CHAPTER 1

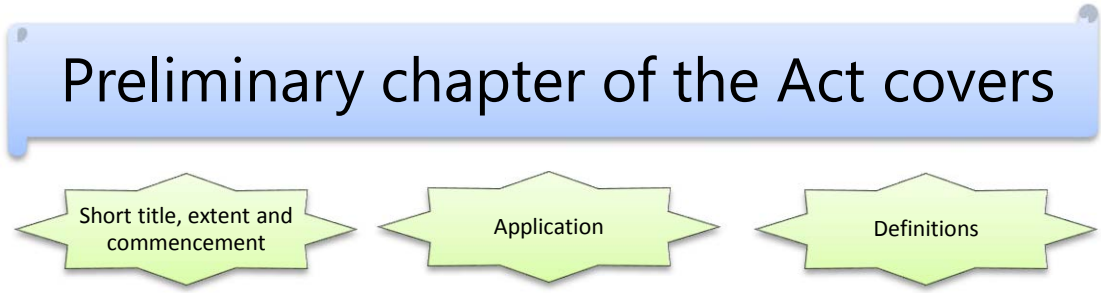
PRELIMINARY

LEARNING OUTCOMES

At the end of this chapter, you will be able to:

- To know about the extent and commencement of the Companies Act, 2013.
- Identify about the application of the Act.
- Gain familiarity with the definition clause given in the Act.

CHAPTER OVERVIEW



1. 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.

2. SHORT TITLE, EXTENT, COMMENCEMENT AND APPLICATION

Section 1 of the Companies Act, 2013 deals with the title of the Act according to which this Act may be called as the Companies Act, 2013.

Further, section deals with the extent to the applicability of the Act. It says that the Act shall extend to the whole of India.

This section also specifies the date of commencement of this Act. Accordingly, this section shall come into force at once and the remaining provisions of this Act shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint and different dates may be appointed for different provisions of this Act and any reference in any provision to the commencement of this Act shall be construed as a reference to the coming into force of that provision.

This Section furthermore states of the applicability of the Act. The provisions of this Act shall apply to-

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

Example 1: 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.

(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;

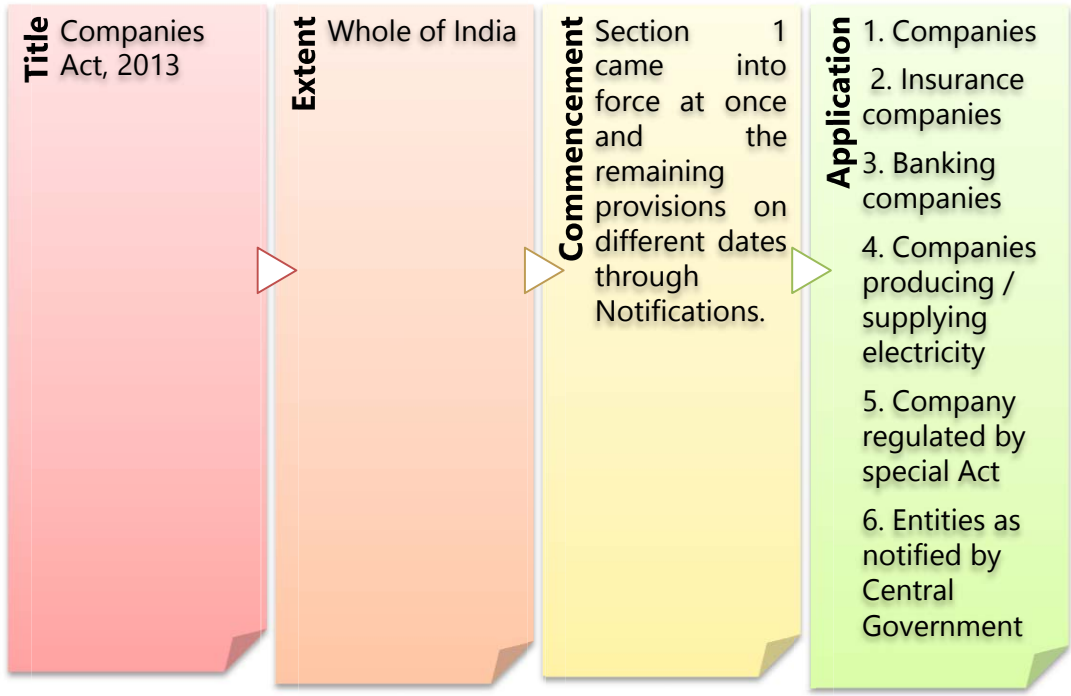
(d) companies engaged in the generation or supply of electricity, except in so far as the said provisions are inconsistent with the provisions of the Electricity Act, 2003;

(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 2: 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.



3. DEFINITIONS

Section 2 of the Companies Act, 2013 is a definition section. It provides various terminologies used in the Act. Definitional Sections or Clauses, are known as 'internal aids to construction' and can be of immense help in interpreting or construing the enactment or any of its parts.

Also, according to clause 95 of section 2, words and expressions used and not defined in this Act but defined in the Securities Contracts (Regulation) Act, 1956 or the Securities and Exchange Board of India Act, 1992 or the Depositories Act, 1996 shall have the meanings respectively assigned to them in those Acts.

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 while interpreting a

Section of the Act unless there be anything repugnant in the context.

Section 2[1] states that- In this Act, unless the context otherwise requires, —

(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 regulations 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 Institute of Chartered Accountants of India, 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 National Financial Reporting Authority* 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.

Further, in exercise of the powers conferred by section 133, the Central Government in consultation with the National Advisory Committee on Accounting Standards prescribed that *Companies (Accounting Standards)*

[1] The number given in brackets i.e. **( )** at the start of definition**,** denotes the clauses to section 2.

Rules, 2006 and the *Companies (Indian Accounting Standards) Rules, 2015* may be followed.

*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 additions, omissions and substitutions;

(5) 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**;

(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 purpose of this clause, —

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

(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 (persons or group of persons. 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.

Note: Students may please note that the definition of Associate company as defined under AS 23/ Ind AS 28 (Accounting for Investments in Associates in Consolidated Financial Statements/ Investment in Associates and Joint Ventures) is slightly different from the above definition as given in the Companies Act, 2013.

(7) Auditing standards means the standards of auditing or any addendum thereto for companies or class of companies referred to in sub-section (10) of section 143.

****Section 143 of the Companies Act, 2013 deals with the Powers and Duties of Auditors and Auditing Standards.** Sub-section (10) to section 143 provides that the Central Government may prescribe the standards of auditing or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, 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:

Provided that until any auditing standards are notified, any standard or standards of auditing specified by the Institute of Chartered Accountants of India shall be deemed to be the auditing standards.

(8) Authorised capital or Nominal capital means such capital as is authorised by the memorandum of a company to be the maximum amount of share capital of the company;

(10) Board of Directors or Board, in relation to a company, means the collective body of the directors of the 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;

** Just for information of the students

(12) Book and Paper and Book or Paper include books of account, deeds, vouchers, writings, documents, minutes and registers maintained on paper or in electronic form;

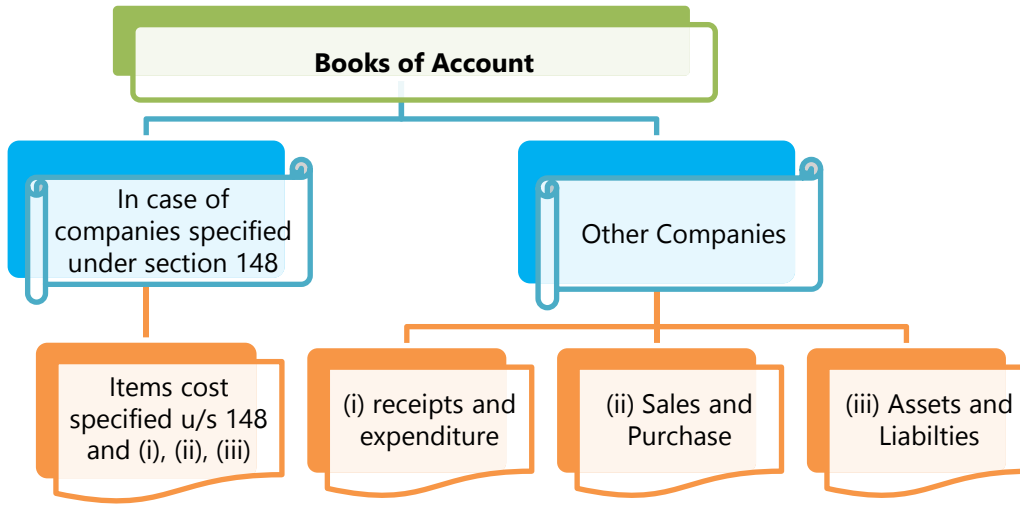
(13) "Books of account" includes records maintained in respect of—

(i) **all sums of money received and expended by a company** and matters in relation to which the receipts and expenditure take place;

(ii) **all sales and purchases of goods and services by the company**;

(iii) the **assets and liabilities** of the company; and

(iv) the **items of cost** as may be prescribed under section 148[2] in the case of a company which belongs to any class of companies specified under that section;



(14) Branch office, in relation to a company, means any establishment described as such by the company;

(15) Called-up capital means such part of the capital, which has been called for payment;

[2] Section 148 of the Companies Act, 2013 authorises Central Government to Specify Audit of Items of Cost in Respect of Certain Companies.

(16) Charge means 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;

(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;

(18) Chief Executive Officer **(CEO)** means an officer of a company, who has been designated as such by it;

(19) Chief Financial Officer **(CFO)** means a person appointed as the Chief Financial Officer of a company;

These definitions of CEO & CFO should be read with section 2(51) and 203 which deals with the definition and appointment of Key Managerial Personnel (KMP) of the Companies Act, 2013.

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

Example 3: 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.

(21) Company limited by guarantee means a company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake to contribute to the assets of the company in the event of its being wound up;

(22) Company limited by shares means a company having the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them;

Example 4: A shareholder who has paid rupees 75 on a share of face value rupees 100 can be called upon to pay the balance of rupees 25 only.

(26) Contributory means a person liable to contribute towards the assets of the company in the event of its being wound up

Explanation: For the purpose of this clause, it is hereby clarified that a person holding fully paid-up shares in a company shall be considered as a contributory.

(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.

(30) Debenture includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not;

Provided that—

(a) the instruments referred to in Chapter III-D of the Reserve Bank of India Act, 1934; and

(b) such other instrument, as may be prescribed by the Central Government in consultation with the Reserve Bank of India, issued by a company,

shall not be treated as debenture;

(34) Director means a director appointed to the Board of a company;

(35) Dividend includes any interim dividend;

(36) Document includes summons, notice, requisition, order, declaration, form and register, whether issued, sent or kept in pursuance of this Act or under any other law for the time being in force or otherwise, maintained on paper or in electronic form;

(37) Employees' stock option means the option given to the directors, officers or employees of a company or of its holding company or subsidiary company or companies, if any, which gives such directors, officers or employees, the benefit or right to purchase, or to subscribe for, the shares of the company at a future date at a pre-determined price;

(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;

(40) Financial statement 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):

Provided that the financial statement, with respect to One Person Company, small company and dormant company, may not include the cash flow statement;

Exemptions

For private companies, the proviso to section 2(40) shall be read as follows:

"Provided that the financial statement, with respect to one person company, small company, dormant company and private company (if such private company is a start-up) may not include the cash flow statement;

***Explanation.* -** *For the purposes of this Act, the term "start-up" or "start-up company" means a private company incorporated under the Companies Act, 2013 or the Companies Act, 1956 and recognised as start-up in accordance with the notification issued by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry."*

The exceptions, modifications and adaptations shall be applicable to a private company which has not committed a default in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar.

Note: Students may note that 'Profit and Loss Account' may also be referred as 'Statement of Profit and Loss' under the Act at some places.

(41) 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:[3]

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.[4]

Note: The term "company incorporated outside India" refers to Foreign Company incorporated under any applicable laws for the constitution of company outside India.

(43) Free reserves means such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend:

Provided that—

(i) any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or

[3] With respect to specified IFSC public company & specified IFSC Private company, a proviso has been inserted vide *notification dated 5th January, 2017* stating that above stated company which is subsidiary of a foreign company, the financial year of the subsidiary may be same as the financial year of its holding company & approval of Tribunal shall not be required.

[4] Provided also that any application pending before the Tribunal as on the date of commencement of the Companies (Amendment) Ordinance, 2019, shall be disposed of by the Tribunal in accordance with the provisions applicable to it before such commencement.

Provided also that 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. (this provision is not relevant now, however, it is still forming part of the Act)

(ii) any change in carrying amount of an asset or of a liability recognized in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value,

shall not be treated as free reserves;

(44) Global Depository Receipt means any instrument in the form of a depository receipt, by whatever name called, created by a foreign depository outside India and authorised by a company making an issue of such depository receipts.

(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;

[5]Explanation. - 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 5: 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.

(46) Holding company in relation to one or more other companies, means a company of which such companies are subsidiary companies

Explanation. — For the purposes of this clause, the expression "company" includes any body corporate.

For meaning of "subsidiary company" refer the definition given in section 2(87) of the Companies Act, 2013.

[5] Inserted by Exemptions to Government Companies under section 462 of the CA 2013, notification dated 02.03.2020 (Effective From 03rd March 2020)

(50) Issued capital means such capital as the company issues from time to time for subscription;

(51) Key Managerial Personnel, in relation to a company, means—

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

(ii) the company secretary;

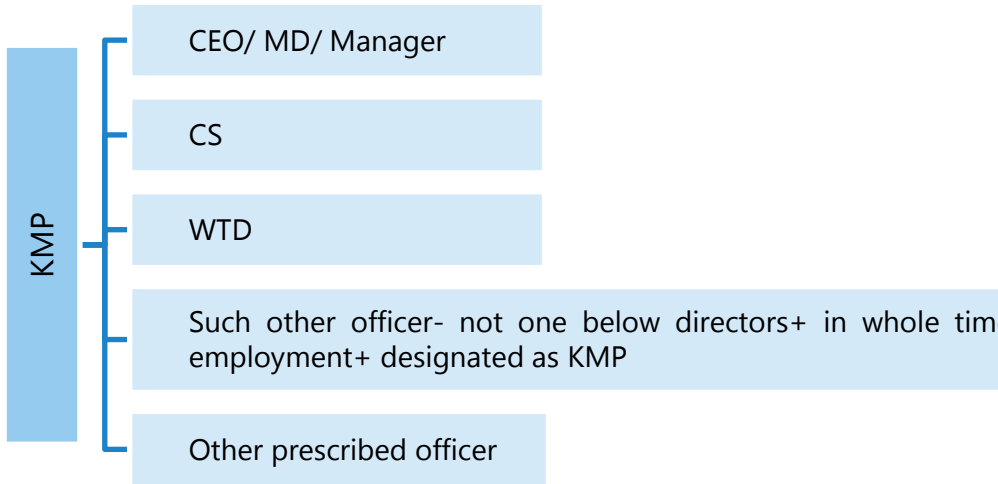
(iii) the whole-time director;

(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 key managerial personnel by the Board; and

(vi) such other officer as may be prescribed;

Note: However, till now no other officer has been prescribed.



(52) 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, 2014[6], 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 in terms of SEBI (Issue and Listing of Debt Securities) Regulations, 2008; or

(ii) non-convertible redeemable preference shares issued on private placement basis in terms of SEBI (Issue and Listing of Non-Convertible Redeemable Preference Shares) Regulations, 2013; or

(iii) both categories of (i) and (ii) above.

(b) Private companies which have listed their non-convertible debt securities on private placement basis on a recognized stock exchange in terms of SEBI (Issue and Listing of Debt Securities) Regulations, 2008;

(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 sub-section (3) of section 23 of the Act.

(53) Manager means an individual who, subject to the superintendence, control and direction of the Board of Directors, has the management of the whole, or substantially the whole, of the affairs of a company, and includes a director or any other person occupying the position of a manager, by whatever name called, whether under a contract of service or not;

(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

[6] As amended by the Companies (Specification of definitions details) Second Amendment Rules, 2021

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 is 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;

(56) Memorandum means the memorandum of association of a company as originally framed or as altered from time to time in pursuance of any previous company law or of this Act;

(57) Net worth means the aggregate value of the paid-up share capital and all reserves created out of the profits, securities premium account and debit or credit balance of profit and loss account, **after deducting** the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet, **but does not include** reserves created out of revaluation of assets, write-back of depreciation and amalgamation;

Example 6: 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 2020 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. Advise whether this fair valuation would be covered in the net worth of the company as per the legal requirements.

Note: 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.

(58) Notification means a notification published in the Official Gazette and the expression "notify" shall be construed accordingly;

(59) Officer includes any director, manager or key managerial personnel or any person in accordance with whose directions or instructions the Board of Directors or any one or more of the directors is or are accustomed to act;

(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 key managerial personnel, 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 key managerial personnel, 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 7: 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.

(62) One Person Company means a company which has only one person as a member;

(63) Ordinary or special resolution means an ordinary resolution, or as the case may be, special resolution referred to in section 114 (Ordinary and Special Resolution);

(64) Paid-up share capital **or** share capital paid-up means such aggregate amount of money credited as paid-up as is equivalent to the amount received as paid-up in respect of shares issued and also includes any amount credited as paid-up in respect of shares of the company, but does not include any other amount received in respect of such shares, by whatever name called;

(65) Postal ballot means voting by post or through any electronic mode;

This definition is related to section 110 to be read with Rule 22 of the *Companies (Management and Administration) Rules, 2014* specifying the procedure to be followed for conducting of business through postal ballot and provides the list of items of business which should be transacted only by means of voting through a postal ballot.

(66) Prescribed means prescribed by rules made under this Act;

(68) Private company means a company having a minimum paid-up share capital as may be prescribed[7], 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

[7] Since nothing has been prescribed so far, thus, there is no minimum paid up share capital to form a private company.

(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;

The requirement of having a minimum paid up share capital shall not apply to a section 8 company (Formation of companies with charitable objects, etc.) *vide notification dated 5th June 2015*.

The above-mentioned exemption shall be applicable to a section 8 company which has not committed a default in filing its financial statements under section 137 of the Companies Act, 2013, or annual return under section 92 of the said Act with Registrar. [Vide amendment notification G.S.R. 584(E) dated 13th June 2017.]

(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;

(70) Prospectus means any document described or issued as a prospectus and includes a red herring prospectus or shelf prospectus 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;

(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[8]:

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;

Example 8: 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.

The requirement of having a minimum paid up share capital shall not apply to a section 8 company vide notification dated 5th June 2015.

(74) Register of companies means the register of companies maintained by the Registrar on paper or in any electronic mode under this Act;

(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 **key managerial personnel** 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 or manager is a director and holds along with his relatives, more than two per cent of its paid-up share capital;

[8] Since nothing has been prescribed so far, thus, there is no minimum paid up share capital to form a public company.

(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;

[9](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.

(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 9: XYZ Pvt. Ltd. has two 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

[9] 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

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 10: 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. Therefore, as per section 2(76)(viii)(B), Y Pvt. Ltd and Z Pvt. Ltd are related parties. In addition, XYZ Ltd. will also be related Party to Y Pvt. Ltd and Z Pvt. Ltd.

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

(i) they are members of a Hindu Undivided Family;

(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.

(78) Remuneration means any money or its equivalent given or passed to any person for services rendered by him and includes perquisites as defined under the Income Tax Act, 1961

(84) Share means a share in the share capital of a company and includes stock;

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

(i) paid-up share capital of which does not exceed fifty lakh 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 two 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.

As per the Companies (Specification of Definitions Details) Rules, 2014[10], for the purposes of sub-clause (i) and sub-clause (ii) of clause (85) of section 2 of the Act, paid up capital and turnover of the small company shall not exceed rupees four crore and rupees forty crore respectively.

Capital- ₹ 4 crores

Turnover- ₹ 40 crores

[10] As amended by the Companies (Specification of definition details) Amendment Rules, 2022.

Example 11: H Ltd. is the holding company of S Pvt. Ltd. As per the last profit and loss account for the year ending 31st March, 2023 of S Pvt. Ltd., its turnover was to the extent of ₹ 1.50 crores; and paid up share capital was ₹ 40 lacs. Since S Pvt. Ltd., as per the turnover and paid up share capital norms, qualifies for the status of a 'small company' it wants to be categorized as 'small company'. S Pvt. Ltd. cannot be categorized as a 'small company' because it is the subsidiary of another company (H Ltd.). [Proviso to section 2(85)].

(86) Subscribed capital means such part of the capital which is for the time being subscribed by the members of a company;

Example 12: ABC Ltd. was registered with Registrar with an Authorised capital of ₹ 2,00,00,000 where each share is of ₹ 10.

In response to the advertisements made by the company to buy shares in the company, applications have been received for 10,00,000 shares but company actually issued 700,000 shares where company has called for ₹ 8 per share.

All the calls have been met in full except three shareholders who still owe for their 6000 shares in total.

Amount of various share capital

Authorized share capital = ₹ 2,00,00,000 (2 crores)

Subscribed capital = 10,00,000 x 10 = ₹ 1,00,00,000 (1 Crore)

Issued capital = 7,00,000 x 10 = ₹ 70,00,000

Called-up capital = 7,00,000 x 8 = ₹ 56,00,000

Paid-up capital = 56,00,000 – (6000 x ₹ 8) = ₹ 55,52,000

(87) Subsidiary company or Subsidiary, in relation to any other company (that is to say the holding company), means a company in which the holding company—

(i) controls the composition of the Board of Directors; or

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

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

Explanation—For the purposes of this clause,—

(a) a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (ii) is of another subsidiary company of the holding company;

(b) the composition of a company's Board of Directors shall be deemed to be controlled by another company if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors;

(c) the expression "company" includes any body corporate;

(d) "layer" in relation to a holding company means its subsidiary or subsidiaries;

As per the notification dated 27th December 2013, Ministry clarified that the shares held by a company or power exercisable by it in another company in a fiduciary capacity shall not be counted for the purpose of determining the holding –subsidiary relationship in terms of the provision of section 2(87) of the Companies Act, 2013.

(88) 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;

(89) Total voting power, in relation to any matter, means the total number of votes which may be cast in regard to that matter on a poll at a meeting of a company if all the members thereof or their proxies having a right to vote on that matter are present at the meeting and cast their votes;

(90) Tribunal means the National Company Law Tribunal constituted under section 408;

(91) Turnover means the gross amount of revenue recognised in the profit and loss account from the sale, supply, or distribution of goods or on account of services rendered, or both, by a company during a financial year;

(92) Unlimited company means a company not having any limit on the liability of its members;

(93) Voting right means the right of a member of a company to vote in any meeting of the company or by means of postal ballot.

TEST YOUR KNOWLEDGE

MCQ based Questions

1. *Green Ltd. is incorporated on 3rd January, 2022. As per the Companies Act, 2013, what will be the financial year for the company:*

   (a) 31st March, 2022

   (b) 31st December, 2022

   (c) 31st March, 2023

   (d) 30th September, 2023

2. *Roma along with her six friends has incorporated Roma Trading Ltd. in May 2021. The paid-up share capital of the company is ₹ 2 crore. Further, in April 2022, she noticed that in the last financial year, the turnover of the company was well below ₹ 40 crore. Advise whether the company can be treated as a 'small company'.*

   (a) Roma Trading Ltd. is definitely a 'small company' since its paid-up capital is much below ₹ 4 crore and also its turnover has not exceeded the threshold limit of ₹ 40 crore.

   (b) The concept of 'small company' is applicable only in case of a private limited company/OPC and therefore, despite meeting the criteria of 'small company' it being a public limited company it cannot enjoy benefits of 'small company'.

(c) *Unlike a private limited company/OPC which automatically becomes a 'small company' as soon as it meets the criteria of 'small company', Roma Trading Ltd. being a public limited company has to maintain the norms applicable to a 'small company' continuously for two years so that, thereafter, it will be treated as a 'small company'.*

(d) *If all the shareholders of Roma Trading Ltd. give an undertaking to the ROC stating that they will not let the paid-up share capital and also turnover exceed the limits applicable to a 'small company' in the next two years, then it can be treated as a 'small company'.*

3. *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, 2022, its turnover was less than ₹ 40 crore and its paid up share capital was less than ₹ 4 crore. 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'.*

4. *Kaveri Goods Carriers Private Limited (KGCPL) issued 9% Non-convertible Debentures worth ₹ 10 lakhs and thereafter, the directors contemplated to get*

them listed. After due formalities, these privately placed non-convertible debentures of ₹ 10 lakhs were listed. Which of the following options is applicable in the given situation:

(a) KGCPL shall be considered as a listed company.

(b) KGCPL shall not be considered as a listed company.

(c) KGCPL shall be considered as a listed company only when minimum amount of listed privately placed non-convertible debentures is ₹ 15 lakhs.

(d) KGCPL shall be considered as a listed company only when minimum amount of listed privately placed non-convertible debentures is minimum ₹ 20 lakhs.

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. Here, the words 'significant influence' means:*

(a) Control of at least 10% of total voting power

(b) Control of at least 15% of total voting power

(c) Control of at least 20% of total voting power

(d) Control of at least 25% of total voting power

Descriptive Questions

1. *MNP Private Ltd. is a company registered under the Companies Act, 2013 with a paid-up share capital of ₹ 2 crore and turnover of ₹ 60 crore. Explain the meaning of the "Small Company" and examine the following in accordance with the provisions of the Companies Act, 2013:*

(i) Whether the MNP Private Ltd. can avail the status of small company?

(ii) What will be your answer if the turnover of the company is ₹ 30 crore?

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

(a)	*Directors and their relatives*	*50*
(b)	*Employees*	*15*
(c)	*Ex-Employees (Shares were allotted when they were employees)*	*10*
(d)	*5 couples holding shares jointly in the name of husband and wife (5*2)*	*10*
(e)	*Others*	*145*

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

ANSWERS

Answer to MCQ based Questions

1.	**(c)**	31st March, 2023
2.	**(b)**	The concept of 'small company' is applicable only in case of a private limited company/OPC and therefore, despite meeting the criteria of 'small company' it being a public limited company cannot enjoy benefits of 'small company'.
3.	**(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.
4.	**(b)**	KGCPL shall not be considered as a listed company.
5.	**(c)**	Control of at least 20% of total voting power

Answer to Descriptive Questions

1. **Small Company:** According to Section 2(85) of the Companies Act, 2013, Small Company means a company, other than a public company,—

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

(2) turnover of which as per its last profit and loss account does not exceed two crore rupees or such higher amount as may be prescribed which shall not be more than one hundred crore rupees.

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.

As per the Companies (Specification of Definitions Details) Rules, 2014, for the purposes of sub-clause (i) and sub-clause (ii) of clause (85) of section 2 of the Act, paid up capital and turnover of the small company shall not exceed rupees four crores and rupees forty crores respectively.

(i) In the present case, MNP Private Ltd., is a company registered under the Companies Act, 2013 with a paid up share capital of ₹ 2 crore and having turnover of ₹ 60 crore. Since only one criteria of share capital not exceeding ₹ 4 crore is met, but the second criteria of turnover not exceeding ₹ 40 crore is not met and the provisions require both the criteria to be met in order to avail the status of a small company, MNP Ltd. cannot avail the status of small company.

(ii) If the turnover of the company is ₹ 30 crore, then both the criteria will be fulfilled and MNP Ltd. can avail the status of small company.

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

However, where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this clause, be treated as a single member.

It is further provided that -

(A) persons who are in the employment of the company; and

(B) persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased,

shall not be included in the number of members.

In the instant case, Flora Fauna Limited may be converted* into a private company only if the total members of the company are limited to 200. Total Number of members

(i)	Directors and their relatives	50
(ii)	5 Couples (5x1)	5
(iii)	Others	145
	Total	**200**

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

*The provisions relating to conversion of public company to private company is covered in the Chapter 2 – Incorporation of Company and Matters incidental thereto.

NOTES

CHAPTER 2

INCORPORATION OF COMPANY AND MATTERS INCIDENTAL THERETO

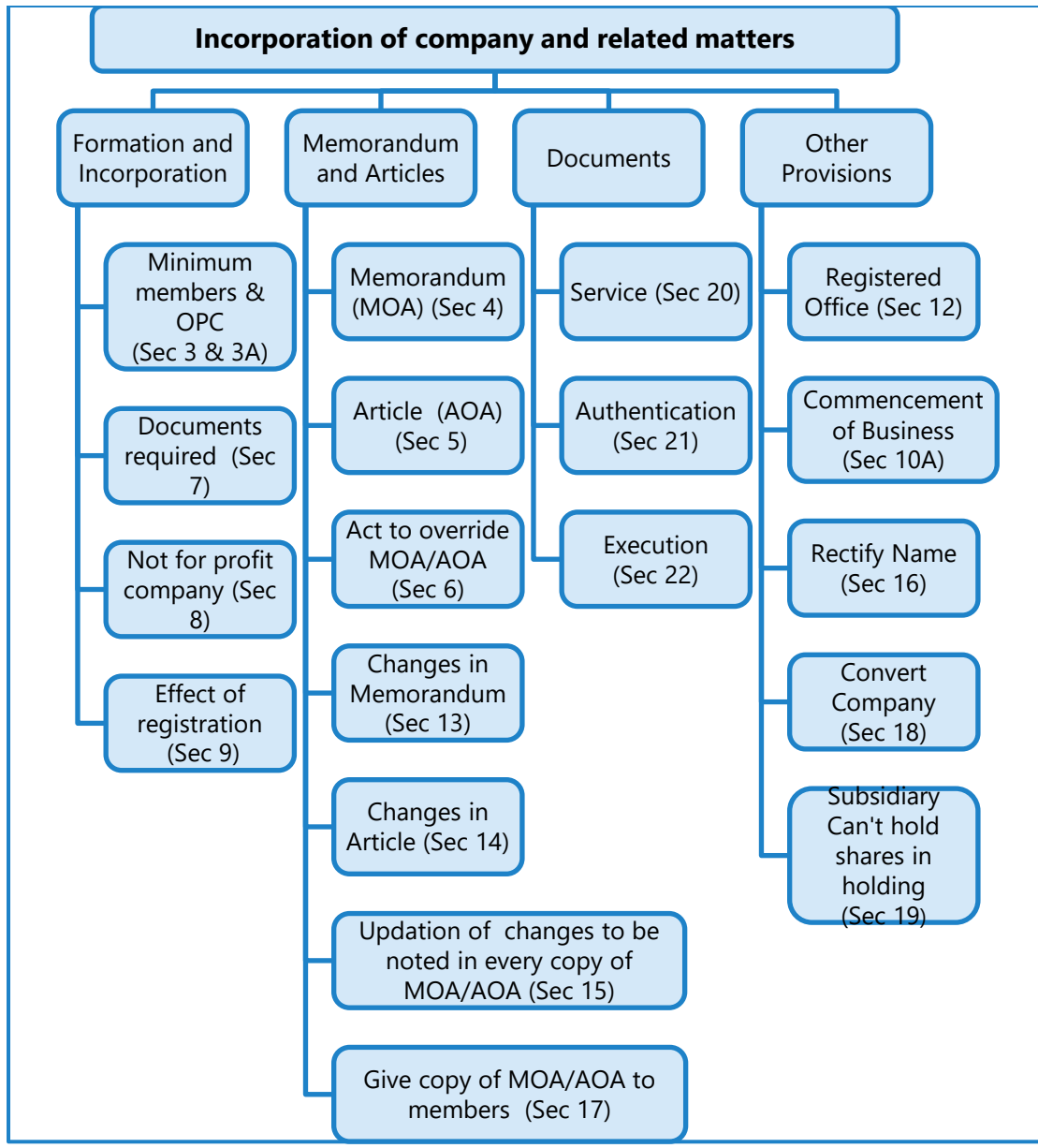
LEARNING OUTCOMES

At the end of this chapter, you will be able to:

- Explain the Formation & Incorporation of company (Private Limited/ Public Limited), One person company (OPC) and the formation of Not for Profit Organization (Section 8 Company).
- Identify the need for Memorandum of Association (MOA) and Articles of Association (AOA) and changes incidental thereto.
- Know the effect of registration.
- Explain and identify the concepts related to registered office of company.
- Understand how documents may be served and filing thereof.
- Know about Authentication of documents, proceedings and contracts and Execution of bills of exchange, etc.

CHAPTER OVERVIEW

This chapter will discuss in detail the provisions contained in Chapter II of the Companies Act 2013 pertaining to the incorporation of companies and matters incidental thereto. The scope of this chapter is shown in below figure;



1. INTRODUCTION TO INCORPORATION OF COMPANIES & PROMOTOR

Chapter II	**Consists of sections 3 to 22 as well as the Companies (Incorporation) Rules, 2014.**

A company is a separate legal entity from its members. It has perpetual succession and can be incorporated only for lawful purposes. Prior to incorporation, promotion activities are essential. Promotion signifies a number of business operations familiar to the commercial world by which a company is brought into existence[1]

Persons who undertake promotion activities in order to incorporate the company are generally known as promoters. The section 2(69) of Companies Act, 2013[2] (herein after referred to as 'the Act') defines the term **"Promoter"** (already mentioned in chapter 1 of module; elaborated here). Promoter means a person;

a. Who has been named as promoter in a prospectus; **or**

b. Who is identified as promoter by the company in the annual return; **or**

c. Who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; **or**

d. In accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act, but shall not include a person who is acting merely in a professional capacity such as attorney, technical or functional experts.

Students are advised to take note that above definition serves the purpose to make a person liable 'in capacity of promoter' for fraud through misstatement, but not highlighting what actually promoters do. Hence, considering the judicial pronouncements improves our understanding regarding role of promoter.

Promoter is one who undertakes to form a company with reference to a given project, and to set it going, and who takes the necessary steps to accomplish that

[1] Whaley Bridge Printing Co. v. Green (1880) 5 B.D. 109
[2] Act 18 of 2013

purpose.[3] To be a promoter, one need not necessarily be associated with the initial formation of the company; one who subsequently helps to arrange floating of its capital will equally be regarded as a promoter.[4]

Hence, "promoter" denotes any individual, association, partnership or a company that takes all the necessary steps to incorporate (create and mould)[5] a company and set it going, in a fiduciary position.[6]

Illustration (True/False)

Statement *– To be a promoter one necessarily be associated with the initial formation of the company.*

Answer - False, one who subsequently helps company to keep going, raise fund & advice to board (other than in professional capacity) will equally be regarded as a promoter.

2. FORMATION OF COMPANY [SECTION 3]

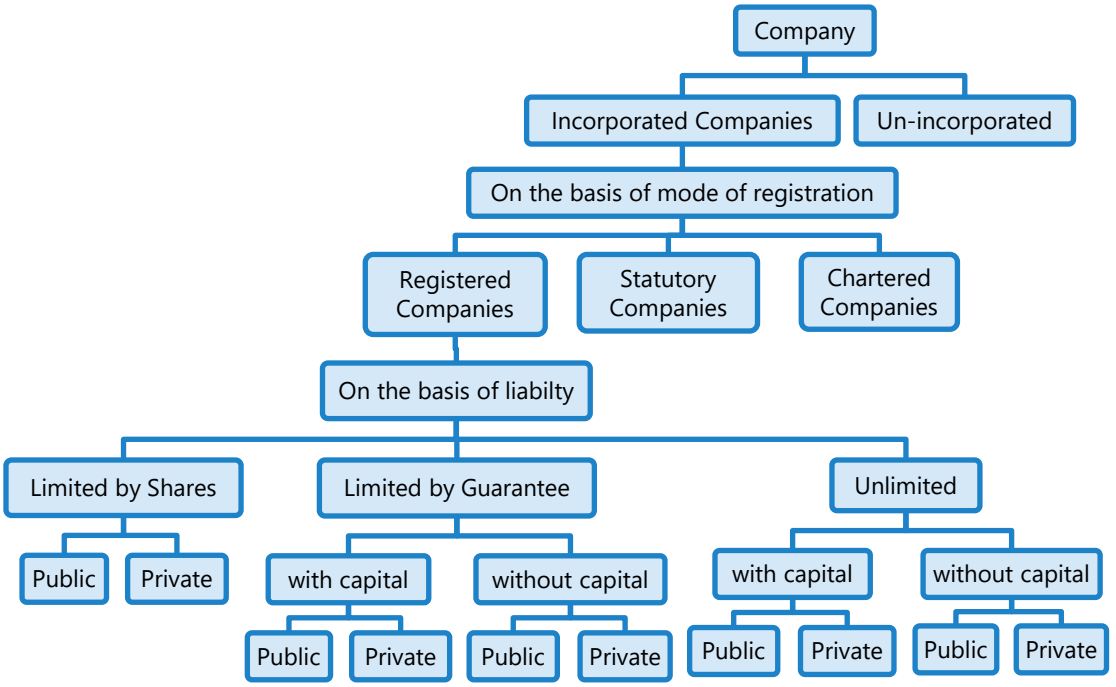
Earlier companies were granted rights by royal charter, but now a company may be incorporated by either a special Act of the legislature or under the Companies Act, 2013. Accordingly, an incorporated company may be either Chartered Company, Statutory Company, or Registered Company. Section 3 of the Act deals with registered companies.

FORMS OF COMPANIES

The Companies are broadly classified into categories shown below in figure. Definitions of many of these are already covered under chapter 1 of this module.

[3] Twycross v. Grant (1877) 2 C.P.D. 469
[4] Lagunas Nitrate Co. v. Lagunas Syndicate (1899) 2 Ch. 392.
[5] Erlanger v New Sombrero Phosphate Co. (1878) 48 LJ Ch. 73
[6] *ibid*

Kind of Companies



Sub-section 1 to section 3 provides that for **lawful purpose**, by **subscribing** their name to **memorandum** and complying with requirement of this Act;

a. A public company may be formed by **seven (7)** or more persons

b. A private company may be formed by two (2) or more persons

c. A one person company (as private company) may be formed by **one (1)** person.

Further, sub-section 2 to section 3 provides that, company formed as specified above may be incorporated either as;

a. Companies limited by shares; or

b. Companies limited by guarantee; or

c. Unlimited liability companies.

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.

ONE PERSON COMPANY (OPC)

The Companies Act, 2013 for the first time allowed the formation of company by just one person with limited liability, called one person company; such a company is described as a private company under section 3(1)(c). Further section 3(1) along with rule 3 and 4 of *the Companies (Incorporation) Rules, 2014*, provides certain provisions specifically applicable in case of One Person Company listed below;

Who can form one person company?

Only a natural person, other than minor; who is an Indian citizen and **whether resident in India or otherwise** shall be eligible to incorporate a One Person Company.

Resident in India means a person who has stayed in India for a period of not less than one hundred and twenty days during the immediately preceding financial year.

OPC can't be incorporated or converted into a company under section 8 of the Act. Further, OPC can't carry out Non-Banking Financial Investment activities including investment in securities of any body-corporates.

Indicate Name & Consent Nominee

The memorandum of One Person Company shall also indicate the name of the natural person, other than minor; who is an Indian citizen, whether resident in India or otherwise (as nominee), along with his prior written consent in the Form No. INC-3, who shall, in the event of the subscriber's death or his incapacity to contract become the member of the company.

Note: This provision is to ensure perpetual succession of legal existence of OPC.

Example – Ms. Madhu formed an OPC wherein Mr. Sudan is nominee as his name is specified in MOA along with his consent. Ms. Madhu declared insolvent, pending

to discharge insolvency, she becomes incompetent to contract, hence, Mr. Sudan becomes the member of such OPC.

The name of such nominated person in **Form No. INC-32 (SPICe)** along with consent of such nominee obtained in Form No. INC-3 and fee as provided in the Companies (Registration offices and fees) Rules, 2014 shall be filed with the Registrar at the time of incorporation of the company along with its memorandum and articles.

Note: A natural person shall not be member of more than a One Person Company at any point of time and the said person shall not be a nominee of more than a One Person Company

Where a natural person, being member in One Person Company in accordance with this rule becomes a member in another such Company by virtue of his being a nominee in that One Person Company, such person shall meet the above specified criteria (can be member of only one OPC) within a period of one hundred and eighty days.

Withdraw of Consent by Nominee

Such other person (nominee) **may withdraw** his consent by giving a notice in writing to such sole member and to the One Person Company

In this case, the sole member shall nominate another person as nominee **within fifteen days** of the receipt of the notice of withdrawal and shall send an intimation of such nomination in writing to the Company, along with the written consent of such other person so nominated in Form No. INC-3.

Note: Despite name of such other (old nominee) and another person (new nominee) specified in memorandum, any such change in the name of the person shall not be deemed to be an alteration of the memorandum.

Replacing Nominee with another one

The member **may change** the name of the person nominated by him at any time for **any reason** including in case of death or incapacity to contract of nominee and nominate another person (new nominee) after obtaining the prior consent of such another person in Form No. INC-3.

Member can do so by intimation in writing to the company.

This is not specified, either in Act or rules whether intimation shall be prior to making change or can be made afterward, but if we consider reasonable construction the intimation shall be 'Prior Intimation'.

Any such change in the name of the person shall not be deemed to be an alteration of the memorandum.

Example - Rajesh has formed a 'One Person Company (OPC), wherein his wife Roopali is named 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.

When Nominee become Member

Where the **sole member ceases** to be the member and nominee become new member, then such new member shall **nominate within fifteen days** of becoming member, a person (new nominee) who shall in the event of his death or his incapacity to contract become the member of such company.

Notice of change to Registrar

In all the three case of change discussed above (Withdraw of Consent by Nominee, Replacing Nominee with another one and When Nominee become Member) the company **within thirty days** of receipt of notice of withdrawal of consent by nominee, intimation of change of nominee from member, or cessation; shall file the notice with the Registrar of such withdrawal of consent, change or cessation respectively and intimate the name of such another person (new nominee) in Form No. INC-4 along with the fee as provided in the Companies (Registration offices and fees) Rules, 2014 along with the prior written consent of such another person so nominated in Form No. INC-3.

Note: All the notices and intimations required above shall be in written only, whether specific form provided or otherwise.

Illustration (True/False)

Statement *– Even a Non-Resident Indian can form and become member of OPC.*

Answer – True, Rule 3(1) of The Companies (Incorporation) Rules, 2014.

Only a natural person, other than minor; who is an Indian citizen and **whether resident in India or otherwise** shall be eligible to incorporate a One Person Company.

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.

3. MEMBERS SEVERALLY LIABLE IN CERTAIN CASES i.e. REDUCTION IN MINIMUM MEMBERSHIP [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)

Example – Amar, Akbar, and Anthony along with five of their friends were member of Harmony Limited. Amar and Akbar died on 18th August 2022, resultantly members count reduced to 6 and every one aware about it. Harmony limited continued its operation without increasing members. In March 2023, Company took loan for business operations, and defaulted in payment thereof. The lender of such loan can sue company, or Anthony or any of rest of five friends, because members shall severally liable for said loan in given case.

Illustration (True/False)

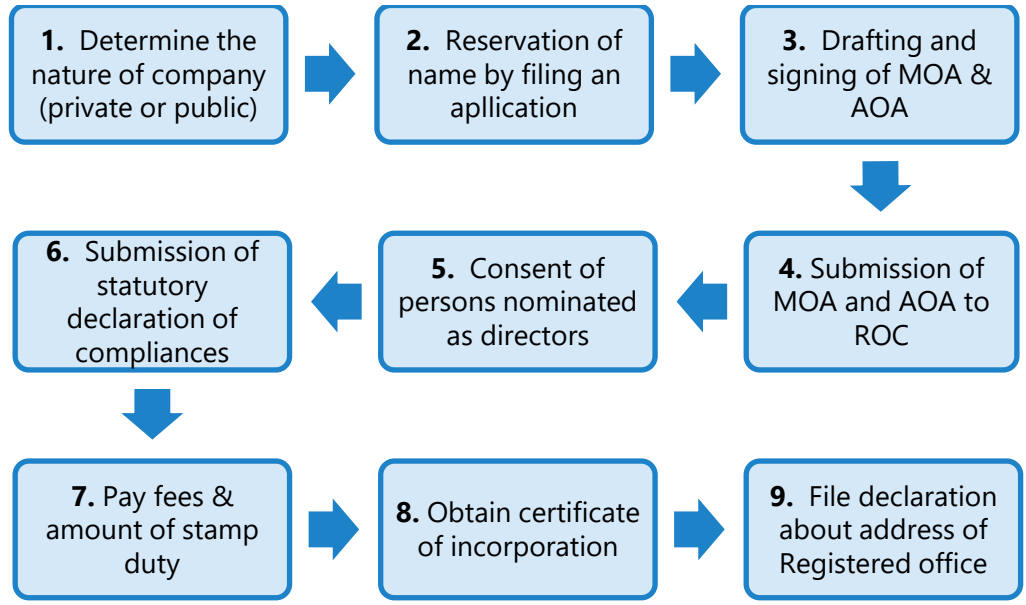
Statement *– Members who knowingly operating the company for more than six months with less than the minimum number of members specified in Section 3(1) are severally liable for the payment of all debts contracted by the company during the period since the number of members was first reduced.*

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)

4. INCORPORATION OF COMPANY [SECTION 7]

Section 7 of the Act provides for the procedure to be followed for incorporation of a company. The steps involved in the process of incorporation are enumerated in Figure shown below (Steps for Incorporation). Majority of steps are covered under section 7 while some other related to documents such as MOA and AOA governed by section 4 and 5 respectively. Corresponding procedural aspects are described by rule 12 to 18 of the *Companies (Incorporation) Rules, 2014* and Fees are notified through rule 12 of the *Companies (Registration Offices and Fees) Rules, 2014*.

Steps for Incorporation



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: INC-32) **along with the fee** as provided under *the Companies (Registration offices and fees) Rules, 2014* **accompanied by** following **documents and information**;

SPICe+ is an integrated Web form offering 10 services by 3 Central Govt. Ministries & Departments. (Ministry of Corporate Affairs, Ministry of Labour & Department of Revenue in the Ministry of Finance) thereby saving as many procedures, time and cost for starting a business in India. SPICe+ is initiatives towards Ease of Doing Business. Students may refer to FAQs on SPICe+ form at MCAs' website for more details https://www.mca.gov.in/MinistryV2/spicefaq.html

The duly signed memorandum of association and articles of association

The memorandum (e-MOA in Form No. INC-33) and article (e-AOA in Form No. INC-34) of company so furnished shall be duly signed by all the subscribers to the memorandum in the manner prescribed by rule 13 of the *Companies (Incorporation) Rules, 2014* as stated below:

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.

Practical Insight / Illustration

Extracts from Memorandum of Association of Infosys Limited (Corporate Identification Number: L85110KA1981PLC013115)

We the several persons whose names and addresses are subscribed below are desirous of being formed into a Company in pursuance of this Memorandum of Association and we respectively agree to take the number of shares in the Capital of the Company set opposite to our respective names.

Signature, Name, Address, description and occupation of Subscribers	Number of Equity Shares taken by Subscriber	Signature, Name, Address, description and occupation of Witness
Nagavara Ramarao Narayana Murthy (Son of Nagavara Ramarao) Flat 6, Padmanabhan Apartment, 1126/2, Shivajinagar, Pune - 411 016 Consultant	1 (One equity)	VIPUL DEVENDRA KINKHABWALA (S/o. Devendra Vithaldas Kinkhabwala) 14, Thakurdwar Road, Zaveri Building, Bombay - 400 002. Service
Nadathur Srinivasa Raghavan (Son of N. Sarangapani) 5, "Ravikripa", Station Road, Matunga (C. R.), Bombay- 400019. Consultant	1 (One equity)	
Senapathy Gopalakrishnan (Son of P. G. Senapathy) Krishna Vihar, Kalapalayam Lane, Pathenchanthai, Trivandrum - 695 001. Consultant	1 (One equity)	
Nandan Mohan Nilekani (Son of M. R. Nilekani) 37, Saraswatput, Dharwar - 580 002. KARNATAKA Consultant	1 (One equity)	
	4 (Four equity)	

Dated this 15th day of June 1981.

Amended on August 23, 2018

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, manager 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,

Address for correspondence

The address for correspondence till its registered office is established.

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

The following particulars of every subscriber to the memorandum shall be filled;

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.

As per rule 12 of the *Companies (Incorporation) Rules, 2014*

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.

Practical Insight

Certificate of Incorporation

GOVERNMENT OF INDIA

MINISTRY OF CORPORATE AFFAIRS

Registrar of Companies, Delhi
4th Floor , IFCI Tower , 61 , Nehru Place

Certificate of Incorporation

[Pursuant to sub-section (2) of section 7 of the Companies Act, 2013 and rule 8 of the Companies (Incorporation) Rules, 2014]

I hereby certify that DARPAN TECHNOLOGIES PRIVATE LIMITED is incorporated on this Eleventh day of December Two Thousand Fifteen under the Companies Act, 2013 and that the company is limited by shares.

The CIN of the company is U72900DL2015PTC288378.

Given under my hand at Delhi this Eleventh day of December Two Thousand Fifteen.

Nitin Phartyal
Assistant Registrar of Companies
Delhi

Mailing Address as per record available in Registrar of Companies office:

DARPAN TECHNOLOGIES PRIVATE LIMITED
I-229, Jaitpur Extn.,, Part-1, Badarpur,,
NEW DELHI - 110044,
Delhi, INDIA

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.

[7]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.

[7] This Example is only for understanding of the students.

Note: Provisions of section 447 explained in detail in book chapter 3; Prospectus and Allotment of securities.

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.

Example - The Certificate of incorporation is not the conclusive proof with respect to the legality of the objects of the company mentioned in the objects clause of the memorandum of association. As such, if a company has been registered whose objects are illegal, the incorporation does not validate the illegal objects. In such a case, the only remedy available is to wind up the company.

5. FORMATION OF COMPANIES WITH CHARITABLE OBJECTS, ETC. [SECTION 8]

The underlying purpose of formation of company is not always making profit through operating economic activities, it may have charitable or social objects.

To illustrate, Tata Foundation (CIN U85191MH2014NPL253500) and Azim Premji Foundation (CIN U93090KA2001NPL028740). Students are advised to take note that 5th data section of both the CIN comprises of 'NPL', which signify Not-for-Profit License Company.

Such companies are licensed by Central Government* under section 8 of the Companies Act, 2013[8], relevant provisions of section 8 and applicable rules thereto are described below.

Note: The power of *Central Government under section 8 delegated to:

(i) **ROCs[9]** to the extent and for purpose of:

[8] Act 18 of 2013

[9] S.O. 1353(E), dated 21st May, 2014

- sub-section (1);
- clause (i) to sub-section (4), except for alteration of memorandum in case of conversion into another kind of company; and
- sub-section (5)

(ii) Regional Directors[10] to the extent and for purpose of:

- clause (i) to sub-section (4), for alteration of memorandum in case of conversion into another kind of company; and
- sub-section (6)

WHO CAN ISSUE AND GET THE LICENSE UNDER SECTION 8(1)?

As per section 8, the Central Government (ROC in its behalf) may grant such a licence if it is proved to the satisfaction 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 (if any) or other income in promoting its objects; and

c. intends to **prohibit payment of any dividend** to its members.

Note: The use of the word 'person' appears to allow even a single person to form a company for the objects specified. However, as discussed earlier also (under heading 'OPC' of this chapter) that rule 3(5) of *the Companies (Incorporation) Rules, 2014* prohibit the OPC to be incorporated or converted into a company under section 8. Likewise, as per section 2(85), a small company cannot be incorporated or converted into a section 8 company. A firm may be a member of the company registered under section 8.

Despite, members liability is limited, the words 'Limited' or 'Private Limited' shall not be added to its name. But on registration, the company shall enjoy same privileges and obligations as of a limited company.

Licence issued may on such conditions as Central Government (ROC) deems fit.

[10] S.O. 4090(E), dated 19th Dec, 2016

REGISTRATION OF COMPANY USING LICENSE

After granting licence, an application shall be made to registrar under section 8(1) itself for registration of company in the manner specified in rule 19 of *the Companies (Incorporation) Rules 2014*.

Application for registration

A person or an association of persons desirous of incorporating a company with limited liability under section 8(1), shall make an application to registrar in **Form SPICe+** (Simplified Proforma for Incorporating company Electronically Plus: INC-32) along with the fee as provided in *the Companies (Registration offices and fees) Rules, 2014*.

Supporting document along with Application

The application furnished as specified above shall be accompanied by the following documents;

a. The memorandum and articles of association of the proposed company in the Form No. INC-13 and Form No. INC-31, respectively;

b. An estimate of the future annual income and expenditure of the company for next three years, specifying the sources of the income and the objects of the expenditure;

c. The declaration in by an Advocate, a Chartered Accountant, cost accountant or Company Secretary in practice Form No. INC-14 and by each of the persons making the application in Form No. INC-15, that;

- the memorandum and articles of association have been drawn up in conformity with the provisions of section 8 and rules made thereunder and
- all the requirements of the Act and the rules made thereunder relating to registration of the company under section 8 and matters incidental or supplemental thereto have been complied with;

ALTERATION OF MEMORANDUM AND ARTICLES REQUIRES PRIOR PERMISSION OF GOVERNMENT

A company registered under this section requires prior permission from;

a. Central Government (power delegated to **regional directors**) for alteration of its **memorandum** and

b. Central Government (power delegated to **ROCs**) for alteration of its **articles**.

CONVERSION INTO ANY OTHER KIND OF COMPANY

A company registered under this section may convert itself into company of any other kind only after complying with such conditions as may be prescribed in rule 21 and 22 of *the Companies (Incorporation) Rule 2014* as described below;

a. A company shall pass a **special resolution** at a general meeting for approving such conversion

b. An **explanatory statement** to notice of such general meeting must set-out the details on reason of such conversion.

c. The company shall file an application in Form No. INC-18 with the **Regional Director** with the fee along with a certified true copy of the special resolution and a copy of the Notice convening the meeting including the explanatory statement for approval for conversion.

   Also attach the proof of serving of the notice served by **registered post or hand delivery**, to:

   - the Chief Commissioner of Income Tax having jurisdiction over the company,
   - Income Tax Officer who has jurisdiction over the company,
   - the Charity Commissioner,
   - the Chief Secretary of the State in which the registered office of the company is situated,
   - any organisation or Department of the Central Government or State Government or other authority under whose jurisdiction the company has been operating.

   Note: If any of these authorities wish to make any representation to Regional Director, it shall do so within sixty days of the receipt of the notice, after giving an opportunity to the Company.

d. A **copy** of the application with annexures as filed with the Regional Director shall also be **filed with the Registrar**.

e. The company shall, within a week from the date of submitting the application to the Regional Director, **publish a notice** at its own expense, and a copy of

the notice, as published, shall be sent forthwith to the Regional Director and the said notice shall be in Form No. INC-19 and shall be published;

- at **least once in a vernacular newspaper** in the principal vernacular language of the district in which the registered office of the company is situated, and having a wide circulation in that district, and **at least once in English language** in an English newspaper having a wide circulation in that district; and
- on the **website of the company**, if any, and as may be notified or directed by the Central Government.

f. The company should have filed all its **financial statements** and **Annual Returns** upto the financial year preceding the submission of the application to the Regional Director and all other returns required to be filed under the Act up to the date of submitting the application to the Regional Director

> **Note:** In the event the application is made after the expiry of three months from the date of preceding financial year to which the financial statement has been filed, a statement of the financial position duly certified by chartered accountant made up to a date not preceding thirty days of filing the application shall be attached.

g. On receipt of the application, and on being satisfied , the Regional Director shall issue an **order approving the conversion** of the company into a company of any other kind subject to **such terms and conditions** as may be imposed in the facts and circumstances of each case.

h. Before imposing the conditions or rejecting the application, the company shall be given a reasonable **opportunity of being heard** by the Regional Director

i. On **receipt of the approval** of the Regional Director, the company shall convene a **general meeting** of its members to pass a **special resolution** for amending its **memorandum of association and articles of association** and the Company shall thereafter **file these with the Registrar** (with declaration to adhere conditions if any, imposed by Regional Director)

j. On receipt of the documents referred above, the Registrar shall register the documents and **issue the fresh Certificate of Incorporation**.

REVOCATION OF LICENSE

a. The Central Government (power delegated to regional director) may by order revoke the licence of the company where;

- the company contravenes any of the requirements or the conditions of this sections subject to which a licence is issued or
- the affairs of the company are conducted fraudulently, or in violation of the objects of the company or prejudicial to public interest,

Note: On revocation, the Registrar shall put 'Limited' or 'Private Limited' against the company's name in the register.

Before such revocation a written notice must be served on such company and opportunity to be heard in the matter shall be given.

b. Where a licence is revoked and the Central Government is satisfied, that it is essential in the public interest; then after giving a reasonable opportunity of being heard; by order it may direct that

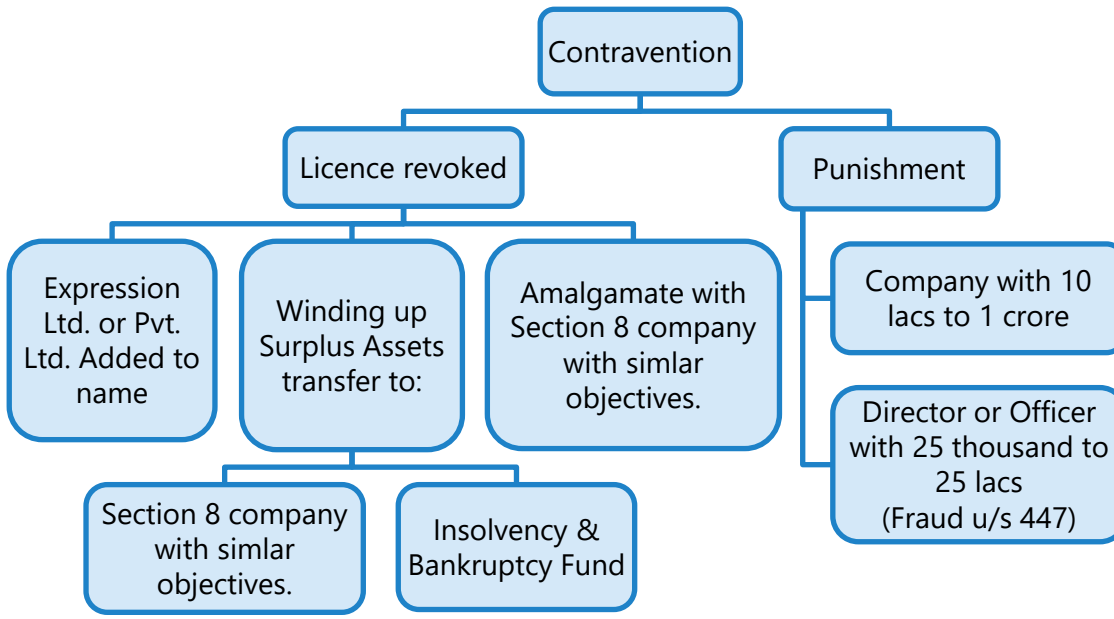
- Company be **wound up** under this Act. **Excess assets** on the winding up or dissolution, after the satisfaction of its debts and liabilities, may be transferred to;
  - **Another company** registered under this section and **having similar objects**, subject to such **conditions** as the Tribunal 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.
- Company be **amalgamated** with another company registered under this section and **having similar objects**. The Central Government empowered with **overriding effects** to **provide the said amalgamation** to form single entity with such constitution, properties, powers, rights, interest, authorities and privileges and with such liabilities, duties and obligations as may be specified in the order.

PENALTY/ PUNISHMENT IN CONTRAVENTION

Penalty for offences under section 8 are summarised below;

Offence	Penalty
company makes any default in complying with any of the requirements laid down in this section	company shall, be punishable with fine varying from ten lakh rupees to one crore rupees
	directors and every officer of the company who is in default shall be punishable with fine varying from twenty-five thousand rupees to twenty-five lakh rupees
the affairs of the company were conducted fraudulently	every officer in default shall be liable for action under section 447

FIGURE- SUMMARY OF SUB-SECTION 6 TO 11 OF SECTION 8



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.

6. 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;

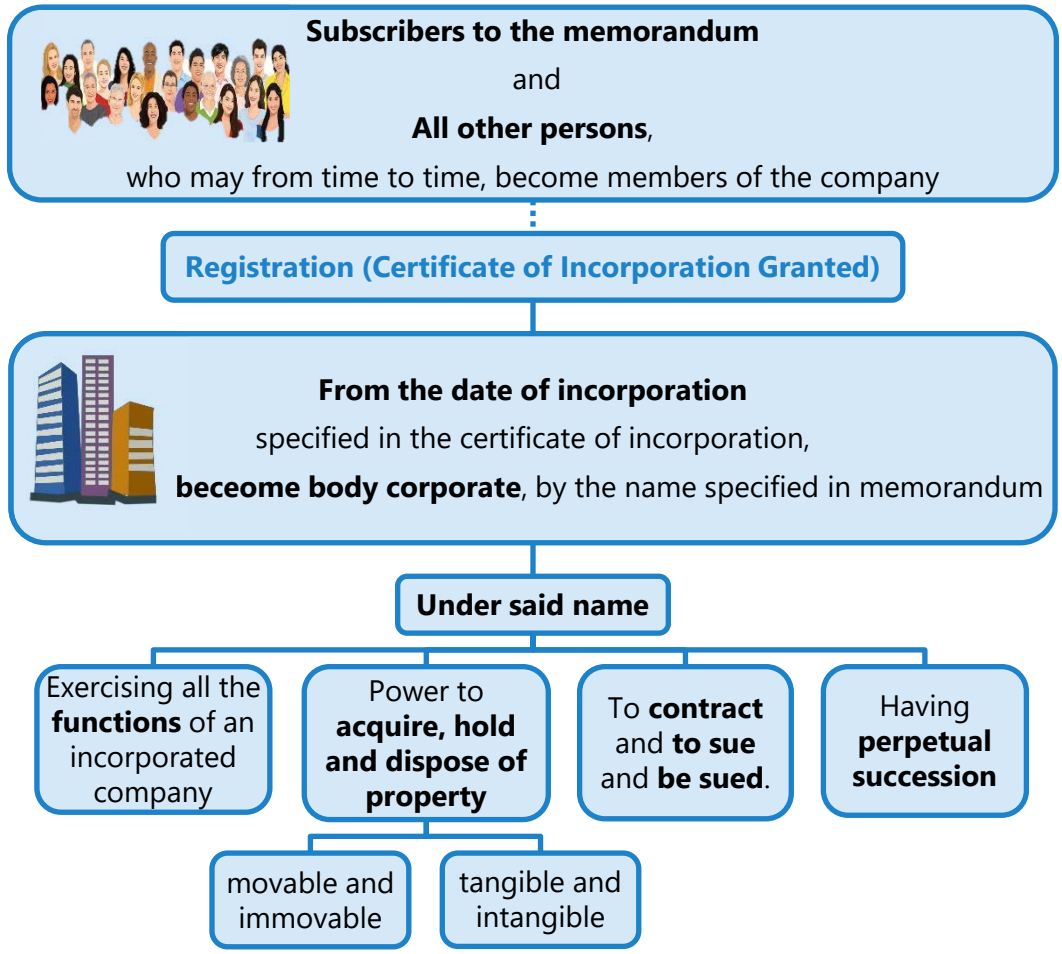
a. Exercising all the functions of an incorporated company under this Act and

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.

SUMMARY OF SECTION 9



7. MEMORANDUM OF ASSOCIATION – MOA [SECTION 4]

Memorandum of association (MOA) is the fundamental document for the formation of the company, hence considered as its charter or constitution. Memorandum defines the relationship of the company with outsiders because it enables all those who deals with the company to know what its powers are and what activities it can engage in. The memorandum shall contains the following clauses:

a. Name Clause

b. Situation Clause (also called registered office clause)

c. Objects Clause

d. Liability Clause

e. Capital Clause (applicable, if company is formed with share capital)

f. Association Clause or Subscription Clause (specifically drafted in case of OPC)

g. Nomination Clause (applicable, in case of OPC)

Section 4 of the Act along with relevant rules from the Companies (Incorporation) Rules 2014, provides for the requirements with respect to memorandum.

NAME CLAUSE [SECTION 4 (1) (a) READ WITH SUB-SECTION 2 TO 5]

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

The above clause is not applicable in case of section 8 companies.

In case of Specified IFSC Public Company[11] & IFSC Private Company[12], name shall have the suffix, "International Financial Service Company" or "IFSC".

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.

[11] GSR 08 (E) dated 04.01.2017
[12] GSR 09 (E) dated 04.01.2017

Restriction regarding names and use of words & expressions therein [sub-section 2 and 3]

Sub-section 2 states that the name mentioned in the memorandum **shall not** be;

a. **Identical** 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)[13]

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.

A name is said to 'resemble' when difference is only and only of

a. Plural or singular form of words in one or both names (Green Technology Ltd. is same as Greens Technology Ltd. and Greens Technologies Ltd.)

