualifications specified in sub-sections (3) of Section 141, shall be deemed to have vacated his office as an auditor.

**Conclusion:** In the present case, Anil is auditor of M/s Laxman Ltd. and any employee of Laxman Ltd. cannot become the Partner of the firm where Anil is a Partner. In case that happens, he/the firm shall be deemed to have vacated office of the auditor of M/s Laxman Ltd.

**2) "Mr. Ashish", a practicing CA, is holding securities of "XYZ Ltd." having face value of ₹ 900/-. Whether Mr. Ashish is qualified for appointment as an Auditor of "XYZ Ltd."?**

**Answer:** As per section 141 (3)(d) (i) an auditor is disqualified to be appointed as an auditor if he, or his relative or partner holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company:

In the present case, Mr. Ashish is holding security of ₹ 900 in the XYZ Ltd, therefore he is not eligible for appointment as an Auditor of "XYZ Ltd".

**3) "Mr. P" is a practicing Chartered Accountant and "Mr. Q", the relative of "Mr. P", is holding securities of "ABC Ltd." Having face value of ₹ 90,000/-. Whether "Mr. P" is qualified for being appointed as an auditor of "ABC Ltd."?**

**Answer**: An auditor is disqualified to be appointed as an auditor if he, or his relative or partner holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company. Further as per proviso to this Section, the relative of the auditor may hold the securities or interest in the company of face value not exceeding of ₹1,00,000.

In the present case, Mr. Q. (relative of Mr. P, an auditor), is having securities of ₹90,000 face value in ABC Ltd., which is as per requirement of proviso to section 141 (3)(d)(i). Therefore, Mr. P will not be disqualified to be appointed as an auditor of ABC Ltd.

**4) "ABC & Co." is an audit firm having partners "Mr. A", "Mr. B" and "Mr. C", Chartered Accountants. "Mr. A", "Mr. B" and "Mr. C" are holding appointment as auditors in 4, 6 and 10 companies respectively.**

**(i) Provide the maximum number of audits remaining in the name of "ABC & Co."**

**(ii) Provide the maximum number of audits remaining in the name of individual partner i.e. Mr. A, Mr. B and Mr. C.**

**Fact of the Case:** In the instant case, Mr. A is holding appointment in 4 companies, Mr. B is having appointment in 6 companies and Mr. C is having appointment in 10 companies. In aggregate all three partners are having 20 audits.

As per section 141 (3)(g), this limit of 20 company audits is per person. In the case of an audit firm having 3 partners, the overall ceiling will be 3 × 20 = 60 companies audit. Sometimes, a

CA may be a partner in a number of auditing firms. In such a case, all the firms in which he is partner or proprietor will be together entitled to 20 company audits only on his account.

**Conclusion:**

(i) Therefore, ABC & Co. can hold appointment as an auditor of 40 more companies:
Total Number of audits for which the firm would be eligible = 20*3 = 60
Number of audits already taken by all the partners
In their individual capacity = 4+6+10 = 20
Remaining number of audits available to the firm= 40

(ii) With reference to above provisions, an auditor can hold more appointment as auditor = ceiling limit as per section 141(3)(g)- already holding appointments as an auditor.

Hence

(1) Mr. A can hold: 20 – 4 = 16 more audits.
(2) Mr. B can hold 20 - 6 = 14 more audits and
(3) Mr. C can hold 20-10 = 10 more audits.

## REMUNERATION OF AUDITORS [SECTION 142]

Section 142 of the Companies Act, 2013 provides for remuneration of auditors. According to this section:

(i) The remuneration of the auditors of a company **shall be fixed in general meeting.**

(ii) In the **case of 1st auditor**, remuneration may be fixed by the Board.

(iii) The remuneration mentioned aforesaid shall, in addition include the expenses, if any, incurred by the auditor in connection with the audit of the company and any facility extended to him. But the **remuneration does not include** any remuneration paid to him for any other service rendered by him at the request of the company.

## POWERS AND DUTIES OF AUDITORS AND AUDITING STANDARDS - Section 143

**(1) Power of Auditor**

a) Every auditor of a company **shall have a right of access at all times to the books of account and vouchers** of the company, whether kept at the registered office of the company or at any other place and shall be entitled to require from the officers of the company such information and explanation.

b) **auditor of a holding company** shall also have the right of access to the records of all its subsidiaries and associate companies in so far as it relates to the consolidation of its financial statements

**(2) Duties of Auditor**

(a) whether **loans and advances made by the company on the basis of security have been properly secured**
(b) whether **transactions of the company which are represented merely by book entries** are prejudicial to the interests of the company;

(c) whether **loans and advances** made by the company **have been shown as deposits**;
(d) whether **personal expenses have been charged to revenue account**;
(e) where it is stated in the books and documents of the company that any shares have been allotted for cash, **whether cash has actually been received in respect of such allotment,** and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading:

**(3)** The **auditor shall make a report to the members of the company** on the accounts examined by him and on every financial statement and to the best of his information and knowledge, the said accounts, financial statements give a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year.

**(4) The auditor's report shall also state—**

(a) whether **he has sought and obtained all the information and explanations** which to the best of his knowledge and belief **were necessary** for the purpose of his audit
(b) whether, in his opinion, **proper books of account as required by law have been maintained**
(c) **whether the report on the accounts of any branch office of the company audited** by a person other than the company's auditor has been sent to him and the manner in which he has dealt with it in preparing his report;
(d) whether the **company's balance sheet and profit and loss account** dealt with in the report are **in agreement with the books of account and returns**;
(e) whether, in his opinion, the **financial statements comply with the accounting standards;**
(f) the **observations or comments of the auditors on financial transactions** or matters **which have any adverse effect** on the functioning of the company;
(g) **whether any director is disqualified** from being appointed as a director under sub-section (2) of section 164;
(h) whether the company has **adequate internal financial controls** with reference to financial statements in place and the operating effectiveness of such controls

(i) Rule 11 prescribed that **Auditor's Report shall also include their views and comments** on the following matters, namely:

(i) whether the company has disclosed the **impact, if any, of pending litigations** on its financial position in its financial statement;
(ii) whether the company has made **provision**, **as required** under any law or accounting standards, **for material foreseeable losses**, if any, on long term contracts including derivative contracts;
(iii) whether there has been **any delay in transferring amounts**, required to be transferred, to the **Investor Education and Protection Fund** by the company.
The auditor is required to provide the reasons, where any of the matters required to be included in the Audit Report under this Clause is answered in negative or with a qualification. [Section 143 (4)]

**(5) Audit of Government Company**

- The auditor so appointed **shall submit a copy of the audit report to the CAG** of India
- The CAG of India shall within 60 days from the date of receipt of the audit report under sub-section (5) have a right to,—
  (a) **conduct a supplementary audit of the financial statement** of the company by

such person or persons as he may authorise in this behalf; and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised

(b) **comment** upon or supplement such audit report:

(c) If CAG considers necessary, by an order, **cause test audit** to be conducted of the accounts of such company.

- Comments given by the CAG of India upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements AGM.

**(6) Reporting of frauds by auditors [Section 143(12)]**

If an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud, which involves or is expected to involve

**(A)** **an amount of ` 1 crore or above**, the auditor shall report the matter to the Central Government in following manner:

(a) the auditor shall report the matter to the Board or the Audit Committee, as the case may be, immediately but not later than 2 days of his knowledge of the fraud, seeking their reply or observations within 45 days;

(b) on receipt of such reply or observations, the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within 15 days from the date of receipt of such reply or observations;

(c) in case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of 45 days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations;

(d) the report shall be sent to the **Secretary, Ministry of Corporate Affairs** (MCA) in a sealed cover by Registered Post with Acknowledgement Due or by Speed Post followed by an e-mail in confirmation of the same;

(e) the report shall be on the letter-head of the auditor containing postal address, e-mail address and contact telephone number or mobile number and be signed by the auditor with his seal and shall indicate his Membership Number; and

(f) The report shall be in the form of a statement as specified in **Form ADT-4.**

**(B)** In case of a fraud involving **lesser than the 1 crore**, the auditor shall report the matter to the audit committee constituted under section 177 or to the Board **immediately but not later than 2 days of his knowledge of fraud** and he shall report the matter specifying the following:

(i) Nature of fraud with description;

(ii) Approximate amount involved; and

(iii) Parties involved.

The following details of each of the fraud reported to the Audit Committee or the Board under sub-rule (3) of amended Rule 13 during the year **shall be disclosed in the Board's Report:**

(i) Nature of fraud with description;
**(ii) Approximate amount involved;**
**(iii) Parties involved, if remedial action not taken; and**
**(iv) Remedial actions taken.**

**Note:** The provision of this section shall **mutatis mutandis apply to a Cost Auditor and a Secretarial Auditor during the performance of his duties** under section 148 and section 204 respectively.

**(7) Audit of accounts of branch office of company [Section 143(8)]**

**(a) Branch office in India:**

Where a company has a branch office, the accounts of that office shall be audited either by:

(A) the company's auditor appointed under section 139, or
(B) by any other person qualified for appointment as an auditor of the company under section 139.

**(b) Branch office outside India:**

If the branch office is situated in a country outside India, the accounts of the branch office shall be audited either by:

(A) the company's auditor or
(B) by an accountant or
(C) by any other person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country.

(c) The **branch auditor shall prepare a report** on the accounts of the branch examined by him **and send it to the auditor of the company** who shall deal with it in his report in such manner as he considers necessary.

(d) The provisions regarding reporting of fraud by the auditor shall also extend to such branch auditor to the extent it relates to the concerned branch.

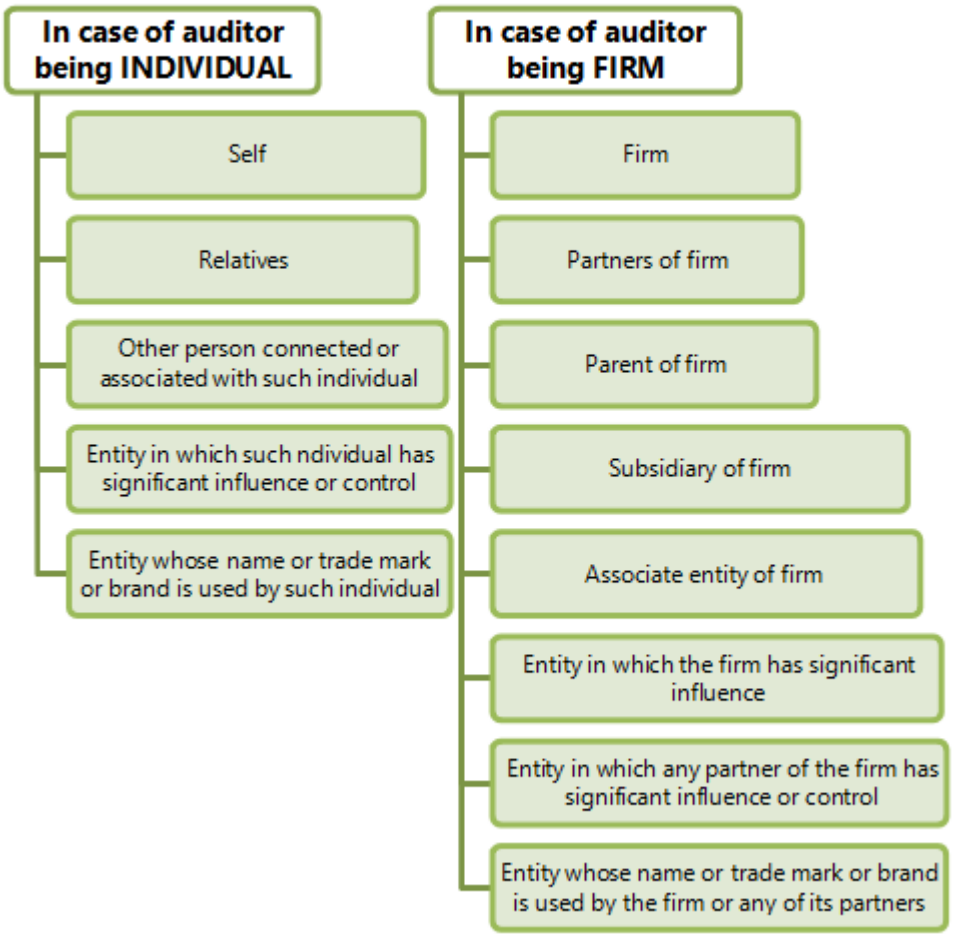
**Duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor [Rule 12 of the Companies (Audit & Auditors) Rules, 2014**]
The duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor, if any, shall be as contained in sub-sections (1) to (4) of section 143.
The branch auditor shall submit his report to the company's auditor.
The provisions regarding reporting of fraud by the auditor shall also extend to such branch auditor to the extent it relates to the concerned branch.

**AUDITOR NOT TO RENDER CERTAIN SERVICES [SECTION 144]**

The Auditor shall not provide any of the following services (directly or indirectly to the company or its holding company or subsidiary company), namely—

(a) accounting and book keeping services;
(b) internal audit;
(c) design and implementation of any financial information system;
(d) actuarial services;
(d) investment advisory services;
(f) investment banking services;
(g) rendering of outsourced financial services;
(h) management services; and
(i) any other kind of services as may be prescribed. [However no other kind of services has been prescribed till date]

## RENDERING OF SERVICES 'DIRECTLY OR INDIRECTLY'



**Example**: MNP Ltd is a medium-sized company engaged in the business of pharmaceuticals. For the year ended 31st March 2018, the company is looking for appointment of GST (Goods and Services Tax) auditor. The company wants to appoint somebody for this work who is familiar with the business of the company i.e. who would have worked with the company in the past so that lesser efforts are required to get the GST audit completed. The company has options of Statutory auditors that can be appointed for this work for betterment of company.

## AUDITORS TO SIGN AUDIT REPORTS, ETC. [SECTION 145]

(i) The person appointed as an auditor of the company **shall sign the auditor's report or sign or certify any other document of the company**.

(ii) in case of firm including LLP, any and only Chartered Accountants are authorised to act as statutory auditors and sign.

**(iii)** The **qualifications, observations or comments** on financial transactions or matters, which have any adverse effect on the functioning of the company mentioned in the auditor's report **shall be read before the company in general meeting and shall be open to inspection by any member of the company.**

## AUDITORS TO ATTEND GENERAL MEETING [SECTION 146]

(i) All notices of, and other communications relating to, any general meeting **shall be forwarded** to the **auditor of the company**.

**(ii)** The auditor **shall**, unless otherwise exempted by the company, **attend either by himself or through his authorised representative, who shall also be qualified to be an auditor, any general meeting.**

**(iii)** The auditor shall have right to be heard at such meeting **on any part of the business which concerns him as the auditor.**

## PUNISHMENT FOR CONTRAVENTION [SECTION 147]

If any of the provisions of sections 139 to 146 (both inclusive) is contravened,

**(i) Penalty on company [Section 147(1)]:**

fine which shall not be less than ` 25,000 but which may extend to ` 5 lacs.

**(ii) Penalty on officers [Section 147(1)]:**

(1) with fine which shall not be less than ` 10,000 but which may extend to ` 1 lac; or

**(iii) Penalty on auditor [Section 147(2) & (3)]:**

(a) If an auditor of a company **contravenes any of the provisions of section 139, section 143, section 144 or section 145**, the auditor shall be punishable with fine which shall not be less than ` 25,000 but which **may extend to ` 5 lacs** or **4 times the remuneration** of the auditor, **whichever is less.**

(b) If an auditor has contravened **such provisions knowingly or willfully**, he shall be punishable with-

(1) imprisonment for a term which **may extend to 1 year** and

(2) with fine which shall not be less than 50 thousand rupees but which may extend to 25 lakh rupees or **8 times the remuneration** of the auditor, **whichever is less**.

(c) Further, **where an auditor has been convicted as above**, he shall be liable to—

(1) **refund the remuneration** received by him to the company; and

(2) **pay for damages** to the company, statutory bodies or authorities or to members or creditors of the company **for loss arising out of incorrect or misleading statements** of particulars made in his audit report.

**(iv) Liability of Audit firm [Section 147(5)]:**

Where, in case of audit of a company being conducted by an audit firm, it is proved that the partner or partners of the audit firm has acted in a fraudulent manner for such act **shall be of the partner or partners and of the firm jointly and severally** and shall also be liable under section 447.

Provided that **in case of criminal liability** of an audit firm, **in respect of liability other than fine**, the concerned partner or partners, **who acted in a fraudulent manner or abetted or, as the case may be, colluded in any fraud shall only be liable.**

## CENTRAL GOVERNMENT TO SPECIFY AUDIT OF ITEMS OF COST IN RESPECT OF CERTAIN COMPANIES - Section 148

Section 148 of the Companies Act, 2013 provides the provisions for Central Government to specify **audit of items of cost in respect of certain companies**. According to this section:

(i) **Central Government may, by order**, in respect of **companies engaged in the production of such goods or providing such services** as may be prescribed,

- direct that **particulars relating to the utilisation of material or labour** or

- to **other items of cost,** shall also be **included in the books of account** kept under section 128 by that class of companies.

(ii) The **CG shall, before issuing such order to companies regulated by special act, consult the regulatory body** constituted or established under such special Act.

(iii) If the **CG is of the opinion**, **that it is necessary to do so**, **it may, by order, direct that the AUDIT of cost records** of companies, which are covered aforesaid and which have a net worth of such amount as may be prescribed or a turnover of such amount as may be prescribed,

**shall be conducted in the manner specified in the order**. **An audit conducted under this section shall be in addition to the audit conducted under section 143.**

(iv) The **cost audit shall be conducted by a Cost Accountant** who shall be **appointed by the Board** on such **remuneration as determined by the members**.

**COST AUDITOR [SUB-SECTION 3 AND 5]**

**Who can be appointed as cost auditor? [Sub-Section 3]**

Only a **Cost Accountant**, as defined under section 2(28) of the Companies Act, 2013, can be appointed as a cost auditor.

First Proviso to sub-section 3 provides that person appointed under section 139 as an auditor of the company (i.e. company auditor) shall not be appointed for conducting the audit of cost records.

**Qualifications, disqualifications, rights, duties and obligations of cost Auditor [Sub-section 5]**

The **qualifications, disqualifications, rights, duties and obligations applicable to auditors (**i.e. applicable to company auditor) shall, so far as may be applicable, apply to a cost auditor appointed under section 148 and it shall be the duty of the company to give all assistance and facilities to the cost auditor appointed under this section for auditing the cost records of the company

**Note:** The provisions of sub-section (12) of section 143 of the Act and the relevant rules made thereunder shall apply mutatis mutandis to a cost auditor during performance of his functions under section 148 of the Act and rule notified thereunder.

**Manner and Procedure – Appointment, Removal and Resignation [Rule 6 of Companies (Cost Records and Audit) Rules, 2014]**

**Time Limit for appointment**

Cost Auditor shall within **one hundred and eighty days** of the commencement of every financial year, appoint a cost auditor

**Written Consent and Certificate**

Before such appointment is made, the written consent of the cost auditor to such appointment, and a certificate following shall be obtained from him or it

a. The individual or the firm, as the case may be, is eligible for appointment and is not disqualified for appointment under the Act, the Cost and Works Accountants Act, 1959 and the rules or regulations made thereunder;

b. The individual or the firm, as the case may be, satisfies the criteria provided in section 141 of the Act, so far as may be applicable;

c. The proposed appointment is within the limits laid down by or under the authority of the Act; and

d. The list of proceedings against the cost auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct

**Notice of appointment**

every company shall inform the **cost auditor** concerned of his or **its appointment as** such and file a notice of such **appointment with the Central Government** within a **period of thirty days** of the Board meeting in which such appointment is made or within a period of one hundred and eighty days of the commencement of the financial year, whichever is earlier, through electronic mode, in form CRA-2, along with the fee as specified in Companies (Registration Offices and Fees) Rules, 2014

**Tenure of appointment as cost auditor**

Every cost auditor appointed as such shall continue in such capacity till the **expiry of one hundred** and **eighty days from the closure of the financial year** or till he submits the cost audit report, for the financial year for which he has been appointed.

**Removal of cost Auditor** The cost auditor appointed under these rules may be removed from his office before the **expiry of his term**, through a board resolution **after giving a reasonable opportunity of being heard** to the Cost Auditor and recording the reasons for such removal in writing.

**Note: Form CRA-2** to be filed with the Central Government for intimating appointment of another cost auditor shall enclose the relevant Board Resolution to the effect Nothing shall prejudice the right of the cost auditor to resign from such office of the company

**Filling of casual vacancy in the office of a cost auditor**

Any casual vacancy in the office of a cost auditor, whether **due to resignation, death or removal**, shall be filled by the Board of Directors within thirty days of occurrence of such vacancy and the company shall inform the Central Government in form CRA-2 within thirty days of such appointment of cost auditor

## COST AUDIT REPORT

**Form and timing to submit cost audit report**

The report on the audit of cost records shall be submitted by the cost accountant to the Board of Directors of the company

Every cost auditor, who conducts an audit of the cost records of a company, shall submit the cost audit report along with his or its reservations or qualifications or observations or suggestions, if any, in form CRA-3.

Every cost auditor shall forward his duly signed report within a period of one hundred and eighty days from the closure of the financial year to which the report relates and the Board of Directors shall consider and examine such report, particularly any reservation or qualification contained therein

**Filing of cost audit report with Central Government [Sub-section 6 and 7 read with rule 4 of the Companies (Filing of Documents and forms in Extensible Business Reporting Language) Rules, 2015]**

A company shall

a. Within 30 days from the date of receipt of a copy of the cost audit report

b. Furnish the Central Government with such report

c. Along with full information and explanation on every reservation or qualification contained therein.

Rule 4 of the Companies (Filing of Documents and forms in Extensible Business Reporting Language) Rules, 2015, provides a company which is required to furnish cost audit report and other documents to the Central Government under subsection 6 of the section 148 of the Act and rules made thereunder, shall file such report and other documents using the XBRL taxonomy given in Annexure III for the financial year commencing on or after 1 April 2014 in e-form CRA-4 specified under the Companies (Cost Records and Audit) Rules, 2014.

If, after considering the cost audit report and the information and explanation furnished by the company, the Central Government is of the opinion that any further information or explanation is

necessary, it may call for such further information and explanation and the company shall furnish the same within such time as may be specified by that Government

| Form | Purpose |
|---|---|
| **CRA-1** | The manner in which cost records to be maintained |
| **CRA-2** | For intimation of appointment of cost auditor by company to the Central Government |
| **CRA-3** | Cost Audit Report |
| **CRA-4** | Filling of the cost audit report with the Central Government |

**Contravention:** If any default is made in complying with the provisions of section 148—

(a) The company and every officer of the company who is in default shall be punishable in the manner as provided in section 147(1);

(b) the cost auditor of the company who is in default shall be punishable in the manner as provided in sub-sections (2) to (4) of section 147.

(xiv) The provisions of section 143 shall mutatis mutandis apply to the cost accountant conducting cost audit under section 148.



**Question and Answers**

1. **State the procedure for the following, explaining the relevant provisions of the Companies Act, 2013:**
   **(i) Appointment of First Auditor, when the Board of directors did not appoint the First Auditor within one month from the date of registration of the company.**
   **(ii) Removal of Statutory Auditor (appointed in last Annual General Meeting) before the expiry of his term.**

**Answer**

(i) Section 139(6) of the Companies Act, 2013 lays down that the first auditor of a company shall be appointed by the Board of Directors within 30 days of the registration of the company.

Section 139 (6) continues to provide further that if the Board of Directors fails to appoint such auditor, it shall inform the members of the company, who shall within ninety days at an extraordinary general meeting appoint such auditor and such auditor shall hold office till the conclusion of the first annual general meeting.

From the above provisions of law if the Board of Directors fails to appoint the first auditors within the stipulated 30 days, it shall take the following steps:

a. Inform the members of the Company;
b. Immediately take steps to convene an extra ordinary general meeting not later than 90 days;
c. Members shall at that extra ordinary meeting appoint the first auditors of the company;
d. The first auditors so appointed shall hold office upto the conclusion of the first AGM of the company.

(ii) Section 140 of the Companies Act, 2013 prescribes certain procedure for removal of auditors. Under section 140 (1) the auditor appointed under section 139 may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the previous approval of the Central Government in that behalf in the prescribed manner. From this sub section it is clear that the approval of the Central Government shall be taken first and thereafter the special resolution of the company should be passed.

Provided that before taking any action under this sub-section, the auditor concerned shall be given a reasonable opportunity of being heard.

Therefore, in terms of section 140 (1) of the Companies Act, 2013 read with Rule 7 of the Companies (Audit & Auditors) Rules, 2014,the following steps should be taken for the removal of an auditor before the completion of his term:

The application to the Central Government for removal of auditor shall be made in Form ADT-2 and accompanied with fees as provided for this purpose under the Companies (Registration Offices and Fees) Rules, 2014.

The application shall be made to the Central Government within thirty days of the resolution passed by the Board.

The company shall hold the general meeting within sixty days of receipt of approval of the Central Government for passing the special resolution.

2. **One-fourth of the subscribed capital of AMC Limited was held by the Government of Rajasthan. Mr. Neeraj, a Chartered Accountant, was appointed as an auditor of the Company at the Annual General Meeting held on 30 April,2018 by an ordinary resolution. Mr. Sanjay, a shareholder of the Company, objects to the manner of appointment of Mr. Neeraj on the ground of violation of the Companies Act, 2013. Decide whether the objection of Mr. Sanjay is tenable? Also examine the consequences of the above appointment under the said Act.**

Answer

As per the section 2(45) of the Companies Act, 2013, the holding of 25% shares of AMC Ltd. by the Government of Rajasthan does not make it a government company. Hence, it will be treated as a non-government company.

Under section 139 of the Companies Act, 2013, the appointment of an auditor by a company vests generally with the members of the company except in the case of the first auditors and in the filling up of the casual vacancy not caused by the resignation of the auditor, in which case, the power to appoint the auditor vests with the Board of Directors. The appointment by the members is by way of an ordinary resolution only and no exceptions have been made in the Act whereby a special resolution is required for the appointment of the auditors.

Therefore, the contention of Mr. Sanjay is not tenable. The appointment is valid under the Companies Act, 2013.

**3. EF Limited appointed an individual firm, Naresh & Company, Chartered Accountants, as Auditors of the company at the Annual General Meeting held on 30 September2019. Mrs. Kamala, wife of Mr. Naresh, invested in the equity shares face value of ` 1 lakh of EF Limited on 15 October 2019. But Naresh & Company continues to function as statutory auditors of the company. Advice**

**Answer**

**Disqualification of auditor:** According to section 141(3)(d)(i) of the Companies Act, 2013, a person who, or his relative or partner holds any security of the company or its subsidiary or of its holding or associate company a subsidiary of such holding company, which carries voting rights, such person cannot be appointed as auditor of the company. Provided that the relative of such person may hold security or interest in the company of face value not exceeding 1 lakh rupees as prescribed under the Companies (Audit and Auditors) Rules, 2014.

In the case Mr. Naresh, Chartered Accountants, did not hold any such security. But Mrs. Kamala, his wife held equity shares of EF Limited of face value ` 1 lakh, which is within the specified limit.

Further Section 141(4) provides that if an auditor becomes subject, after his appointment, to any of the disqualifications specified in sub-section 3 of section 141, he shall be deemed to have vacated his office of auditor. Hence, Naresh & Company can continue to function as auditors of the Company even after 15 October 2019 i.e. after the investment made by his wife in the equity shares of EF Limited.

Question 4

**4. Explain how the auditor will be appointed in the following cases:**

**(i) A Government company within the meaning of section 394 of the Companies Act 2013.**

**(ii) A public company whose shareholders include XYZ Bank (a nationalized bank) holding 18% of the subscribed capital of the company.**

**Answer**

(i) The appointment and re-appointment of auditor of a Government Company or a government controlled company is governed by the provisions of section 139 of the Companies Act, 2013 which are summarized as under:

The first auditor shall be appointed by the Comptroller and Auditor General of India within 60 days from the date of incorporation and in case of failure to do so, the Board shall appoint auditor within next 30 days and on failure to do so by Board of Directors, it shall inform the members, who shall appoint the auditor within 60 days at an extraordinary general meeting (EGM), such auditor shall hold office till conclusion of first Annual General Meeting.

In case of subsequent auditor for existing government companies, the Comptroller & Auditor General of India shall appoint the auditor within a period of 180 days from the commencement of the financial year and the auditor so appointed shall hold his position till the conclusion of the Annual General Meeting.

(ii) In the given case as the total shareholding of the XYZ Bank is just 18% of the subscribed capital of the company, it is not a government company. Hence the provisions applicable to non-government companies in relation to the appointment of auditors shall apply.

**The auditor shall be appointed as follows:**

(1) The company shall, at the first annual general meeting, appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting.

(2) Before such appointment of auditor is made, the written consent of the auditor to such appointment, and a certificate from him or firm of auditors that the appointment, if made, shall be obtained from the auditor:

Further, the company shall inform the auditor concerned of his or its appointment, and also file a notice of such appointment with the Registrar within 15 days of the meeting in which the auditor is appointed.

**5. Examine the following situations in the light of the Companies Act, 2013**

**(i) Mr. Ayush, a Chartered Accountant, has been appointed as an auditor of X Ltd. in the Annual General Meeting of the company held in September2018, in which he accepted the assignment. Subsequently, in January2019 he joined B, as a partner in the consultancy firm of Mr. B. Mr. B is also working as a Finance Executive of X Ltd.**

**(ii) "Mr. Abhi", a practicing Chartered Accountant, is holding securities of Abhiman Ltd. having face value of ` 1000/-. Whether Mr. Abhi is qualified for appointment as an Auditor of Abhiman Ltd.?**

Answer

(i) Provisions and Explanation: Section 141(3) (c) of the Companies Act, 2013 prescribes that any person who is a partner or in employment of an officer or employee of the company will be disqualified to act as an auditor of a company. Sub-section (4) of Section 141 provides that an auditor who becomes subject, after his appointment, to any of the disqualifications specified in sub-sections (3) of Section 141, he shall be deemed to have vacated his office as an auditor.

Conclusion: In the present case, Ayush, an auditor of X Ltd., joined as partner with consultancy firm where B is also a partner and B is also the Finance executive of X Ltd. Hence, Ayush has attracted clause (3)(c) of Section 141 and, therefore, he shall be deemed to have vacated office of the auditor of X Limited.

(ii) As per section 141(3)(d)(i), an auditor is disqualified to be appointed as an auditor if he, or his relative or partner holds any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company.

In the present case, Mr. Abhi. is holding security of`1000 in the Abhiman Ltd, therefore, he is not eligible for appointment as an auditor of Abhiman Ltd.

**6. Examine whether the following persons are eligible for being appointed as auditor under the provisions of the Companies Act, 2013:**

**(i) "Mr. Prakash" is a practicing CA and "Mr. Aakash", who is a relative of "Mr. Prakash" is holding securities of "ABC Ltd." having face value of ` 70,000/- (market value 1, 10,000/-). Directors of ABC Ltd. want to appoint Mr. Prakash as an auditor of the company.**

**(ii) Mr. Ramesh is a practicing Chartered Accountant indebted to MNP Ltd. for rupees 6 lakh. Directors of MNP Ltd. want to appoint Mr. Ramesh as an auditor of the company.**

**(iii) Mrs. KVJ spouse of Mr. Kumar, a Chartered Accountant, is the store keeper of PRC Ltd. Directors of PRC Ltd. want to appoint Mr. Kumar as an auditor of the company**

**Answer**

(i) As per section 141 (3)(d)(i) of the Companies Act, 2013, an auditor is disqualified to be appointed as an auditor if he, or his relative or partner holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company. Further as per proviso to this Section, the relative of the auditor may hold the securities or interest in the company of face value not exceeding of` 1,00,000. In the present case, Mr. Aakash (relative of Mr. Prakash, an auditor), is having securities of ABC Ltd. having face value of ` 70,000 (market value ` 1,10,000), which is within the limit as per requirement of under the proviso to section 141 (3)(d)(i). Therefore, Mr. Prakash will not be disqualified to be appointed as an auditor of ABC Ltd.

(ii) As per section 141(3)(d)(ii), an auditor is disqualified to be appointed as an auditor if he or his relative or partner is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of rupees 5 Lacs. In the instant case, Mr. Ramesh will be disqualified to be appointed as an auditor of MNP Ltd. as he indebted to MNP Ltd. for rupees 6 lacs.

(iii) As per section 141(3)(f), an auditor is disqualified to be appointed as an auditor if a person whose relative is a director or is in the employment of the company as a director or a key managerial personnel. In the instant case, since Mrs. KVJ Spouse of Mr. Kumar (Chartered Accountant) is the store keeper (not a director or KMP) of PRC Ltd., hence Mr. Kumar will not be disqualified to be appointed as an auditor in the said company.

**7. The Board of Directors of A Ltd. requested its Statutory Auditor to accept the assignment of designing and implementation of suitable financial information system to strengthen the internal control mechanism of the Company. How will you approach to this proposal,**

**as an Statutory Auditor of A Ltd., taking into account the consequences, if any, of accepting this proposal?**

**Answer:**

According to section 144 of the Companies Act, 2013, an auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be. But such services shall not include designing and implementation of any financial information system.

In the said instance, the Board of directors of A Ltd. requested its Statutory Auditor to accept the assignment of designing and implementation of suitable financial information system to strengthen the internal control mechanism of the company. As per the above provision said service is strictly prohibited.

In case the Statutory Auditor accepts the assignment, he will attract the penal provisions as specified in Section 147 of the Companies Act, 2013.

In the light of the above provisions, we shall advise the Statutory Auditor not to take up the above stated assignment.

# CHAPTER 11

# COMPANIES INCORPORATED OUTSIDE INDIA

**[Section 379 to 393]**

**[The Companies (Registration of Foreign Companies) Rules, 2014]**

**What is a Foreign company?**

It means any **company or body corporate** **incorporated outside India** which-

(a) has a **place of business in India** whether by **itself or through an agent**, **physically or through electronic mode**; **AND**

(b) **conducts any business activity in India** in any other manner.

As per Companies (Registration of Foreign Companies) Rules, 2014, "**electronic mode" means** carrying out electronically based, whether main server is installed in India or not, including, but not limited to:
(a) **B2B and B2C transactions**, data interchange and other digital supply transactions;
(b) offering to **accept deposits or inviting deposits** or accepting deposits or subscriptions in securities, **in India or from citizens of India**;
(c) financial settlements, web based marketing, advisory and transactional services, **database services** and products, supply chain management;
(d) online services such as **telemarketing, telecommuting, telemedicine, education and information research**; and
(e) all related data communication services, whether conducted by e-mail, mobile devices, social media, cloud computing, document management, voice or data transmission or otherwise.

For the purposes of this clause, electronic based offering of securities, subscription thereof or listing of securities in the International Financial Services Centres set up under section 18 of the Special Economic Zones Act, 2005 (28 of 2005) shall not be construed as 'electronic mode' for the purpose of clause (42) of section 2 of the Act

**APPLICATION OF ACT TO FOREIGN COMPANIES [SECTION 379]**

**(i) Applicability of Act to foreign companies:** Sections 380 to 386 (both inclusive) and sections 392 and 393 shall apply to all foreign companies. It implies that **all companies which falls within the definition of foreign company** as per section 2(42), **shall comply with the provisions of this Chapter**.

**(ii) Requirement of holding of paid-up share capital:** Where not less than 50% of the paid- up share capital, whether equity or preference or partly equity and partly preference, of a foreign company incorporated outside India is held by:

(i) one or more **citizens of India**; or

(ii) by **one or more companies** or bodies corporate incorporated in India; or
(iii) by one or more citizens of India and one or more companies or bodies corporate incorporated in India, whether singly or in the aggregate, such foreign company shall also comply with the provisions of Chapter XXII and **such other provisions of this Act as may be prescribed with regard to the business carried on by it in India as if it were a company incorporated in India.** [Section 379(2)]

**Illustration:**

The shareholding of Emaar Company LLC, incorporated in Dubai and having a place of business in India, is as follows:

1. Hinduja Company Limited (Indian Company): 26%
2. Vaishali Company Limited (Indian Company): 25%
3. Remaining: Citizens of Dubai

As per section 379(2), Emaar Company LLC will also be required to comply with the provisions of Chapter XXII as not less than 50% of the shareholders of Emaar Company LLC consists of body corporates incorporated in India. Emaar Company LLC will also be required to comply with other provisions of this Act as may be prescribed with regard to the business carried on by its place of business in India as if it were a company incorporated in India.

**#Previously asked Questions:**

**1) Examine with reference to the provisions of the Companies Act, 2013 whether the following companies can be treated as foreign companies:**
**(i) A company incorporated outside India having a share registration office at Mumbai.**
**(ii) Indian citizens incorporated a company in Singapore for the purpose of carrying on business there.**

**Solution:**
Section 2(42) of the Companies Act, 2013 defines a "foreign company" as any company or body corporate incorporated outside India which:
(a) Has a place of business in India whether by itself or through an agent, physically or through electronic mode; and
(b) Conducts any business activity in India in any other manner.
(i) Therefore, a company incorporated outside India having a share registration office at Mumbai **will be treated as a foreign company** provided it conducts any business activity in India.
(ii) In the case of a company incorporated in Singapore for the purpose of carrying on business in Singapore, it will not fall within the definition of a foreign company. Its incorporation outside India by Indian citizen is immaterial. In order to be a foreign company it has to have a place of business in India and must also conduct a business activity in India.

**2) Examine in the light of the provisions of the Companies Act, 2013 whether the following companies can be considered as "Foreign Companies":**

**(i) A company Incorporated outside India having a share registration office at New Delhi;**

**(ii) A company incorporated outside India having shareholders who are all Indian Citizens;**

**(iii) A company incorporated in India but all the shares are held by foreigners.**

**examine whether the above companies can lssue Indian Depository Receipts under the provisions of the Companies Act, 2013 (CA (Final) May 2013]**

**Solution:**

Ans. As per Section 2(42) of the Companies Act, 2013, "foreign company' means any company or body corporate incorporated outside India which-

(a) has a place of business in India whether by itself or through an agent, physically or through electronic mode: and

(b) conducts any business activity in India in any other manner.

**The answer to the given problem is as follows:**

(i) A share transfer office or share registration office constitutes a place of business (Section 386). Thus, a company incorporated outside India having a share registration office at Mumbai shall be a foreign company, whether or not it conducts any business activity in India.

(ii) A company incorporated outside India does not become a foreign company by the mere fact that all its shareholders are Indian Citizens. Assuming that the company does not have a place of business in India, the company is not a foreign company

(iii) A Company incorporated in India is a 'company' within the meaning of Clause (20) of Section 2 of the Companies 2013. It cannot become a foreign company by the mere fact that all the shares of the company are held by foreigners.

Section 390 of the Companies Act, 2013 authorises a company incorporated outside India (whether or not it has established a place of business in India, ie. whether or not it is a foreign company) to issue Indian Depository Receipts in accordance with the Rules prescribed by the Central Government. Accordingly, -

(i) 'A company incorporated outside India having a share registration office at New Delhi' can issue IDRS in accordance with the Rules prescribed by the Central Government.

(ii) 'A company incorporated outside India, having shareholders who are all Indian Citizens' can issue IDRS in accordance with the Rules prescribed by the Central Government.

(iii) 'A company incorporated in India but all the shares are held by foreigners' cannot issue IDRS

**3) Robertson Ltd. is a company registered in Thailand. Although, it has no place of business established in India, yet it is doing online business through telemarketing in India**

**Whether it will be treated as a Foreign Company under the Companies Act, 2013? Explain.**

(CA (Final) Nov. 2015]

**Solution: [I**n Short]

As per the definition of foreign company, electronic mode includes providing online services such as telemarketing

Since Robertson Ltd. is a Company incorporated outside India and it also conducts business activities in India, it is a foreign company.

**3) In the light of the provisions of the Companies Act, 2013, examine whether the following companies can be considered as foreign companies:**

**(i) M/s Red Stone Limited is a company registered in Singapore. The Board of directors meets and executes business decisions at their board meeting held in India.**

**(ii) M/s Blue Star Public Company Limited registered in Thailand has authorized Mr. Y' in India to find customers and to enter into contracts with them on behalf of the company.**

**(iii) M/s Xex Limited Liability Company registered in Dubai has installed its main server in Dubai for maintaining office automation software by cloud computing for its client In India.**

**[CA (Final) Nov. 2019**

**Solution:**

(i) The mere fact that the Board meetings of Red Stone Limited are held in India does not imply that it has established any place of business in India and Assuming it has not established any place of business in India and does not conduct any business activity in India in any manner, Red stone is not a foreign company.

(ii) M/s Blue Star Public Company Limited is incorporated in Thailand. It has authorized Mr.Y in India to find customers and to enter into contracts with them on behalf of Company. It implies that Mr. Y is an agent of Blue star and it implies that blue star has established a place of business in India through its agent. Hence M/S Blue Star Public Company Limited is a foreign company.

(iii) XEX ltd Company is incorporated in Dubai, i.e. it is a body corporate incorporated outside India. XEX has installed its main server in Dubai for maintaining office automation software by cloud computing for its client In India. It implies that M/s Xex is conducting business In India. Therefore it is a Foreign Company as per section 2(42) of the Companies Act, 2013.

**#Questionable Point:**

| **Scenario** | **Foreign company or not?** |
|---|---|
| 1) Company incorporated outside India, No place of business in India | No |
| 2) Company incorporated in India by foreign shareholders | No (Indian Company) |
| 3) Company incorporated outside India by Indian Shareholders, No place of business in India | No (No place of business in India) |

## DOCUMENTS, ETC., TO BE DELIVERED TO REGISTRAR BY FOREIGN COMPANIES [SECTION 380]

According to section 380 (1) of the Companies Act, 2013,

**(i) Every foreign company shall, within 30 days of the establishment of its place of business in India, deliver to the Registrar for registration:**

(a) a **certified copy of the charter, statutes or memorandum and articles**, of the company or other instrument constituting or defining the constitution of the company. If the instrument is not in the English language, a certified translation thereof in the English language;

(b) the **full address of the registered or principal office** of the company;

(c) a **list of the directors and secretary** of the company containing such particulars as may be prescribed;

In relation to the nature of particulars to be provided as above, 3the Companies (Registration of Foreign Companies) Rules, 2014, provide that the list of directors and secretary or equivalent (by whatever name called) of the foreign company shall contain the following particulars, for each of the persons included in such list, namely:

| | |
|---|---|
| (1) personal name and surname in full; | (8) passport Number, date of issue and country of issue; (if a person holds more than one passport then details of all passports to be given) |
| (2) any former name or names and surname or surnames in full; | (9) income-tax permanent account number (PAN), if applicable; |
| (3) father's name or mother's name and spouse's name; | (10) occupation, if any; |
| (4) date of birth; | (11) whether directorship in any other Indian company, (Director Identification Number (DIN), Name and Corporate Identity Number (CIN) of the company in case of holding directorship); |
| (5) residential address; | (12) other directorship or directorships held by him; |
| (6) nationality; | (13) Membership Number (for Secretary only); and |
| (7) if the present nationality is not the nationality of origin, his nationality of origin; | (14) e-mail ID. |

(d) the **name and address of one or more persons resident in India authorised to accept** on behalf of the company service of process and any notices or other documents required to be served on the company;

(e) the **full address of the office of the company in India** which is deemed to be its principal place of business in India;

(f) particulars of **opening and closing of a place of business in India on earlier occasion**

(g) declaration that **none of the directors of the company or the authorised representative in India has ever been convicted** or debarred from formation of companies and management in India or abroad; and

(h) any other information as may be prescribed.

**(ii) Form, procedure and time for making application and submission of prescribed documents:** According to the Companies (Registration of Foreign Companies) Rules, 2014, the above information shall be **filed with the Registrar within 30 days of the establishment of its place of business in India**, in **Form FC-1**. The application shall also be supported with an attested copy of approval from the Reserve Bank of India under the Foreign Exchange Management Act or Regulations, and also from other regulators, if any, approval is required by such foreign company to establish a place of business in India or a declaration from the authorised representative of such foreign company that no such approval is required.

**(iii) Office where documents to be delivered and fee for registration of documents:**

1. According to the Companies (Registration of Foreign Companies) Rules, 2014, any document which any foreign company is required to deliver to the Registrar shall be **delivered to the Registrar having jurisdiction over New Delhi**.

2. It shall be accompanied with the prescribed fees.

3. If any foreign company **ceases to have a place of business in India**, it shall forthwith **give notice of the fact to the Registrar**, and from the date on which such notice is so given, the obligation of the company to deliver any document to the Registrar shall cease, provided it has no other place of business in India.

(iv) Under section 380 (2) every foreign company existing at the commencement of the Companies Act 2013, which has not delivered to the Registrar the documents and particulars specified in section 592(1) of the Companies Act, 1956, it shall continue to be subject to the obligation to deliver those documents and particulars in accordance with the Companies Act, 1956.

**(v)** Where any **alteration is made or occurs in the documents delivered to the Registrar** under section 380, the foreign company shall, **within 30 days of such alteration**, **deliver to the Registrar** for registration, a return containing the particulars of the alteration **in form FC-2** along with prescribed fees.

**Illustration :** Search & Find Pte. Ltd., incorporated in Singapore. The Company sells its goods through electronic mode on the e-commerce platforms in India, however, it does not have any branch or office in India. Is the Company required to submit the documents as required under Section 380 of the Companies Act, 2013.

**Answer:** Yes, as per 2(42) of Companies Act, 2013, any company or body corporate incorporated outside India which (a) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and (b) conducts any business activity in India in any other manner shall be considered as a foreign company. Accordingly, as Search & Find Pte. Ltd., is conducting its business through electronic

mode, it is considered a foreign company as per Companies Act, 2013 and is required to submit the documents mentioned under Section 380 of the Companies Act, 2013.

**ACCOUNTS OF FOREIGN COMPANY [SECTION 381]**

According to this section:

(i) Every **foreign company shall, in every calendar year**,—

(a) make out a **balance sheet and profit and loss account**

- of **its Indian business operations** in accordance with **Schedule III**
- documents that are required to be annexed should be **in accordance with Chapter IX i.e. Accounts of Companies.**
- documents relating to **copies of latest consolidated financial statements of the parent foreign company,** as submitted by it to the prescribed authority in the country of its incorporation

(b) deliver a copy of those documents **to the Registrar**.

**Note:** A company or body corporate, which is a holding company or a subsidiary or associate company of company incorporated outside India and is required to follow a different financial year for consolidation of its accounts outside India, the Central Government may, on an application made by that company or body corporate in such form and manner as may be prescribed, allow any period as its financial year, whether or not that period is a year.

It is important to note that a foreign company having its place of business in India **may not necessarily follow a financial year ending on the 31st day of March every year** provided it has obtained the requisite approvals from the Central Government for the same.

(ii) The **Central Government is empowered to** direct that, in the case of any foreign company the requirements of clause (a) given above shall not apply, or shall apply subject to such exceptions.

(iii) If documents are **not in the English, a certified translation** thereof in the English language shall be annexed.

(iv) Every foreign company shall send **to the Registrar** along with the above documents required, **a list of all places of business established by the company in India** in **Form FC- 3**

(v) According to the Companies (Registration of Foreign Companies) Rules, 2014,

(a) Further, every foreign company shall, **along with the financial statement**, attach thereto the following documents; namely:-

(1) Statement of **related party transaction**
(2) Statement of **repatriation of profits**
(3) Statement of **transfer of funds** (including dividends, if any)

(b) All these documents **shall be delivered to the Registrar within a period of 6 months of the close of the financial year of the foreign company** to which the documents relate.

**Note:** Registrar may, on application made extend the period by a period not exceeding 3 months.

(vi) **Audit of accounts of foreign company:** According to the Companies (Registration of Foreign Companies) Rules, 2014,

(a) Every foreign company shall get its accounts, **pertaining to the Indian business operations**, **audited by a practicing Chartered Accountant in India**.

(b) The provisions of Chapter X i.e. Audit and Auditors and rules made there under, as far as applicable, shall apply, mutatis mutandis, to the foreign company.

**DISPLAY OF NAME, ETC., OF FOREIGN COMPANY [SECTION 382]**

**Every foreign company shall—**

(a) conspicuously **exhibit on the outside of every office** or place where it carries on business in India, **the name of the company and the country in which it is incorporated**, and **if the liability of the members is limited**, cause notice of that fact, in letters **easily legible in English characters**, and **also in languages in general use in the locality** in which the office or place is situate;

(b) cause **the name of the company, if the liability of the members is limited**, cause notice of that fact **and of the country in which the company is incorporated**, to be stated in legible English characters **in all business letters, bill-heads and letter paper, and in all notices, and other official publications** of the company; and

(c) if the liability of the members of the company is limited, cause notice of that fact—

(i) to be stated in every such prospectus issued and in all business letters, bill-heads, letter paper, notices, advertisements and other official publications of the company, in legible English characters; and

(ii) to be conspicuously exhibited on the outside of every office or place where it carries on business in India, in legible English characters and also in legible characters of the language or one of the languages in general use in the locality in which the office or place is situated.

**SERVICE ON FOREIGN COMPANY [SECTION 383]**

Any process, notice, or other document **required to be served on a foreign company** shall be **deemed to be sufficiently served**, **if addressed to any person whose name and address have been delivered to the Registrar** under section 380 and left at, or sent by post to, the address which has been so delivered to the Registrar or by electronic mode.

**DEBENTURES, ANNUAL RETURN, REGISTRATION OF CHARGES, BOOKS OF ACCOUNT AND THEIR INSPECTION [SECTION 384]**

(i) The **provisions of section 71** (Issue of Debentures) shall **apply mutatis mutandis to a foreign company**.

(ii) The provisions of **section 92 (Preparation and filing of Annual return) and section 135 (Corporate Social Responsibility)** shall, subject to such exceptions, modifications and adaptations as may be made

therein by rules made under this Act, apply to a foreign company as they apply to a company incorporated in India.

Every foreign company shall prepare and **file an annual return in Form FC-4 along with prescribed fees, within a period of 60 days from the last day of its financial year**, to the Registrar containing the particulars as they stood on the close of the financial year.

(iii) The provisions of **section 128 (Books of account, etc., to be kept by company)** shall apply to a foreign company to the extent of requiring it to keep at its principal place of business in India, the books of account referred to in that section, with respect to monies received and spent, sales and purchases made, and assets and liabilities, in the course of or **in relation to its business in India.**

(iv) The provisions of **Chapter VI (Registration of Charges) shall apply mutatis mutandis** to charges on properties which are created or acquired by any foreign company.

(v) The provisions of **Chapter XIV (Inspection, inquiry and investigation) shall apply mutatis mutandis** to the Indian business of a foreign company as they apply to a company incorporated in India.

## FEE FOR REGISTRATION OF DOCUMENTS [SECTION 385]

According to the Companies (Registration of Foreign Companies) Rules, 2014, the fees to be paid to the Registrar for registering any document relating to a foreign company shall be such as provided in the Companies (Registration Offices and Fees) Rules, 2014.

## INTERPRETATION [SECTION 386]

For the purposes of the foregoing provisions of this Chapter, the expression:

(a) "**Certified**" means certified in the prescribed manner to be a **true copy or a correct translation**;
(b) "**Director**", in relation to a foreign company, **includes** any **person in accordance with whose directions or instructions the Board of Directors of the company is accustomed to act**; and
(c) "**Place of business**" **includes a share transfer or registration office.**

## DATING OF PROSPECTUS AND PARTICULARS TO BE CONTAINED THEREIN [SECTION 387]

According to this section:

**(i) Prospectus to be dated and signed [Section 387(1)]:** No person shall issue, circulate or distribute in India any prospectus offering to subscribe for securities of a company

- incorporated or to be incorporated outside India,
- whether the company has or has not established, a place of business in India,

**unless the prospectus is dated and signed**, and—

**(a) contains particulars with respect to the following matters, namely:—**

(1) the instrument defining the **constitution of the company**;
(2) the **enactments under which the company is incorporated**;

(3) **address in India where the said instrument, enactments** [in English] **can be inspected**;

(4) the **date on which and the country in which** the **company would be or was incorporated**; and

(5) **whether the company has established a place of business in India** and, if so, the address of its principal office in India; and

**(b) states the matters specified under section 26 (Matters to be stated in prospectus).**

Provided that points **(1), (2) and (3) of point (a) above shall not apply** in the case of a **prospectus issued more than 2 years** after the date at which the company is entitled to **commence business**.

**Example:** Mir Company LLC, a company incorporated in Dubai, on 28th April 2017. Mir Company LLC has established a place of Business in Mumbai in the year 2020. Now the place of business in India proposes to offer subscription to securities of Mir Company LLC. Now the place of business in India before going with the subscription will have to file a prospectus dated and signed and the prospectus shall not be required to contain the particulars mentioned in points (1), (2) and (3) of point (a) above as the prospectus will be getting issued after a period of more than 2 years since the Mir Company LLC has commenced its business.

**(ii) No waiver of compliance in prospectus [Section 387(2)]:**

- Any condition **requiring or binding an applicant for securities to waive compliance with any requirement imposed by virtue of section 387(1) or purporting to impute him** with notice of any contract, documents or matter not specifically referred to in the prospectus, **shall be void.**

**(iii) Form of application for securities to be issued along with prospectus [Section 387(3)]:** No person shall issue to any person in India a **form of application for securities of such a company**, as mentioned in section 387(1), **unless the form is issued with a prospectus** which complies with the provisions of this Chapter (Chapter XXII) and such issue does not contravene the provisions of section 388:

**Exception:** If it is shown that the form of application was issued in connection **to enter into an underwriting agreement** with respect to securities.

**(iv) Section 387(4) further provides that the provisions of section 387 shall not apply to —**

(a) **the issue to existing members or debenture holders** of a company of a prospectus or form of application relating to securities of the company, whether an applicant for securities will or will not have the right to renounce in favour of other persons; and

(b) except in so far as it requires a prospectus to be dated, to the issue of a prospectus relating to securities **which are in all respects uniform** with securities previously issued and for the time being dealt in or quoted on a recognised stock exchange,

(v) Nothing in Section 387 shall limit or diminish any liability which any person may incur under any law for the time being in force in India or under the Companies Act, 2013 apart from Section 387.

**PROVISIONS AS TO EXPERT'S CONSENT AND ALLOTMENT [SECTION 388]**

**According to this section:**

**No person shall issue in India any prospectus** offering for subscription in securities of

- a company incorporated or to be incorporated outside India,
- whether the company has or has not been established, a place of business in India,—

(a) if, **where the prospectus includes a statement** purporting (claiming) to be **made by an expert**,
- he has **not given**, or
- has **before delivery of the prospectus** for registration **withdrawn**, his written consent to the issue of the prospectus with the statement included in the form and context in which it is included, or;

(b) if the prospectus does not have the effect, where an application is made in pursuance thereof, of rendering **all persons concerned bound by all the provisions of section 33** (Issue of application forms for securities) **and section 40** (Securities to be dealt with in stock exchanges), so far as applicable.

(ii) For the purposes of this section, a statement shall be deemed to be included in a prospectus, if it is contained in any report or memorandum appearing on the face thereof or by reference incorporated therein or issued therewith.

## REGISTRATION OF PROSPECTUS [SECTION 389]

**According to this section:**

**No person shall issue, circulate or distribute in India any prospectus** offering for subscription in securities of a company incorporated or to be incorporated outside India, whether the company has or has not established, or when formed will or will not establish, a place of business in India, **unless before the issue**,

- a copy thereof certified by the
  - **chairperson** of the company and
  - **2 other directors** of the company as having been approved by resolution of the managing body

  has been **delivered for registration to the Registrar**; and
- the prospectus states on the **face of it that a copy has been so delivered**, and

According to the Companies (Registration of Foreign Companies) Rules, 2014, **the following documents shall be annexed to the prospectus**, namely:

(a) any **consent to the issue of the prospectus** required from **any person as an expert**;
(b) a **copy of contracts for appointment of managing director or manager**
(c) a copy of **any other material contracts, not entered in the ordinary course of business**, but entered within preceding 2 years;
(d) a copy of **underwriting agreement**; and
(e) a **copy of power of attorney**, if prospectus is signed through duly authorized agent of directors.

## OFFER OF INDIAN DEPOSITORY RECEIPTS [SECTION 390]

For the purposes of this section, and according to the Companies (Registration of Foreign Companies) Rules, 2014, **Indian Depository Receipts (IDR) means any instrument in the form of a depository receipt created by a Domestic Depository in India** and authorized by a company incorporated outside India making an issue of such depository receipts.

According to section 390, notwithstanding anything contained in any other law for the time being in force, the **Central Government may make rules applicable for**—

(i) the offer of **Indian Depository Receipts** (IDR);
(ii) the **requirement of disclosures in prospectus or letter of offer** issued in connection with IDR;
(iii) the **manner in which the IDR shall be dealt** with in a depository mode and by custodian and underwriters; and
(iv) the ***manner of sale, transfer or transmission*** of IDR,

by a company incorporated or to be incorporated outside India, whether the company has or has not established, or will or will not establish, any place of business in India.

According to the Companies (Registration of Foreign Companies) Rules, 2014, **no company shall make an issue of Indian Depository Receipts (IDRs)** unless it complies with the conditions mentioned under **this rule, + SEBI (ICDR) Regulations, 2009 + any directions issued by the RBI**.

**Application of Chapter XV (Compromises, Arrangements and Amalgamations)**: Section 234 of the Companies Act, 2013 deals with merger or amalgamation of company with foreign company.

Section 234(1) states that the provisions of Chapter XV unless otherwise provided under any other law for the time being in force, shall apply mutatis mutandis to schemes or mergers and amalgamations between companies registered under this Act and companies incorporated in the jurisdictions of such countries as may be notified from time to time by the Central Government. Provided that the Central Government may make rules, in consultation with the Reserve Bank of India, in connection with mergers and amalgamations provided under this section

Section 234(2) states that subject to the provisions of any other law for the time being in force, a foreign company, may with the prior approval of the Reserve Bank of India, merge into a company registered under this Act or vice versa and the terms and conditions of the scheme of merger may provide, among other things, for the payment of consideration to the shareholders of the merging company in cash, or in Depository Receipts, or partly in cash and partly in Depository Receipts, as the case may be, as per the scheme to be drawn up for the purpose

Explanation: For the purposes of sub-section (2) above, the expression "foreign company" means any company or body corporate incorporated outside India whether having a place of business in India or no

## APPLICATION OF SECTIONS 34 TO 36 AND CHAPTER XX [SECTION 391]

According to sub-section (1), the **provisions of sections 34 to 36 (both inclusive) shall apply** to—

(i) the issue of a prospectus by a company incorporated outside India under section 389 as they apply to prospectus issued by an Indian company;

(ii) the issue of IDR by a foreign company.

Section 34 deals with criminal liability for mis-statements in prospectus.
Section 35 deals with Civil Liability for mis-statement in prospectus.
Section 36 deals with punishment for fraudulently inducing persons to invest money.

The **provisions of Chapter XX (i.e. Chapter on Winding up) shall apply mutatis mutandis for closure of the place of business of a foreign company in India** as if it were a company incorporated in India in case such foreign company has raised monies through offer or issue of securities under this Chapter which have not been repaid or redeemed.

## PUNISHMENT FOR CONTRAVENTION [SECTION 392]

If a foreign company contravenes the provisions of this chapter, the foreign company shall be punishable with

**Company's Fine** = **Min** 1,00,000 rupees; **Max** 3,00,000 rupees and in the case of a **continuing offence** = Additional 50,000 rupees for every day after the first during which the contravention continues and

**Every officer** of the foreign company who is in default

**Fine** = Min 25,000 rupees; **Max** 5,00,000 rupees.

## COMPANY'S FAILURE TO COMPLY WITH PROVISIONS OF THIS CHAPTER NOT TO AFFECT VALIDITY OF CONTRACTS, ETC [SECTION 393]

Any **failure by a company to comply with the provisions of Chapter XXII**, **shall not affect the validity of any contract, dealing or transaction entered into by the company or its liability to be sued in respect thereof**. **However, the company shall not be entitled to bring any suit,** claim any set-off, make any counter-claim or institute any legal proceeding in respect of any such contract, dealing or transaction, until the company has complied with the provisions of the Companies Act, 2013, applicable to it.

## RULE 12 OF COMPANIES (REGISTRATION OF FOREIGN COMPANIES) RULES, 2014

Action for Improper Use or Description as Foreign Company: It states that if any person or persons trade or carry on business in any manner under any name or title or description as a foreign company registered under the Act or the rules made thereunder, that person or each of those persons shall, unless duly

registered as foreign company under the Act and rules made thereunder, shall be liable for investigation under section 210 of the Act and action consequent upon that investigation shall be taken against that person

**EXEMPTIONS UNDER THIS CHAPTER**

The Central Government may, by notification, exempt any class of foreign companies; from any of the provisions of this Chapter and a copy of every such notification shall, as soon as may be after it is made, be laid before both Houses of Parliament.

**Ministry of Corporate Affairs Vide Notification S.O. 3156(E), Dated 5th August, 2021**, in exercise of the powers conferred by section 393A of the Companies Act, 2013, the Central Government hereby exempts, from the provisions of sections 387 to 392 (both inclusive), the following:-

(a) foreign companies;

(b) companies incorporated or to be incorporated outside India, whether the company has or has not established, or when formed may or may not establish, a place of business in India,

**insofar as they relate to the**

- offering for subscription in the securities,
- requirements related to the prospectus, and
- all matters incidental thereto in the International Financial Services Centres set up under section 18 of the Special Economic Zones Act, 2005.

**Question and Answers**

1.

**(i) ABC Ltd., a foreign company having its Indian principal place of business at Kolkata, West Bengal is required to deliver various documents to Registrar of Companies under the provisions of the Companies Act, 2013. You are required to state, where the said company should deliver such documents.**

**(ii) In case, a foreign company does not deliver its documents to the Registrar of Companies as required under section 380 of the Companies Act, 2013, state the penalty prescribed under the said Act, which can be levied**

**Solution:**

The Companies Act, 2013 vide section 380 state that every foreign company is required to deliver to the Registrar for registration, within 30 days of the establishment of office in India, documents which have been specified therein. According to the Companies (Registration of Foreign Companies) Rules, 2014, any document which any foreign company is required to deliver to the Registrar shall be delivered to the Registrar having jurisdiction over New Delhi.

(ii) The Companies Act, 2013 lays down the governing provisions for foreign companies in Chapter XXII which is comprised of sections 379 to 393. The penalties for non- filing or for contravention of any provision for this chapter including for non-filing of documents with the Registrar as required by section 380 and other sections in this chapter are laid down in section 392 of the Act which provides that if a foreign company contravenes the provisions of this Chapter, the foreign company shall be punishable with a fine which shall not be less than 1,00,000 but which may extend to 3,00,000 and in the case of a continuing offence, with an additional fine which may extend to 50,000 for every day after the first during which the contravention continues and every officer of the foreign company who is in default shall be punishable with fine which shall not be less than 25,000 but which may extend to 5,00,000.

**2. DEJY is a Company Limited incorporated in Singapore desires to establish a branch office at Mumbai. You being a practicing Chartered Accountant have been appointed by the company as a liaison officer for compliance of legal formalities on behalf of the company. Examining the provisions of the Companies Act, 2013, answer the following:**

**(i) Whether branch office will be considered as a company incorporated outside India.**

**(ii) If yes, state the documents you are required to furnish on behalf of the company, on the establishment of a branch office at Mumbai.**

**Solution:**

(i) According to section 2(42) of the Companies Act, 2013, "Foreign company" means any company or body corporate incorporated outside India which-

(a) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and

(b) conducts any business activity in India in any other manner.

Further, branch offices are generally considered as reflection of the Parent Company' office. Thus, branch offices of a company incorporated outside India are considered as a place of business for conducting business activity in India and will be required to follow provisions of this chapter and such other provisions as may be specified elsewhere under Companies Act, 2013.

(ii) Refer section 380

**3. Galilio Ltd. is a foreign company in Germany, and it has established a place of business in Mumbai. Explain the relevant provisions of the Companies Act, 2013 and rules made thereunder relating to preparation and filing of financial statements, as also the documents to be attached alongwith the financial statements by the foreign company.**

Solution: Refer section 381

**4. Abroad Ltd., a foreign company without establishing a place of business in India, proposes to issue prospectus for subscription of securities in India. Being a consultant of the company, advise on the procedure of such an issue of prospectus by Abroad Ltd.**

**Solution:**

As per section 389 of the Companies Act, 2013, no person shall issue, circulate or distribute in India any prospectus offering for subscription in securities of a company incorporated or to be incorporated outside India, whether the company has or has not established, or when formed will or will not establish, a place of business in India, unless before the issue, circulation or distribution of the prospectus in India, a copy thereof certified by the chairperson of the company and two other directors of the company as having been approved by resolution of the managing body has been delivered for registration to the Registrar and the prospectus states on the face of it that a copy has been so delivered, and there is endorsed on or attached to the copy, any consent to the issue of the prospectus required by section 388 and such documents as may be prescribed under Rule 11 of the Companies (Incorporated outside India) Rules, 2014.

Accordingly, the Abroad Ltd. a foreign company shall proceed with the issue of prospectus in compliance with the above stated provisions of section 379 of the Act.

**Section 393A, Recent amendment**

Further, Ministry Of Corporate Affairs vide Notification dated 5th August, 2021 in exercise of the powers conferred by section 393A of the Companies Act, 2013, the Central Government hereby exempts, from the provisions of sections 387 to 392 (both inclusive), the following:-

(a) foreign companies;

(b) companies incorporated or to be incorporated outside India, whether the company has or has not established, or when formed may or may not establish, a place of business in India,
insofar as they relate to the offering for subscription in the securities, requirements related to the prospectus, and all matters incidental thereto in the International Financial Services Centres set up under section 18 of the Special Economic Zones Act, 2005.

# Chapter 12

# Limited Liability Partnership Act, 2008

## INTRODUCTION

An LLP is a new form of legal business entity with limited liability. It is an alternative corporate business vehicle that not only gives the benefits of limited liability at low compliance cost but allows its partners the flexibility of organizing their internal structure as a traditional partnership. The LLP is a separate legal entity and, while the LLP itself will be liable for the full extent of its assets, **the liability of the partners will be limited.**

LLP is an alternative corporate business form that gives the benefits of limited liability of a company and the flexibility of a partnership. Since LLP contains elements of both 'a corporate structure' as well as 'a partnership firm structure' **LLP is called a hybrid between a company and a partnership.**

The LLP Act, 2008 has 81 sections and 4 schedules.

The Ministry of Corporate Affairs and the Registrar of Companies (ROC) are entrusted with the task of administrating the LLP Act, 2008.