[13] S.O. 1353(E), dated 21st May, 2014.

b. Type and case of letters, spacing between letters, and punctuation marks used in one or both names (ABC Ltd. is same as A.B.C. Ltd. and A B C Ltd.)

c. Use of different tenses in one or both names (Ascend Solutions Ltd. is same as Ascended Solutions Ltd. and Ascending Solutions Ltd.)

d. Slight variation in the spelling of the two names including a grammatical variation thereof (Disc Solutions Ltd. is same as Disk Solutions Ltd. but it is not same as Disco Solutions Ltd)

e. Use of different phonetic spellings including use of misspelled words of an expression (Bee Kay Ltd is same as BK Ltd, Be Kay Ltd., B Kay Ltd., Bee K Ltd., B.K. Ltd. and Beee Kay Ltd)

f. Complete translation or transliteration, and not part thereof, of an existing name, in Hindi or in English (National Electricity Corporation Ltd. is same as Rashtriya Vidyut Nigam Ltd.)

g. Use of host name such as 'www' or a domain extension such as .net'. org', 'dot' or 'com' in one or both names (Ultra Solutions Ltd. is same as Ultrasolutions.com Ltd. But Supreme Ultra Solutions Ltd. is not the same as Ultrasolutions.com Ltd.)

h. The order of words in the names (Ravi Builders and Contractors Ltd. is same as Ravi Contractors and Builders Ltd.)

i. Use of the definite or indefinite article in one or both names (Congenial Tours Ltd. is same as A Congenial Tours Ltd. and The Congenial Tours Ltd. But Isha Industries Limited is not the same as Anisha Industries Limited.)

j. Addition of the name of a place to an existing name, which does not contain the name of any place; (If Salvage Technologies Ltd. is an existing name, it is same as Salvage Technologies Delhi Ltd. But Retro Pharmaceuticals Ranchi Ltd. is not the same as Retro Pharmaceuticals Chennai Ltd.)

k. addition, deletion, or modification of numerals or expressions denoting numerals in an existing name, unless the numeral represents any brand (Thunder Services Ltd is same as Thunder 11 Services Ltd and One Thunder Services Ltd.)

Students may also refer to 23 instances specified in rule 8A of the Companies (Incorporation) Rules 2014 that tantamount to "undesirable names"

Reservation of name [sub-section 5]

Upon receipt of an application the Registrar may, on the basis of information and documents furnished along with the application, reserve the name for a **period of twenty days** from the date of approval **or** such other period.

Provided that in case of **an application** for reservation of name or for change of its name by an **existing company**, the Registrar may reserve the name for a period of **sixty days** from the date of approval.

1. While allotting names, the Registrar of Companies concerned should exercise due care to ensure that the names are not in contravention of the provisions of the ***Emblems and Names*** *(Prevention of Improper Use) Act, 1950*. It is necessary that Registrars are fully familiar with the provisions of the said Act.[14]

2. An application for **extension of reservation** of name under rule 9A of the Companies (Incorporation) Rules 2014 can be made before expiry of 20 days;

a. For another 20 days (total of 40 days) with fee of ₹ 1000, which may be further extend by another 20 day (total of 60 days) with fee of ₹ 2000.

Or

b. For another 40 days (total of 60 days) with fee of 3000

Cancellation of reserved name [sub-section 5]

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

a. 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**;

b. if the **company has been incorporated**, the Registrar may, after giving the company an **opportunity of being heard**;

- Either direct the company to **change its name** within a period of 3 months, after passing an ordinary resolution;
- Take action for **striking off** the name of the company from the register of companies; or
- Make a petition for **winding up** of the company.

[14] General Circular No. 29/2014, dated 11th July, 2014

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.

SITUATION CLAUSE - SECTION 4 (1) (b)

Section 4(1)(b) requires, the memorandum of a company shall mention the name of state, where registered office is proposed to be situated.

The situation (place) of registered office is important from perspective of;

a. Establishing the domicile of company for the purpose of determining jurisdictions in context to compliance (ROC, RD etc.), judicial aspects (bench of NCLT, high court etc.), fiscal aspects (taxation), and for many other purposes.

b. Place at which the company's statutory books must normally be kept (in case of public company, general meeting also required to be conducted at registered office or in the city where it is situated).

c. Act as the address to which notices and other communications can be sent.

A company shall, within thirty days of its incorporation and at all times thereafter, have a registered office capable of receiving and acknowledging all communications and notices as may be addressed to it.

OBJECT CLAUSE & DOCTRINE OF ULTRA VIRES

Section 4(1)(c), requires the memorandum of a company shall state the **objects** for which the company is proposed to be incorporated **and** any **matter** considered necessary in furtherance thereof.

Specified IFSC Public Company & IFSC Private company **shall state** its objects to do **financial services activities** as permitted under the Special Economic Zones Act, 2005 read with SEZ Rules, 2006 and any matter considered necessary in furtherance thereof **in accordance with license** to **operate, from International Financial Services Centre** located in an approved multi services Special Economic Zone, granted **by the RBI, SEBI, or IRDA.**

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.

Note: Acts ultra-vires to the authority of the directors may be ratified by the company.[15] Articles provide for regulations inside scope established by MOA, hence acts beyond (ultra-vires) the articles, can be ratified by the shareholders provided the relevant provisions are not beyond the memorandum. **To illustrate**; One of the director is authorised to issue cheque of ₹ 10000, but he issued for ₹ 12000; company can ratify so.

It is worth noting here that Memorandum of company can be altered to widen the scope of objects, but such alteration shall have prospective effect only; not the retrospective, hence an act once ultra-vires remain so ever.

A company may do anything which is **incidental to** and **consequential upon** the objects specified and such act will not be an ultra vires act.[16] **To illustrate** for trade one have rent or own a building, issue invoices, make and receive payments.

Essence of the Doctrine of Ultra Vires

The *Doctrine of Ultra Vires* is meant to protect shareholders and the creditors of the company or anyone who deals with the company.

Enunciation of Doctrine of Ultra Vires

The doctrine of ultra vires was first enunciated by the House of Lords in a classic case, ***Ashbury Railway Carriage and Iron Co. Ltd. v. Riche.***[17]

The memorandum of the company in the said case defined its objects thus: "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

[15] Rajendra Nath Dutta v. Shilendra Nath Mukherjee, (1982) 52 Com Cases 293 (Cal.)
[16] Attorney-General v. Great Eastern Rly Co (1880) 5 AC 473
[17] *(1878) L.R. 7 H.L. 653*

"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.

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.

Effects of Doctrine of Ultra Vires

The key effect will be as under;

a. Whenever an ultra vires act has been or is about to be undertaken, any member of the company can get an injunction to restrain it from proceeding with it.[18]

b. Neither party (even outsider) can sue for enforcement or specific performance of such agreement. Reason explained under heading Constructive Notice

LIABILITY CLAUSE

Section 4(1)(d) requires, the memorandum of a company shall state;

a. In the case of a **company limited by shares** the liability of its members is limited to the **amount unpaid**, if any, on the shares held by them; and

b. In the case of a **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 or of such debts and liabilities as may have been contracted before he ceases to be a member, as the case may be; and
- to the costs, charges and expenses of winding-up and

  for adjustment of the rights of the contributories among themselves

[18] Attorney-General v. Great Eastern Rly Co (1880) 5 AC 473

Note: Those shareholders who are members of the company at the time of its winding-up are included in list 'A'. They are primarily liable for making payment to the company at the time of its winding-up. While list 'B' consists of those persons who were the members of the company during the 12 months preceding the date of winding-up. B list contributories are liable to contribute if the amount realised from the contributories of list 'A' is not sufficient to discharge the 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.

CAPITAL CLAUSE

Section 4 (1) (e) (i) requires, in the case of a **company having a share capital**, the memorandum of a company shall state;

a. The amount of share capital with which the company is to be registered (usually termed as **authorised or nominal capital**); and

b. The division thereof into shares of a fixed amount (i.e. **face value** and number of shares); and

c. The number of shares which the subscribers to the memorandum agree to subscribe which shall not be less than one share.

SUBSCRIPTION CLAUSE

Section 4 (1) (e) (ii) requires, the memorandum of a company shall state, the number of shares each subscriber to the memorandum intends to take, indicated opposite his name, in the case of a company having a share capital.

NOMINATION CLAUSE (ONLY IN CASE OF ONE PERSON COMPANY)

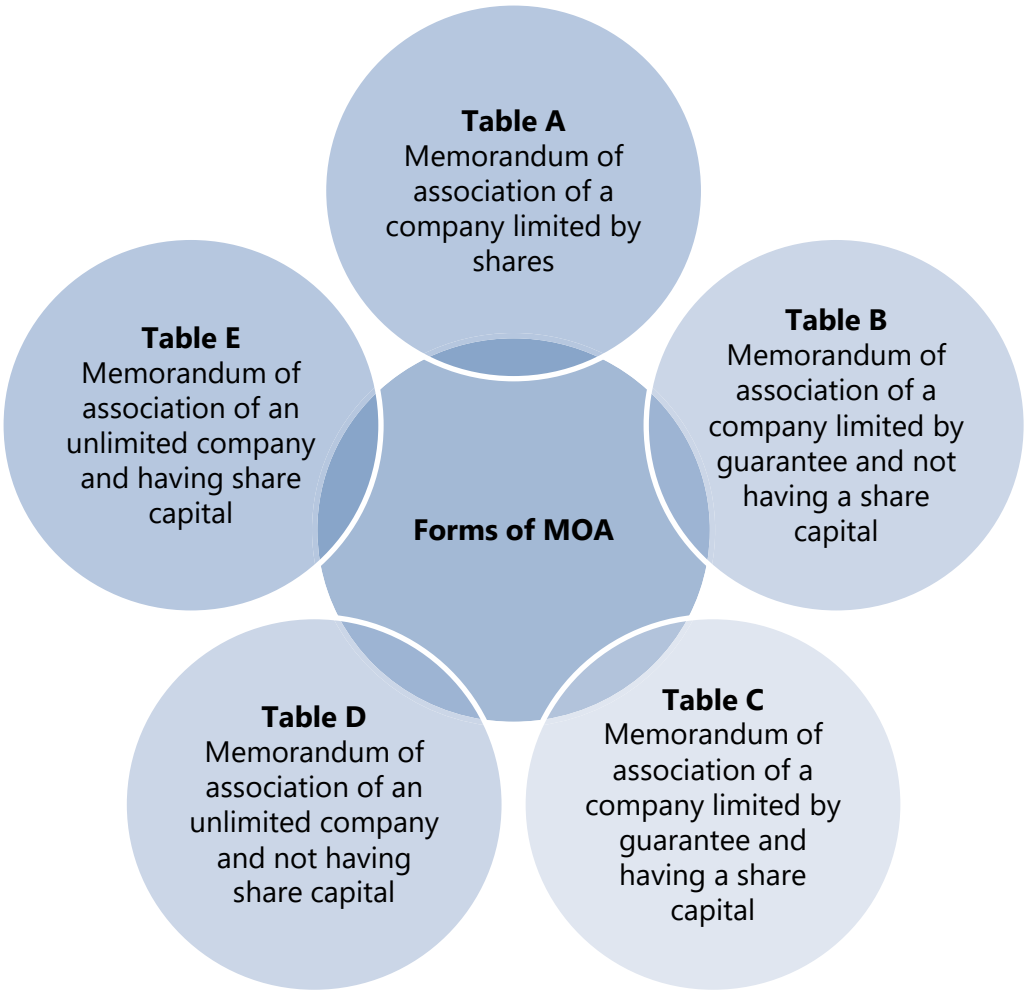
Section 4 (1) (f), requires, the memorandum of a company shall state the name of the person (nominee) who, in the event of death of the subscriber, shall become the member of the company, in the case of One Person Company.

Note: This provision is corresponding to first proviso to section 3 (1) already discussed earlier in this chapter.

FORMS AND SCHEDULE RELATED TO MEMORANDM [SUB-SECTION 6]

The memorandum of a company shall be in respective forms specified in Tables A, B, C, D and E in Schedule I to the Act, as the case shown in figure;

Forms of MOA



1. As per **section 399** of the Act, a memorandum is a public document. Consequently, every person entering into a contract with the company is presumed to have the knowledge of the conditions contained therein.

2. As per **section 4 (7),** any provision in the memorandum or articles, in the case of a company limited by guarantee and not having a share capital, shall not give any person a right to participate in the divisible profits of the company otherwise than as a member. If the contrary is done, it shall be void.

8. ARTICLES OF ASSOCIATION – AOA [SECTION 5]

Actually, articles of association of a company contains internal rules and regulations of the company. It is complementary to Memorandum and together give effect as charter of the company. Article establish a contract between the company and the members and between the members inter se. This contract governs the ordinary rights and obligations incidental to membership in the company[19]

Section 5 of the Companies Act, 2013 and rule 10 and 11 of *the Companies (Incorporation) Rules, 2014* seeks to provide the contents and model of articles of association. The provisions are state below;

CONTENTS AND MATTERS TO BE INCLUDED [SUB-SECTION 1 AND 2]

The articles of a company shall contain;

a. The regulations for management of the company.

b. Such matters as may be prescribed (rules 11 of *the Companies (Incorporation) Rules, 2014* refers to the matters specified in the model forms given under schedule I to the Act).

However, a company may also include such additional matters in its articles as may be considered necessary for its management.

PROVISION FOR ENTRENCHMENT [SUB-SECTION 3 TO 5]

Entrenchment** is the **chronic** or **deep-rooted fact** of an attitude, habit, or belief that is **firmly established** or **accustomed,** therefore it become **difficult or unlikely to change. To illustrate – Men don't cry

***Entrenchment** may be possible for processes, as well as procedures in both way; that processes are so well established, it become difficult to change them **or** make process of change so rigid that process become well established.*

Students, here we are studying the word entrenchment with sense of making the process of alteration in articles more difficult, in order to enhance the protection.

Usually an article of association may be altered by passing special resolution but entrenchment makes it more difficult to change the articles, in manner specified ahead;

[19] Naresh Chandra Sanyal v. Calcutta Stock Exchange Association Ltd. AIR 1971 SC 422

Article may contain provisions for entrenchment [Sub-section 3]

The articles may provide that specified provisions contained in it may be altered only if conditions that are more restrictive and harder than those applicable in the case of a special resolution, are met or complied with.

Manner of inclusion of the entrenchment provision [Sub-section 4]

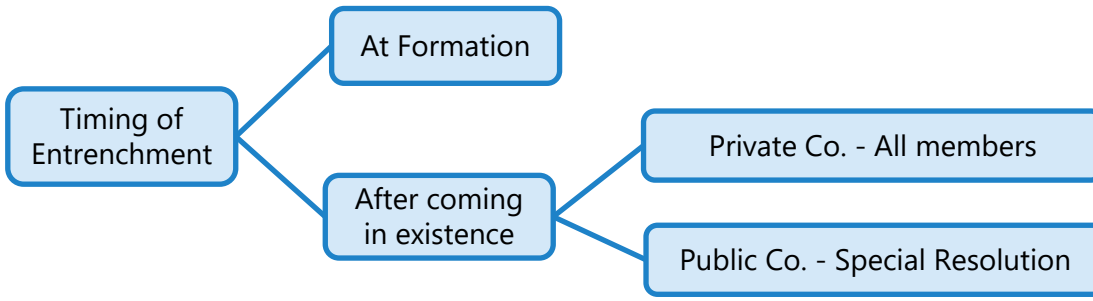
The provisions for entrenchment shall only be made either:

a. On formation of a company, or

b. 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.

Summary of Section 5(4)



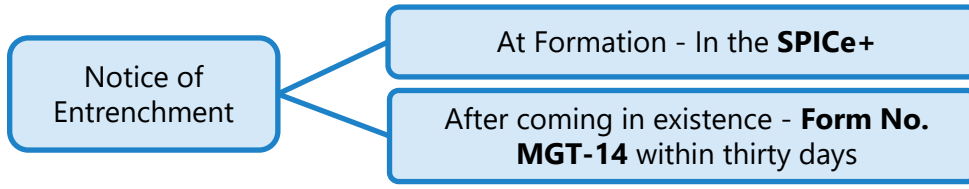
Notice to the registrar of the entrenchment provision [Sub-section 5 read with Rule 10 of *the Companies (Incorporation) Rules, 2014]*

The company shall give notice to the Registrar of entrenchment provisions included in article

a. In the **SPICe+**(Simplified Proforma for Incorporating company Electronically Plus: INC-32), along with the fee as provided in the Companies (Registration offices and fees) Rules, 2014 at the time of incorporation of the company, and

b. In case of existing companies, in Form No. MGT-14 within thirty days from the date of entrenchment of the articles, along with the fee as provided in the Companies (Registration offices and fees) Rules, 2014.

Summary of Section 5(5) and Rule 10

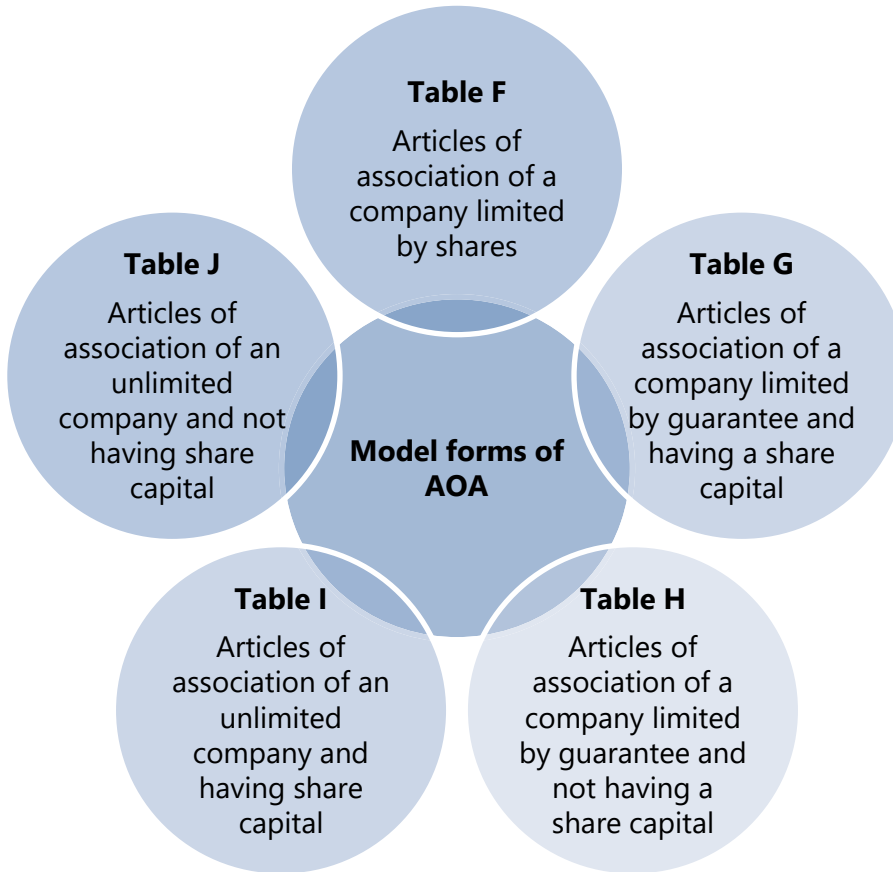


MODEL FORMS OF ARTICLES [SUB-SECTION 6 TO 8]

Sub-section 6 provides that the articles of a company **shall** be in respective forms specified in Tables, F, G, H, I and J in Schedule I to the Act as specified in figure. Such forms are called model forms.

Further, sub-section 7 provides leeway to company, in **adopting all or any of the regulations** contained in the model articles applicable to such company.

Forms of AOA



Students are advised to take note:

Sub-section 8 provides that 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 in the same manner and to the extent as if they were contained in the duly registered articles of the company – **Either exclude or modify expressly or else it applies what stated in model applicable to company.**

Sub-section 9 restricts the scope of section to the **articles either registered or amended under this Act** - Hence no provision of this section (section 5) shall be applicable to articles registered under previous company law; provided not amended under this Act.

Illustration – Question & Answer

Question – Highlight differences between the MOA and AOA

Answer - The key differences between the MOA and AOA includes;

1. Content - The memorandum contains the fundamental conditions as basis of incorporation. It lays down the parameters that define relation of company with outsiders. The Articles contain internal regulations of the company; hence regulate the relationship between company and the members and members inter se.

2. Supremacy - Memorandum cannot include any clause that is contrary to the provisions of the law, whereas the articles shall be subordinate to both the law and memorandum. Therefore, in case on conflict among the two, the MOA shall prevail.

3. Scope -Memorandum lays down the scope beyond which the activities of the company cannot go. An act done by a company beyond the scope of the memorandum are ultra vires and void. They cannot be ratified even by all the shareholders. Articles provide for regulations inside scope established by MOA, hence acts beyond the articles can be ratified by the shareholders provided the relevant provisions are not beyond the memorandum.

9. DOCTRINE OF CONSTRUCTIVE NOTICE AND DOCTRINE OF INDOOR MANAGEMENT

Both the doctrines carries the counter effect to each other, doctrine of constructive notice put onus on outsider to be aware of what is stated in MOA and AOA; whereas doctrine of indoor management protects such outsider from internal irregularities.

DOCTRINE OF CONSTRUCTIVE NOTICE

Essence of Doctrine of Constructive Notice

All those who are dealing with company deemed to be aware of what is stated in its MOA and AOA, in its true perspective, because both this documents are public documents.

Section 399* provides that the Memorandum and Articles when registered with Registrar of Companies 'become public documents' and then they can be inspected by any one by electronic means on payment of the prescribed fee.

Further, **Section 17** provides that a company shall on payment of the prescribed fee send a copy of each of the following documents to a member within seven days of the request being made by him

a. Memorandum;

b. Articles;

c. Every agreement and every resolution referred to in sub-section (1) of section 117, if and so far as they have not been embodied in the memorandum and articles.

Any failure will make the company as well as every officer in default liable to a fine of one thousand rupee for each day during which default continues or one lac rupee whichever is less.

*Section 399 is not part of syllabus, but essential to develop understanding.

Enunciation of Doctrine of Constructive Notice

The doctrine of constructive notice is based on the rule laid down in Ernest v Nicholls.[20] It was held for the first time that any person who is dealing with the company is deemed

[20] (1857) 6 HL Cas 401

to be familiar with the contents of all the public documents of the company. The memorandum and the articles of association of every company are registered with the Registrar of Companies. The office of the Registrar is a public office. Hence, the memorandum and the articles of association become public documents. It is therefore the duty of person dealing with a company to inspect its public documents and make sure that his contract is in conformity with their provisions.

As observed by Lord Hatherley whether a person actually reads them or not, he is to be in the same position as if he had read them.

Effect of Doctrine of Constructive Notice

Every person (dealing with company) shall be presumed to know the contents of the documents and understood them in their true perspective.

Absence of notice of MOA and AOA cannot be an excuse to claim relief for outsiders.[21] Even if the party dealing with the company does not have actual notice of the contents of these documents, it is presumed that he has an implied (constructive) notice of them.

Example - One of the articles of a Modern Furniture Limited provides that a cheque below ₹ 1 lacs may be signed by single director but if above ₹ 1 lac shall be signed by at-least two directors. Similar instructions issued to bank with which MFL have account, as well. M/s Sagwan Wood Works, a vendor accepts a cheque of ₹ 2.20 lacs, signed only by single director. Considering Doctrine of Constructive Notice, the M/s Sagwan Wood Works (payee) has no right to claim, when cheque will be returned without payment by bank.

Criticism of Doctrine of Constructive Notice

The 'Doctrine of Constructive Notice' is an unreal doctrine. People know a company through its officers and not through its documents. Since it does not take notice of the realities of business life, hence caused inconvenient for business transaction.

To illustrate, where the directors or other officers of the company were empowered under the articles to exercise certain powers subject only to certain prior approvals or sanctions of the shareholders, it is difficult for an outsider to ascertain whether necessary sanctions and approvals have been obtained before a certain officer exercises his powers or not.

[21] Kotla Venkataswamy v. Chinta Ramamurthy. AIR (1934) Mad 579

Therefore, to mitigate such a situation, those dealing with the company can assume that if the directors or other officers are entering into those transactions, they would have obtained the necessary sanctions. This is known as the '**Doctrine of Indoor Management**' or **Turquand's Rule,** and act as an exception to the constructive notice.

The Europe Communities Act, 1972 has abrogated this doctrine through effect of its section 9. Even in India also the Calcutta High Court[22] enforced a security which was not signed in accordance with the company's articles.

DOCTRINE OF INDOOR MANAGEMENT

Essence of Doctrine of Indoor Management

The people who are dealing with company are entitled to presume that internal proceedings and requirements has been duly met.

Enunciation of Doctrine of Indoor Management

The Doctrine of Indoor Management was first laid down in the case of ***Royal British Bank v. Turquand***[23]

The directors of a company were authorised by the articles to borrow on bonds such sums of money as should from time to time, by a resolution of the company in general meeting, be authorised to be borrowed. The directors gave a bond to Turquand without the authority of any such resolution. The question arose whether the company was liable on the bond. Held, the company was liable on the bond, as Turquand was entitled to assume that the resolution of the company in general meeting had been passed.

Rationale of Doctrine of Indoor Management

What happens internally in a company is not a matter of public knowledge. An outsider can only presume the intentions of a company, but not know the information he/she is not privy to.

If not for the doctrine, the company could escape creditors by denying the authority of officials to act on its behalf.

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[22] Charnock Collieries Co Ltd v. Bholanath Dhar. ILR (1912) 39 Cal 810.
[23] (1856) 6 E & B 327

Exceptions to Doctrine of Indoor Management

Relief on the ground of 'indoor management' cannot be claimed by an outsider dealing with the company in the following circumstances;

a. **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. In fact, he/she may well be considered part of the irregularity**.**

b. **Negligence:** If with a minimum of effort, the irregularities within a company could be discovered, the benefit of the rule of indoor management would not apply. The protection of the rule is also not available where the circumstances surrounding the contract are so suspicious as to invite inquiry, and the outsider dealing with the company does not make proper inquiry.

c. **Forgery:** The rule does not apply where a person relies upon a document that turns out to be forged since nothing can validate forgery. A company can never be held bound for forgeries committed by its officers.

d. Where the **question** is in regard to the very **existence of an agency.**

e. Where a **pre-condition** is required to be fulfilled before company itself can exercise a particular power. In other words, the act done is not merely ultra vires the directors/officers but ultra vires the company itself.

Illustration

The doctrine of indoor management is considered to be _____ to the doctrine of constructive notice.

a. Exception

b. Extension

c. Alternative

d. Not related

Answer – a. Exception

10. ACT TO OVERRIDE MEMORANDUM, ARTICLES, ETC. [SECTION 6]

The provisions of this Act shall have overriding effect to the provisions contained in;

a. Memorandum of company; **or**

b. Articles of company; **or**

c. Any agreement executed by it; **or**

d. Any resolution passed by the company in general meeting or by its Board of Directors

Whether the same be registered, executed or passed, as the case may be, before or after the commencement of this Act

Any provision contained in the memorandum, articles, agreement or resolution, to the extent in conflict to the provisions of the Act; shall be void.

Example - Section 123 declares that no dividend shall be paid by a company except out of profits. The force of this section cannot be undone by any provision in the articles of association, because the articles cannot sanction something which is forbidden by the Act. Even still it attempts then shall be void.

Note: This section starts with saving clause *i.e.* "Save as otherwise ….", means if any other section of the Act says that provisions contained in the memorandum, articles, agreement or resolution is superior then we will treat it accordingly.

Example - Section 47 of the Act deals with voting power of members. 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.

11. EFFECT OF MEMORANDUM AND ARTICLES [SECTION 10]

Sub-section 1 to Section 10 aims to impart contractual force to the Memorandum and Articles. It provides, when the memorandum and articles got registered; it shall bind the

a. Members to the company;

b. Company to the members;

c. Members to the members;

To observe all the provisions of the memorandum and of the articles, as signatory thereof.

Example (Member to the Company)

The articles of association of the Steel Bros & Co Ltd contained clauses to the effect that on the bankruptcy of a member his shares would be sold to a person and at a price fixed by the directors. Borland, a shareholder, was adjudicated bankrupt. His trustee in bankruptcy claimed that he (Borland) was not bound by these provisions and should be at liberty to sell the shares at their true value. But it was held that contracts contained in the articles of association is one of the original incidents of the shares. Shares having been purchased on those terms and conditions, it is impossible to say that those terms and conditions are not to be observed.[24]

Example (Company to the Member)

The articles of the Odessa Waterworks Co provided that "the directors may, with the sanction of the company at general meeting, declare a dividend to be paid to the members". Instead of paying the dividend in cash to the shareholders a resolution was passed to give them debenture bonds. In an action by Mr. Wood, a member to restrain the directors from acting on the resolution, it was held that "The question is whether that which is proposed to be done in the present case is in accordance with the articles of association of the company. Those articles provide that the directors may, with the sanction of a general meeting, declare a dividend to be paid to shareholders. Prima facie that means to be paid in cash. The debenture bonds proposed to be issued are not a payment in cash."[25]

Example (Member to the Member)

Mr. Rayfield was a shareholder in a company. Clause 11 of the articles of company required him to inform the directors of his intention to transfer his shares in the company and which provided that the directors will take the said shares equally between them at a fair value. In accordance with this provision the Mr. Rayfield so

[24] Borland's Trustee v Steel Bros & Co Ltd (1901) 1 Ch 279
[25] Wood v Odessa Waterworks Co (1889) 42Ch D 636

notified the directors (who are members as well), who contended that they were not bound to take and pay for the shares. They said, articles could not impose such obligation upon them in their capacity as directors. Their argument was set aside by the court by treating those directors as members. Accordingly, the directors (being members) were compelled to take the Mr. Rayfield's shares at a fair value.[26]

Students are advised to take Note;

1. Articles bind the members to the company and the company to the members. But neither of them is bound to an outsider to give effect to the articles. **"No Article can constitute a contract between the company and a third person**."

Example - The articles of association of a company, ***La Trinidad*** contained a clause to the effect that Browne should be a director and should not be removable till after 1888. He was, however, removed earlier and had brought an action to restrain the company from excluding him. It was held that there was no contract between Browne and the company. No outsider can enforce articles against the Company even if they purport to give him certain rights.[27]

2. Further sub-section 2 to section 10 provides, all monies payable by any member to the company under the memorandum or articles shall be a debt due from him to the company.

Example - A company can recover calls in arrear from a member as forcefully as it is recovering loan due.

12. ALTERATION OF MEMORANDUM [SECTION 13]

PROCEDURE OF ALTERATION OF MEMORANDUM

Alteration includes the making of additions, omissions and substitutions. Section 13 of the Act along with Rules 29 to 32 of the Companies (Incorporation) Rules, 2014 provides the provisions that deals with the alteration of the memorandum, detailed below;

[26] Rayfield v Hands (1958) 2 WLR 851
[27] Browne v La Trinidad (1887)37 Ch D 1

Alteration by special resolution [Sub-section 1]

Company may alter the provisions of its memorandum with the approval of the members by a special resolution. Further, as per section 13(6) (a) company shall file with the Registrar, such special resolution.

Name change of the company [Sub-section 2 and 3]

As per sub-section 1**,** any change in the name of a company shall be effected only with the approval of the Central Government (power delegated to ROC by Central Government)[28] in writing in Form No. INC-24 along with fee.

However, no such approval shall be necessary where the change in the name of the company 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.

The change of name shall not be allowed to a company which has not filed annual returns or financial statements due for filing with the Registrar or which has failed to pay or repay matured deposits or debentures or interest thereon. Once the necessary documents filled or payment or repayment made then change shall be allowed.

As per clause (b) to sub-section 6 to section 13, the approval from the Central Government, shall be filed with registrar by the company. Practically importance of provision is demeaned as power of central government is already delegated to ROC.

Further, as per **sub-section 2,** 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** in the Form No. INC-25 with the new name and the change in the name shall be complete and effective only on the issue of such a certificate.

Example – Tata Sky Limited changed its Name to Tata Play Limited (CIN U92120MH2001PLC130365).

Industrial Insight

On August 24, 1910, a company was registered in India under the name Imperial Tobacco Company of India Limited. As the Company's ownership progressively

[28] Notification S.O. 1353(E), dated 21st May, 2014

Indianised, the name of the Company was changed to India Tobacco Company Limited in 1970 and then to I.T.C. Limited in 1974. In recognition of the ITC's multi-business portfolio encompassing a wide range of businesses, the full stops in the Company's name were removed effective September 18, 2001. The Company now stands rechristened 'ITC Limited,' where 'ITC' is today no longer an acronym or an initialised form.

Students are advised to that note that:

Even If a company has to rectify its name under section 16, then also, nothing shall prevent such company from subsequently changing its name in accordance with the provisions of section 13.

RECTIFICATION OF NAME OF COMPANY [SECTION 16]

Where Central Government (power of Central Government under this section conferred (delegated) upon **Regional Directors** by section 458 of the Act) [29] is of opinion that name (original or revised/new) of company is **identical** with or **too nearly resembles** to the name by which a company in existence;

a. On its own **or**

b. On an application by a proprietor of already registered trade mark under the Trade Marks Act, 1999

Then it may direct the company to change its name;

The company **shall change** its name or new name, as the case may be, **within a period of three months** from the issue of such direction, after adopting an **ordinary resolution** for the purpose.

Note - Application by a proprietor of registered trade mark shall be made **within three years** of incorporation or registration or change of name of the company

Further, the company, after changing its name or obtains a new name shall give notice of the change to the Registrar along with the order of the Central Government (Regional Directors) within a period of **fifteen days** from the date of such change.

Registrar on receipt of notice shall carry out necessary changes in the certificate of incorporation and the memorandum.

[29] S.O. 4090(E), dated 19th December, 2016

If a company makes default in complying with any directions for rectification;

a. company shall be punishable with fine of ₹ 1,000 for every day during which the default continues **and**

b. every officer who is in default shall be punishable with fine which shall not be less than ₹ 5000 but which may extend to ₹ 1,00,000.

Change in the registered office [Sub-section 4, 5, and 7]

Application [sub-section 4]

The alteration of the memorandum relating to the place of the registered office from **one State to another** shall not have any effect unless it is approved by the Central Government (power delegated to Regional Director by Central Government)[30] on an application in Form No. INC-23 along with the fee and shall be accompanied by the following documents, namely;

a. Copy of Memorandum of Association, with proposed alterations;

b. Copy of the minutes of the general meeting at which the resolution authorising such alteration was passed, giving details of the number of votes cast in favour or against the resolution;

c. Copy of Board Resolution or Power of Attorney or the executed vakalatnama, as the case may be.

d. List of creditors and debenture holders

e. Acknowledgment of service of a copy of the application with complete annexures to the Registrar and Chief Secretary of the State Government or Union territory where the registered office is situated at the time of filing the application.

Advertisement in Newspapers

The Company **not more than thirty days before** the date of filing the above application, shall advertise in the Form No. INC-26 in the vernacular newspaper in the principal vernacular language in the district and in English language in an English newspaper with wide circulation in the state in which the registered office of the company is situated.

[30] Notification S.O. 4090(E), dated 19th December, 2016

Dispose of the application by central government [sub-section 5]

The Central Government (power delegated to Regional Director by Central Government) shall dispose of the application of change of place of the registered office **within a period of 60 days**. Before passing of order, Central Government may satisfy itself that-

a. the alteration has the consent of the creditors, debenture-holders and other persons concerned with the company, or

b. the sufficient provision has been made by the company either for the due discharge of all its debts and obligations, or

c. adequate security has been provided for such discharge.

Filing of the certified copy of the order with the registrar [sub-section 7]

Where an alteration of the memorandum results in the transfer of the registered office of a company from one State to another, a certified copy of the order of the Central Government approving the alteration shall be filed by the company with the Registrar of each of the States in Form No. INC-28 along with the fee **within thirty days** from the date of receipt of certified copy of the order, who shall register the same.

Issue of fresh certificate of incorporation [sub-section 7]

The **Registrar** of the State **where the registered office is being shifted** to, shall issue a fresh certificate of incorporation indicating the alteration.

Change in the object of the company [Sub-section 8 and 9]

Who can make change in object clause & How? [Sub-section 8]

Where the company has **raised money from public** through prospectus and has any **un-utilised amount** out of the money so raised, can change the objects for which the money so raised is to be applied only after passing a **special resolution through postal ballot** and the notice in respect of the resolution for altering the objects shall contain the following particulars, namely;

a. Total money received;

b. Total money utilized for the objects stated in the prospectus;

c. Un-utilized amount out of the money so raised through prospectus,

d. Particulars of the proposed alteration or change in the objects;

e. Justification for the alteration or change in the objects;

f. Amount proposed to be utilised for the new objects;

g. Estimated financial impact of the proposed alteration on the earnings and cash flow of the company;

h. Other relevant information which is necessary for the members to take an informed decision on the proposed resolution;

i. Place from where any interested person may obtain a copy of the notice of resolution to be passed.

Advertisement [Sub-section 8]

The advertisement giving **details of each resolution** to be passed for change in objects, simultaneously to the dispatch of **postal ballot** notices to shareholders; shall be:

a. 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

b. Hosted on the **website** of the company, if any.

Dissenting shareholders to change of object [Sub-section 8]

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.

Registrar to certify the registration on alteration of the objects [sub-section 9]

The Registrar shall register any alteration of the memorandum with respect to the objects of the company and certify the registration **within a period of 30 days** from the date of filing of the special resolution under clause (a) to sub-section 6 of this section.

Sub-section 10 provides that alteration made under this section (section 13) shall have effect only after it has been registered in accordance with provisions of section.

Sub-section 11 states 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. This provision is confirming and extending provision to Section 4(7).

13. ALTERATION OF ARTICLES [SECTION 14]

Section 14 of the Companies Act, 2013, vests companies with power to alter its articles. A company cannot divest itself of these powers[31]. Matters as to which the memorandum is silent can be dealt with by the alteration of article. The law with respect to alteration of articles is as follows:

ALTERATION BY SPECIAL RESOLUTION [SUB-SECTION 1]

A company may alter its articles by a special resolution, subject to the provisions of this Act and the conditions contained in its memorandum. Alteration of articles include alterations having the effect of conversion of a private company into a public company or vice-versa,

Any alteration having the effect of 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 **within sixty days** from the date of passing of special resolution, be filed with Regional Director in e-Form No. RD-1 along with the fee as provided in the Companies (Registration Offices and Fees) Rules, 2014 and shall be accompanied by the following documents, namely;

a. Draft copy of Memorandum of Association and Articles of Association, with proposed alterations;

b. Copy of the minutes of the general meeting at which the special resolution authorising such alteration was passed together with details of votes cast in favour and or against with names of dissenters;

c. Copy of Board resolution or Power of Attorney dated not earlier than thirty days, as the case may be, authorising to file application for such conversion;

d. Declaration by a key managerial personnel regarding the compliance under difference section of the Act and rules made there under;

[31] Andrews vs. Gas Meter Co. (1897) 1 Ch. 161

In case of a private company, where post alteration the articles no longer include the restrictions and limitations which are required to be included in the articles of a private company under this Act, then such company shall cease to be a private company, from the date of such alteration.

FILING OF ALTERATION WITH THE REGISTRAR [SUB-SECTION 2]

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 **fifteen days** in Form No. INC 27 along with fee, who (Registrar) shall register the same.

Sub-section 3 provides that alteration made under sub-section 1 and registered under sub-section 2 subject to provision of this, shall be valid and have effect as if it were originally contained in the Articles.

14. ALTERATION OF MEMORANDUM OR ARTICLES TO BE NOTED IN EVERY COPY [SECTION 15]

Section 15 of the Act requires that every alteration made in memorandum and articles of a company shall be noted in every copy. Be it issued in electronic form or otherwise; because MOA and AOA considered to be public document under section 399.

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 **one thousand rupees for every copy** of the articles issued without such alteration.

15. REGISTERED OFFICE OF COMPANY [SECTION 12]

A company is considered to be a separate legal entity from the members. Once a company gets incorporated, it is required to maintain a registered office. This is a physical office where the corporation will receive service of legal documents from ROC or in case of a lawsuit, etc.

This address cannot be a P.O. Box but must be a physical location where someone is present, to receive service of legal documents during normal business hours. It could be different from a Head Office or Corporate office.

Section 12 of the Companies Act, 2013 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 officer. This is also important for determining the jurisdiction of the court.

REGISTERED OFFICE & VERIFICATION THEREOF [SUB-SECTION 1 & 2]

As per **sub-section 1,** a company shall, **within thirty days** of its incorporation and at all times thereafter, have a registered office capable of receiving and acknowledging all communications and notices as may be addressed to it.

Further, **sub-section 2** requires the company shall furnish to the Registrar **verification** of its registered office **within a period of thirty days** of its incorporation.

With the respected specified IFSC public & IFSC private companies, they shall have its registered office at the IFSC located in the approved multiservice SEZ set up under the SEZ Act, 2005 read with SEZ Rules, 2006.[32]

In case of specified IFSC public & IFSC private company word "thirty days" will be read as "sixty days".[33]

LABELING OF COMPANY [SUB-SECTION 3]

Every company shall;

a. **Paint or affix** its **name**, and the **address** of its **registered office**, and keep the same painted or affixed, on the 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.

b. Have its name engraved in legible characters on its seal, if any;

c. 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

d. Have its name printed on hundies, promissory notes, bills of exchange and such other documents as may be prescribed:

[32] G.S.R. 08 (E) dated 4th January, 2017
[33] *ibid*

Note:

Where a company has **changed its name(s) during the last two years**, it shall paint or affix or print, both or all such names in case of point **a** as well as **c** above.

In case of One person company, the words ''One Person Company'' shall be mentioned in brackets below the name of such company, wherever its name is printed, affixed or engraved.

NOTICE OF CHANGE & VERIFICATION TO REGISTRAR [SUB-SECTION 4]

Notice of every change of the situation of the registered office after the date of incorporation of the company, verified in the Form No. INC-22, along with fee as prescribed shall be given to the Registrar within 30 days of the change, who shall record the same.

In case of specified IFSC public & IFSC private company word "thirty days" will be read as "sixty days".[34]

APPROVAL/CONFIRMATION OF CHANGE [SUB-SETION 5]

Change by passing of special resolution

The registered office of the company shall be changed only by passing of special resolution by a company, outside the local limits of any city, town or village where such office is situated or where it may be situated later by virtue of a special resolution passed by the company.

Change of registered office outside the jurisdiction of registrar

Where a company changes the place of its registered office from the jurisdiction of one Registrar to the jurisdiction of another Registrar within the same State, there such change is to be confirmed by the Regional Director on an application made by the company. Application shall be made in Form No. INC-23 along with fee.

In case of specified IFSC public & IFSC private company Board resolution will sufficient, provided that such Company shall not change the place of its registered office to any other place outside the said International Financial Services Centre.[35]

[34] G.S.R. 08 (E) dated 4th January, 2017
[35] G.S.R. 08 (E) dated 4th January, 2017

COMMUNICATION AND FILING OF CONFIRMATION [SUB-SECTION 6]

The confirmation of change of registered office from jurisdiction of one registrar to another registrar within the same state, shall be:

a. **Communicated within 30 days** from the date of receipt of application **by the Regional Director** to the company, and

b. The **company shall file** the confirmation with the Registrar **within a period of 60 days** of the date of confirmation who shall register the same, and

c. Certify the registration **within a period of thirty days** from the date of filing of such confirmation.

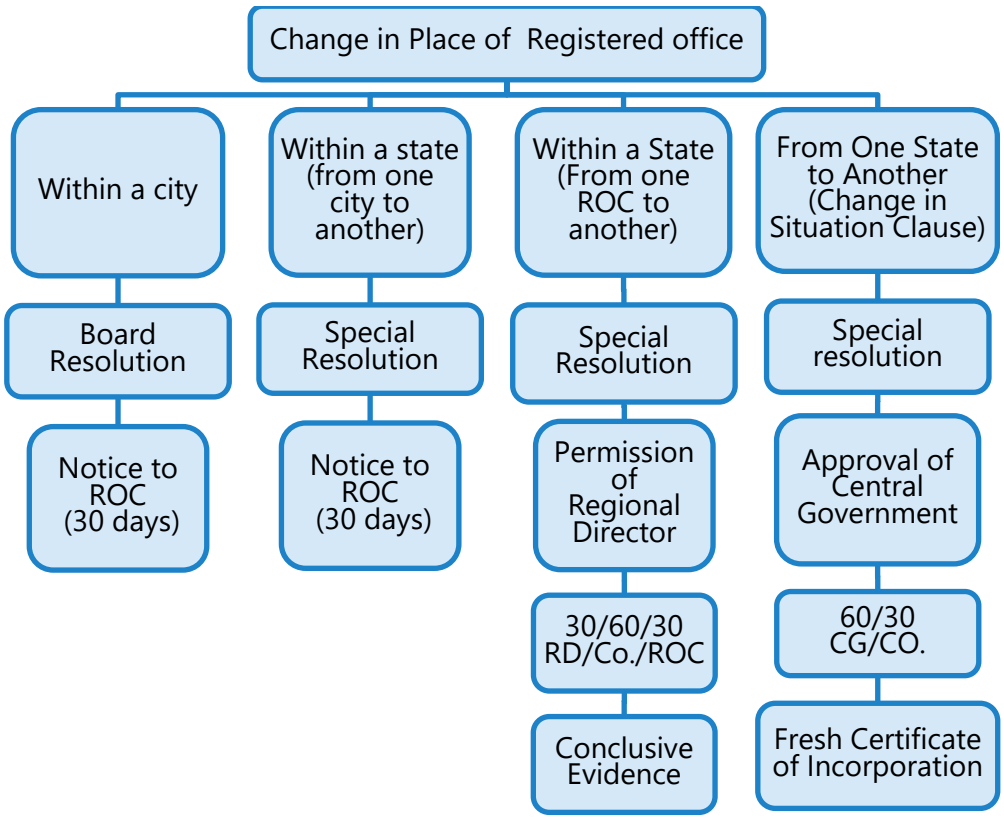
The certificate so issued by registrar shall be conclusive evidence that all the requirements of this Act with respect to change of registered office have been complied with and the change shall take effect from the date of the certificate.

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 in such manner as may be prescribed 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 contained in this section regarding the penalties, initiate action for the removal of the name of the company from the register of companies under Chapter XVIII.

PENALTIES IN CASE OF DEFAULTS [SUB-SECTION 8]

If any default is made in complying with the requirements of this section, the company **and** every officer who is in default shall be liable to a penalty of **one thousand rupees for every day** during which the default continues **but not exceeding one lakh rupees**.

Summary of Provisions applicable in case of change of place of registered office



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

CONDITIONS FOR COMMENCEMENT OF BUSINESS

A company incorporated

a. After the commencement of the Companies (Amendment) Ordinance, 2019 **and**

b. Having a share capital

Shall commence any business or exercise any borrowing powers only if;

a. The company has filed with the Registrar a **verification of its registered office** as provided in sub-section (2) of section 12, **and**

b. A declaration is filed with the Registrar, by a director, within a period of **180 days** of the date of incorporation of the company, in Form No. INC-20A, duly verified by a Company Secretary or a Chartered Accountant or a Cost Accountant, in practice, along with prescribed fee; 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

Note:

1. Section 12(2) i.e. Verification of registered office with registrar, discussed earlier heading i.e. 15 in this chapter.

2. In the case of a company pursuing objects requiring registration or approval from any sectoral regulators such as the Reserve Bank of India, Securities and Exchange Board of India, etc., the registration or approval, as the case may be from such regulator shall also be obtained and attached with the declaration.

OUTCOME WHERE CONDITIONS ARE NOT SATISFIED

Penalty

If any default is made in complying with the requirements of this section, the penalty shall be:

Liable	Quantum of penalty
Company	Fifty thousand rupee
Every officer who is in default	One thousand rupees for each day during which such default continues but not exceeding an amount of one lakh rupees.

Declaration not filled by director within 180 days

Where no declaration has been filed by directors within a period of 180 days of the date of incorporation with the Registrar **and** the Registrar has reasonable cause to believe that the company is not carrying on any business or operations, he may initiate action for the removal of the name of the company from the register of companies under Chapter XVIII.

Note: Action by registrar for removal of name can be take place simultaneously with levy of penalty.

Example – Modern Furniture incorporated on 27th June 2022, its directors filled a declaration regarding receipt of payment i.e. value of share (against share subscribed by subscriber) to registrar on 30th January 2023. The company shall be charged with penalty of ₹ 50,000, while penalty of its officers (officers who are in default) shall be ₹ 34000 (for 34 days i.e. 4 days of December 2022 and 30 days of January 2023).

17. CONVERSION OF COMPANIES ALREADY REGISTERED [SECTION 18]

Section 18 of the Act, empower a company to convert itself into some other class of company by altering its memorandum and articles of association.

Following is the law with respect to the conversion of the companies already registered.

BY ALTERATION OF MEMORANDUM AND ARTICLES

A company of any class registered under this Act may convert itself as a company of other class under this Act by alteration of memorandum and articles of the company in accordance with the provisions of this Chapter.

FILE AN APPLICATION TO THE REGISTRAR

Wherever conversion to be done under section 18, **Registrar** on **basis of an application** filled with it by company, shall after **satisfying himself** that the provisions applicable for registration of companies have been complied with,

a. Close the former registration of the company; and

b. After registering the required documents, issue a certificate of incorporation in the same manner as its first registration.

Students may also refer to: Rule 6, 7, 7A, and 20 to 22 of the Companies (Incorporation) Rules, 2014 and 37 and 38 of the Companies (Incorporation) Rules, 2016 & Form Nos. INC-5 & INC-6 under the Companies (Incorporation) Rules, 2014 and INC-27 under the Companies (Incorporation) Rules, 2016.

NO EFFECT ON THE DEBTS, LIABILITIES ETC. INCURRED BEFORE CONVERSION

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.

To put in more simple way, the company remains the same entity as it was before in respect of its debts and liabilities, obligations or contracts.

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

As per section 19 of the Act, a subsidiary company is not allowed to hold shares of its holding company. The prohibition also extends up to the nominees of the subsidiary company.

Consequently, any allotment or transfer of shares in a holding company to its subsidiary shall be void. If the holding company is a guarantee or unlimited company, not having a share capital the above restriction will apply on holding the interest, whatever be the form of interest.

The prohibition does not apply to the following cases:

a. Where the subsidiary is concerned as a **legal representative** of a deceased member of the holding company; or

b. Where the subsidiary 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:

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**

b. The prohibition does not apply to the case of a subsidiary company which already had shares in its holding company at the commencement of the Act

c. A subsidiary can buy shares in its holding company where it is a part of a scheme of amalgamation sanctioned by the court/tribunal.[36]

[36] Himachal Telematics Ltd v Himachal Futuristic Communications Ltd, (1996) 37 DRJ 476

Example - RPIP Ltd. has invested 51% in the shares of SSP Pvt. Ltd. on 31st March 2019. SSP Pvt. Ltd. have been holding 2% equity of RPIP Ltd. since 2013. SSP Pvt. Ltd. cannot increase its equity beyond that 2% on or after 31st March 2019. However, it could continue to hold or reduce its initial 2% stake.

19. SERVICE OF DOCUMENTS [SECTION 20]

Section 20 of the Companies Act, 2013 read with Rule 35 (Service of Documents) of *Companies (Incorporation) Rules,* 2014, provides the mode in which documents may be served on the company, on the members and also on the registrars. Law with respect to the service of documents is as follows-

SERVING OF DOCUMENT TO COMPANY OR AN OFFICER THEREOF

A document may be served on a company **or** an officer thereof by sending it to the company **or** the officer at the registered office of the company by-

a. registered post, or
b. speed post, or
c. courier service, or
d. leaving it at its registered office, or
e. means of such electronic or other mode as may be prescribed

However, where securities are held with a depository, the records of the beneficial ownership may be served by such depository on the company by means of electronic or other mode.

SERVING OF DOCUMENT TO REGISTRAR OR MEMBERS

Save as provided in this Act or the rules made thereunder 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 post, or
c. speed post, or
d. courier, or
e. by delivering at his office or address, or
f. by such electronic or other mode as may be prescribed.

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 annual general meeting.

For the purposes of this section, the term "courier" means a person or agency which delivers the document and provides proof of its delivery.

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

- Facsimile telecommunication **(fax)** or electronic mail **(email),** which the company or the officer has provided from time to time for sending communications,
- 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
- 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 purporting to send the transmission.

Further sub-section 2 provides, in case of delivery by post, such service shall be deemed to have been effected:

a. In the case of a notice of a meeting, at the **expiration of 48 hours** after the letter containing the same is posted; **and**

b. In any other case, at the time at which the letter would be delivered in the **ordinary course of post**.

Section 20 (2) shall apply to a Nidhi Company, subject to the modification; that

a. 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; whichever is less.

b. 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.

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).

20. AUTHENTICATION OF DOCUMENTS, PROCEEDINGS AND CONTRACTS [SECTION 21]

As per section 21 of the Act:

a. A document or proceeding requiring authentication by a company **or**

b. Contracts made by or on behalf of a company

May be signed by:

a. Any key managerial personnel[37], **or**

b. An officer or employee of the company duly authorized by the Board in this behalf.

In the case of specified IFSC public company and IFSC private company, for the word "An officer" read as "An officer or any other person".[38]

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

Sub-section 1 provides, 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 made, accepted, drawn, or endorsed **in the name** of, or **on behalf** of or **on account** of, the company **by any person acting under its authority**. Authority can be either express or implied.

[37] Who all are included in key managerial person under section 2 (51) already discussed in chapter 1 of this module

[38] G.S.R. 08 (E) dated 4th January, 2017

Formal deeds can be executed only through a power of attorney. Therefore sub-section 2 and 3 together provides;

a. A company may, by writing under

- Its common seal, if any,
- Where in case a company does not have a common seal, then authorized by 2 directors or by a director and the Company Secretary, wherever the company has appointed a Company Secretary.

b. Authorize any person,

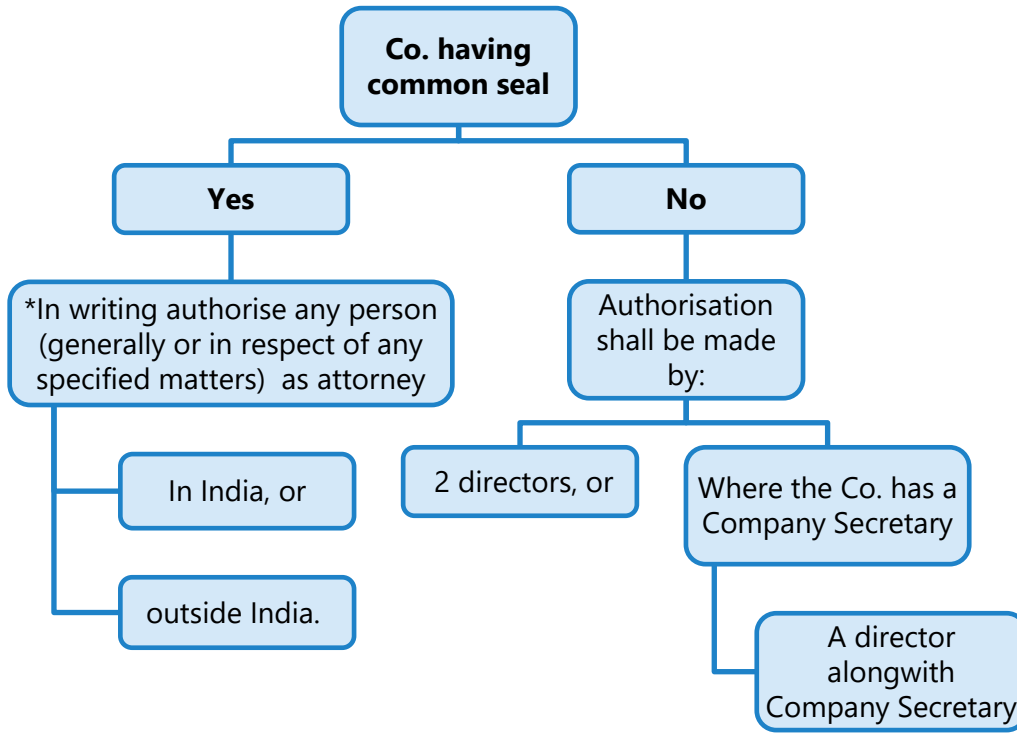
c. Either generally or in respect of any specified matters,

d. As its attorney to execute other deeds on its behalf

e. In any place either in or outside India.

f. Deed signed by such an attorney on behalf of the company and under his seal shall bind the company.

Summary of sub-section 2



Note: It can be observed from above that a company may or may not have a common seal. If company decides to have a common seal then it has to affix the same for specified matters, execution of deeds on behalf of the company.

The seal is a method of making a physical impression upon the documents of the company, of its name, etc.

Section 22 comes into play when a person wants to enforce obligations against a company arising out of a contract and the company denies the contract or disputes its liability. The section cannot be used where the proceeding is by the company.

SUMMARY

- Once an association becomes incorporated it acquires a legal status, it becomes a legal entity in its own right, separate from the individual members. It will have perpetual succession i.e. not affected by the death, insanity, or insolvency of an individual member.
- 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.
- CIN is a 21 alpha-numeric digit based unique identification number, comprising data sections/elements that reveals the basis aspects about company
- The memorandum of association (MOA) is the document that sets up the company and the articles of association (AOA) set out how the company is run, governed and owned. These documents can be altered.
- As per Doctrine of Ultra Vires, acts outside the powers conferred under MOA are ultra-vires. Such acts and resulting agreements are void.
- Doctrine of Constructive Notice put onus on those who delas with company to be aware of what is stated in MOA and AOA, while Doctrine of Indoor Management protects outsider as an exception to earlier specified doctrine.
- A company of any class may convert itself as a company of other class by alteration of its MOA and AOA.
- Certain relaxations are provided in case of specified IFSC companies working in or from International Financial Services Centre, regarding provisions contained in chapter II of the Act.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. *Entrenchment enhance the protection. Modern Furniture Limited, an existing private company willing to insert the provisions for entrenchment; it*

   (a) Can amend the article by passing an ordinary resolution

   (b) Can amend the article by passing a special resolution

   (c) Can amend the article agreed by all the members

   (d) Can't amend article to made the provisions for entrenchment

2. *Today, it's May 2023. Mr. Nilanjan Chattopadhyay a 24 years old Indian youngster, who returned back to India in January month of 2023 after completing his education in bio-nutrient and willing to form an OPC; but not sure about the requirements or pre-conditions regarding eligibility. He read some articles on provisions related to OPC and concluded;*

   (i) OPC can be formed by Indian Citizen only

   (ii) He can't form OPC because in immediate previous year he was not resident in India

   (a) Both the conclusions are valid

   (b) None of the conclusion is valid

   (c) First conclusion is invalid

   (d) Second conclusion is invalid

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

   (a) 90 days

   (b) 60 days

   (c) 30 days

   (d) 20 days

4. *Modern Furniture incorporated on 30th June 2022, its directors filled a declaration under section 10A (1)(a) regarding receipt of payment i.e. value of share (against share subscribed by subscriber) to registrar on 18th April 2023. The company and its officers (officers who are in default) shall be charged with penalty of:*

   (a) ₹ 1,11,000 and ₹ 1,11,000 respectively

   (b) ₹ 50,000 and ₹ 1,11,000 respectively

   (c) ₹ 1,11,000 and ₹ 50,000 respectively

   (d) ₹ 50,000 and ₹ 1,00,000 respectively

5. *I.T.C limited changed its name to ITC limited. Company and officers thereat made default by failing to make alteration in every issued copy of memorandums and articles. In this context you are required to pick incorrect statements out of followings*

   (i) Alternation shall be made to every copy of MOA/AOA because these are considered as public document.

   (ii) Alternation shall be made to every copy be it in electronic form or otherwise.

   (iii) Penalty shall be rupees one thousand for every copy of the articles issued without such alteration.

   (a) (ii) only

   (b) (iii) only

   (c) (ii) and (iii) only

   (d) None of (i), (ii) and (iii)

Descriptive Questions

1. *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.*

2. *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.

3. *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 2020, 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?*

4. *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.*

5. *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.

6. *The object clause of the Memorandum of Vivek Industries Limited., 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?*

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

8. *Manglu and friends got registered a company in the name of Taxmann advisory private limited. Taxmann is a registered trademark. After 5 years when the owner of trademark 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 trademark? Can the owner of registered trademark request the company and then company changes its name at its discretion?*

9. *Explain in the light of the provisions of the Companies Act, 2013, the circumstances under which a subsidiary company can become a member of its holding company.*

10. *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?*

11. *Explain the provisions of the Companies Act, 2013 relating to the 'Service of Documents' on a company and the members of the company.*

12. *Ashok, a director of Gama Electricals Ltd. gave in writing to the company that the notice for any general meeting and of the Board of Directors' meeting be sent to him only by registered post at his residential address at Kanpur for which he deposited sufficient money. The company sent notice to him by ordinary mail under certificate of posting. Ashok did not receive this notice and could not attend the meeting and contended that the notice was improper.*

Decide:

(i) Whether the contention of Ashok is valid.

(ii) Will your answer be the same if Ashok remains in U.S.A. for one month during the notice of the meeting and the meeting held?

13. *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?*

ANSWERS

Answer to MCQ based Questions

1.	**(c)**	Can amend the article agreed by all the members
2.	**(d)**	Second conclusion is invalid
3.	**(b)**	60 days
4.	**(d)**	₹ 50,000 and ₹ 1,00,000 respectively
5.	**(d)**	None of (i), (ii) and (iii)

Answer to Descriptive Questions

1. 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.

2. According to section 8(1) of the Companies Act, 2013, 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, if any, or other income in promoting its objects; and

(c) intends to prohibit the payment of any dividend to its members;

the Central Government may, by issue of licence, allow that person or association of persons to be registered as a limited liability company.

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 ten 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.

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

license is issued by the Central Government to them. Since, Alfa School was a Section 8 company and it had started violating the objects of its objective clause, hence in such a situation the following powers can be exercised by the Central Government:

(i) The Central Government may by order revoke the licence of the company where the company contravenes any of the requirements or the conditions of this sections subject to which a licence is issued or where the affairs of the company are conducted fraudulently, or violative of the objects of the company or prejudicial to public interest, and on revocation the Registrar shall put 'Limited' or 'Private Limited' against the company's name in the register. But before such revocation, the Central Government must give it a written notice of its intention to revoke the licence and opportunity to be heard in the matter.

(ii) Where a licence is revoked, the Central Government may, by order, if it is satisfied that it is essential in the public interest, direct that the company be wound up under this Act or amalgamated with another company registered under this section. However, no such order shall be made unless the company is given a reasonable opportunity of being heard.

(iii) Where a licence is revoked and where the Central Government is satisfied that it is essential in the public interest that the company registered under this section should be amalgamated with another company registered under this section and having similar objects, then, notwithstanding anything to the contrary contained in this Act, the Central Government may, by order, provide for such amalgamation to form a single company with such constitution, properties, powers, rights, interest, authorities and privileges and with such liabilities, duties and obligations as may be specified in the order.

4. 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.

5. According to section 13 of the Companies Act, 2013 a company, which has raised money from public through prospectus and still has any unutilised 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.

6. Alteration of Objects Clause of Memorandum

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 Limited can make the required changes in the object clause of its Memorandum of Association.

7. Doctrine of Indoor Management

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

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

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

The doctrine of indoor management is opposite to the doctrine of constructive notice. Whereas the doctrine of constructive notice protects a company against outsiders, the doctrine of indoor management protects outsiders against the actions of a company.

This doctrine also is a safeguard against the possibility of abusing the doctrine of constructive notice.

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

(i) **Knowledge of irregularity**: In case an 'outsider' has actual knowledge of irregularity within the company, the benefit under the rule of indoor management would no longer be available. In fact, he/she may well be considered part of the irregularity.

(ii) **Negligence:** If with a minimum of effort, the irregularities within a company could be discovered, the benefit of the rule of indoor management would not apply.

The protection of the rule is also not available where the circumstances surrounding the contract are so suspicious as to invite inquiry, and the outsider dealing with the company does not make proper inquiry.

(iii) **Forgery:** The rule does not apply where a person relies upon a document that turns out to be forged since nothing can validate forgery. A company can never be held bound for forgeries committed by its officers.

8. According to section 16 of the Companies Act, 2013 if a company is registered by a name which,—

- in the opinion of the Central Government, is identical with the name by which a company had been previously registered, it may direct the company to change its name. Then the company shall by passing an ordinary resolution change its name within 3 months.
- is identical with a registered trade mark and owner of that trade mark apply to the Central Government within three years of incorporation of registration of the company, it may direct the company to change its name. Then the company shall change its name by passing an ordinary resolution within 6 months.

Company shall give notice to ROC along with the order of Central Government within 15 days of change. In case of default company and defaulting officer are punishable.

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 trademark 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.

9. In accordance with the provisions of Section 19 of the Companies Act, 2013, a subsidiary company cannot 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 subsidiary companies. Any such allotment or transfer of shares in a company to its subsidiary is void. The section however does not apply where:

(1) the subsidiary company holds shares in its holding company as the legal representative of a deceased member of the holding company,

(2) the subsidiary company holds such shares as a trustee, or

(3) the subsidiary company was a shareholder in the holding company even before it became its subsidiary.

10. According to section 19 of the Companies Act, 2013 a company shall not hold any shares in its holding company either by itself or through its nominees. Also, holding company shall not 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.

Following are the exceptions to the above rule;

(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, but in this case, it will not have a right to vote in the meeting of holding company.

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.

11. Under section 20 of the Companies Act, 2013 a document may be served on a company or an officer thereof by sending it to the company or the officer at the registered office of the company by registered post or by speed post or by courier service or by leaving it at its registered office or by means of

such electronic or other mode as may be prescribed. However, in case where securities are held with a depository, the records of the beneficial ownership may be served by such depository on the company by means of electronic or other mode.

Under section 20 (2), save as provided in the Act or the rule thereunder 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 post or by registered post or by speed post or by courier or by delivering at his office or address, or by such electronic or other mode as may be prescribed. 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 annual general meeting.

12. According to section 20(2) of the Companies Act, 2013, a document may be served on Registrar or any member by sending it to him by post or by registered post or by speed post or by courier or by delivering at his office or address, or by such electronic or other mode as may be prescribed.

Provided that 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 annual general meeting.

Thus, if a member wants the notice to be served on him only by registered post at his residential address at Kanpur for which he has deposited sufficient money, the notice must be served accordingly, otherwise service will not be deemed to have been effected.

Accordingly, the questions as asked may be answered as under:

(i) The contention of Ashok shall be tenable, for the reason that the notice was not properly served.

(ii) In the given circumstances, the company is bound to serve a valid notice to Ashok by registered post at his residential address at Kanpur and not outside India.

13. As per section 22 of the Companies Act, 2013 a company may authorise any person as its attorney to execute deeds on its behalf in any place either in or outside India. But common seal should be affixed on his authority letter or the authority letter should be signed by two directors of the company or it

should be signed by one director and secretary. This authority may be either general for any deeds or it may be for any specific deed.

A deed signed by such an attorney on behalf of the company and under his seal shall bind the company as if it were made under its common seal.

In the present case company has not neither given any written authority not 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.

NOTES

CHAPTER 3

PROSPECTUS AND ALLOTMENT OF SECURITIES

LEARNING OUTCOMES

At the end of this chapter, you will be able to:

- Define prospectus
- Understand various types of prospectus
- Explain the procedure for issue of prospectus and other related concepts
- Know about the criminal and civil liability for mis- statements in prospectus and punishment for fraudulently inducing persons to invest money
- Understand the procedure for allotment of securities by companies
- Know the procedure of private placement of securities

CHAPTER OVERVIEW

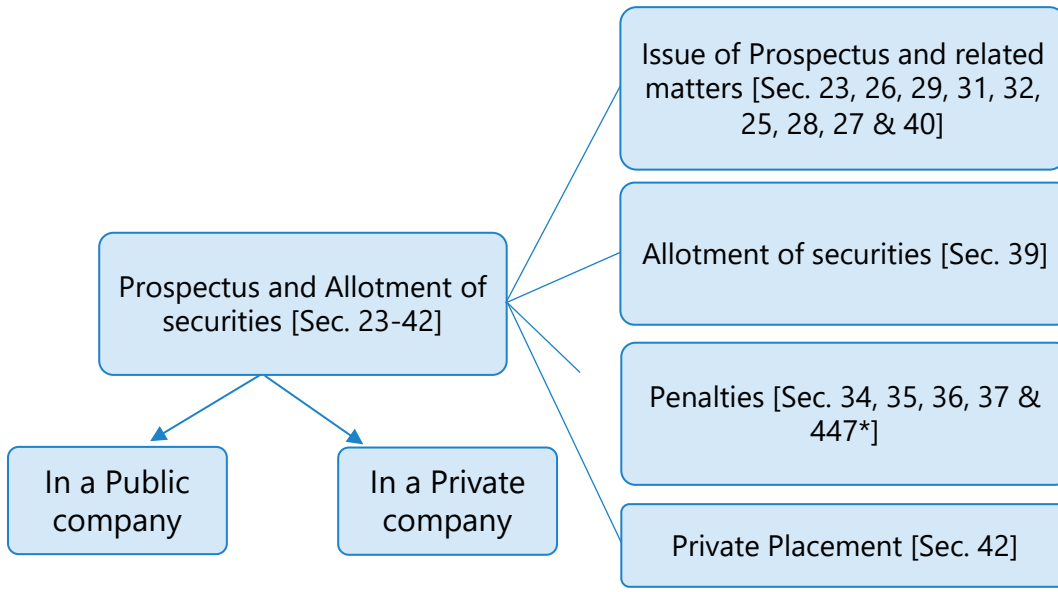
This chapter explains the provisions of Chapter III of the Companies Act, 2013[1] (hereinafter also referred to as "the Act" or "this Act"), consisting of Sections 23 to 42 dealing with the prospectus and allotment of securities. Due to the inherent differences between the nature of public and private companies in addition to restrictions on the later, Chapter III of the Act contained the provisions for issue of securities under two distinct headings (parts):

Part I - Public offer (Section 23-41);

Part II - Private placement (Section 42).

The provisions contained in Part I and part II are supplemented by the Companies (Prospectus and Allotment of Securities) Rules, 2014.

Following diagram depicts the arrangement of relevant sections:



* Section 447 contains provisions relating to 'punishment for fraud'.

[1] Act 18 of 2013

1. INTRODUCTION

Chapter III	**Consists of sections 23 to 42 as well as the Companies (Prospectus and Allotment of Securities) Rules, 2014.**

One of the advantages that a company has over other forms of business is its ability to raise capital, either from the public at large or from a set of identified persons. When the capital is raised from the public at large, it is done through a **'Public Offer'** and when it is raised from a selected group of identified persons it is carried out through a **'Private Placement'** of securities. Where the capital is raised from the public at large through 'Public Offer', an advertisement shall be issued in accordance with applicable provisions to protect the prospective investors from fraud. Securities are allotted against those applications that are received in full and in accordance with the advertisement issued. Such securities may be listed on an appropriate segment of a recognised stock exchange.

This chapter will explain the provisions relating to raising of capital i.e. issue of prospectus, allotment of securities, and other matters incidental thereto.

2. 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**") by complying with the provisions specified in Section 23 to Section 41 of the Act; or

b. Through private placement by complying with the provisions specified in section 42 of the Act; or

c. Through a rights issue or a bonus issue in accordance with the provisions of the Act and in case of a listed company or a company which intends to get its securities listed also with the provisions of the Securities and Exchange Board of India Act, 1992[2] and the rules and regulations made thereunder.

[2] Act 15 of 1992

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.

Students are advised to note; that Further Public Offer also known as Fellow-on Public Offer, whereas OFS is sometimes called deemed Public Offer.

As per **Section 23(2),** a **private company** *may* issue *securities*;

a. By way of rights issue or bonus issue in accordance with the provisions of the Act; or

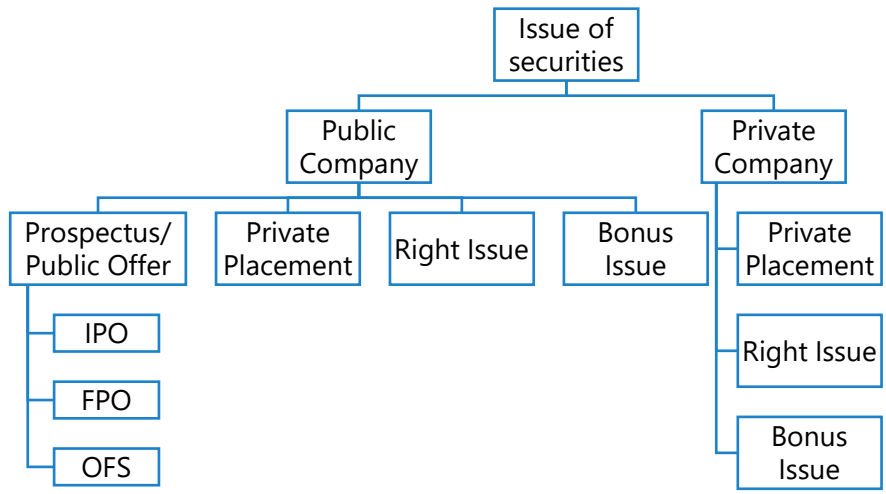
b. Through private placement by complying with the provisions specified in section 42 of the Act.

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

*For a listed company or a company proposed to be listed.

Various modes of issue of securities available to a public company or a private company are depicted in the following diagram for better understanding;



Security is a wider term, not restricted to equity, preference, or debenture.

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[3]. The definition given thereunder provides, "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[4].

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

Explanation **-** For the removal of doubts, it is hereby declared that "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[5].

(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.

[3] Act 42 of 1956
[4] Act 54 of 2002
[5] Act 4 of 1938

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, 2020**[6] (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.

Note: How overseas direct listing is different from ADRs/GRDs?

In a direct listing, a domestic company can enlist itself with the stock exchanges of other countries without an intermediary. Unlike American Depositary Receipts (ADRs) and Global Depositary Receipts (GDRs), the Indian company can directly offer their shares in foreign markets instead of giving them to a foreign depository bank. Direct listing excludes intermediaries, decreases the overall transaction cost, and increases transparency.

Section 23(4) of the Act empowers the Central Government to **exempt any class or classes of public companies** 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.

Illustration (MCQ)

Which of following shall be considered as securities for purpose of section 23 of the Act;

(i) Unit linked insurance policy

[6] Act 29 of 2020

(ii) Actionable claim regarding mortgaged debt

(iii) Securities issued by National Asset Reconstruction Ltd

Options

(a) (iii) only

(b) Both (i) and (iii) only

(c) Both (ii) and (iii) only

(d) None of the (i), (ii), and (iii)

Answer – (c) (Refer section 2(h) of the Securities Contracts (Regulation) Act, 1956[7])

3. 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.

Additional Reading

Being capital market regulator, the power is conferred upon Securities and Exchange Board of India under section 11, 11A, 11B and 11D of the Securities and Exchange Board of India Act 1992[8]

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)

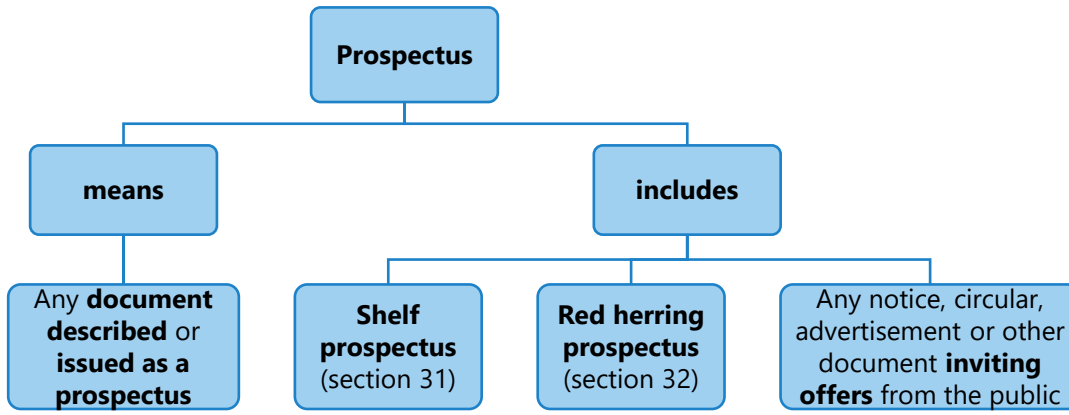
[7] Act 42 of 1956
[8] Act 15 of 1992

4. PROSPECTUS

Meaning

As per the definition given in Section 2 (70) of the Act, **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.

The definition of prospectus has two limbs (*means* part and *includes* part) with four elements in totality, these four constituents can be appreciated though diagram presented below:



Out of four constituents of prospectus definition, first three are quite clear; but the fourth one i.e. **document inviting offer from the public** (considered as **deemed prospectus** or **prospectus by implication**) need to be decoded further that too in context to section 25 and landmark judicial pronouncements (elaborated later).

Other elements are also explained/elaborated at relevant place in this chapter.

DEEMED PROSPECTUS [SECTION 25] - THE DOCUMENTS CONTAINING OFFER OF SECURITIES FOR SALE

Deemed Prospectus

Sub-section 1 provides, where a company allots or agrees to allot any of its securities with a ***view*** that those securities (all or any part thereof) being **offered**

for sale to the public, any document by which the offer is made; shall **deemed to be a prospectus** (issued by the company) for all purposes.

All the enactments and rules of law containing provisions pertaining to prospectus, matters to be stated, liability for misstatement shall apply to such deemed prospectus; subject to section 25(3) and 25(4).

The purpose of deeming provision is to protect gullible investors from various fraudulent practices.

Presumption of *view* (intent to offer securities for sale to public) under sub-section 1

As per **sub-section 2,** the allotment is **presumed** to have been made with a ***view*** of **offering them to the public** where **either** of following conditions fulfilled;

a. Securities are offered to the public **within six months of allotment**, or

b. Where the **full consideration has not been received** by the company at the date of offer to the public.

It means, in case if any of above two conditions met; then issuing document shall deemed to be Prospectus under sub-section 1.

Sub-section 1 and 2 to section 25 are not exhaustive in nature, there may be certain other situations when issuing document may construe as deemed prospectus.

SEBI v Kunnamkulam Paper Mills Ltd[9]

Where a rights issue is made to existing members with a right to renounce in favour of others, if the number of such others exceeds fifty, it also becomes a deemed prospectus.

Requirements in case of Deemed Prospectus

Matters to be stated additionally

As per **Sub-section 3,** following **matters need to be stated** (in the deemed prospectus i.e. the document through which offer of securities to public is made under sub-section 1) **in addition to those required under section 26**;

a. A statement of the **net amount received** or **to be received** as consideration for the securities to which the offer relates.

[9] (2013)178 Comp Cas 371 (Ker)

b. The **time** and **place** at which the underlying contract for allotment may be inspected.

c. The **persons making the offer** were named in the prospectus **as directors** of the company.

Signing of deemed prospectus (on behalf of company)

Further, as per **Sub-section 4,** it is sufficient, if the document (**deemed prospectus** i.e. through which offer of securities to public is made under sub-section 1) on behalf of the company is signed by its two directors.

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.]

Additional Reading – For better understanding only

Since the provisions of the Act relating to prospectus and the penal provisions are attracted only when the prospectus (including deemed prospectus) has been **issued.** "Issued" means issued to the **public.**

Hence In context of 'Invitation to Public' 'Inviting offer from the Public' or 'Offer of securities for sale to Public' two valid questions arise here:

1. What constitute as 'Public'? Does only 'Public at large' constitute as Public?

The term public is not restricted to the public at large. It includes any section of the public, it is immaterial howsoever such section is selected.

Public connotes persons not personally known to the promoter as distinguished from his own friends, relatives, connections and acquaintances.

Re, South of England Natural Gas and Petroleum Co. Ltd[10]

Facts – 3000 copies of a document which was offered for subscription of shares in a company and which was headed "For Private Circulation only," circulated to the members of certain number of gas companies only.

Legal Question – Was this a prospectus? Should it contain the particulars required by the Act?

[10] (1911) 1 Ch. 573 | 104 LT 378

Decision – It was decided that though the offer was only to limited class, it was not less than an offer to the public in any sense, because **those persons from limited class were nonetheless the public**. Hence, the distribution of a document entitled, "For Private Circulation only" offering the company shares was an offer to the public and their document was a prospectus. Therefore, it must contain the particulars required by the Act.

2. Whether a single private communication tantamount to issue; can it be construe to a prospectus to attract the provisions of the Act?

The term "issue" is **not satisfied by a single private communication**. There must be some measure of publicity, however modest. A **private communication** is not thus open and **does not construe to be a prospectus**, hence not attracting the provisions of the Act.

Nash Vs Lynde[11]

Facts – Nash applied for certain shares in a company on the basis of a document sent to him by Lynde, the managing director of the company. The document was marked 'strictly private and confidential'. The document did not contain all the material facts required by the Act to be disclosed. Nash filed a suit for compensation for loss suffered by him by reason of the Omissions.

Decision – Suit was dismissed.

Viscount Summer's landmark dictum in this case is worth to consider here as basis of above answer. "The public in the definition is of course a general word, no particular number are prescribed. Anything from two to infinity may serve, perhaps even one if he is intended to be the first of a series of subscribers but made further proceedings needless by himself subscribing the whole. The point is that the offer is such as to be opened to anyone who brings his money and applies in due from, whether the prospectus was addressed to him on behalf of the company or not. A private communication is not thus open and does not construe to be a prospectus."

Illustration (Q&A)

Company's prospectus was given to a solicitor of the company and he forwarded it to one of his clients despite it was marked strictly private, who applied for share

[11] (1929) AC 158 | 140 LT 146 (HL)

based upon same. Later filed suit for damages. Will this communication amount to an issue to the public and whether the provisions of the Act are attracted?

Answer - No, this did not amount to an issue to the public and accordingly the provisions of the Act relating to liability for omissions, etc. not attracted here. (Refer **Nash Vs Lynde**[12])

MATTERS TO BE STATED IN PROSPECTUS [SECTION 26] – CONTENTS & REQUIREMENTS AS TO PROSPECTUS

Requirements as regards to date, sign, and contents to be included [Sub-section 1]

Prospectus 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 of India** (SEBI) in consultation with the Central Government.

Proviso to sub-section 1 says the regulations made by SEBI in respect of such financial information or reports on financial information shall apply until the SEBI specifies the information and reports on financial information u/s 26(1).

A declaration shall be made **affirming the compliance** of the provisions of this Act (the Companies Act 2013[13])

A statement shall also include to the effect that **nothing** in the prospectus **is contrary** to the provisions of;

a. The Companies Act, 2013[14]

b. Securities Contract (Regulation) Act, 1956[15]

c. Securities and Exchange Board of India Act, 1992[16]

d. Rules and Regulations made under above three statutes.

The provisions of Section 26(1) shall not apply [Sub-section 2]

a. If prospectus issued to **existing** members or debenture-holders of a company;

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[12] (1929) AC 158 | 140 LT 146 (HL)
[13] Act 18 of 2013
[14] ibid
[15] Act 42 of 1956
[16] Act 15 of 1992

b. If prospectus issued relating to shares or debentures which are in all respects **uniform** with shares or debentures previously issued and for the time being dealt in or quoted on a recognised stock exchange.

Date of publication of prospectus [Explanation to Sub-section 3]

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

Filing of signed copy with Registrar [Sub-section 4]

A prospectus shall not be issued unless a **signed copy** of such prospectus has been **delivered to the Registrar for filing**.

Such copy shall be signed by **every** person who is named as either director or proposed director in such prospectus. Duly authorised attorney can sign in representative capacity.

Example – Ms. Sarika, executive director of leading Fintech Company has to fly to Davos to attend World Economic Forum meet.

While company secretary of the company intended to file a copy of prospectus with registrar upcoming, Ms. Sarika authorised in writing, Mr. Gautam for signing of such copy on her behalf.

Date of filing copy of prospectus with registrar is important in context of concept of **validity of prospectus for issue,** discussed under section 26(8)

Conditions in regard to Experts' statement [Sub-section 5]

A prospectus issued under section 26(1) **shall not** include a statement purporting to be made by an **expert**, if any of following condition met;

a. If he is engaged or interested in the formation or promotion or management of the company, **or**

b. If the expert has not given written consent to the issue of the prospectus, **or**

c. If he has withdrawn the consent before the delivery of a copy of the prospectus to the Registrar for filing

A **statement to that effect** (non-existence of conditions, if expert's statement is included) shall also be included in the prospectus.

Purpose of sub-section 5 is to ensure independence of expert to protect the financial interest of prospective investor who may invest in company after relaying upon the statement of such expert.

Expert as per Section 2(38) of the Act, **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.

Disclosure on the face of prospectus [Sub-section 6]

Prospectus issued under sub-section (1) shall, on the face of it, state/specify;

a. That a copy has been delivered for filing to the Registrar under sub-section (4);

b. 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.

Validity of Prospectus for issue [Sub-section 8]

A prospectus is considered to be valid for issue, only if **90 days** has not been lapsed from the date on which a copy thereof is delivered to the Registrar under section 25(4).

The date of issue is important for many reasons, one of them being the value of securities keeps changing.

If 90 days have expired after filling of prospectus, it is better to send a fresh copy of prospectus to registrar under section 26(4); to avoid the penalties imposed under section 26(9)

Validity of Prospectus for issue [Sub-section 9]

If a prospectus is issued in contravention of the provisions of section 26 the **company** and **every person who is knowingly a party to the issue of such prospectus** shall be punishable with **fine of ₹ 50,000 to ₹ 3,00,000**.

Example - The Board of Directors of a Pharmaceutical Limited has allotted shares to the public by issuing a prospectus that is not filed with the Registrar of Companies.

In this regard, it is to be noted that a public company can issue securities to the public only by issuing a prospectus, under section 23(1)(a) of the Act.

Further section 26(4) requires that no prospectus shall be issued unless, a duly signed copy of the prospectus forwarded to Registrar for filing.

In the given case, the company has issued the prospectus in violation of the provisions of section 26. Hence, company as well as the person who is knowingly a party to this, will be punishable with penalty under section 26 (9) of the Act.

Illustration (True/False)

Statement *– The copy of prospectus submitted with registrar for filling need to be duly signed by majority of directors.*

Answer – False

Under section 26(4) of the Act, the copy of prospectus submitted with registrar for filing shall be signed by every person who is named as either director or proposed director in such prospectus. Duly authorised attorney can sign in representative capacity.

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

Sub-section 1 provides, the terms of a **contract** referred to in the prospectus or **objects** for which the prospectus has been issued **can be varied,** but **only with the authority** of the company given by it in **general meeting** by way of **special resolution.**

First proviso to sub-section 1 requires that prescribed details of the **notice** which has to be given to the shareholders are to be **published in newspapers** (one in English and one in vernacular language) circulating in the city where the registered office of the company is situated **indicating clearly the justification for such variation.**

The second proviso to sub-section (1) also prescribes that **such company** is **not** to **use any amount raised** by it through the prospectus for **buying, trading or otherwise dealing in equity shares of any other listed company**.

Sub-section (2) provides that the **dissenting shareholders** (i.e. those who did not agree to the variation) are to 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** by making regulations for this purpose.

Example – Ind-swift pharma limited after issue of prospectus, willing to make variation in object of issue of prospectus (due to change in industry brought by covid-19 among other dynamics of pharma industry). What is your piece of advice to Ind-swift pharma limited?

In given case, Ind-swift should authorise the changes through special resolution passed at general meeting and copy of notice that is given to shareholder for such variation shall be published in newspaper along with justification of variation.

If any shareholder shows dissent then exit option shall be provided in accordance with guideline issued in this regards by SEBI.

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.

But if in any case variation need to made, then such deviations are required to be pre-approved by the investors and 'recall option' needs to be given to the dissenting investors. Deviation regarding use of proceeds of issue for buying, trading or otherwise dealing in equity shares of any other listed company is not permitted in any case.

Procedural Aspects

Rule 7 of the Companies (Prospectus and Allotment of Securities) Rules, 2014

Sub-rule 1, provides for **Special Resolution to be passed through Postal Ballot and Contents to be included in Notice.**

Further Sub-rule 2, provides the advertisement of the notice (for getting the resolution passed) shall be in Form PAS-1 and such advertisement shall be published simultaneously with dispatch of Postal Ballot Notices to Shareholders.

According to Sub-rule 3, the notice shall also be placed on the **website** of the company, if any.

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 – (c)

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.

Procedural Aspects

Rule 8 of the Companies (Prospectus and Allotment of Securities) Rules, 2014

According to Rule 8 (1) the provisions of section 23 to 41 of this Act and rules

made thereunder shall be applicable to an **offer of sale** referred to in section 28 except for the provisions relating to;

a. minimum subscription

b. minimum application value

c. any statement to be made by the Board of directors in respect of the utilization of money; and

d. information which cannot be compiled or gathered by the offer or, with detailed justifications for not being able to comply with such provisions.

Further, Rules 8 (2) requires that 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.

Illustration (Q&A)

In case of Super-Fix-it Limited, some of members of a company offer part of their holding of shares to the public (in consultation with board of directors), wherein company took all actions on their behalf for carrying out the transaction.

Company incur the expense of ₹ 3.2 lakh for carrying out such transactions, can company recover the amount so incurred in full from such members?

Answer – Yes, members who offer whole or part of their holding of shares to the public, in consultation with board of directors, shall authorise the company to take all actions on their behalf for carrying out the transaction, and bound to reimburse the company for all expenses made by it on this matter (Refer section 28(3).

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, 1996[17] and regulations made under it.

[17] Act 22 of 1996

Sub-section 1A inserted in 2019, provides that in case of **prescribed 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, 1996[18] 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, 1996[19] and the regulations made thereunder.

Rule 9 (Dematerialisation of securities) and 9A (Issue of securities in dematerialised form by unlisted public companies; inserted vide Companies (Prospectus and Allotment of Securities) Third Amendment Rules, 2018) of *Companies (Prospectus and Allotment of Securities) Rules, 2014* is relevant for procedural aspects pertaining to Public Offer of Securities to be in Dematerialised Form

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:

a. Objects,

b. Liability of members and the amount of share capital of the company,

c. Names of the signatories to the memorandum,

d. Number of shares subscribed for by the signatories, and

e. Capital structure of the company.

[18] ibid
[19] ibid

SHELF PROSPECTUS [SECTION 31]

Meaning of Shelf Prospectus [explanation to section 31]

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.

Need of Shelf Prospectus

A company is required to issue a prospectus each time it accesses the capital market. It leads to unnecessary repetition for a company which makes **more than one offer of securities** in a year to mobile funds from the public. A way out is shelf prospectus which **remains valid (on the shelf) for a specified time period** during which offers for securities may be made by a company to the public without going through the arduous exercise of issuing fresh prospectus every time.

Filing of shelf prospectus with the Registrar [Sub-section 1]

Shelf prospectus may be filled with the Registrar **at the stage of first offer of securities**, by class or classes of companies as the Securities and Exchange Board of India may provide by regulations in this behalf.

It has to indicate a period not exceeding one year as the **period of validity** of such shelf prospectus.

The period of validity is to commence **from the date of opening of the first offer** of securities under such prospectus.

In respect of any **second or subsequent offer** of such securities issued **during the period of validity** of such prospectus, **no further prospectus is required**.

Filing of 'Information Memorandum' with the Shelf Prospectus [Sub-section 2]

A company filing a shelf prospectus **shall be required** to file an information memorandum with the Registrar within the prescribed time, prior to the issue of a second or subsequent offer of securities under the shelf prospectus containing;

a. All material facts relating to new charges created,

b. 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

c. Such other changes as may be prescribed,

Proviso to Sub-section 2, provides a safeguard (in case of changes) to applicants who made payment in advance. It is provided that 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.

Procedural Aspects

Rule 10 of the Companies (Prospectus and Allotment of Securities) Rules, 2014

The information memorandum shall be prepared in Form PAS-2.

It shall be 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.

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.

Illustration (MCQ)

An applicant who made application for allotment along with advance payment of subscription, if he expresses a desire to withdraw his application after changes reported in information memorandum came to his knowledge. The company;

Options

a. *May refund the monies at discretion of Board of Directors*

b. *Shall refund the monies after deducting the administrative charges within fifteen days*

c. *Shall refund all the monies received as subscription within fifteen days*

d. *Shall refund the monies after deducting the administrative charges within 30 days*

Answer – c [Refer proviso to section 31(2). It is provided that 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].

RED HERRING PROSPECTUS [SECTION 32]

Meaning of Red Herring Prospectus (explanation to section 32)

The expression "red herring" means a prospectus which **does not include complete particulars** of the **quantum or price** of the securities.

Need of Red Herring Prospectus

Developments taking place in the financial markets from time to time allow innovative methods of raising funds so as **to avail the most of favourable market conditions.** Timing the issue and book building of issue are 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.

Timing of issue the Red Herring Prospectus [Sub-section 1]

A company proposing to make an offer of securities may issue a red herring prospectus **prior to the issue of a prospectus**.

Filing of Red Herring Prospectus with the registrar [Sub-section 2]

A company proposing to issue a red herring prospectus shall file it with the Registrar **at least three days prior** to the **opening of the subscription** list and the offer.

Obligations under Red Herring Prospectus vis-à-vis Prospectus [Sub-section 3]

A red herring prospectus shall carry the **same obligations** as are applicable to a **prospectus** and any **variation** between the red herring prospectus and a prospectus **shall be highlighted as variations in the prospectus**.

Filing with Registrar and SEBI upon closing of Offer [Sub-section 4]

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.

Book Building is actually a price discovery method. In this method, the company doesn't fix up a particular price for the shares, but instead gives a **price range**.

An underwriter builds a book by accepting orders from fund managers, indicating the number of shares they desire and the price they are willing to pay.

CONCEPT OF ABRIDGED PROSPECTUS - ISSUE OF APPLICATION FORMS FOR SECURITIES [SECTION 33]

Meaning of Abridged Prospectus [Section 2(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 regulations in this behalf.

Need of Abridged Prospectus

In fact, 'Abridged Prospectus' is a summarized form of actual prospectus, containing the salient features of a prospectus to **cut the cost involved in the publication** of large number of prospectus which has to accompany the application forms for shares or debentures in case of public offer.

Abridged Prospectus accompany the application form [Sub-section 1]

Section 33(1) provides that every application form for shares or debentures has to be accompanied with the abridged prospectus.

Proviso to sub-section 1 provides exceptions, when the requirement of abridged prospectus does not apply;

a. When application form is issued in connection with a bona fide invitation to a person to enter into an underwriting agreement with respect to shares or debentures:

b. In relation to shares or debentures which were not offered to the public; or

c. Where offer is made only to existing members of the company

Right to receive prospectus [Sub-section 2]

Sub-section 2 provides that a prospectus (full prospectus) is to be made available to any person who request for it before the closing of the subscription list and the offer.

Penalty [Sub-section 3]

A company who makes any default in complying with the provisions of section 33, shall be liable to a penalty of **fifty thousand rupees for each default**.

5. MIS-STATEMENTS IN PROSPECTUS

A contract of shares in a company is a contract of ***Uberrimae fides*** (Latin), which means '**utmost good faith'**. The legal doctrine of *Uberrimae fides* provides that all parties to contract must deal in good faith, making a full declaration of all material facts. The intending purchasers of shares are entitled to true and correct disclosures of all the facts in the prospectus.

Hence, a prospectus must make all statements with **scrupulous accuracy** and not state facts which are not strictly correct. Neither any information which the law requires to be disclosed to the public be concealed or omitted to be stated from the prospectus nor should the information given be false and misleading.

Mis- statements in prospectus is a serious offence which attracts the provisions of section 34 (criminal liability) and / or section 35 (civil liability) of the Act. In this section we will learn about misleading prospectus, remedies for misrepresentation in the prospectus.

WHAT CONSTRUE AS MIS-STATEMENT AND MISLEADING PROSPECTUS

A prospectus is said to be misleading, **if it includes any mis- statement**. In common parlance, mis-statement is the act of stating **anything that is false** (or not accurate). A statement become false statement, if it produces a **wrong impression of actual facts**. It could either be due to **commission or omission or both**.

As per section 34, a statement included in a prospectus shall be deemed to be untrue;

a. if the statement is misleading in the form and context in which it is included: or

b. where any inclusion or omission of any matter is likely to mislead

Some of landmark judicial pronouncements - only for reference and better understanding

Mislead through false Statement (prima-facie of facts) - Henderson v. Lacon[20]

It was stated in the prospectus, 'the directors and their friends have subscribed a large portion of the capital and they now offer to the public the remaining shares.' Whereas, in actually each of director had subscribed only 10 shares. It was held that such a statement is misleading one.

Misled by hiding truth through superficial statement - Rex v. Kylsant[21]

In the prospectus, it is stated that the company had regularly paid dividends, in actual, company has been incurring substantial losses during all those years. Company used to write back some of the past provisions to the credit of the profit and loss account. It was held that the prospectus did not disclose the true picture of the company.

Misled through ambiguous statement - Smith v. Chadwick[22]

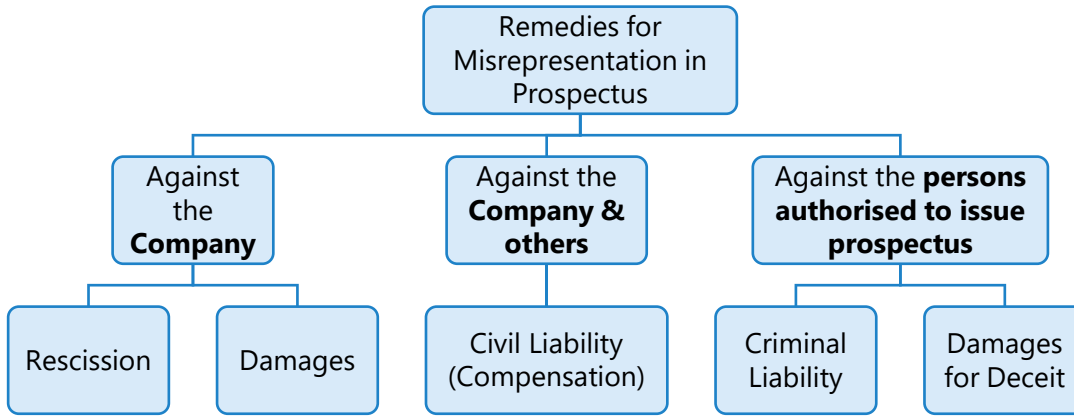
The prospectus of a manufacturing company contain, 'the present value of turnover is £1million sterling per annum,' the statement was true only if production capacity is considered but untrue if it meant the present production level (capacity in utilisation). It was held that, such a statement which director knew may bear multiple meaning out of which any can be false to their knowledge, considered to be furnishing of misleading statement.

EFFECT OF MISLEADING PROSPECTUS – REMEDIES OF MISREPRESENTATION

The fear of heavy liability and criminal sanctions have controlled the directors' tendency of "using extravagant terms and flattering description".

But if the prospectus contains a misleading or false statement or omits to disclose a material fact which amounts to misrepresentation, the aggrieved shareholder has the remedies. The law allows the following remedies for misrepresentation:

[20] C 16/276/H211 (1865 - Cause number: 1865 H211)
[21] Harvard Law Review Vol. 45, No. 6 (Apr., 1932), pp. 1078-1083 (available at https://doi.org/10.2307/1332145)
[22] HL 18 Feb 1884



Remedy of Rescission, Damages and Deceit are not specified under this Act, they are available under the Indian Contract Act 1872[23] read with relevant provisions of Specific Relief Act 1963[24]. Whereas Criminal and Civil Liability is provided under section 34 and 35 respectively of this Act.

Since remedies specified above are alternative courses, hence all of these remedies are not available simultaneously, whereas appropriate combination of these can be claimed.

To illustrate, claim for compensation under section 35 (civil liability) of this Act (being special statute where jurisdictional power is vested in NCLT) shall not be moved simultaneously with claim for Damages (under general provisions).

RIGHT OF RESCISSION

When to seek rescission?

A person who has purchased shares from the company on the basis of the prospectus containing untrue and misleading statement of material facts is entitled to apply to the court for the rescission of the contract, under the relevant provisions of the Indian Contract Act 1872[25].

Effect of rescission

The agreement to take up shares is voidable at the option of the subscriber to the shares, it will remain valid unless he actually rescinds it.

[23] Act 9 of 1872
[24] Act 47 of 1963
[25] Act 9 of 1872

If the court accepts his application for the repudiation of the contract, company will remove his name from the register of members and return his money with interest and other incidental cost.

Entitlement to compensation for any damages which he sustained through the non-fulfilment of the contract arises under section 75 of the Indian Contract Act 1872[26].

Exceptions – When right of rescission is not available?

a. Right to rescind allotment of shares will not be available to the subsequent purchasers of shares from the market.

b. A subscriber to the Memorandum of Association cannot also seek any relief, as the company cannot be considered to be in existence at the time when he appended his signatures to the Memorandum of Association. He cannot be said to have been influenced by any statement in the prospectus.

Illustration (Q&A)

All the statements contained in a prospectus issued by a company were literally true. It was also stated in the prospectus that the company had paid dividends for a number of years but there was no disclosure regarding the fact that the dividends were paid out of realised capital profits and not out of trading profits. An allottee of shares wants to avoid the contract on the ground that the prospectus was false in material particulars.

Answer – The non-disclosure of the fact that dividends were paid out of capital profits is a concealment of material fact as a company is normally required to distribute dividend only from trading or revenue profits and under exceptional circumstances it can pay dividend out of capital profits. Hence, a material misrepresentation has been made.

Accordingly, in the given case the allottee can avoid the contract of allotment of shares.

RIGHT OF ACTION FOR DAMAGES

When to evoke?

In the cases where mis- statement amounts to fraud, aggrieved investor also gets a right of action for damages against the company. This right is available even after the company has gone into liquidation.

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[26] *ibid*

Pre-requisite to claim for damages

a. Misrepresentation (fraudulent) was there in the prospectus and it is of material fact

b. Person is intended to act upon it

c. Person suffered the damages as consequences of acting upon such fraudulent misrepresentation.

CIVIL LIABILITY FOR MIS-STATEMENTS IN PROSPECTUS [SECTION 35]

Offence under section 35

Loss or damage to subscriber of securities, as a consequence of acting on basis of inclusion or omission of any matter in the prospectus; which is misleading the subscriber/s.

Who shall be held liable?

a. Company; and

b. Every person who is/has;

i. A **director** of the company at the time of the issue of the prospectus;

ii. **Authorised himself** to be named and is named in the prospectus as a director of the company, or has agreed to become such director, either immediately or after an interval of time;

iii. A **promoter** of the company;

iv. **Authorised** the **issue of the prospectus**; and

v. An **expert** referred to in sub-section (5) of section 26,

Liability for an offence under section 35

A person found guilty under section 35, in addition to any punishment under section 36, a company and every other person shall also be **liable to pay compensation** to every person who has sustained loss or damage.

Exception to liability for guilty/offence under section 35 [Sub-section 2]

Sub-section 2, provides the instances when a person shall not be held guilty under section 35 of this Act, if he proves;

a. He **withdrew his consent** to be a director of company and prospectus issued without his consent and authority.

b. He has given reasonable public notice to effect, that **prospectus** was **issued without his knowledge** and **consent.**

c. He made the statement on the **authority of an expert** whom he believed to be competent and that the expert had given his consent and had not withdrawn it.

d. He had **reasonable ground** for **believing the statement to be true** and that he did believe it to be true up to the time of allotment.

e. The statement was a **correct copy of some extract** from an official document and that he had in fact believed.

Personal Liability when intend to defraud [Sub-section 3]

Every person referred under sub-section 1 shall be **personally responsible, without any limitation of liability;**

– 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;

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.

Illustration (Q&A)

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.

CRIMINAL LIABILITY FOR MIS-STATEMENTS IN PROSPECTUS [SECTION 34]

Offence under section 34?

Where a prospectus is issued, circulated or distributed that includes;

a. Any statement which is **untrue** or **misleading** in form or context in which it is included or

b. Where any **inclusion** or **omission** of any matter is likely to mislead.

Who shall be held liable?

Every **person who authorises** the **issue** of **such prospectus**

Liability for an offence under section 34

Such persons found guilty under section 34 shall be liable for punishment under **section 447** of this Act,

Exception to liability for guilty/offence under section 34 [Proviso to section 34]

Proviso to section 34 provides the instances when a person shall not be held guilty under section 34 of this Act, if he proves that;

a. Such mis-statement or omission was immaterial, or

b. 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.

Note

a. Loss from mis-statement is not essential, to held a person guilty under section 34.

b. Liability for offence under section 34, is strict liability, hence it is immaterial where the omission is intentional or unintentional, in both case person will be held guilty under section 34 and liable for punishment under section 447 of this Act.

Summary of section 34 and 35.

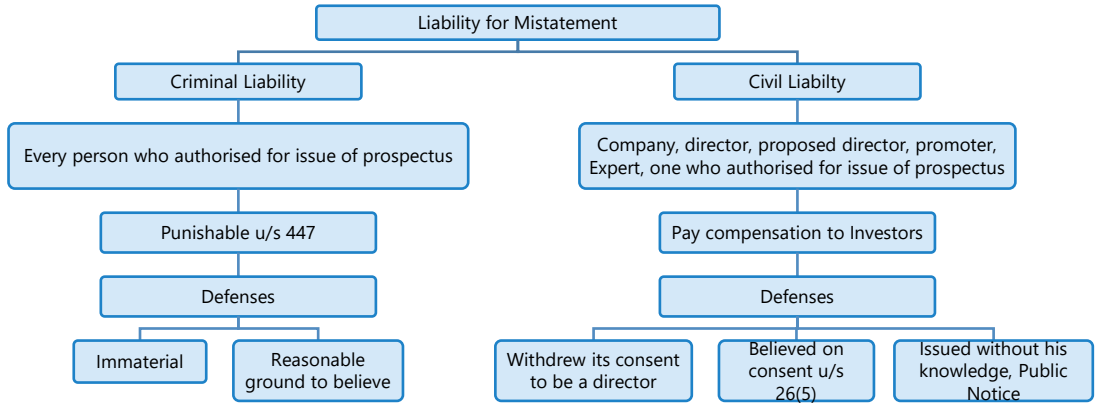


Illustration (Q&A)

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 the circumstances?

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.

Certain situations when a director will not incur any liability for mis-statements in a prospectus are covered under exceptions provided by Section 35 (2) but no such exception specifies that relying on the statements prepared by the promoters of the company is a valid ground for a director to escape liability for mis-statement.

DAMAGES FOR DECEIT

When remedy of damages for deceit is available?

Persons responsible for the issue of prospectus can also be held liable in an action for deceit, under general law as provided by section 19 of the Indian Contract Act.

This remedy shall be available even where the remedy by way of rescission as against the company is lost either through latches or negligence or even if the company goes into liquidation.

Prerequisite to claim damages for deceit is available

a. There was a fraudulent mis-statement related to some existing material facts.

b. He is original allottee and had seen the prospectus.

c. He has been actually deceived.

Peek v. Gurney

Gurney issued a fraudulent prospectus on behalf of a company. No shares were purchased by Peek at that time. Several months afterwards, Peek purchased 2,000 shares of the company from the stock exchange. He brought an action against the directors for deceit (on the basis of prospectus). Court held, the directors were not liable as the shares were not purchased on the basis of prospectus.

6. 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 or the pretended 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.

7. ACTION BY AFFECTED PERSONS [SECTION 37]

A suit may be filed or any other action may be taken under section 34 or section 35 or section 36 by:

a. Any person,

b. Group of persons or

c. Any association of persons

If **affected** by any **misleading statement** or the **inclusion or omission** of any matter in the **prospectus**.

Illustration

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.

Section 37 has paved way for class action

Class action suit is for a group of people filing a suit against a defendant who has caused common harm to the entire group or class. This is not like a common litigation method where one defendant files a case against another defendant while both the parties are available in court. 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 benefit of these type of suits is that if several people have been injured by one defendant, each of the injured person need not to file a case separately but all the people can file one single case together against the defendant.

8. 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.

Note:

A person who gets shares allotted in a fictitious name becomes liable as a shareholder. Thus, where a person carried on business under an assumed name and took shares in that name, his trustee in bankruptcy of the said person, could not avoid liability.

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.

The amount received through disgorgement or disposal of securities under sub-section (3), is to be credited to the Investor Education and Protection Fund. [Sub section (4)]

9. PUNISHMENT FOR FRAUD [SECTION 447]

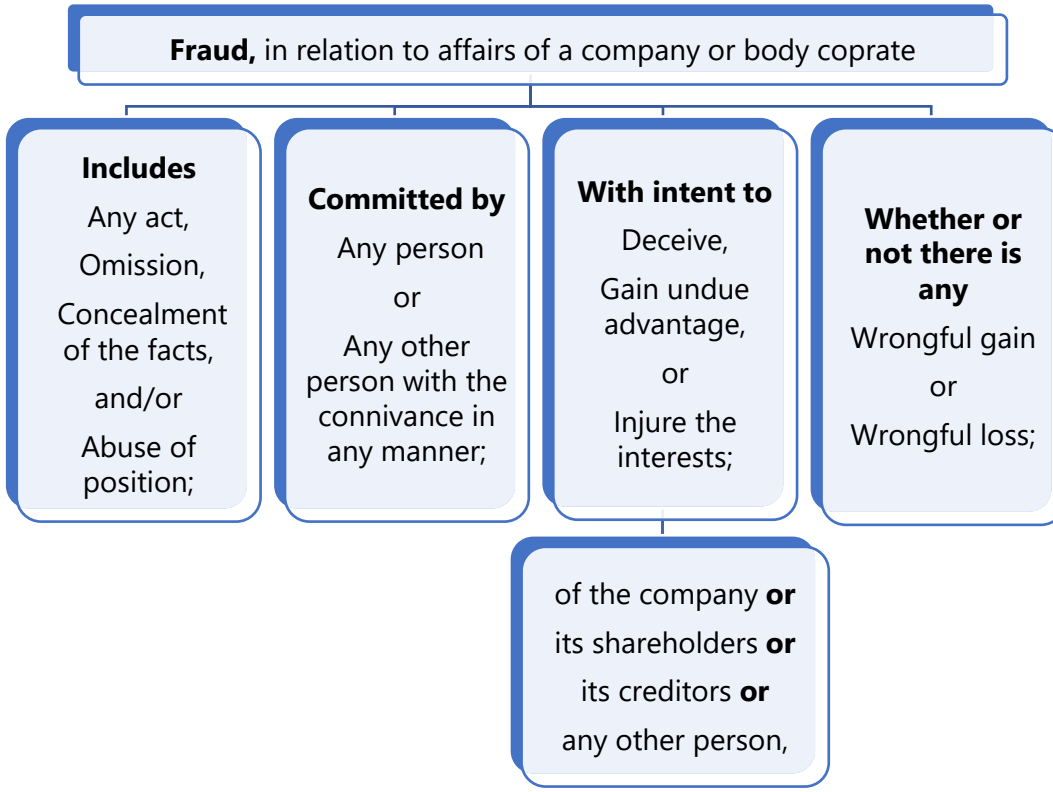
Amount and nature of fraud	Fine			Imprisonment	
	Minimum	Maximum		Minimum	Maximum
Fraud involving less than 10 lakh rupees or 1% of turnover, whichever is lower (*public interest not involved*)	-	Up to ₹ 50 lakh	or/and	-	Up to 5 years
Fraud involving at least 10 lakh rupees or 1% of turnover, whichever is lower (*public interest not involved*)	Equal to amount of fraud	3 times of amount of fraud	and	6 Months	10 Years
Fraud in question involves public interest	Equal to amount of fraud	3 times of amount of fraud	and	3 Years	10 Years

Section 447 provides three explanations, read as:

(i) "fraud" in relation to affairs of a company or any body corporate, includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss.

(ii) "wrongful gain" means the **gain by unlawful means** of **property** to which the person gaining **is not legally entitled.**

(iii) "wrongful loss" means the **loss by unlawful means** of **property** to which the person losing **is legally entitled**.



Illustration

Mr. Raju one of prospective investor under section 37 of this Act, sue the persons who authorise the issue of prospectus for the fraudulent misstatements they made in the prospectus. Mr. Raju also filed a complaint under section 420 of the IPC, 1860 and section 447 of this Act.

Mr. Angad one of the authorised persons, plead that Mr. Raju did not took any share, hence he has not borne any sort of loss, therefore he cannot seek the remedies, for what he is asking for and they are not punishable under section 447, because fraud is not committed against Mr. Raju. Whether the persons who authorised the issue of prospectus punishable under section 447?

Answer

In this case, the persons who authorised the issue of prospectus shall be punishable under section 447 for the fraudulent misstatement, despite the fact that Mr. Raju had not borne any loss. Because wrongful gain or loss is not essential constituent of fraud under section 447.

10. ALLOTMENT OF SECURITIES BY COMPANY [SECTION 39]

MEANING OF ALLOTMENT

Offers for shares are made on application forms supplied by the company. When an application is accepted, it is an allotment

Hence, in general sense 'allotment' is neither more nor less than the acceptance by the company of the offer to take shares.

In technical context, it is an appropriation out of the previously unappropriated capital of a company.

Note

Where forfeited shares are re-issued, it is not the same thing as an allotment.

A valid allotment has to comply with the requirements of the Act and principles of the law of contract relating to acceptance of offers.

Section 39 of the Act and *the Companies (Prospectus and Allotment of Securities) Rules, 2014* contains provisions in respect of allotment of securities when there is a public offer.

MINIMUM SUBSCRIPTION IS A MUST [SUB-SECTION 1]

The first requisite of a valid allotment is that of minimum subscription.

Hence, when shares are offered to the public, the amount of minimum subscription has to be stated in the prospectus.

No shares can be allotted unless:

a. At least so much amount (which is stated as minimum subscription) has been subscribed and

b. The sums payable on application for the amount so stated have been paid to and received by the company by cheque or other instrument from the subscribers or investors at the time of making application.

Note:

As per the regulation 45(1) of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018[27], the minimum subscription is 90% of the entire issue.

Any means by which money can be remitted may be used, but remittances must be cleared and actual cash received by the company before proceeding to allotment. An application for shares, if not accompanied by any such payment, does not constitute a valid offer.

QUANTUM OF AMOUNT PAYABLE ON APPLICATION [SUB-SECTION 2]

The amount payable on application **shall not be less than:**

a. **5%** of the nominal amount of the security **or**

b. Such other percentage or amount, as may be **specified by the Securities and Exchange Board** by making regulations in this behalf.

Here, it is important to note that as per the regulation 47(4) of the [28]Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018, the minimum sum payable on application per specified security shall be **at least twenty five percent** of the **issue price**.

Further, proviso to regulation 47(4) provides that in case of an offer for sale, the full issue price for each specified security shall be payable at the time of application.

Example - If listed company offer the shares with nominal value of ₹ 10 then application money shall be at least ₹ 2.5 and if nominal value is ₹ 100 then shall be at least ₹ 25.

CONSEQUENCES IF MINIMUM AMOUNT IS NOT SUBSCRIBED [SUB-SECTION 3]– RETURN OF APPLICATION MONEY

If the stated minimum amount has not been subscribed and the sum payable on

[27] SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 are not a part of syllabus at Intermediate Level. However, it is necessary to build the understanding of the students.

[28] SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 are not a part of syllabus at Intermediate Level. However, it is necessary to build the understanding of the students.

application is not received within a period of **30 days** (or any other period as prescribed by SEBI) from the date of issue of the prospectus, the amount received from applicants shall be returned.

Time period for return of application money

As per rule 11(1) of the Companies (Prospectus and Allotment of Securities) Rules, 2014, such refund shall be made within a period of **15 days** from the closure of such issue.

Default in return of application money

As per rule 11(1) of the Companies (Prospectus and Allotment of Securities) Rules, 2014, in case of default in refund within that period, **directors and other officers** responsible for default shall be **jointly and severally** liable to repay that money with interest at the rate of **15% pa**.

Source for return of application money

According to Rule 11 (2), the application money to be refunded shall be credited only to the bank account from which the subscription was remitted.

Section 40(3) and Rule 11(2) of the Companies (Prospectus and Allotment of Securities) Rules, 2014 are confirming provisions regarding **return of application money**, in case where allotment is not done.

RETURN OF ALLOTMENT [SUB-SECTION 4]

Whenever a **company having a share capital** makes any allotment of securities, it shall file with the Registrar a return of allotment in manner as prescribed in the Companies (Prospectus and Allotment of Securities) Rules, 2014.

Time Limit for filing Return of Allotment

According to Rule 12 (1) of the Companies (Prospectus and Allotment of Securities) Rules, 2014, the company shall file a return of allotment with Registrar in Form PAS-3 within 30 days along with the fee as specified in the Companies (Registration Offices and Fees) Rules, 2014.

Attachments to Form PAS-3

According to Rule 12 (2) of the Companies (Prospectus and Allotment of Securities) Rules, 2014, lists of following particulars (duly certified by the signatory of the Form PAS-3 for completeness and correctness) shall accompany:

a. A list of allottees stating their names, address, occupation, if any, and

b. Number of securities allotted to each of the allottees.

Additional attachments to Form PAS-3 – In case share issued for consideration other than cash.

Rule 12 (3) of the Companies (Prospectus and Allotment of Securities) Rules, 2014, provides, in the case of securities (not being bonus shares) allotted as fully or partly paid up for **consideration other than cash**, then following documents shall also be attached;

a. A copy of the contract, duly stamped, pursuant to which the securities have been allotted

b. Any contract of sale if relating to a property or an asset, or a contract for services or other consideration.

Further Rule 12 (4) states that where a contract referred above is not reduced to writing, the company shall furnish complete particulars of the contract stamped with the same stamp duty as would have been payable if the contract had been reduced to writing and same shall deemed to be an instrument within the meaning of the Indian Stamp Act, 1899.

Rule 12 (5), requires a report of a registered valuer in respect of valuation of the consideration if either of rule 12(3) or 12(4) applicable.

Attachments to Form PAS-3 – In case share issued in pursuance of Section 62(1)(c)

Rule 12 (7) of the Companies (Prospectus and Allotment of Securities) Rules, 2014, states that in case the shares have been issued in pursuance of clause (c) of sub-section (1) of section 62 by a **company other than a listed company** whose equity shares or convertible preference shares are listed on any recognised stock exchange, there shall be attached to Form PAS-3, the **valuation report of the registered valuer**.

PUNISHMENT FOR DEFAULT [SUB-SECTION 5]

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.

Illustration

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.

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

FILING OF AN APPLICATION WITH RECOGNISED STOCK EXCHANGE [SUB-SECTION 1]

Before making public offer, every company shall make an application to one or more recognised stock exchange or exchanges and obtain permission for the securities to be dealt with in such stock exchange or exchanges.

PROSPECTUS TO STATE NAME OF STOCK EXCHANGE [SUB-SECTION 2]

Name or names of the stock exchange in which the securities shall be dealt with, must be stated in the prospectus.

MAINTAINING OF SEPARATE BANK ACCOUNT [SUB-SECTION 3]

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

a. For **adjustment against allotment of securities** where the securities have been permitted to be dealt with in the stock exchange or stock exchanges specified in the prospectus; or

b. For the **repayment of monies within the time specified** by the Securities and Exchange Board, received from applicants in pursuance of the prospectus, where the company is for any other reason unable to allot securities.

Note: Section 40(3) and Rule 11(2) of the Companies (Prospectus and Allotment of Securities) Rules, 2014 are confirming provisions regarding **return of application money**; in case where allotment is not done.

Rule 11(2) of the Companies (Prospectus and Allotment of Securities) Rules, 2014 is already discussed before in the chapter.

CONDITION PURPORTING TO WAIVE COMPLIANCE SHALL BE VOID [SUB-SECTION 4]

Any condition purporting to require or bind any applicant for securities to waive compliance with any of the requirements of this section shall be void.

DEFAULT IN COMPLYING WITH PROVISIONS [SUB-SECTION 5]

If a default is made in complying with the provisions of this section, the company shall be punishable with a fine which shall not be less than five lakh rupees but which may extend to fifty lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees.

Penalty provisions provided under sub-section 5 can be summarized as:

Defaulter	Minimum Fine	Maximum Fine
Company	5,00,000	50,00,000
Defaulting Officer	50,000	3,00,000

PAYMENT OF COMMISSION [SUB-SECTION 6]

A company may pay commission to any person in connection with the subscription to its securities subject to rule 13 of the Companies (Prospectus and Allotment of Securities) Rules, 2014.

Note- No commission shall be paid to any underwriter on securities, which are not offered to the public for subscription.

Authorisation and Source

The payment of such commission shall be authorized in the company's **Articles of Association**. The commission may be paid out of;

a. proceeds of the issue, or

b. the profit of the company, or

c. both

Rate of commission

Security	Rate
Shares	**Should not exceed;** 5% of the price at which the shares are issued **Or** Any less rate/amount authorised by articles
Debentures	**Should not exceed;** 2.5% of the price at which the debentures are issued **Or** Any less rate/amount authorised by articles

Hence students are advised to note;

Maximum rate of commission can be 5% and 2.5% in case of shares and debentures respectively subject to rate authorised by article.

Example – Ind-swift Pharma Labs Limited issued the shares to raise capital. Article of Ind-swift authorised payment of commission at rate of 2%. Since rate of commission **should not exceed** 5% of the price at which the shares are issued **or**

any less rate/amount authorised by articles Hence, cap for payment of commission under section 40(6) of the Act is 2%.

Disclosure of the particulars in prospectus regarding underwriting

The prospectus of the company shall disclose the following particulars:

a. the name of the underwriters;

b. the rate and amount of the commission payable to the underwriter; and

c. the number of securities which is to be underwritten or subscribed by the underwriter absolutely or conditionally.

Copy of payment of commission to be delivered to Registrar

A copy of the contract for the payment of commission is delivered to the Registrar at the time of delivery of the prospectus for filling.

Illustration Q&A

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.

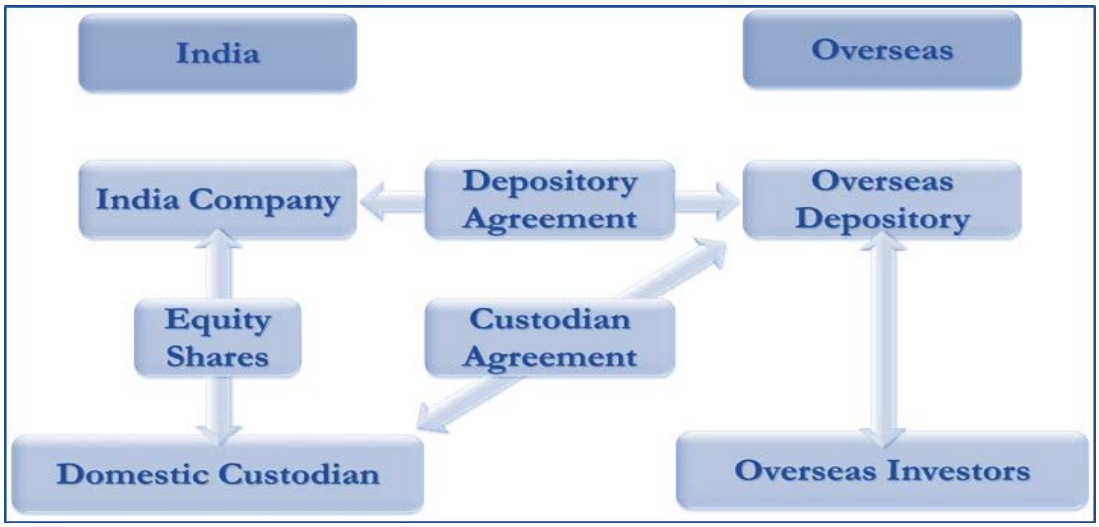
12. GLOBAL DEPOSITORY RECEIPT [SECTION 41]

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).

HOW GDR OPERATES?



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.

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.

13. PRIVATE PLACEMENT [SECTION 42]

Provisions relating to the 'private placement' are contained in Part II of Chapter III of the Act, which consist of only one section i.e. section 42 – Issue of shares on private placement basis.

A company may make private placement of securities subject to provisions of section 42 of this Act in supplement with those stated under rule 14 of the Companies (Prospectus and Allotment of securities) Rules, 2014.

MEANING OF PRIVATE PLACEMENT [EXPLANATION I TO SECTION 42(3)]

Private placement means any **offer or invitation** to subscribe or issue of securities **to a select group of persons** by a company (other than by way of public offer) through private placement offer-cum-application, which satisfies the conditions specified in section 42.

OFFER TO BE MADE ONLY TO A SELECT GROUP OF PERSONS [SUB-SECTION 2]

A private placement shall be made only to a select group of not more than **two hundred (200) persons** in a financial year, who have been identified by the Board, after passing as special resolution in this regard.

Note:

1. These select group of persons is referred to as "identified persons"
2. While computing threshold limit of 200, following shall be excluded;
   - **a**. qualified institutional buyers and,
   - **b.** employees of the company being offered securities under a scheme of employees stock option under section 62(1)(b)
3. As per Explanation II to sub-section 3, the term "**qualified institutional buyer**" means the qualified institutional buyer as defined in the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009.
4. Section 42(2) originally contains '**fifty (50) or such higher number as may be prescribed'**. Since Rule 14 (2) of the Companies (Prospectus and Allotment of Securities) Rules, 2014 (as amended through Companies (Prospectus and Allotment of Securities) Second Amendment Rules, 2018) prescribed '**an offer or invitation to subscribe securities under private placement shall not be made to persons more than two hundred (200) in the aggregate in a financial year'**, hence limit of identified persons under section 42(2) shall be read as **two hundred (200)**.
5. The aforesaid restrictions would be reckoned individually for each kind of security that is equity share, preference share or debenture.
6. Non-banking financial companies (NBFCs) which are registered with the Reserve Bank of India; and housing finance companies (HFCs) which are registered with the National Housing Bank; if they are complying with any regulations made by the Reserve Bank of India or the National Housing Bank in respect of offer or invitation to be issued on private placement basis, then need not to comply with rule 14(2) stated above.

PRIVATE PLACEMENT SHALL BE DEEMED TO BE AN OFFER TO THE PUBLIC [EXPLANATION III TO SECTION 42(3) READ WITH SUB-SECTION 11 TO SECTION 42)]

As per explanation III to section 42(3), if a company, listed or unlisted, makes an offer to allot or invites subscription, or allots, or enters into an agreement to allot, securities **to more than 200 identified persons**, whether the payment for the

securities has been received or not or whether the company intends to list its securities or not on any recognised stock exchange in or outside India, the same shall be deemed to be an offer to the public and provisions contained in section 23 to 41 shall apply.

Further section 42(11) provides, in such case all the provisions of this Act and the Securities Contracts (Regulation) Act, 1956 and the Securities and Exchange Board of India Act, 1992 shall be applicable.

Though penalty under sub-section 9 and 10 to section 42 of this Act, still can be imposed.

MANNER OF ISSUING PRIVATE PLACEMENT OFFER AND APPLICATION [SUB-SECTION 3]

A company making private placement **shall** issue **private placement offer and application** to **identified persons** (whose names and addresses are recorded by the company) in the form and manner prescribed below.

Note: Private placement offer and application shall not carry any right of renunciation.

Resolution for the Private Placement Offers

Rule 14 (1) of the Companies (Prospectus and Allotment of Securities) Rules, 2014, requires prior approval of the shareholders of the company, by a **special resolution** for **each** of the **private placement offers** or **invitations**. The explanatory statement annexed to the notice for shareholders' approval, must disclose the following;

a. Particulars of the offer including date of passing of Board resolution;

b. Kinds of securities offered and the price at which security is being offered;

c. Basis or justification for the price (including premium, if any) at which the offer or invitation is being made;

d. Name and address of valuer who performed valuation;

e. Amount which the company intends to raise by way of such securities;

f. 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.

Students are advised to take note of certain exceptions above rule;

Board resolution under section 179(3)(c) shall be adequate in case of offer or invitation for **non-convertible debentures**, where the proposed amount to be raised **does not exceed** the limit as specified in **section 180(1)(c).** But if amount is above the said limit, it shall be sufficient if the company passes a **previous special resolution only once in a year** for all the offers or invitations for such debentures during the year.

Even for issue of securities to QIBs, it shall be sufficient to pass a **previous special resolution only once in a year** for all the offers or invitations for all the allotments to such buyers during the year.

Filing of Resolution with Registrar

Copy of resolutions passed above shall be moved to registrar **prior** to issue of **private placement offer cum application letter.**

Note: Vide Companies (Prospectus and Allotment of Securities) Amendment Rules, 2022 the principal rules of 2014 further amended to insert a proviso to Rule 14(1) which deals with Private Placement.

The proviso states that when a company makes an offer or invitation to subscribe to securities, no offer or invitation of any securities shall be made to a body corporate incorporated in, or a national of, a country which shares a land border with India, unless such body corporate or the national, as the case may be, have obtained Government approval under the FEMA[29] Rules, 2019 and attached the same with the private placement offer cum application letter.

This means that companies will now have to obtain government approval under the FEMA Rules before inviting subscription to securities or offering securities to any entity from a country that shares a land border with India i.e. China, Bhutan, Nepal, Pakistan, Bangladesh, and Myanmar.