**It is also to be noted that the Indian Partnership Act, 1932 is not applicable to LLPs.**

## DIFFERENCES WITH OTHER FORMS OF ORGANISATION

| | Basis | LLP | Partnership firm |
|---|---|---|---|
| 1. | Regulating Act | The Limited Liability Partnership Act, 2008. | The Indian Partnership Act, 1932. |
| 2. | Body corporate | It is a **body corporate.** | It is not a body corporate, |
| 3. | Separate legal entity | It is a **legal entity separate** from its members. | It is a group of persons with no separate legal entity. |
| 4. | Creation | It is created by a legal process called registration under the LLP Act, 2008. | It is created by an agreement between the partners. |
| 5. | Registration | **Registration is mandatory**. LLP can sue and be sued in its own name. | Registration is **voluntary**. Only the registered partnership firm can sue the third parties. |
| 6. | Perpetual succession | The death, insanity, retirement or insolvency of the partner(s) does not affect its existence of LLP. **Members may join or leave but its existence continues forever**. | The death, insanity, retirement or insolvency of the partner(s) may affect its existence. **It has no perpetual succession.** |
| 7. | Name | Name of the LLP to contain the word **limited liability partners (LLP)** as suffix. | No guidelines. The partners can have any name as per their choice. |

| | | | |
|---|---|---|---|
| 8. | Liability | Liability of each partner **limited to the extent to agreed contribution** except in case of willful fraud. | Liability of each **partner is unlimited**. It can be extended upto the personal assets of the partners. |
| 9. | Mutual agency | Each partner **can bind the LLP** by his acts **but not the other partners**. | Each partner **can bind the firm** as well as other partners by his own acts. |
| 10. | Designated partners | At least **2 designated partners** and atleast one of them shall be resident in India. | There is no provision for such partners under the Partnership Act, 1932. |
| 11. | Common seal | It **may have its common seal** as its official signatures. | There is no such concept in partnership |
| 12. | Legal compliances | Only **designated partners are responsible for all the compliances** and penalties under this Act. | **All partners are responsible** for all the compliances and penalties under the Act. |
| 13. | Annual filing of documents | LLP is required to file:<br>(i) Annual statement of accounts<br>(ii) Statement of solvency<br>(iii) Annual return with the registration of LLP every year. | Partnership firm is not required to file any annual document with the registrar of firms. |
| 14. | Foreign partnership | Foreign nationals can become a partner in a LLP. | Foreign nationals cannot become a partner in a partnership firm. |
| 17. | Minor as partner | **Minor cannot be admitted** to the benefits of LLP. | Minor can be admitted to the benefits of the partnership with the prior consent of the existing partners. |

**DISTINCTION BETWEEN LLP AND LIMITED LIABILITY COMPANY**

| | **Basis** | **LLP** | **Limited Liability Company** |
|---|---|---|---|
| 1. | Regulating Act | The LLP Act, 2008. | The Companies Act, 2013. |
| 2. | Members/Partners | The persons who contribute to LLP are **known as partners** of the LLP. | The persons who invest the money in the shares are **known as members** of the company. |
| 3. | Internal governance structure | The internal governance structure of a LLP is governed by **contract agreement** between the partners. | The internal governance structure of a company **is regulated by statute** (i.e., Companies Act, 2013). |
| 4. | Name | Name of the LLP to contain the word "**Limited Liability partnership**" or "LLP" as suffix. | Name of the public company to contain the word "**limited" and Pvt. Co. to contain** the word "Private limited" |
| 5. | No. of members/partners | Minimum – **2 members**<br>Maximum – **No such limit** on the members in the Act. The members of the LLP can be individuals/or body corporate through the nominees. | Private company: Minimum – 2 members Maximum 200 members Public company: Minimum – 7 members |

| | | | |
|---|---|---|---|
| | | | Maximum – No such limit on the members.<br>Members can be organizations, trusts, another business form or individuals. |
| 6. | Liability of members/partners | Liability of a partners is limited to the **extent of agreed contribution** in case of intention is fraud. | Liability of a member is limited to the amount Unpaid on the shares held by them. |
| 7. | Management | The business of the company managed by the partners including the designated partners authorized in the agreement. | The affairs of the company are managed by board of directors elected by the shareholders. |
| 8. | Minimum number of directors/ designated partners | Minimum 2designated partners. | Pvt. Co. – 2 directors Public co. – 3 directors |

**IMPORTANT DEFINITIONS**

1) **Body Corporate [(Section 2(d)]:** It means a company as defined in section 3 of the Companies Act, 1956 (now Companies Act, 2013) and includes—

(i) an LLP registered under this Act;
(ii) an LLP incorporated outside India; and
(iii) a company incorporated outside India,

**but does not include—**

(i) a corporation sole;
(ii) a co-operative society registered under any law for the time being in force; and
(iii) any other body corporate (not being a company as defined in ~~section 3 of the Companies Act, 1956~~ clause (20) of section 2 of the Companies Act, 2013 or a limited liability partnership as defined in this Act), which the Central Government may, by notification in the Official Gazette, specify in this behalf.

(1) Every LLP shall have **at least two designated partners who are individuals** and at least **one of them shall be a resident in India**:

Provided that in case of a limited liability partnership in which **all the partners are bodies corporate** or in which one or more partners are individuals and bodies corporate, at least two individuals who are partners of such limited liability partnership or **nominees** of such body corporate shall act as designated partners.

**Explanation**: For the purposes of this section, the term resident in India means a person who has stayed in India for a period of **not less than 120 days during the financial year**.

(2) Subject to the provisions of sub-section (1),

**(i) if the incorporation document**

(a) specifies who are to be designated partners, such persons shall be designated partners on incorporation; or

(b) states that each of the partners from time to time of limited liability partnership is to be designated partner, every partner shall be a designated partner;

(ii) any partner may become a designated partner by and in accordance with the limited liability partnership agreement and a partner may cease to be a designated partner in accordance with limited liability partnership agreement.

(3) An individual shall not become a designated partner in any limited liability partnership unless he has **given his prior consent** to act as such to the limited liability partnership in such form and manner as may be prescribed.

(4) Every **LLP shall file with the Registrar** the particulars of every individual who has given his consent to act as designated partner in such form and manner as may be prescribed **within 30 days of his appointment**.

(5) An individual eligible to be a designated partner shall satisfy such conditions and requirements as may be prescribed.

(6) Every designated partner of a limited liability partnership **shall obtain a Designated Partners Identification Number (DPIN)** from the Central Government and the provisions of sections 153 to 159 (both inclusive) of the Companies Act, 2013 shall apply mutatis mutandis for the said purpose.

**2) Minimum number of partners (Section 6):**

(i) Every LLP shall **HAVE AT LEAST 2 PARTNERS.**
(ii) If at any time the number of partners of a **LLP is reduced below two and the LLP carries on business for more than six months** while the number is so reduced, the person, who is the only partner of the LLP during the time that it **so carries on business after those 6 months** and has the knowledge of the fact that it is carrying on business with him alone, **SHALL BE LIABLE PERSONALLY FOR THE OBLIGATIONS OF THE LLP** incurred during that period.

**3) "Small limited liability partnership [Section 2(ta)]:** It means a limited liability partnership—
(i) the **contribution** of which, **does not exceed 25 lakh rupees** or such higher amount, not exceeding 5 crore rupees, as may be prescribed; and
(ii) the **turnover** of which, as per the Statement of Accounts and Solvency for the immediately preceding financial year, **does not exceed 40 lakh** rupees or such higher amount, not exceeding fifty crore rupees, as may be prescribed; or

(iii) which meets such other requirements as may be prescribed, and fulfils such terms and conditions as may be prescribed;

**4) Designated Partners [Section 7]**

(1) Every LLP shall have at least two designated partners who are individuals and at least one of them shall be a resident in India.

Provided, if in LLP, all the partners are bodies corporate or in which one or more partners are individuals and bodies corporate, at least two individuals who are partners of such LLP or nominees of such bodies corporate shall act as designated partners.

**Liabilities of Designated Partners [Section 8]**

(a) responsible for the doing of all acts, matters and things as are required to be done by the limited liability partnership in respect of compliance of the provisions of this Act including filing of any document, return, statement and the like report pursuant to the provisions of this Act and as may be specified in the limited liability partnership agreement; and

(b) liable to all penalties imposed on the limited liability partnership for any contravention of those provisions.

**Changes in Designated Partners [Section 9]**

A limited liability partnership may appoint a designated partner within 30 days of a vacancy arising for any reason and provisions of sub-section (4) and sub-section (5) of section 7 shall apply in respect of such new designated partner, provided that if no designated partner is appointed, or if at any time there is only one designated partner, each partner shall be deemed to be a designated partner.

**Punishment for contravention of sections 7 and 9 [Section 10]**

1. If the LLP contravenes the provisions of sub-section (1) of section 7 (meaning that the number of designated partners are less than two or none of the designated partner is a resident in India), the LLP and its every partner shall be liable to a penalty of `10,000 and in case of continuing contravention, with further penalty of `100 per day subject to maximum `1,00,000 for LLP and `50,000 for every partner of such LLP.
2. If the LLP contravenes the provisions of sub-section (4) of section 7 (failure to file the consent of appointment of designated partner within 30 days of his appointment), the LLP and its every designated partner shall be liable to a penalty of `5,000 and in case of continuing contravention, with further penalty of `100 per day subject to maximum `50,000 for LLP and `25,000 for every designated partner.
3. If the LLP contravenes the provisions of sub-section (5) of section 7 or section 9, the LLP and its every partner shall be liable to a penalty of `10,000 and in case of continuing contravention, with further penalty of
4. `100 per day subject to maximum `1,00,000 for LLP and `50,000 for every partner of such LLP.

## SALIENT FEATURES OF LLP

i. **LLP is a body corporate:** LLP is a body corporate formed and incorporated under this Act and is a **legal entity separate from that of its partners.**

ii. **Perpetual Succession:** The LLP can **continue its existence irrespective** of changes in partners. **Death, insanity, retirement or insolvency of partners has no impact on the existence of LLP.**

iii. **Separate Legal Entity:** The LLP is a separate legal entity; it is liable to the full extent of its assets **but liability of the partners is limited** to their agreed contribution in the LLP.

iv. **Mutual Agency:** Further, **no partner is liable on account of the independent or un-authorized** actions of other partners, **thus individual partners are shielded from joint liability** created by another partner's wrongful business decisions or misconduct. In other words, all partners will be the agents of the LLP alone. No one partner can bind the other partner by his acts.

v. **LLP Agreement: Mutual rights and duties of the partners within an LLP are governed by an agreement between the partners**.

**In the absence of any such agreement, the mutual rights and duties shall be governed by the provisions of the LLP Act, 2008.**

vi. **Artificial Legal Person:** A LLP is an artificial legal person because it is created by a legal process and is clothed with all rights of an individual. It can do everything which any natural person can do

vii. **Common Seal:** A LLP being an artificial person can act through its partners and designated partners. LLP may have a common seal, if it decides to have one [Section 14(c)]. Thus, it is not mandatory for a LLP to have a common seal.

viii. **Limited Liability:** The liability of the partners will be limited to their agreed contribution in the LLP.

ix. **Conversion into LLP:** A firm, private company or an unlisted public company would be allowed to be converted into LLP in accordance with the provisions of LLP Act, 2008.

x. **Business for Profit Only:** The essential requirement for forming LLP is carrying on a lawful business with a view to earn profit. Thus LLP cannot be formed for charitable or non- economic purpose.

xi. **Management of Business**: The partners in the LLP are entitled to manage the business of LLP. But only the designated partners are responsible for legal compliances.

xii. **Investigation:** The Central Government shall have powers to investigate the affairs of an LLP.

xiii. **E-Filling of Documents:** Every form or application of document shall be authenticated by a partner or designated partner of LLP, filed on its website www.mca.gov.in .

xiv. **Foreign LLPs:** Section 2(1)(m) defines foreign limited liability partnership "as a limited liability partnership formed, incorporated, or registered outside India which established as place of business within India". Foreign LLP can become a partner in an Indian LLP.

## INCORPORATION OF LLP

## 1. INCORPORATION DOCUMENT

**a.** The 1st step to incorporation of LLP shall be that **two or more persons associated for carrying on a lawful business with a view to profit** shall subscribe their names to incorporation document;

**b.** the incorporation document shall be **filed with the Registrar** of the State in which the registered office of the LLP is to be situated

**c.** The incorporation document shall

- be in a **form** as may be prescribed;
- state the **name of the LLP**;
- state the **proposed business** of the LLP;
- state the **address** of the registered office of the LLP;
- state the **name and address** of each of the persons who are to be **partners** of the LLP on incorporation;
- state the **name and address** of the persons who are to be **designated partners** of the LLP on incorporation;
- other information as may be prescribed.

## 2. STATEMENT

a. there shall be filed along with the incorporation document, a statement in the prescribed form,

b. made by either **an advocate, or a Company Secretary or a Chartered Accountant or a Cost Accountant**, who is engaged in the formation of the LLP and

c. by **anyone who subscribed** his name to the incorporation document, that **all the requirements of this Act and the rules** made thereunder **have been complied with**

d. that all the requirements of this Act and the rules made thereunder have been complied with,

e. in respect of incorporation and matters precedent and incidental thereto.

**(2) The incorporation document shall**—

- be in a form as may be prescribed
- state the name of the LLP;
- state the proposed business of the LLP;
- state the address of the registered office of the LLP;
- state the name and address of each of the persons who are to be partners of the LLP on incorporation
- state the name and address of the persons who are to be designated partners of the LLP on incorporation;
- contain such other information concerning the proposed LLP as may be prescribed.

**(3) If a person makes a statement as discussed above which he**

(a) knows to be false; or

(b) does not believe to be true

- with imprisonment for a term which may extend to 2 years and
- with fine which shall not be less than `10,000 but which may extend to `5 Lakhs.

### CERTIFICATE OF INCORPORATION

When the above two points are complied with, the Registrar shall retain the incorporation document and within a period of 14 days-

• register the incorporation document; and
• give a certificate that the LLP is incorporated by the name specified therein.

The certificate issued shall be signed by the Registrar and authenticated by his official seal and it shall be conclusive evidence that the LLP is incorporated by the name specified therein.

**Incorporation by Registration [Section 12]**

(1) When the requirements imposed by clauses (b) and (c) of sub-section (1) of section 11 have been complied with, the **Registrar shall retain the incorporation document** and, unless the requirement imposed by clause (a) of that sub-section has not been complied with, he shall, within a period of 14 days—
(a) register the incorporation document; and
(b) give a certificate that the LLP is incorporated by the name specified therein

(2) The **Registrar may accept the statement** delivered under clause (c) of subsection (1) of section 11 as sufficient evidence that the requirement imposed by clause (a) of that sub-section has been complied with.

(3) The certificate issued under clause (b) of sub-section (1) shall be signed by the Registrar and authenticated by his official seal.

(4) The **certificate shall be conclusive evidence that the LLP is incorporated** by the name specified therein

**Registered Office of LLP and Change therein [Section 13]**

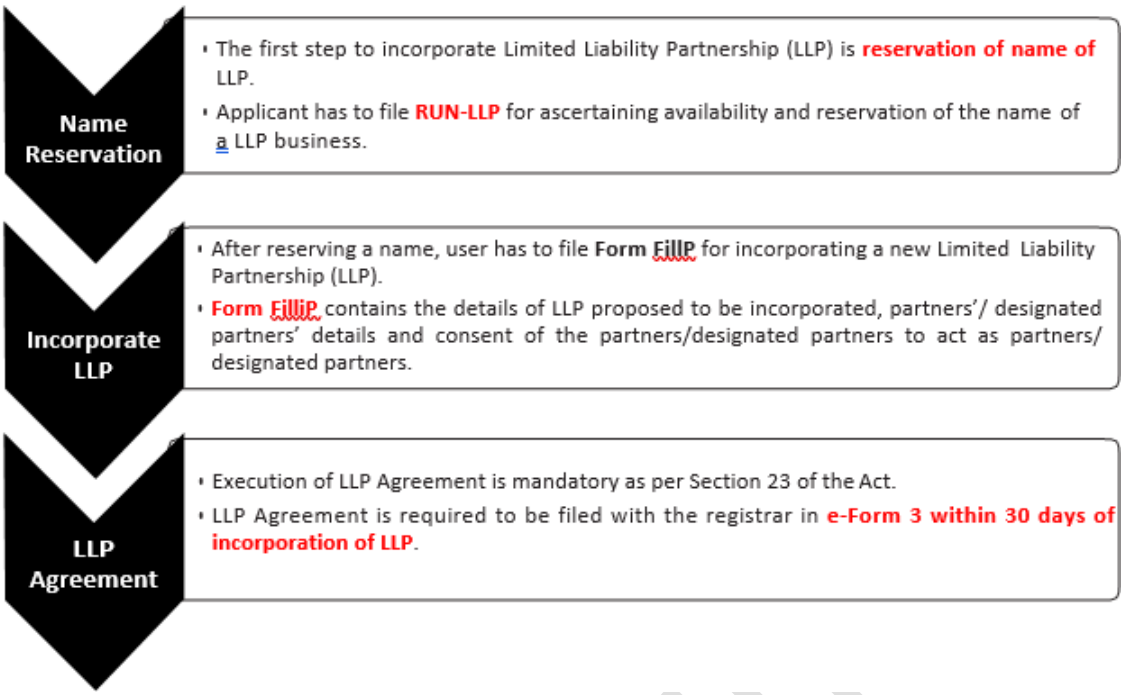
(1) Every LLP shall have a registered office to which all communications and notices may be addressed and where they shall be received.

(2) A document may be served on a LLP or a partner or designated partner thereof by sending it by post under a certificate of posting or by registered post or by any other manner, as may be prescribed, at the registered office and any other address specifically declared by the LLP for the purpose in such form and manner as may be prescribed.

(3) A LLP may change the place of its registered office and file the notice of such change with the Registrar in such form and manner and subject to such conditions as may be prescribed and any such change shall take effect only upon such filing.

(4) If the LLP contravenes any provisions of this section, the LLP and its every partner shall be punishable with penalty of ` 500 per day subject to maximum ` 50,000.

**Steps to incorporate LLP-**




Registered office of LLP and change therein (Section 13):

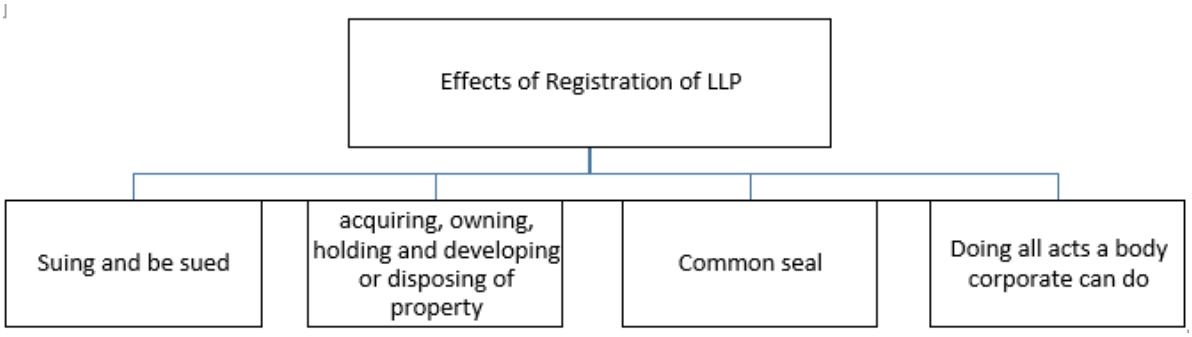
(1) Every limited liability partnership **shall have a registered office** to which all communications and notices may be addressed and where they shall be received.

(2) A document may be served on a limited liability partnership or a partner or designated partner thereof by sending it by post under a certificate of posting or by registered post or by any other manner, as may be prescribed, at the registered office and any other address specifically declared by the limited liability partnership for the purpose in such form and manner as may be prescribed.

(3) A LLP may **change the place of its registered office and file the notice of such change** with the Registrar in such form and manner and subject to such conditions as may be prescribed and any such change shall take effect only upon such filing.

(4) If any default is made in complying with the requirements of this section, the limited liability partnership and its every partner shall be **liable to a penalty of 500 rupees for each day** during which the default continues, subject to a **maximum of fifty thousand rupees** for the limited liability partnership and its every partner.

**EFFECT OF REGISTRATION (Section 14)**




**Name [Section 15]**

(1) Every limited liability partnership shall have either the words "limited liability partnership" or the acronym "LLP" as the last words of its name.

**(2)** No LLP shall be registered by a name which, in the opinion of the Central Government is—

(a) undesirable; or

**(b)** identical or too nearly resembles to that of any other LLP or a company or a registered trademark of any other person under the Trade Marks Act, 1999.

**Reservation of name [Section 16]**

(1) A person may apply in such form and manner and accompanied by such fee as may be prescribed to the Registrar for the reservation of a name set out in the application as—

(a) the name of a proposed LLP; or

(b) the name to which a LLP proposes to change its name.

(2) Upon receipt of an application under sub-section (1) and on payment of the prescribed fee, the Registrar may, if he is satisfied, subject to the rules prescribed by the Central Government in the matter, that the name to be reserved is not one which may be rejected on any ground referred to in sub-section (2) of section 15, reserve the name for a period of 3 months from the date of intimation by the Registrar.

**Rectification of name of LLP [Section 17]**

1. Notwithstanding anything contained in sections 15 and 16, if through inadvertence, or otherwise, the LLP, on its first registration or on its registration by new name, is registered by a name which is identical with or too nearly resembles to-

(a) that of any other LLP or a company; or

(b) a registered trade mark of a proprietor under the Trade Marks Act, 1999 as likely to be mistaken, then on an application of such LLP or proprietor referred to in clauses (a) and (b) respectively or a company, the Central Government may direct such LLP to change its name or new name within a period of 3 months from the date of issue of such direction,

Provided that an application of the proprietor of the registered trade marks shall be maintainable within a period of 3 years from the date of incorporation or registration or change of name of the LLP under this Act.

2. Where an LLP changes its name or obtains new name, it shall within a period of 15 days from the date of such change, give notice of the change to Registrar along with the order of the Central Government, who shall carry out necessary changes in the certificate of incorporation and within 30 days of such change in the certificate of incorporation, such LLP shall change its name in the LLP agreement.

3. If the LLP is in default in complying with any direction given under subsection (1), the Central

Government shall allot a new name to the LLP and the Registrar shall enter the new name in the register of LLP in place of the old name and issue a fresh certificate of incorporation with new name. Provided that nothing contained in this sub-section shall prevent a LLP from subsequently changing its name

## PARTNERS AND THEIR RELATIONS

**Eligibility to be partners (Section 22):** On the incorporation of a LLP, the persons who subscribed their names to the incorporation document shall be its partners and any other person may become a partner of the LLP by and in accordance with the LLP agreement.

## RELATIONSHIP OF PARTNERS (Section 23)

(1) Save as otherwise provided by this Act, the mutual rights and **duties of the partners of a LLP**, and the mutual rights and duties of a LLP and its partners, **shall be governed by the LLP agreement** between the partners, or between the LLP and its partners.
(2) The **LLP agreement and any changes, if any, made therein shall be filed with the Registrar**
(3) An agreement in writing made before the incorporation of a LLP between the persons who subscribe their names to the incorporation document may impose obligations on the LLP, provided such agreement is ratified by all the partners after the incorporation of the LLP.

## CESSATION OF PARTNERSHIP INTEREST (Section 24)

(1) A person **may cease to be a partner** of a LLP **in accordance with an agreement** with the other partners or, in the absence of agreement, **by giving a notice in writing of not less than 30 days** to the other partners of his intention to resign as partner.

(2) A person shall cease to be a partner of a LLP—
(a) on his **death** or dissolution of the LLP; or
(b) if he is **declared to be of unsound mind** by a competent court; or
(c) if he has **applied to be adjudged as an insolvent** or **declared as an insolvent.**

### CONSEQUENCE OF CESSATION OF A PARTNER

(3) Where a person has ceased to be a partner of a LLP (hereinafter referred to as "former partner"), the former partner is to be regarded (in relation to any person dealing with the LLP) as still being a partner of the LLP unless—
(a) the **person has notice that the former partner has ceased** to be a partner of the LLP; or
(b) **notice that the former partner has ceased** to be a partner of the LLP has been delivered to the **Registrar**.
(4) The **cessation** of a partner **does not discharge** the partner **from any obligation** to the LLP or to the other partners or to any other person **which he incurred while being a partne**r.
(5) Where a partner of a LLP ceases to be a partner, the **former partner** or a **person entitled to his**

**share in consequence of the death or insolvency** of the former partner, **shall be entitled to receive** from the LLP—

(a) an **amount equal to the capital contribution** of the former partner actually made to the LLP; &

(b) his **right to share in the accumulated profits** of the LLP, after the deduction of accumulated losses of the LLP, determined as at the date the former partner ceased to be a partner.

(6) **A former partner or a person entitled to his share in consequence of the death or insolvency** of the former partner **shall not have any right to interfere in the management** of the LLP.

## REGISTRATION OF CHANGES IN PARTNERS (Section 25)

(1) Every partner **shall INFORM THE LLP of any change in his name or address within a period of 15 days of such change.**

(2) A **LLP shall**—

(a) where a **PERSON BECOMES (admission)** or **CEASES** to be a partner, file a notice with the Registrar within 30 days from the date he becomes or ceases to be a partner; and; and

(b) where **there is any CHANGE IN THE NAME OR ADDRESS of a partner**, file a **notice with the Registrar within 30 days of such change**.

(3) A **notice filed with the Registrar** under sub-section (2)—

(a) shall be in such form and accompanied by such fees as may be prescribed;

(b) shall be signed by the designated partner of the LLP and authenticated in a manner as may be prescribed; and

(c) if it relates to an incoming partner, shall contain a statement by such partner that he consents to becoming a partner, signed by him and authenticated in the manner as may be prescribed.

(4) If the limited liability partnership contravenes the provisions of sub- section (2), the limited liability partnership and its every designated partner shall be liable to a penalty of ten thousand rupees.

(5) If the contravention referred to in sub- section (1) is made by any partner of the limited liability partnership, such partner shall be liable to a penalty of ten thousand rupees.

(6) Any **person who ceases to be a partner of a LLP MAY HIMSELF FILE WITH THE REGISTRAR THE NOTICE** referred to in sub-section (3) **if he has reasonable cause to believe that the LLP may not file the notice** with the Registrar and in case of any such notice filed by a partner, the **Registrar shall obtain a confirmation to this effect from the LLP** unless the LLP has also filed such notice. However, where no confirmation is given by the LLP within 15 days, the registrar shall register the notice made by a person ceasing to be a partner under this section.

## EXTENT AND LIMITATION OF LIABILITY OF LLP AND PARTNER

1) **PARTNER AS AGENT (SECTION 26):** Every partner of a LLP is, **THE AGENT OF THE LLP, BUT NOT OF OTHER PARTNERS. (No Mutual Agency concept)**
2) **EXTENT OF LIABILITY OF LLP (SECTION 27):**

(1) A **LLP is not bound by anything** done by a partner in dealing with a person if—

(a) the **partner in fact has no authority to act** for the LLP in doing a particular act; **AND**

(b) the **person knows that he has no authority** or does not know or believe him to be a partner of the LLP.

(2) The **LLP is liable if a partner of an LLP is liable to any person as a result of a wrongful act** or omission on his part **in the course of the business** of the LLP or with its authority.

**Example:** P wants to purchase a car from XYZ LLP, which can have a mileage of 20 km/litre. Q the partner of LLP, pointing at a particular vehicle says "This car will suit you." Later P buys the car but finds out later on that this car only has a top mileage of 15 km/ litre. This amounts to a breach of condition because the seller made the stipulation which forms the essence of the contract. In this case the LLP shall also be held liable for the wrongful act of the Partner.

(3) An **obligation of the LLP** whether arising in contract or otherwise, **shall be solely the obligation of the LLP.**

(4) The **liabilities of the LLP shall be met out of the property of the LLP.**

**3) EXTENT OF LIABILITY OF PARTNER (Section 28):**

(1) A **PARTNER IS NOT PERSONALLY LIABLE**, **directly or indirectly for an obligation referred to in sub-section (3)** of section 27 solely by reason of being a partner of the LLP.

(2) **These sections shall not affect the personal liability of a partner for his own wrongful act** or omission, **but a partner shall not be personally liable for the wrongful act or omission of any other partner of the LLP.**

**4) HOLDING OUT (Section 29):**

**(1)** Any person,

- who by **words spoken or written or by conduct**,
- **represents himself**, or **knowingly permits himself to be a partner** in a LLP
- is **liable to any person**
- **who has on the faith** of any such representation
- **given credit to the LLP**

**However,**

- where **any credit is received by the LLP** as a result of such representation,
- the **LLP shall,**
- **be liable to the extent of credit received by it** or any financial benefit derived thereon.

**(2)** Where after a partner's death the business is continued in the same LLP name, the continued use of that name or of the deceased partner's name as a part thereof shall not of itself make his legal representative or his estate liable for any act of the LLP done after his death.

**5) UNLIMITED LIABILITY IN CASE OF FRAUD (Section 30):**

**(1)** In case of fraud:

- In the event of an act carried out by a LLP, or any of its partners,
- with **intent to defraud creditors of the LLP or any other person**, or for any fraudulent purpose,

• the **liability of the LLP and partners who acted with intent to defraud creditors** or for any fraudulent purpose

• **shall be unlimited for all or any of the debts** or other liabilities of the LLP.

However, in case any such act is carried out by a partner, the LLP is liable to the same extent as the partner unless it is established by the LLP that such act was without the knowledge or the authority of the LLP.

**(2)** Where any business is carried on with such intent or for such purpose as mentioned in sub-section (1), **every person who was knowingly a party to the carrying on of the business** in the manner aforesaid **shall be punishable** with

• imprisonment for a term which may extend ~~to 2 years~~ **5 years** and

• with fine which shall not be less than ` 50,000 but which may extend to ` 5 Lakhs.

**(3)** Where a LLP or any partner or designated partner or employee of such LLP has conducted the affairs of the LLP in a fraudulent manner, **the LLP and any such partner or designated partner or employee shall be liable to pay compensation to any person who has suffered any loss** or damage by reason of such conduct.

However, such LLP shall not be liable if any such partner or designated partner or employee has acted fraudulently without knowledge of the LLP.

**6) WHISTLE BLOWING (SECTION 31):**

(1) The **Court or Tribunal MAY REDUCE OR WAIVE ANY PENALTY** leviable against any partner or employee of a LLP, **if it is satisfied that**—

• such **partner or employee of a LLP has provided useful information** during investigation of such LLP; or

• when any information given by any partner or employee **leads to LLP or any partner or employee of such LLP being convicted** under this Act or any other Act.

(2) No **partner or employee of any LLP may be discharged, demoted, suspended, threatened, harassed** or in any other manner discriminated against the terms and conditions of his LLP or employment merely because of his providing information or causing information to be provided pursuant to sub-section (1)

**(3) <u>CONTRIBUTIONS</u>**

**Form of contribution [Section 32]**

(1) A contribution of a partner may consist of **tangible, movable or immovable or intangible** property or other benefit to the limited liability partnership, including **money, promissory notes, other agreements to contribute cash or property**, and contracts for services performed or to be performed.

(2) The **monetary value of contribution** of each partner shall be accounted for and disclosed in the accounts of the limited liability partnership in the manner as may be prescribed

**Obligation to contribute [Section 33]**

(1) The obligation of a partner to contribute money or other property or other benefit or to perform services for a limited liability partnership shall be as per the limited liability partnership agreement.

(2) A creditor of a limited liability partnership, which extends credit or otherwise acts in reliance on an obligation described in that agreement, without notice of any compromise between partners, may enforce the original obligation against such partner.

**FINANCIAL DISCLOSURES**

**(1) Proper Books of account:** The LLP shall **maintain such proper books of account**, on **cash basis or accrual basis** and according **to double entry system** of accounting and **shall maintain the same at its registered office.**

**(2) Statement of Account and Solvency: Every LLP shall, within a period of 30 days from the end of 6 months of the financial year**, prepare a **Statement of Account and Solvency** for the said financial year as at the last day of the said financial year in such form as may be prescribed, and such statement **shall be signed by the designated partners of the LLP**.

(3) Any LLP **which fails to comply with the provisions** of sub-section (3), such limited liability partnership and its designated partners shall be liable to a penalty of one hundred rupees for each day during which such failure continues, subject to a maximum of one lakh rupees for the LLP and fifty thousand rupees for every designated partner.

(4) Any limited liability partnership which fails to comply with the provisions of sub-section (1), sub-section (2) and sub-section (4), such LLP shall be punishable with fine which shall not be less than twenty-five thousand rupees, but may extend to five lakh rupees and every designated partner of such limited liability partnership shall be punishable with fine which shall not be less than ten thousand rupees, but may extend to one lakh rupees

**Example:** Suppose, the financial year of a LLP closes on 31st March, 2021 then the LLP has to file Statement of Account and Solvency with the Registrar latest by 30th October 2020.

**Accounting and auditing standards.**

The Central Government may, in consultation with the National Financial Reporting Authority constituted under section 132 of the Companies Act, 2013,—

(a) prescribe the standards of accounting; and

(b) prescribe the standards of auditing, as recommended by the Institute of Chartered Accountants of India constituted under section 3 of the Chartered Accountants Act, 1949, for a class or classes of limited liability partnerships.]

**(3) Annual return (Section 35): Every LLP shall file an annual return duly authenticated with the Registrar within 60 days of closure of its financial year** in such form and manner and companied by such fee as may be prescribed.

**(4) INSPECTION OF DOCUMENTS KEPT BY REGISTRAR [SECTION 36]**

The incorporation document, name of partners and changes, if any, made therein, Statement of Account and Solvency and annual return filed by each LLP with the Registrar shall be available for inspection by any person in such manner and on payment of such fee as may be prescribed

**Example:** Suppose, the financial year of a LLP closes on 31st March, 2020 then the LLP has to file an annual return with the Registrar latest by 30th May, 2020.

**(5)PENALTY FOR FALSE STATEMENT [SECTION 37]**

If in any return, statement or other document required by or for the purposes of any of the provisions of this Act, any person makes a statement—

(a) which is false in any material particular, knowing it to be false; or

(b) which omits any material fact knowing it to be material,

he shall, save as otherwise expressly provided in this Act, be punishable with imprisonment for a term which may extend to 2 years, and shall also be liable to fine which may extend to 5 lakh rupees but which shall not be less than 1 lakh rupees.

**(6) POWER OF REGISTRAR TO OBTAIN INFORMATION [SECTION 38]**

(1) In order to obtain such information as the Registrar may consider necessary for the purposes of carrying out the provisions of this Act, the Registrar may require any person including any present or former partner or designated partner or employee of a limited liability partnership to answer any question or make any declaration or supply any details or particulars in writing to him within a reasonable period.

(2) In case any person referred to in sub-section (1) does not answer such question or make such declaration or supply such details or particulars asked for by the Registrar within a reasonable time or time given by the Registrar or when the Registrar is not satisfied with the reply or declaration or details or particulars provided by such person, the Registrar shall have power to summon that person to appear before him or an inspector or any other public officer whom the Registrar may designate, to answer any such question or make such declaration or supply such details, as the case may be.

(3) Any person who, without lawful excuse, fails to comply with any summons or requisition of the Registrar under this section shall be punishable with fine which shall not be less than two thousand rupees but which may extend to twenty-five thousand rupees.