Applicable Application Form

Rule 14 (4) of the Companies (Prospectus and Allotment of Securities) Rules, 2014, provides a **private placement offer cum application letter** shall be;

[29] FEM (Non-debt Instruments) Rules, 2019

a. Issued in form **PAS-4**

b. **Serially numbered**

c. Addressed **specifically** to the person to whom the offer is made

d. Sent either in **writing** or in **electronic mode**

e. Sent within **thirty days** of recording the name of such person pursuant to section 42 (3).

Note:

1. No person other than the person so addressed in offer-cum-application letter, allowed to apply through such application form.

2. Any application not conforming to this condition shall be treated as invalid.

Maintaining Complete Records

Rule 14 (4) of the Companies (Prospectus and Allotment of Securities) Rules, 2014, requires the company to maintain a complete record of private placement offers in Form PAS-5.

MANNER OF SUBSCRIBING TO THE PRIVATE PLACEMENT ISSUE [SUB-SECTION 4]

Person who is identified and provided with private placement application cum letter, if willing to subscribe securities in the private placement, then may apply in through same letter along with subscription money.

Note:

1. Subscription money shall be paid either by cheque or demand draft or other banking channel, but not by cash.

2. Rule 14(5) of the Companies (Prospectus and Allotment of Securities) Rules, 2014, Payment 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.

3. First proviso to rule 14(5) state above, provides that; in case of joint holders, monies payable on subscription to securities shall be paid from the bank account of the person whose name appears first in the application.

4. 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.

Illustration Q&A

Ruhi and her 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. Offer-cum-application letter addressed to both containing their names as "Ms. Ruhi, Mr. Sohit". 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 Companies (Prospectus and Allotment of Securities) Rules, 2014, 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. Since Ruhi's name appears first in the application, 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 brother Sohit.

LIMIT ON FRESH OFFER [SUB-SECTION 5]

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.

Proviso to sub-section 5 read as, subject to the maximum number of identified persons (i.e. 200), a company may, at any time, make more than one issue of securities to such class of identified persons as may be prescribed.

TIME LIMIT FOR ALLOTMENT OF SECURITIES [SUB-SECTION 6]

A company making an offer or invitation under this section shall allot its securities within **sixty days** from the date of receipt of the application money.

1. If company fails to make allotment within 60 days, then repayment of the application money to the subscribers shall be made within **fifteen days** from the expiry of sixty days

2. If the company further fails to repay the application money within the 60 days, then it shall be liable to repay that money with **interest at the rate of twelve percent** per annum from the expiry of the sixtieth day.

It is provided that the monies received on application under this section shall be kept in a **separate bank account** in a scheduled bank and shall not be utilised for any purpose other than;

a. For adjustment against allotment of securities; **or**

b. For the repayment of monies where the company is unable to allot securities.

PROHIBITION ON PUBLIC ADVERTISEMENT [SUB-SECTION 7]

No company shall release any public advertisements or utilise any media, marketing or distribution channels or agents to inform the public at large about issue under section 42.

FILING OF RETURN OF ALLOTMENT [SUB-SECTION 8]

Section 42(8) read with Rule 14 (6) of the Companies (Prospectus and Allotment of Securities) Rules, 2014 provides, a return of allotment in form PAS-3 (along-with the fee as provided in the Companies (Registration Offices and Fees) Rules, 2014) shall be filed with the Registrar within **fifteen days** from the date of the allotment under section 42, with a complete list of all the allottees containing;

a. the full name, address, Permanent Account Number and E-mail ID of such security holder;

b. the class of security held;

c. the date of allotment of security;

d. 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.

DEFAULT IN FILING THE RETURN OF ALLOTMENT [SUB-SECTION 9]

For defaults in filing the return of allotment, 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 twenty-five lakh rupees.

Example – An allotment of security under private placement (section 42) was completed on 9th November 2022. Return of allotment in Form PAS-3 filed on 28th November 2022. Therefore, a penalty of ₹ 4000 shall be imposed on company, its promoter and directors.

PUNISHMENT FOR CONTRAVENING THE PRIVATE PLACEMENT PROVISIONS [SUB-SECTION 10]

For making offer or accepting money in contravention to section 42, liability will be:

Liable	Nature of penalty	Description
Promoters and Directors	Fine	Amount raised through the private placement **or** two crore rupees, whichever is **lower**
Company	Refund	All monies along-with interest (as specified in sub-section 6) to subscribers within a period of **thirty days** of the order

SUMMARY

- Securities can be offered to public at large (public offer) or through private placement. However, a private company is prohibited from resorting to public offer.
- SEBI has power to deal with matters relating to listed or proposed to be listed securities. Central Government (through MCA represented by Regional Directors and ROCs) has power to deal with matters relating to unlisted securities.
- Prospectus, deemed prospectus, abridged prospectus, red-herring prospectus, shelf prospectus, information memorandum need to comply with the minimum information requirements as prescribed in the Companies Act, 2013 and the applicable Rules.
- Existing holders of securities could offload their stake through required compliances for an offer for sale of securities to the public (OFS route).
- Fraudulent omission or commission in the prospectus attracts civil as well as criminal liability.
- Issue of securities (shares, debentures or hybrid securities) through public offer is to be made only in demat form by the companies which are not exempted.

- Provision related to timelines, pre-requisites for allotment and listing wherever applicable needs to strictly adhered to avoid any penal provision.
- Private placements have somewhat diluted disclosure requirements as public exposure is not there.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. *Trident Limited is in process of making private placement of securities. It received application money on 2nd March 2023. It shall allot its securities by _____, if failed then repay application money to the subscribers by _____, else liable to repay that money with interest at the rate of _____.*

   (a) 1st April, 16th April, and 12% respectively

   (b) 1st May, 16th May, and 12% respectively

   (c) 1st April, 16th April, and 6% respectively

   (d) 16th April, 1st May, and 12% respectively

2. *Modern Furniture Limited, issued a document containing offer of securities for sale that is considered as deemed prospectus under section 25, which requires such document must contains certain matters/disclosures in addition to those required under section 26. Which of following are correct requirements;*

   i. A statement of the net amount received or to be received as consideration for the securities to which the offer relates

   ii. The persons making the offer were named in the prospectus as promoters of the company.

   iii. The time and place at which the underlying contract for allotment may be inspected.

   (a) i or ii only

   (b) i or iii only

   (c) ii or iii only

   (d) All of i, ii and iii

3. *Section 40 of the Companies Act, 2013 requires every company shall make an application to one or more recognised stock exchange or exchanges before making public offer. Madhav Casting Limited filed an application to three exchanges for the securities to be dealt with in such stock exchanges, it received permission from couple of them and proceed with public issue. There will be:*

   (a) *No penalty, as application has been filed*

   (b) *Penalty on Madhav Casting Limited ranging from ₹ 5 lakh to ₹ 50 lakh*

   (c) *Penalty on Madhav Casting Limited ranging from ₹ 5 lakh to ₹ 50 lakh and every officer of the company who is in default ranging from ₹ 50 thousand to ₹ 3 lakh*

   (d) *Penalty on Madhav Casting Limited ranging from ₹ 5 lakh to ₹ 50 lakh and every officer of the company who is in default ranging from ₹ 50 thousand to ₹ 3 lakh and/or Imprisonment upto one year.*

4. *Rig exploration and refinery limited (RERL) decided to raise capital through issue of a shelf prospectus. Company secretary explains the requirement to board that RERL shall be required to file an information memorandum with the Registrar within_____, prior to the issue of a second or subsequent offer of securities under the shelf prospectus.*

   (a) *15 days*

   (b) *21 days*

   (c) *30 days*

   (d) *1 month*

5. *Modern Furniture decided to raise capital by issue for which prospectus need to be issued. The copy of prospectus submitted with registrar for filling need to be duly signed by:*

   (a) *Any two directors including managing directors*

   (b) *Majority of directors*

   (c) *Majority of directors including proposed directors*

   (d) *Every director or proposed director*

Descriptive Questions

1. *Explain various instances which make the allotment of securities as irregular allotment under 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.*

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.*

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.*

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?

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.

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

The Articles of Association of X Limited contained 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."

ANSWERS

Answer to MCQ based Questions

1.	**(b)** 1st May, 16th May, and 12% respectively
2.	**(b)** i or iii only
3.	**(c)** Penalty on Madhav Casting Limited ranging from ₹ 5 *lakh* to ₹ 50 *lakh* and every officer of the company who is in default ranging from ₹ 50 thousand to ₹ 3 lakh.
4.	**(d)** 1 month
5.	**(d)** Every director or proposed director

Answer to Descriptive Questions

1. **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 25% 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. As per **explanation to section 31,** 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.

A company is required to issue a prospectus each time it accesses the capital market. It leads to unnecessary repetition for a company which makes **more than one offer of securities** in a year to mobile funds from the public. A way out is shelf prospectus which **remains valid (on the shelf) a specified time period** during which offers for securities may be made by a company to the public without going through the arduous exercise of issuing fresh prospectus every time.

1. Filing of shelf prospectus with the Registrar

Shelf prospectus may be filled with the Registrar **at the stage of first offer of securities**, by class or classes of companies as the Securities and Exchange Board may provide by regulations in this behalf.

It has to indicate a period not exceeding one year as the **period of validity** of such shelf prospectus.

The period of validity is to commence **from the date of opening of the first offer** of securities under such prospectus.

In respect of any **second or subsequent offer** of such securities issued **during the period of validity** of such prospectus, **no further prospectus is required**.

2. Filing of 'Information Memorandum' with the Shelf Prospectus

A company filing a shelf prospectus **shall be required** to file an information memorandum with the Registrar within the prescribed time, prior to the issue of a second or subsequent offer of securities under the shelf prospectus containing;

a. All material facts relating to new charges created,

b. 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

c. Such other changes as may be prescribed,

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.

3. Safeguard (in case of changes) to applicants who made payment in advance.

It is provided that 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.

4. Information Memorandum together with Shelf Prospectus is deemed Prospectus

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. 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. 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 since there is no prohibition on payment of underwriting commission in kind. Further, in case of *Booth v New Africander Gold Mining Co.,* it was held that underwriting commission may be paid in cash or in kind or in lump sum or by way of a percentage.

5. 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. 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

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.

7. 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

LEARNING OUTCOMES

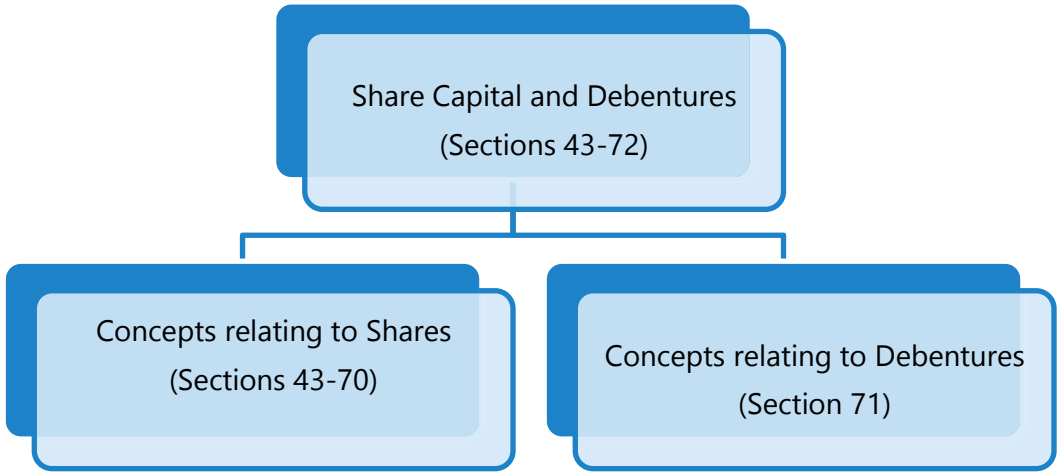
At the end of this chapter, you will be able to:

- Know about the Kinds of Share Capital
- Explain the basic requirements for issue of Share Certificates, Voting Rights and Variation of Shareholders' Rights
- Explain Calls on Unpaid Shares
- Know about the Time Period permitted for delivery of Certificates of Securities
- Understand the application of Securities Premium Amount
- Identify prohibition on issue of Shares at a Discount
- Understand the issue of Sweat Equity Shares, Issue and Redemption of Preference Shares and creation of Capital Redemption Reserve Account
- Know about the Transfer and Transmission of Securities, Refusal to Register and Appeal against Refusal

- Explain the concepts relating to the Alteration of Share Capital and Notice to Registrar thereof
- Understand the concept relating to Further issue of Share Capital
- Know about the issue of Bonus Shares, Reduction of Share Capital, Buy-Back of Shares and applicable restrictions thereon
- Know about issue of Debentures and creation of Debenture Redemption Reserve Account
- Identify the Punishments and penalties for various offences including impersonation.

CHAPTER OVERVIEW

This chapter explains the provisions contained in Chapter IV (comprising Section 43 to 72) of the Companies Act 2013 (hereinafter referred to as the Act or this Act) regarding the '**Share Capital and Debentures'**, along with relevant procedural aspects explained in the *Companies (Share Capital and Debentures) Rules, 2014*.



1. INTRODUCTION

Chapter IV	**Consists of sections 43 to 72 as well as the Companies (Share Capital and Debentures) Rules, 2014.**

Finance, the lifeblood for running the affairs of a company, can be raised, *inter-alia,* by issuing shares and debentures. In fact, shares and debentures are financial instruments which help in arranging funds for the company. Under the Companies Act, 2013, they are jointly referred to as "securities".

Shares represent ownership interest in a company with entrepreneurial risks and rewards whereas debentures depict lenders' interest in the company with limited risks and returns.

Sometimes, after the issue of capital, a company may either alter or reduce the share capital depending upon the exigencies of the situation. The company has to follow the requisite provisions for alteration or reduction of share capital.

Both the shares and debentures are presented in the Balance Sheet on the liabilities side of the issuer company and on the assets side of the investor and lender respectively.

Legal provisions relating to these instruments are covered under Chapter IV of the Companies Act, 2013 (comprising sections 43 to 72) and the *Companies (Share Capital & Debentures) Rules, 2014* as amended from time to time along with endorsement in the company formation documents or approved at the suitable company forum, wherever necessary.

2. SHARE CAPITAL-TYPES

WHAT ARE SHARE AND STOCK?

Share – Definition & Description

Section 2(84) of the Act defines **share** as a **share in the share capital** of a company and **includes stock**.

Capital of a company is termed as share capital, which is divided into units; having a certain face value. Each such unit is termed as **share**.

New London & Brazilian Bank v. Brockle Bank[1]

A share is not a sum of money..., but **is an interest** measured in a sum of money, and made up of **various rights**, contained in the **contract**, including the right to a sum of money of a more or less amount.

Around two decade later, **J. Farwell** in landmark case of **Borland's Trustee v Steel Brothers & Co Ltd**[2] place his trust in the opinion stated above, and observe that share is the interest of a shareholder in the company measured by a sum of money, for the purpose of liability in the first place and of interest in the second, and also consists of a series of mutual covenants entered into by all the shareholders inter se in accordance with the provisions of the Companies Act and the Articles of Association.

[1] (1882) 21 Ch D 302 (F)
[2] (1901) 1 Ch 279

Example 1 - Sun Bakers Limited has authorised share capital of ₹ 50.00 lakh. The face value of each unit of capital or 'share' is ₹ 10. In this case, it can be said that the company has 5.00 lakh shares of ₹ 10 each. When these shares (either in part or whole) are allotted to various persons, they, on the date of allotment, become shareholders of the company.

Note: Company limited by share or those which having share capital has to quote in their memorandum - The share capital of the capital is _ _ _ _ _ rupees, divided into _ _ _ _ _ shares of _ _ _ rupees each.

Stock - Description

The definition of 'share' states that the term 'share' includes **'stock'**. If a company undertakes to aggregate the fully paid up shares of various members as per their requests and merge those shares into one **fund**, then such fund is called **'stock'**. In more simple words we can say that 'stock' is a collection or **bundle of fully paid-up shares**.

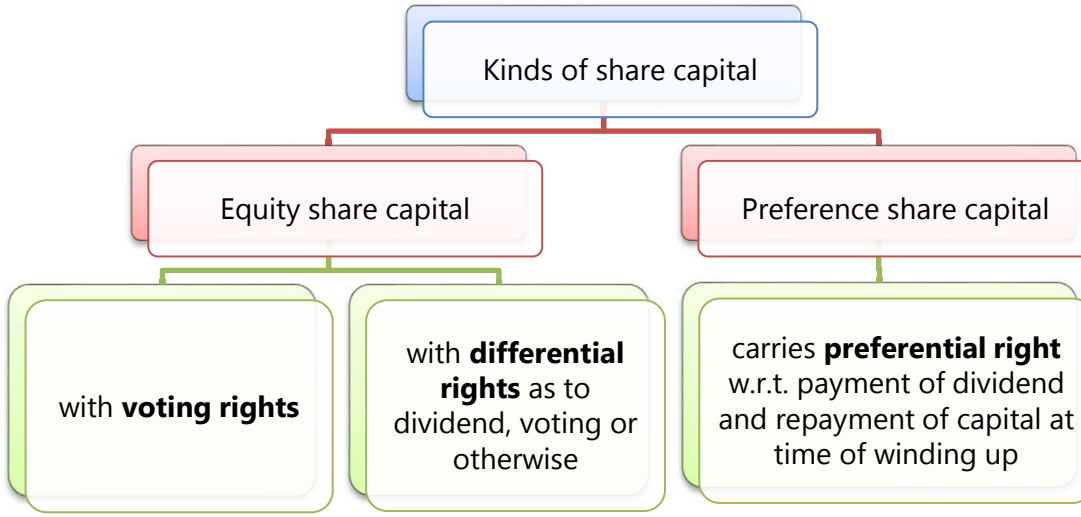
Section 61 (1) (c) of the Act, empower a limited company having a share capital to **convert** all or any of its **fully paid-up shares** into stock, and **reconvert** that stock into fully paid-up shares of any denomination.

Students are advised to take note of - What make stock different?

Stock is stated in lump sum whereas a 'share' being the smallest unit is having face value. Originally shares are issued to the shareholders while in case of stock, the fully paid-up shares of the members are converted into 'stock' afterwards. Thus, 'stock' is not issued originally but is obtained by conversion of fully paid-up shares.

KINDS OF SHARE CAPITAL [SECTION 43]

Broadly, there are two kinds of share capital of a company limited by shares; **Equity share capital** and **Preference share capital**. Equity Share capital can be further segregated into two categories based upon rights. Following diagram depicts kinds of share capital;



Preference Share Capital [explanation II to section 43]

Preference share capital is that part of issued share capital of any company limited by shares which carries preferential right in respect to;

a. **Payment of dividend**, may be absolute amount or at fixed rate (which may either be free of or subject to income-tax); and

b. **Repayment of capital**, in the case of **winding up or repayment of capital.** This preference exists only **up to amount paid up** or **deemed to have been paid up** on the shares, unless there is an agreement in contrary to this.

Example 2 – Ind-swift Pharma Labs Limited and Panacea Biotec Limited issued preference share.

Ind-swift Pharma provides that the preferential dividend may be a **fixed amount** say ₹ 5,00,000 in one year, payable to preference shareholders before anything is paid to the ordinary shareholders.

Whereas the Panacea Biotec provides that the amount payable as preferential dividend may be calculated at a **fixed rate @ 8 percent of the nominal value** of each share.

Note:

1. Nothing contained in this Act shall affect the rights of the preference shareholders who are entitled to participate in the proceeds of winding up before the commencement of this Act.

2. Preference shareholders **may also participate** in equity pool post the preferential entitlements.

But to find out their rights of participation we must look within the four corners of the **articles of association** and the **terms of the issue**.

If the right to participate in the surplus is not specified in the terms of the issue, preference shares are presumed to be not participating. This was affirmed by the House of Lords in Scottish Insurance Corpn Ltd vs. Wilsons & Clyde Coal Co Ltd[3]

3. Preference shares are always **presumed to be cumulative** and the accumulation of dividend can be excluded only by a clear provision in the articles of association[4]

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[5]

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*.

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[3] 1949 AC 462 HL
[4] Staples v Eastman Photographic Materials Co (1896)
[5] Bihar State Financial Corporation vs. CIT Bihar (1976)

Equity shares are often referred as to ordinary share and sometime as common share

Equity Shares with Differential Rights [Rule 4 of the *Companies (Share capital and Debenture) Rules, 2014]*

I. Conditions to issue shares with differential rights

As per ***sub-rule 1***, A company **limited by shares** may issue equity shares with differential rights as to dividend, voting or otherwise, if it complies with the following **conditions**:

a. The articles of association of the company authorizes the issue of these shares.

b. Approval of the shareholders is obtained by passing of **ordinary resolution** at the general meeting. A listed public company is required to pass the **resolution through postal ballot**

c. The voting power in respect of shares with differential rights of the company shall not exceed **Seventy Four**[6] percent of total voting power 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. The company **has not defaulted** in the payment of declared dividend, interest, or coupon; redemption of preference shares or debenture; or repayment of matured deposits.

f. The company **has not defaulted** in the

1. Payment of dividend on preference shares, or

2. Payment of interest or Repayment of any term loan from a Public Financial Institution (PFI) or State-level Financial Institution (SFI) or Scheduled Bank.

3. Repayment of any term loan from a PFI or SFI or Scheduled Bank.

4. Statutory dues relating to its employees

5. Crediting the amount in Investor Education and Protection Fund

[6] W.e.f. 16th August 2019 through G.S.R. 574(E) (Note - Earlier limit was 26%)

Note:

A company may issue equity shares with differential rights upon **expiry of five years** from the **end of the financial year** in which **default** mentioned in point **f** stated above, was **made good**[7]

g. the company **has not been penalized** by Court or Tribunal during the **last three years** of any offence under

1. Reserve Bank of India Act, 1934[8],

2. Securities and Exchange Board of India Act, 1992[9],

3. Securities Contracts Regulation Act, 1956[10],

4. Foreign Exchange Management Act, 1999[11] or

5. Any other special Act, under which such companies being regulated by sectoral regulators.

Note:

1. Equity shares with differential rights issued by any company under the provisions of the Companies Act, 1956[12] and the rules made thereunder, shall continue to be regulated under such provisions and rules.[13]
2. Here it is also worth noting that; before the amendment made in year 2000, to the Companies Act 1956[14], the shares with differential voting rights were not permitted to be issued. Though such differential voting rights existed prior to the enactment of the Companies Act 1956[15].

II. Contents of Explanatory statement (annexed to notice)

Sub-Rule 2 provides the explanatory statement annexed to the notice of the general meeting or of a postal ballot shall contains various matters like **particulars**

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[7] Inserted w.e.f. 19th July 2016 though G.S.R. 704(E) - Companies (Share Capital and Debentures) Third Amendment Rules, 2016
[8] Act 2 of 1934
[9] Act 15 of 1992
[10] Act 42 of 1956
[11] Act 42 of 1999
[12] Act 1 of 1956
[13] W.e.f 18th June 2014, inserted though G.S.R. 413.(E). - Companies (Share Capital and Debentures) Amendment Rules, 2014 after Rule 4(6).
[14] *Supra* note 15
[15] *ibid*

of the issue including its size, **details of differential rights**, etc.

III. Prohibition on Conversion

Sub-Rule 3 prohibit the conversion of 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

Sub-Rule 4 requires, the Board of Directors to disclose the specified particulars, in the Board's Report for the financial year in which the issue of equity shares with differential rights was completed.

V. Rights to the holders of the equity shares with differential rights

Sub-rule 5 states that subject to the differential rights, the holders of the equity shares with differential rights shall enjoy all other rights such as bonus shares, rights shares, etc., which the holders of equity shares are entitled to.

VI. Particulars of shares to be maintained in the register of members

Sub-rule 6 provides that where a company issues equity shares with differential rights, 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.

Section 43 shall not apply to:

1. Specified IFSC Public Company, where memorandum of association or articles of association of such company provides for it.[16]
2. Private company, where memorandum or articles of association of the private company so provides; however, this exemption shall be available to only that private company which has not committed a default in filing its financial statements under section 137 or annual return under section 92 with the Registrar.[17]

[16] GSR 8 (E), dated 4th January, 2017

[17] GSR 464 (E), dated 5th June, 2015 as amended by GSR 583 (E), dated 13th June, 2017

3. CERTIFICATE OF SHARES [SECTION 46]

PRIMA FACIE EVIDENCE OF TITLE

Shares Issued and held in physical form

As per sub-section 1, a **certificate** specifying the shares held by any person, shall be ***prima facie*** **evidence of the title** of the person to such shares if issued;

a. Under the common seal if any of the company **or**

b. Signed by two directors **or**

c. Signed by a director and the Company Secretary, wherever the company has appointed a Company Secretary

Note:

1. Since *w.e.f. 29-05-2015 though* Companies Amendment Act 2015, requirement to have common seal is optional for companies, hence physical share certificate issued under sign of two director or of one director along with company secretary is valid.
2. If the composition of the Board permits of it, at least one of the aforesaid two directors shall be a person other than the managing or whole-time director
3. A director shall be deemed to have signed the share certificate if his signature is printed thereon as a facsimile signature by means of any machine, equipment or other mechanical means such as engraving in metal or lithography, or digitally signed, but not by means of a rubber stamp, provided that the director shall be personally responsible for permitting the affixation of his signature thus and the safe custody of any machine, equipment or other material used for the purpose.

Shares held in Depository Form

As per sub-section 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.

Students are advised to take note:

Requirement regarding securities issued in Dematerialised form, can be referred in Rule 9 and Rule 9A of the *Companies (Prospectus and Allotment of Securities) Rules, 2014*.

Rule 9A was inserted by the *Companies (Prospectus and Allotment of Securities) Third Amendment Rules, 2018*, w.e.f. 2-10-2018 and requires every unlisted public company to issue the securities only in dematerialised form and also facilitate dematerialisation of all its existing securities.

ISSUE OF RENEWED/DUPLICATE SHARE CERTIFICATE [SUB-SECTION 2 READ WITH RULE 6 OF THE COMPANIES (SHARES AND DEBENTURES) RULES, 2014]

Issue of renewed certificate

A case wherein originally issued share certificate has been defaced, mutilated or torn, a renewed share certificate in replacement shall be issued, in lieu of surrender of such original certificate, to the company.

Note:

1. A company may replace all the existing certificates by new certificates upon sub-division or consolidation of shares or merger or demerger or any reconstitution without requiring old certificates to be surrendered
2. On renewed certificate it shall be stated that it is "Issued in lieu of share certificate No..... sub-divided/replaced/on consolidation"
3. Company may charge such a fee as board may think fit, but not exceeding ₹ 50 per certificate; and no fee shall be payable pursuant to scheme of arrangement sanctioned by the High Court or Central Government.

Issue of duplicate certificate

A case wherein share certificate originally issue has been lost or destroyed, a share certificate in duplicate may be issued if board is consented for the same based upon evidences produced.

Students are advised to take note;

1. Company may charge fees as the Board thinks fit, not exceeding rupees fifty per certificate
2. On the face of duplicate certificate, it shall be stated prominently that it is "duplicate issued in lieu of share certificate No....." and the word "duplicate" shall be stamped or printed prominently
3. In case unlisted companies, the duplicate share certificates shall be issued within a period of three months and in case of listed companies such certificate shall be issued within fifteen days, from the date of submission of complete documents with the company respectively.

Record of renewed and duplicate certificate to be maintained

Particulars of every renewed and duplicate share certificates maintained in Form SH 2 with cross reference to register of members, in shape of register.

Such register shall be kept at **registered officer or any other place where register of members in custody** of company secretary or such other person as may be authorised by the Board.

All entries made in such register shall be **authenticated by the company secretary** or such other person as may be authorised by the Board.

MANNER OF ISSUE OF CERTIFICATES/DUPLICATE CERTIFICATES

Sub-section 3 overrule the articles of a company, and say the issue of a certificate of shares or the duplicate thereof, the particulars to be entered in the register of members and other matters shall be in manner and form as prescribed in rule 5, 6, and 7 of the *Companies (Shares and Debentures) Rules, 2014*.

Rule 5 of the *Companies (Shares and Debentures) Rules, 2014* applies, where shares are not in demat form

Share certificate is in vogue in case of shares which are **held in the physical form**, not in the demat form (under the depository mode). Hence provisions contained in *rule 5* of the *Companies (Shares and Debentures) Rules, 2014* pertaining to share certificate applicable where shares are not in demat form.

Pre-requisites for issue of share certificate

Share Certificate shall be issued on **surrender of letter of allotment** or fractional coupons of requisite value (save in cases of issues against letters of acceptance or of renunciation, or in cases of issue of bonus shares); in pursuance of a **resolution passed by the Board.**

Form of share certificate

Certificate of share shall be in Form SH 1 or as near thereto as possible and shall specify;

a. The name(s) of the person(s) in whose favor the certificate is issued,

b. The shares to which it relates and

c. The amount paid-up thereon.

Recording of particulars stated in share certificate

The particulars of every share certificate issued in accordance with sub-rule (1) shall be entered in the Register of Members maintained in accordance with the provisions of section 88 along with the name(s) of person(s) to whom it has been issued, indicating the date of issue.

Maintenance of share certificate forms and related books and documents (Rule 7 of *the Companies (Shares and Debentures) Rules, 2014*)

All blank forms to be used for issue of share certificates shall be printed and the printing shall be done only on the authority of a resolution of the Board and these shall be consecutively machine-numbered. Such forms shall be kept in the custody of the secretary or such other person as the Board may authorise for the purpose.

All books pertain to record of share certificates shall be preserved in good order not less than thirty years and in case of disputed cases, shall be preserved permanently.

All certificates surrendered to a company shall immediately be defaced by stamping or printing the word "cancelled" in bold letters and may be destroyed after the expiry of three years from the date on which they are surrendered, under the authority of a resolution of the Board and in the presence of a person duly appointed by the Board in this behalf.

Note:

1. Share Certificate is not a negotiable instrument.
2. Company shall issue only one share certificate in all those cases where shares are held by more than one person jointly with others and delivery of share certificate to any one of them will amount to delivery to all of them.

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

If a company with intent to defraud issues a duplicate certificate of shares, the punishment shall be as specified in table;

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 **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.

4. VOTING RIGHTS [SECTION 47]

VOTING RIGHTS OF MEMBERS HOLDING EQUITY SHARE CAPITAL [SUB-SECTION 1]

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. But in case of **Nidhi Company**, no member shall exercise voting rights on poll in **excess of five per cent**, of total voting rights of equity shareholders.[18]

Note:

1. As per section 2(93) Voting right means the right of a member of a company to vote in any meeting of the company or by means of postal ballot.

2. Section 106 specify provisions regarding restriction on voting rights.

3. Section 43 has overriding effect on section 47, hence holders of equity share capital with differential rights will exercise voting right as per clauses of article of association or terms of issue; rather on proportional basis.

VOTING RIGHTS OF MEMBERS HOLDING PREFERENCE SHARE CAPITAL [SUB-SECTION 2]

Every member of a company limited by shares who is holding any preference share capital shall, in respect of such capital, have a right to vote on **resolution**;

a. Placed before the company which directly **affect the rights** attached to his preference shares, and

b. For the **winding up** of the company, or for the **repayment or reduction** of its **equity or preference** share capital.

Note:

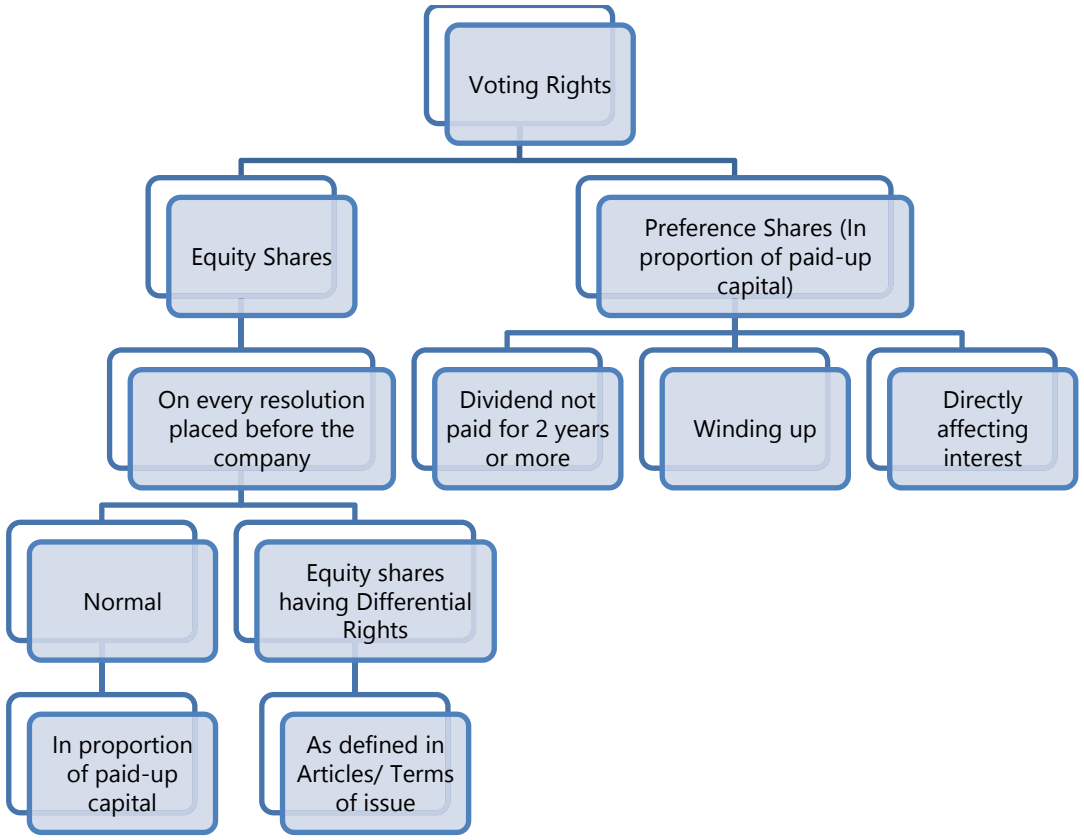
Voting right of preference share holder, on a poll shall be in proportion to his share in the paid-up preference share capital of the company.

Second Proviso to section 47 (2) empowers preference shareholder with right to vote on all the resolutions placed before the company, in case where the dividend in respect of his class of preference shares has not been paid for a period of two years or more.

First Proviso to section 47 (2), provides that in case of resolutions wherein both equity shareholders and preference shareholders are entitled to vote, the proportion of the voting rights of equity shareholders to the voting rights of 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.

[18] Notification No. GSR 465 (E), dated 5th June, 2015.

Summary of section 47



Example 4 – Indswift Pharma Labs Limited raised the capital of 300 crore through issue of single series of 8% preference share apart from 1200 crore ordinary shares. Indswift last paid dividend to such preference share holder, for 2019-20.

Preference shareholder w.e.f 1st April 2022 assume the right to vote on any resolution placed before company. But till 31st March 2022 they can vote only on that resolution which directly affect the rights attached to his preference shares or involve matter of the winding up of the company, or for the repayment or reduction of its equity or preference share capital.

The proportion of voting right of equity shareholders to the voting rights of the preference shareholders shall be 4:1.

Section 47 shall not apply to;

1. A Specified IFSC Public Company, where memorandum of association or articles of association of such company provides for it.[19]
2. A private company, where memorandum or articles of association of the private company so provides, however, this exemption shall be avaible to only that private company which has not committed a default in filing its financial statements under section 137 or annual return under section 92 with the Registrar.[20]

5. VARIATION OF SHAREHOLDERS' RIGHTS [SECTION 48]

A shareholder who was given the right to purchase the shares of the company on a pre-emptive basis was held to constitute a special class distinguishing him from other shareholders who did not have any such right, and consequently, his right was not permitted to be taken away without his consent.[21] If it is proposed to change the rights of any class, certain procedure has to be followed.

Section 48 allows the variation, if **three conditions** (First two stated by sub-section 1, while third and last one by sub-section 2) has been met.

First - There should be a **provision in the memorandum or articles** of the company entitling it to vary such class rights, in absence of same; the **terms of issue** of the shares of that class **not prohibiting such a variation**.

Second - The holders of **at-least 75% of the issued shares** of that class must have given their **consent in writing** or pass a **special resolution** sanctioning the variation at a **separate class meeting**.

Proviso to sub-section 1, provides if variation by one class of shareholders affects the rights of any other class of shareholders, the **consent of three-fourths of such other class of shareholders** shall also be obtained and the provisions of this section shall apply to such variation.

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[19] GSR 8 (E), dated 4th January, 2017
[20] GSR 464 (E), dated 5th June, 2015 as amended by GSR 583 (E), dated 13th June, 2017
[21] Cumbrian Newspapers Group Ltd v Cumberland Sf Westmorland Herald Newspaper & Printing Co Ltd (1987) 2 Comp LJ39.

Third - The holders of at least 10 per cent of the shares of that class who did not consent to or vote in favour of the resolution may apply to the Tribunal and then variation shall not take effect unless and until it is confirmed by the Tribunal.

Procedural Aspects for confirmation from tribunal

An application should be made **within 21 days** of the date of consent or resolution. It can be made by one (or more of their number) as they may appoint in writing; on behalf of the shareholders entitled to make the application

Sub-section 3 provides, the decision of the Tribunal have **binding effect** upon shareholders of the class. Further **sub-section 4** requires the company to **file a copy** of the order with the **Registrar within 30 days** of the date of the order.

Example 5 – A resolution sanctioning the variation has been moved on 1st November 2022, the application with tribunal shall be filled by 22nd November 2022. Further if tribunal pass its order on 4th January 2023, then copy of order shall be filed with registrar by 6th March 2023.

Illustration - MCQ

DBS Chemicals Limited issue ordinary share of different classes. DBS planned to vary rights of one the class wherein there were only 105 holders. 100 out of 105 holders own 0.5% shares of that class, whereas each of remaining 5 holders hold 10% shares of that class. Presuming 100 holder who own 0.5% shares already signed/authorised the consent letter sanctioning the variation, how many holders out of such 5 need to authorise the said letter to approve the variation.

Options;

a. *0*

b. *1*

c. *3*

d. *5*

Answer – **c.** (Refer section 48(1)

The **holders of at-least 75% of the issued shares** of that class must have given their consent in writing or pass a special resolution sanctioning the variation at a separate class meeting.

Mind it is 75% of issued shares' holders not 75% of holders.

Crux of some of landmark judgements – to better understand the 'variation'

New issue of preference shares ranking *pari-passu* with the existing shares does not amount to variation so as to require the consent of preference shareholders.[22]

Cancellation of shares and reduction of capital also do not amount to variation of class rights.[23]

6. CALLS ON SHARE [SECTION 49 TO SECTION 51]

The liability of a shareholder to pay the full value of the shares held by him, which is currently partly paid-up is enforced by making "calls" for payment.

It is worth noting here that every shareholder is under a statutory liability to pay the full amount of his shares as Section 10(2) declares that "all money payable by any member to the company under the memorandum or articles shall be a debt due from him to the company".

But the liability to pay this debt arises only when a valid call has been made. Section 49 lay down the principle of uniformity, whereas section 50 deals with calls in advance and section 51 contains the provisions regarding dividend rights on paid-up amount.

CALL SHALL BE ON UNIFORM BASIS [SECTION 49]

Calls shall be made on a uniform basis on all shares that are falling under the same class.

Note:

1. Usually share with same nominal value are considered as same class, but shares of the same nominal value on which different sums have been paid shall not be deemed, for this purpose, to fall under the same class.
2. A shareholder on whom a regular call for payment has been served may choose to pay only a part of the sum due.

[22] White v Bristol Aeroplane Co Ltd (1953) 2 WLR 144.
[23] Essar Steel Ltd, re, (2005) 59 SCL457 (Guj)

Here it is important to consider the debt (of calls made) is not **an entire and indivisible debt**, therefore, the company may be bound to accept the amount tendered by the shareholder

3. How much to call on partly-paid share?

This will be the decision of board, subject to clauses to Article and terms of issue.

Example 6 – Prism Glass Limited issued three series of equity shares, all carry the nominal value of ₹ 100, and the paid-up value for each series is 100, 80 and 55 respectively.

All will be considered as different class of shares. Since for first class share is fully paid-up, no call can be made, whereas in case of remaining two classes call can be made.

Illustration – Q&A

Where a shareholder paid the first two calls after a great delay and neglected to pay the third call and the directors, being annoyed, and called upon him to pay the whole amount due. In your opinion is call valid?

Answer - A call can't be made on some of the members only, unless they constitute a separate class of shareholders, hence such a call shall be invalid.[24]

CALLS-IN-ADVANCE [SECTION 50]

As per **Section 50**, a company may, if so authorised by its articles, **accept** from any member the **whole or a part** of the amount **remaining unpaid** on any shares held by him, **although no part** of that amount **has been called up**.

Note

1. Such advance payment will **not entitle** the member to more **voting rights** as compared with other members until all have been called upon to pay.

2. **Interest can be paid** on such advance, **if permitted by article**. Here it is worth nothing that, where the rate of interest is permitted by the articles on such advance payment, same could be varied by shareholders in general meeting. **To illustrate**; a rate 6 percent may increase to 10% by shareholders.[25]

[24] Galloway v Halle Concerts Society, (1915) 2 Ch 233
[25] CIT v Manipal Industries Ltd, (1997) 12 SCL 15 (ITAT).

Example 7 - 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.

Illustration – Q&A

Moon Star Machineries Limited is authorised by its articles to accept the whole or any part of the amount of remaining unpaid calls from any member even if no part of that amount has been called up by it. 'Anand', a shareholder, deposits in advance the remaining amount due on his partly paid-up shares without any calls being made by the company. Advise the company about the validity of accepting money in advance.

Answer - In view of the authorisation given by the Articles, Moon Star Machineries Limited is permitted to accept the advance amount received on unpaid calls from Anand. In other words, this is a valid transaction.

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.

7. ISSUE OF SHARES AT A PREMIUM OR DISCOUNT [SECTION 52 & SECTION 53]

ISSUE OF SHARES AT A PREMIUM & APPLICATION OF PREMIUM [SECTION 52]

Since there is no restriction imposed by the Act on the sale of shares at a premium, hence if the market exists, a company may issue its shares at a price higher than their face/nominal value. But the Act does regulate the disbursement of the amount collected as premium through section 52.

Note:

1. The power to issue shares at premium need not be specifically provided by AOA.
2. SEBI guidelines have to be observed by listed entities, as regulations indicate when an issue has to be at par and when premium is chargeable.

When a company issues shares at a price higher than their face value, the shares are said to be issued at premium and the differential amount is termed as premium.

Example 8 - A share having face value of ₹ 10 is issued at a price of ₹ 14. The amount over and above the face value of ₹ 10 i.e. ₹ 4 is called premium.

Practical Insight

Lloyds Luxuries IPO opens on Sep 28, 2022, and closes on Sep 30, 2022. The date of listing on NSE SME was October 11, 2022 (Tuesday). Fixed issue price against the Face Value of ₹ 10 per share is ₹ 40 per share. Hence, premium charges is ₹30 per share.

Transfer of premium to Securities Premium Account [Sub-section1]

Sub-section 1 lay-down following principles that shall be observed in regards to premium;

a. Premium may be received in **cash** or in **kind**.

b. The amount of premium so received, whether in cash or kind, shall be carried to a separate account to be known as the **Securities Premium Account**.

c. The amount to the credit of share premium account has to be maintained with the same sanctity as **paid-up share capital**

d. It can be **reduced** only **in the manner** of **paid-up share capital can be reduced** under this act. Liberty is, however, given to use the fund in the sub-section 2 and 3.

Note:

1. The amount to the credit of the share premium account has to be shown as a separate item in the Balance-sheet under Schedule III, Part B of the Act and if it was disposed of either wholly or partly, then disclosure shall be made 'how it was disposed'?

2. The DCA was of opinion that the amount of premium can't be treated as a free reserve as it is in the nature of a capital reserve.[26]
3. A reduction of the premium account was allowed under a scheme which experts had approved as fair, just and proper.[27]

Application of Premium received on Issue of Shares [sub-section 2 & 3]

Sub-section 2 allow the companies to apply securities premium account for;

a. Issue of **fully paid bonus shares**;

b. **Writing off** the **preliminary expenses**;

c. **Writing off** the **issue expenses** (expenses including commission paid or discount allowed on any issue of shares or debentures);

d. **Premium** payable on the **redemption** (of any preference shares or of any debentures); or

e. **Buy-back** (purchase of its own shares or other securities under section 68).

Sub-section 3 has overriding effect over sub-section 1 and 2. It restricts the application of Securities Premium Account 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

For the purpose of;

a. Issue of **fully paid bonus shares**;

b. **Writing off** the **issue expenses** (expenses including commission paid or discount allowed on any issue of shares);

c. **Buy-back** (purchase of its own shares or other securities under section 68).

PROHIBITION ON ISSUE OF SHARES AT DISCOUNT [SECTION 53]

Where the issue price is lower than the face value of the shares, such issue of shares is regarded as being issued at discount and the differential amount is known as discount.

[26] Circular No 3/77 of 15-4-1977
[27] Zee Tele Films Ltd, re, (2005) 124 Comp Cas 102 (Bom).

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).

Sub-section 1, except the issue of 'Sweat Equity Shares' under section 54 of this Act, a company **shall not issue shares at discount**.

Further, **sub-section 2**, provides any share issued at discount by company is **void**.

Sub-section 2A, is overriding provision (to sub-section 1 and 2) inserted though Companies (Amendment) Act, 2017 empowers the company to issue shares at discount to its creditors as result of **converting their debt on company into shares** as a result of;

a. Statutory resolution plan or

b. Debt restructuring scheme

In accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.

Sub-section 3 provides the penalties that can be imposed where any company fails to comply with the provisions of Section 53;

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

Note:

It is to be noted that the restrictions mentioned in Sections **52 and 53** shall apply only in respect of issue of shares (either equity or preference shares) but not to the issue of any debt related products like bonds or debentures whose pricing is mostly governed by YTM (yield to maturity) considerations.

8. ISSUE OF SWEAT EQUITY SHARES [SECTION 54]

MEANING OF 'SWEAT EQUITY SHARES' [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.

Hence one can say, sweat equity shares are issued to keep the employees of a company motivated by making them partner in the growth of the company. Mind it, Sweat equity shares is a different concept from Employee stock option in multiple ways.

Section 54 lists out the conditions that shall be fulfilled by company prior to issue of sweat equity share apart from designates these at equal footing to equity shares.

STATUS OF SWEAT EQUITY SHARES AND HOLDER THEREOF [SECTION 54(2)]

Sub-section 2 provides;

a. 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 of the Act

b. The holders of sweat equity shares shall rank ***pari-passu*** with other equity shareholders.

Pari-passu is a Latin phrase that means "on equal footing"

CONDITIONS FOR ISSUE OF SWEAT EQUITY SHARES [SECTION 54(1)]

According to Section 54 (1), a company may issue sweat equity shares if all of the following conditions are fulfilled;

a. Share of that class must be **already issued**

b. Issue is authorised by a **special resolution** passed by the company;

c. Resolution **specifies the details** regarding 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;

d. The issue of sweat equity shares must be in **accordance with regulations/rules** as state in table;

Company	Applicable Provisions/Regulations
Listed on Recognised Stock Exchange	Regulations made by the Securities and Exchange Board in this behalf
Other than above	Rule 8 of the *Companies (Share and Debentures) Rules, 2014*

Illustration – T&F

A company that incorporated and commenced the business on 9th Nov 2022, can issue sweat equity share only after 8th Nov 2023.

Answer - **False.** Currently there is no condition prescribed by section 54 (1) regarding age of company.

Students are advised to take note;

Clause c to section 54(1) omitted by the Companies (Amendment) Act, 2017 w.e.f 7th May 2018 "not less than one year has, at the date of such issue, elapsed since the date on which the company had commenced business".

SOME OF THE IMPORTANT PROVISIONS CONTAINED IN RULE 8 *OF THE COMPANIES (SHARE AND DEBENTURES) RULES, 2014*

Meaning of Employee (Explanation I to sub-rule 1)

Employee means

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; or

c. an employee or a director as defined above, either of subsidiary or holding company of concerned company; in India or outside India

Meaning of 'Value additions (Explanation II to sub-rule 1)

The expression 'Value additions' means;

a. **Actual** or **anticipated economic benefits** derived or to be derived by the company from an expert or a professional

b. For providing know-how or making available rights in the nature of **intellectual property rights**,

c. By such person to whom sweat equity is being issued

d. For which the **consideration is not paid or included in the normal remuneration** payable under the contract of employment (in the case of an employee).

Validity of Special Resolution (Sub-rule 3)

The **special resolution** authorising the issue of sweat equity shares shall be valid for making the allotment within a **period of not more than twelve months** from the date of passing.

Limit on issue of Sweat Equity Shares (Sub-rule 4)

During a year, the **maximum amount/limit** for which sweat equity shares can be issued is higher of;

a. Fifteen percent of the existing paid up equity share capital **or**

b. Shares of the issue value of rupees five crore.

The issuance of sweat equity shares (cumulative, including all previous issues, if any) **shall not exceed twenty five percent**, of the paid-up equity capital of the Company at any time. This limit for Startup companies is fifty percent of paid up capital upto ten years from the date of its incorporation or registration.

Lock-in Period [Sub-rule 5]

Sweat equity shares issued to directors or employees shall be locked in/non-transferable for a **period of three years** from the date of allotment.

Valuation of Sweat Equity Shares [Sub-rule 6]

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.

Quoted market prices in an active market are the best evidence of fair value and should be used, where they exist, to measure the financial instrument.

Valuation of IPR/know-how/value additions [Sub-rule 7]

The valuation of intellectual property rights or of know how or 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.

Treatment of non-cash consideration [Sub-rule 9]

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:

Form of Non-cash consideration	**Treatment**
Depreciable or amortizable asset	Carried to the **balance sheet**
Other than above	Shall be recorded as **expense**

Disclosure in the Directors' Report [Sub-rule 13]

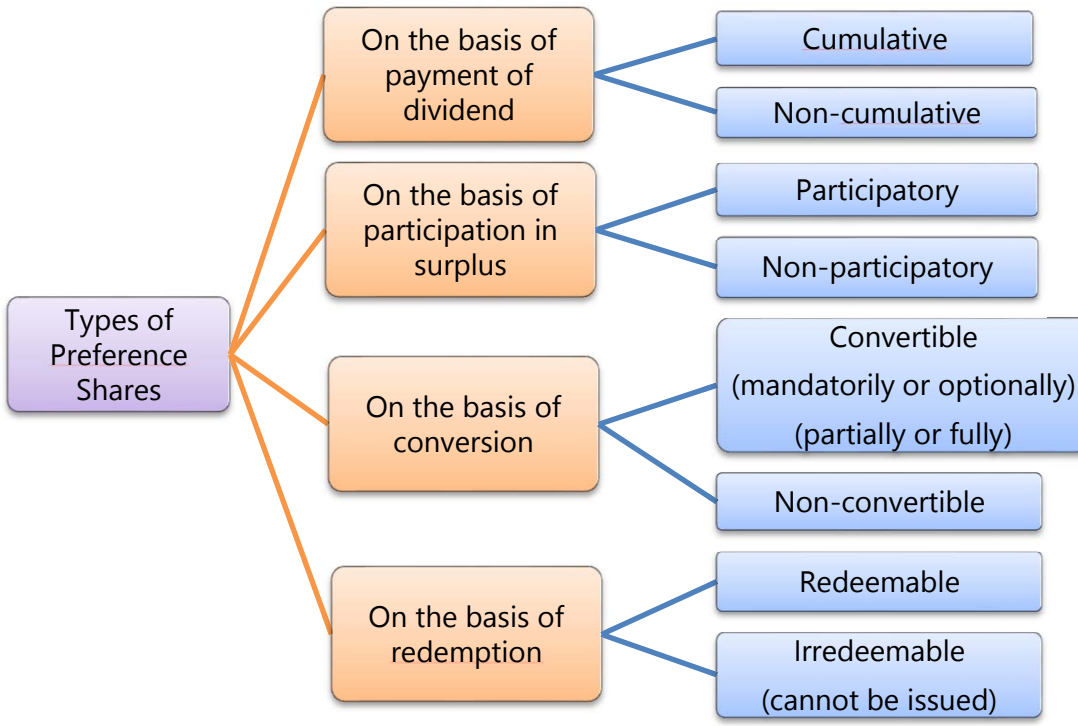
The Board of Directors shall, *inter alia*, disclose in the Directors' Report for the year in which such shares are issued, the specified details of issue of sweat equity shares.

Maintenance of Register [Sub-rule 14]

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. ISSUE AND REDEMPTION OF PREFERENCE SHARES [SECTION 55]

Following diagram depicts the types of preference shares:



PROHIBITION ON ISSUE OF IRREDEEMABLE PREFERENCE SHARES [SUB-SECTION 1]

A company limited by shares shall not issue any preference shares which are irredeemable.

It worth noting that the amendment of 1988 to the Companies Act 1956, abolished the category of irredeemable preference shares.

ISSUE AND REDEMPTION OF REDEEMABLE PREFERENCE SHARE [SUB-SECTION 2]

From the sub-section 1, it can be constructed reasonably that only redeemable preference shares can be issued by company limited by shares, sub-section 2

provides for conditions as applicable to the issue and redemption of redeemable preference shares.

Authorised by Article of Association

A company limited by shares may issue redeemable preference shares only if so authorised by its articles.

Example 10 – Medanta Healthcare Limited is planning to raise the capital through issue of preference share. It article is silent about this. Board of Directors are of opinion that redeemable share can be issued.

Since in the given case article is silent, not authorise the issue of preference shares expressly, hence Medanta Healthcare Limited can't issue preference share. They may alter the article of association.

Maximum Tenor of redeemable Preference Shares and exception thereto

Sub-section 2 also provides preference shares shall be redeemed within a period not exceeding **twenty years** from the date of their issue **subject to** such **conditions** as are prescribed in **Rule 9** of the *Companies (Share Capital and Debentures) Rules, 2014*.

These **conditions** laid-down by **sub-rule 1** are;

a. A **special resolution** in the **general meeting** of the company shall be passed

b. At the time of such issue of preference shares, the company should **not have subsisting default** in the;

- **i.** Redemption of preference shares or
- **ii.** Payment of dividend due on any preference shares.

Sub-rule 2 and 3 enumerates the **matters to be specified** in resolution and explanatory statement to be annexed to the notice of such general meeting in which resolution has to be passed respectively.

Sub-rule 4 requires a company that issues preference shares, to maintain a **Register of Members under Section 88**, which shall contain the particulars in respect of such preference shareholder(s).

Further **sub-rule 5** provides that if company wish to **list** its preference shares on a **recognized stock exchange,** shall issue such shares in accordance with the regulations made by the **SEBI i**n this behalf.

Exception to maximum tenor limit of twenty years (First proviso to section 55(2) read with explanation to section 55 and Rule 9 of the Companies (Share Capital and Debentures) Rules, 2014).

For infrastructure projects specified in schedule VI of this Act, a company may issue preference shares for a period exceeding twenty years but not exceeding thirty years subject to the redemption of at least 10% of such preference shares annually, beginning from 21st year onwards or earlier, on proportionate basis, at the option of preferential shareholders.

Redemption of Preference Shares [Second proviso to section 55(2)]

Second proviso to **section 55(2)** provide conditions for redemption and payment of premium on redemption, if any

a. Preference shares shall be redeemed out of;

1. **Profits** of the company which would otherwise be available for dividend or
2. **Proceeds of a fresh issue** of shares made for the purposes of such redemption.

b. Shares to be redeemed shall be **fully paid**.

c. Where such shares are proposed to be redeemed **out of the profits** of the company;

1. A sum equal to the **nominal amount** of the shares to be redeemed, **out of such profits** (profit & free reserves, which otherwise is available for dividend), shall be transferred to a reserve, called **Capital Redemption Reserve**
2. The amount to the credit of Capital Redemption Reserve has to be maintained with the same sanctity as **paid-up share capital**
3. Capital Redemption Reserve can be **reduced** only **in the manner** of **paid-up share capital can be reduced** under this Act.

For the purpose of this section

1. Redemption of preference shares is not taken as reduction of the company's authorised share capital.
2. The company may issue new shares up to the nominal amount of the shares redeemed and the capital shall not be deemed to have been increased.

Example 11 - 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 account 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.

d. Source of premium, if any; payable at redemption of preference shares

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 shall be provided for out of the profits of the company, before the shares are redeemed.

Provided also that premium, if any, payable on redemption of any preference shares issued on or before the commencement of this Act by any such company 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.

In a case not falling under above scenario, the premium, if any, payable on redemption 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.

Summary of above provisions are tabled below;

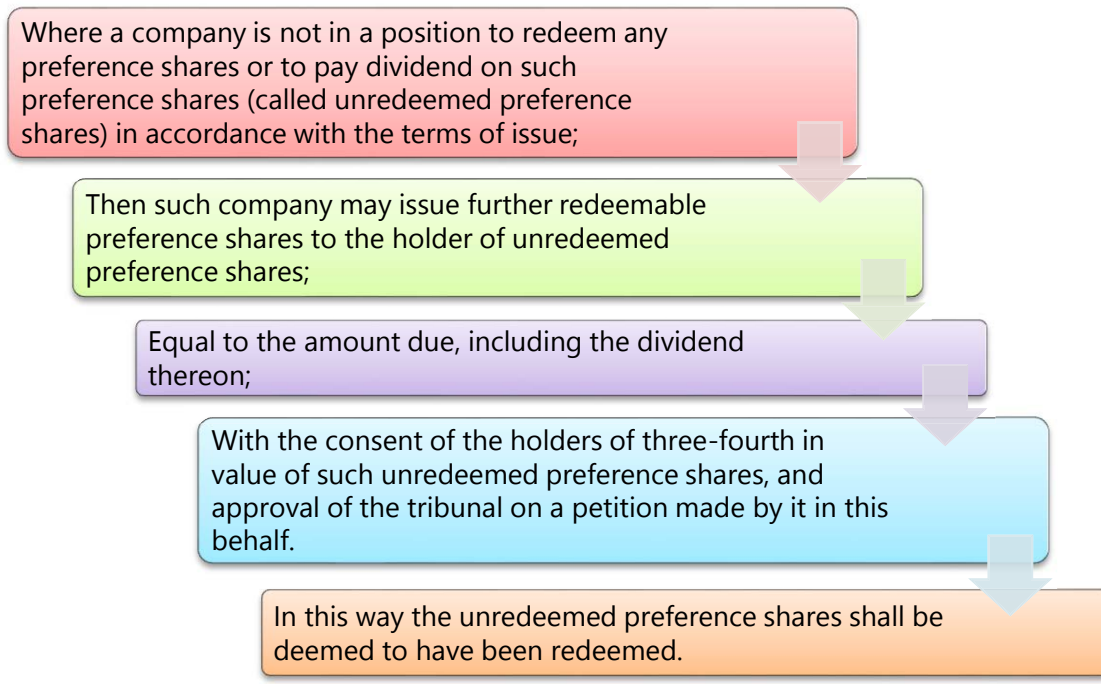
Category	**Source**	**Timing (Shall be provided)**
Such class of companies, as may be prescribed and whose financial statement comply with the accounting standards prescribed for such class of companies under section 133	Out of the **profits** of the company	before such shares are redeemed

Premium payable on redemption of any preference shares issued on or before the commencement of this Act	Out of the **profits** of the company **or** out of the company's **securities premium account**	
Any other case		

Issue of further Redeemable Preference Shares (if a Company is unable to redeem existing preference shares or pay dividend) [Sub-section 3]

Where a company is not in a position to redeem any preference shares or to pay dividend on such preference shares (called unredeemed preference shares) in accordance with the terms of issue; then such company may issue further redeemable preference shares to the holder of unredeemed preference shares; equal to the amount due, including the dividend thereon; with the consent of the holders of three-fourth in value of such unredeemed preference shares, and approval of the tribunal on a petition made by it in this behalf.

In this way the unredeemed preference shares shall be deemed to have been redeemed.



Note:

In regards to preference shares held by shareholder who have not consented to the issue of further redeemable preference shares, the tribunal shall order the redemption forthwith; while giving approval under section 55(3)

Example 12 – Bell Homes Furnisher Limited (BHFL) unable to redeem the preference shares as they become due. Hence BHFL decided to issue further preference share against unredeemed preference shares. Holder holding 93% of such unredeemed preference shares in value, gave their consent; tribunal also assented to issue of further preference shares. The 18 holders who own remaining 7% seek redemption of shares held by them.

In this case while giving approval under section 55(3), tribunal shall order the redemption forthwith of shares (7% in value) held by dissenting 18 holders.

Utilisation of CRR Account [Sub-section 4]

The capital redemption reserve account may be applied in paying up unissued shares of the company to be issued to the members as fully paid bonus shares.

10. TRANSFER AND TRANSMISSION OF SECURITIES AND THE ALLIED PROVISIONS [SECTION 56 TO SECTION 59]

The procedures and formalities for the transfer of the securities as laid down by sections 56-59 are largely applicable to securities that are in other form than demat form.

TRANSFER AND TRANSMISSION OF SECURITIES OR INTEREST OF MEMBER IN COMPANY [SECTION 56]

Requirement for Registering the Transfer of Securities [Sub-section 1]

Except, where the transfer is between persons both of whose names are entered as holders of beneficial interest in the **records of a depository**

A company **shall register a transfer** of;

a. securities of the company, or

b. the interest of a member in the company in the case of a company having no share capital,

Only if, following **conditions** fulfilled prior to such registration;

a. The **instrument of transfer** must be **executed** both by the transferor and the transferee.

b. The instrument must specify the **name, address and occupation**, if any, of the transferee.

c. The instrument of transfer should be **duly stamped and dated**.

d. The instrument of transfer should be in the **prescribed form**. As per Rule 11 (1) of *the Companies (Share Capital and Debentures) Rules, 2014*, Form No. SH-4 is to be used, in case securities are held in physical form

e. The instrument should be delivered to the company along with the **certificate relating to the shares** transferred **within 60 days** from the date of execution. If the share certificate is not in existence, the **letter of allotment** of securities should be filed.

The proviso to Section 56(1) says that where **the instrument of transfer has been lost or it has not been delivered** within the prescribed period (i.e. 60 days from the date of Execution), the company may register the transfer on such terms as to **indemnity** as the Board may think fit.

Transfer of partly paid Shares on an application of transferor alone (Sub-section 3 read with rule 11 (3) of *the Companies (Share Capital and Debentures) Rules, 2014*

Where an **application is made by the transferor alone** and relates to partly paid shares, a company shall not register a transfer of **partly paid shares**, unless the company has given a 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 13 - Himanshu has received a notice from Chaitanya Progressive Books Private Limited on 7th August, 2023 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, 2023.

Exemptions[28] in case of government companies/securities

Government Company, which has not committed a default in filing its financial statements under section 137 or Annual Return under section 92 with the Registrar given.

Full exemption from conditions laid-down by section 56(1) in respect to **transfer of securities held by nominees of the Government.**

Partial exemption in respect to **transfer of bonds issued by a Government company**. Only 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. There is no requirement of proper instrument of transfer, to be duly stamped and executed by or on behalf of the transferor and by or on behalf of the transferee.

Power to Register Transmission not affected by section 56 (1) (Sub-section 2)

The power of company to register transmission shall not be affected by the conditions imposed by Section 56 (1) for registration of transfer.

Hence company is empowered to register transmission of right, if it receives an intimation from any person to whom such right has been transmitted. There is no need for submission of instrument of transfer in case of transmission.

Transmission (vis-à-vis transfer).

The word '**transmission**' means devolution of title to securities otherwise than by transfer, for example, devolution by death, succession, inheritance, bankruptcy, marriage, etc. On registration of the transmission of securities, the person entitled to transmission of securities becomes the holder and is entitled to all rights and subject to all liabilities arising therefrom.

While transfer of shares is brought about by delivery of a proper instrument of transfer (viz, transfer deed) duly stamped and executed, transmission of shares is done by forwarding the necessary documents (such as a notarised copy of death certificate) to the company.

[28] In terms of Notification No. GSR 463 (E), dated 5th June, 2015

Few cases of transmission for better understanding - In the following cases (mind it this list is not exhaustive, only illustrative), transmission of shares shall take place;

1. **Death:** When a shareholder expires, his shares need to be transmitted to his legal representative.
2. **Insolvency:** When a shareholder becomes insolvent, his shares are to be transmitted to his Official Receiver.
3. **Lunacy:** When a shareholder becomes lunatic, his shares are to be transmitted to his administrator appointed by the Court.

Transfer of Security of the Deceased Person by his Legal Representative [Sub-section 5]

The transfer of any security (or other interest in company) made by legal representative of a deceased person, shall be valid as if such legal representative is holder at the time of the execution of the instrument of transfer; even if, in actual such legal representative is not a registered holder.

This sub-section is basically bringing ease to legal heir with deeming effect of being holder of security or other interest in company of a deceased person.

Example 14 - 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.

Note - 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. This is so because transfer deed cannot be signed by the deceased person as transferor.

On receipt of these documents, the company will scrutinize them and if found in order, it shall proceed to enter the name of Richa Daniel in the Register of Members. Consequently, the name of the deceased person *i.e.* Alexender Daniel shall be deleted. Further, new share certificates will be issued in the name of Richa Daniel, the legal representative of Alexender Daniel.

Time Period for Delivery of certificates [sub-section 4]

Every company shall, unless prohibited by any provision of law or any order of Court, Tribunal or other authority, deliver the certificates of all securities allotted, transferred or transmitted;

Particulars	Time Period for delivering the Certificates
In the case of subscribers to the memorandum.	Within a period of **two months** from the date of **incorporation**.
In the case of any allotment of any of its shares by a company.	Within a period of **two months** from the date of **allotment**.
In the case of a transfer of securities.	Within a period of **one month** from the date of receipt of the **instrument of transfer** by the company
In the case of a transmission of securities.	Within a period of **one month** from the date of receipt of the **intimation of transmission** by the company
In the case of any allotment of debenture.	Within a period of **six months** from the date of **allotment**.
In the case of all securities by specified IFSC public and private company[29]	Within a period of **sixty days** after incorporation, allotment, transfer or transmission.

[29] GSR 9 (E), dated 4th January, 2017

Note:

In case where the securities are dealt with in a depository, the company shall intimate the details of allotment of securities to depository immediately on allotment of such securities. (Proviso to sub-section 4)

Example 15 – A request for transfer of shares has been received by Ind-swift Pharma Labs Limited in form SH-4 along with instrument of transfer on 25th November 2022. The company shall deliver the certificate to that effect by 24th December 2022.

Penalty [Sub-section 6]

Liable	Default	Penalty
Company **and** every officer of the company who is in default	In complying with the provisions of sub-sections (1) to (5) to section 56	₹ 50,000

Liability of Depository [Sub-section 7]

Where any depository or depository participant, with an intention to defraud a person, has transferred shares, it shall be liable under Section 447 along with the liability mentioned under the Depositories Act, 1996[30].

Note:

1. With the dematerialisation process becoming a necessity in case of unlisted public companies *i.e.* they are required to dematerialise all of their securities as per Rule 9A of the *Companies (Prospectus and Allotment of Securities) Rules, 2014*, the chances of forgery are very thin or almost negligible.

2. The provisions contained in Section 447 which describe 'punishment for fraud' are stated in the earlier Chapter 3 relating to 'Prospectus and Allotment of Securities'.

[30] Act 22 of 1996

PUNISHMENT FOR PERSONATION OF SHAREHOLDER [SECTION 57]

If any person **deceitfully** personates;

a. as an owner of any security **or**

b. interest in a company, **or**

c. as an owner 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;

a. Imprisonment for a term which shall not be less than one year but which may extend to three years **and**

b. Fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

Penalty	**Minimum**	**Maximum up to**
Imprisonment	One year	Three years
And		
Fine	One Lakh	Five lakh

Note:

Personation for acquisition of securities is offence under section 38 punishable under section 447. Mind it section 447 is general provision.

Gravity of offence committed by personation under section 38 and section 57 may be considered while imposing penalty out of range provided.

It is worth noting, offence of cheating by personation under section 416 of Indian Penal Code, 1860 is punishable under section 419 of code, with punishment of either description which may extend upto three year or with fine or with both.

Student may refer section 38 and section 447, both covered under chapter 3 of this module.

Additional Reading on Forged Transfer

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.

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.

REFUSAL OF REGISTRATION AND APPEAL AGAINST REFUSAL [SECTION 58]

Shares are movable property, hence can be transferred by the shareholders in the manner prescribed by the Articles. The right to transfer shares is absolute in nature and inherently vested with the ownership of the shares. In no case Articles can take away the rights of members to transfer shares in absolute, by making shares non-transferable.

Shares of a public company are freely transferable, whereas a private company is required under section 2(68)(i) to restrict the right of the members to transfer the shares. The articles of association of private companies contain certain kind of restrictions on the transferability of shares. Generally, the restriction put by a private company is that of pre-emption whereby the members are required to offer their shares first to the existing members of the company before offering them to the outsiders.

Section 58 contains the procedure which needs to be followed by a company while refusing to register the transfer of securities. It also contains process of filing appeal against such refusal.

Notice of Refusal to be sent [Sub-section 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 and **stating reasons** thereto,

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.

Securities/other interest in Public Company [sub-section 2]

The securities or other interest of any member in a public company are **freely transferable.**

Any contract or arrangement between two or more persons in respect of transfer of securities shall be **enforceable as a contract**.

Appeal to Tribunal against Refusal [Sub-section 3]

The transferee may **appeal to the Tribunal** against the refusal by private company to register the transfer or transmission, within a period of;

a. **Thirty days** from the date of **receipt of the notice** or

b. **Sixty days** from the date on which the instrument of transfer or the intimation of transmission, was delivered to the company, in case **no notice has been sent by the company.**

Example 16 – An application has been received by Private Company for transfer of share on 25th Nov 2022. The transferee didn't get any response from company, hence may advance an appeal to the tribunal by 24th January 2023.

Appeal to Tribunal against Refusal by a Public Company without sufficient cause [Sub-section 4]

If a public company **without sufficient cause** refuses to register the transfer of securities **within a period of thirty days** from the date on which the instrument of

transfer or the intimation of transmission, is delivered to the company, the transferee may **appeal to the tribunal**, within, within a period of

a. **Sixty days** of such refusal or

b. **Ninety days** of the delivery of the instrument of transfer or intimation of transmission, where no intimation has been received from the company.

Example 17 – An application has been received by Public Company for transfer of share on 25th Nov 2022. The transferee didn't get any response from company, hence may advance an appeal to the tribunal by 23rd February 2023.

Order of Tribunal [Sub-section 5]

The Tribunal, while dealing with an appeal **may**, after hearing the parties, **either dismiss** the appeal, or **by order direct**;

a. Transfer or transmission **shall be registered** by the company and the company shall comply with such order within a period of **ten 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.

Contravention of the Order of the Tribunal [Sub-section 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.

Summary of penalty

Penalty	Minimum	Maximum up to
Imprisonment	One year	Three years
And		
Fine	One Lakh	Five lakh

Summary of section 58

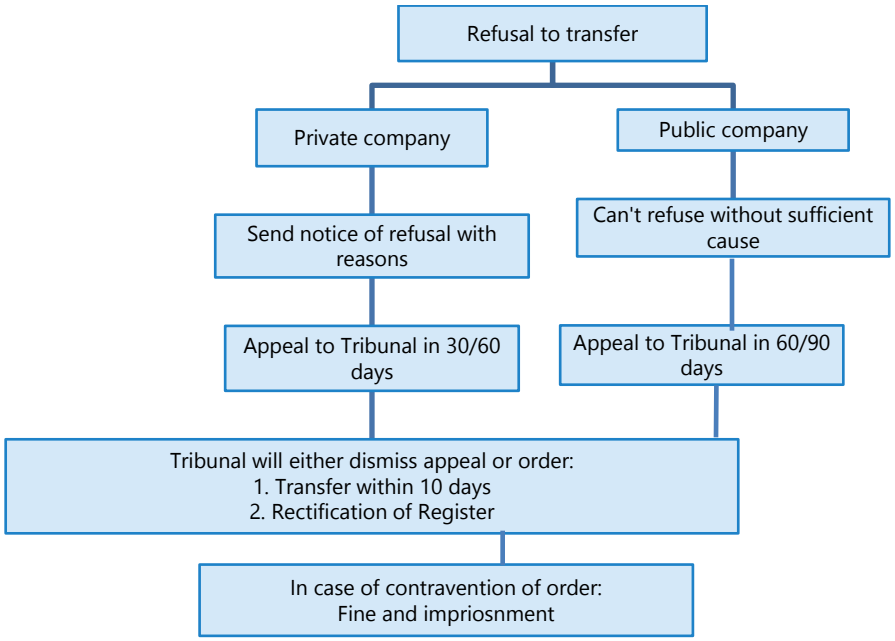


Illustration – T&F

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]

It is the duty of the company to keep the register up to date so as to give at all times the accurate and correct position as to particulars of shareholding, because If a person's name appears in the register of members, he is presumed to be the shareholder or member, even if, in fact, he is not so. Contrarily, if a person's name is absent from the register, apparently he is not a member, although he may have done everything to entitle him to become one.

Section 59 entrust right to appeal with aggrieved person, apart from vesting power in tribunal to order for rectification of register of members.

Appeal by Aggrieved Person [Sub-section 1]

An **aggrieved person, member of company or company** may **appeal** to **tribunal** or to a **competent court** (outside India, specified by the Central Government by

notification, in respect of foreign members or debenture holders residing outside India), for **rectification of the register** if **without sufficient cause**,

a. the name of any person is **entered** in the register of members of a company, or

b. the name of any person is **omitted**, after having been entered in the register, or

c. 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.

Note:

The words "**unnecessary delay**" have not been defined in the Act and, therefore, it becomes a question of evidence to be decided on the facts of each case. A failure to register a transfer within one month of the application, which was contrary to the listing agreement, was held to be an unreasonable delay.

Every shareholder has an interest in the proper maintenance of the company's register of members. Any member can make an application without showing any injury or prejudice to him. Personal grievance is not necessary for ***locus standi.***

Order of the Tribunal [Sub-section 2]

Tribunal may, **after hearing** the parties to the appeal either **dismiss the appeal** or by **order**;

a. Direct that the transfer or transmission shall be **registered** by the company **within a period of ten days** of the receipt of the order, **or**

b. 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.

Example 18 – After hearing both parties of appeal over removal of name of applicant from register of member without sufficient cause, tribunal pass an order to reinstate the name in register with payment of damages to holder as well cost of litigation. Company has to pay damages as ordered apart from rectification of the register.

Rights of holder is protected [Sub-section 3]

Sub-section 3 protects 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.

Transfer of Securities contravenes certain Acts and Direction of Tribunal [Sub-Section 4]

Tribunal may, on an application (made by the depository, depository participant, company, the holder of the securities or the Securities and Exchange Board), direct any company or a depository to **set right the contravention** and **rectify its register or records concerned**, where the transfer of securities is in contravention of any of the provisions of the;

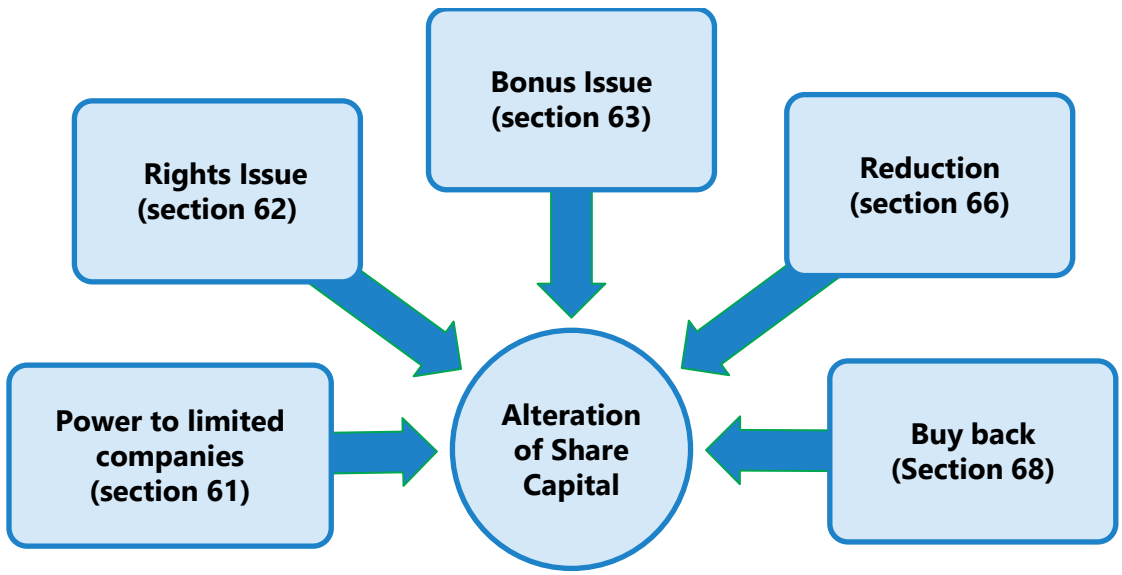
a. The Securities Contracts (Regulation) Act, 1956

b. The Securities and Exchange Board of India Act, 1992

c. The Companies Act, 2013 or

d. Any other law for the time being in force

11. ALTERATION OF SHARE CAPITAL [SECTIONS 61-70]



Definition:

1. Authorised Capital or Nominal Capital

Section 2(8) defines the term authorised capital or nominal capital to mean such capital as is **authorised by the memorandum** of a company to be the **maximum amount of share capital** of the company.

2. Called-up Capital

Section 2(15) states that the term called-up capital means **such part of the capital**, which has been **called for payment**.

POWER OF LIMITED COMPANY TO ALTER ITS SHARE CAPITAL [SECTION 61]

A limited company with a share capital can alter the capital clause of its memorandum of association in any of the following ways, provided authority to alter is given by the articles.

a. It may **increase** its authorised capital by such amount as it thinks expedient.

b. **Consolidate** and **divide** the whole or any part of its share capital into shares of larger amount.

c. **Convert** all and any of its fully paid up **shares into stock** or **vice-versa** into any denomination.

d. **Sub-divide** the whole or any part of its share capital into shares of smaller amount.

The proportion between the amount paid and unpaid (if any) on each reduced share shall be the same as it was in the case of the share from which the reduced share is derived.

e. **Cancel** those shares which have not been taken up and reduce its capital accordingly.

Example 19 – A share with face value of ₹ 100, on which ₹ 80 is paid up, can be split into 10 shares of ₹ 10 nominal value each, with ₹ 8 being paid up.

Note:

Any of the above things can be done by the company by **passing a resolution** at a **general meeting**.

Approval of the **National Company Law Tribunal** requires only in the case wherein consolidation and division [suggested in point (b)] results in changes in the voting percentage of shareholders.

Within **30 days** of alteration, a **notice** must be given in Form SH-7 to the Registrar who will record the same and make necessary **alteration in the company's memorandum**. (Section 64 read with Rule 15 of the *Companies (Share Capital and Debentures) Rules, 2014*).

Further subsection 2 provides that the cancellation of shares **shall not be deemed to be a reduction** of share capital. Mind it, reduction of capital covered under section 66 of the Act.

FURTHER ISSUE OF SHARE CAPITAL – RIGHTS ISSUE; PREFERENTIAL ALLOTMENT [SECTION 62]

A rights issue involves pre-emptive subscription rights to buy additional securities in a company offered to the company's existing security holders. It is a non-dilutive prorata way to raise capital.

Example 20 - If a company announces '1:10 rights issue', it means an existing shareholder can buy one extra share for every ten shares held by him/her. Usually the price at which the new shares are issued by way of rights issue is less than the prevailing market price of the stock to encourage subscription.

Practical Insight

Right Issue by Suzlon Energy Limited (October 2022)

Suzlon Energy Limited (SEL) is among the world's leading renewable energy solutions provider in India operating in wind energy segment.

To part finance its needs for repayment/prepayment of certain borrowings (₹ 900.00 crore) and general corporate purposes (₹ 283.50 crore), SEL is offering a rights issue of 240 crore equity shares (Face Value ₹ 2) each at a price of ₹ 5 per share (Current Market Price of Share was ₹ 8.47) to mobilize ₹ 200.00 crore.

The company is offering the right shares in the ratio of 5 shares for every 21 shares held as of the record date of October 04, 2022. Rights entitlements can be renounced up till Oct 14, 2022 (Current Market Price of Rights Entitlement was ₹ 1.32).

The issue opens for subscription on October 11, 2022, and will close on October 20, 2022.

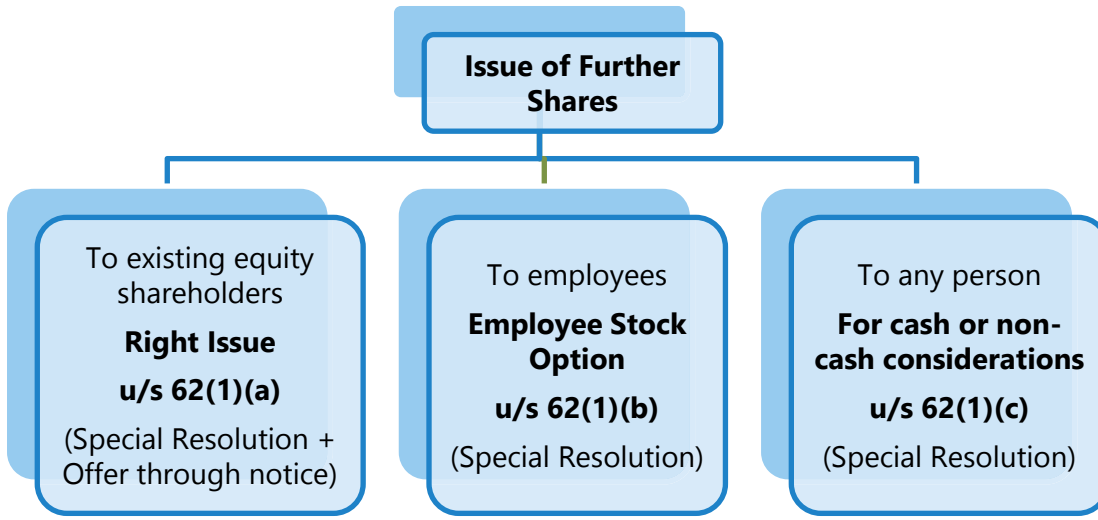
Only 50% amount (i.e. ₹ 2.50 per share) is to be paid on application and the balance on one or more calls by the company from time to time.

Post allotment, shares will be listed on BSE and NSE.

SEL is proposed to spend ₹ 16.50 crore for this Right Issue process.

Class of companies	Power to Right Issue	Applicable Provisions
Listed companies or companies intended to get its securities listed	23(1)(c)	Provisions of the Securities and Exchange Board of India Act, 1992 and the rules and regulations made thereunder
Public companies not covered above		Provisions of this Act and rules made thereunder
Private companies not covered above	23(2)(a)	

Offering of issue of further Shares [Sub-section 1]



Whenever a company having a share capital, proposes to increase its subscribed capital by the **issue of further shares**, such shares shall be offered;

a. To persons who are **holders** of equity shares (**existing** on date of such offer),

1. in **proportion** to the **paid-up capital** on those shares held by them;

2. by sending a letter of offer in form of **notice**, such notice **shall specify**;

i. Specify the **number of shares** to be offered

ii. Specify the **time period** within which the offer must be accepted. The time period should not be less than 15 days or such lesser number of days as may be prescribed but not exceeding 30 days from the date of the offer

Note – **Rule 12A** inserted in *the Companies (Share Capital and Debentures) Rules, 2014,* that provides the time period within which the offer shall be made for acceptance **shall be not less than seven days** from the date of offer[31]

iii. Specify, if the offer is not accepted within the specified time, it shall be **deemed** to have been **declined**.

iv. Confirm the right to renounce all or any of shares to existing holders, in favour of some other person; unless article otherwise provided.

Note:

1. If offer **declined by existing holder**, then at intimation of such decline or after **expiry of the specified time** given to him for exercise the right, the Board of Directors **may dispose of them** (such shares, in regard to which offer is declined) in such manner which is **not dis-advantageous to the shareholders and the company**.

2. While determining/checking proportion, then **as nearly as the circumstances admits** shall be acceptable.

[31] G.S.R. 113(E) dated 11th Feb 2021

3. In case of a **Private Company**[32] and **Specified IFSC Public Company**[33], any shorter time periods to accept the offer may be provided, if **ninety percent** of the members have given their **consent in writing** or in **electronic mode** for such shorter period

b. To employees under a scheme of **employees' stock option,** subject to:

1. **Special resolution** passed by company, and

2. Conditions as may be prescribed in **Rule 12** of the *Companies (Share Capital and Debentures) Rules, 2014.*

Note:

1. The term '**employees' stock option'** means the option given to the directors, officers or employees of a company or of its holding company or subsidiary company or companies, if any, which gives such directors, officers or employees, the benefit or right to purchase, or to subscribe for, the shares of the company at a future date at a pre-determined price **(Section 2(37)**

2. Instead of special resolution, **ordinary resolution** will be sufficient, in following cases;

a. **Private company** which has not defaulted in filing its financial statements under Section 137 or Annual Return under Section 92.[34]

b. Specified **IFSC Public Company**.[35]

3. In case of a **listed company**, conditions prescribed by ***SEBI (Share Based Employee Benefits) Regulations, 2014*** shall be observed.

c. To **any persons**, if so authorised by a **special resolution** even if they are not within the two categories mentioned above.

[32] GSR 464 (E), dated 5th June, 2015 as amended by GSR 583 (E), dated 13th June, 2017
[33] GSR 8 (E), dated 4th January, 2017
[34] GSR 464 (E), dated 5th June, 2015 as amended by GSR 583 (E), dated 13th June, 2017
[35] GSR 8 (E), dated 4th January, 2017

Note:

1. Where further shares are offered through manner specified in point iii above, then such offer can be for **cash or for a consideration other than cash**.
2. Further, in case of non-cash consideration, price to be determined by valuation report of a **registered valuer** subject to such conditions as may be prescribed in **Rule 13** of *the Companies (Share Capital and Debentures) Rules, 2014*.

Example 21 - A company, listed at Bombay Stock Exchange, intends to offer its further shares to the non-members. The existing members of the company consider such offer as invalid in view of the provisions contained in Section 62 (1) (a). However, the company is not prohibited in absolute terms while offering new shares to the non-members. It can do so after passing a special resolution as required in Section 62 (1) (c). Thus, new shares of a company limited by shares may be issued to non-members under certain circumstances.

Illustration– Q&A

What shall be length of period specified by notice of offer of further issue for giving acceptance?

Answer – Notice of offer of further shares shall specify the **time period** within which the offer must be accepted. The time period should not be less than 15 days or such lesser number of days as may be prescribed but not exceeding 30 days from the date of the offer

Note – **Rule 12A** inserted in *the Companies (Share Capital and Debentures) Rules, 2014,* provides the time period within which the offer shall be made for acceptance **shall be not less than seven days** from the date of offer.

Dispatch of Notice to the existing Shareholders [sub-section 2]

Notice referred in sub-section (1) shall be dispatched through registered post or speed post or through electronic mode or courier or any other mode having proof of delivery to all the existing shareholders **at least three days before the opening of the issue.**

In case of a **Private Company**[36] any shorter length (less than 3 days) of notice period shall also be acceptable, if **ninety percent** of the members have given their **consent in writing** or in **electronic mode** for such shorter period.

Example 22 – Notice of right issue dispatch to holders at their registered e-mail ID in two days advance to opening of issue. Out of 4230 members 3075 member holding 94% of shares acknowledges the mail and consented to shorter length of notice. Despite the mode of dispatching notice and furnishing consent by members to shorter length is valid, the notice stands invalid because at-least 90% of members shall give their consent to shorter length of notice; where as in given case nearly 72.70% (3075 out of 4230) given consent. Here number of members is to be considered not their holding.

Exception – Section 62 shall not be applicable on conversion of debenture or loan into equity shares [Sub-section 3]

Conversion of debenture (pursuant to conditions of issue) or loan (pursuant to conditions of grant of loan) into equity shares leads to **increase in the subscribed capital** of a company.

Sub-section 3 states **section 62 shall not be applicable** to **such increase** in subscribed capital provided;

a. Those **terms and conditions** under which such conversion took place,

b. Must be approved by company in general meeting through **special resolution**,

c. **Prior** to issue of debenture and grant of loan.

Compulsorily conversion of Debentures/Loan from government into Shares [Sub-section 4, 5 and 6]

Sub-section 4 empowers the government to direct by order;

a. **Conversion** of **debentures** (issued to government) or **loans** (issued by government) to company, either **full or in part** thereof **into shares** of such company,

b. If that Government considers it necessary in the **public interest** so to do,

[36] GSR 464 (E), dated 5th June, 2015 as amended by GSR 583 (E), dated 13th June, 2017

c. on such **terms and conditions** as appear to the Government to be **reasonable in the circumstances** of the case,

d. even if **terms of the issue** of such debentures or the **raising** of such loans **do not providing for an option for such conversion**.

Proviso to sub-section 4 provides remedy to company against hostile conversion.

Where the terms and conditions of such conversion are not acceptable to the company, it may appeal to the **Tribunal**, within **sixty days** from the date of communication of such order.

Tribunal after hearing the company and the Government shall pass such order as it deems fit.

Sub-section 5 requires, **government shall consider following** while determining the terms and conditions of conversion;

a. the financial position of the company,

b. the terms of issue of debentures or loans, as the case may be,

c. the rate of interest payable on such debentures or loans, and

d. such other matters as it may consider necessary.

Sub-section 6 states pursuant to order of government for conversion of debenture and loan into equity shares, under sub-section 4, the **authorised share capital** of such company **shall stand increased** by an amount equal to the amount of the value of shares which such debentures or loans or part thereof has been converted into and **memorandum shall stand altered**.

Section 62 shall not apply to Nidhi Company. While complying with such exception, the Nidhi Companies shall ensure that the interests of their shareholders are protected.[37]

ISSUE OF BONUS SHARES [SECTION 63]

The term bonus share is not defined anywhere in the Companies Act 2013. However, the characteristics of bonus shares along with condition and manner of issue of fully paid-up bonus share by a company to its member highlighted by section 63.

[37] GSR 465 (E), dated 5th June, 2015

In commercial parlance, the bonus shares are shares issued proportionately by a company to its current shareholders as fully paid-up shares free of cost.

Example 23 – If a company decided to issue bonus share in ratio of 1:2 (one for every two shares held), then the holder of 100 shares of a company will get 50 bonus share without making any payment. There his holding of shares will now be 150 instead of 100.

Status of Bonus Shares from lens of the Judiciary

Hon'ble Supreme Court in case of **Standard Chartered Bank v Custodian**[38]

Bonus share is an accretion. A bonus share is issued when the company capitalises its profits by transferring an amount equal to the face value of the share from its reserve to the nominal capital.

In other words, the undistributed profit of the company is retained by the company under the head of capital against the issue of further shares to its shareholders. Bonus shares have, therefore, been described as a distribution of capitalised undivided profit.

In the case of issue of bonus share there is an increase in the capital of the company by transferring of an amount from its reserve to the capital account and thereby resulting in additional shares being issued to the shareholders.

A bonus share is a property which comes into existence with an identity and value of its own and capable of being bought and sold as such.

Sources for issue of Bonus Share [Sub-section 1]

A company may issue **fully paid-up bonus shares** to its members out of;

a. its free reserves (other than revaluation reserve);

b. the securities premium account; or

c. the capital redemption reserve account.

[38] (2000) 6 SCC 427

Bonus shares shall not be issued by capitalising reserves created by the revaluation of assets **[Proviso to section 63(1)]**

Bonus shares **may** be issued from	Bonus shares **shall not** be issued from
Free Reserves	Revaluation Reserve
Securities Premium Reserve	
Capital Redemption Reserve	

Pre-requisites for issue of bonus shares [Sub-section 2]

No company may capitalise its profits or reserves for the purpose of issuing fully paid-up bonus shares, if;

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. it complies with such conditions as prescribed by Rule 14 of the *Companies (Share capital and debenture) Rules, 2014*, that a company which has once announced the decision of its Board recommending a bonus issue, **shall not subsequently withdraw** the same.

Note:

1. The bonus shares **shall not** be issued in lieu of dividend **(Sub-section 3 to section 63)**

2. Proviso to sub-section 5 to section 123 of this act carries **confirmatory** provisions to those contained in **section 63**.

According to the proviso to **Section 123(5)** of the Act, it is permissible for a

company to **capitalise** its **profits or reserves** for the purpose of issuing **fully paid up bonus shares** or **paying up any amount** for the time being **unpaid** on any shares held by the members of the company.

Illustration – True/False

Bonus share can be issued to partly paid shares in proportion to paid-up value.

Answer – False, Bonus shares can only be issued against fully paid, the partly paid-up 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]

As and when, there is an alteration (including increase and decrease) of share capital, the company concerned shall notify the registrar. The provisions in this respect are contained in Section 64.

Filing of Prescribed Notice [sub-section 1]

Company shall file a notice in the Form No. SH-7 as per Rule 15 of *the Companies (Share Capital and Debentures) Rules, 2014* with the **Registrar**, along with an **altered memorandum**; within **thirty days** of **alteration** (including increase or decrease) to its capital in case of;

a. Alternation of capital in manner specified in section 61 (1),

b. Order made by the Government under section 62(4) read with 62(6) has the effect of increasing authorised capital of a company; or

c. Redemption of any redeemable preference shares,

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.

Summary of penalty

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]

Conservation of capital is one of the main principles of company law, because any reduction of capital diminishes the fund; out of which creditor and other debt holders are to be paid, therefore it adversely impact them. But sometimes it may become necessary for the company to bring about a reduction in its capital. Therefore, closely fenced power is given by Section 66.

Reduction of Share Capital by Special Resolution to be confirmed by Tribunal [Sub-section 1]

A company being **'company limited by shares'** or **'company limited by guarantee and having a share capital' may reduce the share capital** in **any manner** and in **particular manners** as state below -

a. Extinguish or reduce the liability on any of its shares in respect of the share capital not paid-up; or

b. Cancel any paid-up share capital which is lost or is unrepresented by any available assets; or

c. Pay off any paid-up share capital which is in excess of the wants of the company

a. **Subject to** Passing a **special resolution;** and

b. **Alter its memorandum** by reducing the amount of its share capital and of its shares accordingly; and

c. Repayment of any deposits accepted by it, either before or after the commencement of this Act, or the interest payable thereon shall not be in arrear.

Example 24 - In respect of a share of ₹ 10, a company has called only ₹ 7 per share and the same has been paid by all the shareholders. The company decides not to call remaining ₹ 3 per share and reduces its shareholders' liability. If done, the company is said to have reduced its share of ₹ 10 to ₹ 7 as fully paid-up share.

Issue of Notice by the Tribunal [Sub-section 2]

The Tribunal shall give notice of every application made to it;

a. to the Central Government (power delegated to Regional Directors)

b. to the Registrar and

c. to the Securities and Exchange Board, in the case of listed companies, and

d. the creditors of the company

Tribunal shall **consider** the representations (if any) made by them within a **period of three months** from the date of receipt of the notice.

Note:

1. Where no representation has been received within the said period of three months, it shall be presumed that they have **no objection** to the reduction.

2. Considering representations is statutorily required, not admitting it in full.

Example 25 – An application for reduction of capital received by NCLT on 22nd November 2022 from a unlisted company, he send a notice of such application to concerned RD, RoC as well as to creditor on 28th November 2022. Notice to RD and RoC sent in registered post which reached to them on 1st December 2022. Hence in given case RD and RoC can make representation till 28th Feb 2023. If any representation made thereafter, Tribunal is not bound to consider that.

Order of Tribunal [Sub-section 3]

The Tribunal **may make an order confirming the reduction** of share capital on such terms and conditions as it deems fit only if it is satisfied that -

a. The **debt or claim** of every creditor of the company has been either

i. **Discharged** or

ii. **Determined** or

iii. Has been **secured** or

iv. His **consent is obtained**.

b. The **accounting treatment**, proposed by the company for such reduction is in conformity with the **accounting standards** specified in Section 133 or any other provision of this Act.

How tribunal determine that, 'whether accounting treatment, proposed by the company for such reduction is in conformity with the accounting standards specified in Section 133 or not'?

While making an application, a certificate to that effect by the company's auditor has been filed with the Tribunal.

Publication of Order of Confirmation of Tribunal [Sub-Section 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**.

Delivery of Certified Copy of Order of Tribunal to Registrar [Sub-section 5]

Within **thirty days** of the **receipt of the copy of the order**, the company shall deliver; to the Registrar, a certified copy of the tribunal order and minutes (containing special resolution) approved by 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,

Registrar on receipt, shall register the same and issue a certificate to that effect.

Exemption to Buy-Back [Sub-section 6]

Nothing in this section shall apply to buy-back of its own securities by a company under Section 68.

No Liability of Members [Sub-Section 7]

A member (whether in past or present) shall be liable to pay the amount (call or contribution) maximum upto difference (if any) between the amount deemed to have been paid on his shares and the nominal value of the reduced shares.

'Deemed to have been paid' here signify reduced amount against the amount that have been actually paid on the share.

In case where Creditor is entitled to object but was not included in the list of Creditors [Sub-section 8]

If a reduction of share capital took place; and where a creditor is entitled to object to a reduction of share capital, but his name and interest (his debt or claim on company) not entered on the list of creditors, either because of:

a. His ignorance of the proceedings for reduction or

b. Nature of his interest (debt or claim)

Then in respect of his interest, company commits a default, within the meaning of section 6 of the Insolvency and Bankruptcy Code, 2016.

Action to make claim of creditor good (Remedy available to such unpaid creditor)

If company is running its operation

a. Every person, who was a member of the company on the **date of the registration of the order for reduction** by the Registrar,

b. Shall be liable to contribute to the **payment of such debt or claim**,

c. But **not exceeding** the **amount** which he would have been **liable to contribute** if the company had commenced **winding up** on the day immediately before the said date.

If 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,

a. Settle a list of persons so liable to contribute, and

b. Make and enforce calls and orders on the contributories settled on the list, as if they were ordinary contributories in a winding up.

Example 26 – Name and Interest of Mr. Nilanjan Iyer, a creditor of Modern Furniture Limited has been kept outside the list of creditor while company went into reduction of its capital; later when Mr. Iyer came to know about this he wish to take legal action against company under IBC 2016, as limitation period is not

expired yet. Mr. Iyer entitled to do so, exclusion of his name construe as offence under IBC as well.

Note: Period of limitation is a maximum period set by statute within which a legal action can be brought or a right enforced. The Limitation Act 1963 governing the provisions regarding period of limitation.

Rights of Contributories not affected [Sub-section 9]

Sub-section 9 is overriding provision that prevent the rights of contributories inter-se. Nothing in sub-section 8 shall affect the rights of the contributories among themselves.

Liability of Officers [Sub-section 10]

Officer of the company shall be liable for punishment under **section 447**, if he:

a. **Knowingly conceals** the name of any creditor entitled to object to the reduction or **abets** or is **privy** to any such concealment; or

b. **Knowingly misrepresents** the nature or amount of the debt or claim of any creditor or **abets** or is **privy** to any such misrepresentation.

Note:

1. **Abet** means to encourage or incite another to commit a crime
2. **Privy** signify a coparticipant; one who has an interest in a matter
3. The provisions contained in Section 447 which describe 'punishment for fraud' are stated in the earlier Chapter 3 relating to 'Prospectus and Allotment of Securities'.

RESTRICTION ON PURCHASE BY COMPANY OR GIVING OF LOANS BY IT FOR PURCHASE OF ITS SHARES [SECTION 67]

Conservation of capital is one of the main principles of company law, because the share capital of a company is the only security on which the creditors rely.

Therefore, a company cannot buy its own shares because reduction of capital, results in diminishing of the fund out of which creditor are to be paid; hence adversely affect the creditors. However, this restriction is not absolute.

Reduction according to the applicable Provisions [Sub-section 1]

'Company limited by shares' or 'company by guarantee that having a share capital' **shall not** buy its own shares **unless** the consequent **reduction of share capital is effected** under the provisions of this Act.

Restriction on giving Loan, Guarantee or provision of Security, etc. [Sub-section 2]

Public company shall not give any financial assistance;

a. Whether directly or indirectly and whether by means of a loan, guarantee, the provision of security or otherwise

b. For the purpose of, or in connection with, a purchase or subscription made or to be made, by any person of or for any shares in the company or in its holding company.

Exceptions [Sub-section 3]

Company may provide the financial assistance, in following case;

a. Lending of money by a banking company in the **ordinary course of its business**;

Note:

1. The words "lending in the ordinary course of business" are not defined

2. Banks have to make loans in the ordinary course of their business and they can hardly supervise the purpose for which the borrower uses the loan money. Hence if a borrower from a bank uses the money for purchasing the bank's shares, the bank and its officers will be protected from liability.

3. An English court held that where money is given for the very purpose of purchasing the bank's shares that would not be lending in the ordinary course of business, then the provision would said to be violated.

b. The provision of money for the purchase of fully paid shares in the company or its holding company by trustees for and on behalf of the company's employees in accordance with any scheme (**Employee share schemes**) approved by company through special resolution with such requirements

as may be prescribed in **Rule 16** of the *Companies (Share Capital and Debentures) Rules, 2014*,

Note:

1. In case the shares of the company are **listed** - Such purchase of shares shall be made only through a recognized stock exchange and not by way of private offers or arrangements.

2. Where shares of a company are **not listed** - the valuation at which shares are to be purchased shall be made by a **registered valuer**.

3. The **value of shares** to be purchased or subscribed in the aggregate **shall not exceed five percent** of the aggregate of paid up capital and free reserves of the company;

4. Disclosures in respect of **voting rights not exercised directly** by the employees in respect of shares to which the scheme relates shall be made in the Board's report for the relevant financial year, namely:

(a) Names of the employees who have not exercised the voting rights directly;

(b) Reasons for not voting directly;

(c) Name of the person who is exercising such voting rights;

(d) Number of shares held by or in favour of, such employees and the percentage of such shares to the total paid up share capital of the company;

(e) Date of the general meeting in which such voting power was exercised;

(f) Resolutions on which votes have been cast by persons holding such voting power;

(g) Percentage of such voting power to the total voting power on each resolution;

(h) Whether the votes were cast in favour of or against the resolution.

c. **Lending** money by a company **to its employees** (other than its directors or key managerial personnel), **not exceeding six month salary** of the employees to enable them to buy or subscribe **fully paid shares** in the **company or its holding** company and to hold them by way of **beneficial ownership**.

Redemption of Preference Shares Permitted [Sub-section 4]

Nothing in Section 67 shall affect the right of a company to redeem any preference shares issued under this Act or under any previous company law.

Punishment for Contravention [Sub-section 5]

If a company contravenes the provisions of this section, the punishment shall be;

Liable	**Penalty**		
Company	Fine which shall not be less than one lakh rupees but may extend to twenty-five lakh rupees		
Every **officer** of the company who is in default	Imprisonment for a term which may extend to three years	and	Fine which shall not be less than one lakh rupees but may extend to twenty-five lakh rupees.

1. Section 67 shall not apply to **private companies**[39] (if not defaulted in filing its financial statements under Section 137 and Annual Return under Section 92) and **Specified IFSC Public Company**[40] in whose case all of following 3 condition fulfilled;

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 anybody corporate is less than twice its paid-up share capital or fifty 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 under this section.

[39] GSR 464 (E), dated 5th June, 2015 as amended by GSR 583 (E), dated 13th June, 2017
[40] GSR 8 (E), dated 4th January, 2017

2. Section 67 (1) shall not apply to **Nidhi Companies**, when shares are purchased by the company from a member on his ceasing to be a depositor or borrower and it shall not be considered as reduction of capital under Section 66 of the Companies Act, 2013. While complying with such exception, the Nidhi Companies shall ensure that the interests of their shareholders are protected.[41]

POWER OF COMPANY TO PURCHASE ITS OWN SECURITIES [SECTION 68] - BUY BACK OF SECURITIES

Buy back is the re-acquisition by a company of its own securities. It is a way of returning money to its investors. Section 68 contains provisions which describe the power of a company to purchase its own securities subject to the applicable conditions.

Sources of Funds for Buy-Back of Shares [Sub-section 1]

A company may purchase its own shares or other specified securities. The purchase should be made out of its:

a. Free reserves; or

b. Securities premium account; or

c. Proceeds of the issue of any shares or other specified securities.

However, buy-back of shares or other specified securities cannot be made out of the proceeds of earlier issued shares or other specified securities of same kind.

Specified securities includes employees' stock option or other securities as may be notified by the Central Government from time to time (Explanation I to section 68)

Conditions for Buy-Back [Sub-section 2]

A company may purchase its own shares or other specified securities, if met with following conditions, namely;

a. The buy-back is **authorised by its articles**;

b. A **special resolution** authorising the buy-back is passed in general meeting of the company;

[41] GSR 465 (E), dated 5th June, 2015

A **special resolution is not necessary** where:

1. The buy-back is, **not exceeding ten percent** of the total paid-up equity capital and free reserves of the company; **and**
2. Such buy-back has been **authorised by the Board resolution** passed at its meeting;

c. The amount involved in buy-back **should not be more 25%** of the **aggregate** of **paid-up capital** and **free reserves** of the company; further in case of **buyback of equity shares**, the maximum limit is **25% of its total paid-up equity capital** in **any financial year**.

d. After the buyback, the ratio between the **debts** (secured and unsecured) owed by the company should **not be more than twice** the **paid-up capital and free resources** of the company (Central Government may prescribe a higher ratio for a class or classes of companies).

e. Shares or other specified securities for buy-back shall be **fully paid-up**;

f. The buy-back should be in accordance with the **Rule 17** of *the Companies (Share Capital and Debentures), Rules, 2014*; but in case of **listed** shares or other specified securities should be in accordance with regulations made by the **Securities and Exchange Board of India** in this behalf.

No offer of buy-back shall be made within **one year** reckoned from the date of the closure of the preceding offer of buy back [Proviso to section 68(2)]

Free reserves includes securities premium account (Explanation II to section 68)

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 [refer Section 68(2)]

Procedure before Buy-Back [Sub-section 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 under the buy back;

d. the amount to be invested under the buy-back; and

e. the time limit for completion of buy-back.

Rule 17(1) of the Companies (Share Capital and Debentures), Rules, 2014 specify list of 14 matters, regarding which particulars shall be stated in explanatory statement.

Securities to be purchased under 'Buy-Back' [Sub-section 5]

The buy-back may be from;

a. the **existing shareholders** or security holders on a **proportionate basis**; or

b. the **open market**; or

c. the securities issued to **employees** of the company pursuant to a scheme of stock option or sweat equity.

Declaration of Solvency [Sub-section 6]

A declaration of solvency has to be filed, **before** the resolution for buying back is implemented; with the Registrar and also with SEBI, if such shares of such company are listed on any stock exchange.

Declaration of solvency has to be on a Form SH-9 and verified by an **affidavit,** stating that the Board of directors has made a full inquiry into the affairs of the company and have found that it is capable of meeting all its liabilities and **will not be rendered insolvent** for a **period of 12 months** from the date of the declaration.

It has to be **signed by at least two directors** of the company, one of whom should be the **managing director,** if any.

Example 27 – Form SH-9 filed by a listed company, Rainbow Sports Limited with registrar as well as SEBI stating Board of directors has made a full inquiry into the affairs of the company and have found that it is capable of meeting all its liabilities and will not be rendered insolvent for a period of 6 months from the date of the

declaration. Declaration was duly signed by 3 directors, none of them being MD, as MD is out of country to attend FIFA world cup event in Qatar (being one of the sponsors).

There are two lacuna in compliance to sub-section 6, first being declaration shall be for period of 12 months; secondly if managing director is appointed then he shall sign the declaration of solvency.

Time limit for Completion of Buy-Back [Sub-section 4]

Every buy-back shall be completed within **twelve months** from the date of passing the special resolution **or** board resolution authorising the buy-back.

Time Check Points and Procedural aspects of Buy-Back

The company before the buy-back of shares, file with the Registrar a **letter of offer** in Form No. SH.8, along with the fee. The letter of offer shall be dispatched to the shareholders or security holders immediately after filing the same with the Registrar of Companies but not later than **twenty days** from its filing with the Registrar of Companies.

The **offer** for buy-back **shall remain open** for a period of not less than **fifteen days** and not exceeding **thirty days** from the date of dispatch of the letter of offer, but where all members of a company agree, the offer for buy-back may remain open for a period **less than fifteen days.**

In case the number of shares or other specified securities offered by the shareholders or security holders is more than the total number of shares or securities to be bought back by the company, the acceptance per shareholder shall be on **proportionate basis** out of the total shares offered for being bought back.

The company shall **complete the verifications** of the offers received within **fifteen days from the date of closure** of the offer and the shares or other securities lodged shall be deemed to be accepted unless a **communication of rejection is made within twenty one days** from the date of closure of the offer.

The company shall **make payment within seven days of verification process** and **make payment** in cash to those shareholders or security holders whose securities have been accepted. Company will **return the share certificates** to the shareholders or security holders whose securities have not been accepted at all or the balance of securities in case of part acceptance.

Extinguishment of Securities [Sub-section 7]

Where a company buy's back its own securities or other specified securities, it shall **extinguish and physically destroy** the shares or securities so bought-back within **seven days** of the last date of completion of buy-back.

Cooling Period – No fresh Issue [Sub-section 8]

Where a company completes a buy-back of its shares or other specified securities, it shall not make further issue of same kind of shares or other specified securities within a period of **six months**.

It may, however, make a bonus issue and discharge its existing obligations such as conversion of warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity shares.

Note: This restriction applies only to the type of securities bought back. The company is free to issue other types of security.

Register of Buy Back [Sub-section 9]

The company, shall maintain a register of shares or other securities which have been bought-back in Form No. SH.10 containing details of;

a. Shares or securities so bought,

b. Consideration paid for the shares or securities bought-back,

c. Date of cancellation of shares or securities,

d. Date of extinguishing and physically destroying the shares or securities and

e. Such other particulars as may be prescribed.

Note:

1. This register shall be maintained at the registered office in the custody of the secretary of the company or any other person authorized by the board in this behalf.
2. The entries in the register shall be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose.

Filing of Return of Buy-back [Sub-section 10]

A return of buy-back in Form No. SH.11 along with the fee shall be filled with;

a. The Registrar and also SEBI, if shares of company are listed on any recognised stock exchange

b. Containing such particulars relating to the buy-back

c. Within thirty days of such completion.

Note: Along with return, a certificate in Form No. SH.15 signed by two directors of the company including the managing director, if any, certifying that the buy-back of securities has been made in compliance with the provisions of the Act and the rules made thereunder.

Penalty for Default [Sub-section 11]

If a company makes default in complying with the provisions of this section or any regulations made by Securities Exchange Board of India specified for the purposes of section 68(2)(f), the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees.

Summary of punishment

Liable	Minimum Fine	Maximum Fine
Company	One lakh rupee	Upto three lakh rupee
Every officer of the company who is in default		

Illustration – True and False

Passing an ordinary resolution is sufficient where the buy-back is, not exceeding ten percent of the total paid-up equity capital and free reserves of the company.

Answer - False, such buy-back has to be authorised by the Board resolution passed at its meeting.

TRANSFER OF CERTAIN SUMS TO CAPITAL REDEMPTION RESERVE ACCOUNT [SECTION 69]

Section 69 requires certain amount to be transferred to the capital redemption reserve (CRR) account in case a company buys back its own shares.

Amount to be transferred to CRR Account [Sub-section 1]

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

b. Details of such transfer shall be **disclosed** in the balance sheet.

Application of CRR Account [Section 2]

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**.

Similar use of CRR is also specified under-section 55(4) of this Act, that created when preference shares redeemed out of profit, as provided under section 55(2)(c).

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]

Sub-section 1 states 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

i. repayment of deposits or interest thereon, or

ii. redemption of debentures, or

iii. redemption of preference shares or

iv. payment of dividend to any shareholder or

v. repayment of any term loan or interest thereon to any financial institutions or banking company

Note:

1. Specified securities includes employees' stock option or other securities as may be notified by the Central Government from time to time (Explanation I to section 68)

2. Where the default is remedied and a period of three years has lapsed after such default ceased to subsist, such buy-back is not prohibited.

Further **sub-section 2** prohibit the company from directly or indirectly to purchase its own shares or other specified securities in case such company has not complied with provisions of

a. Section 92 (Annual Report),

b. Section 123 (Declaration and Payment of Dividend),

c. Section 127 (Punishment for failure to distribute dividends), and

d. Section 129 (Financial Statement).

Example 28 – Sigma Electronic Limited (SEL) was financial unstable in 2018 due to economic slowdown, finally it made default in repayment of loan that it has taken from public finance corporation in June 2020 pursuant to cash crunch caused by nation-wide lock down. SEL's account was marked in defaulters list by lender and classified in NPA category. But stimulus package helped SEL to pass the high turbulence phase, it able to repay the due amount on December 2020. In February 2021 SEL account removed from NPA category. SEL won a tender in mid of 2021 and become supplier to military retail canteens. SEL accumulate reasonable amount of reserve and attain the position cash surplus. SEL decided to Buy-back 10% of its equity shares in December 2022.

Consider the facts stated in case, SEL shall not be allowed to buy-back it securities as 3 years has not been elapse since when default is remedied.

12. DEBENTURE [SECTIONS 71]

DEFINITION AND FEATURES OF DEBENTURE

Definition [Section 2(30)]

Debenture includes debenture stock, bonds or any other instrument of a company evidencing a debt, **whether constituting a charge on the assets of the company or not**

Provided that following shall not be treated as debenture

a. the instruments referred to in Chapter III-D of the Reserve Bank of India Act, 1934; and

b. such other instrument, as may be prescribed by the Central Government in consultation with the Reserve Bank of India, issued by a company,

Debenture **Includes**	Debenture **Excludes**
Debenture stock Bonds Any other instrument of a company evidencing a debt Whether constituting a charge on the assets of the company or not	Instruments referred to in Chapter III-D of the Reserve Bank of India Act, 1934 and Such other instrument, as may be prescribed by the Central Government

Features of Debentures

a. A debenture is the **smallest unit** of a sizeable amount of loan.

b. When debentures are issued, the applicants are given **certificates** representing the **money they have lent** to the company.

c. 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 company secretary, if he has been appointed.

d. The company pays **periodic interest** on the amount raised by issuing debentures till they are fully redeemed.

e. A debenture is generally **pre-fixed with the rate of interest** which the company intends to pay.

Example 29 - 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.

f. **Voting rights are not available** in case of debentures as section 71 (2) of the Act, clearly states that no company shall issue any debentures carrying any voting rights.

g. As per section 44 of the Act, a debenture is in the nature of **movable property** which is transferable as per the provisions contained in the Articles of the company issuing the debentures.

h. 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.

i. As per the terms of the issue of debentures, they may be **redeemed** (i.e. repaid) at the end of **full term or in installments**, say yearly or bi-yearly or any other period like in two installments.

j. The terms of issue may also provide for **conversion** of debentures at maturity into equity shares at the option of the debenture holders.

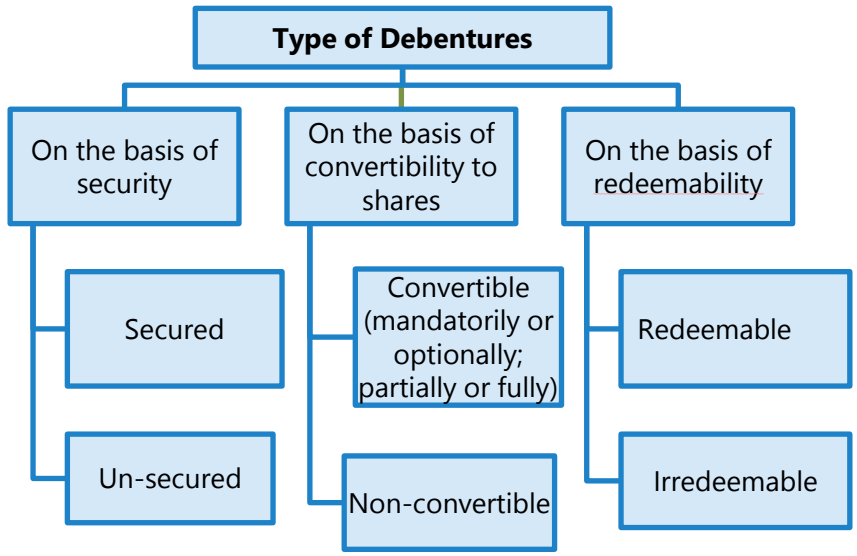
k. The **debenture certificates** are required to be delivered within a period of **six months under section 56(4)(d) of the Act,** from the date of allotment of debentures, unless the company is prohibited by any provision of law or any order of Court, Tribunal or any other authority.

Example 30 - Sigma Computers Limited desires to borrow ₹ 50,00,000 from the public by issuing 7% debentures. It is intended that each unit of debenture shall be of ₹ 100. Thus, it can issue 50,000 debentures of ₹ 100 each carrying 7% rate of interest which can be paid at the end of every quarter. If such debentures (secured by a charge on the assets of the company) are issued for six-year duration, the

principal amount shall be repaid by the end of sixth year. The terms 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.

Thus, Sigma Computers Limited is able to borrow a large sum of money from different borrowers with the help of debentures and it is not required to approach a single borrower for such a big amount.

In other words, 'issue of debentures' is the most convenient way of borrowing large sums of money and at the same time the debenture holders do not exert any influence over the ownership and working of the company unless their interest is jeopardized by certain decisions.



MANNER OF ISSUE OF DEBENTURES AND APPLICABLE PROVISION THERETO [SECTION 71]

Issue of Debentures with an Option to Convert [Sub-section 1]

A company if authorised by passing special resolution at general meeting, then it may issue debentures with an **option to convert** such debentures into shares, either wholly or partly at the time of redemption.

No Voting Rights [Sub-section 2]

No company shall issue any debentures carrying any **voting rights**.

Issue of Secured Debentures [Sub-Section 3]

Secured debentures may be issued by a company subject to such terms and conditions as are prescribed in Rule 18 (1) of the *Companies (Share Capital and Debentures) Rules, 2014;* which are explained below;

a. Maximum Period of Secured Debenture

The tenor of secured debenture shall not be more than 10 years from the date of issue, except in following cases where tenor can be upto 30 years

i. Companies engaged in setting up of **infrastructure projects**;

ii. **Infrastructure Finance Companies** as defined in clause (viia) of sub direction (1) of direction 2 of Non-Banking Financial (Non-deposit accepting or holding) Companies Prudential Norms (Reserve Bank) Directions, 2007;

iii. **Infrastructure Debt Fund NBFCs'** as defined in clause (b) of direction 3 of Infrastructure Debt Fund Non-Banking Financial Companies (Reserve Bank) Directions, 2011;

iv. Companies **permitted by a Ministry or Department of the Central Government** or by **Reserve Bank of India** or by the **National Housing Bank** or by **any other statutory authority** to issue debentures for a period exceeding ten years.

b. Appointment of Debenture Trustee

Debenture trustee shall be appointed by company before the issue of prospectus or letter of offer for subscription of its debentures.

c. Security by Creation of Charge

Security for the debenture can be provided by way of creating a **charge or mortgage** in **favour of debenture trustee**, on;

i. **Specified movable** of the **company or its subsidiaries or its holding company or its associates companies**, **or**

ii. **Specified immovable properties** wherever situate, or any interest therein.

Note:

1. Value of such assets or properties upon which charge is created shall be sufficient for the due repayment of the amount of debentures and interest thereon.
2. In case of NBFCs, the charge or mortgage may be created on any movable property.
3. In case of any issue of debentures by a **Government company** which is fully **secured by the guarantee, given by the Central Government or one or more State Government or by both**, as per the requirement for creation of charge under rule 18(1) of *the Companies (Share Capital and Debentures) Rules, 2014* shall not apply.

d. Debenture Trust Deed

Debenture trust deed shall be executed in Form SH-12 to protect the interest of the debenture holders, **within three months** of closure of the issue or offer.

Creation of Debenture Redemption Reserve (DRR) Account [Sub-section 4 read with Rule 18 (7) of the Companies (Share Capital and Debentures) Rules, 2014]

Company shall create a debenture redemption reserve (DRR) account out of the profits of the company available for payment of dividend.

The amount credited to such DRR account shall not be utilised by the company except for the redemption of debentures.

a. Requirement of DRR

Category	Publicly placed debenture	Privately places debenture
All India Financial Institutions (regulated by RBI)	Exempted	Exempted
Banking Companies	Exempted	Exempted
Listed companies (other than All India Financial Institutions and Banking	Exempted except NBFCs not registered	Exempted except NBFCs not registered

Companies covered above)	with RBI u/s 45IA of RBI Act, and for House Finance companies not registered with National Housing bank	with RBI u/s 45IA of RBI Act, House Finance companies not registered with National Housing bank
Unlisted Companies (other than All India Financial Institutions and Banking Companies covered above)	DRR equal to 10% of Outstanding Debenture	DRR equal to 10% of Outstanding Debenture Except NBFCs registered with RBI u/s 45IA of RBI House Finance Companies registered with National Housing bank

Note:

1. The main purpose of these relaxations was introduced by the MCA for the reduction of the cost of borrowings incurred by companies.
2. Other Financial Institution covered under 2(72) of the Companies Act 2013 for purpose of creating and maintaining DRR shall be dealt in manner as Non–Banking Finance Companies registered with Reserve Bank of India
3. In case of partly convertible debentures, Debenture Redemption Reserve shall be created in respect of non-convertible portion of debenture

b. Amount and methods of Investment or deposits for debentures maturing during the fiscal

By 30th April of each year, the in case of;

Company	In case of
Listed Company, other than All India Financial Institutions and Banking Companies	Publicly placed debenture

Unlisted companies, other than All India Financial Institutions, Banking Companies	Publicly placed debenture & Privately placed debenture (other than those by NBFCs registered with RBI u/s 45IA of RBI and House Finance companies registered with National Housing bank)

An amount equal to 15% of its debentures maturing during the financial year, ending on the 31st day of March of the next year, shall be invested or deposited in any of following **methods of deposits or investments**, namely;

a. Deposits with any scheduled bank, free from any charge or lien;

b. Unencumbered securities of the Central Government or any State Government;

c. Unencumbered securities mentioned in sub-clause (a) to (d) and (ee) of section 20 or 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 remaining invested or deposited, as the case may be, shall not any time fall below fifteen percent of the amount of the debentures maturing during the year ending on 31st day of March of that year. Meaning thereby that amount shall be invested or deposited by 30th April and maintained there after till end of financial year (or till maturity if fall earlier).

Restrictions on the Issue of Prospectus/Offer/Invitation to the public [Sub-section 5]

Prior to 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, the company **shall appoint one or more debenture trustees**. Except in case of public offer of debenture, in all other cases appointment and removal of debenture trustee governed by provisions prescribed in Rule 18 (2) of the Companies (Share Capital and Debentures) Rules, 2014; namely;

a. Name and Consent of Denture Trustee

The **names** of the debenture trustees shall be stated in **offer related letters and notices** or subsequent thereto.

Written consent before the appointment of debenture trustee must be obtain and statement to that effect shall appear in the letter of offer.

b. Who can be denture trustee?

Following persons **shall not** be appointed as a debenture trustee,

i. A **beneficiary holders of shares** in the company;

ii. 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. **Relative** of any **promoter, director or key managerial personnel** of the company;

iv. A **beneficiary entitled to moneys** which are to be paid by the company otherwise than as remuneration payable to the debenture trustee;

v. Who is **indebted to the company**, or its **subsidiary, holding or associate** company or a **subsidiary of such holding** company;

vi. Who has **furnished any guarantee** in respect of the principal debts secured by the debentures or interest thereon;

vii. Who has any **pecuniary relationship** with the company amounting to **two per cent 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;

c. Removal of debenture trustee prior to his term

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 three fourth in value of the debentures outstanding, at their meeting.

d. Filling of vacancy of debenture trustee

Nature of vacancy	How to fill
Casual Vacancy*	Board themselves may fill any casual vacancy
Caused by the resignation	With the written consent of the majority of the debenture holders.

*While any such vacancy continues, the remaining trustee or trustees, if any, may act till appointment made.

Debenture Trustee to protect Interest of Debenture Holders [Sub-section 6]

A debenture trustee shall take steps to protect the interests of the debenture-holders and redress their grievances. Duties of debenture trustee enumerated under rule 18(3) of *the Companies (Share Capital and Debentures) Rules, 2014*. Further, Rule 18 (4) of *the Companies (Share Capital and Debentures) Rules, 2014* requires debenture holders to convene the meeting of all the debenture holders on:

a. Receiving a request (duly signed and in writing) from debenture holders holding at least one-tenth in value of the debentures

b. Happening of any such event, which constitutes a breach, default or which in the opinion of the debenture trustees affects the interest of the debenture holders.

Note: Rule 18(3) and 18(4) are not applicable in case of public offer of debenture

Example 31 – Roshan Bulb Limited took a bank loan in contravention to covenant regarding permissible debt-equity ratio, stated in offer document issued for subscription of its debentures. In this case debenture trustee bound to convene the meeting of all the debenture holder as decision of taking loan by company is not only breach but also a default that will affect the interest of the debenture holders.

Liability of Debenture Trustee [Sub-section 7]

Where debenture trustee **fails to show the degree of care and due diligence** required of him as a trustee.

Any provision, that **exempt or indemnify a debenture-trustee** from any liability for breach of trust; as contained in;

a. A trust deed for securing the issue of debentures or

b. Any contract with debenture holders secured by a trust deed

Shall be **void.**

Note: Exemptions given to debenture trustee, shall be agreed upon by debenture holders holding at least 75% value of debentures at time of meeting held for this purpose.

How to determine the reasonable degree of care and due diligence – Means a yardstick to determine failure – One have to determine in regard to the provisions of the trust deed conferring any power, authority or discretion on such debenture trustee.

Example 32 – Debenture trustee fails in keeping a close watch on change in value of asset against which such debenture are secured, which is specified a preliminary responsibility marked upon him; it can be said debenture trustee fails to show degree of care and due diligence required of him as a trustee.

To pay Interest and Redeem Debentures [Sub-section 8]

A company **shall pay interest and redeem** the debentures in accordance with the **terms and conditions of their issue**.

Filing of Petition before Tribunal by Debenture Trustee [Sub-section 9]

Where debenture trustee reach to 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, **may file a petition** before the Tribunal.

The tribunal may pass order:

a. To impose restrictions on the incurring of any further liabilities by the company as it may consider necessary in the interests of the debenture-holders.

b. After hearing the company and any other person interested in the matter

Order of Tribunal on Failure to Redeem Debentures/Pay Interest [Sub-section 10]

Tribunal may direct by order;

a. On the company to redeem the debentures forthwith on payment of principal and interest due thereon

b. After hearing the parties concerned, on the application of any or all of the debenture-holders, or debenture trustee

c. Where a company fails to redeem the debentures on the date of their maturity or fails to pay interest on the debentures when it is due,

Specific Performance of the Contract [Sub-section 12]

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.

Debenture holder has right to seek relief under the Specific Relief Act, 1963 for specific performance. Court may pass decree (in favour of denture holder in this case) under 2(2) of the Civil Procedure Code, 1908 (CPC) and same can be executed under order 21 of CPC.

Specific performance means, forcing other party (company in this case) of contract to perform his part of contract (repayment of debenture) through court's decree.

Decree is final order passed by court as outcome of adjudication, explaining right of parties.

Procedure to be prescribed by Central Government [Sub-section 13]

Sub-section 13 empowers the Central Government to prescribe the:

a. Procedure for the securing the issue of debentures,

b. Procedure for the debenture-holders to inspect the trust deed and to obtain copies thereof

c. Form of debenture trust deed,

d. Quantum of debenture redemption reserve required to be created and

e. Such other matters.

Illustration – True/False

If interest to debenture holder remain un-paid for two years then they may vote on resolution affecting their interests.

Answer – False, no debenture holder can never assume voting right, unless their debenture is converted in equity as per terms of issue. Though similar provision exist in case of preference dividend remain unpaid for two year to preference shareholder.

Note:

1. **If issue results in debt-equity ratio more than 1 -** In case of company other than private company, the Board of Directors of the company shall obtain approval of the shareholders 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, then prior to the issue of debentures.

   Note – Borrowing shall not include short term or temporary loan in nature.

2. **Pursuant to rule 12 (1) of the companies (Prospectus and allotment of securities) Rules 2014,** a company having share capital, when makes allotment of any debentures (falls within the definition of 'securities'), it is required to file a **Return of Allotment** in form No. PAS-3 within **thirty days** of such allotment with the **jurisdictional Registrar**.

SUMMARY

- There are two kinds of long-term capital to run a business viz., owners' capital and lender's capital.
- Each type of capital is denominated by different securities with applicable rights which can be varied by following the legal procedure.
- Most of the requirements applicable to a company are to be in accordance with its Articles of Association and Memorandum of Association or with the decisions taken by the shareholders at the general meetings but they must be legally valid as per the provisions of the Companies Act.
- There are mandated provisions relating to the application of securities premium amount.
- Companies are not permitted to issue shares at a discount except when such shares are issued as sweat equity.
- No company can issue irredeemable preference shares. Maximum tenor of redeemable share also capped upto twenty years with exception in case infrastructure project, where it can be issued for maximum upto thirty years.
- Only fully paid-up preference shares are eligible for redemption.