**(7)COMPOUNDING OF OFFENCES [SECTION 39]**

(1) Notwithstanding anything contained in the Code of Criminal Procedure, 1973, the Regional Director or any other officer not below the rank of Regional Director authorised by the Central Government may compound any offence under this Act which is punishable with fine only, by collecting from a person reasonably suspected of having committed the offence, a sum which may extend to the amount of the

maximum fine provided for the offence but shall not be lower than the minimum amount provided for the offence.

(2) Nothing contained in sub-section (1) shall apply to an offence committed by a limited liability partnership or its partner or its designated partner within a period of three years from the date on which similar offence committed by it or him was compounded under this section.

**Explanation.—**For the removal of doubts, it is hereby clarified that any second or subsequent offence committed after the expiry of the period of three years from the date on which the offence was previously compounded, shall be deemed to be the first offence.

(3) Every application for the compounding of an offence shall be made to the Registrar who shall forward the same, together with his comments thereon, to the Regional Director or any other officer not below the rank of Regional Director authorised by the Central Government, as the case may be.

(4) Where any offence is compounded under this section, whether before or after the institution of any prosecution, intimation thereof shall be given to the Registrar within a period of seven days from the date on which the offence is so compounded.

(5) Where any offence is compounded before the institution of any prosecution, no prosecution shall be instituted in relation to such offence.

(6) Where the compounding of any offence is made after the institution of any prosecution, such compounding shall be brought by the Registrar in writing, to the notice of the court in which prosecution is pending and on such notice of the compounding of the offence being given, the offender in relation to which the offence is so compounded shall be discharged.

(7) The Regional Director or any other officer not below the rank of Regional Director authorised by the Central Government, while dealing with the proposal for compounding of an offence may, by an order, direct any partner, designated partner or other employee of the LLP to file or register or on payment of fee or additional fee as required to be paid under this Act, such return, account or other document within such time as may be specified in the order.

(8) Notwithstanding anything contained in this section, if any partner or designated partner or other employee of the LLP who fails to comply with any order made by the Regional Director or any other officer not below the rank of Regional Director authorised by the Central Government, under subsection (7), the maximum amount of fine for the offence, which was under consideration Regional Director or such authorised officer for compounding under this section shall be twice the amount provided in the corresponding section in which punishment for such offence is provided

## ASSIGNMENT AND TRANSFER OF PARTNERSHIP RIGHTS

### PARTNER'S TRANSFERABLE INTEREST [SECTION 42]

(1) The rights of a partner to a share of the profits and losses of the limited liability partnership and to receive distributions in accordance with the limited liability partnership agreement are transferable either wholly or in part.

(2) The transfer of any right by any partner pursuant to sub-section (1) does not by itself cause the disassociation of the partner or a dissolution and winding up of the limited liability partnership.

(3) The transfer of right pursuant to this section does not, by itself, entitle the transferee or assignee to participate in the management or conduct of the activities of the limited liability partnership, or access information concerning the transactions of the limited liability partnership.

## CONVERSION INTO LLP

**Conversion from firm into LLP (Section 55):** Firm may convert into a LLP in accordance with the provisions of this Chapter and **the 2nd Schedule.**

**Conversion from private company into LLP (Section 56):** A private company may convert into a LLP in accordance with the provisions of this Chapter and **the 3rd Schedule.**

**Conversion from unlisted public company into LLP** (Section 57): An unlisted public company may convert into a LLP in accordance with the provisions of this Chapter and **the 4th Schedule.**

**REGISTRATION AND EFFECT OF CONVERSION (SECTION 58):**

(i) The Registrar, on satisfying that a firm, private company or an unlisted public company has **complied with the provisions of schedules of the Act**, **will issue a certificate of registration**

(ii) The LLP shall, **within 15 days of the date of registration**, **inform the concerned Registrar of Firms or Registrar of Companies, about the conversion.**

(iii) Upon such conversion, they **shall be bound by the provisions of the various Schedules**, as the case may be, applicable to them.

(iv) the firm or the company, as the case may be, shall be deemed to be dissolved and removed from the records of the Registrar of Firms or Registrar of Companies, as the case may be.

## FOREIGN LLP

**Foreign limited liability partnerships (Section 59):** The Central Government may make rules for provisions in relation to establishment of **place of business by foreign LLP within India** and carrying on their business therein by applying or incorporating, with such modifications, as appear appropriate

## COMPROMISE, ARRANGEMENT OR RECONSTRUCTION OF LIMITED LIABILITY PARTNERSHIPS

**Compromise or arrangement of limited liability partnerships [Section 60]**

(1) Where a compromise or arrangement is proposed—

(a) between a limited liability partnership and its creditors; or

(b) between a limited liability partnership and its partners,

the Tribunal may, on the application of the limited liability partnership or of any creditor or partner of the limited liability partnership, or, in the case of a limited liability partnership which is being wound up, of the liquidator, order a meeting of the creditors or of the partners, as the case may be, to be called, held and conducted in such manner as may be prescribed or as the Tribunal directs

(2) If a majority representing three-fourths in value of the creditors, or partners, as the case may be, at the meeting, agree to any compromise or arrangement, the compromise or arrangement shall, if sanctioned by the Tribunal, by order be binding on all the creditors or all the partners, as the case may be, and also on the limited liability partnership, or in the case of a limited liability partnership which is being wound up, on the liquidator and contributories of the limited liability partnership:

Provided that no order sanctioning any compromise or arrangement shall be made by the Tribunal unless the Tribunal is satisfied that the limited liability partnership or any other person by whom an application has been made under sub-section (1) has disclosed to the Tribunal, by affidavit or otherwise, all material facts relating to the limited liability partnership, including the latest financial position of the limited liability partnership and the pendency of any investigation proceedings in relation to the limited liability partnership.

(3) An order made by the Tribunal under sub-section (2) shall be filed by the limited liability partnership with the Registrar within thirty days after making such an order and shall have effect only after it is so filed.

(4) If default is made in complying with the provisions of sub-section (3), the LLP and its every designated partner shall be 'liable to a penalty of `10,000 and in case of continuing default, with further penalty of `100 for each day after the first during which such default continues, subject to maximum `1,00,000 for LLP and `50,000 for every designated partner

(5) The Tribunal may, at any time after an application has been made to it under this section, stay the commencement or continuation of any suit or proceeding against the limited liability partnership on such terms as the Tribunal thinks fit, until the application is finally disposed of.

**Power of Tribunal to enforce compromise or arrangement (Section 61)**

(1) Where the Tribunal makes an order under section 60 sanctioning a compromise or an arrangement in respect of a limited liability partnership, it—

(a) shall have power to supervise the carrying out of the compromise or an arrangement; and

(b) may, at the time of making such order or at any time thereafter, give such directions in regard to any matter or make such modifications in the compromise or arrangement as it may consider necessary for the proper working of the compromise or arrangement

(2) If the Tribunal aforesaid is satisfied that a compromise or an arrangement sanctioned under section 60 cannot be worked satisfactorily with or without modifications, it may, either on its own motion or on the application of any person interested in the affairs of the limited liability partnership, make an order for winding up the limited liability partnership, and such an order shall be deemed to be an order made under section 64 of this Act.

**Provisions for facilitating reconstruction or amalgamation of limited liability partnerships [Section 62]**

(1) Where an application is made to the Tribunal under section 60 for sanctioning of a compromise or arrangement proposed between a limited liability partnership and any such persons as are mentioned in that section, and it is shown to the Tribunal that—

(a) compromise or arrangement has been proposed for the purposes of, or in connection with, a scheme for the reconstruction of any limited liability partnership or limited liability partnerships, or the amalgamation of any two or more limited liability partnerships; and

(b) under the scheme the whole or any part of the undertaking, property or liabilities of any limited liability partnership concerned in the scheme (in this section referred to as a "transferor limited liability partnership") is to be transferred to another limited liability partnership (in this section referred to as the "transferee limited liability partnership"), the Tribunal may, either by the order sanctioning the compromise or arrangement or by a subsequent order, make provisions for all or any of the following matters, namely:—

(i) the transfer to the transferee limited liability partnership of the whole or any part of the undertaking, property or liabilities of any transferor limited liability partnership;

(ii) the continuation by or against the transferee limited liability partnership of any legal proceedings pending by or against any transferor limited liability partnership;

(iii) the dissolution, without winding up, of any transferor limited liability partnership;

(iv) the provision to be made for any person who, within such time and in such manner as the Tribunal directs, dissent from the compromise or arrangement; and

(v) such incidental, consequential and supplemental matters as are necessary to secure that the reconstruction or amalgamation shall be fully and effectively carried out:

Provided that no compromise or arrangement proposed for the purposes of, or in connection with, a scheme for the amalgamation of a limited liability partnership, which is being wound up, with any other limited liability partnership or limited liability partnerships, shall be sanctioned by the Tribunal unless the Tribunal has received a report from the Registrar that the affairs of the limited liability partnership have not been conducted in a manner prejudicial to the interests of its partners or to public interest:

Provided further that no order for the dissolution of any transferor limited liability partnership under clause (iii) shall be made by the Tribunal unless the Official Liquidator has, on scrutiny of the books and papers of the limited liability partnership, made a report to the Tribunal that the affairs of the limited liability partnership have not been conducted in a manner prejudicial to the interests of its partners or to public interest.

(2) Where an order under this section provides for the transfer of any property or liabilities, then, by virtue of the order, that property shall be transferred to and vest in, and those liabilities shall be transferred to and become the liabilities of, the transferee limited liability partnership; and in the case of any property, if the order so directs, freed from any charge which is, by virtue of the compromise or arrangement, to cease to have effect.

(3) Within thirty days after the making of an order under this section, every limited liability partnership in relation to which the order is made shall cause a certified copy thereof to be filed with the Registrar for registration

(4) If default is made in complying with the provisions of sub-section (3), the LLP and its every designated partner shall be 'liable to a penalty of `10,000 and in case of continuing contravention, with further penalty of `100 for each day after the first during which such default continues, subject to maximum `1,00,000 for LLP and `50,000 for every designated partner'.

## WINDING UP AND DISSOLUTION

**1)** A LLP may be wound up by the Tribunal:

**a.** if the **LLP decides** that LLP be wound up by the Tribunal;

**b.** if, for a period of **more than 6 months**, the **number of partners of the LLP is reduced below 2**;

**c.** if the **LLP is unable to pay its debts**;

**d.** if the LLP **has acted against the interests of the sovereignty and integrity** of India, the security of the State or public order;

**e.** if the LLP has **made a default in filing** with the **Registrar the Statement of Account and Solvency or annual return for any 5 consecutive financial years**; or

**f.** if the Tribunal is of the opinion that it is **just and equitable that** the LLP be wound up.

**Rules for winding up and dissolution [Section 65]:** The Central Government may make rules for the provisions in relation to winding up and dissolution of LLP.

## MISCELLANEOUS

**Business Transactions of Partner with LLP [Section 66]:** A partner may lend money to and transact other business with the LLP and has the same rights and obligations with respect to the loan or other transactions as a person who is not a partner

**Application of the Provisions of the Companies Act [Section 67]**

(1) The Central Government may, by notification in the Official Gazette, direct that any of the provisions of the Companies Act, 1956 specified in the notification—

- shall apply to any LLP; or
- shall apply to any LLP with such exception, modification and adaptation, as may be specified, in the notification.

(2) A copy of every notification proposed to be issued under sub-section (1)

- or rules made thereunder. Eshall be laid in draft before each House of Parliament, while it is in session,
- for a total period of 30 days which may be comprised in one session or in two or more successive sessions, and
- if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in disapproving the issue of the notification or both Houses agree in making any modification in the notification,

- the notification shall not be issued or, as the case may be,

shall be issued only in such modified form as may be agreed upon by both the Houses.

**Payment of additional fee (Section 69):**

Any document or return required to be registered or filed under this Act with Registrar, if, is not registered or filed in time provided therein, may be registered or filed after that time, **on payment of such additional fee as may be prescribed in addition to any fee as is payable for filing of such document** or return:

Provided that such document or return shall be filed after the due date of filing, without prejudice to any other action or liability under this Act:

Provided further that a **different fee or additional fee may be prescribed for different classes of limited liability partnerships** or for different documents or returns required to be filed under this Act or rules made thereunder.

**Enhanced Punishment [Section 70]**

In case a limited liability partnership or any partner or designated partner of such limited liability partnership commits any offence, the limited liability partnership or any partner or designated partner shall, for the second or subsequent offence, be punishable with imprisonment as provided, but in case of offences for which fine is prescribed either along with or exclusive of imprisonment, with fine which shall be twice the amount of fine for such offence.

# Chapter 13

# THE GENERAL CLAUSES ACT, 1897

## INTRODUCTION

1) The General Clauses Act, 1897 **contains general definitions** which shall be **APPLICABLE TO ALL CENTRAL ACTS AND REGULATIONS** where
   - **there is** absence of clear definition in the specific enactments and
   - where there is a **conflict between the pre-constitutional laws and post-constitutional laws**. The Act gives a clear suggestion for the conflicting provisions and differentiates the legislation according to the commencement and enforcement to avoid uncertainty.

2) The General Clauses Act has **been enacted to shorten language** used in parliamentary legislation and to **avoid the repetition of the same words** in the same course of the same piece of legislation.
3) Also called as **INTERPRETATION ACT**, which has been called the **"Law of all Laws"**
4) The General Clauses Act, 1897 was **enacted on 11th March, 1897** to consolidate and extend the General Clauses Act, 1868 and 1887.

## APPLICATION OF THE GENERAL CLAUSES ACT

The Act does not define any "**territorial extent**" clause. Its application is primarily with reference to all Central legislation and also to rules and regulations made under a Central Act. It is in a sense a part of every Central Acts or Regulations. If a Central Act is extended to any territory, the General Clauses Act would also deem to be applicable in that territory and would apply in the construction of that Central Act. The Central Acts to which this Act apply are: —

(a) Acts of the **Indian Parliament (Central Act)** along with the rules and regulations made under the Central Act;

(b) Acts of the **Dominion Legislature** passed **between the 15th August, 1947 and the 26th January, 1950**;

(c) Acts passed **before the commencement of the Constitution by the Governor-General in Council or the Governor-General** acting in a legislative capacity. The Act does not define any "territorial extent" clause.

**#Remember: Article 367 of the Constitution of India authorises use of General Clauses Act** for the interpretation of constitution. Article 367 states that:

"Unless the context otherwise requires, the General Clauses Act, 1897, shall, subject to any adaptations and modifications that may be made therein under Article 372, apply for the interpretation of this Constitution as it applies for the interpretation of an Act of the Legislature of the Dominion of India".

The provisions of the General Clauses Act, 1897 are mere rules of interpretation and it applies automatically in each and every case. It all depends on the facts and circumstances of each case.

## OBJECT, PURPOSE AND IMPORTANCE OF THE GENERAL CLAUSES ACT

**OBJECT:**

(1) To **shorten the language of Central Acts**;
(2) To **provide uniformity of expression in Central Acts**, by giving definitions of common use;
(3) To state explicitly certain **convenient rules for the construction and interpretation** of central acts.
(4) To guard against slips and oversights by importing into every act certain common form clauses, which otherwise ought to be inserted in every central act

**THE PURPOSE OF THE ACT** has been stated by the Supreme Court in the case of **The Chief Inspector of Mines v. Karam Chand Thapar.**

- It stated that the purpose of this Act is **to place in one single Statute different provisions as regards interpretation of words and legal principles** which would otherwise have to be specified separately in many different Acts and regulations.
- The purpose of the Act is to **avoid superfluity of language in statutes wherever it is possible to do so**.

**Example:**

***Ananda Behera v. State of Orissa.*** The court tended to decide whether the right to catch or carry fish is a movable or immovable property. It was observed

• Section 3(26) of the General Clauses Act, 1897 reads as under: - "**Immovable property" shall include land, benefits to arise out of land, and things attached to the earth, or permanently fastened to anything attached to the earth**;" The S.3 Transfer of Property Act does not define the term except to say that immovable property does not include standing timber, growing crops or grass.

***As fish do not come under that category, the definition in the General Clauses Act applies and is regarded as a benefit arising out of land it follows that it is immovable property within the meaning of the Transfer of Property Act."***

**Thus, the court construed "right to catch or carry fish" as an immovable property**

## SOME BASIC UNDERSTANDING OF LEGISLATION

**Preamble**
**Definitions**
**"Means" and/or "include"**
**"Shall" and "May"**

**Already Discussed in IOS**

## GENERAL RULES OF CONSTRUCTION: [SECTION 5 TO SECTION 13]

- **"Coming into operation of enactment" [Section 5]:** Where any Central Act has not specifically mentioned a particular date to come into force, it shall be implemented on the day on which it receives the assent of the Governor General in case of a Central Acts made before the commencement of the Indian Constitution and/or, of the President in case of an Act of Parliament.
  **Note:** Thus where an Act provides that it is to come into force on the first day of January, **it will come into force on as soon as the clock has struck 12 on the night of 31st December.**

**Example:**

a) The Companies Act, 2013 received assent of President of India on 29th August, 2013 and was notified in Official Gazette on 30th August, 2013 with the enforcement of section 1 of the Act. Accordingly, the Companies Act, 2013 came into enforcement on the date of its publication in the Official Gazette.
   Where, if any specific date of enforcement is prescribed in the Official Gazette, Act shall into enforcement from such date.

b) SEBI (Issue of Capital and Disclosure Requirements) (Fifth Amendment) Regulations, 2015 was issued by SEBI vide **Notification dated 14th August, 2015 with effect from 1 January, 2016**. Here, this regulation shall come into force on 1st January, 2016 rather than the date of its notification in the gazette.

c) **The Supreme Court in A.K. Roy v UOI**: An Act empowers the government to bring any of the provisions into operation on any day which it deems fit, **no Court can issue a mandamus with a view to compel the Government** to bring the same into operation on particular day.

**d) State of Uttar Pradesh v. Mahesh Narain:** Supreme Court held that effective date of Rules would be when the Rules are published vide Gazette notification **and not when the Rules were under preparation.**

**PRESUMPTION AGAINST RETROSPECTIVITY**

All laws generally **operate prospectively and there is a presumption against their retrospectivity till there are express words giving retrospective effect**. Hence, the question whether a statutory provision has retrospective effect or not depends primarily on the language in which it is couched.

- **"Effect of Repeal" [Section 6]:** Where any Central legislation or any regulation made after the commencement of this Act repeals any Act made or yet to be made, unless another purpose exists, **the repeal shall not:**
  a) **Revive anything not enforced** or prevailed during the period at which repeal is effected or;
  b) **Affect the previous operation of any enactment** so repealed or anything duly done or suffered thereunder; or
  c) **Affect any right, privilege, obligation or liability acquired**, accrued or incurred under any enactment so repealed; or

d) **Affect any penalty, forfeiture or punishment incurred** in respect of any offence committed against any enactment so repealed; or

e) **Affect any inquiry, litigation or remedy with regard** to such claim, privilege, debt or responsibility or any inquiry, litigation or remedy may be initiated, continued or insisted.

**Section 6A -** "Repeal of Act making textual amendment in Act or Regulation" [Section 6A]- Where any Central Act or Regulation made after the commencement of this Act repeals any enactment by which the text of any Central Act or Regulation was amended by the **express omission, insertion or substitution of any matter**, then unless a different intention appears, **the repeal shall not affect the continuance of any such amendment made by the enactment** so repealed and in operation at the time of such repeal.

**Also read – Sec 24**

**#In short – Such repealed act shall not repeal any amendments passed unless expressly provided to do so.**

- **"Revival of repealed enactments" [Section 7]-** (1) In any Central Act or Regulation **made after the commencement of this Act**, it shall be necessary, **for the purpose of reviving, either wholly or partially, any enactment wholly or partially repealed, expressed to state that purpose.**
  (2) This section applies also to all Central Acts made after the third day of January, 1968 and to all Regulations made on or after the fourteenth day of January, 1887.

**#In Short -** In other words, to revive (get back) a repealed(deleted) statute, it is necessary to state an intention to do so.

**Example:** Commencement of business = Sec 11 was deleted and inserted again as section 10A in Companies Act, 2013

- **"Construction of references to repealed enactments" [Section 8]-** (1) Where this Act or Central Act or Regulation made after the commencement of this Act, **repeals and re-enacts, with or without modification, any provision of a former enactment**, **then references in any other enactment or in any instrument to the provision so repealed shall, unless a different intention appears, be considered as references to the provision so re-enacted.**

**#Also read section 28**

**Example:**

1) In section 115 JB of the Income Tax Act, 1961, for calculation of book profits, the Companies Act, 1956 are required to be referred. With the advent of Companies Act, 2013, the corresponding change has not been made in section 115 JB of the Income Tax Act, 1961. On referring of section 8 of the General Clauses Act, book profits to be calculated under section 115 JB of the Income Tax Act will be as per the Companies Act, 2013.
2) Company definition under FCRA, 2010

**"Foreign company"** means any company or association or body of individuals incorporated outside India and includes— (i) a **foreign company** as per Companies Act, 1956

- **"Commencement and termination of time" [Section 9]:** In any legislation or regulation, it shall be sufficient, for the purpose of **excluding the first in a series of days** or any other period of time to **use the word "from"** and for the purpose of **including the last in a series of days** or any other period of time, to use the word "to".

**Example:** A company declares dividend for its shareholder in its Annual General Meeting held on 30/09/2016. Under the provisions of the Companies Act, 2013, company is required to pay declared dividend within 30 days from the date of declaration i.e. from 01/10/2016 to 30/10/2016. In this series of 30 days, 30/09/2016 will be excluded and last 30th day i.e. 30/10/2016 will be included.

- **"Computation of time" [Section 10]:** Where by any legislation or regulation, any act or proceeding is directed or allowed to be done or taken in any court or office on a certain day or within a prescribed period then, **if the Court or office is closed on that day or last day of the prescribed period**, the act or proceeding shall be considered as done or taken in due time if it is done or taken **on the next day afterwards on which the Court or office is open**.

- **"Measurement of Distances" [Section 11]:** In the measurement of any distance, for the purposes of any Central Act or Regulation made after the commencement of this Act, that distance shall, unless a different intention appears, **be measured in a straight line on a horizontal plane**.

- **"Duty to be taken pro rata in enactments" [Section 12]:** Where, by any enactment now in force or hereafter to be in force, any duty of customs or excise or in the nature thereof, is leviable on any given quantity, by weight, measure or value of any goods or merchandise, **then a like duty is leviable according to the same rate on any greater or less quantity**.

**Example:** When a company pays dividends to its shareholders, each investor is paid according to their holdings. If a company has 100 shares outstanding, for example, and issues a dividend of Rs. 2 per share, the total amount of dividends paid will be Rs. 200. No matter how many shareholders there are, the total dividend payments cannot exceed this limit. In this case, Rs.200 is the whole, and the pro rata calculation must be used to determine the appropriate portion of that whole due to each shareholder.

Assume there are only four shareholders who hold 50, 25, 15, and 10 shares, respectively. The amount due to each shareholder is their pro rata share.

**the total dividends. The remaining shareholders get Rs.50, Rs.30, and Rs.20, respectively.**

- **"Gender and Number" [Section 13]: In all legislations and regulations, unless there is anything repugnant in the subject or context-**

(1) Words importing the **masculine gender shall be taken to include females**, and

(2) Words in **singular shall include the plural** and vice versa.

**Exception examples:**

a) But the general rule in Section 13(1) has to be applied with circumspection of interpreting laws dealing with matters of succession. Thus, the words "male descendants" occurring in Section 7 and Section 8 of the Chota Nagpur Tenancy Act, 1908 were not interpreted to include female descendants.

b) Where a word connoting a common gender is available but the word used conveys a specific gender, there is a presumption that the provisions of General Clauses Act, 1897 do not apply. Thus, the word 'bullocks' could not be interpreted to include 'cows'

- **"Power conferred to be exercisable from time to time" [Section 14]:**

(1) Where, by any Central Act or Regulation made after the commencement of this Act, **any power is conferred, then unless a different intention appears** that **power may be exercised from time to time as occasion requires**.

(2) This section applies to all Central Acts and Regulations made on or after the fourteenth day of January, 1887.

- **"Power to appoint to include power to appoint ex-officio" [Section 15]:** Where by any legislation or regulation, a **power to appoint any person to fill any office**, **may be made either by name or by virtue of office.**

***Ex-officio is a Latin word which means BY VIRTUE OF ONE'S POSITION OR OFFICE. Provision under this section states that where there is a power to appoint, the appointment may be made by appointing ex-officio as well.***

**#Remember Sec 125 of companies Act, 2013?** Secretary, Ministry of Corporate Affairs is the Chairperson of the Authority Ex-officio

- **"Power to appoint to include power to suspend or dismiss" [Section 16]**
  **Also read 21**

**Example:**

**1)** Article 229(1) of the Constitution which empowers the Chief Justice to make appointment of officers and servants of a High Court has been interpreted to include a power to suspend or dismiss.

**2)** Central govt has power to issue **license for section 8** companies and also to suspend or cancel them

- **"Substitution of functionaries" [Section 17]:**

**it shall be sufficient, for the purpose of indicating the application of a law** to every person or number of persons for the time being executing the functions of an office, **to mention the official title of the officer at present executing the functions**, or that of the officer by whom the functions are commonly executed.

(2) This section applies also to all Central Acts made after the third day of January, 1868 and to all Regulations made on or after the fourteenth day of January, 1887.

**Example:** To Incorporate a Company in India then file an application with CRC/ROC. No need of specifying the name of ROC. The act can just mention the title of the authority.

- **"Successors" [Section 18]:** (1) In any Central Act or Regulation made after the commencement of this Act, it shall be sufficient, for the **purpose of indicating the relation of a law to the successors of any functionaries or of corporations having perpetual succession, to express its relation to the functionaries or corporations.**

(2) This section shall also apply to all Central Acts made after the third day of January, 1868 and to all Regulations made on or after the fourteenth day of January, 1887.

- **"Official Chiefs and subordinates" [Section 19]:** A **law relative to the chief or superior of an office shall apply to the deputies or subordinates lawfully performing the duties of that office in the place of their superior,** to prescribe the duty of the superior. This section applies to all the 12 Central Acts made after the third day of January, 1868, and to all Regulations made on or after the fourteenth day of January, 1881.

  **Example:** In K.G. Krishnayya v. State, it was held that it is not essential that same statutory authority that initiated a scheme under the Road Transport Corporation Act 1950, should also implement it. It is open to the successor authority to implement or continue the same.

- **"Construction of orders, etc., issued under enactments" [Section 20]**: Where by any legislation or regulation, a power to issue any notification, order, scheme, rule, form, or by-law is conferred, then **expression used in the notification, order, scheme, rule, form or bye-law, shall, unless there is anything otherwise provided, have the same respective meaning** as in the Act or regulation conferring power.

- **"Power to issue, to include power to add to, amend, vary or rescind notifications, orders, rules or bye-laws" [Section 21]:** Where by any legislations or regulations a power to issue notifications, orders, rules or bye-laws is conferred, then that power, exercisable in the like manner and subject to the like sanction and conditions **(if any), to add, to amend, vary or rescind any notifications, orders, rules or bye laws so issued.**

- **"Making of rules or bye-laws and issuing of orders between passing and commencement of enactment" [Section 22]:**

  - Where, by any Central Act or Regulation **which is not to come into force immediately, on the passing thereof**, a power is conferred to make **rules or bye-laws**, or to issue **orders** with respect to the application of the Act or establishment of **any Court** or the **appointment of any Judge** or officer thereunder or the **fees** for which, anything is to be done under the Act or Regulation, then that power may be exercised at any time

after passing of the Act or Regulation; **but rules, bye-laws or orders so made or issued shall not take effect till the commencement of the Act or Regulation**

**Example:**

The Companies Act, 2013 received the assent of the Hon'ble President of India on 29th August, 2013 and was notified in the Official Gazette on 30th August, 2013 for public information stating that different dates may be appointed for enforcement of different provisions of the Companies Act,2013, through notifications.

**Example**: Section 1 came into force on 30th August, 2013; 98 sections came into force on 12th September, 2013; 143 sections were enforced from 1st April, 2014 and so on.

So, the NCLT rules were effective from December, 2016. And hence NCLT will be effective from December 2016 and not from 29th August.

- **"Provisions applicable to making of rules or bye-laws after previous publications" [Section 23]:** Where, by any Central Act or Regulation, **a power to make rules or bye-laws is expressed after previous publication,** then the following provisions shall apply, namely:-

(1) The authority, before making rules or bye-laws, **PUBLISH A DRAFT OF THE PROPOSED RULES OR BYE-LAWS for the information of persons likely to be affected thereby**;

(2) The **PUBLICATION SHALL BE MADE IN SUCH MANNER** as that **authority deems to be sufficient**, or in such manner as the Government concerned prescribes;

(3) There shall be a **NOTICE SPECIFYING A DATE** on which the draft will be taken into consideration;

(4) The such rules are to be made with the **sanction, approval or concurrence of ANOTHER AUTHORITY**, that **authority also shall consider any objection or suggestion**, from any person with respect to the draft before the date so specified;

(5) The **PUBLICATION IN THE OFFICIAL GAZETTE** of a rule or bye-law, shall be conclusive proof that the rule or bye-laws has been duly made.

(6) The authority is also entitled **TO MAKE SUITABLE CHANGES IN THE DRAFT BEFORE FINALLY PUBLISHING THEM**. It is not necessary for that authority to re-publish the rules in the amended form before their final issue so long as the changes made are ancillary to the earlier draft and cannot be regarded as foreign to the subject matter thereof.

- **"Continuation of orders etc., issued under enactments repealed and re- enacted" [Section 24]:** Where any Central Act or Regulation, is, **after, the commencement of this Act, repealed and re-enacted with or without modification**, **then unless it is otherwise expressly provided any appointment notification, order, scheme, rule, form or bye-law, made or issued under the repealed Act**, **continue in force, and be deemed to have been made or issued under the notification, order, scheme, rule, form or bye-law, made or issued under the provisions so re-enacted**.

**Example:** In State of Punjab v. Harnek Singh, AIR 2002 SC 1074, It was held that investigation conducted by Inspectors of Police, under the authorization of notification issued under Prevention of Corruption Act, of 1947 will be proper and will not be quashed under new notification taking the above power, till

the aforesaid notification is specifically superseded or withdrawn or modified under the new notification.

The Mines Act of 1923 was repealed and replaced by the Mines Act of 1952. Rules made under the repealed Act must be deemed to continue in force by virtue of this section until superseded.

Where an Act is repealed and re-enacted, the fact that the repealed Act stated that rules made under that Act shall have effect as if enacted in the Act does not mean that the rules automatically disappear with the repeal of the Act under which they are made and that there is no room for the application of this section.

- **"Recovery of fines" [Section 25]:** Section 63 to 70 of the Indian Penal Code and the provisions of the Code of Criminal Procedure for the time being in force in relation to the issue and the execution of warrants for the levy of fines shall apply to all fines imposed under any Act, Regulation, rule or bye-laws, unless the Act, Regulation, rule or bye-law contains an express provision to the contrary.

- **"Provision as to offence punishable under two or more enactments" [Section 26]:** Where an act or omission constitutes an offence under two or more enactments, then the offender shall be liable to be prosecuted and **PUNISHED UNDER EITHER OR ANY OF THOSE ENACTMENTS, BUT SHALL NOT BE PUNISHED TWICE FOR THE SAME OFFENCE.**

**ARTICLE 20(2) OF THE CONSTITUTION STATES THAT NO PERSON SHALL BE PROSECUTED AND PUNISHED FOR THE SAME OFFENCE MORE THAN ONCE.**

**Note:** there is no bar to the trial or conviction of an offender under two enactments, but there is only a bar to the punishment of the offender twice for the same offence.

- **"Meaning of Service by post" [Section 27]:** Where any legislation or regulation requires any document to be served by post, then unless a different intention appears, the service shall be deemed to be effected by:

(i) Properly addressing
(ii) Pre-paying, and
(iii) Posting by registered post.

A letter containing the document to have been effected at the time at which the letter would be delivered in the ordinary course of post.

In Jagdish **Singh.v Natthu Singh**, it was held that where a notice is sent to the landlord by registered post and the same is returned by the tenant with an endorsement of refusal, it will be presumed that the notice has been served.

- **"Citation of enactments" [Section 28]:** (1) In any Central Act or Regulation, and in any rule, bye law, instrument or document, made under, or with reference to any such Act or Regulation, **any enactment may be cited by reference to the title or short title (if any) conferred thereon or by reference to the number and years thereof**, and any provision in an enactment may be cited by reference to the section or sub-section of the enactment in which the provision is contained.

- **"Saving for previous enactments, rules and bye laws" [Section 29]:** The provisions of this Act respecting the construction of Acts, Regulations, rules or bye-laws made after commencement of this Act **shall not affect the construction of any Act, Regulation, rule or bye-law is CONTINUED OR AMENDED by an Act**, Regulation, rule or bye-law **made after the commencement of this Act**.

## DEFINITIONS [SECTION 3]

Three sections of the General Clauses Act, i.e., section 3 (Definitions), 4 (application of foregoing definitions to previous enactment) and 4A (Application of certain definitions to Indian laws), contain general definitions.

Section 3, which is the **principal section containing definitions, applies to the General Clauses Act itself and to post-1897 Central Acts and Regulations unless those laws contain separate definitions of their own or there is something repugnant in the subject or context**. Section 3 seeks to define 67 phrases and terms commonly used in enactments and are intended to serve as a dictionary for the phrases.

Here in this chapter, we shall be discussing some of the relevant definitions or terms which are by and large seen in the Acts.

1) "**Act**" [Section 3(2)]: 'Act', used with reference to an **offence or a civil wrong**, shall include a **series of acts**, and words which refer to acts done extend also to **illegal omissions;**

**Example:** The act 'by which A causes Z's death consists of a series of acts, namely, the blows given in beating him, plus a series of illegal omissions, namely, wrongfully neglecting or refusing to supply him with food at proper times.

2) **"Affidavit" [Section 3(3)]**: 'Affidavit' **SHALL INCLUDE affirmation and declaration** in the case of persons by law allowed to affirm or declare instead of swearing.