- When preference shares are redeemed out of profits, the company is required to create Capital Redemption Reserve Account.
- Capital Redemption Reserve Account may be applied for issuing fully paid bonus shares.
- Power to alter share capital by a limited company having a share capital is envisaged under Section 61.
- Companies can issue rights shares to their existing shareholders in accordance with Section 62.
- Issue of bonus shares is governed by Section 63.
- After following the prescribed legal procedure, a company is permitted to bring about reduction in its share capital.
- A company is restricted to purchase or give loans for purchase of its shares except where buy-back is resorted to in accordance with the applicable provisions.
- Buy-back of shares is prohibited under certain circumstances.
- Debenture Redemption Reserve account is created to ring - fence funds requirement for redemption of Debentures.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. *Sarvodhaya Urban Nidhi Limited has ₹ 14 Crore and ₹ 6 Crore as paid-up equity and preference share capital respectively. Balance in retain earnings account is ₹ 2.4 Crore. Equity share capital having face value of ₹ 10 each, while preference share has face value of 100 each. Mr. Surya and Mr. Chandan own 11,20,000 and 5,60,000 shares respectively. In context of resolution placed before the company which directly affect the rights attached to his preference shares, the voting right of Mr. Surya and Mr. Chandan in percentage term shall be:*

   (a) 8% and 4% respectively

   (b) 5.6% and 2.8% respectively

(c) *5% and 2.8% respectively*

(d) *5% and 2.5% respectively*

2. *In a litigation regarding title of shares, a share certificate issued in physical form by Modern Furniture Limited, an unlisted private company that doesn't have a common seal submitted as evidence of the title. The same shall be clear and convincing evidence of title, if signed by;*

i. *two directors*

ii. *two directors, out of which one shall be managing director*

iii. *two directors and the Company Secretary, wherever the company has appointed a Company Secretary*

iv. *a director and the Company Secretary, wherever the company has appointed a Company Secretary*

(a) *By i or iii only*

(b) *By i or iv only*

(c) *By ii or iii only*

(d) *By ii or iv only*

3. *Mr. Bahu has received a notice from Mahishmati Private Limited on 2nd March, 2023 intimating that Mr. Bali has submitted a transfer deed duly signed by him for transfer of 1000 partly paid shares (₹ 8 paid-up out of Face Value of ₹ 10 per share) in his (Mr. Bahu) name. Mr. Bahu as transferee must raise his objection to the proposed transfer of partly paid shares latest by*

(a) *9th March, 2023*

(b) *16th March, 2023*

(c) *17th March, 2023*

(d) *31st March, 2023*

4. *Section 67 of the Companies Act, 2013 impose a restriction on public company from giving any financial assistance whether directly or indirectly and whether by means of a loan, guarantee, the provision of security or otherwise for the purpose of, or in connection with, a purchase or subscription made or to be made, by any person of or for any shares in the company or in its holding company. Star Engineering Limited which is not covered by any of exemptions specified under*

said section, contravene the restrictive provisions stated above. Every officer of the company who is in default shall be liable for;

(a) Fine which shall not be less than one lakh rupees but may extend to twenty-five lakh rupees

(b) Fine which shall not be less than one lakh rupees but may extend to twenty-five lakh rupees or Imprisonment for a term which may extend to three years or both

(c) Fine which may extend to twenty-five lakh rupees or Imprisonment for a term which may extend to three years or both

(d) Fine which shall not be less than one lakh rupees but may extend to twenty-five lakh rupees and Imprisonment for a term which may extend to three years

5. *Modern Furniture an unlisted company receive a request for issue of duplicate share certificate. Complete documents in this regards submitted with the company on 30th December 2022. Modern furniture shall issue the duplicate share certificates by:*

(a) 29th January 2023

(b) 13th February 2023

(c) 28th February 2023

(d) 29th March 2023

Descriptive Questions

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. provided 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.

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.*

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. Is there any liability of company and officer in default in the said 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?*

5. *Trisha Data Security Limited was incorporated just a year ago with a paid- up share capital of ₹ 200 crore. Within such a small period of about 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.*

6. *Walnut Foods Limited has an authorized share capital of 2,00,000 equity shares of ₹ 100 per share and an amount of ₹ 2 crore 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.*

7. *OLAF Limited, a subsidiary of PQR Limited, decides to give a loan of ₹ 4,00,000 to its Human Resource Manage,r 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.*

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*

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?

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?*

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.

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.*

ANSWERS

Answer to MCQ based Questions

1.	**(c)**	5% and 2.8% respectively
2.	**(b)**	two directors, out which one shall be managing director
3.	**(c)**	16th March, 2023
4.	**(d)**	Fine which shall not be less than one lakh rupees but may extend to twenty-five lakh rupees and Imprisonment for a term which may extend to three years
5.	**(d)**	29th March 2023

Answer to Descriptive Questions

1. 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. **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 Form No. SH-7 as per Rule 15 of *the Companies (Share Capital and Debentures) Rules, 2014* with the **Registrar**, along with an **altered memorandum** within **thirty days** of **alteration** 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. 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, as per Section 56 (6), where any default is made in complying with the provisions of sub-sections (1) to (5), the company and every officer of the company who is in default shall be liable to a penalty of fifty thousand rupees.

4. 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. 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 any difference that the company is just about a year old, because there is no such age (time since commencement of business) requirement under Section 54.

6. 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. **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. 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. **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. 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. 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. 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 managing director, if any.

NOTES

CHAPTER 5

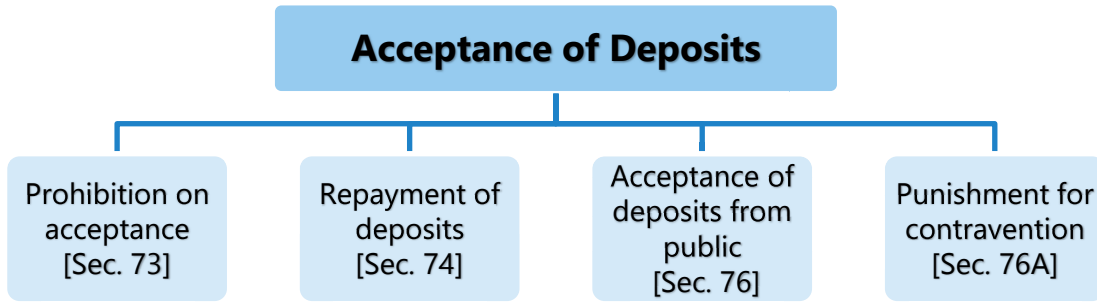
ACCEPTANCE OF DEPOSITS BY COMPANIES

LEARNING OUTCOMES

At the end of this chapter, you will be able to:

- Explain the meaning of the term 'Deposit'.
- Comprehend the requirements for and restrictions on acceptance of deposits from members and public.
- Grasp the concept of 'eligible companies' which can accept deposits from public in addition to their members.
- Identify the punishment for contravention of the provisions relating to acceptance of deposits by companies.

CHAPTER OVERVIEW



1. INTRODUCTION

Chapter V	**Consists of sections 73 to 76A as well as the Companies (Acceptance of Deposits) Rules, 2014.**

Acceptance of deposits from the members as well as public at large is an important source of finance for the corporate sector. It is, therefore, necessary to control the companies which invite deposits in order to safeguard the general and wider interest of all those persons who offer deposits out of their precious savings. The statutory provisions as contained in sections 73 to 76A of the Companies Act, 2013 (hereinafter referred to as 'the Act') and the *Companies (Acceptance of Deposits) Rules, 2014* (hereinafter referred to as 'the Rules') govern the acceptance of deposits and also renewal thereof.

2. CERTAIN IMPORTANT TERMS EXPLAINED

A. DEPOSIT

Definition: According to section 2 (31) of the Act, 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.

Features:

(i) The above definition of 'deposit' is inclusive one.

(ii) It includes any money received by way of:

a) deposit; or

b) loan; or

c) in any other form.

(iii) Repayment of 'deposit' is time-bound.

(iv) It can be secured or unsecured.

(v) It does not include prescribed categories of amounts (as stated in the 'Acceptance of Deposits' Rules).

(vi) It may be accepted in joint names not exceeding three persons.

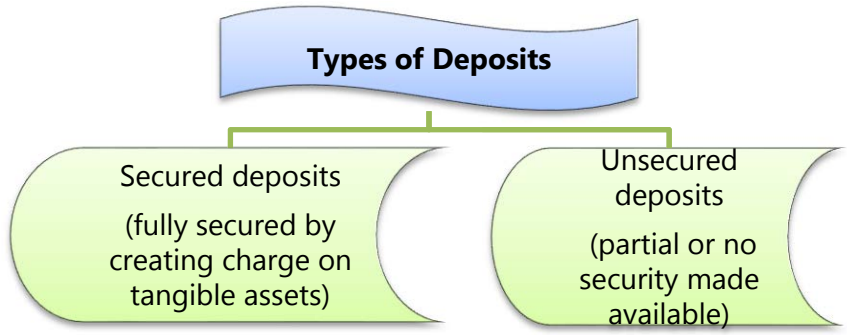
(vii) A depositor may nominate any person at any time.

(viii) Every deposit accepted by the company shall be repaid with interest.

(ix) Premature repayment of a deposit can be made by the company.

(x) A private company can accept deposits from its members only.

(xi) A public company can accept deposits from its members and also from the public if it fulfills certain parameters.



B. AMOUNTS NOT CONSIDERED AS DEPOSIT

Following categories of amounts are not considered as deposit *[Rule 2 (1) (c)]:*

(i) Any amount received from:

- the Central Government; or
- a state Government; or
- any other source whose repayment is guaranteed by the Central Government or a State Government; or
- local authority; or
- a statutory authority constituted under an Act of Parliament or a State Legislature;

(ii) Any amount received from:

- foreign Governments,
- foreign or international banks,
- multilateral financial institutions (including, but not limited to, International Finance Corporation, Asian Development Bank, Commonwealth Development Corporation, and International Bank for Industrial and Financial Reconstruction),
- foreign Governments owned development financial institutions,
- foreign export credit agencies,
- foreign collaborators,
- foreign bodies corporate and foreign citizens,

- foreign authorities or persons resident outside India;

The receipt of funds shall be subject to the provisions of Foreign Exchange Management Act, 1999 and rules and regulations made thereunder;

(iii) Any amount received as a loan or facility from:

- any banking company, or
- State Bank of India or its subsidiary banks, or
- a notified banking institution, or
- a corresponding new bank (as defined in the Banking Companies (Acquisition and Transfer of Undertakings) Acts of 1970 and 1980), or
- any co-operative bank;

(iv) Any amount received as a loan or financial assistance from:

- [1]Public Financial Institutions, or
- any regional financial institutions, or
- Insurance companies, or
- Scheduled banks (as defined in Reserve bank of India Act, 1934;

(v) Any amount received against issue of commercial paper or any other instruments issued in accordance with the guidelines or notification issued by the Reserve Bank of India;

(vi) Any amount received by a company from any other company (Mainly known as Inter Company Deposit (ICD));

(vii) Any amount received and held towards subscription to any securities (including share application money or advance towards allotment of securities, pending allotment), so long as such amount is appropriated only against the amount due on allotment of the securities applied for;

Notes:

(a) It is clarified by way of *Explanation* that if the securities for which application money or advance for such securities was received cannot

[1] Such PFI's as notified by the Central Government in this behalf in consultation with the Reserve Bank of India.

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.

(b) Further, it is clarified that any adjustment of the amount for any other purpose shall not be treated as refund.

(viii) Any amount received from a person who, at the time of the receipt of the amount, was a director of the company or a relative of the director of the private company;

However, the director of the company or relative of the director of the private company, as the case may be, from whom money is received, is required to furnish to the company at the time of giving the money, 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) Any amount raised by the issue of:

- bonds or debentures secured by a first charge or a charge ranking *pari passu* with the first charge on any assets referred to in Schedule III[2] of the Companies Act, 2013 excluding intangible assets of the company, or
- bonds or debentures compulsorily convertible into shares of the company within 10 years;

However, if such bonds or debentures are secured by the charge of any assets referred to in Schedule III of the Companies Act, 2013, excluding intangible assets, the amount of such bonds or debentures shall not exceed the market value of such assets as assessed by a registered valuer.

(ixa) Any amount raised by issue of non-convertible debenture not constituting a charge on the assets of the company and listed on a recognised stock exchange as per applicable regulations made by Securities and Exchange Board of India;

[2] Schedule III contains format of Balance Sheet.

Example 1: Soorya Ltd. has raised ₹ 20,00,000 through issue of non-convertible debentures (20,000 NCDs of ₹ 100 each) not constituting a charge on the assets of the company. The NCDs are listed on a recognised stock exchange as per applicable regulations made by Securities and Exchange Board of India. The said amount will not be considered as deposit in terms of the rule stated above *[Sub-clause (ixa)]*

(x) any 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;

Example 2: Ratnakar was appointed as Supervisor by Siddhi Transporters and Logistics Limited on an annual salary of ₹ 6,00,000. He was required to deposit a sum of ₹ 6,50,000 under the contract of employment with the company as security deposit on which no interest was payable to him.

In the above case, the amount so received by Siddhi Transporters and Logistics Limited from Ratnakar under the contract of employment with the company being non-interest bearing security deposit, will be considered as deposit in terms of sub-clause (x), since the amount is more than his annual salary. Had the amount of non-interest bearing security deposit received by the company under the contract of employment been limited to ₹ 6,00,000 or less, it would not have been considered as deposit.

(xi) Any non-interest bearing amount received and 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 provision of services accounted for in any manner whatsoever provided that such advance is appropriated against supply of goods or provision of services within **three hundred and sixty-five days** from the date of acceptance of such advance:

However, in case of any advance which is subject matter of any legal proceedings before any court of law, the said time limit of **three hundred and sixty-five days shall not apply**.

(b) as advance, accounted for in any manner whatsoever, received in connection with consideration for an immovable property under an

agreement or arrangement, 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 provision of services;

(d) as advance received under long term projects for supply of capital goods except those covered under item (b) above;

(e) 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) as an advance received and as allowed by any sectoral regulator or in accordance with directions of Central or State Government;

(g) as an advance for subscription towards publication, whether in print or in electronic to be adjusted against receipt of such publications;

However, *it is clarified that* 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, by way of Explanation it is clarified that 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.

(xiii) any amount brought in by the promoters of the company by way of unsecured loan in pursuance of the stipulation of any lending financial institution or a bank subject to the fulfillment of following conditions:

(a) the loan is brought because of the stipulation imposed by the lending institutions on the promoters to contribute such finance;

(b) the loan is provided by the promoters themselves or by their relatives or by both; and

(c) such exemption shall be available only till the loans of financial institution or bank are repaid and not thereafter.

(xiv) any amount accepted by a Nidhi company in accordance with the rules made under section 406 of the Act;

(xv) any amount received by way of subscription in respect of a chit under the Chit Fund Act, 1982;

(xvi) any amount received by the company under any collective investment scheme in compliance with regulations framed by the Securities and Exchange Board of India;

(xvii) an amount of **twenty-five 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 **ten years** from the date of issue) in a single tranche, from a person;

By way of Explanation it is clarified that:

1. *"Start-up company"* means a private company incorporated under the Companies Act, 2013 or Companies Act, 1956 and recognised as such in accordance with Notification Number G.S.R. 127 (E), dated 19-02-2019 issued by the Department for Promotion of Industry and Internal Trade ;

2. *"Convertible note"* means an instrument evidencing receipt of money initially as a debt, which is repayable at the option of the holder, or which is convertible into such number of equity shares of the start-up company upon occurrence of specified events and as per the other terms and conditions agreed to and indicated in the instrument.

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[3] and Mutual Funds registered with the Securities and Exchange Board of India in accordance with regulations made by it.

Note: Clarification regarding 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 (General Circular No. 5/2015, dated 30-03-2015)

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.

However, any renewal or acceptance of fresh deposits on or after 1st April, 2014 shall be in accordance with the Companies Act, 2013 and the rules made thereunder.

C. DEPOSITOR

Definition:

As per Rule 2 (1) (d) of the Companies (Acceptance of Deposits) Rules, 2014, the term '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.

In other words:

- any member of a private or public company who has deposited money with his company is a 'depositor'.

[3] The words 'Real Estate Investment Trusts' have been inserted vide the Companies (Acceptance of Deposits) Amendment Rules, 2019 w.e.f. 22-01-2019.

- any person (even if not a member of the company) who has deposited money with a public company is also a 'depositor'.

D. ELIGIBLE COMPANY

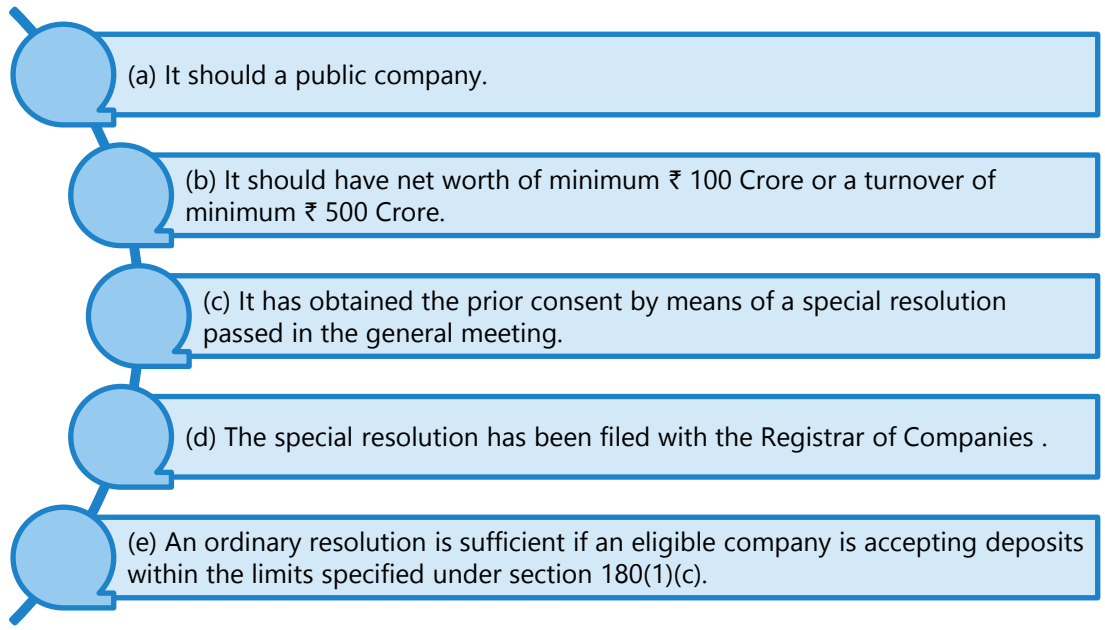
Definition:

As per Rule 2 (1) (e) the term "eligible company" means a public company as referred to in section 76 (1), 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 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.

A public company is 'eligible' to accept deposits from the public at large only if it meets the above-mentioned criteria.

Accordingly,



3. 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 of the Act for acceptance or renewal of deposits from public. Manner of acceptance of deposits from public is explained later in the Chapter.

B. Exempted Companies

According to Section 73 (1), on and after the commencement of this Act, no company shall invite, accept or renew deposits under this Act from the public except in a manner provided under this Chapter:

Provided that **nothing** in this sub-section shall apply to a banking company and non-banking financial company as defined in the Reserve Bank of India Act, 1934 and to such other company as the Central Government may, after consultation with the Reserve Bank of India, specify in this behalf.

Besides above exempted companies, Rule 1 (3) also states that 'Deposit Rules' shall not apply to any Housing Finance Company registered with National Housing Bank established under the National Housing Bank Act, 1987.

In nutshell, following are the **exempted companies** to which 'deposit provisions' are not applicable:

(i) any banking company;

(ii) any Non-banking Financial Company (NBFC);

(iii) any Housing Finance Company (HFC); and

(iv) such other company as may be notified by the Central Government.

This brings out the fact that 'deposit provisions' as contained in the Companies Act, 2013 and 'Deposit Rules' have been enacted to regulate acceptance of deposits by **non-banking non-financial companies** (i.e. manufacturing companies, trading companies, etc.) only.

4. PROVISIONS REGARDING ACCEPTANCE OF DEPOSITS FROM MEMBERS

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 containing Statement:** 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 towards deposits in respect of any previous deposits accepted by the company and such other particulars in the prescribed form and manner. [Section 73 (2) (a)]

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.

Further, the circular may be published in English language in an English newspaper and in vernacular language in a vernacular newspaper having wide circulation in the State in which the registered office of the company is situated.

In addition, a certificate of the statutory auditor of the company shall be attached in Form DPT-1, stating that the company **has not committed default** in the repayment of deposits or in the payment of interest on such deposits accepted either before or after payment of interest on such deposits accepted either before or after the commencement of the Act.

In case a company had **committed a default** in the repayment of deposits accepted either before or after the commencement of the Act or in the payment of interest on such deposits, a certificate of the statutory auditor of the company shall be attached in Form DPT-1, stating that the company had made good the default and a period of **five years** has lapsed since the date of making good the default as the case may be.

Such Circular shall be issued on the authority and in the name of Board of Directors of the company.

The Circular shall remain valid till the earliest of the following dates:

(a) up to **six months** from the closure of the financial year in which it is issued; or

(b) the date on which the financial statements are laid before the company at the 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)]*

According to Rule 13 (*Maintenance of Liquid Assets and Creation of Deposit Repayment Reserve Account*), every company referred to in sub-section (2) of section 73 and every eligible company shall on or before the 30th day of April of each year deposit the sum as specified in clause (c) of the said sub-section with any scheduled bank and the amount so deposited shall not be utilised for any purpose other than for the repayment of deposits:

Provided that the amount remaining deposited shall not at any time fall below **twenty per cent** of the amount of deposits maturing during the financial year.

[4](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 five years had lapsed since the date of making good the default. [Section 73 (2) (e)]

Exemption to certain Private Companies[5]:

Clauses (a) to (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 **one hundred per cent** of aggregate of the paid-up share capital, free reserves and securities premium account; or

(B) which is a start-up, for five 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 fifty crore rupees**, whichever is **lower**; and

(c) such a company has not defaulted in the repayment of such borrowings subsisting at the time of accepting deposits under this section.

[4] Clause (*d*) relating to 'deposit insurance' was omitted vide the Companies (Amendment) Act, 2017 w.e.f. 15th August, 2018.

[5] In terms of Notification No. GSR 464 (E), dated 05-06-2015 as amended from time to time. Further, in terms of Notification No. GSR 8(E), dated 04-01-2017, 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).

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).

(6) **Provision of Security:** The company may provide security, if any, 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.

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) **Repayment of deposit:** Every deposit accepted by a company shall be repaid with interest in accordance with the terms and conditions of the agreement. [Section 73 (3)]

(8) **Application to National Company Law Tribunal (NCLT) 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 NCLT 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 NCLT may deem fit. [Section 73 (4)]

(9) **Utilising the Amount of Deposit Repayment Reserve Account:** The Deposit Repayment Reserve Account shall not be used by the company for any purpose other than repayment of deposits. [Section 73 (5)]

Rule 13 also states that the amount so deposited in the Account shall not be used by the company for any purpose other than repayment of deposits.

(10) **Tenure for which Deposits can be Accepted[6]:** A company is not permitted to accept or renew deposits (whether secured or unsecured) which is repayable on demand or in less than six months. Further, the maximum period of acceptance of deposit cannot exceed thirty-six months.

Example 5: Arpit, a member of Swapnil Traders Private Limited deposited ₹1,00,000 with his company on 1st April, 2022. The earliest repayment date in

[6] As per Rule 3 (1).

this case shall be 30th September, 2022 and the latest repayment date shall be 31st March, 2025. Thus, the tenure will range between six months and thirty-six months, as per the policy of Swapnil Traders Private Limited.

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 six months subject to the condition 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.

Example 6: Continuing the example of Swapnil Traders Private Limited, it is assumed that aggregate of its paid-up share capital, free reserves and securities premium account is ₹ 2,00,00,000. In order to meet its short-term requirement of funds, it can raise deposits maximum up to ₹ 20,00,000 (being 10% of ₹ 2,00,00,000) whose repayment tenure can be less than six months; but such tenure cannot be less than three months.

Therefore, Swapnil Traders Private Limited must ensure that the short-term deposits so accepted are repaid only on or after three months from the date of such deposits.

(11) Maximum Amount of Deposits from Members[7]: A company is permitted to accept or renew any deposit from its members including other such deposits outstanding as on the date of acceptance or renewal maximum up to **35%** of the aggregate of its paid-up share capital, free reserves and securities premium account.

However, *as an exception,* a Specified IFSC Public company[8] 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

[7] As per Rule 3 (3).

[8] A Specified IFSC Public company means an unlisted public company which is licensed to operate by the Reserve Bank of India or the Securities and Exchange Board of India or the Insurance Regulatory and Development Authority of India from the International Financial Services Centre located in an approved multi services Special Economic Zone set-up under the Special Economic Zones Act 2005 read with the Special Economic Zones Rules, 2006.

account. Further, such company shall file the details of monies so accepted with the Registrar in Form DPT-3.

In addition, the maximum limit in respect of deposits to be accepted from members shall not apply to the following classes of private companies:

(i) a private company which is a start-up, for ten 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) 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 fifty 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.

(12) Appointment of Trustee for Depositors: As regards appointment of trustee, refer provisions given under 'Acceptance of Deposits from Public' because same provisions are applicable.

(13) Trustee to call Meeting of Depositors[9]: The trustee for depositors shall call a meeting of all the depositors in the following cases:

(a) on receipt of a requisition in writing signed by at least one-tenth of the depositors in value for the time being outstanding;

(b) on the happening of any event, which constitutes a default or which, in the opinion of the trustee for depositors, affects the interest of depositors.

(14) Ceiling on Rate of Interest and Brokerage Payable on Deposits[10]: A company is permitted to invite or accept or renew any deposit at any rate of interest or pay any amount of brokerage but in no case, it shall exceed the

[9] As per Rule 9.
[10] As per Rule 3 (6).

maximum rate of interest or brokerage prescribed by the Reserve Bank of India 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. Payment of brokerage to any other person for procuring deposits shall be deemed to be in violation of 'deposit rules'.

(15) Filling of Application Form for making Deposits[11]: A company shall accept or renew any deposit, whether secured or unsecured, only when an application, as specified by the company, is submitted by the intending depositor for the acceptance of deposit.

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.

(16) Deposits in Joint Names[12]: In case the depositors so desire, deposits may be accepted by the company 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 of deposits.

Example 7: A, B and C have jointly deposited ₹ 3,00,000 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.

[11] As per Rule 10.
[12] As per Rule 3 (2).

- *In case of 'Anyone or Survivor' clause:*

  the repayment of deposit on maturity shall be as in the case of 'Either or Survivor'.

(17) Nomination[13]: Every depositor may nominate any person at any time. The nominee shall be the person to whom his deposits shall vest in the event of his death.

(18) Deposit Receipt[14]: Within a period of twenty-one 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 an officer duly authorised by the Board 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.

(19) Register of Deposits[15]: As regards Register of Deposits**,** refer provisions given under 'Acceptance of Deposits from Public' because same provisions are applicable.

(20) Premature Repayment of Deposits[16]: As regards premature repayment of deposits, refer provisions given under 'Acceptance of Deposits from Public' because same provisions are applicable.

(21) Filing of Return of Deposits with the Registrar[17]*:* A duly audited Return of Deposits in DPT-3 (containing particulars as on 31st March of every year) shall be filed with the Registrar of Companies along with requisite fee on or before 30th June of that year and declaration to that effect shall be submitted by the auditor in Form DPT-3.* *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).

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[13] As per Rule 11.
[14] As per Rule 12.
[15] As per Rule 14.
[16] As per Rule 15.
[17] As per Rule 16.
* Inserted by Companies (Acceptance of Deposits) Amendment Rules, 2022

(22) No Right to Alter any Terms and Conditions of Deposit[18]: The company has no right to alter, either directly or indirectly, any of the terms and conditions of the deposit, deposit trust deed and deposit insurance contract which may prove disadvantageous to the interest of the depositors after circular or circular in the form of advertisement is issued and deposits are accepted.

(23) Disclosures in Financial Statements[19]: 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.

(24) Penal Rate of Interest[20]: In case the company fails to repay deposits (both secured and unsecured) on maturity, after they are claimed, it shall pay penal rate of interest of **eighteen per cent** per annum for the overdue period.

(25) Punishment for Contravention[21]: 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 five thousand rupees; and
- in case the contravention is a continuing one, with a further fine which may extended to five hundred rupees for every day after the first day during which the contravention continues.

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[18] As per Rule 3 (7).

[19] As per Rule 16A. — *Vide Rule 16A (3), as a onetime measure, every company (other than a Government company) was required to 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 ninety days from 31st March, 2019 along with requisite fee.*

[20] As per Rule 17.

[21] As per Rule 21.

5. 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.

Section 76 of the Act and the *Companies (Acceptance of Deposits) Rules, 2014* deal with acceptance of deposits from public by eligible companies.

The acceptance of deposits from public shall be subject to compliance with section 73 (2) and the prescribed rules.

These provisions are stated as under:

(1) Net Worth/Turnover Criterion[22]: A public company, having **net worth of not less than one hundred crore rupees** or **turnover of not less than five hundred crore rupees**, may accept deposits from persons other than its members. Such type of public company is known as 'eligible company'.

(2) Passing of Special Resolution[23]: 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 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**.

(3) Obtaining of Credit Rating[24]**:** 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 ensuring 'adequate safety' shall be informed to the public at the time of invitation of

[22] As per Rule 2 (1) (e).
[23] As per Rule 2 (1) (e).
[24] As per first Proviso to section 76 (1).

deposits from the public. Further, the rating shall be obtained every year during the tenure of deposits.

As per Rule 3 (8), a 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.

(4) Charge Creation on Assets Necessary if the Deposits are Secured[25]: Every company which accepts secured deposits from the public shall within **thirty 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 charge shall be created in favour of the deposit holders in accordance with the prescribed rules.

In respect of creation of security, Rule 6 states that the company accepting secured deposits shall create security by way of charge on its tangible assets only.

The other notable points are:

- The company cannot create charge on intangible assets *(i.e. goodwill, trade-marks, etc.)*.
- Total value of security should not be less than the amount of deposits accepted and interest payable thereon.
- The market value of assets subject to charge shall be assessed by a registered valuer.
- The security shall be created in favour of a trustee for the depositors on specific movable and immovable property of the company.

(5) Tenure for which Deposits can be Accepted[26]**:** A company is not permitted to accept or renew deposits (whether secured or unsecured) which is repayable on demand or in less than six months. Further, the maximum period of acceptance of deposit cannot exceed thirty-six months.

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[25] As per second Proviso to section 76 (1).
[26] As per Rule 3 (1).

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 six months subject to the condition 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.

(6) Appointment of Trustee for Depositors[27]: 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.
- A statement shall appear in the 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;

[27] As per Rule 7.

(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.

No trustee for depositors shall be removed from office 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.

(7) Meeting of Depositors to be called by Trustee[28]: The trustee for depositors shall call a meeting of all the depositors in the following cases:

(a) on receipt of a requisition in writing signed by at least one-tenth of the depositors in value for the time being outstanding;

(b) on the happening of any event, which constitutes a default or which, in the opinion of the trustee for depositors, affects the interest of depositors.

(8) Maximum Amount of Deposits[29]: An eligible company is permitted to accept or renew deposits as under:

- **From its Members**: The amount of such deposit together with outstanding deposits from the members as on the date of acceptance or renewal can be **maximum ten per cent.** of the aggregate of its paid-up share capital, free reserves and securities premium account;
- **From Persons other than its Members**: The amount of such deposits together with the amount of outstanding deposits (excluding deposits from members) on the date of acceptance or renewal can be **maximum twenty-five per cent.** of the aggregate of its paid-up share capital, free reserves and securities premium account.

(9) Maximum Amount of Acceptable Deposit in case of an Eligible Government Company[30]: Such a company is permitted to accept or renew any deposit together with the amount of other outstanding deposits as on the date of

[28] As per Rule 9.
[29] As per Rule 3 (4).
[30] As per Rule 3 (5).

acceptance or renewal **maximum up to thirty-five per cent.** of the aggregate of its paid-up share capital, free reserves and securities premium account.

(10) Issuance of Circular in the Form of Advertisement[31]: 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 in an English newspaper and in vernacular language in a vernacular newspaper. Both newspapers should have wide circulation in the State in which the registered office of the company is situated.

If the company has its website, the circular shall also be placed on the website.

Such advertisement shall be issued on the authority and in the name of Board of Directors of the company.

- **Filing with the Registrar**: At least **thirty days** before the issue of the advertisement, its copy duly signed by a majority of the directors who approved the advertisement or otherwise signed by their duly authorised agents is required to be delivered to the Registrar of Companies for registration.
- **Validity of the Advertisement**: The advertisement shall remain valid till the earliest of the following dates:
  (a) up to six months from the closure of the financial year in which it is issued; or
  (b) the date on which the financial statements are laid before the company at the 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.
- **Fresh Advertisement**: A fresh advertisement 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.

[31] As per Rule 4.

(11) Maintenance and Using the Amount of Deposit Repayment Reserve Account: The company is required to deposit, on or before 30th April of 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.

(12) Ceiling on Rate of Interest and Brokerage Payable on Deposits[32]: An eligible company is permitted to invite or accept or renew any deposit at any rate of interest or pay any amount of brokerage but in no case, it shall exceed the maximum rate of interest or brokerage prescribed by the Reserve Bank of India 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.

(13) Filling of Application Form for making Deposits[33]: A company shall accept or renew any deposit, whether secured or unsecured, only when an application, as specified by the company, is submitted by the intending depositor for the acceptance of deposit.

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.

(14) Deposits in Joint Names[34]: 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 of deposit.

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[32] As per Rule 3 (6).
[33] As per Rule 10.
[34] As per Rule 3 (2).

(15) Nomination[35]: Every depositor may nominate any person at any time. The nominee shall be the person to whom his deposits shall vest in the event of his death.

(16) Deposit Receipt[36]: Within a period of **twenty-one** 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.

(17) Register of Deposits[37]:

- Every company accepting deposits shall maintain one or more 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) mandate and instructions for payment of interest and for non-deduction of tax at source, if any;

  (j) date or dates on which the payment of interest shall be made;

[35] As per Rule 11.
[36] As per Rule 12.
[37] As per Rule 14.

[38](l) particulars of security or charge created for repayment of deposits;

(m) any other relevant particulars.

- The entries shall be made within **seven 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.
- The said register shall be preserved in good order for a period of not less than **eight years** from the financial year in which the latest entry is made in the register.

(18) Premature Repayment of Deposits[39]: After the expiry of six months but before the actual date of maturity, if a depositor requests for premature repayment, the rate of interest payable shall be one percent less than the rate which would be payable for the period for which the deposit has actually run.

In this respect it is to be noted that the period for which the deposit has run, if it contains any part of the year which is less than six months then it shall be excluded; otherwise if that part is six months or more it shall be taken as one year.

Reduction of rate of interest is not applicable in the following cases:

- Where the deposit is prematurely repaid to comply with *Rule 3 i.e.* premature repayment made in order to reduce the total amount of deposits to bring it within the permissible limits; or
- Where the deposit 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.

(19) Premature Closure of Deposit to Earn Higher Rate of Interest[40]: 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.

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[38] Clause (k) relating to details of deposit insurance was omitted by the Companies (Acceptance of Deposits) Amendment Rules, 2018, w.e.f. 15-08-2018. *[Notification No. G.S.R. 612 (E), dated 5th July, 2018 w.e.f. 15-08-2018]*

[39] As per Rule 15.

[40] As per Rule 15 (Second Proviso).

(20) Filing of Return of Deposits with the Registrar[41]: A duly audited Return of Deposits in DPT-3 (containing particulars as on 31st March of every year) shall be filed with the Registrar of Companies along with requisite fee on or before 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).

(21) Disclosures in Financial Statements[42]**:** A public company shall disclose in its financial statement by way of note about the money received from its directors.

(22) Penal Rate of Interest[43]**:** In case the company fails to repay deposits (both secured and unsecured) on maturity, after they are claimed, it shall pay penal rate of interest of **eighteen per cent** per annum for the overdue period.

(23) No Right to Alter any Terms and Conditions of Deposit[44]**:** The company has no right to alter any of the terms and conditions of the deposit, deposit trust deed and deposit insurance contract 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.

(24) Punishment for Contravention[45]**:** If any eligible 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 five thousand rupees; and
- in case the contravention is a continuing one, with a further fine up to five hundred rupees for every day after the first day during which the contravention continues.

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[41] As per Rule 16.

[42] As per Rule 16A. — Vide Rule 16A (3), as a onetime measure, every company (other than a Government company) was required to 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 ninety days from 31st March, 2019 along with requisite fee.

[43] As per Rule 17.

[44] As per Rule 3 (7).

[45] As per Rule 21.

(25) Applicability of Section 73 and 74 to Eligible Companies: *Rule 19* states that pursuant to provisions of sub-section (2) of section 76 of the Act, the provisions of sections 73 and 74 shall, *mutatis mutandis*, apply to acceptance of deposits from public by eligible companies.

Note: Besides Rule 19, section 76 (2) of the Act states that the provisions of Chapter V shall, *mutatis mutandis*, apply to the acceptance of deposits from public under section 76.

6. PUNISHMENT FOR CONTRAVENTION OF SECTION 73 OR SECTION 76 [SECTION 76A]

According to section 76A of the Act, in case a company accepts or invites or allows any other person to accept or invite on its behalf any deposit in contravention of the manner or the conditions prescribed under section 73 or section 76 or rules made thereunder or if a company fails to repay the deposit or part thereof or any interest within the time specified under section 73 or section 76 or rules made thereunder or such further time as may be allowed by the Tribunal under section 73, then the following consequences will follow:

(a) **Punishment for the company**: 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 but which may extend to ten crore rupees; and

(b) **Punishment for officer-in-default:** Every officer of the company who is in default shall be punishable with imprisonment which may extend to seven years and with fine which shall not be less than twenty-five lakh rupees but which may extend to two crore rupees.

Further, 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 *(Punishment for fraud)*.

7. REPAYMENT OF DEPOSITS ACCEPTED BEFORE COMMENCEMENT OF THE COMPANIES ACT, 2013 [SECTION 74]

The provisions regarding repayment of deposits accepted before commencement of the Companies Act, 2013, have been dealt with in section 74. These provisions are explained as under:

(i) **Filing of Statement of Deposits with the Registrar of Companies and Repayment thereafter**: As per section 74 (1), 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 by the company and sums remaining unpaid on such amount with the interest payable thereon along with the arrangements made for such repayment. This is to be done notwithstanding anything contained in any other law for the time being in force or under the terms and conditions subject to which the deposit was accepted or any scheme framed under any law; and

(b) *repay within three years* from such commencement or on or before expiry of the period for which the deposits were accepted, whichever is earlier.

Note 1: *As per Explanation to Rule 19* if the company has been repaying such deposits and interest thereon without any default on due dates for the remaining period of such deposit in accordance with the terms and conditions, point (b) above shall be deemed to have been complied with.

Note 2: It is to be noted that renewal of any such deposits shall be done in accordance with the provisions of Chapter V and the rules made thereunder.

(ii) **Extension of Time for Repayment of Deposits by the Tribunal**: As per section 74 (2), the Tribunal may, on an application made by the company,

after considering the financial condition of the company, the amount of deposit and the interest payable thereon and such other matters, 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.

8. 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.

SUMMARY

- Deposit includes any receipt of money by way of (i) deposit or (ii) loan or (iii) in any other form by a company.

  But it does not include such categories of amount which are prescribed in the 'Acceptance of Deposits' Rules.

- Depositor means any member of the company who has made a deposit with the company.

  Depositor also means any other person (not being a member of the company) who has made a deposit with a public company categorised as 'eligible company'.

- A public company, having net worth of not less than one hundred crore rupees or turnover of not less than five hundred crore rupees, is known as 'eligible company'. It can accept deposits both from the public and its members.
- Section 73 prohibits a company to invite, accept or renew deposits from public if they are not accepted or renewed in the prescribed manner. This prohibition however shall not apply in case of certain exempted companies *i.e.*:
  - banking company;
  - non- banking financial company;
  - a housing finance company registered with NHB;
  - such other company as the Central Government may specify.
- A company may accept deposits from its members on mutually agreed terms and conditions subject to the passing of a resolution in general meeting.
- Every company referred to in section 73 (2) intending to invite deposits from its members shall issue a circular to all its members in Form DPT-1. Exemption is available to certain private companies.
- An 'eligible company' shall obtain the prior consent of the company in general meeting by means of a special resolution and also file the same with the Registrar of Companies before making any invitation to the public for acceptance of deposits.
- An 'eligible company' accepting deposits within the limits specified under section 180 (1) (c) may accept deposits by means of an ordinary resolution.
- Every 'eligible company' intending to invite deposits shall issue a circular in the form of advertisement in Form DPT-1.
- Deposits shall be accepted by the companies within the specified limits.
- Deposits may be accepted by a company in joint names not exceeding three.
- The Deposit Repayment Reserve Account shall not be used by the company for any purpose other than repayment of deposits.
- In case of secured deposits, the company is required to create security of equivalent amount by way of charge on its tangible assets.

- A company shall not issue any circular or advertisement for inviting secured deposits unless it appoints one or more trustees.
- Every company accepting deposits shall maintain at its registered office one or more separate registers for deposits accepted or renewed.
- A public company shall disclose in its financial statements by way of note about the money received from its directors.
- A private company shall disclose in its financial statements by way of notes, about the money received from the directors, or relatives of directors.
- A 'Deposit Receipt' shall be issued by the company to the depositor or his agent within twenty-one days from the date of receipt of money or realisation of cheque or date of renewal.
- Nomination facility shall be available to every depositor.
- Premature repayment of deposits is permissible.
- Every company shall pay a penal rate of interest of 18% p.a. for the overdue period in case of default in repayment.
- The Return of Deposits shall be filed in Form DPT-3 with the Registrar.
- If a company fails to repay the deposit or part thereof or any interest thereon, the depositor concerned may apply to the National Company Law Tribunal (NCLT) 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 NCLT may deem fit.
- In case of default in repayment, a company is punishable with fine and every *officer-in-default* shall be punishable with imprisonment and also fine. In case of willful default committed with the intention to deceive various stakeholders, he shall be liable for action under section 447.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. *Varsha Limited decides to raise deposits of ₹ 20.00 lakh from its members. However, it proposes to secure such deposits partially by offering a security worth ₹ 15.00 lakh. Which of the following options best describe such deposits:*

(a) *Fully secured deposits (except a small portion)*

(b) *Unsecured deposits*

(c) *Partially secured deposits*

(d) *These cannot be classified as deposits*

2. *What is the maximum tenure for which a company can accept or renew deposits from its members as well as public?*

(a) *12 months*

(b) *24 months*

(c) *36 months*

(d) *48 months*

3. *Fin Limited is accepting deposits of various tenures from its members from time to time. The current Register of Deposits, maintained at its registered office is complete. State the minimum period for which it should mandatorily be preserved in good order.*

(a) *Four years from the financial year in which the latest entry is made in the Register.*

(b) *Six years from the financial year in which the latest entry is made in the Register.*

(c) *Eight years from the financial year in which the latest entry is made in the Register.*

(d) *Ten years from the latest date of entry.*

4. *Every company shall pay a penal rate of interest of ---------- per annum for the overdue period in case of deposits, whether secured or unsecured, matured and claimed but remaining unpaid:*

(a) *9%*

(b) *14%*

(c) *18%*

(d) *24%*

5. *As per the provisions of the Companies Act, 2013 and relevant rules thereunder, an eligible company is not permitted to accept from public or renew the same deposits (whether secured or unsecured) which is repayable on demand or in less than _____ months. Further, the maximum period of acceptance of deposit cannot exceed _____ months. But, for the purpose of meeting any of its short- term requirements of funds, a company may accept or renew deposits for repayment earlier than _____ months subject to certain conditions.*

   (a) six, thirty six, six

   (b) three, twenty four, three

   (c) six, sixty, six

   (d) three, sixty, six

Descriptive Questions

1. *Enumerate the amounts which when received by a company in the ordinary course of business are not to be considered as deposits.*

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?*

3. *Explain the provisions for 'Appointment of Trustee for Depositors' under the Companies Act, 2013 read with the 'Acceptance of Deposits' Rules, 2014.*

4. *What are the provisions relating to 'Credit Rating' which an 'eligible company' must follow if it wants to raise public deposits?*

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 lakh 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 lakh 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 crore 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 lakh 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?*

6. *ABC Limited having a net worth of ₹ 120 crore 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'.*

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. Tarun, 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.*

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 lakh, if the aggregate of its paid-up capital, free reserves and security premium account is ₹ 50.00 lakh.*

(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.*

9. *Answer the following citing relevant provisions:*

(a) *Prayas Electricals Limited having paid-up capital of ₹ 1 crore availed a term loan of ₹ 10,00,000 from Beta Bank Limited to purchase electrical items. Mr. Sambhav, one of the directors of the company, is of the opinion that it shall be considered as 'deposit'. Is his contention correct?*

(b) *Eklavya Publishing Company Limited facing acute cash crunch wants to utilise a portion of 'Deposit Repayment Reserve Account' to pay off its short-term creditors who are pressing hard for repayment of ₹ 20,00,000. Is it justified to use funds lying in 'Deposit Repayment Reserve Account' in this manner?*

(c) *Sanjiv is a shareholder in Utsah Textiles Private Limited holding 10,000 shares of ₹ 10 each. His wife Sneha and his three sons Aayush, Pranav and Himanshu are also shareholders in the company holding 1,000 shares each. In response to the invitation from the company inviting deposits from its members, Sanjiv wants to deposit Rs. 1,00,000 for 36 months jointly with his wife and three sons. Whether Utsah Textiles Private Limited can accede to the request of Sanjiv and accept deposit jointly in five names since all the depositors are shareholders of the company.*

10. *Shubhra Chemicals Private Limited (not a start-up company) is desirous of accepting 'deposits' from its members amounting to two hundred percent of aggregate of its paid-up share capital, free reserves and securities premium account. What are the conditions it must fulfill before such acceptance?*

ANSWERS

Answer to MCQ based Questions

1.	**(b)**	Unsecured deposits
2.	**(c)**	36 months
3.	**(c)**	Eight years from the financial year in which the latest entry is made in the Register.
4.	**(c)**	18%
5.	**(a)**	six, thirty six, six

Answer to Descriptive Questions

1. According to Rule 2 (1) (c) (xii) of the Companies (Acceptance of Deposits) Rules, 2014, 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 it became due for refund.

2. **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 National Company Law Tribunal (NCLT) 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 NCLT may deem fit.

Exemption to certain private companies:

In terms of Notification No. GSR 464 (E), dated 05-06-2015 as amended from time to time, 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 one hundred per cent of aggregate of the paid-up share capital, free reserves and securities premium account; or

(B) which is a start-up, for five 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 fifty crore rupees, whichever is lower; and

(c) such a company has not defaulted in the repayment of such borrowings 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. **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.

- No trustee for depositors shall be removed from office 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.

4. 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. **(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 ₹ 3.00 lakh 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 lakh 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 lakh 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 lakh shall not be treated as deposit.

(iii) By not repaying the deposit of ₹ 50.00 crore 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 rupees one crore or twice the amount of deposit accepted by the company, whichever is lower but which may extend to rupees 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 lakh but which may extend to rupees two crore.

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 (whether secured or unsecured) which is repayable on demand or in less than six months. Further, the maximum period of acceptance of deposit cannot exceed thirty six 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 six 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 lakh 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 nothing in this sub-section shall apply to a banking company and non-banking financial company as defined in the Reserve Bank of India Act, 1934 and to such other company as the Central Government may, after consultation with the Reserve Bank of India, specify in this behalf. Further, Rule 1 (3) (iii) states that the Companies (Acceptance of Deposits) Rules, 2014 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 'Acceptance of Deposits' Rules shall not apply to it.

Hence, Diamond Housing Finance Limited being an exempted company, can accept and renew deposits from the public from time to time without following the prescribed manner.

6. 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. **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. Tarun, 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. Further, according to Rule 16 (A) (2), it shall also disclose in its financial statement, by way of notes, about the money received from the directors, or relatives of directors.

8. **(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'.

9. (a) In terms of Rule 2 (1) (c) (iii) of the Companies (Acceptance of Deposits) Rules, 2014, any amount received as a loan or facility from any banking company shall not be considered as 'deposit'.

In view of the above, the contention of Mr. Sambhav that the term loan of ₹ 10,00,000 availed by the company from Beta Bank Limited shall be considered as 'deposit' is not correct.

(b) Rule 13 of the Companies (Acceptance of Deposits) Rules, 2014, states that the amount deposited in the 'Deposit Repayment Reserve Account' shall not be used by a company for any purpose other than repayment of deposits.

Since there is a prohibition, Eklavya Publishing Company Limited is not permitted to utilise its 'Deposit Repayment Reserve Account' to pay off its short-term creditors.

(c) Rule 3 (2) of the Companies (Acceptance of Deposits) Rules, 2014, provides that where depositors so desire, deposits may be accepted in joint names not exceeding three.

In view of this provision, Sanjiv can deposit ₹ 1,00,000 with Utsah Textiles Private Limited jointly with two other persons only irrespective of the fact that all the five persons are members of the company.

10. According to first proviso to Rule 3 (3), 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.

According to second proviso to Rule 3(3), the maximum limit in respect of deposits to be accepted from members shall not apply to the classes of 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) 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 fifty 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:

According to third proviso all the companies accepting deposits shall file the details of monies so accepted with the Registrar in Form DPT-3.

In case Shubhra Chemicals Private Limited is not an associate or a subsidiary company of any other company and its borrowings from banks, etc. is less than twice of its paid-up share capital or fifty crore rupees, whichever is less and also it has not defaulted in the repayment of such borrowings subsisting at the time of accepting deposits, then it can accept 'deposits' from its members amounting to two hundred percent of aggregate of its paid-up share capital, free reserves and securities premium account.

Further, it shall file the details of monies so accepted with the Registrar in Form DPT-3.

NOTES

CHAPTER 6

REGISTRATION OF CHARGES

LEARNING OUTCOMES

At the end of this Chapter, you will be able to:

- Define Charge
- Know about Fixed Charge and Floating Charge
- Explain the steps involved in Registration of Charge
- Identify the consequences of non-registration of a Charge and the steps to be followed for registering Satisfaction of Charge
- Know the applicability of penal provisions in case of default

CHAPTER OVERVIEW

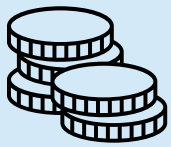
CHARGE

- Definition of Charge [Sec 2 (16)]
- Duty to Register Charges,etc [Sec 77]
- Application for registration of Charge [Sec 78]
- Date of Notice of Charge [Sec 80]
- Keeping of Register of Charges [Sec 81 & 85]
- Satisfaction of Charge [Sec 82 & 83]
- Punishment and Rectification in Register of Charges [Sec 86 & Sec 87]

1. INTRODUCTION

Chapter VI	**Consists of sections 77 to 87 as well as the Companies (Registration of Charges) Rules, 2014.**

Definition of Charge

 **Loan taken**	 **created on the property or assets of a company**

REGISTRATION OF CHARGES

Section 2(16) of the Companies Act, 2013 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.

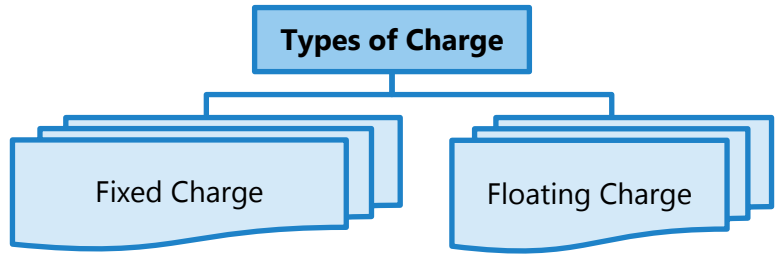
- an interest or lien
- created on the property or assets
  - of a company or
  - any of its undertakings or
  - both
- It is created as Security for repayment of loan
- Charge includes Mortgage

Whenever a company borrows money by way of loans including term loans or working capital loans from financial institutions or banks or any other person by offering its property or assets as security or any of its undertakings, then 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

A charge may be either fixed or floating.



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, machinery, office premises, etc. Further, these assets are identified at the time of creation of charge. A fixed charge is usually created by way of mortgage or by deposit of title deeds.

When a charge is created on such assets, the charge remains 'fixed' and the borrowing company is not permitted to sell such assets during the period of charge 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 is vacated when the money borrowed against the assets subject to fixed charge is repaid in full.

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.

Floating Charge

A 'Floating Charge' is created on assets or a class of assets which are of fluctuating or changing in nature- like raw material, stock-in-trade, debtors, etc. It is a charge upon assets both present and future. The assets under floating charge keep on changing because the borrowing company is permitted to use them for

trading or producing final goods for sale. Thus, a floating charge is a charge that floats above ever-changing assets.

Example 2: A retail showroom in Lajpat Nagar, New Delhi contains numerous articles like clothes, apparels, footwears, kitchen items, cosmetics, etc. kept for sale. The owner of the showroom might have borrowed against the security of all these goods; but he may still sell or otherwise deal with them in the ordinary course of business. The buyer *i.e.* customer will get the items purchased by him free of charge.

Example 3: Smart Shoes Limited manufactures leather goods. The raw material in the form of leather, which is subject matter of floating charge, may be used by the company to manufacture leather goods without seeking any permission from the lender.

Thus, unlike a fixed charge, the assets offered as security by the company can be dealt with by it in the ordinary course of business. The buyer of the asset will get it free of charge.

Crystallization of a Floating Charge

When the creditor enforces the security due to the breach of terms and conditions of floating charge or the company goes into liquidation, the floating charge will become a fixed charge on all the assets available on that date. This is called **crystallization of a floating charge.**

A floating charge remains dormant until it becomes fixed or crystallizes. On crystallization of charge, the security (*i.e.* raw material, stock-in-trade, etc.) becomes fixed and is available for realization by the lender so that borrowed money is repaid. Crystallization of floating charge may occur when the terms and conditions of floating charge are violated or the company ceases to continue its business or the company goes into liquidation or the creditors enforce the security covered by the floating charge.

Example 4: Prism Limited had taken a loan from ABC Bank, on the security of it stock. Now, in the event of Prism Limited failing to repay the security interest or entering liquidation, the floating charge will change to a fixed charge. Once a floating charge gets converted to a fixed charge, the stock can neither be sold nor used by the company in its business operations.

2. DUTY TO REGISTER CHARGES, ETC. [SECTION 77]

Section 77 of the Companies Act, 2013 contains provisions regarding registration of charges with the Registrar of Companies.

A. Registration of Charges

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 subject-matter of the charge *i.e.* the property or assets or any of the company's undertakings, may be situated within India or outside India. Accordingly, charge may be created within India or outside India depending upon the location of the assets.

The property or assets charged may be tangible assets such as land and buildings, machinery or financial assets like investment in shares or debentures. It may be otherwise also, *i.e.* 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.

When a charge is created by deposit of title deeds (normally banks agree for this mode of charge instead of proper mortgage), it is also registrable by the borrowing company.[1]

Registration by the charge-holder: Section 78, **Application for registration of charge** (explained later) provides that in case the borrowing 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 (i.e. lender) can get the charge registered.

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

[1] As per Section 58 (f) of the Transfer of Property Act, 1882.

the property shall get the charge registered in its name in place of seller in the records of Registrar of Companies.

B. How to Register Charge[2]

The particulars of the charge in the prescribed form[3] 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[4]

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 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) **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.

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

[2] As per Section 77 (1) and Rule 3 (1) of the Companies (Registration of Charges) Rules, 2014.
[3] As per Rule 3, Form CHG-1 or Form CHG-9 (in case of debentures) is to be filled.
[4] As per Rule 3 (4).

or charge. This type of verification is not possible when the instrument or deed relates to the property situated in India, whether wholly or partly.

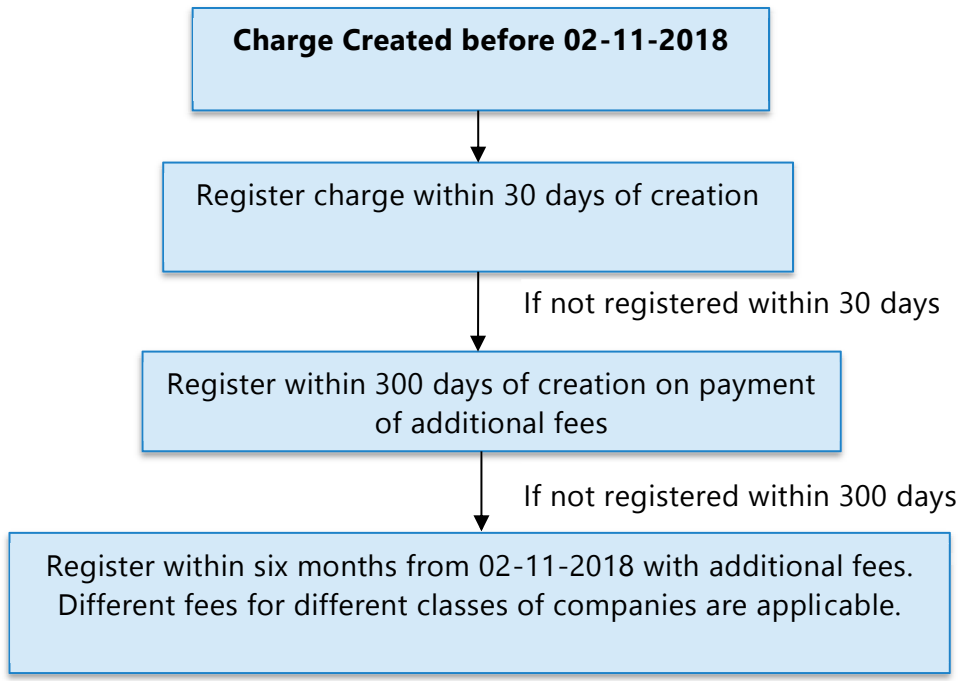
D. Extension of Time Limit

The original period within which a charge needs to be registered from the date of creation of charge is 30 days. In respect of extension of time limit for registration of charges, following provisions are applicable:

(i) **Charges created before 02-11-2018 [5]:** In such cases, where the 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 six months from 02-11-2018 on payment of prescribed additional fees.

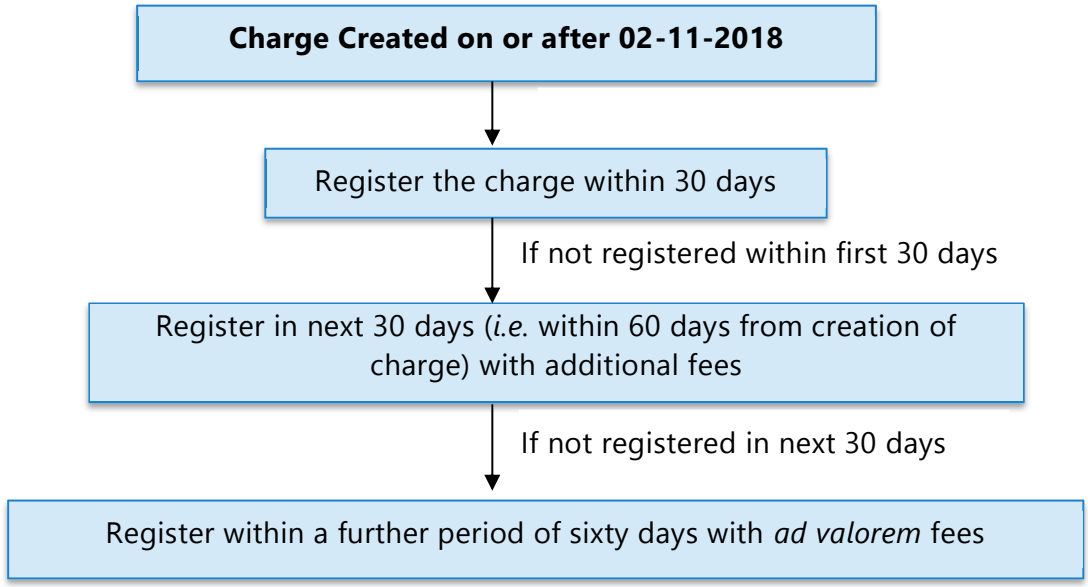
It is provided that different fees may be prescribed for different classes of companies.



[5] As per Clause (a) of First Proviso and also Clause (a) of Second Proviso to Section 77 (1).

(ii) ***Charges created on or after 02-11-2018***[6]: In cases where the charge was created on or after 02-11-2018 but the registration of charge was not effected 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. In other words, a grace period of another 30 days is granted after the expiry of the original 30 days, 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 sixty days after payment of prescribed *ad valorem*[7] fees.



Procedure for Extension of Time Limit[8]**:** The company is required to make an application to the Registrar in the prescribed form[9] for seeking extension of time. The said application needs to be supported by a declaration from the company

[6] As per Clause (b) of First Proviso and also Clause (b) of Second Proviso to Section 77 (1).
[7] *ad valorem* means in proportion to the estimated value of the transaction concerned. In this case it will be based on value of the charge *i.e.* the amount of loan advanced against security of the property.
[8] As per Rule 4.
[9] As per Rule 4 (2), the application shall be made in Form CHG-1 (for other than debentures) or in Form CHG-9 (for debentures).

signed by its company secretary or a director that such belated filing shall not adversely affect the rights of any other intervening creditors of the company.

After receipt of application for extension of time period, the Registrar, on being satisfied that the company had sufficient cause for not filing the particulars and instrument of charge, if any, within the original period of thirty days, may allow registration of charge within the extended time period. Further, requisite additional fee or *ad valorem fee*, as applicable, shall also be paid.

E. Issue of Certificate of Registration[10]

Where a charge or modification is duly registered by the Registrar of Companies, a Certificate of Registration/Modification shall be issued by the Registrar in the prescribed form[11]. The certificate so issued by the Registrar shall be conclusive evidence that the requirements of Chapter VI of the Companies Act, 2013 and the Rules made thereunder as to registration of creation of charge or modification of charge have been complied with.

F. 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.[12]

Note: Rule 3 (5) states that nothing contained in Rule 3 shall apply to any charge required to be created or modified by a banking company under section 77 in favour of the Reserve Bank of India 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.

3. DEEMED NOTICE OF CHARGE [SECTION 80]

All charges registered with the respective Registrars of Companies are public documents. It implies that any person who wishes to lend money to the company against the security of such property or buy it can refer to the Ministry of

[10] As per Section 77 (2) and Rule 6.

[11] Certificate in Form No. CHG-2 shall be issued for fresh registration of charge (Where a charge is registered with the Registrar under section 77(1) or section 78) and Certificate in Form No. CHG-3 shall be issued for modification of charge. (Rule 6)

[12] As per Fourth Proviso to Section 77 (1), inserted by the Companies (Amendment) Act, 2017, w.e.f. 7th May 2018.

Corporate Affairs (MCA) Portal and find out if there is any charge created on that asset.

It is to be noted that any document filed with the registrar for registration acts as Constructive Notice. Constructive means 'implied' or 'deemed'. Notice means "knowledge". So constructive notice means 'implied or deemed knowledge'. This means even though the third party has not referred to the public document, he would still be considered or deemed to have seen it. This is because a deeming provision creates a legal fiction.

Accordingly, section 80 of the Companies Act, 2013 states as under:

"where any charge is registered under section 77, 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, every person proposing to deal with a company should verify whether the asset is already under any charge or not by going through the record of charges maintained at the office of Registrar of Companies before entering into the transaction.

In case he enters into the transaction without making any enquiry and later on suffers loss because of charge, then he cannot claim the loss from the company, for it shall be deemed that he had notice of charge.

It is noteworthy that compulsory registration of charge also acts as a method of preventing a company from offering the same assets as security to borrow funds fraudulently from a different lender.

Example 5: Vishnu Marketing Limited obtained a term loan of rupees fifty lakh from Alpha Commercial Bank Limited by creating a charge on one of its office buildings and got the charge duly registered. Later on, if the building is sold to another person, say Neeraj, then he is deemed to have notice of such charge. In other words, it shall be presumed that Neeraj knew beforehand that the building was mortgaged to the bank for obtaining a loan. Therefore, Neeraj 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.