The above **definition is inclusive in nature**. It states that Affidavit shall include affirmation and declarations. However, we can understand this term in general parlance. Affidavit is a **written statement confirmed by oath or affirmation for use as evidence in Court or before any authority**.

3) **Central Act" [Section 3(7)]:** 'Central Act' shall mean an Act of Parliament, and shall include-

(a) An Act of the Dominion Legislature or of the Indian Legislature passed before the commencement of the Constitution*, and

(b) An Act made before such commencement by the Governor General in Council or the Governor General, acting in a legislative capacity;

*The date of the commencement of the Constitution is 26th January, 1950

4) **Central Government: [Section 3(8)]: 'Central Government' shall-**

(a) In relation to **anything done before the commencement of the Constitution**, **mean the GOVERNOR GENERAL IN COUNCIL, as the case may be; and shall include**,-

(i) In relation to functions entrusted under sub-section (1) of the section 124 of the Government of India Act, 1935, to the Government of a Province, the Principal Government acting within the scope of the authority given to it under that sub- section; and
(ii) In relation to the administration of a Chief Commissioner's Province, the Chief Commissioner acting within the scope of the authority given to him under sub-section (3) of section 94 of the said Act; and

(b) In relation to anything **done after the commencement of the constitution**, **mean the President**; and shall include;-

(i) In relation to function entrusted under clause (1) of the article of the Constitution, to the Government of a state, the **State Government acting within the scope** of the authority given to it under that clause;

(ii) In relation to the administration of a **Part C State before the commencement** of the Constitution (Seventh Amendment) Act, 1956*, the Chief Commissioner or the Lieutenant Governor or the Government of a neighboring State or other authority acting within the scope of the authority

(iii) In relation to the administration of a **Union territory**, the administrator thereof acting within the scope of the authority given to him under article 239 of the Constitution;

The new Constitution of India, which came into force on 26 January 1950, made India a sovereign democratic republic. The new republic was also declared to be a "Union of States". Between 1947 and 1950 the territories of the princely states were politically integrated into the Indian Union. The constitution of 1950 distinguished between three main types of states and a class of territories:

**Part A states**, which were the **former governors' provinces of British India, were ruled by a Governor** appointed by the President and an elected state legislature. The nine Part A states were Assam, Bihar, Bombay, Madhya Pradesh (formerly Central Provinces and Berar), Madras, Orissa, Punjab (formerly East Punjab), Uttar Pradesh (formerly the United Provinces), and West Bengal.

**Part B states**, which were **former princely states** or groups of princely states, governed by a Rajpramukh, who was usually the ruler of a constituent state, and an elected legislature. The Rajpramukh was appointed by the President of India. The eight Part B states were Hyderabad, Jammu and Kashmir, Madhya Bharat, Mysore, Patiala and East Punjab States Union (PEPSU), Rajasthan, Saurashtra, and Travancore-Cochin.

**Part C states** included both the former chief commissioners' provinces and some princely states, and each was governed by a chief commissioner appointed by the President of India. The ten Part C states were Ajmer, Bhopal, Bilaspur, Coorg, Delhi, Himachal Pradesh, Cutch, Manipur, Tripura, and Vindhya Pradesh.

**Part D** territory was the Andaman and Nicobar Islands, which were administered by a Lieutenant Governor appointed by the Central Government.

5) **"Document" [Section 3(18)]:** 'Document' shall include any matter **written**, **expressed or described** upon any **substance** by **means of letters, figures or marks** or by more than one of

those means which is intended to be used or which may be used, for the purpose or recording that matter.

6) **"Enactment" [Section 2(19)]: '**Enactment' shall include a Regulation (as hereinafter defined) and any Regulation of Bengal, Madras or Bombay Code, and shall also include any provision contained in any Act or in any such Regulation as aforesaid;

7) **"Financial Year" [Section 3(21)]:** Financial year shall mean the year commencing on the first day of April.

8) **"Good Faith" [Section 3(22)]:** A thing shall be deemed to be done in "good faith" where it is in **fact done honestly, whether it is done negligently or not**;

The term "Good faith" has been defined differently in different enactments. This definition of the good faith does not apply to that enactment which contains a special definition of the term "good faith" and there the definition given in that particular enactment has to be followed. This definition may be applied only if there is nothing repugnant in subject or context, and if that is so, the definition is not applicable.

9) **"Immovable Property" [Section 3(26)]:**

'Immovable Property' shall include:

i) Land,

ii) **Benefits** to arise out of land, and

iii) **Things attached to the earth**, or

iv) Permanently fastened to anything attached to the earth. It is an inclusive definition. It contains four elements:

**Note: Where, in any enactment, the definition of immovable property is in the negative and not exhaustive, the definition as given in the General Clauses Act will apply to the expression given in that enactment.**

Example: In Shantabai v. State of Bombay,46 the Supreme Court pointed out that trees must be regarded as immovable property because they are attached to or rooted in the earth.

a) ***the soil for making bricks,***

b) ***the right to build on and occupy the land for business purposes and***

c) ***the right to grow new trees and to get leaves from trees that grow in further are all included in the term immovable property***

**As per Section 3 of Transfer of Property act, immovable property does not include standing timber, growing crop and grass.**

**Reasons:**

**1)** Standing timbers are tree fit for use for building or repairing houses. This is an exception to the general rule that growing tree are immovable property.

**2)** Growing Crop:- It includes all vegetables growths which have no existence apart from their produce such as pan leave, sugarcane etc

**3)** Grass:- Grass is an movable property

**Example: Right of way to access from one place to another, may come within the definition of Immovable property whereas to right to drain of water is not immovable property. Any machinery fixed to the soil, standing crops can be held as immovable property according to the General Clauses Act, 1897.**

10) **"Indian law" [Section 3(29)]**: 'Indian law' shall mean any Act, Ordinance, Regulation, rule, order, bye law or other instrument **which before the commencement of the Constitution, had the force of law in any Province of India** or part thereof or thereafter has the **force of law in any Part A or Part C State or part thereof**, **but does not include any Act of Parliament of the United Kingdom or any Order in Council**, rule or other instrument made under such Act;

11) **"Month" [Section 3(35)]**: 'Month' shall mean a month reckoned according to the **British calendar**;

12) **"Official Gazette" [Section 3(39)]:** 'Official Gazette' or 'Gazette' shall mean:
(i) The Gazette of India, or
(ii) The Official Gazette of a state.

The Gazette of India is a public journal and an authorised legal document of the Government of India, **PUBLISHED WEEKLY BY THE DEPARTMENT OF PUBLICATION**, **Ministry of Housing and Urban Affairs**. As a public journal, the Gazette prints official notices from the government. It is authentic in content, accurate and strictly in accordance with the Government policies and decisions. The gazette is printed by the Government of India Press.

13) **"Person" [Section 3(42)]:** "Person" shall include:
(i) any company, or
(ii) association, or
(iii) body of individuals, whether incorporated or not

14) **"Swear" [Section 3(62)]:** "Swear", with its grammatical variations and cognate expressions, shall include affirming and declaring in the case of persons by law allowed to affirm or declare instead of swearing.
**Note**: The terms "Affidavit", "Oath" and "Swear" have the same definitions in the Act.

15) **"Writing" [Section 3(65)]:** Expressions referring to 'writing' shall be construed as including references to printing, lithography, photography and other modes of representing or reproducing words in a 1visible forms; and
16) **"Year" [Section 3(66)]:** 'Year' shall mean a year reckoned according to the British calendar.

**Application to foregoing definitions to previous enactments [Section 4]-**

There are **certain definitions in section 3** of the General Clauses Act, 1897 which would **also apply to the Acts and Regulations made prior to 1897** i.e., on the previous enactments of 1868 and 1887. This provision is divided into two parts-

*(1) Application of terms/expressions to all [Central Acts] made after 3rd January, 1868, and to all Regulations made on or after the 14th January, 1887-*

Here the given relevant definitions in section 3 of the following words and expressions, that is to say, 'affidavit', 'immovable property', 'imprisonment', ''month', 'movable property', 'oath', 'person', 'section', 'and 'year' apply also, unless there is anything repugnant in the subject or context, to **all [Central Acts] made after** the **3rd January, 1868**, and to **all Regulations made on or after the 14th January, 1887.**

(2) **Application of terms/expressions to all Central Acts and Regulations made on or after the fourteenth day of January, 1887**- The relevant given definitions in the section 3 of the following words and expressions, that is to say, 'commencement', 'financial year', 'offence', 'registered', schedule', 'sub-section' and 'writing' apply also, unless there is anything repugnant in the subject or context, to all Central Acts and Regulations made on or after the fourteenth day of January, 1887.

**Application of certain definitions to Indian Laws [Section 4A]-**

(1) The definitions in section 3 of the expressions 'Central Act', 'Central Government', ''Gazette', 'Government', 'Government Securities', 'Indian Law', and ''Official Gazette', 'shall apply, unless there is anything repugnant in the subject or context, to all Indian laws.

(2) In any Indian law, references, by whatever form of words, to **revenues of the Central Government or of any State Government shall**, on and from the first day of April, 1950, be construed as references to the Consolidated Fund of India or the Consolidated Fund of the State, as the case may be.

**Question and Answer**

1. **What is "Financial Year" under the General Clauses Act, 1897?**

**Answer**

According to Section 3(21) of the General Clauses Act, 1897, 'Financial Year' shall mean the year commencing on the first day of April.

The term year has been defined under Section 3(66) as a year reckoned according to the British calendar. Thus as per General Clauses Act, Year means calendar year which starts from January to December.

Hence, in view of the both above definitions, it can be concluded that Financial Year is a year which starts from first day of April to the end of March.

2. **What is "Immovable Property" under the General Clauses Act, 1897?**

**Answer**

According to Section 3(26) of the General Clauses Act, 1897, 'Immovable Property' shall include:

(i) Land,

(ii) Benefits to arise out of land, and

(iii) Things attached to the earth, or permanently fastened to anything attached to the earth.

For example, trees are immovable property because trees are benefits arise out of the land and attached to the earth. However, timber is not immovable property as the same are not permanently attached to the earth. In the same manner, buildings are immovable property.

3. **As per the provisions of the Companies Act, 2013, a whole time Key Managerial Personnel (KMP) shall not hold office in more than one company except its subsidiary company at the same time. Referring to the Section 13 of the General Clauses Act, 1897, examine whether a whole time KMP can be appointed in more than one subsidiary company?**

**Answer**

Section 203(3) of the Companies Act, 2013 provides that whole time key managerial personnel shall not hold office in more than one company except in its subsidiary company at the same time. With respect to the issue that whether a whole time KMP of holding company be appointed in more than one subsidiary companies or can be appointed in only one subsidiary company.

It can be noted that Section 13 of General Clauses Act, 1897 provides that the word 'singular' shall include the 'plural', unless there is anything repugnant to the subject or the context. Thus, a whole time key managerial personnel may hold office in more than one subsidiary company as per the present law.

4. **A notice when required under the Statutory rules to be sent by "registered post acknowledgment due" is instead sent by "registered post" only. Whether the protection of presumption regarding serving of notice by "registered post" under the General Clauses Act**

**is tenable? Referring to the provisions of the General Clauses Act, 1897, examine the validity of such notice in this case.**

**Answer**

As per the provisions of Section 27 of the General Clauses Act, 1897, where any legislation or regulation requires any document to be served by post, then unless a different intention appears, the service shall be deemed to be effected by:

(i) Properly addressing,

(ii) Pre-paying, and

(iii) Posting by registered post.

A letter containing the document to have been effected at the time at which the letter would be delivered in the ordinary course of post.

Therefore, in view of the above provision, since, the statutory rules itself provides about the service of notice that a notice when required under said statutory rules to be sent by 'registered post acknowledgement due', then, if notice was sent by 'registered post' only it will not be the compliance of said rules. However, if such provision was not provided by such statutory rules, then service of notice if by registered post only shall be deemed to be effected.

Furthermore, in similar case of In United Commercial Bank v. Bhim Sain Makhija, AIR 1994 Del 181, A notice when required under the statutory rules to be sent by 'registered post acknowledgement due' is instead sent by 'registered post' only, the protection of presumption regarding serving of notice under 'registered post' under this section of the Act is neither tenable nor based upon sound exposition of law.

**5. X owned a land with fifty tamarind trees. He sold his land and the timber (obtained after cutting the fifty trees) to Y. X wants to know whether the sale of timber tantamount to sale of immovable property. Advise him with reference to provisions of "General Clauses Act, 1897".**

**Answer**

"Immovable Property" [Section 3(26) of the General Clauses Act, 1897]:

'Immovable Property' shall include:

(i) Land,

(ii) Benefits to arise out of land, and

(iii) Things attached to the earth, or

(iv) Permanently fastened to anything attached to the earth.

It is an inclusive definition. It contains four elements: land, benefits to arise out of land, things attached to the earth and things permanently fastened to anything attached to the earth. Where, in any enactment, the definition of immovable property is in the negative and not exhaustive, the definition as given in the General Clauses Act will apply to the expression given in that enactment. In the instant case, X sold Land along with timber (obtained after cutting trees) of fifty tamarind trees of his land. According to the above definition, Land is immovable property; however, timber cannot be immovable property since the same are not attached to the earth.

**6. What is the meaning of service by post as per provisions of the General Clauses Act, 1897?**

**Answer**

"Meaning of Service by post" [Section 27 of the General Clauses Act, 1897]: Where any legislation or regulation requires any document to be served by post, then unless a different intention appears, the service shall be deemed to be effected by:

(i) properly addressing

(ii) pre-paying, and

(iii) posting by registered post.

A letter containing the document to have been effected at the time at which the letter would be delivered in the ordinary course of post.

**7. Komal Ltd. declares a dividend for its shareholders in its AGM held on 27th September, 2019. Referring to provisions of the General Clauses Act, 1897 and Companies Act, 2013, advice:**

**(i) The dates during which Komal Ltd. is required to pay the dividend?**

**(ii) The dates during which Komal Ltd. is required to transfer the unpaid or unclaimed dividend to unpaid dividend account?**

**Answer**

As per section 9 of the General Clauses Act, 1897, for computation of time, the section states that in any legislation or regulation, it shall be sufficient, for the purpose of excluding the first in a series of days or any other period of time to use the word "from" and for the purpose of including the last in a series of days or any other period of time, to use the word "to".

(i) Payment of dividend: In the given instance, Komal Ltd. declares dividend for its shareholder in its Annual General Meeting held on 27/09/2019. Under the provisions of Section 127 of the Companies Act, 2013, a company is required to pay declared dividend within 30 days from the date of declaration, i.e. from 28/09/2019 to 27/10/2019. In this series of 30 days, 27/09/2019 will be excluded and last 30th day, i.e. 27/10/2019 will be included. Accordingly, Komal Ltd. will be required to pay dividend within 28/09/2019 and 27/10/2019 (both days inclusive).

(ii) Transfer of unpaid or unclaimed divided: As per the provisions of Section 124 of the Companies Act, 2013, where a dividend has been declared by a company but has not been paid or claimed within 30 days from the date of the declaration, to any shareholder entitled to the payment of the dividend, the company shall, within 7 days from the date of expiry of the said period of 30 days, transfer the total amount of dividend which remains unpaid or unclaimed to a special account to be opened by the company in that behalf in any scheduled bank to be called the "Unpaid Dividend Account" (UDA). Therefore, Komal Ltd. shall transfer the unpaid/unclaimed dividend to UDA within the period of 28th October, 2019 to 3rd November, 2019 (both days inclusive).

**8. 'Repeal' of provision is different from 'deletion' of provision. Explain as per the General Clauses Act, 1897.**

**Answer**

In Navrangpura Gam Dharmada Milkat Trust Vs. Rmtuji Ramaji, AIR 1994 Guj 75 case, it was decided that 'Repeal' of provision is in distinction from 'deletion' of provision. 'Repeal' ordinarily brings

about complete obliteration (abolition) of the provision as if it never existed, thereby affecting all incoherent rights and all causes of action related to the 'repealed' provision while 'deletion' ordinarily takes effect from the date of legislature affecting the said deletion, **never to effect total** effecting or wiping out of the provision as if it never existed. [In Deletion only a part of it will be deleted.]

9. **The Companies Act, 2013 provides that the amount of dividend remained unpaid/unclaimed on expiry of 30 days from the date of declaration of dividend shall be transferred to unpaid dividend account within 7 days from the date of expiry of such period of 30 days. If the expiry date of such 30 days is 30.10.2019, decide the last date on or before which the unpaid/unclaimed dividend amount shall be required to be transferred to a separate bank account in the light of the relevant provisions of the General Clauses Act, 1897?**

**Answer**

Section 9 of the General Clauses Act, 1897 provides that, for computation of time, in any legislation or regulation, it shall be sufficient, for the purpose of excluding the first in a series of days or any other period of time to use the word "from" and for the purpose of including the last in a series of days or any other period of time, to use the word "to".

As per the facts of the question the company shall transfer the unpaid/unclaimed dividend to unpaid dividend account within the period of 7 days. 30th October 2019 will be excluded and 6th November 2019 shall be included, i.e. 31st October, 2019 to 6th November, 2019 (both days inclusive).

10. **Referring to the provisions of the General Clauses Act, 1897, find out the day/ date on which the following Act/Regulation comes into force. Give reasons also,**

**(1) An Act of Parliament which has not specifically mentioned a particular date.**

**(2) The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) (Fifth Amendment) Regulations, 2015 was issued by SEBI vide Notification dated 14th August, 2015 with effect from 1st January, 2016.**

**Answer**

(1) According to section 5 of the General Clauses Act, 1897, where any Central Act has not specifically mentioned a particular date to come into force, it shall be implemented on the day on which it receives the assent of the President in case of an Act of Parliament.

(2) If any specific date of enforcement is prescribed in the Official Gazette, the Act shall come into enforcement from such date.

Thus, in the given question, the SEBI (Issue of Capital and Disclosure Requirements) (Fifth Amendment) Regulations, 2015 shall come into enforcement on 1st January, 2016 rather than the date of its notification in the gazette.

# Chapter 14

# INTERPRETATION OF STATUTE

## INTRODUCTION

1) It is not necessary that the words used in a statute are always clear, explicit and unambiguous and thus, in such cases it is **very essential for courts to determine a clear and explicit meaning of the words or phrases used by the legislature**.
2) When the language of the statute is clear, there is no need for the rules of interpretation. But, in certain cases, more than one meaning may be derived from the same word or sentence. It is, therefore, necessary to interpret the statute to find out the real intention of the statute.
3) The purpose of Interpretation of Statutes is to **help the Judge to ascertain the intention of the Legislature**
4) The process of statute making and the process of interpretation of statutes take place separately from each other, and two different agencies are concerned.
5) An interpretation of Act serves as the **bridge of understanding between the two**.

**This study relates to 'Interpretation of Statutes, Deeds and Documents'.**

**Definitions:**

1. **'STATUTE':**
   The word "**statute" is now synonymous with an Act of Parliament**. Maxwell defines "statute" as the will of the legislature. **In India 'statute' means an enacted law i.e. the law either enacted by the Parliament or by the state legislature.**
   **How the law is made:** In India the constitution provides for the passing of a bill in Lok Sabha and Rajya Sabha and finally after obtaining the assent of the President of India to it, it becomes an Act of Parliament or statute.
   **Normally, the term denotes an Act enacted by the legislative authority (e.g. Parliament of India).**
   - In short 'statute' signifies written law in contradiction to unwritten law.
     Thus, that which originates through legislation is called **"enacted law or statute or written law"** as against **"unenacted or unwritten law" the law based upon custom, usage, and judicial decisions,**
   - However, **The term 'law' includes** any ordinance, order, bye-law, rule, regulation, notification, and the like.
2. '**DOCUMENT**':
   Section 3 of the Indian Evidence Act, 1872 states that 'document' means any matter expressed or described upon any substance by means of letters, figures or marks or by more than one of those means, intended to be used, or which may be used, for the purpose of recording that matter.

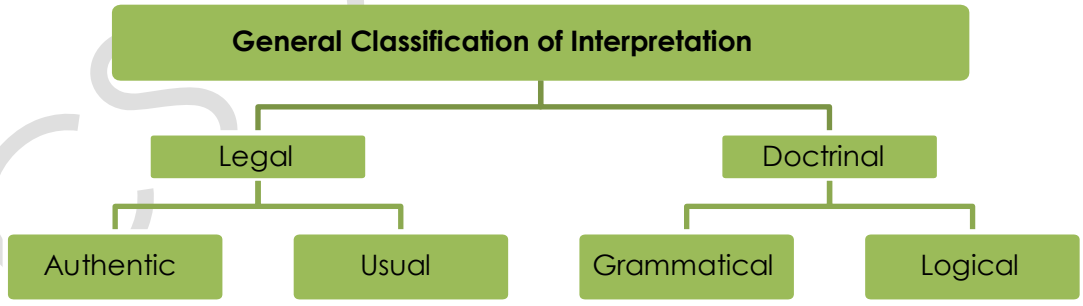
Section 3(18) of the General Clauses Act, 1897 states that the term 'document' shall include **any matter** written, expressed or described upon **any substance** by **means** of **letters, figures or marks**, or by more than one of those means which is intended to be used, or which may be used, for the purpose of **recording** this matter.

**Generally, documents comprise of following four elements:**

(i) **Matter**—Its usage with the word "any" shows that the definition of document is comprehensive.
(ii) **Record**— Must be **certain mutual or mechanical device** employed on the substance.
(iii) **Substance**— element on which a mental or intellectual element **comes to find a permanent form**.
(iv) **Means**—permanent form is acquired and those can be **letters, any figures, marks, symbols which can be used to communicate between two persons.**

3. **'INSTRUMENT':** In common parlance, **'instrument' means a formal legal document which creates or confirms a right or records a fact**. Section 2(14) of the Indian Stamp Act, 1899 states that '**instrument' includes every document by which any right or liability is or purports to be created, transferred, extended, extinguished or recorded.**
4. **'DEED':** The Legal Glossary defines 'deed' as an instrument in writing (or other legible representation or words on parchment or paper) purporting to effect some legal disposition. Simply stated deeds are instruments though all instruments may not be deeds
5. **'INTERPRETATION':** It is the process by which the real meaning of an Act (or a document) and the intention of the legislature in enacting it, is ascertained.
   A person is there by assisted in arguing, contesting and interpreting the proper significance of a section, a proviso, explanation or schedule to an Act or any document, deed or instrument.

## CLASSIFICATION OF INTERPRETATION




**I. Jolowicz, says: Interpretation is usually said to be either 'legal' or 'doctrinal'.**

1) It is '**LEGAL'** when **there is an actual rule of law which binds the Judge to place a certain interpretation of the statute**.
   'Legal' interpretation is sub- divided into 'authentic' and 'usual'.
   a) It is 'authentic' when **rule of interpretation is derived from the legislator himself**;
   b) it is 'usual' when it comes from some other source such as **custom or case law**.

Thus, Justinian ordered that all the difficulties arising out of his legislation should be referred to him for decision.

2) It is '**DOCTRINAL'** when its purpose is to **discover 'real' and 'true' meaning of the statute**. It may again be divided into two categories: 'grammatical' & 'logical'.
   a) It is **'grammatical' when the court applies only the ordinary rules of speech** for finding out the meaning of the words used in the statute.
   b) When **the court goes beyond the words and tries to discover the intention** of the statute, then it is called a 'logical' interpretation.

**II. According to Fitzerald, interpretation is of two kinds** – 'literal' and 'functional'.

1) The **literal interpretation** is that which regards conclusively the **verbal expression** of the law. It does not look beyond the 'literaligis'. "Literaligis means if the language of section is not ambiguous, follow the section".
2) **'Functional' interpretation**, on the other hand, is that which **departs from the letter of the law** and seeks more satisfactory evidence of the **true intention of the legislature**. In other words, it is necessary to determine letters and **the spirit of the law.**

**WHY DO WE NEED INTERPRETATION/ CONSTRUCTION?**

- The **enacted laws are drafted by legal experts**, yet they are **expressed in language and no language is so perfect as to leave no ambiguities.**
- Further, **intent of the legislature** has to be gathered **not only from the language but the surrounding circumstances** that prevailed at the time when that particular law was enacted.
- Denning L.J. has said:
  - It is **not within human powers to foresee the manifold sets of facts which may arise**; and that, even if it were, it is not possible to provide for them in terms free from all ambiguity.
  - This is **why the draftsmen of Acts have often been unfairly criticized**. A judge, believing himself to be bound by the rule that he must look to the language and nothing else, laments (Complain) that the draftsmen have not provided for this or that, or have been guilty of some or other ambiguity.
  - '**It would certainly save the judges**' trouble if Acts of Parliament were drafted with divine prescience and perfect clarity. In the absence of it, **when a defect appears, a judge cannot simply fold his hands and blame the draftsman.** He must set to work on the constructive task of finding the intention of Parliament, and he must do this, not only from the language of the statute, but also from a consideration of the social conditions which gave rise to it.
- **In this process of interpretation, several aids are used. They may be statutory or non-statutory**. The former category (statutory aids) is illustrated by the General Clauses Act, and by specific definitions contained in individual Acts, as also by certain provisions of a general nature which are, for example, contained in the Indian Penal Code", and are relevant to the construction of penal enactments. The latter is illustrated by common law rules of interpretation (including

certain presumptions relating to interpretation), and also by case-law relating to the interpretation of statutes.

## DIFFERENCE BETWEEN INTERPRETATION AND CONSTRUCTION

While more often the 2 terms are used interchangeably to denote a process adopted by the courts to ascertain the meaning of the legislature from the words with which it is expressed, these two terms have different connotations.

1) **Interpretation**:
   - Interpretation is the art of ascertaining the **meaning of words and the true sense** in which the **author intended that they should be understood**.
   - It is the **duty of the courts to give EFFECT TO THE MEANING OF AN ACT** when the meaning can be equitably gathered from the words used.

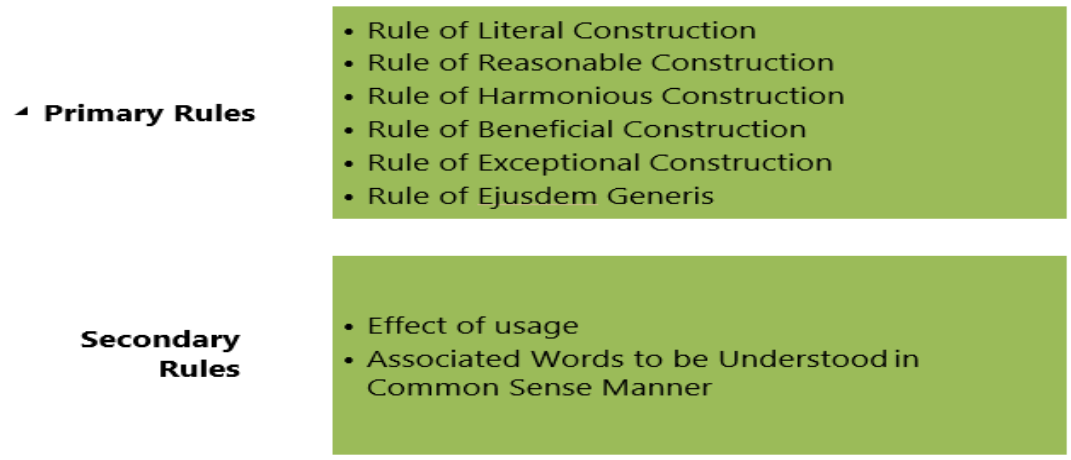
   Thus, where the Court adheres to the plain meaning of the language used by the legislature, it would be 'interpretation' of the words
2) **Construction**: It is the **DRAWING OF CONCLUSION** respecting subjects **that lie beyond the direct expression of the text**., but where the meaning is not plain, the court has to decide whether the wording was meant to cover the situation before the court. Here the court would be resorting to what is called 'construction'.

**Final conclusion:**

Thus, where the Court adheres to the **plain meaning of the language used by the legislature, it would be 'interpretation'** of the words, but where the meaning is not plain, the court has to decide whether the wording was meant to cover the situation before the court. Here, the court would be resorting to 'construction'. Conclusions drawn by means of construction are within the spirit though not necessarily within the letter of the law.

In practice construction includes interpretation and the terms are frequently used synonymously.

## RULES OF INTERPRETATION/ CONSTRUCTION




### (A) PRIMARY RULES

## (1) Rule of Literal Construction: - ABSOLUTA SENTENTIA EXPOSITORE NON INDIGET

- It is the **FIRST** and **CARDINAL RULE OF CONSTRUCTION** that words, sentences and phrases of a statute **should be read in their ordinary, natural and grammatical meaning**.
- When the **language of the statute is plain and unambiguous and admits of only one meaning, no question of construction of a statute arises**, for the Act speaks for itself.
- The maxim being '**ABSOLUTA SENTENTIA EXPOSITORE NON INDIGET'** -which means when you have plain words capable of only one interpretation, no explanation to them is required). i.e., **plain words require no explanation.**
- When a choice has to be made between two interpretations – **ONE NARROWER AND THE OTHER WIDER OR BOLDER**. In such a situation, if the narrower interpretation would fail to achieve the manifest purpose of the legislation, one should rather adopt the wider one.

**Example:** When we talk of disclosure of 'the nature of concern or interest, financial or otherwise' of a director or the manager of a company in the subject-matter of a proposed motion (as referred to in section 102 of the Companies Act, 2013), we have to interpret in its broader sense of referring to any concern or interest containing any information and facts that may enable members to understand the meaning, scope and implications of the items of business and to take decisions thereon.
What is required is a full and frank disclosure. They have to disclose, **where a son or daughter or father or mother or brother or sister is concerned in any contract or matter, the shareholders ought fairly to be informed of it** and the material facts disclosed to them. Here a restricted narrow interpretation would defeat the very purpose of the disclosure.

**THIS RULE OF LITERAL INTERPRETATION CAN BE READ AND UNDERSTOOD UNDER THE FOLLOWING HEADINGS:**

**(I) Natural and grammatical meaning**: Statute are to be first understood in their **natural, ordinary**, or **POPULAR SENSE** and must be construed according to their plain, literal and grammatical meaning.

- If there is an inconsistency with any intention or purpose of the statute, **Then the grammatical sense must then be modified, extended or abridged only to avoid such an inconvenience, but no further.**

**EXAMPLE**: In a question before the court whether the **sale of betel leaves** was subject to sales tax. In this matter SC held that betel leaves could not be given the dictionary, technical or botanical meaning when the ordinary and natural meaning is clear and unambiguous. Being the word of everyday use, it must be understood in its popular sense by which people are conversant with it as also the meaning which the statute dealing with the matter would attribute to it. Therefore, the sale of betel leaves was liable to sale tax. (Ramavtar V. Assistant Sales Tax Officer, AIR 1961 SC 1325)

**(II) Technical words in technical sense:** This point of literal construction is that technical words are understood in the technical sense only.

**EXAMPLE**, in construing of word 'practice' in Supreme Court Advocates Act, 1951, it was observed that practice of law generally involves the exercise of both the functions of acting and pleading on behalf of a litigant party. When legislature confers upon an advocate the right to practice in a court, it is legitimate to understand that expression as authorizing him to appear and plead as well as to act on behalf of suitors in that court. (Ashwini Kumar Ghose V. Arabinda Bose AIR 1952 SC 369).

[**Person in Income tax Act**]

**#Extra Gyaan (Not in syllabus)**

**Maqbool Hussain v. State of Bombay [AIR 1953 SC 325]**

The appellant, on arrival at the airport in India did not declare that he had brought gold with him. Gold, found in his possession during search in violation of government notification, was confiscated under Section 167(8) of Sea Customs Act, 1878. Appellant was also charged under Section 8 of Foreign Exchange Regulation Act, 1947 also. The appellant pleaded that his trial under the Act of 1947 was violative of Article 20(2) of the Constitution **relating to double jeopardy** as he was already punished for his act by way of confiscation of his gold. It was held by the Supreme Court that the Sea Customs Authority is not a court or a judicial tribunal and the adjudging of confiscation under the Sea Customs Act was not a prosecution. Consequently, his trial under the Act of 1947 was valid.

**(2) Rule of Reasonable Construction: UT RES MAGIS VALEAT QUAM PEREAT**

- According to this Rule, the words of a statute must be construed **'UT RES MAGIS VALEAT QUAM PEREAT' meaning thereby that words of statute must be construed so as to lead to a sensible meaning**.
- Generally, the words or phrases of a statute are to be given their ordinary meaning.
- It is only when the words of an enactment are capable of two constructions that there is scope for interpretation or construction. Then, that interpretation, which furthers the object, can be preferred to that which is likely to defeat or impair the policy or object.
- Thus, if the Court finds that giving a plain meaning to the words will not be a fair or reasonable construction, it becomes the duty of the court to depart from the dictionary meaning and adopt the construction which will advance the remedy and suppress the mischief.

**Example:** In Maqbool Hussain v State of Bombay, the appellant, a citizen of India, on arrival at an airport did not declare that he brought gold with him. Gold, found in his possession during search in violation of government notification, was confiscated under S 167 (8) Sea Customs Act, 1878.

He was charged under s 8 of the Foreign Exchange Regulation Act, 1947. The appellant pleaded that his trial under the Act was violative of Art 20(2) of the constitution relating to double jeopardy as he was already punished for his act by way of confiscation of the gold. It was held by the Supreme Court that the sea customs authority is not a court or a judicial tribunal and the confiscation is not a penalty. Consequently he was subjected to trial under FERA Act 1947.

## (3) Rule of Harmonious Construction:

- This Rule comes to our aid **when there is conflict between the provisions of a statute** and the object, which the legislature had in view.
- Where there are in an enactment in which 2 or more provisions cannot be reconciled with each other, they should be so interpreted, wherever possible, **as to give effect to all of them**. This is what is known as the Rule of Harmonious Construction.
- It must always be borne in mind that a statute is passed as a whole and not in sections. The Court's duty is to give effect to all the parts of a statute, if possible.
- When it is not possible to give effect to both the provisions harmoniously, collision may be avoided by holding that one section which is in conflict with another merely provides for an exception or a specific rule different from the general rule contained in the other. **A specific rule will override a general rule**. This principle is usually expressed by the maxim, "**generalia specialibus non derogant".**

  **Example**: As per the facts given in the Raj Krishna V. Binod AIR1954 SC 202, there was a conflict between section 33(2) and 123(8) of the Representation of People Act, 1951. Section 33(2) stated that a government servant may nominate or second a candidate seeking election, whereas section 123(8) provided that a government servant is not entitled to assist a candidate in an election in any manner except by casting his vote. SC observed that both these provisions should be harmoniously interpreted and held that a government servant was entitled to nominate or second a candidate seeking election to the state legislature assembly. This harmony could be achieved only if section 123(8) of the Act is interpreted as conferring power on a government servant of voting as well as of proposing and seconding a candidature and forbidding him from assisting a candidate in any other manner.

- **The Rule of Harmonious Construction is applicable only when there is a real and not merely apparent conflict between the provisions of an Act, and one of them has not been made subject to the other.**
- When after having construed their context, the words are capable of only a single meaning, the rule of harmonious construction disappears and is replaced by the rule of literal construction.
- In some cases, **the statute may give a clear indication as to which provision is subservient (subordinate) and which overrides**. This is done by the use of the terms "subject to", "notwithstanding" and "without prejudice".

1) **Subject to**

The words "subject to" when used in a provision is that when the **same subject matter is covered by that provision and by another provision** or enactment subject to which it operates and there is a conflict between them, **then the latter will prevail over the former.**

2) **Notwithstanding**

A clause that begins with the words "**notwithstanding anything contained**" is called a non-obstante clause. Unlike the "subject to" clause, the notwithstanding clause has the effect of making the provision prevail over others. When this term is used then the clause will prevail over the other provision(s) mentioned therein.

3) **Without prejudice**

The particular provisions **shall operate in addition** to and not in derogation of the general provisions.

## (4) Rule of Beneficial Construction or the Heydon's Rule or Purposive construction or Mischief rule

Where the language used in a statute is capable of more than one interpretation, the most firmly established rule for construction is the principle laid down in the Heydon's case (1584. The rule which is also known as '' or mischieve rule, enables consideration of four matters in construing an Act:

(1) **what was the law before the making of the Act**;
(2) **what was the mischief** or defect for which the law did not provide;
(3) **what is the remedy that the Act has provided**; and
(4) what is **the reason for the remedy**.

**Example:** Section 2(d) of the Prize Competition Act, 1955, defines 'prize competition' as "any competition in which prizes are offered for the solution of any puzzle based upon the building up arrangement, combination or permutation of letters, words or figures".

**The issue is whether Act applies to competitions which involve substantial skill and are not in the nature of gambling.**

Supreme Court, after referring to the mischief that continued under that law and to the resolutions of various states under Article 252(1) authorizing Parliament to pass the Act. **It was stated that the competitions which are sought to be controlled and regulated by the Act are only those competitions in which success does not depend on any substantial degree of skill. (RMD Chamarbaugwalla V. Union of India, AIR 1957 SC 628).**

**Section 2(d) in The Prize Competitions Act, 1955**

(d) " prize competition" means any competition (whether called a cross- word prize competition, a missing- word prize competition, a picture prize competition or by any other name) in which prizes are offered for the solution of any

## (5) Rule of Exceptional Construction

The rule of exceptional construction **STANDS FOR THE ELIMINATION OF STATUTES AND WORDS IN A STATUTE WHICH DEFEAT THE REAL OBJECTIVE** of the statute or make no sense.

It also stands for construction of words 'and', 'or', 'may', 'shall' & 'must'.

This rule has several aspects, viz.:

**(a) The Common Sense Rule:** Despite the general rule that full effect must be given to every word, **if no sensible meaning can be fixed to a word or phrase**, or if it would defeat the real object of the enactment, it should be eliminated. They ought to be construed '**UTRES MAGIS VALEAT QUAM PEREAT'** meaning thereby that it is better for a thing to have effect than to be made void.

**(b) Conjunctive and Disjunctive Words 'or' 'and'**: The **word 'or' is normally disjunctive** and **'and' is normally conjunctive**. However, **at times they are read as vice versa to give effect to the manifest intention of the legislature** as disclosed from the context. In such a case 'and' may by read for 'or' and 'or' for 'and' even though the result of so modifying the words is less favourable to the subject, provided that the intention of the legislature is otherwise quite clear.

**Example**: In the Official Secrets Act, 1920, as per section 7 any person who attempts to commit any offence under the principal Act or this Act, or solicits or incites or endeavours to persuade another person to commit an offence, or aids or abets **AND** does any act preparatory to the commission of an offence'. Here, the word '**AND**' in bold is to be read as 'or'. Reading 'and' as 'and' will result in unintelligible and absurd sense and against the clear intention of the Legislature. [R v. Oakes, (1959)]

**(c) 'May', 'must' and 'shall':**

- Practically speaking, the distinction between a provision which is 'mandatory' and one which is 'directory' is that **when it is mandatory, it must be strictly observed**;
- when it is **'directory' it would be sufficient that it is substantially complied with**.
- Let us first appreciate the distinction between mandatory and directory provisions. Where the enactment or provision prescribes that the contemplated **action be taken without any option or discretion, then such statute or provision or enactment will be called mandatory**. Where, the acting authority is vested with **discretion, choice or judgment, the statute or provision will be called directory**.
- In **deciding whether the statute is directory or mandatory**, the question is whether there is anything that makes it the duty of the person on whom the power is conferred to exercise that power. If it is so then the Statute is a mandatory one; otherwise it is directory.
- In cases where the normal significance of imperative and permissive terms leads to absurd, inconvenient or unreasonable results, they should be discarded.
- "May" though permissive sometimes has compulsory force and is to be read as shall. Although it is well – settled that ordinarily the word 'may' is always used in a permissive sense, there may

be circumstances where this word will have to be construed as having been used in a mandatory or compulsory sense.

The question whether any requirement is mandatory or directory has to be decided not merely on the basis of any specific provision which, for instance, sets out the consequences of the omission to observe the requirement, but on the purpose for which the requirement has been enacted, particularly in the context of the other provisions of the Act and the general scheme thereof. It would, inter alia, depend on whether the requirement is insisted on as a protection, for the safeguarding of the right of liberty of person or of property that the action might involve.

**(6) Rule of Ejusdem Generis: The term 'ejusdem generis' means 'of the same kind or species'. Simply stated, the rule means**

(i) The rule of ejusdem generis means that where specific words are used and after those specific words, some general words are used, the **general words would take their colour from the specific words used earlier**.

**(ii) This rule applies when**

1. The statute contains an enumeration of specific words
2. The subject of enumeration constitutes a class or category;
3. That class or category is not exhausted by the enumeration
4. General terms follow the enumeration; and
5. There is no indication of a different legislative intent.

**Example:**

1) Where an Act permits keeping of dogs, cats, cows, buffaloes **and other animals**, the expression 'other animals' would not include wild animals like lions and tigers, but would mean only domesticated animals like horses, etc.
2) Where there was prohibition on importation of 'arms, ammunition, or gunpower or any other goods' the words '**any other goods**' were construed as referring to goods similar to 'arms, ammunition or gun powder' (AG vs. Brown (1920), 1 KB 773).
3) In Devendra Surti v State of Gujarat, under s2 (4) of the Bombay shops and Establishments Act, 1948 the term commercial establishment means "an establishments which carries any trade, business or profession". Here the word profession is associated to business or trade and hence a private doctor's clinic cannot be included in the above definitions as under the rule of Ejusdem Generis.

In the expression charges, rates, duties and taxes', the term charge was read ejusdem generis taking colour from the succeeding terms rates, duties, and taxes. Here, the general category preceded the enumeration of specific categories and so rule of ejusdem generis was technically not applicable and the court in fact applied the more general rule- Noscitur a sociis and rightly limited the meaning of the term charges.

Exceptions:

1. If the preceding term is general, as well as that which follows this rule cannot be applied.
2. Where the particular words exhaust the whole genus.
3. Where the specific objects enumerated are essentially diverse in character.
4. Where there is an express intention of legislature that the general term shall not be read ejusdem generis the specific terms
   - This rule has to be applied judiciously. This rule may be understood as an attempt to settle a conflict between specific and general words.
   - The fifth ground contained in Section 271 (e) of the Companies Act, 2013 shall not be read ejusdem generis the earlier five although it is a general phrase following specific phrases.
   - This is because the earlier grounds are essentially diverse in character.

**#Not in Syllabus**

In the matter of Anil kumar Poddar vs. Nessville Trading (P.) Ltd., Appellant made an application for **inspection of register of members and annual return of respondent company**. When company failed to provide copies of aforementioned documents, he filed petition for supply of documents. The **Respondent (Company) relied upon doctrine of "ejusdem generis"** saying the word "any other person" Section 94 of the Companies Act, 2013 is limited to the person holding commercial interest such as creditor, financier, customer etc., because the preceding would the member and debenture holder to this word "any other person" being the persons having interest in the company, then the following word "any other person" cannot be said as extendable to any person who has no interest in the company, normally, a person considered to aggrieved when his interest is affected by the act of somebody else, **but whereas this Petitioner has no interest in these companies, therefore, he cannot be called aggrieved to file these company petitions against the Respondent**. The NCLT, Mumbai Bench held that, since petitioner was neither a shareholder, nor debenture holder nor holding commercial interest in respondent company, he was not entitled to seek documents.

## (B) OTHER (SECONDARY) RULES OF INTERPRETATION.

### (1) Doctrine of Contemporanea Expositio / Effect of usage

**In this connection, we have to bear in mind 2 Latin maxims:**

(i) '**OPTIMA LEGUM INTERPRES EST CONSUETUDE**' (**the custom is the best interpreter of the law**); and

(ii) '**CONTEMPRANEA EXPOSITO EST OPTIMA ET FORTISSINIA IN LEGE**' - **the best way to interpret a document is to read it as it would have been read when made**. Therefore, the best

interpretation/construction of a statute or any other document is **that which has been made by the contemporary authority.**

Simply stated, **old statutes and documents should be interpreted as they would have been at the time when they were enacted/written**.

**But remember that this maxim is to be applied for construing ancient statutes, but not to acts that are comparatively modern.**

**Example**: Documents issued by the Government simultaneously with the notification under section 16(1) of the Securities Contracts (Regulation) Act, 1956 were used as contemporanea expositio of the notification. [DeshBandhu Gupta & Co. v. Delhi Stock Exchange Association Ltd., AIR 1979 SC]

## (2) Doctrine of Noscitur a Sociis

- The concept of '**NOSCITUR A SOCIIS**' ('**it is known by its associates'**), that is to say 'the meaning of a word is to be judged by the company it keeps'.
- When two or more words which are capable of analogous (similar or parallel) meaning are coupled together, they are to be understood in their **COGNATE SENSE** (connected sense).
- It is a rule wider than the rule of ejusdem generis, rather ejusdem generis is only an application of the noscitur a sociis. It must be borne in mind that nocitur a sociis, merely a rule of construction and it cannot prevail in cases where it is clear that the wider words have been deliberately used in order to make the scope of the defined word correspondingly wider.

**Example:**

In Commissioners of Customs and Excise v. Savoy Hotel, Ltd. [(1966) 2 All E.R.299]:

While dealing with a Purchase Tax Act, which used the expression "**manufactured beverages, including fruit-juices and bottled waters and syrups**,"

The issue was whether a hotel guest who ordered orange juice was served with the juice of a single orange, unsweetened, freshly pressed out to his order is liable to Purchase Tax within the description "manufactured beverages", including fruit juices. It was held that a portion of orange juice, so prepared and served, was not a "manufactured beverage" and the description "including fruit juices" was to be construed in the context of the words which preceded it and hence **Fresh orange juice is not a fruit juice and not liable for purchase tax.**

## A. INTERNAL AIDS TO INTERPRETATION/ CONSTRUCTION

Every enactment has its **Title, Preamble, Heading, Marginal Notes, Definitional Sections/Clauses, Illustrations etc**. They are known as 'internal aids to construction' and can be of immense help in interpreting/construing the enactment or any of its parts.


**(a) Long Title:** An enactment would have what is known as a 'Short Title' and also a 'Long Title'. The 'Short Title' merely identifies the enactment and is chosen merely for convenience, the 'Long Title' on the other hand, describes the enactment and does not merely identify it.

It is now settled that the Long Title of an Act is a part of the Act. We can, therefore, refer to it to ascertain the object, scope and purpose of the Act and so is admissible as an aid to its construction.

**Short Title:** Supreme Court Advocates (Practice in High Courts) Act, 1951
**Long Title:** This is an Act to authorize Advocates of the Supreme Court to practice as of right in any High Court.

**Note:** So, the title of a statute is an important part of the Act and may be referred to for the purpose of ascertaining its general scope and of throwing light on its construction, although it cannot override the clear meaning of the enactment. [Aswini kumar Ghose v. Arabinda Bose, AIR 1952 SC]

**(b) PREAMBLE:**

- The Preamble expresses the **SCOPE, OBJECT AND PURPOSE OF THE ACT more comprehensively than the Long Title.**
- The Preamble may recite the **GROUND AND THE CAUSE** of making a statute and the **evil which is sought to be remedied** by it.
- However, the **Preamble does not over-ride the plain provision of the Act** but if the wording of the statute gives rise to doubts as to its proper construction, the Preamble can and ought to be referred to in order to arrive at the proper construction.

**Example**: Use of the word 'may' in section 5 of the Hindu Marriage Act, 1955 provides that "a marriage may be solemnized between two Hindus….." has been construed to be mandatory in the sense that both parties to the marriage must be Hindus as defined in section 2 of the Act. It was held that a marriage between a Christian male and a Hindu female solemnized under the Hindu Marriage Act was void. This result was reached also having regard to the **preamble of the Act which reads: 'An**

**Act to amend and codify the law relating to marriage AMONG HINDUS**" [Gullipoli Sowria Raj V. Bandaru Pavani, (2009)1 SCC714]

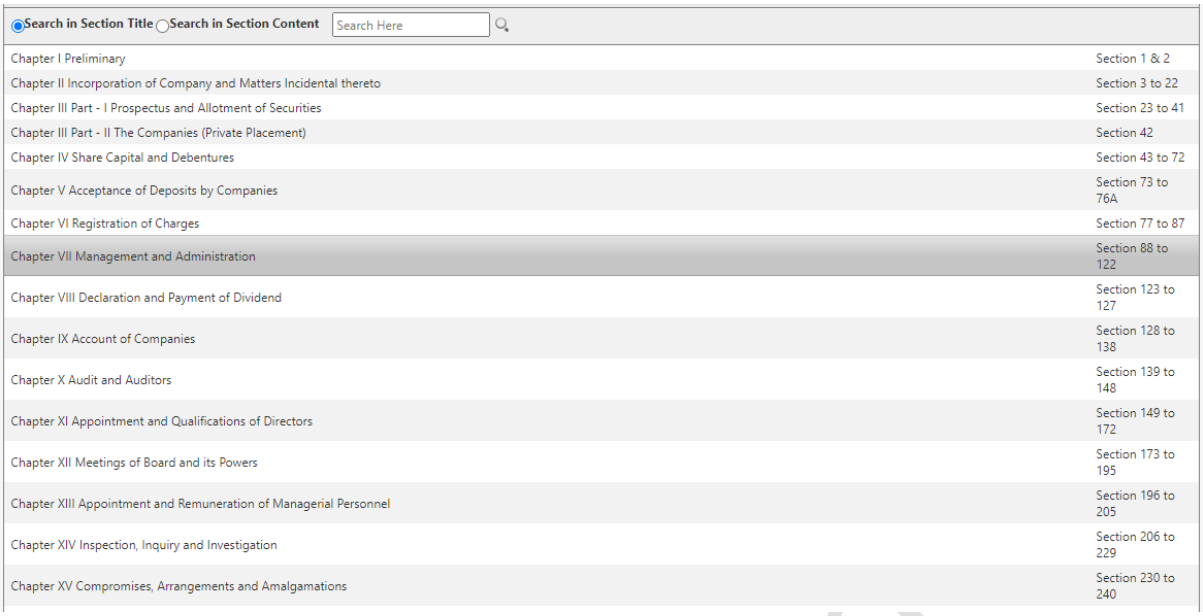
**#Extra gyaan:**

Long title – this appears on the first page after the contents page, immediately before section 1 of the Act. The long title begins 'An Act …' and explains briefly the Act's content. Some long titles are quite detailed and informative but others are brief and convey little. Although it may provide evidence of the purpose behind the Act, a long title is likely to be phrased in very general terms and so unlikely to help interpretation of substantive provisions within the Act.

Preamble - older pieces of legislation often include a preamble in place of the long title. A preamble describes the purpose of an Act, and tends to be more comprehensive than a long title. Senedd Acts, Assembly Acts and Measures do not contain preambles.

**(c) HEADING AND TITLE OF A CHAPTER:**

- If we glance through any Act, we would generally find that a number of its sections applicable to any particular object are grouped together, sometimes in the form of Chapters, prefixed by Heading and/or Titles.
- These Heading and Titles prefixed to sections or groups of sections can legitimately be referred to for the purpose of construing the enactment or its parts.
- However, there is a conflict of opinion about the weightage to be given to them. According to this view headings or titles prefixed to sections or group of sections may be referred to as to construction of doubtful expressions, but cannot be used to restrict the plain terms of an enactment.
- It may be noted that headings may sometimes be referred to know the scope of a section in the same way as the preamble.
- But a heading cannot control or override a section.



Search in Section Title ○ Search in Section Content  Search Here

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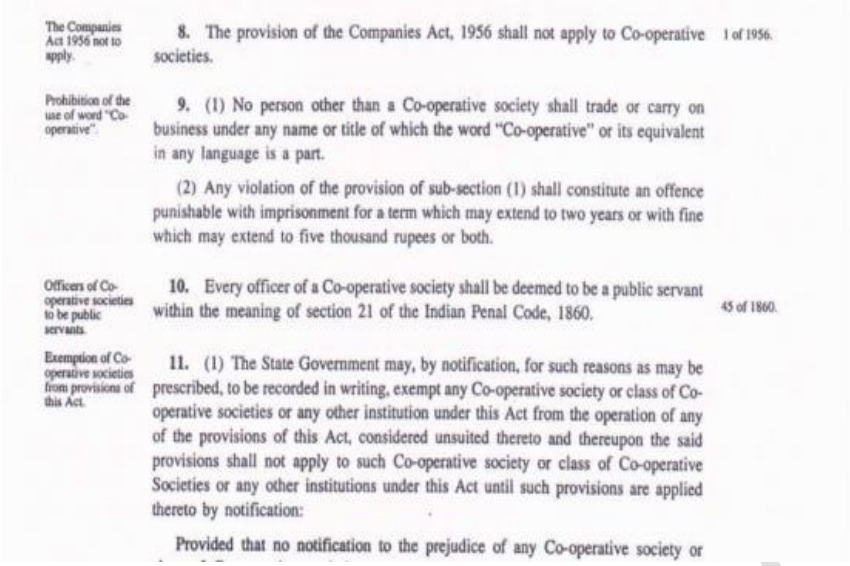
## (d) MARGINAL NOTES

- Marginal notes are **summaries and side notes often found at the side of a section or group** of sections in an act, purporting to sum up the effect of that section or sections.
- **They are not a part of the enactment**, for they were not present when the Act was passed in Parliament, but inserted after the act has been so passed.
- Hence, **they are not an aid to construction.**
- In C.I.T. vs. Ahmedbhai Umarbhai & Co. (AIR 1950 SC 134 at 141), Patanjali Shastri, J., had declared: "Marginal notes in an Indian statute, as in an Act, of Parliament cannot be referred to for the purpose of construing the statute", and the same view has been taken in many other cases. Many cases show that reference to marginal notes may be permissible in exceptional cases for construing a section in a statute. [Deewan Singh v. Rajendra Pd. Ardevi, (2007)10 SCC, Sarabjit Rick Singh v. Union of India, (2008) 2 SCC]
- However, **marginal notes appended to Articles of the Constitution have been held to be part of the Constitution** as passed by the Constituent Assembly and therefore have been used in construing the Articles.



The Companies Act 1956 not to apply.

**8.** The provision of the Companies Act, 1956 shall not apply to Co-operative societies. 1 of 1956.

Prohibition of the use of word "Co-operative".

**9.** (1) No person other than a Co-operative society shall trade or carry on business under any name or title of which the word "Co-operative" or its equivalent in any language is a part.

(2) Any violation of the provision of sub-section (1) shall constitute an offence punishable with imprisonment for a term which may extend to two years or with fine which may extend to five thousand rupees or both.

Officers of Co-operative societies to be public servants.

**10.** Every officer of a Co-operative society shall be deemed to be a public servant within the meaning of section 21 of the Indian Penal Code, 1860. 45 of 1860.

Exemption of Co-operative societies from provisions of this Act.

**11.** (1) The State Government may, by notification, for such reasons as may be prescribed, to be recorded in writing, exempt any Co-operative society or class of Co-operative societies or any other institution under this Act from the operation of any of the provisions of this Act, considered unsuited thereto and thereupon the said provisions shall not apply to such Co-operative society or class of Co-operative Societies or any other institutions under this Act until such provisions are applied thereto by notification:

Provided that no notification to the prejudice of any Co-operative society or

**#Extra Gyaan:** It briefly indicates the contents of that section. **It saves the reader time and prevents confusion** in the use of that statute.

**(e) DEFINITIONAL SECTIONS/INTERPRETATION CLAUSES:**

- The legislature has the power to embody in a statute **itself the definitions of its language and it is quite common to find in the statutes 'definitions'** of certain words and expressions used in the body of the statute.
- When a **word or phrase is defined as having a particular meaning in the enactment, it is that meaning alone which must be given** to it in interpreting a Section of the Act.
- The Court cannot ignore the statutory definition and try and extract what it considers to be the true meaning of the expression independently of it.
- **The purpose of a definition clause is two-fold:**
  (i) to **provide a key** to the proper interpretation of the enactment, and
  (ii) to **shorten the language of the enacting part by avoiding repetition** of the same words contained in the definition part every time the legislature wants to refer to the expressions contained in the definition.

**Construction of definitions may be understood under the following headings:**

(i) Restrictive and extensive definitions
(ii) Ambiguous definitions
(iii) Definitions subject to a contrary context

**(i) RESTRICTIVE AND EXTENSIVE DEFINITIONS**: The definition of a word or expression in the definition section may either be restricting of its ordinary meaning or may be extensive of the same.

- **MEAN**- When a word is defined to 'mean' such and such it is **restrictive and exhaustive we must restrict the meaning of the word to that given in the definition section**.

**Example:** Section 13 of Negotiable Instruments Act 1881: A "negotiable instrument" **means** a promissory note, bill of exchange or cheque payable either to order or to bearer.

- **INCLUDE-** The definition is 'prima facie' **extensive**: here the word defined **is not restricted** to the meaning assigned to it but has extensive meaning which also includes the meaning assigned to it in the definition section.

**Example** 1:

According to Section 2 (m) of Consumer Protection Act, 1986, "person" **includes**,—

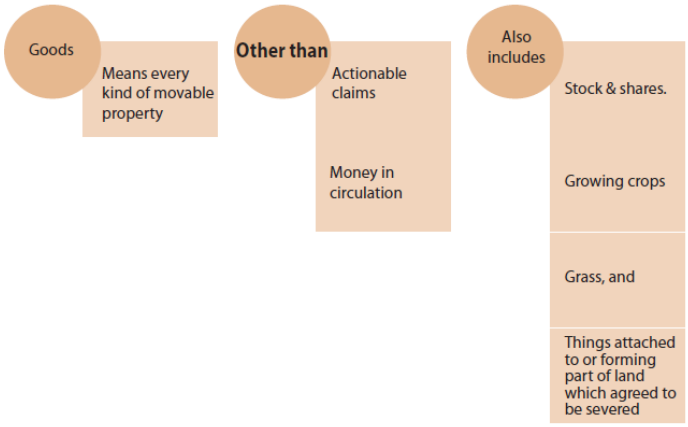
(i) a firm whether registered or not;
(ii) a Hindu undivided family;
(iii) a co-operative society;
(iv) every other association of persons whether registered under the Societies Registration Act, 1860 (21 of 1860) or not;

Example 2: Section 2(3), of companies act, 2013
"alter" or "alteration" includes the making of additions, omissions and substitutions;

**As it is an inclusive definition:** It has been held to include a 'company' although it is not specifically named therein [Karnataka Power Transmission Corporation v. Ashok Iron Works Pvt. Ltd., (2009)3 SCC 240]

- **MEANS and INCLUDE -** here again the **definition would be exhaustive**.

**Goods definition as per SOGA:**




- **TO APPLY TO and INCLUDE'-** the definition is **understood as extensive**.
- **IS DEEMED TO INCLUDE'-** which again is an **inclusive or extensive** definition as such a words are used to bring in by a legal fiction something within the word defined which according to its ordinary meaning is not included within it
  **Example: Subsidiary company, Public Company definitions**

**(ii) AMBIGUOUS DEFINITIONS:**

- Sometime we may find that the **definition section may itself be ambiguous**, and so it may have to be **interpreted in the light of the other provisions of the Act** and having regard to the ordinary meaning of the word defined.
- Such type of **definition is not to be read in isolation**. It must be read in the context of the phrase which it defines.

**Example**: **Termination of service of a seasonal worker** after the work was over **does not amount to retrenchment** as per the Industrial Disputes Act, 1947. [Anil Bapurao Karase v. Krishna Sahkari Sakhar Karkhana, AIR 1997 SC 2698]. But the **termination of employment of a daily wager** who is engaged in a project, on completion of the project will amount to retrenchment if the worker had not been told when employed that his employment will end on completion of the project. [S.M. Nilajkarv.Telecom District Manager Karnataka, (2003)4 SCC].

**(iii) Definitions subject to a contrary context:** When a word is defined to **bear a number of inclusive meanings**, the sense in which the word is used in a particular provision must **be ascertained from the context** of the scheme of the Act, the language of the provision and the object intended to be served thereby.

**(f) ILLUSTRATIONS:** We would find that many, though not all, sections have illustrations appended to them. However, **illustrations do form a part of the statute** and are considered to be of relevance and value in construing the text of the sections. However, illustrations cannot have the effect of modifying the language of the section and can neither curtail nor expand the ambit of the section.

**(g) PROVISO:** The normal function of a proviso **is to EXCEPT something out** of the enactment **or to QUALIFY something stated in the enactment** which would be within its purview if the proviso were not there. The effect of the proviso is to qualify the preceding enactment which is expressed in terms which are too general.

It is a cardinal rule of interpretation that a proviso to a particular provision of a statute only embraces the field which is covered by the main provision.

Example: 2 (*68*) "private company" means a [8][company having a minimum paid-up share capital [4][Omitted] 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;

| Differences | | |
|---|---|---|
| 'Exception' is intended to restrain the enacting clause to particular cases | 'Proviso' is used to remove special cases from general enactment and provide for them specially | 'Saving clause' is used to preserve from destruction certain rights, remedies or privileges already existing |

**Exception**

| Serial number | Chapter/ Section number/ Sub-section(s) in the Companies Act, 2013 | Exceptions/ Modifications/Adaptations |
|---|---|---|
| (1) | (2) | (3) |
| 1. | Chapter I, sub-clause (viii) of clause (76) of section 2. | Shall not apply with respect to section 188. |
| 2. | Chapter IV, section 43 and section 47. | Shall not apply where memorandum or articles of association of the private company so provides. |
| 3. | Chapter IV, sub-clause (i) of clause (a) of sub-section (1) and sub-section (2) of section 62. | Shall apply with following modifications:—<br>In clause (a), in sub-clause (i), the following proviso shall be inserted, namely:—<br>Provided that notwithstanding anything contained in this sub-clause and sub-section (2) of this section, in case ninety per cent. of the members of a private company have given their consent in writing or in electronic mode, the periods lesser than those specified in the said sub-clause or sub-section shall apply. |
| 4. | Chapter IV, clause (b) of sub-section (1) of section 62. | In clause (b), for the words "special resolution", the words "ordinary resolution" shall be substituted. |
| 5. | Chapter IV, section 67. | Shall not apply to private companies -<br>(a) in whose share capital no other body corporate has invested any money;<br>(b) if the borrowings of such a company from banks or financial institutions or any body corporate is less than twice its paid up share capital or fifty crore rupees, whichever is lower; and<br>(c) such a company is not in default in repayment of such borrowings subsisting at the time of making transactions under this section. |

**Save as:**

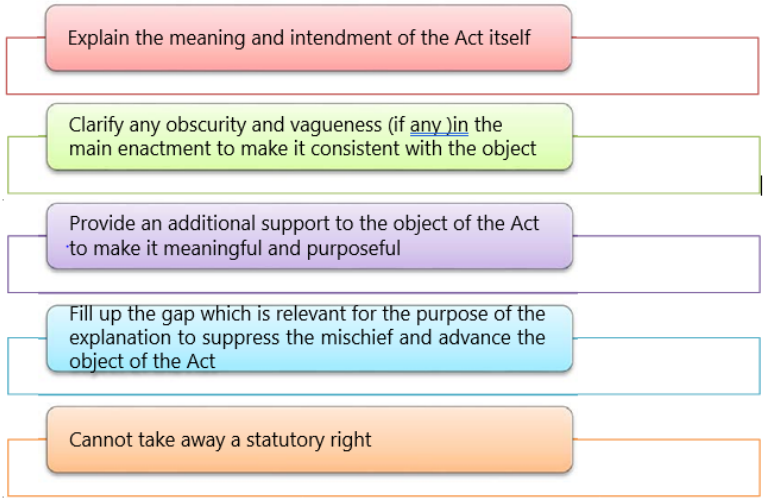
**Alteration of Memorandum**

**13.** (1) Save as provided in section 61, a company may, by a special resolution and after complying with the procedure specified in this section, alter the provisions of its memorandum.

**(h) EXPLANATION: (Section 2(87))]**

- An Explanation **is at times appended to a section to explain the meaning of the text of the section**.
- An Explanation may be **added to include something** within the section or to **exclude something from it**.
- An Explanation should normally be so read as to **harmonise with and clear up any ambiguity in the main section**.
- It should **not be so construed as to widen the ambit** of the section.

  **In Sundaram Pillai v. Pattabiraman, Fazal Ali,** J. gathered the following objects of an explanation to a statutory provision:




**Example:**

**(6) 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.

**Explanation.**—For the purposes of this clause, "significant influence" means control of at least twenty per cent of total share capital, or of business decisions under an agreement;

As per the *Companies (Specification of Definitions Details) Rules, 2014* term total Share Capital, for the purposes of this clause, means the aggregate of the –

(a) Paid-up equity share capital; and

(b) Convertible preference share capital;

**(i) SCHEDULES**: The **Schedules form part of an Act**.

Therefore, they **must be read together with the Act for all purposes of construction**. However, the expressions in the **Schedule cannot control or prevail over the expression in the enactment**. If there appears to be any inconsistency between the schedule and the enactment, the enactment shall always prevail.

**List of Schedules under Companies Act 2013**

1. Schedule I: Memorandum and Articles (Section 4 and 5)
2. Schedule II: Depreciation (Section 123)
3. Schedule III: Balance Sheet and Statement of Profit & Loss (Section 129)
4. Schedule IV: Code for Independent Directors (Section 149(8))
5. Schedule V: Appointment of managing director, whole-time director or manager (Section 196 and 197)
6. Schedule VI: Infrastructure Projects (Section 55 and 186)
7. Schedule VII: Corporate Social Responsibility (Section 135)

**(j) 'READ THE STATUTE AS A WHOLE':**

- It is the **elementary principle that construction of a statute** is to be made of **all its parts taken together and not of one part only.**

- The deed must be read as a whole in order to ascertain the true meaning of its several clauses, and the words of each clause should be so interpreted as to bring them into harmony with other provisions – if that interpretation does no violence to the meaning of which they are naturally susceptible. And the same approach would apply with equal force with regard to Acts and Rules passed by the legislature.
- **Example:** If one section of an Act requires 'notice' should be given, then a verbal notice would generally be sufficient. But, if another section provides that 'notice' should be 'served' on the person or 'left' with him, or in a particular manner or place, then it would obviously indicate that a written notice was intended.

## B. EXTERNAL AIDS TO INTERPRETATION/ CONSTRUCTION

- Society **does not function in a void**. Everything done has its reasons, its background, the particular circumstances prevailing at the time, and so on.
- These factors are of great help in interpreting/construing an Act and have been given the convenient nomenclature of '**External Aids to Interpretation'**.
- Apart from the statute itself there are many matters which may be taken into account when the statute is ambiguous.

**(a) HISTORICAL SETTING:**

- The **history of the external circumstances which led to the enactment** in question is of much significance in construing any enactment.
- We have to **TAKE HELP FROM ALL THOSE EXTERNAL OR HISTORICAL FACTS** which are necessary in the **understanding the subject matter and the scope and object of the enactment**.
- History in general and Parliamentary History in particular, ancient statutes, contemporary or other authentic works and writings all are relevant in interpreting and construing an Act.

**(b) CONSOLIDATING STATUTES & PREVIOUS LAW:**

- The Preambles to many statutes contain expressions such as **"An Act to consolidate"** the previous law, etc.
- In such a case, the **Courts may stick to the presumption that it is not intended to alter the law**. They may solve doubtful points in the statute with the aid of such presumption in intention, rejecting the literal construction.

**(c) USAGE**:

- The acts done under a statute provide quite often the key to the statute itself.
- It is well known that **where the meaning of the language in a statute is doubtful**, usage – **how that language has been interpreted and acted upon over a long period** – may determine its true meaning.