4. CONSEQUENCES OF NON-REGISTRATION OF CHARGE [SECTION 77 (3) & (4)]

No charge created by a company shall be taken into account by the liquidator appointed under the Companies Act, 2013 or the Insolvency and Bankruptcy Code, 2016 or any other creditor unless it is duly registered and a certificate of registration of such charge is given by the Registrar.[13]

It means that the charge will become void against the liquidator and other creditors of the company. Simply stated, at the time of winding up, the creditor whose charge has not been registered will be reduced to the level of an unsecured creditor. Neither the liquidator nor any other creditor will give legal recognition to a charge that is not registered.

However, this shall not prejudice any contract or obligation for the repayment of the money secured by a charge.[14] It implies that the debt is 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 Chapter VI.

Another important consequence of non-registration is that the charge-holder loses priority. Any subsequent registration of a charge (*i.e.* even if it is registered within the extended period instead of original thirty days) shall not prejudice any right acquired in respect of any property before the charge is actually registered.[15].

Example 6: Bank A advanced ₹ one crore to Vasudha Medicos 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 2022. The company did not register the charge within 30 days. Subsequently, the charge was registered on 12th August 2022 after payment of *ad valorem* fees and providing sufficient cause.

In the meantime, Bank B advanced ₹ two crore to Vasudha Medicos Limited against the security of the same property on 18th June 2022. This charge was duly registered on 26th June 2022.

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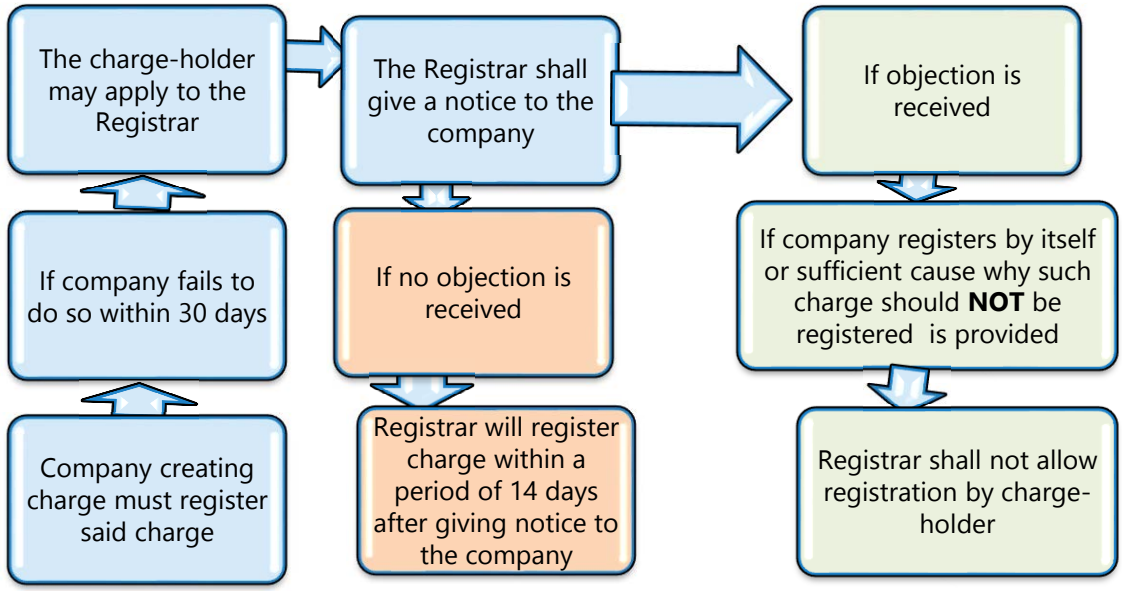
[13] As per Section 77 (3)
[14] As per Section 77 (4)
[15] As per Third Proviso to Section 77 (1).

Subsequently, Vasudha Medicos Limited goes into liquidation and the property realises only ₹ two crore.

In such a situation, Bank B will get repayment of its loan in full, but Bank A will not realise anything because 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.

5. APPLICATION FOR REGISTRATION OF CHARGE BY CHARGE-HOLDER [SECTION 78]

It can be seen from the above discussion that non-registration or delayed registration would seriously affect the interest of the charge-holder. Therefore, the law provides the charge-holder an opportunity in this respect. Section 78 of the Companies Act, 2013, empowers the holder of charge to get the charge registered in case the company creating the charge on its property fails to do so.



Accordingly, if a charge is created but the company primarily responsible for registering the charge fails to do so within the prescribed period of 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 on payment of the prescribed fees within a period of 14 days after giving notice to the company.

However, the Registrar shall not allow such registration by the charge-holder, if the company itself registers the charge or shows sufficient cause why such charge should not be registered.

Recovery of fees: In case, registration is effected on an application made by the holder of charge, 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.

6. ACQUISITION OF PROPERTY SUBJECT TO CHARGE AND MODIFICATION OF CHARGE [SECTION 79]

The provisions of section 77 relating to registration of charges shall, so far as may be, apply to:

a. a company acquiring any property subject to a charge within the meaning of that section; or

b. any modification in the terms or conditions or the extent or operation of any charge registered under that section.

The provisions contained in section 77 relating to registration of charge shall, as far as may be, 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 now acquired the property.

B. Modification of Charge when there is Change in Terms and Conditions, etc. [Section 79 (b)]

Section 79 (b) requires any modification in charge (*i.e.* change in terms and conditions or change in extent or operation of any charge, etc.) to be registered by the company in accordance with section 77.

'Modification' includes variation in any of the terms and conditions of the agreement including change in rate of interest which may be by mutual agreement or by operation of law. Variation in extent or operation of any charge is also a kind of modification. Even if the rights of a charge holder are assigned to a third party, it will be regarded as a modification.

Some examples of 'modification of charge' 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 in pursuance of an agreement for enhancing or decreasing the limits;
3. where the modification is by ceding a *pari passu*[16] charge;
4. where there is change in the rate of interest (other than bank rate);
5. where there is change in repayment schedule of loan (not applicable in case of working loans which are repayable on demand); and
6. where there is partial release of the charge on a particular asset or property.

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.

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 modification of charge have been complied with.

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[16] A *pari passu* charge-holder is entitled to a proportionate share in the mortgaged property. When this is ceded, the charge-holder will become a second charge-holder and as such his entitlement in the property will be subject to full satisfaction of the claim of the first charge-holder.

7. REGISTER OF CHARGES

Register of Charges to be kept by the Registrar

Section 81 of the Companies Act, 2013 contains provisions regarding Register of Charges to be kept by the Registrar.

Section 81 (1) states that the Registrar shall, in respect of every company, keep a register containing particulars of the charges registered under Chapter VI in the prescribed form and manner.

In addition, Rule 7 (1) states that the particulars of charges maintained on the Ministry of Corporate Affairs portal *(www.mca.gov.in/MCA21)* shall be deemed to be the register of charges for the purposes of Section 81.

Inspection of Register: According to section 81 (2) such register shall be open to inspection by any person on payment of such fees as may be prescribed for each inspection.

Similarly, Rule 7 (2) states that the Register shall be open to inspection by any person on payment of fee.

Register of Charges to be kept by the company

Section 85 of the Companies Act, 2013 contains provisions regarding Register of Charges to be kept by a company.

(i) According to section 85 (1):

- Every company shall keep a Register of Charges in the prescribed form[17] and manner at its registered office.
- The Register shall include all charges and floating charges affecting any property or assets of the company or any of its undertakings, indicating in each case the prescribed particulars.

(ii) According to Proviso to section 85 (1):

- A copy of the instrument creating the charge shall also be kept at the registered office along with the Register of Charges.

[17] As per Rule 10 (1) the Register of Charges shall be maintained in Form CHG-7.

(iii) Provisions of Rule 10 are as under:

- According to Rule 10 (1), the company shall enter in the Register particulars of all the charges registered with the Registrar on any of its property, assets or undertakings and the particulars of any property acquired subject to a charge as well as particulars of any modification of a charge and satisfaction of charge.
- According to Rule 10 (2), the entries in the Register shall be made forthwith after the creation, modification or satisfaction of charge, as the case may be.
- According to Rule 10 (3), the entries in the Register shall be authenticated by a director or the secretary of the company or any other person authorised by the Board for the purpose.

Inspection of Register of Charges and Instrument of Charges:

As regards inspection, section 85 (2) states that the register of charges and the instrument of charges shall be open for inspection[18] during business hours:

(a) by any member or creditor without any payment of fees; or

(b) by any other person on payment of prescribed fees. subject to such reasonable restrictions as the company may, by its articles, impose.

Preservation of Register:

According to Rule 10 (4) the register of charges shall be preserved permanently and the instrument creating a charge or modification thereon shall be preserved for a period of eight years from the date of satisfaction of charge.

[18] Regarding inspection, Rule 11 states that the Register of Charges and the instrument of charges kept by the company shall be open for inspection-
(a) by any member or creditor of the company without fees;
(b) by any other person on payment of fee.

8. COMPANY TO REPORT SATISFACTION OF CHARGE [SECTION 82]

1. Intimation regarding Satisfaction of Charge

Section 82 of the Companies Act, 2013, requires a company to give intimation of payment or satisfaction [19] in full of any charge earlier registered, to the Registrar in the prescribed form[20]. The intimation needs to be given within a period of 30 days from the date of such payment or satisfaction.[21]

Extended period of intimation: Proviso to Section 82 (1)[22] extends the period of intimation from thirty days to three hundred days. Accordingly, it is provided that 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 **three hundred days** of such payment or satisfaction on payment of prescribed additional fees[23].

2. Notice to the Holder of Charge by the Registrar[24]

On receipt of intimation, the Registrar shall cause a notice to be sent to the holder of the charge calling upon him to show cause within such time as specified in the notice but not exceeding 14 days, as to why payment or satisfaction in full should not be recorded.

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[19] Satisfaction happens when the amount is not repaid but an asset of equal value is offered in the place of the property being released from charge.

[20] As per Rule 8 Form CHG-4 is to be used.

[21] (1) In case of a *specified IFSC public company*, the Registrar may, on an application by the company, allow such registration to be made within a period of three hundred days of such creation on payment of such additional fees as may be prescribed (*vide Notification No. GSR 8 (E), dated 04-01-2017).*

(2) In case of a *specified IFSC private company*, the Registrar may, on an application by the company, allow such registration to be made within a period of three hundred days of such creation on payment of such additional fees as may be prescribed (*vide Notification No. GSR 9 (E), dated 04-01-2017).*

[22] Proviso inserted *vide* the Companies (Amendment) Act, 2017, w.e.f. 5-7-2018.

[23] Rule 8 (1) has been substituted *vide* the Companies (Registration of Charges), Amendment Rules, 2018 (w.e.f. 05-07-2018) to provide for giving of intimation within three hundred days instead of thirty days.

[24] As per Section 82 (2).

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[25] 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.

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[26]

The instrument creating a charge or modification thereon shall be preserved for a period of eight years from the date of satisfaction of charge by the company.

9. POWER OF REGISTRAR TO MAKE ENTRIES OF SATISFACTION AND RELEASE IN ABSENCE OF INTIMATION FROM COMPANY [SECTION 83]

Section 83 of the Companies Act, 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.

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.

[25] As per Rule 8, Form CHG-4 is required to be filed for this purpose.
[26] As per Rule 10 (4).

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 that:

- the debt has been satisfied in whole or in part; or
- 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.

According to Section 82 (4), Section 82 shall not be deemed to affect the powers of the Registrar to make an entry in the register of charges under section 83 or otherwise than on receipt of an intimation from the company *i.e.* even if no intimation is received by him from the company.

Information to affected parties: According to Section 83 (2), 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.

10. INTIMATION OF APPOINTMENT OF RECEIVER OR MANAGER [SECTION 84]

Section 84 of the Companies Act, 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 turn, the Registrar shall, on payment of the prescribed fees, register particulars of the receiver, person or instrument in the register of charges.

On ceasing to hold such appointment[27], 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.

11. PUNISHMENT FOR CONTRAVENTION [SECTION 86]

(i) According to section 86 (1)[28] of the Companies Act, 2013, 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 five lakh rupees and every officer of the company who is in default shall be liable to a penalty of fifty thousand rupees.

(ii) According to section 86 (2)[29], section 447 relating to 'punishment for fraud' also becomes applicable in certain cases. Accordingly, if any person wilfully furnishes:

- any false or incorrect information; or
- knowingly suppresses any material information;

which is required to be registered under section 77, he shall be liable for action under section 447.

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[27] As per Rule 9, the notice of appointment or cessation shall be filed with the Registrar in Form No. CHG-6.

[28] Substituted section 86 (1). Substitution was made by the Companies (Amendment) Act, 2020, w.e.f. 21-12-2020.

[29] Section 86 (2) was inserted by the Companies (Amendment) Act, 2019 w.r.e.f. 02-11-2018.

12. RECTIFICATION BY CENTRAL GOVERNMENT IN REGISTER OF CHARGES [SECTION 87]

Rectification in Register of Charges

Section 87[30] of the Companies Act, 2013 and Rule 12[31] empowers the Central Government[32] 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.

The order of rectification shall be made by the Central Government on such terms and conditions as it deems just and expedient.

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[30] As substituted by the Companies (Amendment) Act, 2019 w.r.e.f. 02-11-2018.

[31] As substituted by the Companies (Registration of Charges) Amendment Rules, 2019, w.e.f. 30-04-2019.

[32] *Vide* Notification No. S.O. 4090 (E), dated 19-12-2016, powers of the Central Government with respect to Section 87 stand delegated to the Regional Directors.

"According to Rule 12 of the Companies (Registration of Charges) Rules, 2014:

The Central Government may on an application filed in Form No. CHG-8 in accordance with section 87-

(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 three hundred days from the date of such payment or satisfaction."

SUMMARY

- "Charge" means 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.
- A charge created by a company is required to be registered with Registrar within 30 days of its creation.
- A charge may be created within India or outside India.
- In case a charge was created **before 02-11-2018** but was not registered within 30 days, the Registrar may, on an application by the company, allow registration of charge within 300 days of such creation. In case registration is not made within the extended period, it shall be made within six months from 02-11-2018 on payment of prescribed additional fees. Different fees may be prescribed for different classes of companies.
- In case a charge was created **on or after 02-11-2018** but was not registered within 30 days, the Registrar may, on an application by the company, allow registration of charge within **60 days** of such creation on payment of prescribed additional fees. If the registration is not made within the extended period, the Registrar may, on an application, allow such registration to be made within a further period of **sixty days** after payment of prescribed *ad valorem* fees.

- If a company fails to register the charge, the charge-holder can make an application for registration of charge and can also recover the amount of any fees or additional fees paid by him from the company.
- Modification in the terms and conditions, etc. of charge also requires registration of charge afresh. On recording the particulars of modification of charge, the Registrar shall issue a certificate of modification of charge.
- Any person acquiring a property which is subject to charge shall be deemed to have notice of the charge from the date of such registration.
- The Registrar shall, in respect of every company, keep a register containing particulars of the charges registered under Chapter VI.
- Every company shall keep a Register of Charges at its Registered Office.
- The company shall give intimation to Registrar of payment or satisfaction in full of any charge within a period of 30 days from the date of such payment or satisfaction. If no intimation is given within 30 days, the Registrar may allow such intimation to be made within 300 days of such payment or satisfaction on payment of prescribed additional fees.
- On receipt of intimation, the registrar shall issue a notice to the holder of charge calling upon him to show cause within such time not exceeding 14 days as to why payment or satisfaction in full should not be recorded as intimated to the Registrar. If no cause is shown, the Registrar shall order recording of memorandum of satisfaction.
- In case intimation of payment or satisfaction in full of charge is in prescribed form and signed by the holder of charge no notice shall be sent.
- In case, the company fails to send intimation of satisfaction of charge to the Registrar, the Registrar may enter in the register of charges memorandum of satisfaction on receipt of evidence to his satisfaction regarding the same.
- Where Registrar enters a memorandum of satisfaction of charge in full, he shall issue a certificate of registration of satisfaction of charge.
- If a company contravenes any provision relating to the registration of charges or modification or satisfaction of charges, the company and every defaulting officer is punishable.
- The Central Government is empowered to order rectification of Register of Charges in certain cases of default.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. *Any person acquiring property, on which charge is registered under section 77, shall be deemed to have notice of the charge from:*

   (a) the expiry of thirty days of such charge

   (b) the date of application for registration of the charge

   (c) the date of acquiring the property

   (d) the date of such registration

2. *A charge was created by Cygnus Softwares Limited on its office premises to secure a term loan of ₹ 1 crore availed from Next Gen Commercial Bank Limited through an instrument of charge executed by both the parties on 16th February, 2023. Inadvertently, the company could not get the charge registered with the concerned Registrar of Companies (ROC) within the first statutory period permitted by law and the default was made known to it by the lending banker with a stern warning to take immediate steps for rectification. The latest date within which the company must register the charge with the ROC so as to avoid paying ad valorem fees for registration of the charge is:*

   (a) 27th April, 2023

   (b) 17th April, 2023

   (c) 2nd May, 2023

   (d) 16th June 2023

3. *The instrument creating a charge or modification thereon shall be preserved for a period of _____ years from the date of satisfaction of charge by the company.*

   (a) 5

   (b) 7

   (c) 8

   (d) 15

4. *An interest or lien created on the property or assets of a company or any of its undertakings or both as security is known as:*

   (a) Debt

   (b) Charge

   (c) Liability

   (d) Hypothecation

5. *Who cannot inspect the register of charges and instrument of charges, during business hours, without paying any fees:*

   (a) Any member of the company

   (b) The Creditor of the company

   (c) Persons other than member and creditor of the company

   (d) No person is allowed to inspect the register of charges

Descriptive Questions

1. *How will a copy of an instrument evidencing creation of charge and required to be filed with the Registrar be verified?*
2. *What is 'Floating Charge'? When does it get crystallised?*
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.*
4. *Renuka Soaps and Detergents Limited realised on 2nd May, 2022 that particulars of charge created on 10th March, 2022 in favour of a Sankalp Commercial Bank Limited 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, 2022 instead of 2nd May, 2022? Explain with reference to the relevant provisions of the Companies Act, 2013.*
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 came to know that the title deed of the company was not free and the company expressed its inability to get the title deed*

transferred in Antriksh's 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?

6. *'A company is required to keep a Register of Charges at its Registered Office'. Considering this statement, mention the provisions of the Companies Act, 2013 in respect of keeping of Register of Charges by the companies.*

7. *ABC Limited created a charge in favour of OK Bank which was duly registered. Later on, the Bank enhanced the facility by another ₹ 20 crore. Due to inadvertence, the modification in the original charge was not registered. Advise the company as to the course of action to be pursued in this regard.*

8. *Ranjit acquired a property from PQR Limited which was mortgaged to Pyramid Bank. He settled the dues to Pyramid Bank in full and the same was registered with the sub-registrar who noted that the mortgage had been settled. But neither the company nor Pyramid Bank filed particulars of satisfaction of charge with the jurisdictional Registrar of Companies. Can Ranjit approach the Registrar and seek any relief in this regard? Discuss this matter in the light of provisions of the Companies Act, 2013.*

ANSWERS

Answer to MCQ based Questions

1.	**(d)**	the date of such registration
2.	**(b)**	17th April, 2023
3.	**(c)**	8
4.	**(b)**	Charge
5.	**(c)**	Persons other than member and creditor of the company

Answer to Descriptive Questions

1. 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. A 'Floating Charge' is a type of charge that is created on assets or a class of assets which are of fluctuating or changing in nature. The assets which are under floating charge may include raw material, stock-in-trade, debtors, etc.

It is a charge created upon a class of assets both present and future.

The assets under floating charge keep on changing because the borrowing company is permitted to use them in the ordinary course of business.

The buyers of the assets covered under floating charge will get them free of charge.

Crystallization of a Floating Charge

In the following events, a floating charge will get crystallised or fixed:

(i) When the creditor enforces the security due to the breach of terms and conditions of floating charge like there is non-payment of interest or default in repayment of instalments as per the terms of agreement.

(ii) When the company ceases to continue its business.

(iii) When the borrowing company goes into liquidation.

A floating charge remains dormant until it becomes fixed or crystallised. On crystallisation of charge, the security (*i.e.* raw material, stock-in-trade, etc.) becomes fixed and is available for realization so that borrowed money is repaid.

3. 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, if any company is in default in complying with any of the provisions of Chapter VI, the company shall be liable to a penalty of five lakh rupees and every officer of the company who is in default shall be liable to a penalty of fifty thousand rupees.

Further, if any person willfully furnishes any false or incorrect information or knowingly suppresses any material information which is required to be registered under section 77, he shall be liable for action under section 447 (punishment for fraud).

4. The charge in the present case was created after 02-11-2018. The relevant provisions of the Companies Act, 2013 applicable in the present case are as explained below:

Initially, the prescribed particulars of the charge together with the instrument of charge, 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 original 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 jurisdictional Registrar of Companies 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, 2022 instead of 2nd May, 2022, 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 9th May, 2022, Renuka Soaps and Detergents Limited can still get the charge registered within a further period of sixty days from 9th May, 2022 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. 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. In respect of keeping of Register of Charges by a company, Section 85 of the Companies Act, 2013 and Rules 10 as well as 11 of the Companies (Registration of Charges) Rules, 2014 are relevant.

(i) According to section 85 (1):

- Every company shall keep a Register of Charges in the prescribed form and manner at its registered office.

  Note: Rule 10 (1) specifies Form CHG-7 in which the Register of Charges shall be maintained.

- The Register shall include all charges and floating charges affecting any property or assets of the company or any of its undertakings, indicating in each case the prescribed particulars.

(ii) According to Proviso to section 85 (1):

- A copy of the instrument creating the charge shall also be kept at the registered office along with the Register of Charges.

(iii) Provisions of Rule 10 are as under:

- *Entry of Particulars of all Charges:* According to Rule 10 (1), the company shall enter in the Register particulars of all the charges registered with the Registrar on any of its property, assets or undertakings and the particulars of any property acquired subject to a charge as well as particulars of any modification of a charge and satisfaction of charge.
- *When to make Entries:* According to Rule 10 (2), the entries in the Register shall be made forthwith after the creation, modification or satisfaction of charge, as the case may be.
- *Who can authenticate Entries:* According to Rule 10 (3), the entries in the Register shall be authenticated by a director or the secretary of the company or any other person authorised by the Board for the purpose.

Inspection of Register of Charges and Instrument of Charges: As regards inspection, section 85 (2) states that the register of charges and the instrument of charges shall be open for inspection during business hours:

(a) by any member or creditor without any payment of fees; or

(b) by any other person on payment of prescribed fees.

Similarly, regarding inspection, Rule 11 states that the Register of Charges and the instrument of charges kept by the company shall be open for inspection-

(a) by any member or creditor of the company without fees;

(b) by any other person on payment of fee.

Preservation of Register: According to Rule 10 (4) the Register of Charges shall be preserved permanently. However, the instrument creating a charge or modification thereon shall be preserved for a period of eight years from the date of satisfaction of charge.

7. ABC Limited is advised to immediately file an application for rectification of the Register of Charges in Form No. CHG-8 with the Central Government in accordance with Section 87 of the Companies Act, 2013.

Section 87 and Rule 12 empower 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 was not of a nature to prejudice the position of creditors or shareholders of the company.

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.

8. Section 83 of the Companies Act, 2013 empowers the Registrar to make entries with respect to the satisfaction and release of charge 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.

NOTES

CHAPTER 7

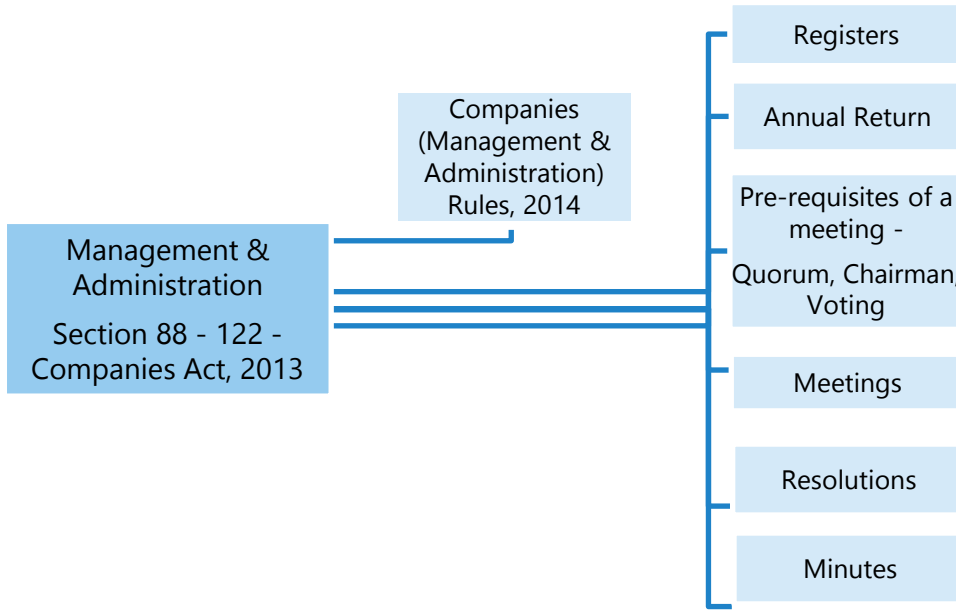
MANAGEMENT AND ADMINISTRATION

LEARNING OUTCOMES

At the end of this Chapter, you will be able to:

- Learn about the maintenance of registers and other documents required to be kept by a company.
- Understand the significance and provisions relating to filing of Annual Return.
- Know about pre-requisites of holding meetings for transacting business.
- Explicate provisions governing Quorum and appointment of proxies.
- Identify the various modes of casting votes.
- Know about the ordinary and special resolution.
- Elucidate provisions in respect of maintenance of Minutes.

CHAPTER OVERVIEW



1. INTRODUCTION

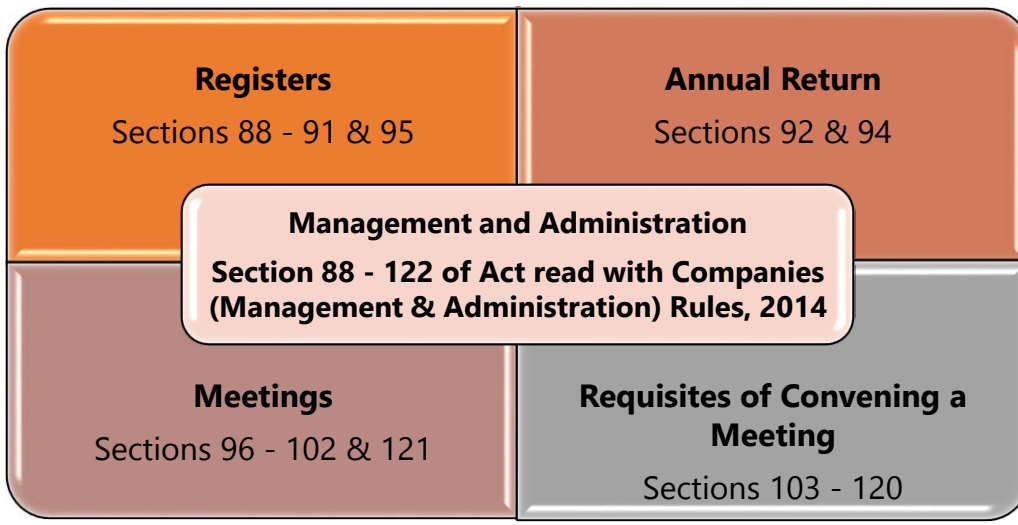
Chapter VII	**Consists of sections 88 to 122 as well as the Companies (Management and Administration) Rules, 2014.**

A company is an artificial legal entity distinct from its members. The affairs of the company are managed by the members and directors through resolutions passed at the validly held meetings. The day-to-day affairs of the company are managed by the directors who collectively act through Board of Directors. The Board performs its role within the powers granted to it. Certain powers can be exercised by the board on its own and some with the consent of the company at the general meetings. In the capacity as owners of the company, the shareholders ratify the actions of the board at the general meetings. In a way, the general

meetings serve as the focal point for the shareholders to converge and give their decisions on the actions taken by the directors.

The proceedings of the general meetings are recorded in the 'minutes book'. On yearly basis, a company is required to hold its Annual General Meeting to transact requisite businesses including adoption of financial statements, appointment/re-appointment of directors and auditors, etc., after the close of the financial year. In between two AGMs, a company may hold extra-ordinary general meetings (EGM) also if there is any need to transact certain urgent business. After the conclusion of AGM, the company is required to prepare Annual Return and file a copy thereof with the jurisdictional Registrar of Companies. Every company is duty-bound to maintain register of members, register of debenture-holders and register of other security holders.

Chapter VII of Companies Act, 2013 deals with the provisions relating to management and administration of companies. It covers Sections 88 to 122 and is divided under the following headings–

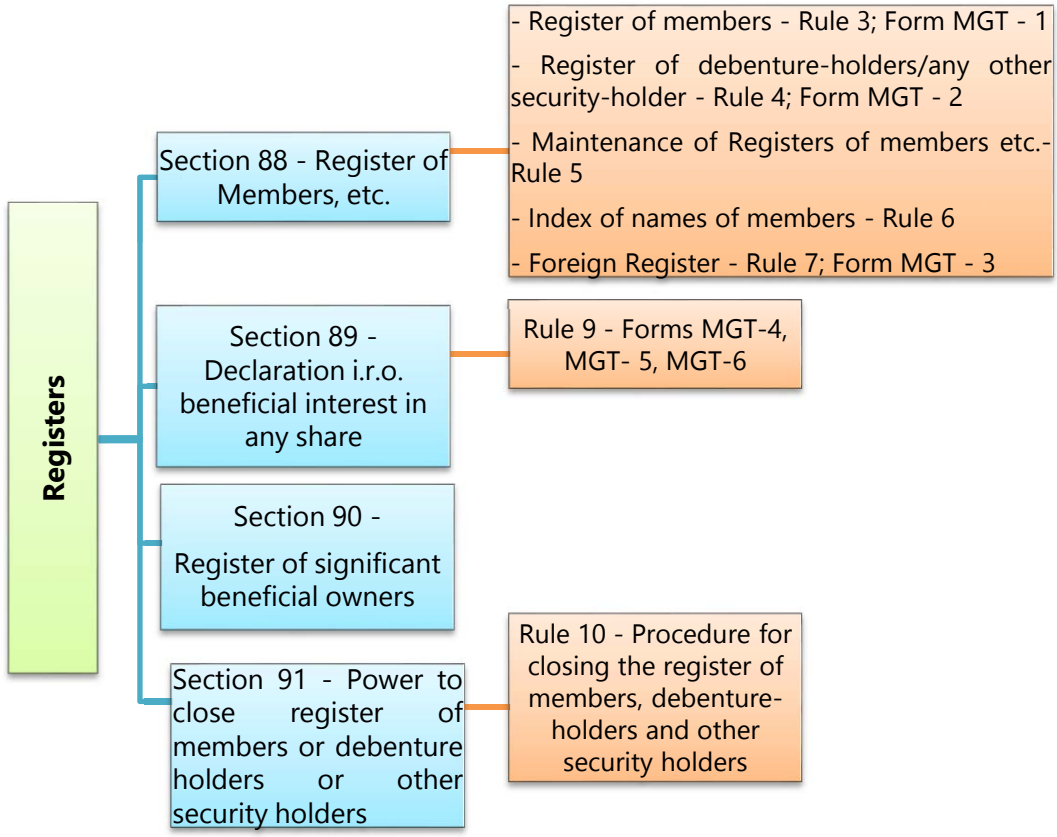


To initiate, it is imperative that we streamline the understanding of this chapter so as to link it with the essential concepts along with their procedures which can be found in the respective rules, *i.e. the Companies (Management and Administration) Rules, 2014* as amended from time to time.

Chapter VII applies to all the companies, public and private, and has special provisions applicable to One Person Company (OPC), which are enumerated in section 122 of the Act and are discussed later in this chapter.

2. REGISTERS

The provisions relating to maintaining the various registers as per the Companies Act, 2013 are contained in Sections 88 – 91. Along with these provisions, the *Companies (Management & Administration) Rules, 2014* are also applicable to the maintenance of registers by a company. Various provisions relating to keeping and maintenance of registers are as follows:



REGISTER OF MEMBERS, ETC. [SECTION 88]

Section 88 (1) of the Companies Act, 2013 requires that every company shall keep and maintain the following registers:

(i) Register of Members (holding of each class of equity and preference shares of each member residing in or outside India shall be shown separately in the register)

(ii) Register of Debenture-holders (DH); and

(iii) Register of any other security holders (OSH).

Maintenance of Register of Members

(i) Every company limited by shares shall, from the date of its registration, maintain a register of its members in Form No. MGT-1. *[Rule 3 (1)]*

However, in case of a company existing on the commencement of the Companies Act, 2013, the particulars as available in the register of members maintained under the Companies Act, 1956 shall be transferred to the new register of members in Form No. MGT-1. In case additional information, required as per the provisions of the Companies Act, 2013 and the Rules made thereunder, is provided by the members, such information may also be added in the register as and when provided. *[Proviso to Rule 3 (1)]*

(ii) 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 (registered office address in case the member is a body corporate); 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. *[Rule 3 (2)]*

However, in case of a company existing on the commencement of the Companies Act, 2013, the particulars as available in the register of members maintained under the Companies Act, 1956 shall be transferred to the new register of members in Form No. MGT-1. In case additional information,

required as per the provisions of the Companies Act, 2013 and the Rules made thereunder, is provided by the members, such information may also be added in the register as and when provided. *[Proviso to Rule 3 (2)]*

Maintenance of Register of Debenture Holders (DH) or any Other Security Holders

Every company which issues or allots debentures or any other security shall maintain a separate register for debenture holders or security holders, as the case may be, for each type of debentures or other securities in Form MGT-2. *[Rule 4]*

Other Requirements applicable to all the Registers

Rule 5 contains certain requirements which are applicable to all types of registers *(i.e. Register of Members, Register of Debenture-holders and Register of any Other Security Holders)*. These are stated as under:

- **Time period for making entries in Register**

  As per Rule 5 (1), entries have to be made in the Register 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.

  According to Rule 5 (3), consequent upon any forfeiture, buy-back, reduction, sub-division, consolidation or cancellation of shares, issue of sweat equity shares, transmission of shares, shares issued under any scheme of arrangements, mergers, reconstitution or employees stock option scheme or any of such scheme provided under this Act or by issue of duplicate or new share certificates or new debenture or other security certificates, entry shall be made within seven days after approval by the Board or committee, in the register of members or in the respective registers, as the case may be.

- **Place of maintaining Register**

  According to Rule 5 (2), the registers shall be maintained at the registered office of the company unless a special resolution is passed in a general meeting 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**

  - In terms of Rule 5 (6), if any order is passed by any judicial or revenue authority or by Security and Exchange Board of India (SEBI) or competent authority attaching the shares, debentures or other securities and giving directions for remittance of dividend or interest, the necessary reference of such order shall be indicated in the respective register.

  - According to Rule 5 (7), in case of companies whose securities are listed on a stock exchange in or outside India, the particulars of any pledge, charge, lien or hypothecation created by the promoters in respect of any securities of the company held by the promoter including the names of pledgee/pawnee and any revocation therein shall be entered in the register within fifteen days from such an event.

  - According to Rule 5 (8), if promoters of any listed company, which has formed a joint venture company with another company have pledged or hypothecated or created charge or lien in respect of any security of the listed company in connection with such joint venture company, the particulars of such pledge, hypothecation, charge and lien shall be entered in the register members of the listed company within fifteen days from such an event.

- **Updating of change in status of members**

Rule 5 (4) states that 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.

- **Rectification in register**

  According to Rule 5 (5), if any rectification is made in the register maintained under section 88 by the company pursuant to any order passed by the competent authority under the Act, the necessary reference of such order shall be indicated in the respective register.

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 of the *Companies (Management and Administration) Rules, 2014,* the maintenance of index is not necessary where the number of members is less than 50. Rule 6 also provides that the company shall make the necessary entries in the index simultaneously with the entry for allotment or transfer of any security in such Register.

Register and Index of Beneficial Owners being maintained by 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.

Foreign Register [Section 88(4) read with rule 7]

- **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 or debenture holders or of any other security holders or of beneficial owners, resident in that country. The register shall be called "**Foreign Register**".

- **Other requirements relating to Foreign Register:**

  In case a company decides to keep a Foreign Register, it shall comply with the following requirements:

  (i) *Filing of notice of the situation of the office:* Within 30 days from the date of the opening of any Foreign Register, the company shall file

with the Registrar of Companies, notice of the situation of the office where such register is kept. The notice shall be filed in Form No. MGT–3 along with the requisite fee.

(ii) *Filing of notice in case of change or discontinuance:* In the event of any change in the situation of such office or of its discontinuance, the company 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 Registrar of Companies, of such change or discontinuance.

(iii) *Foreign Register part of company's register:* A foreign register shall be deemed to be part of the company's register (to be called 'principal register') of members or of debenture-holders or of any other security holders or beneficial owners, as the case may be.

(iv) *Format of Foreign Register:* The foreign register shall be maintained in the same format as the principal register.

(v) *Inspection, etc. of Foreign 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. However, advertisement before closing the register shall be inserted in at least two newspapers circulating in the place wherein the foreign register is kept.

(vi) *Decision of the appropriate competent authority binding in regard to the rectification:* 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.

(vii) *Making of Entries in Foreign Register:* Entries in the foreign register 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.

(viii) *Transmission of a copy every entry: 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.

(ix) *Keeping of Duplicate Foreign Register at Registered Office:* The company shall keep at the Registered Office a duplicate register of every foreign register duly updated from time to time.

(x) *Duplicate Foreign Register to be part of Principal Register:* Every duplicate foreign register shall be deemed to be the part of the principal register, for all purposes of the Companies Act.

(xi) *Transactions not to be registered in any other Register:* No transaction with respect to any shares or as the case may be, debentures or any other security, registered in a foreign register shall, during the continuance of that registration, be registered in any other register.

(xii) *Transfer of Entries on discontinuation:* 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 for failure to maintain register in accordance with the provisions of Section 88(1) and 88(2)

If a company does not maintain a register of members or debenture-holders or other security holders or fails to maintain them in accordance with the provisions of sub-section (1) or sub-section (2), the company shall be liable to a penalty of three lakh rupees and every officer of the company who is in default shall be liable to a penalty of fifty thousand rupees.

Nature of offence

The offence under this section is a compoundable offence under section 441 of the Act.

Details of Nominations in the register

It is important to note that Form MGT – 1 and MGT – 2 require details of nomination as referred to in section 72 of the Act, *read with Rule 19 of the Companies (Share Capital and Debentures)* Rules, 2014 to be entered in the register of members and register of debenture-holders or other security holders as the case may be.

Authentication of entries [Rule 8]

- The entries in the registers maintained under section 88 and index included therein shall be authenticated by the company secretary 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.

Illustration 1

Luxy Hairstylefs Private Limited allotted 500 shares in the name of Mr. Zoey's daughter, Mila, who is 4 years old. Mr. Joe, the Director of the Company, has approached you to advise him on the entries to be made in the register of members, since Mila is incompetent to contract in her capacity as minor.

Answer: Since minors are not competent to enter into any contract, their names cannot be entered in the register of members without the details of guardians. Therefore, Mr. Joe is advised that while filling MGT – 1, the name of a minor shall be entered only if the details of the guardian are available. Thus, Zoey's name shall also appear in the register of members of Luxy Hairstyles Private Limited since Mila is a minor.

Illustration 2

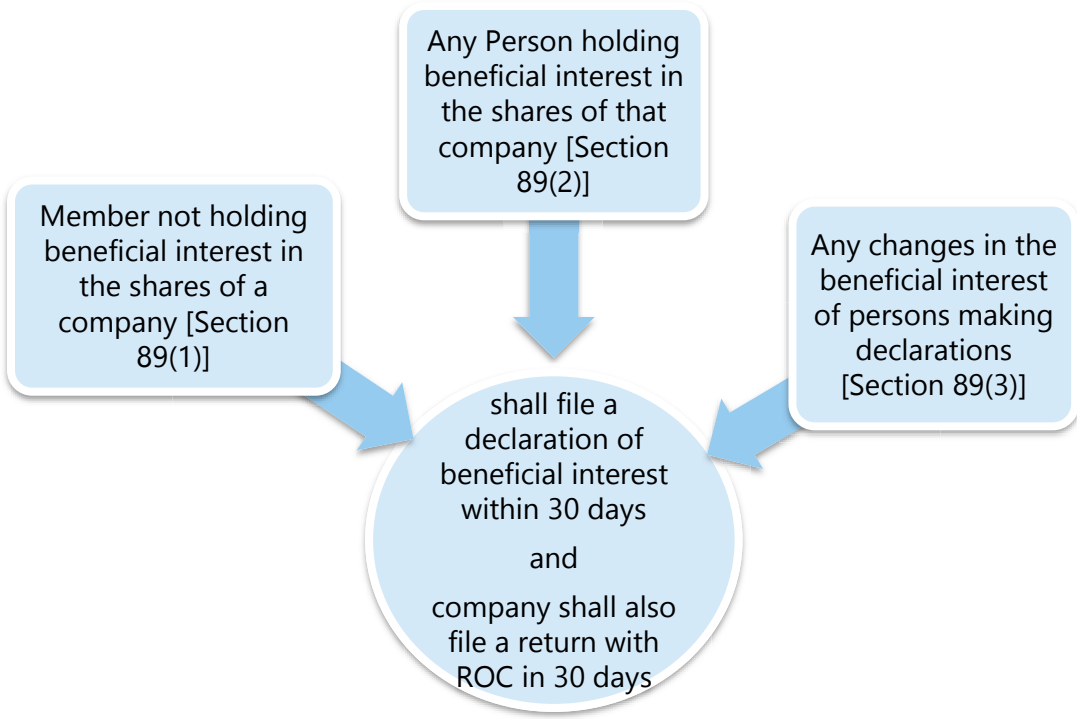
Tanya and Tarun who recently got married were jointly allotted 1000 shares by New Hospitality Services Private Limited. Tarun intimated the company that only the name of his wife should appear in the records of the company in respect of joint holding of shares allotted to them. The directors of the company are not sure whether this is possible, given that the shares are held in the names of both Tanya and Tarun.

Answer: Joint holders of shares may request the company to enter their names in the register in a certain order, or execute transfers to have their holdings split, with the result that part of the holding is entered showing the name of one holder and part showing the name of other holder. However, the condition of Tarun that only the name of his wife, Tanya, should appear in the register as a member cannot be acceded 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.

DECLARATION IN RESPECT OF BENEFICIAL INTEREST IN ANY SHARE [SECTION 89]

Section 89 of the Companies Act, 2013 contains provisions relating to declaration of beneficial interest in any share. Rule 9 of the Companies (Management and Administration) Rules, 2014 provides for procedural aspect.



- **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. The declaration MGT-4 shall be made within a period of thirty days from the date on which his name is entered in the register of members of such company. *[Section 89 (1) and Rule 9 (1)]*

- **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. *[Section 89 (2) and Rule 9 (2)]*
- **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 under section 89 (1) by the registered owner and under section 89 (2) by the beneficial owner then, within 30 days of such change, a declaration is to be made to the company.
- **Filing of return by the company with the Registrar:** Where any declaration under section 89 is made to a company, the company shall make a note of such declaration in the register concerned and shall file, within thirty days from the date of receipt of declaration by it, a return in Form No. MGT-6 with the Registrar in respect of such declaration with fee. [Section 89 (6) and Rule 9 (3)]
- **Consequence of non-filing of declaration:** Where a declaration required to be made under section 89 is not made 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. [Section 89 (8)]
- **Exemption:** Rule 9 shall not apply to a trust which is created to set up a Mutual Fund or Venture Capital Fund or such other fund as may be approved by SEBI. Accordingly, such entities need not file the declarations as envisaged by this rule.
- **Duty of the Company to pay dividend not affected:** Nothing contained in this section shall be deemed to prejudice the obligation of a company to pay dividend to its members under this Act and the said obligation shall, on such payment, stand discharged.
- **Meaning of beneficial interest:** For the purposes of section 89 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 or cause to be exercised 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)]*

Exemption from the provisions of section 89 *[Section 89(11)]*

The Central Government may, by notification, exempt any class or classes of persons from complying with any of the requirements of this section, except sub-section (10), 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 in the notification.

Exemption to a Government Company- In case of Government Company - Section 89 shall not apply. *[Notification No. GSR 463 (E), dated 5th June, 2015]*

The above-mentioned exemption shall be applicable to a government company which has not committed a default in filing its financial statements under section 137 or annual return under section 92 with the Registrar- *[Notification No. GSR 582 (E), dated 13th June, 2017]*.

Penalty for default [Sections 89 (5) & 89 (7)]

Two kinds of penal provisions as described below are included under section 89 –

(i) ***Relating to Default made by persons required to make a declaration -*** If any person fails to make a declaration as required under sub-section (1) or sub-section (2) or sub-section (3), he shall be liable to a penalty of fifty thousand rupees and in case of continuing failure, with a further penalty of two hundred rupees for each day after the first during which such failure continues, subject to a maximum of five lakh rupees. *[Section 89(5)]*

(ii) ***Relating to Default made by a company*** - If a company, required to file a return under sub-section (6), fails to do so before the expiry of the time specified therein, the company and every officer of the company who is in default shall be liable to a penalty of one 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 two lakh rupees in case of an officer who is in default. *[Section 89(7)]*

REGISTER OF SIGNIFICANT BENEFICIAL OWNERS IN A COMPANY [SECTION 90]

As per Section 90 of the Companies Act, 2013, 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 this connection, MCA has issued the Companies (Significant Beneficial Owners) Rules, 2018, which deal with identification and reporting in connection with SBO.

Definition of 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 twenty-five per cent. 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 as defined in clause (27) of section 2, over the company (herein referred to as "significant beneficial owner").

However, the 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, or actually exercises, significant influence or control, in any manner other than through direct holdings alone.

In simple terms, SBO is an individual who either alone or together with other individuals or trust, exercises rights or entitlements in the Reporting Company by way of holding 10% shares or 10% voting rights or right to receive 10% or more dividend, both indirect and direct holdings or right taken together or such individual exercises significant influence or control, indirectly or along with direct holding in the Reporting Company. The amended Rules further explain that if an individual does not hold any indirect right or entitlement as mentioned in (i), (ii) or (iii) above, he will not be considered to be a 'significant beneficial owner'.

Significant influence: The term "significant influence" was previously not defined specifically for the rules, and hence, to provide clarity, the following definition has been inserted through SBO rules: "Significant influence" 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. *[Rule 2 (1) (i)]*

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. *[Rule 2 (1) (d)]*

Direct and Indirect shareholding: The Amendment Rules provide that 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 Reporting Company, if he satisfies any of the following criteria:

a. the shares in the Reporting 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 Reporting Company under section 89 (2), and has made a declaration in this regard to the Reporting Company.

Indirect shareholding is, when a shareholder is a (a) body corporate; (b) Hindu Undivided Family; (c) Partnership entity; (d) Trust; (e) Pooled investment vehicle.

Onus on the reporting company to identify a SBO and cause him to make declaration: The duty is on the reporting company to identify a SBO and cause such SBO to make a declaration in the prescribed Form.

As per sub-section (5) of section 90 read with the Amendment Rules, every reporting company shall give notice in the Form BEN-4 to any person (whether or not a member of the company) whom the company knows or has reasonable cause to believe:

(a) to be a significant beneficial owner of the company;

(b) to be having knowledge of the identity of a significant beneficial owner or another person likely to have such knowledge; or

(c) to have been a significant beneficial owner of the company at any time during the three years immediately preceding the date on which the notice is issued,

and who is not registered as a significant beneficial owner with the company as required under this section.

Maintenance of Register of SBO and Inspection thereof: According to section 90 (2) and 90 (3) read with Rule 5, every company shall maintain a register of significant beneficial owners in Form No. BEN-3 which shall be open for inspection during business hours, at such reasonable time of not less than two hours, on every working day as the board may decide, by any member of the company on payment of such fee as may be specified by the company but not exceeding fifty rupees for each inspection.

Application to the Tribunal [Section 90 (7)]: The company shall,—

(a) Where that person fails to give the company, the information required by the notice within the time specified therein. (According to Rule 7 notice shall be given in Form No. BEN-4 for providing information within 30 days of date of notice); or

(b) Where the information given is not satisfactory,

apply to the Tribunal within a period of fifteen days of the expiry of the period specified in the notice, for an order directing that the shares in question be

subject to restrictions with regard to transfer of interest, suspension of all rights attached to the shares and such other matters as may be prescribed.

Note: According to Rule 7, the reporting company shall apply to the Tribunal in accordance with section 90 (7), for order directing that the shares in question be subject to restrictions including-

(i) restrictions on the transfer of interest attached to the shares in question;

(ii) suspension of the right to receive dividend or any other distribution in relation to the shares in question;

(iii) suspension of voting rights in relation to the shares in question;

(iv) any other restriction on all or any of the rights attached with the shares in question.

Section 90 (8) states that on any application made under sub-section (7), the Tribunal may, after giving an opportunity of being heard to the parties concerned, make such order restricting the rights attached with the shares within a period of sixty days of receipt of application or such other period as may be prescribed.

According to section 90 (9), the company or the person aggrieved by the order of the Tribunal may make an application to the Tribunal for relaxation or lifting of the restrictions placed under section 90 (8) within a period of one year from the date of such order.

Provided that if no such application has been filed within a period of one year from the date of the order such shares shall be transferred, without any restrictions, to the authority constituted under sub-section (5) of section 125 (i.e. Investor Education and Protection Fund Authority), in such manner as may be prescribed.

Declaration by SBO under Section 90:

As regards declaration of significant beneficial ownership under section 90, Rule 3 of SBO Rules, 2018 states as under:

(1) Every individual who is a significant beneficial owner (SBO) in a Reporting Company, as on the date of commencement of the Amendment Rules, 2019 (*i.e.* 8-2-2019), is required to file a declaration in Form No. BEN-1 with the Reporting Company within 90 days from such commencement.

Note: According to Rule 4, the Reporting Company shall be required to file a return in Form No. BEN-2 with the Registrar in respect of such declaration within 30 days of its receipt from the SBO.

(2) Any individual, who subsequently becomes a significant beneficial owner (SBO) in the Reporting Company or whose significant beneficial ownership undergoes any change, shall be required to file a declaration in Form No. BEN-1 with the Reporting Company in within 30 days of such acquisition or change.

Explanation: If an individual becomes a significant beneficial owner in the Reporting Company or if his significant beneficial ownership undergoes any change within ninety days of the commencement of the Companies (Significant Beneficial Owners) Amendment Rules, 2019 (i.e. 8-2-2019), it shall be deemed that such individual became the significant beneficial owner or any change therein happened on the date of expiry of ninety days from the date of commencement of said rules, and the period of thirty days for filing will be reckoned accordingly.

Non-Applicability of SBO Rules

Rule 8 of The Companies (Significant Beneficial Owner) Amendment Rules, 2018 states that the 'SBO' Rules shall not be made applicable to the extent the share of the Reporting Company is held by:

(a) the Investor Education and Protection Fund Authority [constituted under section 125 (5)];

(b) its holding reporting company provided that the details of such holding reporting company shall be reported in Form No. BEN-2;

(c) the Central Government, State Government or any local authority;

(d) (i) a reporting company or (ii) a body corporate or (iii) an entity, controlled wholly or partly by the Central Government and/ or State Government(s);

(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

(f) investment vehicles regulated by Reserve Bank of India, Insurance Regulatory and Development Authority of India or Pension Fund Regulatory and Development Authority.

Penalty for Contravention

(a) ***By SBO*:** If any person fails to make a declaration as required under sub-section (1), he shall be liable to a penalty of fifty thousand rupees and in case of continuing failure, with a further penalty of one thousand rupees for each day after the first during which such failure continues, subject to a maximum of two lakh rupees. *[Section 90(10)]*

(b) ***By Reporting Company*:** If a company, required to maintain register under sub-section (2) and file the information under sub-section (4) or required to take necessary steps under sub-section (4A), fails to do so or denies inspection as provided therein, the company shall be liable to a penalty of one lakh rupees and in case of continuing failure, with a further penalty of five hundred rupees for each day, after the first during which such failure continues, subject to a maximum of five lakh rupees and every officer of the company who is in default shall be liable to a penalty of twenty-five thousand rupees and in case of continuing failure, with a further penalty of two hundred rupees for each day, after the first during which such failure continues, subject to a maximum of one lakh rupees. *[Section 90(11)]*

It is worth noting that any contravention by Company and Officer in Default of the provisions of Section 90 and SBO Rules is compoundable.

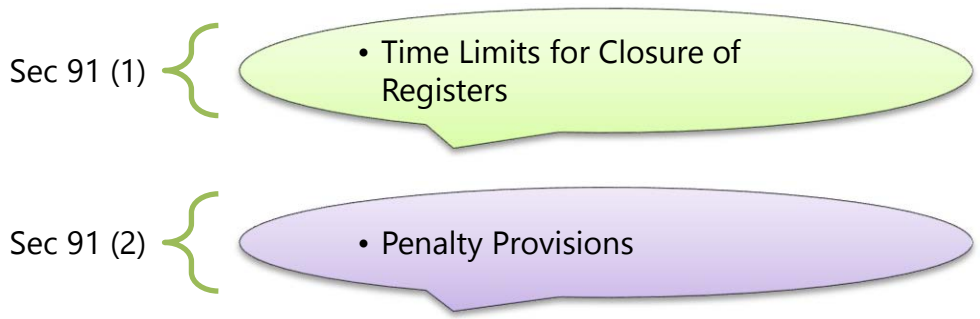
Note: Where any person wilfully furnishes any false or incorrect information or suppresses any material information of which he is aware in the declaration made, he shall be liable for punishment for fraud under section 447. *[Section 90(12)]*

Exemption to a Government Company- In case of Government Company - Section 90 shall not apply - *Notification No. GSR 463 (E), dated 5th June, 2015*.

The above-mentioned exemption shall be applicable to a government company which has not committed a default in filing its financial statements under section 137 or annual return under section 92 with the Registrar- *Notification No. GSR 582 (E), dated 13th June, 2017*.

POWER TO CLOSE REGISTER OF MEMBERS OR DEBENTURE-HOLDERS OR OTHER SECURITY HOLDERS [SECTION 91]

Section 91 (1) deals with the time limits for which the respective registers of members, debenture-holders and other security holders are allowed to be closed. Section 91 (2) mentions the penalty for contravention of the provisions of sub-section (1).



Section 91 (1) contains following provisions:

(i) **Closure Period**: A company may close its register of members or register of debenture-holders or register of other security holders for an aggregate period of 45 days in each year but not exceeding 30 days at any one time.

(ii) **Notice Period:** The respective registers of members, debenture-holders or other security holders may be closed by giving minimum 7 days' notice or such lesser period as may be specified by Securities Exchange Board of India ('SEBI') for listed companies or those companies which intend to get their securities listed.

Rule 10 of the *Companies (Management & Administration) Rules, 2014*, specifies the manner of closure of registers as under:

(a) A company closing the register of members or the register of debenture holders or the register of other security holders shall give at least seven days previous notice and in such manner, as may be specified by SEBI, if such company is a listed company or intends to get its securities listed,

- by advertisement at least once in a vernacular newspaper in the principal vernacular language of the district and having a wide

circulation in the place where the registered office of the company is situated, and

- ♦ at least once in English language in an English newspaper circulating in that district and having wide circulation in the place where the registered office of the company is situated, and
- ♦ publish the notice on the website as may be notified by the Central Government and on the website, if any, of the Company. *[Rule 10 (1)]*

(b) *Exemption to Private Companies:* It is to be noted that a private company has been exempted from issuing a public notice in newspapers, provided it issues minimum 7 days' notice to its members prior to closure of the registers. *[Rule 10 (2)]*

Section 91 (2) contains **penalty provisions** as stated below:

In case of contravention of provisions of section 91(1) (*i.e.* if the respective registers are closed without giving notice, or after giving a shorter notice than that so provided, or for a continuous or an aggregate period in excess of the specified limits), section 91 (2) states following penalty:

- ■ 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.

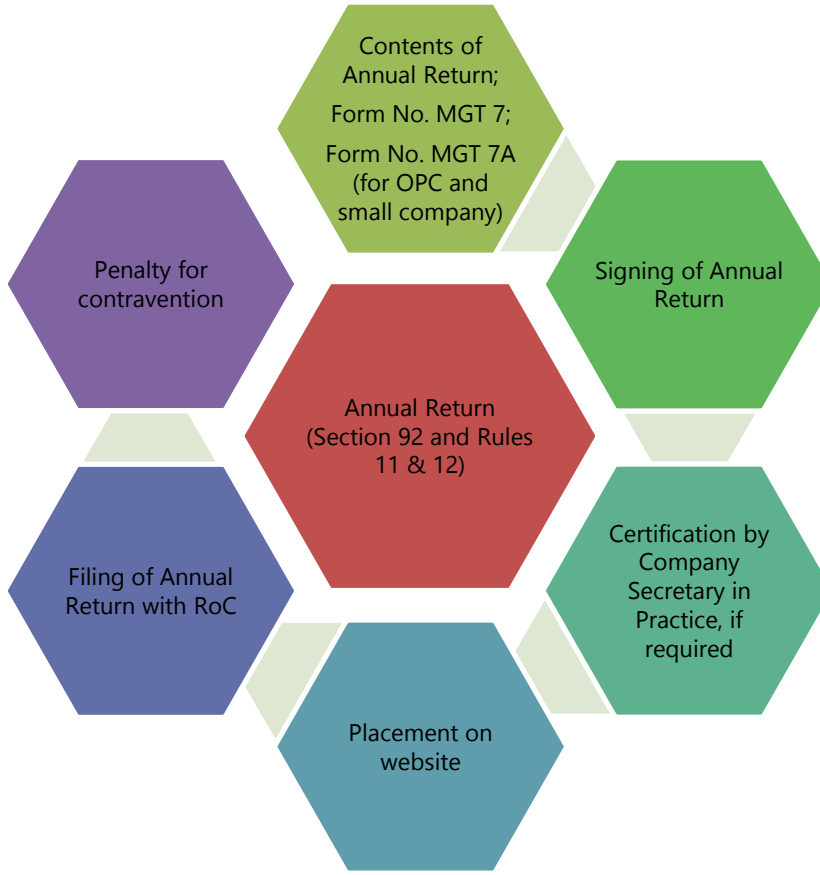
Note: The offence is a compoundable offence under section 441 of the Companies Act, 2013.

3. ANNUAL RETURN [SECTION 92 AND 94]

Provisions with regard to Annual Return are contained in section 92 of the Companies Act, 2013 and Rules 11 and 12 of the *Companies (Management & Administration) Rules, 2014*.

As per Rule 11, every company shall file its annual return in Form No. MGT-7 except One Person Company (OPC) and Small Company.

One Person Company and Small Company shall file the annual return from the financial year 2020-2021 onwards in Form No. MGT-7A.



Contents of Annual Return

According to section 92(1), every company shall prepare a return (referred to as the Annual Return) in the prescribed form containing the particulars as they stood on the close of the financial year regarding—

(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;

[1](c) [Omitted]

(d) its members and debenture-holders along with changes therein since the close of the previous financial year;

[1] Clause (c) of section 92(1) was omitted *vide* the Companies (Amendment) Act, 2017, w.e.f. 5th March, 2021.

(e) its promoters, directors, key managerial personnel along with changes therein 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;

[2](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, as may be prescribed, in respect of shares held by or on behalf of the Foreign Institutional Investors; and

(k) such other matters as may be prescribed,

Abridged Form of Annual Return

In terms of Second Proviso to Section 91 (1), the Central Government may prescribe abridged form of annual return for One Person Company, small company and such other class or classes of companies as may be prescribed. Accordingly, as per Rule 11 (1) One Person Company and small company shall file the annual return from the financial year 2020-2021 onwards in Form No. MGT-7A.

Signing of Annual Return

The annual return shall 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.

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[2] **In case of Private Company** – Clause (g) of sub-section (1) of Section 92 shall apply to private companies which are small companies, as under:-
(g) "aggregate amount of remuneration drawn by directors;". - *Notification No. GSR 464 (E), dated 5-6-2015, as amended by Notification No. GSR 583 (E), dated 13th June, 2017.*

However, in relation to [3]One Person Company and small company, the annual return shall be signed by the company secretary, or where there is no company secretary, by the director of the company.

Certification of Annual Return by a Company Secretary in practice in certain cases

Section 92 (2) read with Rule 11 (2) of the *Companies (Management & Administration) Rules, 2014*, provides that the annual return, filed by:

(i) a listed company or

(ii) 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 Company Secretary in practice stating that the annual return discloses the facts correctly and adequately and that the company has complied with all the provisions of the Companies Act, 2013.

Such certificate shall be in Form No. MGT – 8.

Placing of Annual Return on Website

[4]Every company shall place a copy of the annual return on its website, if any, and the web-link of such annual return shall be disclosed in the Board's report. *[refer Section 92 (3)]*

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[3] **In case of Private Company** - For proviso to sub-section (1) of Section 92, the following proviso shall be substituted, namely:-
"Provided that in relation to One Person Company, 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.".
The above exceptions/ modifications/ adaptations 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 with Registrar. *[Notification No. GSR 464 (E), dated 5-6-2015, as amended by Notification No. GSR 583 (E), dated 13th June, 2017.Notification Dated 13th June, 2017]*

[4] (i) In case of Specified IFSC Public Company - Sub-section (3) of section 92 shall not apply. - *Notification No. GSR 8 (E), dated 4th January, 2017*.
(ii) In case of Specified IFSC Private Company - Sub-section (3) of section 92 shall not apply. - *Notification GSR 9 (E), dated 4th January, 2017*.

Time limit for Filing of Annual Return

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. Where no annual general meeting is held in any year, it shall be filed 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. *[Section 92 (4) and Rule 12]*

Penalty for contravention

(i) Section 92(5) specifies as under:

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 **ten 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 **two lakh rupees in case of a company and fifty thousand rupees in case of an officer who is in default**.

(ii) Section 92(6) specifies penalty in case of a Company Secretary in Practice as under:

If a company secretary in practice certifies the annual return otherwise than in accordance with section 92 or the rules made thereunder, he shall be ***liable to a penalty of two lakh rupees***.

Illustration 3

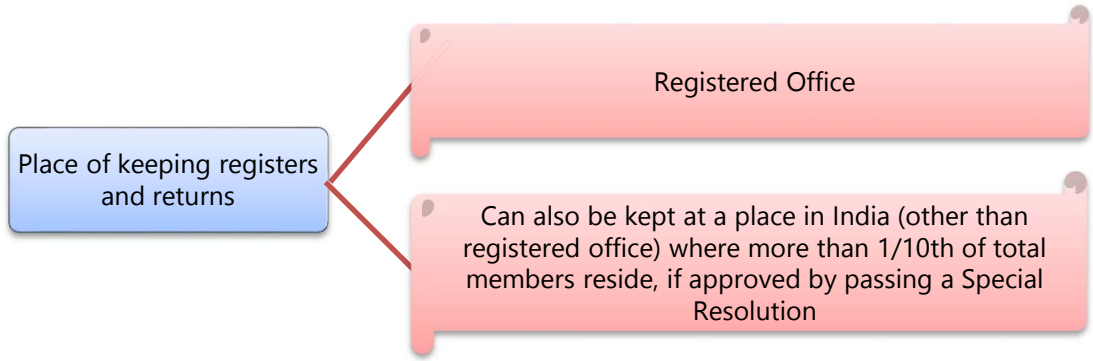
Big Fox Entertainment Limited called its Annual General Meeting on 30th September, 2021, for laying down the financial statements relating to the Financial Year ended 31st March 2021 for approval of its shareholders and conducting of other requisite businesses. However, due to want of quorum, the meeting could not take place and was cancelled. The company did not file the annual return for the year ending 31st March 2021, with the jurisdictional Registrar of Companies till date. The directors are 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.

Answer: The contention of directors is incorrect if they are of the view that there is no contravention of the provisions of the Companies Act, 2013. Section 92 (4) states that every company has to file an annual return with the RoC within 60 days from the date on which Annual General Meeting is held or where no Annual

General Meeting is held in any year, it shall be filed 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.

In the above case, the Annual General Meeting should have been held by 30th September, 2021 but it did not take place for want of quorum. Even if it was not held, Big Fox Entertainment Limited was required to file Annual Return within the specified time along with the reasons for not holding the AGM. By not filing Annual Return, the company has contravened the provisions of Section 92 of the Companies Act, 2013 and therefore, it 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][5]



Place of keeping Registers and Returns

In respect of place of keeping Registers and Returns Section 94 (1) and First Proviso state as under:

(i) *At Registered office:* 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.