**(d) EARLIER & LATER ACTS AND ANALOGOUS ACTS**: Exposition of One Act by Language of Another:

- The general principle is that where **there are different statutes** in 'pari materia' (i.e. Dealing with the same matter or subject), though **made at different times**, or even expired and not referring to each other, **they shall be taken and construed together as one system and as explanatory of each other**.
- If two Acts are to be read together then every part of each Act has to construed as if contained in one composite Act.
- But if **there is some clear discrepancy** then such a discrepancy **may render it necessary to hold the later Act (in point of time) had modified the earlier one.** However, this does not mean that every word in the later Act is to be interpreted in the same way as in the earlier Act.
- **Example:** Suppose the **earlier bye-law** limited the appointment of the chairman of an organisation to a **person possessed of certain qualifications** and the **later bye-law** authorises the election of any person to be the chairman of the organisation. In such a case, in the later bye-law the expression 'any person' used in the later bye-law would be understood to mean only any eligible person who has the requisite qualifications as provided in the earlier bye-law.
  - **Where the earlier statute contained a negative provision but the later one merely omits that negative provision**: this cannot by itself have the result of substantive affirmation. In such a situation, it would be necessary to see how the law would have stood without the original provision and the terms in which the repealed sections are re-enacted.
  - **Reference to Repealed Act: Where a part of an Act has been repealed, it loses its operative force**. Nevertheless, such a repealed part of the Act may still be taken into account for construing the un-repealed part. **This is so because it is part of the history of the new Act**.

**(e) DICTIONARY DEFINITIONS**: First we have to refer to the Act in question to find out if any particular word or expression is defined in it. Where we find that a word is not defined in the Act itself, we may refer to dictionaries to find out the general sense in which that word is commonly understood.

However, in selecting one out of the several meanings of a word, we must always take into consideration the context in which it is used in the Act and for technical terms reference may be made to technical dictionaries.

**(f) USE OF FOREIGN DECISIONS:**

- Foreign decisions of **countries following the same system of jurisprudence as ours** and given on laws similar to ours **can be legitimately used** for construing our own Acts.
- Further, where **guidance can be obtained from Indian decisions,** reference to foreign decisions may become unnecessary.

## RULES OF INTERPRETATION/ CONSTRUCTION OF DEEDS AND DOCUMENTS

- The first and foremost point is that one has to find out what a **REASONABLE MAN**, who has taken care to inform himself of the surrounding circumstances of a deed or a document, and of its scope and intendments, would understand by the words used in that deed or document.

- The **GOLDEN RULE** is to ascertain the **INTENTION OF THE PARTIES** to the instrument after considering all the words in the document/deed concerned in their ordinary, natural sense.
  - For this purpose,
    - document have to be considered as a **whole**.
    - The **circumstances** in which the particular words had been used
    - **the status and training** of the parties using the words have also to be taken into account as the same words may be used by an ordinary person in one sense and by a trained person or a specialist in quite another special sense.
    - if there is a **conflict between two or more clauses/Part** of the same document. An effort must be made to resolve the conflict by interpreting the clauses so that all the clauses are given effect to. If, however, it is not possible to give effect to all of them, then it is the **earlier clause that will over-ride the latter one.**

**Question and Answer**

**1. Explain the rule in 'Heydon's Case' while interpreting the statutes quoting an example.**

**Answer**

Where the language used in a statute is capable of more than one interpretation, the most firmly established rule for construction is the principle laid down in the Heydon's case. This rule enables, consideration of four matters in constituting an act :

(1) what was the law before making of the Act,
(2) what was the mischief or defect for which the law did not provide,
(3) what is the remedy that the Act has provided, and
(4) what is the reason for the remedy.

The rule then directs that the courts must adopt that construction which 'shall suppress the mischief and advance the remedy'. Therefore, even in a case where the usual meaning of the language used falls short of the whole object of the legislature, a more extended meaning may be attributed to the words, provided they are fairly susceptible of it. If the object of any enactment is public safety, then its working must be interpreted widely to give effect to that object. Thus in the case of Workmen's Compensation Act, 1923 the main object being provision of compensation to workmen, it was held that the Act ought to be so construed, as far as possible, so as to give effect to its primary provisions.

However, it has been emphasized by the Supreme Court that the rule in Heydon's case is applicable only when the words used are ambiguous and are reasonably capable of more than one meaning [CIT v. Sodra Devi (1957) 32 ITR 615 (SC)].

**2. Explain the principles of "Grammatical Interpretation" and "Logical Interpretation" of a Statute. What are the duties of a court in this regard?**

**Answer**

Principles of Grammatical Interpretation and Logical Interpretation: In order to ascertain the meaning of any law/ statute the principles of Grammatical and Logical Interpretation is applied to conclude the real meaning of the law and the intention of the legislature behind enacting it.

Meaning: Grammatical interpretation concerns itself exclusively with the verbal expression of law. It does not go beyond the letter of the law, whereas Logical interpretation on the other hand, seeks more satisfactory evidence of the true intention of the legislature.

Application of the principles in the court: In all ordinary cases, the grammatical interpretation is the sole form allowable. The court cannot delete or add to modify the letter of the law. However, where the letter of the law is logically defective on account of ambiguity, inconsistency or incompleteness, the court is under a duty to travel beyond the letter of law so as to determine the true intentions of the legislature. So that a statute is enforceable at law, however, unreasonable it may be. The duty of the court is to administer the law as it stands rather it is just or unreasonable.

However, if there are two possible constructions of a clause, the courts may prefer the logical construction which emerges from the setting in which the clause appears and the circumstances in which it came to be enacted and also the words used therein.

**3.**

**(i) What is the effect of proviso? Does it qualify the main provisions of an Enactment?**

**(ii) Does an explanation added to a section widen the ambit of a section?**

**Answer**

(i) Normally a Proviso is added to a section of an Act to except something or qualify something stated in that particular section to which it is added. A proviso should not be, ordinarily, interpreted as a general rule. A proviso to a particular section carves out an exception to the main provision to which it has been enacted as a Proviso and to no other provision. [Ram Narian Sons Ltd. Vs. Commissioner of Sales Tax AIR (1955) S.C. 765]

(ii) Sometimes an explanation is added to a section of an Act for the purpose of explaining the main provisions contained in that section. If there is some ambiguity in the provisions of the main section, the explanation is inserted to harmonise and clear up and ambiguity in the main section. Something may added be to or something may be excluded from the main provision by insertion of an explanation. But the explanation should not be construed to widen the ambit of the section.

**4. Gaurav Textile Company Limited has entered into a contract with a Company. You are invited to read and interpret the document of contract. What rules of interpretation of deeds and documents would you apply while doing so?**

**Answer:**

The rules regarding interpretation of deeds and documents are as follows:

First and the foremost point that has to be borne in mind is that one has to find out what reasonable man, who has taken care to inform himself of the surrounding circumstances of a deed or a document, and of its scope and intendments, would understand by the words used in that deed or document.

It is inexpedient to construe the terms of one deed by reference to the terms of another. Further, it is well established that the same word cannot have two different meanings in the same documents, unless the context compels the adoption of such a rule.

The Golden Rule is to ascertain the intention of the parties of the instrument after considering all the words in the documents/deed concerned in their ordinary, natural sense. For this purpose, the relevant portions of the document have to be considered as a whole. The circumstances in which the particular words have been used have also to be taken into account. Very often, the status and training of the parties using the words have also to be taken into account as the same words maybe used by an ordinary person in one sense and by a trained person or a specialist in quite another sense and a special sense. It has also to be considered that very many words are used in more than one sense. It may happen that the same word understood in one sense will give effect to all the clauses in the deed

while taken in another sense might render one or more of the clauses ineffective. In such a case the word should be understood in the former and not in the latter sense.

It may also happen that there is a conflict between two or more clauses of the same documents. An effect must be made to resolve the conflict by interpreting the clauses so that all the clauses are given effect. If, however, it is not possible to give effect of all of them, then it is the earlier clause that will override the latter one.

**5. How will you interpret the definitions in a statute, if the following words are used in a statute?**

**(i) Means, (ii) Includes Give one illustration for each of the above from statutes you are familiar with.**

**Answer**

Interpretation of the words "Means" and "Includes" in the definitions- The definition of a word or expression in the definition section may either be restricting of its ordinary meaning or may be extensive of the same.

When a word is defined to 'mean' such and such, the definition is 'prima facie' restrictive and exhaustive, we must restrict the meaning of the word to that given in the definition section.

But where the word is defined to 'include' such and such, the definition is 'prima facie' extensive, here the word defined is not restricted to the meaning assigned to it but has extensive meaning which also includes the meaning assigned to it in the definition section.

Example—

Definition of Director [section 2(34) of the Companies Act, 2013]—Director means a director appointed to the board of a company. The word "means" suggests exhaustive definition.

Definition of Whole time director [Section 2(94) of the Companies Act, 2013]—Whole time director includes a director in the whole time employment of the company. The word "includes" suggests extensive definition. Other directors may be included in the category of the whole time director.

**6. Differentiate Mandatory Provision from a Directory Provision. What factors decide whether a provision is directory or mandatory?**

**Answer**

Practically speaking, the distinction between a provision which is 'mandatory' and one which is 'directory' is that when it is mandatory, it must be strictly observed; when it is 'directory' it would be sufficient that it is substantially complied with. However, we have to look to the substance and not merely the form, an enactment in mandatory form might substantially be directory and, conversely, a statute in directory form may in substance be mandatory. Hence, it is the substance that counts and must take precedence over mere form. If a provision gives a power coupled with a duty, it is mandatory: whether it is or is not so would depend on such consideration as:

- the nature of the thing empowered to be done,

- the object for which it is done, and
- the person for whose benefit the power is to be exercised.

**7. Define Grammatical Interpretation. What are the exceptions to grammatical interpretation?**

**Answer**

**Grammatical Interpretation and its exceptions:** 'Grammatical interpretation' concerns itself exclusively with the verbal expression of the law, it does not go beyond the letter of the law. In all ordinary cases, 'grammatical interpretation' is the sole form allowable. The Court cannot take from or add to modify the letter of the law.

This rule, however, is subject to some exceptions:

(1) Where the letter of the law is logically defective on account of ambiguity, inconsistency or incompleteness. As regard the defect to ambiguity, the Court is under a duty to travel beyond the letter of the law so as to determine from the other sources the true intention of the legislature. In the case of the statutory expression being defective on account of inconsistency, the court must ascertain the spirit of the law.

(2) If the text leads to a result which is so unreasonable that it is self-evident that the legislature could not mean what it says, the court may resolve such impasse by inferring logically the intention of the legislature.

**8. When can the Preamble be used as an aid to interpretation of a statute?**

**Answer**

While the Preamble can be used to know the aims and objects of the legislation it cannot be used to control or qualify the precise and unambiguous language of an enactment. **The preamble is the key to the mind of the maker of the law,** but it cannot override in order to enlarge or restrict the enacting provision of the Act. A provision contained in the Act cannot be considered as invalid because they do not accord with the preamble, which is only a brief summary of legislative objectives behind the Act, and if there is any conflict between the preamble and any provision of an Act, the provision prevails.

The preamble merely affords help in the matter of construction if there is any ambiguity. Where the language of the Act is clear, the court is bound to give it effect.

When will courts refer to the preamble as an aid to construction?

Situation 1: Where there is any ambiguity in the words of an enactment the assistance of the preamble may be taken to resolve the conflict.

Situation 2: Where the words of an enactment appear to be too general in scope or application then courts may resort to the preamble to determine the scope or limited application for which the words are meant.

**9. Explain how 'Dictionary Definitions' can be of great help in interpreting / constructing an Act when the statute is ambiguous.**

**Answer**

Dictionary Definitions: First we refer the Act in question to find out if any particular word or expression is defined in it. Where we find that a word is not defined in the Act itself, we may refer to dictionaries to find out the general sense in which that word is commonly understood. However, in selecting one out of the several meanings of a word, we must always take into consideration the context in which it is used in the Act. It is the fundamental rule that the meanings of words and expressions used in an Act must take their colour from the context in which they appear. Further, judicial decisions laying down the meaning of words in construing statutes in pari materia will have greater weight than the meaning furnished by dictionaries. However, for technical terms, reference may be made to technical dictionaries.

**10. Preamble does not over-ride the plain provision of the Act.' Comment. Also give suitable example.**

**Answer**

Preamble: The Preamble expresses the scope, object and purpose of the Act more comprehensively. The Preamble of a Statute is a part of the enactment and can legitimately be used as an internal aid for construing it. However, the Preamble does not over-ride the plain provision of the Act. But if the wording of the statute gives rise to doubts as to its proper construction, for example, where the words or phrase has more than one meaning and a doubt arises as to which of the two meanings is intended in the Act, the Preamble can and ought to be referred to in order to arrive at the proper construction.

In short, the Preamble to an Act discloses the primary intention of the legislature but can only be brought in as an aid to construction if the language of the statute is not clear. However, it cannot override the provisions of the enactment.

Example: Use of the word 'may' in section 5 of the Hindu Marriage Act, 1955 provides that "a marriage may be solemnized between two Hindus….." has been construed to be mandatory in the sense that both parties to the marriage must be Hindus as defined in section 2 of the Act. It was held that a marriage between a Christian male and a Hindu female solemnized under the Hindu Marriage Act was void. This result was reached also having regard to the preamble of the Act which reads: 'An Act to amend and codify the law relating to marriage among Hindus" [GullipoliSowria Raj V. BandaruPavani, (2009)1 SCC714].

**11. At the time of interpreting a statutes what will be the effect of 'Usage' or 'customs and Practices'?**

**Answer**

Effect of usage: Usage or practice developed under the statute is indicative of the meaning recognized to its words by contemporary opinion. A uniform notorious practice continued under an old statute and inaction of the Legislature to amend the same are important factors to show that the practice so followed was based on correct understanding of the law. When the usage or practice receives judicial or legislative approval it gains additional weight.

In this connection, we have to bear in mind two Latin maxims:

(i) 'Optima Legum interpres est consuetude' (the custom is the best interpreter of the law); and

(ii) 'Contemporanea exposito est optima et fortissinia in lege' (the best way to interpret a document is to read it as it would have been read when made).

Therefore, the best interpretation/construction of a statute or any other document is that which has been made by the contemporary authority. Simply stated, old statutes and documents should be interpreted as they would have been at the time when they were enacted/written.

Contemporary official statements throwing light on the construction of a statute and statutory instruments made under it have been used as contemporanea exposition to interpret not only ancient but even recent statutes in India.

# Chapter 15

# THE FOREIGN EXCHANGE MANAGEMENT ACT, 1999

## INTRODUCTION

### History of the Act/ Need for the Act

1) The change in the economic scenario, globalization of capital, free trade across the globe, necessitated the need for **managing foreign exchange in the country** in an orderly manner.
2) To **facilitate** **cross border trade** and **cross border capital flows**, exchange control **law was required**.
3) Foreign exchange control led to **introduction of exchange control law through Defence of India rules by the Britishers in 1939**.
4) Subsequently, Foreign Exchange Regulation Act (FERA) was enacted in **1947** which was later replaced with 'the Foreign Exchange Regulation Act, **1973'** (FERA).
5) Government as part of its agenda of **liberalisation of the Indian economy in 1991**, permitted
   - Free movement of foreign exchange in trade related receipts and payments
   - Foreign Investment in various sectors.

   This increased the flow of foreign exchange to India and consequently foreign exchange reserves increased substantially.
6) FEMA, 1999 has been made effective from 1st June, 2000. This Act enables management of foreign exchange reserves for the country.

**Salient Features** of the Act: It provides for-

- Regulation of transactions between residents and non-residents
- Investments in India by non-residents and overseas investments by Indian residents
- Freely permissible transactions on current account subject to reasonable restrictions that may be imposed
- Reserve Bank of India (RBI) and Central Government control over capital account transactions
- Requirement for realisation of export proceeds and repatriation to India
- Dealing in foreign exchange through 'Authorised Persons' like Authorised Dealer/ Money Changer/ Off-shore banking unit
- Adjudication and Compounding of Offences
- Investigation of offences by Directorate of Enforcement
- Appeal provisions including Special Director (Appeals) and Appellate Tribunal.

### Broad Structure of FEMA

| Chapters | Matters | Sections |
|---|---|---|
| I | Preliminary | 1 – 2 |
| II | Regulation and Management of Foreign Exchange | 3 – 9 |
| III | Authorised Person | 10 – 12 |
| IV | Contravention and Penalties | 13 – 15 |
| V | Adjudication and Appeal | 16 – 35 |
| VI | Directorate of Enforcement | 36 – 38 |
| VII | Miscellaneous | 39 – 49 |

**Preamble of FEMA**

This Act aims to **consolidate and amend** the law relating to foreign exchange with the objective of:

(i) facilitating **external trade and payments** and

(ii) for promoting the orderly development and **maintenance of foreign exchange** market in India.

**Extent and Application [Sections 1]**

- FEMA, 1999 extends to the whole of India.
- In addition, it shall also apply to all branches, offices and agencies outside India **owned or controlled** by a **person resident in India** and
- also to any contravention thereunder **committed outside India by any person to whom this Act applies**.

**DEFINITIONS [SECTION 2]**

(a) "**Authorised person**" means an **authorised dealer, money changer, off-shore banking** unit or any other person for the time being authorised under section 10(1) to deal in foreign exchange or foreign securities; [Section 2(c)]

(b) "**Capital Account Transaction**" means a transaction, **which alters**

- the assets or liabilities, including contingent liabilities, **outside India of persons resident in India** or
- assets or liability **in India of persons resident outside India** [Section 2(e)]

(c) "**Currency**" includes all currency notes, postal notes, postal orders, money orders, cheques, drafts, travelers cheques, letters of credit, bills of exchange and promissory notes, credit cards or such other similar instruments, as may be notified by the Reserve Bank. [Section 2(h)]

(d) "**Currency Notes**" means and **includes cash in the form of coins and bank notes**; [Section 2(i)]

(e) "**Current Account Transaction**" means a transaction **other than a capital account transaction** and without prejudice to the generality of the foregoing such transaction includes,

(i) payments due in connection with foreign trade, other current business, services, and short-term banking and credit facilities in the ordinary course of business.

(ii) payments due as interest on loans and as net income from investments.

(iii) remittances for living expenses of parents, spouse and children residing abroad, and

(iv) expenses in connection with foreign travel, education and medical care of parents, spouse and children; [Section 2(j)]

**(f)** "**Foreign Currency**" means any currency other than Indian currency; [Section 2(m)]

(g) **"Foreign Exchange"** means foreign currency and includes:

i. deposits, credits and balances **payable in any foreign currency**,
ii. drafts, travelers cheques, letters of credit or bills of exchange, **expressed or drawn in Indian currency** but **payable in any foreign currency**,
iii. drafts, travelers cheques, letters of credit or bills of exchange **drawn by banks, institutions or persons outside India**, but **payable in Indian currency**; [Section 2(n)]

**#Practice Question:**

**Mr. X, PRI was dealing as follows:**

**a) Deposit with Mr. Y a PROI: $ 30,000**

**b) Took credit from Swiss bank $ 2, 00,000**

**c) Have travellers card balance of Rs. 2, 00,000**

**d) Bill of exchange accepted by Mr. A PROI: $ 1,00,000**

**Advise the status of above things whether foreign exchange or not?**

**a) Yes, it is Foreign Exchange**

**b) Yes, it is Foreign Exchange**

**c) Yes, it is Foreign Exchange – Because it can be converted to foreign currency]**

(h) "**Foreign Security**" means any security, in the form of shares, stocks, bonds, debentures or any other instrument **denominated or expressed in foreign currency** and **includes** **securities expressed in foreign currency**, but where redemption or any form of return such as **interest or dividends is payable in Indian currency**;[Section 2(o)]

(i) "**Person Resident Outside India**" means a person who is not resident in India;[Section 2(w)]

(j) "**Person**" includes:

- an individual,
- a Hindu undivided family,
- a company,
- a firm,
- an association of persons or a body of individuals, whether incorporated or not,
- every artificial juridical person, not falling within any of the preceding sub-clauses, and;
- any agency, office or branch owned or controlled by such person; [Section 2(u)]

(k) "**Repatriate to India**" means **bringing into India the realised foreign exchange** and

(i) the selling of such foreign exchange to an authorised person in India in exchange for rupees, or

(ii) the holding of realised amount in an account with an authorised person in India to the extent notified by the Reserve Bank.

It includes use of the realised amount for discharge of a debt or liability denominated in foreign exchange and the expression "repatriation" shall be construed accordingly;[Section 2(y)]

## RESIDENTIAL STATUS

**Person Resident in India [Section 2(v)]**

Person resident in India is a person **residing in India for more than 182 days in the preceding financial year**.

However, 2 categories of persons **are excluded** from the purview of definition.

1) Any **PERSON WHO HAS GONE OUT OF INDIA** or who stays outside India for
   - taking up **employment** outside India, or
   - for carrying on outside India a **business or vocation**
   - person who stays outside India for any other purpose in such circumstances as would indicate his intention to **stay outside India for an uncertain period**.

**#In short:** A person who goes out for **any reason other than** mentioned above, he shall be considered as PRI, if he goes out for the above-mentioned reason he will be considered as PROI.

2) The 2nd category of persons which **have been excluded from the definition**

A **PERSON WHO HAS COME TO STAY OR STAYS IN INDIA**, **OTHERWISE THAN**—

(i) for or taking up employment in India; or

(ii) for carrying on in India a business or vocation in India; or
(iii) for any other purpose, in such circumstances as would indicate his intention to stay in India for an uncertain period.

**#In short:** A person who comes to any India for **any reason other than** mentioned above, he shall be considered as PROI, if he comes for the above-mentioned reason he will be considered as PRI.

**Note:**

**1) Following shall also be considered as PRI**

a) Any person or body corporate registered or incorporated in India;
b) An office, branch or agency in India owned or **controlled by a PROI**;
c) An office, branch or agency outside India owned or **controlled by a PRI**.

2) Entities like HUF and AOP are not required to be incorporated like corporate entities nor the definition can be far stretched to cover by applying the criteria of 'owned or controlled'. Hence legally the definition for HUF, AOP, BOI fail. **Practically if the HUF, AOP etc. are in India, they will be considered as Indian residents.**

**#Questionable Points:**

1) If period of stay in previous FY is 182 days or less then he is a PROI in current year.
2) **Citizenship** does not decide the residential status. So, you may ignore it while answering.
3) **Number of days:**
    a) A person would **cease to be PRI from the date of his departure**.

| **Examples on Residential status** | | |
|---|---|---|
| **Question** | **PRI/PROI** | **Explanation** |
| 1) If a person resides in India for more than 182 days during FY 2018-19 and leaves India on 1st November 2019, for business. | PROI | For FY 2019-20 the person will be a PRII till 31st October 2019. He will be a non-resident from 1st November 2019. |
| 2) Mr. Z had resided in India during the financial year 2019-2020. He left India on 1st August, 2020 for United States for **pursuing higher studies** for 3 years. What would be his residential status during financial year 2020-2021 and during 2021-2022? | PROI | RBI has clarified vide circular **no. 45 dated 8th December 2003, that students will be considered as non-residents**. This is because usually students start working there to take care of their stay and cost of studies.<br>Hence for FY 20-21= He is PRI till 31st July 2020, from 1st Aug 2020 he is a PROI.<br>For the financial year 2021-2022, he would not have been in India in the preceding financial year (2020-2021) for a period exceeding 182 days. |

| | | |
|---|---|---|
| | | Accordingly, he would not be 'person resident in India' during the financial year 2021-2022. |
| 3) Toy Ltd. is a Japanese company having several business units all over the world. It has a robotic unit with its headquarters in Mumbai and has a branch in Singapore. The Headquarters at Mumbai controls the Singapore branch of the robotic unit. What would be the residential status of the robotic unit in Mumbai and that of the Singapore branch? | PRI | Robotic unit in Mumbai is owned or controlled by a person 'resident outside India'. Hence, it would be 'person resident in India'.<br>The robotic unit headquartered in Mumbai, which is a person resident in India as discussed above, controls the Singapore branch, Hence, the Singapore branch is a 'PRI'. |
| **4) Miss Alia is an airhostess with the British Airways. She flies for 12 days in a month and thereafter takes a break for 18 days. During the break, she is accommodated in 'base', which is normally the city where the Airline is headquartered. However, for security considerations, she was based at Mumbai. During the financial year, she was accommodated at Mumbai for more than 182 days. What would be her residential status under FEMA?** | PROI | Miss Alia stayed in India at Mumbai 'base' for more than 182 days in the preceding financial year. She is however employed in UK. She has not come to India for employment, business or circumstances which indicate her intention to stay for uncertain period. Under section 2(v)(B), such persons are not considered as Indian residents even if their stay exceeds 182 days in the preceding year. Thus, while Miss Alia may have stayed in India for more than 182 days, **she cannot be considered to be a Person Resident in India. Hence she is a PROI**<br>If however she has been employed in Mumbai branch of British Airways, then she will be considered a Person Resident in India. |
| 5) 'Printex Computer' is a Singapore based company having several business units all over the world. It has a unit for manufacturing computer printers with its Headquarters in Pune. It has a Branch in Dubai which is controlled by the Headquarters in Pune. What would be the residential status under the FEMA, 1999 of printer units in Pune and that of Dubai branch? | PROI<br><br>PRI | Printex Computer being a Singapore based company would be person resident outside India [(Section 2(w)].<br><br>Printex unit in Pune is owned or controlled by a person resident outside India, and hence it, would be a 'person resident in India.' |
| 6) Suresh resided in India during the Financial Year 2013-14. He left India on 15th July, 2014 for Switzerland for pursuing | 2014 – 15 = PRI till | Mr. Suresh will be treated as PRI till 15th July 2014. However, during the Financial Year 2015-2016, Mr. Suresh will not be considered as resident as he left |

| | | |
|---|---|---|
| higher studies in Biotechnology for 2 years. What would be his residential status under the Foreign Exchange Management Act, 1999 during the Financial Years 2014-15 and 2015-16? | 15th July, 2014<br><br>15 – 16 = PROI from 16th July 2014 and 15 - 16 | India on 15th July 2014. He is determined to be person resident outside from ~~16th July 2014~~ for the financial year 2015-2016.<br><br>[He would be PROI from 15th July 2014. ]<br><br>Referring to RBI clarification. |

**#Previously asked question:**

1. **During the financial year 2000-01, Mr Harsh visited India for the first time for a holiday. He stays in India for more than 182 days and goes back on 1st January 2001. He again comes to India on August 1, 2001 for the purpose of business. He intends to wind up his business and leave India on 31st December 2002. and plans to take up employment outside India. What would be his residential status during the financial years 2000-01, 2001-02 and 2002-03?**

**Answer:** The given problem can be answered as follows:

**(a) Financial year 2000-01:** Mr Harsh came to India for the first time in the financial year 2000-01. It means he did not stay in India for anytime in the financial year 1999-2000. Therefore, for the financial year 2000-01 he is a 'Person resident outside India'.

**(b) Financial year 2001-02:** He resided in India for more than 182 days in the financial year 2000-01. Also, during the financial year 2001-02 he has been in India for the purpose of business. Therefore, for the financial year 2001-02 he is a person resident India.

**(c) Financial year 2002-03:** He resided in India for more than 182 days in the financial year 2001-02. Therefore, he shall be a person resident in India up to 30th December 2002. However, he left India for the purpose of taking up employment outside India. Therefore, with effect from 31st December, 2002, he shall be a 'Person resident outside India'.

2. **Mr Rohit is an Indian Citizen. He has been residing in India since his birth. He left India for employment to Australia on 25th February, 2001. The contract of employment is for 2 years. He comes back on 24th February, 2003. What is his residential status for the financial years 2000-01, 2001-02, 2002-03 and 2003-04?**

**Answer:** The given problem can be answer as follows:

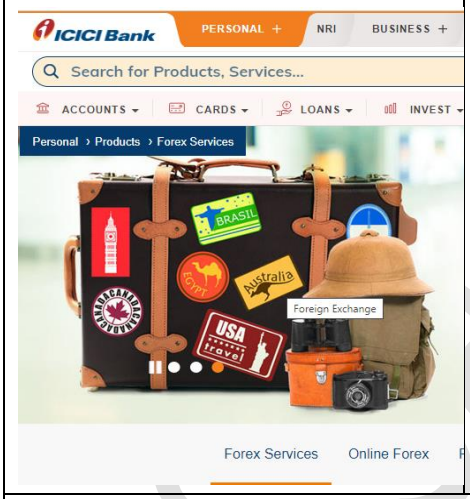
(a) Financial year 2000-01. Mr Rohit resided in India for the whole year in the preceding financial year, i.e., 1999-2000. However, he leaves India for employment outside India in the current financial year, i.e., 2000-01. It is immaterial whether the period of employment is certain or not. Therefore, with effect from **25th February, 2001 he is a 'Person resident outside India'. But he was a person resident in India from 1st April, 2000 till 24th February, 2001.**

(b) Financial year 2001-02. Mr Rohit resided for more than 182 days in the preceding financial year, i.e., 2000-01. However, he has left India for employment outside India. Therefore, he is a 'Person resident outside India' for the entire financial year 2001-02.
(c) Financial year 2002-03. Mr Rohit did not reside at all in the preceding financial year, i.e., 2001-02. Therefore, he shall be a 'Person resident outside India' for the entire financial year 2002-03.
(d) Financial year 2003-04. Mr Rohit resided for less than 183 days in the preceding financial year, i.e., 2002-03. Therefore, he shall 'Person resident outside India' for the entire financial year 2003-04.

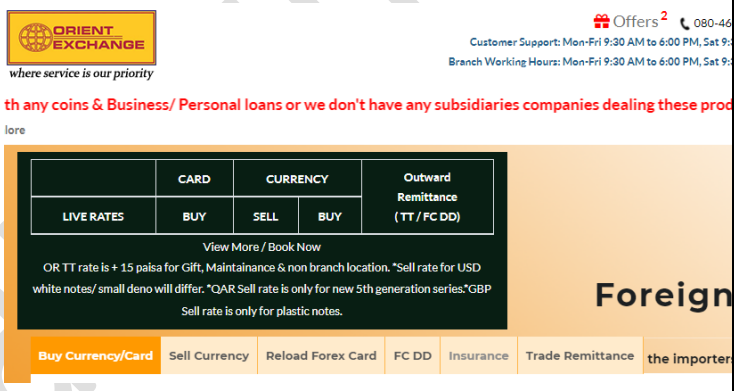
## AUTHORISED PERSON

**Definition:** The term authorised person (AP) is defined under Section 2(c) of the Act to mean an **authorised dealer**, **money changer**, **off-shore banking unit or any other person** authorised to deal in **foreign exchange or foreign securities**.

**authorised dealer**




**Money changer**




**Off Shore Banking Unit**

- An Off Shore Banking Unit means a **branch of a bank in India, located in the Special Economic Zone**.
- Although such an Off Shore Banking Unit may have a licence to operate as an Authorised Dealer, it shall not be regarded as an Authorised Dealer under Foreign Exchange Management Act, 1999.
- It **shall NOT conduct any activity or any transaction with residents in India**.
- An Off Shore Banking Unit may undertake any transaction with any **Authorised Dealer in India on Principal-to-Principal basis.**
- Off Shore Banking Units **are meant to facilitate units in Special Economic Zones** and may undertake transactions in Foreign Exchange with a unit in the SEZ.

**Appointment of authorized person:**

**The RBI has the power to appoint authorised person under Section 10 of the Act.**

1) **Any person** may be authorised by the Reserve Bank of India, **on an application made to it in this behalf, to deal in Foreign exchange or in foreign securities** to function as an authorised dealer, money changer or offshore banking unit or in any other manner as he deems fit.
2) Any such authorisation made by the RBI shall be in writing and shall be subject to the conditions laid down in the authorisation.
3) **AP shall comply with the directions of the RBI:** An authorized person must, in all his dealings in foreign exchange or foreign security, comply with such general or special directions or orders of RBI. Also, except with the previous permission of the Reserve Bank, an authorized person may not engage in any transaction involving any foreign exchange or foreign security, which is not in conformity with the terms of his authorization.
4) **Declaration:** Before commencement of any transactions in Foreign exchange on behalf of any person, an **authorised person must insist that such person should make a declaration and give whatever information is required** in order to satisfy him that the transaction **will not involve and is not designed to contravene or evade the provisions of this Act** or any Rule, Regulation, Notification, Direction, or order made under this Act.

   **If such person refuses to abide by such requirement** or his compliance is not good enough, the authorised person **shall refuse in writing to undertake the transaction**. If the AP has reason to believe that any such **contravention or evasion (as aforesaid)** is contemplated by the other person, the authorised person **shall report the matter to the Reserve Bank of India**.
5) If any person, who has acquired or purchased foreign exchange for any purpose mentioned in the declaration made by him to authorized person
   - Does **not use it** for such purpose or
   - Does **not surrender** it to the authorized person within the specified period or
   - Uses the foreign exchange for any other purpose for which foreign exchange **is not permissible under the provisions** of the Act or the rules or regulations or direction

   Such person shall be deemed to have committed contravention of the provisions of the Act.

**Revocation of authorisation by RBI, if it is satisfied that:** -

1. It is in **public interest** so to do, or
2. The **authorised person has failed to comply** with the conditions laid down in the authorisation.
3. The authorised person has **contravened any of the provisions** of this Act or any Rule, Regulation, Notification, Direction, or order made under this Act.

   An authorisation shall not be revoked on grounds **mentioned in 2 and 3 above**, unless the authorised person has been given a **reasonable opportunity of making a representation** in.

**Reserve Bank's powers to issue directions to authorised person [Section 11]**

In order to secure strict compliance with the provisions of this Act and of any Rules, Regulations, Notifications, or directions, the Reserve Bank may direct the authorised persons with regard to :

1. Matters pertaining to
   (i) Making of **payment**; or
   (ii) The **doing or desisting from doing** of any act relating to Foreign Exchange or foreign security.
2. Furnishing such information, in such manner, as it deems fit.

**Power of Reserve Bank to inspect authorised person [Section 12]**

It shall appear **to the RBI** that it is necessary and expedient to **cause an inspection** of the business of any Authorised person. There upon, it may at any time **specially authorize any officer**, in writing to inspect such business, such an inspection may be made **for the following purpose:-**

1. **Verification of the correctness of any statement**, information, or particulars furnished to the Reserve Bank.
2. **Obtaining any information** or particulars, which such authorised person, **has failed to furnish**, on being called upon to do so.
3. **Securing compliance with the provisions** of this Act or of any Rules, Regulations, Directions, or orders made under the Act.

**Every authorized person is duty-bound**
(i) **to produce such books**, accounts and other documents in his custody or power to the officer making the inspection, and
(ii) **to furnish any statement** relating to the affairs of such person, company or firm.
In the case of company or firm it shall be the duty of every director, partner or other officer of such company or firm.

## REGULATION AND MANAGEMENT OF FOREIGN EXCHANGE

### 1) DEALING IN FOREIGN EXCHANGE, ETC. [SECTION 3]

No person shall-
(a) deal in or transfer any **foreign exchange or foreign security** to any **person not being an authorised person**(AP);
(b) make any payment to or for the credit of any PROI in any manner;
(c) r**eceive otherwise than through an authorised person**, any payment by order or on behalf of any PROI in any manner.
**Explanation**—For the purpose of this clause, where any person in, or resident in, India receives any payment by order or on behalf of any person resident outside India through any other person (including an authorised person) **without a corresponding inward remittance** from any place outside India, then, such person **shall be deemed to have received** such payment otherwise than through an authorised person;
(d) enter into any **financial transaction in India as consideration for** or in association with acquisition or creation or transfer of a right to acquire, any asset outside India by any person.
**The above transactions may be carried on**
a. as otherwise provided in this Act; or
b. with the **general or special permission** of the RBI

**Explanation.—** For the purpose of this clause, "financial transaction" means making any payment to, or for the credit of any person, or receiving any payment for, by order or on behalf of any person, or drawing, issuing or negotiating any bill of exchange or promissory note, or transferring any security or acknowledging any debt.
This section imposes blanket restrictions on the specified transactions. This section applies to PRIIs and PROIs. The purpose of this section is to regulate inflow and outflow of Foreign Exchange through Authorised dealers and in a permitted manner.

**Illustration for understanding Section 3 better**

**(i) Example pertaining to clause (a)-** Dealing in foreign exchange – A PROI comes to India and would like to sell US$ 1,000 to his friend who is resident in India. The friend offers him a rate better than the banks. This cannot be done as it would amount to dealing in foreign exchange.
**(ii) Example pertaining to clause (b)** – A PROI has an insurance policy in India. He requests his brother in India to pay the insurance premium. This will amount to payment for the credit of non-resident. This is not permitted.
**(iii) Example pertaining to clause (c)–** A foreign tourist comes to India and he takes food at a restaurant. He would like to pay US$ 20 in cash to the restaurant. The restaurant cannot accept cash as it will be a receipt otherwise than through Authorised Person. The restaurant will have to take a money changers license to accept foreign currency.
**(iv) Example pertaining to clause (d)**–Transactions covered by this sub-section are known as Hawala transactions. An Indian resident gives ` 70,000 in cash to an Indian dealer. For this transaction, the brother in Dubai will get US$ 1,000 from a Dubai dealer. The two dealers may settle the transactions later. However, transaction is not permitted.

## 2) HOLDING OF FOREIGN EXCHANGE [SECTION 4]

Except as provided in this Act, **no person resident in India shall** acquire, hold, own, possess or transfer any foreign exchange, foreign security or **any immovable property situated outside India**.
This section prevents Indian residents to acquire, hold, own, possess or transfer any foreign exchange, foreign security or immovable property abroad. Then through separate notifications, acquisition of these assets has been permitted subject to certain conditions and compliance rules.

**Example:** If an Indian resident receives bank balance of US$ 10,000 from his uncle in London, the Indian resident cannot hold on to the foreign funds. He is supposed to bring back the funds as provided in section 8.

## 3) CURRENT ACCOUNT TRANSACTIONS [SECTION 5]

The term '**Current Account Transaction**' is defined negatively by **Section 2(j)** of the Act. It means a **transaction other than a capital account transaction** and **includes the following types of transactions**:
(i) Payments in the **course of ordinary course of foreign trade**, other services such as short-term banking and credit facilities in the ordinary course of business etc.
(ii) Payments in the form of **interest on loans or income from investments**.
(iii) **Remittances for living expenses** of parents, spouse, or children living abroad
(iv) Expenses in connection with **foreign travel, education etc.**

**Example:** An **Indian resident imports machinery** from a vendor in UK for installing in his factory. As per accounts and income-tax law, machinery is a "capital expenditure"**. However, under FEMA**, it does not alter (create) an asset in India for the UK vendor. It does not create any liability to a UK vendor for the Indian importer. Once the payment is made, the Indian resident or the UK vendor neither owns nor is owed anything in the other country. **Hence it is a Current Account Transaction.**

**Example:** An Indian resident imports machinery from a vendor in UK for installing in his factory **on a credit period of 3 months**. As per accounts and income-tax law, **for the credit period of 3 months**, there is a liability of the Indian importer to the UK vendor. Technically under FEMA also, it is a liability outside India. However, under definition of Current Account Transaction [S. 2(j)(i)], "**short-term banking and credit facilities in the ordinary course of business" are considered as a Current Account Transaction**. Hence import of machinery on credit terms is Current Account Transaction.

**What if the credit period is 12 months?** Under Master Directions for imports, payment has to be **made within 6 months**. **If the credit period is in excess of 6 months, then it is a loan.** There are separate rules for loan. If the transaction falls within the loan rules, then it is permitted. Short term loan by and large means for 6 months. For exports, the period for realisation of proceeds, is 9 months.

**Example:** A Person Resident in India transfers US$ 1,000 to his NRI brother in New York as "gift". The funds are sent from the PRII's Indian bank account to the NRI brother's bank account in New York. Under FEMA, once the gift is accepted by the NRI, no one owns or owes anything to anyone in India or USA. The transaction is over. Hence it is a Current Account Transaction.

If however the PRII gives a PROI a gift in India in Indian currency, for the PROI it will result in funds lying in India (alteration of Indian asset). For PRII, there is no creation of asset or a liability. As this transaction creates an asset in India for the PROI, it is a Capital Account transaction. (Under separate rules, giving a gift in India to an NRI is permitted subject to certain rules.)

In a similar manner, if a PROI gives a gift to an PRII by remitting funds in India, there is no restriction. **However, if the PROI gives the funds abroad, the resident cannot keep it abroad. He has to bring it to India.**

**#Remember:** The general rule to be understood is that Current Account transactions are freely permitted unless specifically prohibited and Capital Account transactions are prohibited unless specifically or generally permitted.

**Any person may sell or draw foreign exchange to or from an authorised person if such sale or drawal is a current account transaction.**

The Central Government may, in public interest and in consultation with the RBI, impose such reasonable restrictions for current account transactions as prescribed **under the FEM (Current Account Transactions) Rules, 2000.**

**Let us now see the various schedules to the Rules that lay down the restrictions:**

<table>
<tr><th colspan="3">Foreign Exchange Management (Current Account Transactions) Rules, 2000.</th></tr>
<tr><th>SCHEDULE I<br>Transactions for which drawal of foreign exchange is PROHIBITED</th><th>SCHEDULE II<br>Transactions, which require PRIOR APPROVAL OF THE GOVERNMENT of India for drawal of foreign exchange:</th><th>SCHEDULE III<br>Transactions requiring RBI's approval for drawal of forex<br><br>[Discussed below in detail]</th></tr>
<tr>
<td>(i) Remittance out of lottery winnings.<br>(ii) Remittance of income from racing/riding, etc., or any other hobby.<br>(iii) Remittance for purchase of lottery tickets, banned/ prescribed magazines, football pools, sweepstakes etc.<br>(iv)Payment of commission on exports made towards <u>equity investment in Joint Ventures/ Wholly Owned Subsidiaries</u> abroad of Indian companies.<br>(v) Remittance of dividend by any company to which the requirement of <u>dividend balancing is applicable</u>.<br>(vi) Payment of <u>commission on exports under Rupee State Credit Route</u>, <u>except commission up to 10%</u> of invoice value of exports of tea and tobacco.<br>(vii) Payment related to "Call Back Services" of telephones.<br>(viii) Remittance of interest income on funds held in <u>Non-resident Special Rupee Scheme a/c.</u></td>
<td>
<table>
<tr><th>Purpose of Remittance</th><th>Ministry/Department of Govt. of India whose approval is required</th></tr>
<tr><td>Cultural Tours</td><td>Ministry of Human Resources Development (Now Department of Education and Culture)</td></tr>
<tr><td>Advertisement in foreign print media for the purposes other than promotion of tourism, foreign investments and international bidding (exceeding US$ 10,000) by a State Government and its Public Sector Undertakings.</td><td>Ministry of Finance, Department of Economic Affairs</td></tr>
<tr><td>Remittance of freight of vessel charted by a PSU</td><td>Ministry of Surface Transport (Chartering Wing)</td></tr>
<tr><td>Payment of import through ocean transport by a Govt. Department or a PSU on c.i.f. basis (i.e., other than f.o.b. and f.a.s. basis)</td><td>Ministry of Surface Transport (Chartering Wing)</td></tr>
<tr><td>Multi-modal transport operators making remittance to their agents abroad</td><td>Registration Certificate from the Director General of Shipping</td></tr>
<tr><td>Remittance of hiring charges of transponders by<br>• TV Channels<br>• Internet service providers</td><td>• Ministry of Information & Broadcasting<br>• Ministry of Communication and IT. (Respectively)</td></tr>
<tr><td>Remittance of container detention charges exceeding the rate prescribed by Director General of Shipping</td><td>Ministry of Surface Transport (Director General of Shipping)</td></tr>
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| | | | |
|---|---|---|---|
| | Remittance of **prize money/sponsorship of sports activity** abroad by a person **other than** International/National/State Level sports bodies, if the amount involved exceeds US $ 100,000 | Ministry of Human Resource Development (Department of Youth Affairs and Sports) | |
| | Remittance for **membership of P & I Club** **[Protection and indemnity]** | Ministry of Finance (Insurance Division) | |
| **RULE 3**<br>1. a **travel** to **Nepal and/or Bhutan**; or<br>2. a **transaction** with a person **resident in Nepal or Bhutan**. | Read with Rule 4 | | Read with rule 5 |

**SCHEDULE III**

**i. INTRODUCTION – LRS**

- The RBI as **part of its liberalization** measure to facilitate **RESIDENT INDIVIDUALS TO REMIT FUNDS ABROAD**.
- LRS **permits the Authorised Dealers to freely allow remittances by resident individuals** up to ***USD 2,50,000 per Financial Year (April-March)*** for
- Permitted **CURRENT OR CAPITAL ACCOUNT TRANSACTIONS** or **COMBINATION OF BOTH** issues Liberalised Remittance Scheme.
- The Scheme is **available to all resident individuals including minors**. In case of remitter being a minor, the Form must be countersigned by the minor's natural guardian.
- The Scheme is not available to corporates, partnership firms, HUF, Trusts etc.
- The scheme can be **CONSOLIDATED IN RESPECT OF FAMILY MEMBERS** subject to individual family members complying with its terms and conditions.
- However, **clubbing is not permitted by other family members for capital account transactions** such as opening a bank account/investment/purchase of property, if they are not the co-owners/co-partners of the overseas bank account/ investment/property

**ii. Facilities for individuals—Individuals can avail of foreign exchange facility for the following purposes within the limit of USD 250,000 only.:**

i. Private visits to any country (except Nepal and Bhutan)
ii. Gift or donation.
iii. Going abroad for employment
iv. Emigration
v. Maintenance of close relatives abroad

vi. Travel for business, or attending a conference or specialised training or for meeting expenses for meeting medical expenses, or check-up abroad, or for accompanying as attendant to a patient going abroad for medical treatment/ check-up.

vii. Expenses in connection with medical treatment abroad

viii. Studies abroad

ix. Any other current account transaction

**Note:**

1) Any **additional remittance in excess of the said limit** for the said purposes shall require **prior approval of the Reserve Bank of India**.
2) For the purposes mentioned at item numbers **(iv), (vii) and (viii) above,** the individual may **avail of exchange** for an **amount in excess of the LRS limit,** if it is so **required by a country of emigration**, **medical institute** offering treatment or **the university**, respectively.
3) If an individual remits any amount under the LRS in a FY, then the applicable limit for such individual **would be reduced** from USD 250,000 by the amount so remitted
4) For a **person who is resident but not permanently resident** in India and-
   a) is a **citizen of a foreign State** other than **Pakistan**; or
   b) is a **citizen of India**, who is on deputation to the office or branch of a foreign company or subsidiary or joint venture in India of such foreign company,

   may **make remittance up to his net salary** (after deduction of taxes, contribution to provident fund and other deductions).

   **Explanation**: For the purpose of this item, a person resident in India on account of his employment or deputation of a specified duration or for a specific job or assignments, the **duration of which does not exceed 3 years**, **is a resident but not permanently resident:**

**iii. Facilities for persons other than individual that require prior approval of the RBI**

| PURPOSE | LIMIT |
|---|---|
| (i) **DONATIONS**, **FOR-**<br>(a) **creation of Chairs** in reputed educational institutes,<br>(b) **contribution to funds** (not being an investment fund) promoted by **educational institutes**; and<br>(c) contribution to a **technical institution** or body or association in the **field of activity of the donor Company.** | Not exceeding **1% of their foreign exchange earnings** during the previous 3 financial years or **USD 5,000,000**, **whichever is less** |
| (ii) **COMMISSION**, per transaction, **to agents abroad** for **sale of residential flats or commercial plots** in India | **Not exceeding USD 25,000 or 5%** of the inward remittance **whichever is more**. |
| (iii) **Remittances** for any **CONSULTANCY SERVICES per project from outside India** | **Not exceeding USD 10,000,000** for **INFRASTRUCTURE PROJECTS** |
| | USD 1,000,000 for **other consultancy services** |
| (iv) Remittances, by **an entity in India** by way of **reimbursement of pre-incorporation expenses**." | **Not exceeding 5% of investment** brought into India or **USD 100,000 whichever is higher** |

**NOTE:** If the transaction is not listed in any of the above 3 schedules, it can be freely undertaken.

**Exemptions**

a) **Exemption for remittance from RFC Account –** No approval is required where any remittance has to be made for the transactions listed in **Schedule II and Schedule III** above from an RFC account.

b) **Exemption for remittance from EEFC Account –** If any remittance has to be made for the transactions listed in **Schedule II and Schedule III above from EEFC account**, then also no approval is required. However, if payment has to be made for the following transactions, **approval is required** even if payment is from EEFC account:
- Remittance for membership of P & I Club.
- Commission, per transaction, to agents abroad for sale of residential flats or commercial plots in India exceeding USD 25,000 or 5% of the inward remittance whichever is more.
- Remittances exceeding 5% of investment brought into India or USD 100,000 whichever is higher, by an entity in India by way of reimbursement of pre-incorporation expenses.

c) **Exemption for payment by International Credit Card while on a visit abroad –** If a person is on a visit abroad, he can incur expenditure stated **in Schedule III** if he incurs it through **International credit card**.

**#Previously asked Questions:**

1) **Mr Sane, an Indian National desire to obtain foreign exchange for the following purposes:**
**(i) Remittance of US Dollar 50,000 out of winnings on a lottery ticket.**
**(ii) US Dollar 1, 00,000 for sending a cultural troupe on a tour of U.S.A.**
**(iii) US Dollar 50,000 for meeting the expenses of his business tour to Europe:**
**Advise him whether he can get foreign exchange and if so, under what conditions?**

**Solution:** Any person may sell or draw foreign exchange to or from an authorised person if such sale or drawl is an account transaction. However, the Central Government may, in public interest and in consultation with the RBI, impose such reasonable restrictions for current account transactions as may be prescribed (Section 5). The Central Government has framed Foreign Exchange Management (Current Account transactions) Rules, 2000. The rules stipulate some restrictions on drawl of foreign exchange for certain purposes. In the light of provisions of these rules, the answer to the given problem is as follows:

(i) Rule 3 read with Schedule I of Foreign Exchange Management (Current Account Transactions) Rules, 2000 remittances out of lottery winnings is prohibitted. Therefore, Mr Sane cannot obtain foreign exchange of US Dollar 50,000 winnings of a lottery ticket.

(ii) AS per Rule 4 read with Schedule ll of Foreign Exchange Management (Current Account Transactions) Rules 2000, drawl of foreign exchange for cultural tour requires the prior approval of the Central Government. Therefore, Mr Sane can obtain US Dollar 1, 00,000 for sending a cultural troupe on a tour of U.S.A. With the prior approval of Central Government.

However, no approval of the Central Government is required if the payment is made out of the funds held in Resident Foreign Currency Account.

(iii) As per Rule 5 read with Schedule Ill of Foreign Exchange Management (Current Account Transactions) Rules, 2000, any person can draw foreign exchange up to US Dollar 2,50,000 for travel for business (referred to as 'the Liberalised Remittance Scheme'). Drawl of foreign exchange in excess of US Dollar 2, 50,000 shall require prior approval of the Reserve Bank of India. Therefore Mr. Sane can obtain US Dollar 50,000 for business tour to Europe without on approval of the Reserve Bank of India.

**2) Ramesh of Nagpur wants to travel to Nepal and for this proposes to drawl foreign exchange. Specify-**

**(i) Can Mr Ramesh drawl any foreign exchange for his journey?**

**(ii) What are the purposes for which foreign exchange drawl is not allowed for current account transactions?**

**Solution:**

(i) Rule 3 of Foreign Exchange management (Current Account Transactions) Rule 2000 prohibits drawl of foreign exchange (by any person) for the purpose of travel to Nepal and/ or Bhutan. Therefore, Mr Ramesh cannot draw any foreign exchange for journey to Nepal.

(ii) Rule 3 read with Schedule I prohibits drawl of foreign exchange (by any person) for the following purposes:

1. Remittance out of lottery winnings.
2. Remittance of income from racing/riding, etc., or any other hobby.
3. Remittance for purchase of lottery tickets, banned/prescribed magazines, football pools, sweepstakes, etc.
4. Payment of commission on exports made towards equity investment in Joint Ventures/Wholly Owned Subsidiaries Abroad of Indian companies.
5. Remittance of dividend by any company to which the requirement of dividend balancing is applicable.
6. Payment of commission on exports under Rupees State Credit Route, except payment of commission up to 10% of the invoice value of export of tea and tobacco.
7. Payment related to 'Call Back Services' of telephones.
8. Remittance of interest income on funds held in Non-resident Special Rupee Scheme Account.
9. Payment for travel to Nepal and/or Bhutan.
10. Any transaction with a person resident in Nepal or Bhutan.

**3) Mr F, an Indian National desire to obtain foreign exchange for the following purposes:**

**(i) Payment of US $ 10,000 as commission on exports under Rupee State Credit Route**

**(ii) US $ 30,000 for a business trip to U.K.**

**(iii) Remittance of US $ 2,00,000 for payment as prize money to the winning team in a Hockey am in a Hockey Tournament to be held in Australia**

**Advise him. If he can get the foreign Exchange and under what conditions.**

**Solution:** Any person may sell or draw foreign exchange to or from an authorised person if such sale or drawl is a current account transaction. However, the Central Government may, in public interest and in consultation with the RBI, impose such reasonable restrictions for current account transactions as may be prescribed (Section 5). the central Government has framed Foreign Exchange Management (Current Account Transactions) Rules, 2000: the Rules stipulate some prohibitions and restrictions on drawl of foreign exchange for certain purposes. In the light of provisions of these rules, the answer to the given problem is as follows:

(i) Rule 3 read with Schedule 1 of Foreign Exchange Management (Current Account Transactions) Rules, 2000 prohibits payment of commission on exports under Rupees State Credit Route (except commission up to 10% of invoice value of exports of tea and tobacco). Therefore, payment of US $ 10,000 as commission on exports under Rupee state credit route is prohibited unless such commission is paid for export of tea and tobacco, and the commission does not exceed 10% of invoice value of exports.

(ii) As per Rule 5 read with Schedule Ill of Foreign Exchange Management (Current Account Transactions) Rules,2000, any person can draw foreign exchange up to US Dollar 2,50,000 for travel for business (referred to as 'the Liberalised Remittance Scheme'). Drawal of foreign exchange in excess of US Dollar 2, 50,000 shall require priori approval of the Reserve Bank of India. Therefore, Mr. F can obtain US Dollar 30,000 for business tour to U.K. without any approval of the Reserve Bank of India.

(iii) As per Rule 4 read with Schedule Il of Foreign Exchange Management (Current Account Transactions) Rules,2000, Drawal of foreign exchange exceeding US$ 1,00,000 for the purpose of remittance of prize money/sponsorship of sports activity abroad by a person other than International / National / State level sports bodies requires the prior approval of the Central Government. In the given case, the drawal of US $ 2,00,000 for payment as prize money to the winning team in a Hockey Tournament to be held in Australia is organised by Mr. F, who is an Indian National (i.e., Not any International, National or State level Sports Body). Therefore, Mr. F can obtain US Dollar 1, 00,000 without any permission, but for prior approval of the Central Government shall not be required if drawal of additional US Dollar 1,00,000 is made out of funds held in Resident Foreign Currency (RFC) Account. If not through RFC account then prior approval of CG is required.

**4) State which kind of approval is required for the following transactions under the foreign Exchange Management Act ,1999:**

**(i) X, a film star, wants to perform along with associates in New York on the occasion of Diwali for Indians residing at New York. Foreign exchange drawl to the extent of US dollars 20,000 is required for this purpose.**

**(ii) I want to get his heart surgery done at UK. Upton what limit foreign exchange can be drawn by him and what approvals required?**

**(iii)L wants to pursue a course in fashion design in Paris. The foreign exchange drawl is US dollars 20,000 towards tuition. And US dollars 30,000 for incidental and stay expenses for studying abroad.**

**Solution:**

Any person may sell or draw foreign exchange to or from an authorised person if such sale or drawl is a current account transaction. However, the Central Government may, in public interest and in consolation me RDI, impact such reasonable restrictions for current account transactions as may be prescribed (Section 5). The Central Government has framed Foreign Exchange Management (Current Account Transactions) Rules, 2000. The Rules stipulate some prohibitions and restrictions on drawl of foreign exchange for certain purposes. In the light of provisions of these rules the answer to the given problem is as follows:

(i) As per Rule 4 read with Schedule II of Foreign Exchange Management (Current Account Transactions) Rules, 2000 drawl of foreign exchange for cultural tour requires prior approval of the Central Government, irrespective of the amount of foreign exchange required. Therefore, drawl of US$ 20,000 by X can be made only with the prior approval of CG.

(ii) As per Rule 5 read with Schedule III of Foreign Exchange Management (Current Account Transactions) Rules, 2000 any person can draw foreign exchange up to US Dollar 2,50,000 for meeting expenses of medical treatment (referred to as the Liberalised Remittance Scheme'). However, a person may draw more than US Dollar 2, 50,000 under the Liberalised Remittance Scheme if it is so required by the medical institute offering the medical treatment. Therefore, Mr Y can obtain US Dollar 2, 50,000 for his heart surgery without any approval of the Reserve Bank of India. Also, if the expenses of his heart surgery exceed US Dollar 2,50,000, such drawl may also be made without any approval of the Reserve Bank of India provided such amount is required by the medical institute offering the medical treatment (viz. heart surgery) to Mr Y.

(iii) As per Rule 5 read with Schedule Ill of Foreign Exchange Management (Current Account Transactions) Rules, 2000, any person can draw foreign exchange up to US Dollar 2,50,000 for studies abroad (referred to as the Liberalised Remittance Scheme'). However, a person may draw more than US Dollar 2, 50,000 under the Liberalised Remittance Scheme if it is so required by the university or educational institution abroad. Therefore, Mr L can obtain US Dollar 20,000 towards tuition fees and US dollars 30,000 for incidental and stay expenses without any approval of the Reserve Bank of India.

## 4) CAPITAL ACCOUNT TRANSACTIONS [SECTION 2(e) & 6]

Capital Account Transactions means "A transaction which alters the assets or liabilities including contingent liabilities outside India of PRI or assets or liabilities in India of PROI would be a capital account transaction."

**Section 6**

(1) Subject to the provisions of sub-section (2), any person may **sell or draw foreign exchange to or from an authorised person** for a capital account transaction.

(2) Reserve Bank had the power to specify the Capital Account transactions which are permitted and the relevant limits, terms and conditions.

- By Finance Act 2015, powers for **regulation of Capital Account Transactions for Non-debt instruments were transferred to Central Government**.
- RBI continued to have powers to regulate **debt instruments**.

(3) Deleted

(4) A **PRI CAN HOLD, own, transfer or invest** in any **foreign currency, foreign security or any immovable property situated outside India if such thing was acquired, held or owned by him/ her when he/ she**

- was resident outside India or
- inherited from a PROI.; or

The RBI vide A.P. (DIR Series) Circular No. 90 dated 9thJanuary, 2014 has issued a **clarification on section 6(4)** which says **section 6(4) covers the following transactions:**

(i) **Foreign currency accounts opened and maintained** by such a person when he was resident outside India;

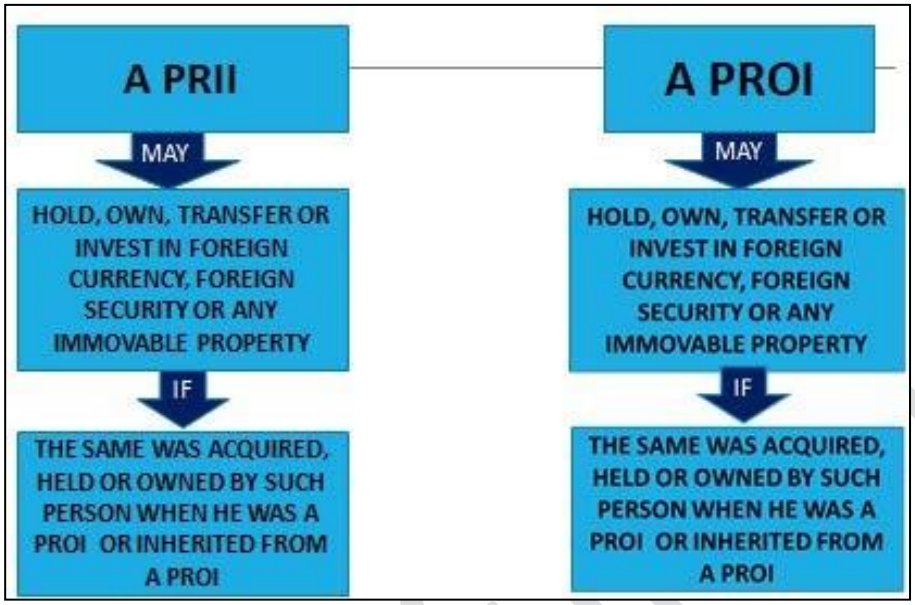
(ii) **Income earned through**

- **employment or business or vocation** outside India taken up or commenced when such person was resident outside India, or
- **from investments** made while such person was resident outside India, or
- **from gift or inheritance** received while such a person was resident outside India;

(iii) Foreign exchange including any income arising therefrom, and conversion or replacement or accrual to the same, held outside India by a **PRI acquired by way of inheritance from a PROI.**

(iv) A **PRI may freely utilize all their eligible assets abroad as well as income** on such assets or sale proceeds thereof received after their return to India **for making any payments or to make any fresh investments abroad without approval of RBI**, provided the cost of such investments and/or any subsequent payments received therefor are met exclusively out of funds forming part of eligible assets held by them and the transactions is not in contravention to extant FEMA provisions.

(5) A **PROI MAY HOLD**, own, transfer or invest in Indian currency, security or any immovable property situated in India if such currency, security or property was acquired, held or owned by a such person when **he was resident** in India or **inherited from a person** who was resident in India




(6) Without prejudice to the provisions of this section, the **RBI may, by regulation, prohibit, restrict, or regulate establishment in India of a branch**, office or other place of business by a PROI, for carrying on any activity relating to such branch, office or other place of business.

(7) For the purposes of this section, the term **"debt instruments"** shall mean, such instruments as may be determined by the Central Government in consultation with the RBI.]

**FEM (Permissible capital account transactions) Regulations, 2000**

**I. Permissible Transactions**

Under Sub-section (2) of Section 6, the RBI has issued the Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000. **The Regulations specify the list of transaction, which are permissible** in respect of **PRI in Schedule-I** and the classes of capital account transactions of **PROI in Schedule-II**.

Further, subject to the provisions of the Act or the rules or regulations or direction or orders made or issued thereunder, any person may sell or draw foreign exchange to or from an authorised person for a capital account transaction specified in the Schedules; provided that the transaction is within the limit, if any, specified in the regulations relevant to the transaction.

| SCHEDULE I<br><br>The list of permissible classes of transactions made by **PRI is:** | SCHEDULE II<br><br>The list of permissible classes of transactions made by **PROI is:** |
|---|---|
| (a) Investment by a PRI in **foreign securities**. [S]<br>(b) **Foreign currency loans** raised in India and abroad by a person resident in India.<br>(c) **Transfer of immovable property** outside India by a person resident in India. [S]<br>(d) **Guarantees** issued by a PRI in favour of a PROI. [S]<br>(e)Export, import and holding of currency/**currency notes**. [S]<br>(f) **Loans and overdrafts** (borrowings) by a PRI **from** a PROI.<br>(g)Maintaining **foreign currency accounts** in India and outside India by a PRI. [S]<br>(h) Taking out of **insurance policy** by a PRI from an insurance company outside India.<br>(i) **Loans and overdrafts** by a person resident in India **to** a PROI.<br>(j) Remittance outside India of **capital assets** of a person resident in India. [S]<br>(k) Undertake **derivative contracts** [S] | (a) Investment in **India by a PROI**, that is to say, [S]<br>(i) **issue of security by a body corporate** or an entity in India and investment therein by a PROI; and<br>(ii) investment by way of contribution by a PROI to the capital of a **firm or a proprietorship concern or an association** of a person in India.<br>(b) Acquisition and **transfer of immovable property** in India by a PROI. [S]<br>(c) **Guarantee** by a person resident outside India in favour of, or on behalf of, a PRI. [S]<br>(d) Import and export of currency/**currency notes** into/from India by a PROI. [S]<br>(e) **Deposits** between a PRI and a PROI.<br>(f) **Foreign currency accounts** in India of a PROI. [S]<br>(g) Remittance outside India of **capital assets** in India of a PROI. [S]<br>(h) Undertake **derivative contracts**[S] |

**PROHIBITED TRANSACTIONS**

**On certain transactions, the Reserve Bank of India imposes prohibition**.

**a)** no person shall undertake or sell or draw foreign exchange to or from an **authorised person for any capital account transaction,** provided that-

(i) a resident individual may, draw from an authorized person foreign exchange not exceeding USD 250,000 per financial year or such amount as decided by Reserve Bank from time to time for a capital account transaction specified in Schedule I.

**Explanation:** Drawal of foreign exchange as per item number 1 of Schedule III to Foreign Exchange Management (Current Account Transactions) Rules, 2000 dated 3rd May 2000 as amended from time to time, shall be subsumed within the limit under proviso (a) above.

Provided further that no part of the foreign exchange of USD 250,000, drawn under proviso

(a) shall be used for remittance **directly or indirectly to countries notified as non-co-operative countries and territories by Financial Action Task Force (FATF)** from time to time and communicated by the Reserve Bank of India to all concerned.

**b)** The PROI is prohibited from making **investments in India in any form**, in any **company, or partnership firm or proprietary concern or any entity** whether incorporated or not which is **engaged or proposes to engage**:

**(i)** In the business of **chit fund**;
[**Registrar of Chits** or an officer authorised by the state government in this behalf, may, in consultation with the State Government concerned, **permit any chit fund to accept subscription from Non-resident Indians**. Non- resident Indians shall be eligible to subscribe, **through banking channel and on non- repatriation basis**, to such chit funds, without limit subject to the conditions stipulated by the RBI

**(ii)** As **Nidhi company**;

**(iii)** In **agricultural or plantation activities**;

**(iv)** In **real estate business, or construction** of **farm houses** or
Explanation: "**real estate business**" **shall not include**

- development of townships,
- construction of residential /commercial premises,
- roads or bridges and
- Real Estate Investment Trusts (REITs) registered and regulated under the SEBI (REITs) Regulations 2014.; or

**(v)** In trading in **Transferable Development Rights** (TDRs).
**'Transferable Development Rights'** means certificates issued in respect of category of land acquired for public purpose either by Central or State Government in consideration of surrender of land by the owner without monetary compensation, which are transferable in part or whole;

**c) Other Prohibited Transactions**

PRI **shall not undertake** any capital account transaction which is not permissible in terms of Order S.O. 1549(E) dated April 21, 2017, of the Government of India, Ministry of External Affairs, with any person who is, a **citizen of or a resident of or** an entity incorporated of **Democratic People's Republic of Korea**, until further orders, unless there is specific approval from the Central Government to carry on any transaction.

d) In case of an **existing investment transactions** on the date of notification (April 21, 2017), shall be **closed/ liquidated/disposed/settled** within a **period of 180 days from the date of issue** of this Notification, unless there is specific approval from the Central Government to continue beyond that period."]

**#Previously asked Question:**

1) **Mr. Bandana, a software Engineer of Indian Origin took employment in USA. He is a resident of USA for a long time. He desires**

**(i) to acquire a farm house in Munar (Kerala).**

**(ii) to make investment in KLJ (Nidhi) Ltd., registered as Nidhi Company.**

**(iii) to make investment in Rose Real Estate Ltd., an Indian Company formed for the development of township.**

**Solution:**

In the given case, Mr. Bandha has been a resident of USA since a long time. So, Mr. Bandha is a person resident outside India. The problems asked in the given question are answered as under:

Whether there are any restrictions in respect of the transactions desired by Mr. Bandha?

(i) Mr. Bandha cannot acquire a farm house in Munar (Kerala) since this transaction is prohibited as per Regulation 4 of The Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000.

(ii) Mr. Bandha cannot make investment in KLJ (Nidhi) Ltd. (a Nidhi Company) since this transaction is prohibited as per Regulation 4 of the Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000.

(iii) As per Regulation 4 of the Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000, development of townships is excluded from the purview of 'real estate business', and so if a company is engaged in the development of townships, the prohibition contained in Regulation 4 is not attracted. In the given case, Rose Real Estate Ltd. is engaged in development of townships, and so Mr. Bandha can make investment in Rose Real Estate Ltd. since this transaction is not prohibited as per Regulation 4.