(ii) *At any other place in India:* The 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.

[5] Section 93 was omitted by the Companies (Amendment) Act, 2017 w.e.f. 13-6-2018.

Inspection of Registers, etc.

According to section 94 (2), the registers and their indices, except when they are closed 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.

As per Rule 14 (1), the registers and indices maintained pursuant to section 88 and copies of returns prepared pursuant to section 92, shall be open for inspection during business hours, at such reasonable time on every working day as the Board may decide, by any member, debenture holder, other security holder or beneficial owner without payment of fee and by any other person on payment of such fee as may be specified in the Articles of Association of the company but not exceeding fifty rupees for each inspection.

Explanation.- For the purposes of this sub-rule, reasonable time of not less than two hours on every working day shall be considered by the company.

Extracts of register or index: According to Section 94 (3) read with Rule 14 (2), any member, debenture-holder or security holder or beneficial owner or any other person can take the extracts without payment of any fee or can also get copies thereof with payment of fee not exceeding ₹ 10 for each page. Such copies or entries or return shall be supplied within 7 days of deposit of fee.

Provided that such particulars of the register or index or return as may be prescribed shall not be available for inspection under sub-section (*2*) or for taking extracts or copies under this sub-section.

As per Rule 14, 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

Preservation of Register of Members etc. and Annual Return

As per Second Proviso to Section 94 (1), the period for which the registers, returns and records are required to be kept shall be such as may be prescribed. In this respect Rule 15 of the *Companies (Management & Administration) Rules, 2014* states as under:

- Preservation **of register of members:** The register of members along with the index shall be preserved **permanently** and shall be kept in the custody of company secretary of the company or any other person authorised by the Board for such purpose.
- **Preservation of register of debenture holders/other security holders:** The register of debenture-holder or any other security holder along with the index shall be preserved for a period of **8 years** from the date of redemption of debentures or securities, as the case may be, and shall be kept in the custody of the company secretary of the company or any other person authorized by the Board for such purpose.
- **Preservation of Copies of documents filed with ROC:** Copies of all annual returns prepared under section 92 and copies of all certificates and documents required to be annexed thereto shall be preserved for a period of **8 years** from the date of filing with the RoC.
- **Preservation of Foreign Register of Members:** 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.

  Foreign register of debenture-holders or any other security holders shall be preserved for a period of **8 years** from the date of redemption of such debentures or securities.

  The foreign register shall be kept in the custody of the company secretary or person authorised by the Board.

Penalty for refusing the inspection or making any extract or copy required –

- If any inspection or the making of any extract or copy required under this section is refused, the company and every officer of the company who is in default shall be liable for each such default, to a penalty of ₹ 1, 000 for every

day subject to a maximum of ₹ 1, 00,000 during which the refusal or default continues. *[Section 94 (4)]*

- The Central Government* may also, by order, direct an immediate inspection of the document, or direct that the extract required shall forthwith be allowed to be taken by the person requiring it. *[Section 94 (5)]*

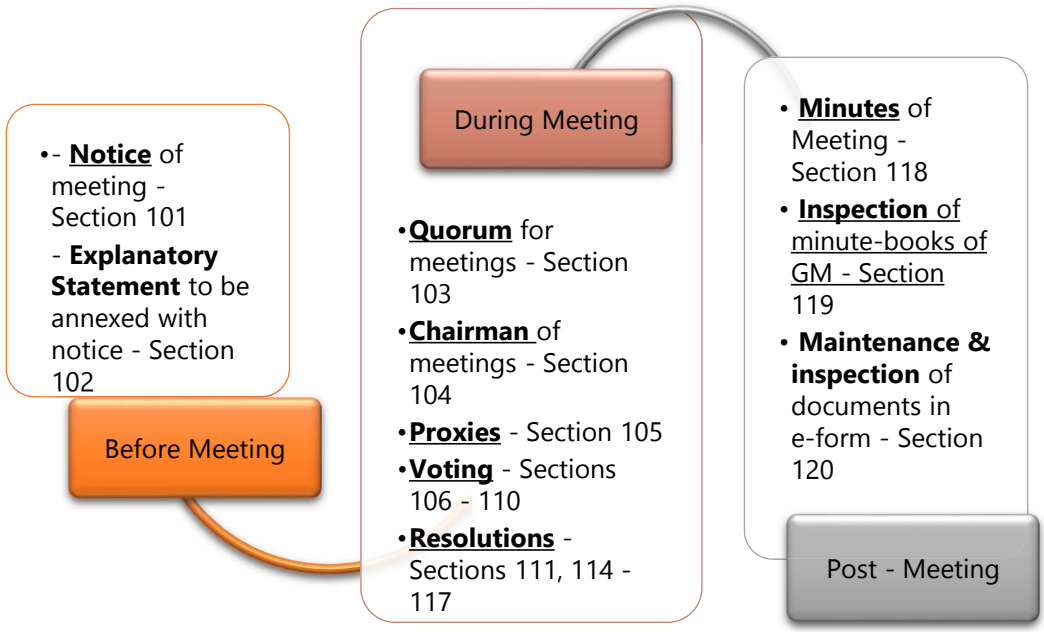
** Powers are delegated to Regional Directors.*

REGISTERS, ETC. TO BE EVIDENCE [SECTION 95]

According to Section 95, the registers, indices and copies of annual return shall be prima facie evidence of any matter directed or authorised to be inserted therein by or under this Act.

4. PRE-REQUISITES OF A MEETING

Before we move on to our next concept of types of meetings and the procedure to convene them as per the Companies Act, 2013, let us understand the terms which are important to know for convening a meeting.



Key terms:

(a) General Meeting: It is the meeting of the shareholders of a company to be held as per the provisions of the Act. The general meeting can be an Annual General Meeting (AGM) or an Extraordinary General Meeting (EGM). An annual general meeting (AGM) is a mandatory yearly gathering of a company's shareholders. The objective of holding an AGM is to provide an opportunity to members to discuss the functioning of the company and take steps to protect their interests. They can discuss any matter relating to the conduct of the affairs of the company. An Extraordinary General Meeting (EGM) can be defined as a meeting of shareholders which is not an AGM. The objective of holding an EGM is to discuss any matter of urgent importance which cannot be postponed till the next Annual General Meeting.

(b) Board Meeting: It is the meeting of the Board of Directors of a company.

(c) Class Meeting: It is the meeting of particular class of persons, like, creditors, preference shareholders, debenture-holders, etc.

The pre-requisites of the meetings are, in general, applicable to all kinds of meetings, although the time limits may differ and there might be a specific mention of a certain type of meeting in the respective section.

NOTICE OF A MEETING [SECTION 101]

Section 101 (1) of the Companies Act, 2013 states that in order to properly call a general meeting, a notice of at least *21 clear days* is required to be given either in writing or through electronic mode in such manner as may be prescribed.

In case of Specified IFSC Public Company - Section 101 shall apply in case of a Specified IFSC public company, unless otherwise specified in the articles of the company. [Notification No. GSR 8 (E), dated 4th January, 2017.]

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" shall be substituted. This exception shall be applicable to a section 8 company which has not committed a default in filing

its financial statements under section 137 or annual return under section 92 with the Registrar. [Notification No. GSR 466 (E), 5-6-2015 as amended by Notification No. GSR 584 (E), dated 13th June, 2017.]

Contents of the Notice [Section 101(2)]

Every notice of a meeting must state the place, date, day and the hour of the meeting and shall contain a statement of business to be transacted at that meeting.

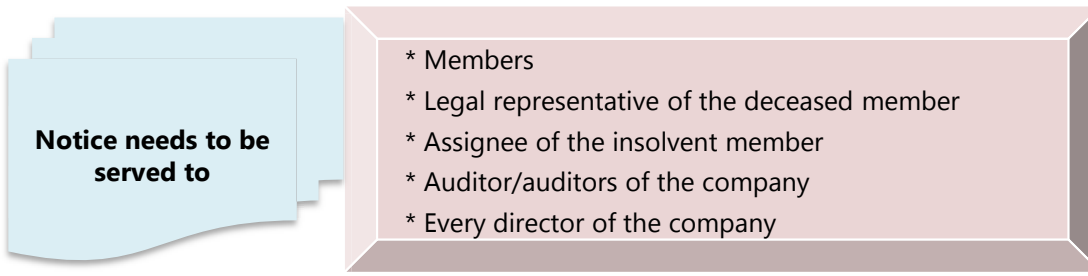
Persons entitled to receive the Notice of the General Meeting [Section 101(3)]

The notice of every meeting of the company shall be given to:

(a) every member of the company, legal representative of any deceased member or the assignee of insolvent member;

(b) the auditor or auditors of the company;

(c) every director of the company.



Meaning of 21 clear days:

The term '21 clear days' means that the date on which notice is served and the date of meeting are excluded while sending the notice of a meeting. A company cannot curtail the requirement of 21 clear days through its Articles of Association.

Note: Where a notice of a 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 *(Rule 35(6) of the Companies (Incorporation) Rules, 2014)*

Sending of Notice of Meeting through Electronic Mode:

As per *Rule 18 of the Companies (Management & Administration) Rules, 2014*, sending of notices through electronic mode has been statutorily recognized. Accordingly, it is permitted for a company to give notice through electronic mode.

The expression ''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.

- 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.
- Rule 18(3)
  - The e-mail shall be addressed to the person entitled to receive such e-mail as per the records of the company as provided by the depository.

    It is to be noted that the company shall provide an advance opportunity at least once in a financial year, to the member to register his e-mail address and the changes therein and such request may be made by only those members who have not got their e-mail ID recorded or to update a fresh e-mail ID and not from the members whose e-mail ids are already registered.
  - 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.
  - If notice is sent in the form of a non-editable attachment to e-mail, such attachment shall be in the Portable Document Format or in a

non-editable format together with a 'link or instructions' for recipient for downloading relevant version of the software.

- 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.
- 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.
- The company may send e-mail through in-house facility or its registrar and transfer agent or authorise any third-party agency providing bulk e-mail facility.
- The notice shall be placed simultaneously on the website of the Company, if any, and on the website as may be notified by Central Government.

Non-receipt of Notice: According to Section 101(4) 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.

Illustration 4

Mr. Abhinav, a member of Elixir Logistics Limited, filed a complaint against the company for not serving him a notice 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. Abhinav, inviting him to attend the annual general meeting of the company. Mr. Abhinav alleges that he never received the email. State whether the company is liable to be guilty for contravening the provisions of section 101 of the Companies Act, 2013 read with the applicable Rules.

Answer: As per Rule 18 (3) (v) 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, Rule 18 (3) (vi) if a 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. Accordingly, Elixir Logistics Limited shall not be held guilty if there was a failure in transmission beyond its control or in case where Mr. Abhinav did not update his e-mail address.

Shorter notice of less than 21 days [Proviso to Section 101 (1)]

As noted earlier, usually general meetings need to be called by giving at least a notice of 21 clear days.

However, a general meeting may be called after giving shorter notice than that specified in sub-section (1) of Section 101, if consent, in writing or by electronic mode, is accorded thereto—

(i) in the case of an annual general meeting, by not less than ninety-five per cent. of the members entitled to vote thereat; and

(ii) in the case of any other general meeting, by members of the company—

(a) holding, if the company has a share capital, majority in number of members entitled to vote and who represent not less than ninety-five per cent. of such part of the paid-up share capital of the company as gives a right to vote at the meeting; or

(b) having, if the company has no share capital, not less than ninety-five per cent. of the total voting power exercisable at that meeting.

Where any member of a company is entitled to vote only on some resolution or resolutions to be moved at a meeting and not on the others, those members shall be taken into account for the purposes of sub section (1) of section 101 in respect of the former resolution or resolutions and not in respect of the latter.

Illustration 5

The paid-up share capital of Aakash Soaps Limited is Rs. fifty lakh divided into five lakh shares of ₹10 each. The directors of the company are desirous of calling an extra-ordinary general meeting (EGM) by giving a shorter notice which is less than 21 days. Sixty percent of the members holding shares worth Rs. forty lakh accorded their consent by electronic mode to the shorter notice. Whether EGM can be validly called.

Answer: In the above case, consent to call the EGM by shorter notice has been accorded by sixty percent members holding shares worth Rs. forty lakh which works out to 80% (40,00,000/50,00,000 *100) whereas the requirement is that majority in number of members who represent not less than 95% of paid-up share capital which gives them a right to vote at the meeting *(i.e. shareholders holding shares worth ₹ 47,50,000)* must consent to shorter notice. Therefore, the EGM cannot be validly called and held.

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][6]

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' shall be annexed to the notice calling such general meeting. The 'Explanatory Statement' must specify,

(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.

Ordinary business and Special business: Companies Act, 2013 sets out two types of businesses as under:

[6] **In case of Specified IFSC Public Company** - Section 102 shall apply in case of a Specified IFSC public company, unless otherwise specified in the articles of the company. *Notification GSR 8 (E), Dated 4th January, 2017*.

- Ordinary business (OB)
- Special business. (SB)

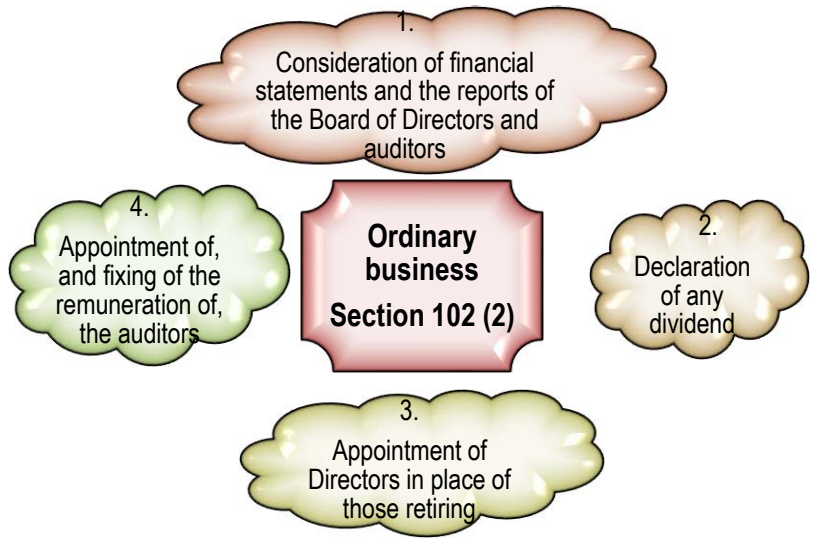
Ordinary business includes the following business which are transacted at the Annual General Meeting of a company–

(i) the consideration of financial statements and the reports of the Board of Directors and auditors;

(ii) the declaration of any dividend;

(iii) the appointment of directors in place of those retiring;

(iv) the appointment of, and the fixing of the remuneration of, the auditors.



- In the case of AGM, all business to be transacted thereat except the ones stated above are **special business**. At the EGM, every business transacted is a **special business**. Explanatory statement is not required for transacting Ordinary Business.
- Proviso to section 102 (2) sets out that if any item of special business relates to, or affects, any other company, the extent of shareholding in that other company of every promoter, director, manager and of every other KMP shall be disclosed, if the extent of shareholding is 2% or more of the paid-up share capital of that other company.
- In case any item of business refers to any document which is to be considered at the meeting, then the time and place where such document can be inspected should also be specified in the explanatory statement.

- **Effect of non-disclosure/insufficient disclosure in Explanatory Statement [Section 102(4)]**: If as a result of non-disclosure or insufficient disclosure in explanatory statement, any benefit accrues to a promoter, director, manager, other key managerial personnel or their relatives, such person shall hold such benefit in trust for the company, and shall, without prejudice to any other action being taken against him under this Act or under any other law for the time being in force, be liable to compensate the company to the extent of the benefit received by him.

Penalty for contravention of the provisions of section 102

Without prejudice to the provisions of sub-section (4), if any default is made in complying with the provisions of this section, every promoter, director, manager or other key managerial personnel of the company who is in default shall be liable to a penalty of fifty thousand 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. *[Section 102 (5)]*

QUORUM FOR MEETINGS [SECTION 103][7]

Quorum means the minimum number of members who must be personally present in order to constitute a valid meeting. Section 103 of the Companies Act, 2013 states that unless the articles of the company provide for a larger number, the quorum for the meeting shall be as follows–

Public Company -

- If number of members is not more than 1000, quorum shall be 5 members personally present.
- if the number of members is more than 1000 but upto 5000, then the quorum shall be 15 members personally present
- If the number of members exceed 5000, then quorum shall be 30 members personally present.

Private Company -

- Two members personally present shall be the Quorum.

[7] **In case of Specified IFSC Public Company** - Section 103 shall apply in case of a Specified IFSC public company, unless otherwise specified in the articles of the company. *Notification No. GSR 8 (E), Date 4th January, 2017.*

- It is to be noted that the term 'members personally present' as mentioned above refers to the members entitled to vote in respect of the items of business on the agenda of the meeting.

Adjournment of Meeting for want of Quorum [Section 103 (2) and (3)]

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 and such other time and place as the Board may determine; or

(b) the meeting, if called by requisitionists under section 100, shall stand cancelled:

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 three days' notice to the members either individually or by publishing an advertisement 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.

Quorum not present at the adjourned meeting also: Where quorum is not present in the adjourned meeting also within half an hour, then the members present shall form the quorum.

Note:

The following points have been prescribed by Secretarial Standard – 2:

1. One person can be an authorised 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. Thus, in case of a public company having not more than one thousand members with a Quorum requirement of five members, an authorised representative of five bodies corporate cannot form a Quorum by himself but can do so if at least one more member is personally present.
2. Quorum shall be present not only at the time of commencement of the Meeting but also while transacting business.

3. Members who have voted by Remote e-voting have the right to attend the General Meeting and accordingly their presence shall be counted for the purpose of Quorum.
4. A Member who is not entitled to vote on any particular item of business being a related party, if present, shall be counted for the purpose of Quorum.
5. The stipulation regarding the presence of a Quorum does not apply with respect to items of business transacted through postal ballot.

Illustration 6

There are 54 members in Nice Games Private Limited. The company called its annual general meeting on Friday, 1st July 2022 at 2:00 p.m. at its registered office. There were 28 members present till 2:30 p.m. at the venue of the AGM. The Chairman of the meeting proceeded to initiate the meeting and passed the resolutions after observing due process. Comment whether the meeting took place as per the provisions of Companies Act, 2013.

Answer: As per the provisions of Section 103 of the Companies Act, 2013, the quorum for a Private Limited Company shall be two members personally present, within half-an-hour from the time appointed for holding a general meeting of the company. Thus, the quorum for the Annual General Meeting of Nice Games Private Limited was complied with and the company has not contravened any of the provisions of the Companies Act, 2013.

Illustration 7

Abbey Lights and Sounds Limited has 2300 members. The company called its Annual General Meeting on Tuesday, 23rd August, 2022 at 10.30 a.m. at its registered office situated in Connaught Place, New Delhi. On the day of the meeting, 18 members were personally present by 11.00 a.m. and the Chairman proceeded to initiate the Annual General 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 and 5 and accordingly passed resolutions 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: According to Secretarial Standard - 2 (SS-2), Quorum shall be present not only at the time of commencement of the Meeting but also while transacting business.

In the above case, while the required quorum as per section 103 of the Companies Act, 2013 was present at the time when the meeting started, the quorum was not present at the time of deciding Agenda 4 and 5. Thus, 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.

CHAIRMAN OF MEETING [SECTION 104][8]

Election of Chairman by Members: Section 104 of the Companies Act, 2013 seeks to provide that unless the Articles of Association of the Company otherwise provide, the members, personally present, shall elect among themselves to be the Chairman on a show of hands.

Demand for Poll: The section further provides that if a poll is demanded on the election of the Chairman, the Chairman elected by show of hands shall continue to be the Chairman of the meeting until some other person is elected as Chairman as a result of poll, and such other elected person shall be the Chairman for rest of the meeting.

Powers of Chairman: Chairman of the meeting is the person who manages the meetings and ensures that the required decorum of the meeting is maintained at all times, till the meeting is concluded and post that, executes the minutes of the meeting. The Chairman has *prima facie* authority to decide all questions which arise at a meeting and which require decision at that time. In order to fulfil his duty properly, he must observe strict impartiality.

Chairman to have 'casting vote' if so provided in the Articles: The Chairman has a casting vote in Board Meetings and general meetings, if specifically empowered by the articles of the company. The term 'casting vote' means that in

[8] In case of **Specified IFSC Public Company** - Section 104 shall apply in case of a Specified IFSC public company, unless otherwise specified in the articles of the company. *Notification No. GSR 8 (E), Dated 4th January, 2017.*

the event of 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. If there is no provision in the articles for a casting vote, an ordinary resolution on which there is equality of votes is deemed to be dropped.

Exemption to a Private Company- In case of a private company - Section 104 shall apply, unless otherwise specified in respective section or the articles of the company provide otherwise. - *Notification No. GSR 464 (E), 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 No. GSR 583 (E), dated 13th June 2017.*

5. PROXIES [SECTION 105][9]

Section 105 of the Companies Act, 2013 and Rule 19 of the *Companies (Management & Administration) Rules, 2014* contain provisions relating to the proxies.

- Appointment of a proxy is an important right of a member of the company. Section 105 (1) provides that 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.

  However, a proxy shall not have the right to speak at such meeting and shall not be entitled to vote except on a poll.

- **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. The Central Government may also prescribe a class or classes of companies whose members shall not be entitled to appoint another person as a proxy.

[9] **In case of Specified IFSC Public Company** - Section 105 shall apply in case of a Specified IFSC public company, unless otherwise specified in the articles of the company. *Notification No. GSR 8 (E), Dated 4th January, 2017.*

According to Rule 19, a member of a company registered under section 8 (companies formed with charitable objects, etc.) shall not be entitled to appoint any other person as his proxy unless such other person is also a member of such company.

A person can act as proxy on behalf of members not exceeding fifty and holding in aggregate not more than 10 per cent of the total share capital of the company carrying voting rights.

However, a member who is holding more than 10 per cent of the total share capital of the company carrying voting rights may appoint a single person as a proxy and such person shall not act as proxy for any other person or shareholder. *[Rule 19 (2)]*

- As a compliance requirement, in every notice calling a meeting of a company which has a share capital, or the articles of which provide for voting by proxy at the meeting, there shall appear with reasonable prominence a statement that a member entitled to attend and vote is entitled to appoint a proxy, or, where that is allowed, one or more proxies, to attend and vote instead of himself, and that a proxy need not be a member. *[Section 105 (2)]*
- The appointment of proxy shall be in Form No. MGT-11. [*Rule 19(3)]*
- If the instrument appointing a proxy is in the prescribed Form, it 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. *[Section 105 (7)]*
- The instrument appointing a proxy shall be in writing and signed by the appointer or his attorney duly authorised in writing. If the appointer is a body corporate, the instrument shall be under its seal or be signed by an officer or an attorney duly authorised by the body corporate. *[Section 105 (6)]*
- Section 105 (4) provides that a proxy received 48 hours before the meeting will be valid even if the articles provide for a longer period.
- Section 105 (8) provides that 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 twenty-four 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 three days' notice in writing of the intention so to inspect is given to the company.

In simple words, it can be said that:

- every member entitled to vote at a meeting of the company, or on any resolution to be moved thereat, shall be entitled to inspect the proxies lodged.
- for the purpose of inspection, a minimum three days' notice in writing is required to be given to the company.
- inspection by any member can be made during the period beginning twenty-four hours before the time fixed for the commencement of the meeting and ending with the conclusion of the meeting.
- inspection can be done at any time but only during the business hours of the company.

■ **Penalty for default–**

♦ If default is made in complying with section 105 (2), every officer of the company who is in default shall be liable to penalty of five thousand rupees. *[Section 105(3)]*

♦ If for the purpose of any meeting of a company, invitations to appoint as proxy a person or one of a number of persons specified in the invitations are issued at the company's expense to any member entitled to have a notice of the meeting sent to him and to vote thereat by proxy, every officer of the company who issues the invitation as aforesaid or authorises or permits their issue, **shall be liable to a penalty of fifty thousand rupees.**

Provided that an officer shall **not be liable** under this sub-section by reason only of the issue to a member at his request in writing of a form of appointment naming the proxy, or of a list of persons willing to act as proxies, if the form or list is available on request in writing to every member entitled to vote at the meeting by proxy. *[Section 105(5)]*

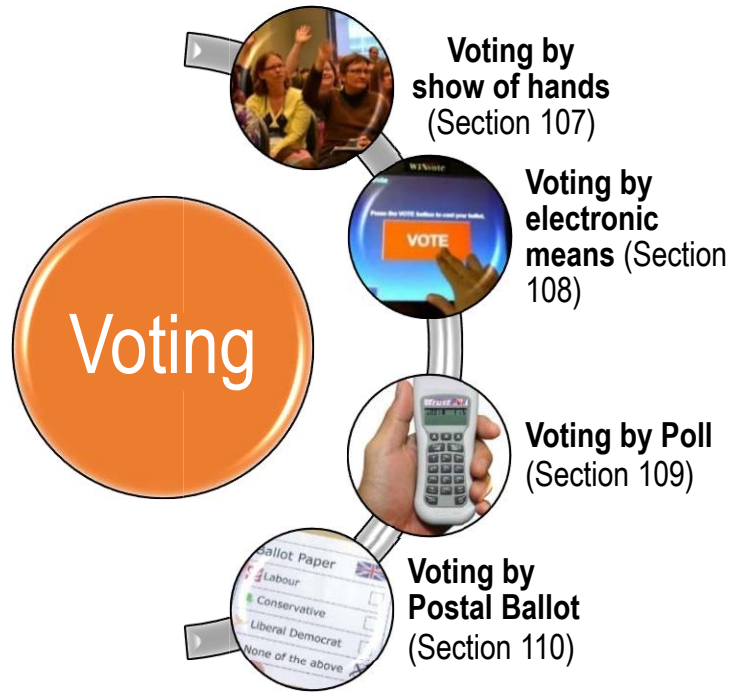
6. VOTING [SECTION 106-109]

The votes cast by the shareholders play decisive role in the business proposed in General Meetings of a company.

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 various modes through which a shareholder can cast his vote are as follows:

- Voting by show of hands – (section 107);
- Voting by electronic means – (section 108);
- Voting by demand of poll – (section 109);
- Voting by Postal Ballot – (section 110).



The right to vote is a personal right of a shareholder and he may use it as he likes it. He may split his vote for and against the resolution.

RESTRICTION ON VOTING RIGHTS [SECTION – 106][10]

Section 106 (1) indicates the supremacy of Articles of Association and specifies that 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 presently payable by him to the company have not been paid, or
- in regard to which the company has exercised any right of lien.

Section 106 (2) requires that a company shall not prohibit any member from exercising his voting rights on any other ground except the grounds mentioned as above.

On a poll taken at a meeting of a company, a member entitled to more than one vote, or his proxy, where allowed, or other person entitled to vote for him, as the case may be, need not, if he votes, use all his votes or cast in the same way all the votes he uses. *[Section 106 (3)]*

In other words, on a poll being taken at a meeting of a company, a member having more than one vote or his proxy, need not use all his votes or cast in the same way all the votes he uses.

Also, such member cannot sign a requisition for an extra-ordinary general meeting.

In case of joint shareholders, they must concur in voting unless the articles provide to the contrary. Regulation 52 of Table F states as under:

(i) In the case of joint holders, the vote of the senior who tenders a vote, whether in person or by proxy, shall be accepted to the exclusion of the votes of the other joint holders.

(ii) For this purpose, seniority shall be determined by the order in which the names stand in the register of members.

[10] **In case of Specified IFSC Public Company** - Section 106 shall apply in case of a Specified IFSC public company, unless otherwise specified in the articles of the company. *Notification No. GSR 8(E), Dated 4th January, 2017.*

Note:

Where the articles of the company do not contain any provision restricting the exercise of voting rights of members, then a member cannot be prevented from voting, even though, calls or other sums payable by him have not been paid or the company has exercised any right of lien over his shares. But, where the articles contain any such provision, and the shares forfeited for non-payment of calls have been re-allotted, the new allottee being liable for the balance, if any, remaining unpaid on the shares would not be entitled to vote so long as any calls presently payable on the shares remain unpaid.

Illustration 8

Suppose Mr. Subramaniam and Mrs. Sneha are joint shareholders of Sports Equipment Private Limited holding 500 equity shares. In respect of a particular special business being transacted at the extra-ordinary general meeting (EGM) of the company, Mr. Subramaniam is in favour of passing the resolution whereas Mrs. Sneha does not favour the resolution. Decide how should the vote be casted in case such a situation arises?

Answer:

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. The joint-holders have a right to instruct the company as to the order in which their names shall appear in the register of members. Accordingly, in case of Mr. Subramaniam and Mrs. Sneha, it is to be seen as to whose name appears first in the register of members; and then to decide whether the vote is casted in favour of resolution or against it.

Illustration 9

Consider a situation where directors are also the shareholders of the company.

Answer:

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 shall vote in the same manner as a common shareholder would have voted in a

general meeting. Therefore, while casting his vote, he is not supposed to be influenced by the fact that he is one of the directors of the company.

VOTING BY SHOW OF HANDS [SECTION 107][11]

- According to section 107 (1) of the Companies Act, 2013, unless the voting is demanded by way of poll or by electronic means, the voting shall be done by way of show of hands in the first instance.
- Section 107(2) states that the declaration by the Chairman of the meeting of the passing of a resolution or otherwise by show of hands and an entry to that effect in the minutes books shall be conclusive evidence that the resolution has been passed.

Illustration 10

Can an insolvent shareholder vote at the general meeting by show of hands?

Answer: 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 a member.

VOTING THROUGH ELECTRONIC MEANS [SECTION 108]

Section 108 of the Companies Act, 2013 has introduced the facility of e-voting in respect of prescribed classes of companies. Accordingly, the members of such companies may exercise their right to vote by electronic means.

Rule 20 of the Companies (Management & Administration) Rules, 2014 provides a detailed procedure for electronic voting.

Rule 20 (1) states that **"voting through electronic means"** shall apply in respect of the general meetings for which notices are issued on or after the date of commencement of Rule 20.

[11] **In case of Specified IFSC Public Company** - Section 107 shall apply in case of a Specified IFSC public company, unless otherwise specified in the articles of the company. *Notification No. GSR 8 (E), Dated 4th January, 2017.*

Companies required to provide its members the facility of exercising right to vote by electronic means *[Rule 20 (2)]:*

Every company which:

- has listed its equity shares on a recognised stock exchange; and

- has not less than one thousand members;

shall provide to its members facility to exercise their right to vote on resolutions proposed to be considered at a general meeting by electronic means.

Exempted entity: However, a Nidhi, or an enterprise or institutional investor referred to in Chapter XB or Chapter XC of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 is not required to provide the facility to vote by electronic means.

Explanation-I.- For the purpose of this sub-rule, "Nidhi" means a company which has been incorporated as a Nidhi with the object of cultivating the habit of thrift and savings amongst its members, receiving deposits from and lending to, its members only, for their mutual benefit, and which complies with such rules as are prescribed by the Central Government for regulation of such class of companies.

Explanation-II.- For the purposes of this rule, the expression-

- ✓ 'cut-off date' means a date not earlier than seven days before the date of general meeting for determining the eligibility to vote by electronic means or in the general meeting. [Explanation II (ii) to Rule 20(2)]
- ✓ 'cyber security' means protecting information, equipment, devices, computer, computer resource, communication device and information stored therein from unauthorised access, use, disclosures, disruption, modification or destruction;
- ✓ 'electronic voting system' means a secured system based process of display of electronic ballots, recording of votes of the members and the number of votes polled in favour or against, in such a manner that the entire voting exercised by way of electronic means gets registered and counted in an electronic registry in a centralised server with adequate cyber security. [Explanation II(iv) to Rule 20(2)]

- ✓ 'remote e-voting' means the facility of casting votes by a member using an electronic voting system from a place other than venue of general meeting. [Explanation II(v) to Rule 20(2)]
- ✓ 'secured system' means computer hardware, software, and procedure that -
  - (a) are reasonably secure from unauthorised access and misuse;
  - (b) provide a reasonable level of reliability and correct operation;
  - (c) are reasonably suited to performing the intended functions; and
  - (d) adhere to generally accepted security procedures; [Explanation II (vi) to Rule 20(2)]
- ✓ 'voting by electronic mean' includes "remote e-voting and voting" at the general meeting through an electronic voting system which may be the same as used for remote e-voting. [Explanation II (vii) to Rule 20(2)]

Exercise of right to vote through voting by electronic means by a member: A member may exercise his right to vote through voting by electronic means on resolutions and the company shall pass such resolutions in accordance with the provisions of this rule.

Procedure: Rule 20 (4) states that a company which provides the facility to its members to exercise voting by electronic means shall comply with the following procedure:

(i) Notice of meeting: The notice of the meeting 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) Placing of Notice 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) Particulars contained in Notice: The notice of the meeting shall clearly state -

(a) that the company is providing facility for voting by electronic means and the business may be transacted through such voting;

(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 be entitled to cast their vote again;

(iv) The Notice shall:

(a) indicate the process and manner for voting by electronic means;

(b) indicate the time schedule including the time period during which the votes may be cast by remote e-voting;

(c) provide the details about the login ID;

(d) specify the process and manner for generating or receiving the password and for casting of vote in a secure manner.

(v) Publication of notice:

The company shall cause a public notice by way of an advertisement to be published, immediately on completion of dispatch of notices for the meeting under clause (i) of sub-rule (4) but at least **twenty-one days** before the date of general meeting, at least once in a **vernacular newspaper** in the principal vernacular language of the district in which the registered office of the company is situated, and having a wide circulation in that district, and at least once in English language in an **English newspaper** having country-wide circulation, and specifying in the said advertisement, inter alia, 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) The manner in which persons who have acquired shares and become members of the company after the dispatch of notice may obtain the login ID and password;

(f) the statement that-

(A) remote e-voting shall not be allowed beyond the said date and time;

(B) the manner in which the company shall provide for voting by members present at the meeting;

(C) 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 in the meeting; and

(D) a person whose name is recorded in the register of members or in the register of beneficial owners maintained by the depositories as on the cut-off date only shall be entitled to avail the facility of remote e-voting as well as voting in the general meeting;

(g) website address of the company, if any, and of the agency where notice of the meeting is displayed; and

(h) name, designation, address, email id and phone number of the person responsible to address the grievances connected with facility for voting by electronic means:

Provided that the public notice shall be placed on the website of the company, if any, and of the agency;

(vi) **Time for opening of e-voting:** The facility for remote e-voting shall remain open for not less than three days and shall close at 5.00 p.m. on the date preceding the date of the general meeting;

(vii) **Option for remote e-voting:** During the period when facility for remote e-voting is provided, 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:

Provided further that 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;

(viii) When to block facility: At the end of the remote e-voting period, the facility shall forthwith 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.

(ix) Appointment of scrutinizer(s): The Board of Directors shall appoint one or more scrutinizer, who may be Chartered Accountant in practice, Cost Accountant in practice, or Company Secretary in practice 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 so appointed may take assistance of a person who is not in employment of the company and who is well-versed with the electronic voting system;

(x) Willingness of scrutinizer for appointment: the scrutinizer shall be willing to be appointed and be available for the purpose of ascertaining the requisite majority;

(xi) Role of Chairman: The Chairman shall, at the general meeting, at the end of discussion on the resolutions on which voting is to be held, allow voting, as provided in clauses (a) to (h) of sub-rule (1) of rule 21, as applicable, with the assistance of scrutinizer, by use of ballot or polling paper or by using an electronic voting system for all those members who are present at the

general meeting but have not cast their votes by availing the remote e-voting facility.

(xii) 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 two witnesses not in the employment of the company and make, not later than three 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, Scrutiniser or any other person till the votes are cast in the meeting.

(xiii) Scrutinisers to have access to details relating to members: For the purpose of ensuring that members who have cast their votes through remote e-voting do not vote again at the general meeting, the scrutiniser shall have access, after the closure of period for remote e-voting and before the start of general meeting, to details relating to members, such as their names, folios, number of shares held and such other information that the scrutiniser may require, who have cast votes through remote e-voting but not the manner in which they have cast their votes:

(xiv) Maintenance of Register by scrutinisers: The scrutiniser 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;

(xv) Safe Custody of register: The register and all other papers relating to voting by electronic means shall remain in the safe custody of the scrutiniser until the Chairman considers, approves and signs the minutes and thereafter, the scrutiniser shall hand over the register and other related papers to the company.

(xvi) Results along with the report of the scrutiniser to be placed on websites: The results declared along with the report of the scrutiniser 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:

Provided that in case of companies whose equity shares are listed on a recognised stock exchange, the company shall, simultaneously, forward the results to the concerned stock exchange or exchanges where its equity shares are listed and such stock exchange or exchanges shall place the results on its or their website.

(xvii) Date when resolution shall be deemed to be passed: Subject to receipt of requisite number of votes, the resolution shall be deemed to be passed on the date of the relevant general meeting.

Explanation: For the purposes of this clause, the requisite number of votes shall be the votes required to pass the resolution as the 'ordinary resolution' or the 'special resolution', as the case may be, under section 114 of the Companies Act, 2013.

(xviii) Resolution not to be withdrawn: A resolution proposed to be considered through voting by electronic means shall not be withdrawn.

DEMAND FOR POLL [SECTION 109][12]

Section 109 provides that before or on the declaration of 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 or on a demand made by the 'specified' members in that behalf.

- **Members who can demand for poll:**
  - In case of a company having a share capital, by the members present in person or proxy, where allowed, 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 or such higher amount as may be prescribed has been paid–up.

[12] **In case of Specified IFSC Public Company** - Section 109 shall apply in case of a Specified IFSC public company, unless otherwise specified in the articles of the company. *Notification No. 8 (E), Dated 4th January, 2017*

- In case of 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.

- **Withdrawal of demand for poll**: The demand for a poll may be withdrawn at any time by the persons who made the demand.

- **To take forthwith poll demanded for adjournment of meeting or appointment of Chairman:** A poll demanded for adjournment of the meeting or appointment of Chairman of the meeting shall be taken forthwith.

- **When to take poll demanded on any other question:** A poll demanded on any question other than adjournment of the meeting or appointment of Chairman 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.

- **Appointment of sufficient number of scrutinizers:** Where a poll is to be taken, the Chairman of the meeting shall appoint sufficient number of scrutinizers to scrutinize the poll process and votes given on poll and to report thereon to him.

- **Duties of scrutinizer:** The duties of a scrutinizer shall be as follows–
  - To ensure proper conduct of the polling process;
  - To maintain proper records of the poll;
  - To submit a report to the Chairman of the meeting which shall contain the details of votes cast in the favour and against the resolution; and
  - To ensure the compliance of the provisions of section 109 and Rule 21.

- **Power of Chairman to regulate:** The Chairman of the meeting shall have the power to regulate the manner in which the poll shall be taken.

- **Rule 21** lays down the procedure describing the manner in which the Chairman shall get the poll process scrutinized-
  - According to Rule 21 (1), the Chairman of the meeting shall ensure that –

- The Scrutinizers are provided with the Register of Members, specimen signatures of the members, Attendance Register and Register of Proxies.
- The Scrutinizers are provided with all the documents received by the Company pursuant to sections 105, 112 and section 113.
- 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 or in his absence to the joint holder attending the meeting as appearing in the chronological order in the folio and the Polling paper shall be in Form No. MGT-12.
- The Scrutinizers shall keep a record of the polling papers received in response to poll, by initialling it.
- The Scrutinizers shall lock and seal an empty polling box in the presence of the members and proxies.
- The Scrutinizers shall open the Polling box in the presence of two persons as witnesses after the voting process is over.
- In case of ambiguity about the validity of a proxy, the Scrutinizers shall decide the validity in consultation with the Chairman.
- The Scrutinizers shall ensure that if a member who has appointed a proxy has voted in person, the proxy's vote shall be disregarded.
- The Scrutinizers shall count the votes cast on poll and prepare a report thereon addressed to the Chairman.
- 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.

- ❖ 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.
- ❖ The Scrutinizers shall submit the Report to the Chairman who shall counter-sign the same.
- ❖ The Chairman shall declare the result of voting on poll. The result may either be announced by him or a person authorized by him in writing.

- ♦ The scrutinizers appointed for the poll, shall submit a report to the Chairman of the meeting in Form No. MGT-13. 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 **seven days** from the date the poll is taken. *[Rule 21 (2)]*
- ♦ The results of the poll shall be deemed to be the decision of the meeting on the resolution. *[Section 109 (7)]*

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. 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 No. 464 (E), dated 5th June, 2015 as amended by Notification No. GSR 583 (E), dated 13th June 2017]*.

POSTAL BALLOT [SECTION 110]

Section 2(65) defines the term "postal ballot" to mean voting by post or through any electronic mode.

The provisions relating to passing of resolutions by means of 'postal ballot' are contained in Section 110.

Further, Rule 22 of the *Companies (Management and Administration) Rules, 2014* contains the provisions relating to procedure to be followed for conducting business through postal ballot.

Extract of Section 110 of the Companies Act, 2013

"(1) Notwithstanding anything contained in this Act, a company—

(a) shall, in respect of such items of business as the Central Government may, by notification, declare to be transacted only by means of postal ballot; and

(b) may, in respect of any item of business, other than ordinary business and any business in respect of which directors or auditors have a right to be heard at any meeting, transact by means of postal ballot,

in such manner as may be prescribed, instead of transacting such business at a general meeting.

Provided that any item of business required to be transacted by means of postal ballot under clause (a), 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.

(2) 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."

- Section 110 seeks to provide that the Central Government may declare certain items of business that can be transacted only by postal ballot. In addition, in respect of any other item of business (except ordinary business and any business in respect of which directors or auditors have a right to be heard at any meeting) postal ballot may be used.
- Sub-section (2) of Section 110 makes a deeming provision that if a resolution is assented by requisite majority of shareholders by means of postal ballot, it shall be deemed to have been passed at a general meeting convened in that behalf.
- Manner in which postal ballot shall be conducted is prescribed in **Rule 22** of the *Companies (Management & Administration) Rules, 2014*. The same is described as under:
  - Where a company is required or decides to pass any resolution by way of postal ballot, it shall send a notice to all the shareholders, along with a draft resolution explaining the reasons therefor and requesting

them to send their assent or dissent in writing on a postal ballot because postal ballot means voting by post or through electronic means within a period of thirty days from the date of dispatch of the notice.

- The notice shall be sent either:
  - (a) by Registered Post or speed post, or
  - (b) through electronic means like registered e-mail id or
  - (c) through courier service for facilitating the communication of the assent or dissent of the shareholder to the resolution within the said period of thirty days.
- An advertisement shall be published at least once in a vernacular newspaper in the principal vernacular language of the district in which the registered office of the company is situated, and having a wide circulation in that district, and at least once in English language in an English newspaper having a wide circulation in that district, about having dispatched the ballot papers and specifying therein, inter alia, the following matters, namely:-
  - (a) a statement to the effect that the business is to be transacted by postal ballot which includes voting by electronic means;
  - (b) the date of completion of dispatch of notices;
  - (c) the date of commencement of voting;
  - (d) the date of end of voting;
  - (e) the statement that any postal ballot received from the member beyond the said date will not be valid and voting whether by post or by electronic means shall not be allowed beyond the said date;
  - (f) a statement to the effect that members, who have not received postal ballot forms may apply to the company and obtain a duplicate thereof; and

(g) contact details of the person responsible to address the grievances connected with the voting by postal ballot including voting by electronic means.

- The notice of the postal ballot shall also be placed on the website of the company forthwith after the notice is sent to the members and such notice shall remain on such website till the last date for receipt of the postal ballots from the members.
- 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 shall be willing to be appointed and be available for the purpose of ascertaining the requisite majority.
- Postal ballot received back from the shareholders shall be kept in the safe custody of the scrutinizer and after the receipt of assent or dissent of the shareholder in writing on a postal ballot, no person shall deface or destroy the ballot paper or declare the identity of the shareholder.
- 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.
- The scrutinizer shall maintain a register either manually or electronically to record their assent or dissent received, mentioning the particulars of name, address, folio number or client ID of the shareholder, number of shares held by them, nominal value of such shares, whether the shares have differential voting rights, if any, details of postal ballots which are received in defaced or mutilated form and postal ballot forms which are invalid.
- 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.

- The assent or dissent received after thirty days from the date of issue of notice shall be treated as if reply from the member has not been received.
- The results shall be declared by placing it, along with the scrutinizer's report, on the website of the company.
- The provisions of rule 20 regarding voting by electronic means shall apply, as far as applicable, mutatis mutandis to this rule in respect of the voting by electronic means.
- pursuant to clause (a) of sub-section (1) of section 110, the following items of business shall be transacted only by means of voting through a postal ballot—

  (a) alteration of the objects clause of the memorandum and in the case of the company in existence immediately before the commencement of the Act, alteration of the main objects of the memorandum;

  (b) alteration of articles of association in relation to insertion or removal of provisions which, under sub-section (68) of section 2, are required to be included in the articles of a company in order to constitute it a private company;

  (c) change in place of registered office outside the local limits of any city, town or village as specified in sub-section (5) of section 12;

  (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 under sub-section (8) of section 13;

  (e) issue of shares with differential rights as to voting or dividend or otherwise under sub-clause (ii) of clause (a) of section 43;

  (f) variation in the rights attached to a class of shares or debentures or other securities as specified under section 48;

  (g) buy-back of shares by a company under sub-section (1) of section 68;

(h) election of a director under section 151 of the Act;

(i) sale of the whole or substantially the whole of an undertaking of a company as specified under sub-clause (a) of sub-section (1) of section 180;

(j) giving loans or extending guarantee or providing security in excess of the limit specified under sub-section (3) of section 186:

Provided that any aforesaid items of business under this sub-rule, required to be transacted by means of postal ballot, 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.

Provided further that One Person Companies and other companies having members upto two hundred are not required to transact any business through postal ballot.

How does the counting happen at the time of postal ballot?

It is important to know here that, a member who is voting by way of postal ballot, has votes in proportion to his share in the paid-up share capital of the company. And in this regard, he need not use all his votes in the same way. Therefore, following types of postal ballots may be received from the shareholders–

(i) Ballots which contain assents;

(ii) Ballots which contain dissents;

(iii) Ballots wherein the member has voted partially assenting, partially dissenting or using not all his shares in any particular way; and

(iv) Invalid ballots (due to absence/mismatch of signature, overwriting, etc.)

The postal ballots shall be segregated as per the above criteria and resolution shall be deemed as passed if assents are greater in number.

7. CIRCULATION OF MEMBERS' RESOLUTIONS [SECTION 111]

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.

(1) Prerequisites of a valid Requisition: The prerequisites for a valid requisition prescribed in sub-section (2) of section 111 are as under:

(a) Requisition must be made in writing and signed

(i) in the case of a company having a share capital, such number of members who hold, on the date of the receipt of the requisition, 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;

(ii) in the case of a company not having a share capital, such number of members who have, on the date of receipt of the requisition, not less than one-tenth of the total voting power of all the members having on the said date a right to vote.

(b) Two or more copies of the said requisition are required to contain signatures of all the requisitionists.

(c) The requisition must be deposited at the registered office of the company not less than six weeks before the meeting in the case of a requisition requiring notice of a resolution. In case of other resolutions, the same is to be deposited not less than two weeks before the meeting.

(d) A sum reasonably sufficient to meet the company's expenses in giving effect to proposing the resolution is deposited or tendered. When the money is tendered, no payment is made but an unconditional offer is made to pay money.

The proviso to sub-section (2) of section 111 provides that the time period provided above need not be complied with in case an annual general meeting is called on a date within six weeks after the copy has been

deposited. The copy of requisition, in such a case, shall be deemed to have been properly deposited for the purposes thereof although not deposited within the time required by this sub-section. The company is not duty bound to circulate the notice of the resolution when the prerequisites are not complied with.

(2) **Notice to members:** As per section 111 of the Companies Act, 2013, a company shall, on requisition in writing of such number of members, as required in section 100 (calling of EGM), give notice to members of any resolution which may properly be moved and is intended to be moved at a meeting; and circulate to members any statement with respect to the matters referred to in proposed resolution or business to be dealt with at that meeting.

(3) **Exemption from circulation of any statement:** The Company shall not be bound to circulate any statement, if on the application either on behalf of the company or of any other person who claims to be aggrieved, the [13]Central Government, by order, declares that the rights conferred are being abused to secure needless publicity for defamatory matter.

(4) **Order to bear the cost:** An order made as above by the Central Government may also direct that the cost incurred by the company shall be paid to the company by the requisitionists, notwithstanding that they are not parties to the application.

(5) **Default in complying with the provisions:** If any default is made in complying with the provisions of this section, the company and every officer of the company who is in default shall be liable to a penalty of twenty-five thousand rupees.

8. REPRESENTATION OF THE PRESIDENT & GOVERNORS IN MEETING OF COMPANIES TO WHICH THEY ARE MEMBER [SECTION 112]

Section 112 of the Companies Act, 2013 provides that 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

[13] The Power of the Central Government has been delegated to Regional Director. *MCA Notification 4090 (E) dated 19th December, 2016.*

person shall be entitled to exercise the same rights and powers including the right to vote by proxy and postal ballot, as the President or, as the case may be, the Governor could exercise as a member of the company.

9. REPRESENTATIONS OF CORPORATIONS MEETING OF COMPANIES AND CREDITORS [SECTION 113]

Section 113 of the Companies Act, 2013 seeks to provide that 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.

10. RESOLUTIONS [SECTION 114–117]

In lay man's language, a resolution is the formal decision of an organization while transacting a business at a meeting. A motion which has obtained the necessary majority vote in its favour becomes a resolution. When a resolution is passed, a company is bound by it.

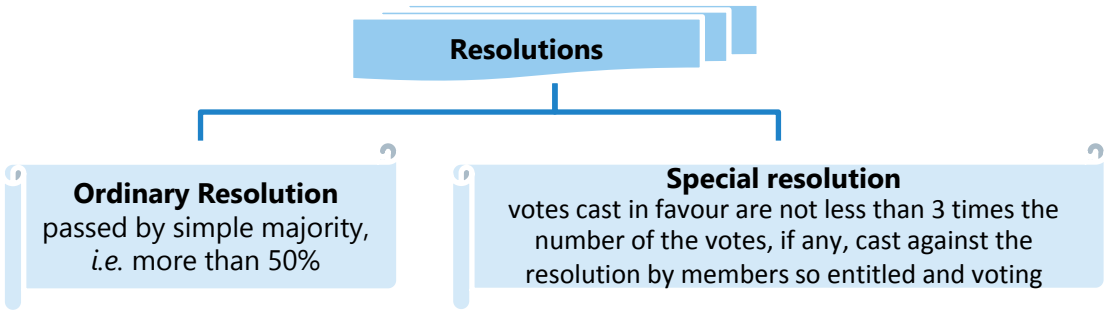
Difference between Motion and Resolution—

- Most matters come before a meeting by way of a motion recommending that the meeting may express approval or disapproval or take certain action or order something to be done.
- A motion is a proposal, and a resolution is the adoption of a motion duly made and seconded. But every motion need not be followed by a resolution, e.g. where a motion is made for the adjournment of the meeting.
- A motion whether it is passed for the closure of discussion or adjournment, etc. can be passed by an ordinary resolution unless there is a specific provision in the articles.

ORDINARY AND SPECIAL RESOLUTION [SECTION 114]

As per the Companies Act, 2013, resolutions are of two types–

- Ordinary Resolutions – which are passed by simple majority; and
- Special Resolutions – votes cast in favour are not less than 3 times the number of the votes, if any, cast against the resolution by members so entitled and voting



Section 114 of the Companies Act, 2013 states as to what constitutes an Ordinary Resolution and a Special Resolution.

Ordinary Resolution

Section 114(1) states that a resolution shall be ordinary resolution, if the notice required under this Act has been duly given and it is required to be passed by the votes cast, whether on a show of hands, or electronically or on a poll, as the case may be, in favour of the resolution, including the casting vote, if any, of the Chairman, by members, who, being entitled so to do, vote in person, or where proxies are allowed, by proxy or by postal ballot, 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.

Special Resolution

As per Section 114(2) of the Act, a resolution shall be a special resolution, when–

(a) The intention to propose the resolution as a special resolution has been duly specified in the notice calling the general meeting or other intimation given to the members of the resolution;

(b) The notice required under this Act has been duly given; and

(c) The votes cast in favour of the resolution, whether on a show of hands, or electronically or on a poll, as the case may be, by members who, being entitled so to do, vote in person or by proxy or by postal ballot, are required to be not less than 3 times the number of the votes, if any, cast against the resolution by members so entitled and voting.

Characteristics of Special Resolution—

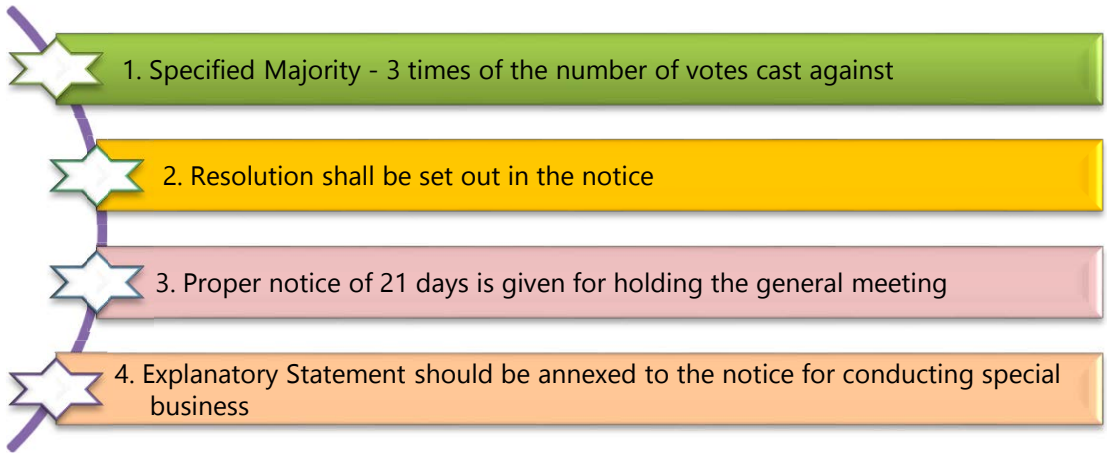


Illustration 11

The Annual General Meeting of Super Star Bakers Limited was attended by 60 members. In respect of a particular business, the resolution was to be passed as a special resolution. Ten members voted against the resolution whereas five abstained themselves from the voting. The Chairman of the meeting Mr. Ravinder declared that the resolution was passed as a special resolution. Whether the declaration is valid.

Answer: In case of a special resolution, the requirement is that the votes cast in favour of the resolution must be three times the number of the votes cast against it. In the above case, ten members voted against the resolution which implies that minimum thirty members (three times of ten) must vote in favour of the resolution. Ignoring five members who abstained themselves from voting, forty-five members (sixty minus ten minus five) voted in favour of the resolution which far exceeds the required majority of thirty members. Therefore, declaration by Mr. Ravinder, Chairman of the meeting, that the resolution was passed as a special resolution is valid.

Illustration 12

In the annual general meeting of Steel Products 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.

Answer: 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 decides 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.

Where notice has been given of several resolutions, each resolution must be put separately. However, if the meeting unanimously adopts all the resolutions, this would be immaterial.

RESOLUTIONS REQUIRING SPECIAL NOTICE [SECTION 115]

Section 115 of the Companies Act, 2013 read with rule 23 of Companies (Management and Administration) Rules, 2014 deals with resolutions requiring special notice

According to Section 115 where, by any provision contained in this Act or in the Articles of a company, special notice is required for passing any resolution, then the notice of the intention to move such resolution shall be given to the company by such number of members holding not less than 1% of the total voting power, or holding shares on which such aggregate sum not exceeding five lakh rupees, as may be prescribed, has been paid-up.

Special notice for passing a resolution is required in the following cases –

(a) Resolution for appointment of an auditor other than the retiring auditor at an annual general meeting. [Section 140 (4)]

(b) Resolution at an annual general meeting providing expressly that a retiring auditor shall not be re-appointed. [Section 140 (4)]

(c) Resolution to remove a director before the expiry of his period of office. [Section 169 (2)]

(d) Resolution to appoint another person as director in place of the removed director at the meeting at which he is removed. [(Section 169 (2)]

Further, the articles may provide for certain additional matters which require special notice.

Rule 23 specifies the procedure to be followed in respect of Special Notice as under:

1. 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 one percent of total voting power or holding shares on which an aggregate sum of not less than 5,00,000 rupees has been paid up on the date of the notice.

2. The afore-mentioned notice shall be sent by members to the company not earlier than 3 months but at least 14 days before the date of 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.

3. The company shall immediately after receipt of the notice, give its members notice of the resolution at least seven 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.

4. 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, both having wide circulation in the State where the registered office of the Company is situated and such notice shall also be posted on the website, if any, of the Company.

5. The notice shall be published at least seven 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 of the Companies act, 2013, where a resolution is passed at an adjourned meeting of:

(a) a company; or

(b) the holders of any class of shares in a company; or

(c) the Board of Directors of a company,

the resolution shall be treated as having been passed on the day on which it was actually passed and not on any earlier date.

Example

The extra-ordinary general meeting of the company, Purple Cosmetics Private Limited was due to be held on Thursday, 23rd June, 2022. However, due to want of quorum, the meeting was adjourned to a later date on Thursday, 30th June, 2022 and two resolutions were passed on that date.

According to section 116 of the Companies Act, 2013, the said two resolutions shall be deemed to have been passed on the adjourned date of meeting, *i.e.* Thursday, 30th June, 2022 and not on the earlier date.

RESOLUTIONS AND AGREEMENTS TO BE FILED [SECTION 117]

Section 117[14&15] **of the Companies Act, 2013** provides that a copy of every resolution or any agreement, in respect of matters specified in sub-section (3) together with the explanatory statement under section 102, if any, annexed to the notice calling the meeting in which the resolution is proposed, shall be filed with the Registrar within thirty days of the passing or making thereof in such manner and with such fees as may be prescribed.

Provided that the copy of every resolution which has the effect of altering the articles and the copy of every agreement referred to in sub-section (3) shall be

[14] **In case of Specified IFSC Public Company** - Sub-section (1) of section 117, for the words "thirty days" read as "sixty days". *Notification No. GSR 8 (E), Dated 4th January, 2017.*

[15] **In case of Specified IFSC Private Company** - Sub-section (1) of section 117, for the words "thirty days" read as "sixty days". *Notification No. GSR 9 (E), Dated 4th January, 2017.*

embodied in or annexed to every copy of the articles issued after passing of the resolution or making of the agreement.

According to Rule 24 of the *Companies (Management and Administration) Rules, 2014*, a copy of every resolution or any agreement required to be filed, together with the explanatory statement under section 102, if any, shall be filed with the Registrar in **Form No. MGT-14** along with the fee.

Resolutions and agreements to be filed with the Registrar as per Section 117 (3) are as under: –

- Special Resolutions
- Resolutions which have been agreed to 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;
- Any resolution of the Board of Directors of a company or agreement executed by a company, relating to the appointment, re-appointment or renewal of the appointment, or variation of the terms of appointment, of a managing director;
- Resolutions or agreements which have been agreed to 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 or otherwise in some particular manner; and all resolutions or agreements which effectively bind such class of members though not agreed to by all those members.
- Resolutions requiring a company to be wound up voluntarily passed in pursuance of section 59 of the Insolvency and Bankruptcy Code, 2016.
- [16] & [17]Resolutions passed in pursuance of sub-section (3) of section 179.

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[16] **In case of a private company** - clause (g) of Sub-section 3 of Section 117 shall not apply.
The above mentioned exemption 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 with the Registrar- *Notification No. GSR 464 (E), dated 5th June, 2015 as amended by Notification No. GSR 583 (E), dated 13th June, 2017.*

[17] **In case of Specified IFSC Public Company** - Clause (g) of sub-section (3) of section 117 shall not apply. *Notification No. GSR 8 (E), Dated 4th January, 2017.*

Provided that no person shall be entitled under section 399 to inspect or obtain copies of such resolutions;

Provided further that nothing contained in this clause shall apply in respect of a resolution passed to grant loans, or give guarantee or provide security in respect of loans under clause (f) of sub-section (3) of section 179 in the ordinary course of its business by,—

(a) a banking company;

(b) any class of non-banking financial company registered under Chapter IIIB of the Reserve Bank of India Act, 1934, as may be prescribed in consultation with the Reserve Bank of India;

(c) any class of housing finance company registered under the National Housing Bank Act, 1987, as may be prescribed in consultation with the National Housing Bank; and

- any other resolution or agreement as may be prescribed and placed in the public domain.

Penalty for contravention [Section 117(2)]

If any company fails to file the resolution or the agreement under sub-section (1) before the expiry of the period specified therein, such company shall be liable to a penalty of ten thousand rupees and in case of continuing failure, with a further penalty of one hundred rupees for each day after the first during which such failure continues, subject to a maximum of two lakh rupees and every officer of the company who is in default including liquidator of the company, if any, shall be liable to a penalty of ten thousand rupees and in case of continuing failure, with a further penalty of one hundred rupees for each day after the first during which such failure continues, subject to a maximum of fifty thousand rupees.

11. MINUTES (SECTION 118)

- Section 118 of the Companies Act, 2013, states that every company shall prepare, sign and keep minutes of every general meeting of any class of shareholders or creditors, including the meeting called by the requisitionists, and every resolution passed by postal ballot and every meeting of its Board of Directors or of every committee of the Board, within 30 days of the conclusion of every such meeting concerned, or passing of resolution by

postal ballot in books kept for that purpose with their pages consecutively numbered. *[Sub-section (1)]*[18 & 19]

- The minutes of each meeting shall contain a fair and correct summary of the proceedings that took place at the concerned meeting.
- All appointments made at any of the meetings aforesaid shall be included in the minutes of the meeting.
- In the case of a Board Meeting or a meeting of a committee of the Board, the minutes shall also contain–
  - the names of the directors present at the meeting; and
  - in the case of each resolution passed at the meeting, the names of the directors, if any, dissenting from, or not concurring with the resolution.
- There shall not be included in the minutes, any matter which, in the opinion of the Chairman of the meeting–
  - is or could reasonably be regarded as defamatory of any person; or
  - is irrelevant or immaterial to the proceedings; or
  - is detrimental to the interests of the company.
- The matter to be included or excluded in the minutes of the meetings on the afore-said grounds shall be at the absolute discretion of the Chairman of the meeting.

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[18] **In case of Specified IFSC Public Company** - In Sub-section (1) of section 118, the following proviso shall be inserted, namely:-
"Provided that in case of a Specified IFSC public company, the minutes of every meeting of its Board of Directors or of every committee of the Board, to be prepared and signed in the manner as may be prescribed under sub section (1) at or before the next Board or committee meeting, as the case may be and kept in books kept for that purpose.".- *Notification Date 4th January, 2017*

[19] **In case of Specified IFSC Private Company** - In Sub-section (1) of section 118, the following proviso shall be inserted, namely:-
"Provided that in case of a Specified IFSC private company, the minutes of every meeting of its Board of Directors or of every committee of the Board, to be prepared and signed in the manner as may be prescribed under sub section (1) at or before the next Board or committee meeting, as the case may be and kept in books kept for that purpose.".- *Notification Date 4th January, 2017*

- The minutes kept in accordance with the provisions of Section 118 shall serve as the evidence of the proceedings recorded therein.
- Where the minutes have been kept in accordance with Section 118 (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.
- No document, purporting to be a report of the proceedings of any general meeting of a company shall be circulated or advertised at the expense of the company, unless it includes the matters requires by this section to be contained in the minutes of the proceedings of such meeting.
- Every company shall observe Secretarial Standards with respect to general and Board meetings, specified by the Institute of Company Secretaries of India and approved as such by the Central Government.[20 & 21] *[Section 118 (10)]*
- **Penalty for contravention–**
  - 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 ₹ 25,000 and every officer of the company who is in default shall be liable to a penalty of ₹ 5,000.
  - If a person is found guilty of tampering with the minutes of the proceedings of the 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 ₹ 25,000 but which may extend to ₹ 1,00,000.

Rule 25 of the Companies (Management & Administration) Rules, 2014 prescribes the procedure for maintenance of minutes of proceedings of general meeting, meeting of Board of Directors and other meetings and resolutions passed by postal ballot as follows–

- *Distinct minute books to be maintained for each type of meeting:* A distinct minute book shall be maintained for each type of meeting namely:

[20] **In case of Specified IFSC Public Company**- Sub-section (10) of section 118 Shall not apply. - Notification No. GSR 8 (E), Dated 4th January, 2017.

[21] **In case of Specified IFSC Private Company**- Sub-section (10) of section 118 Shall not apply. - Notification No. GSR 9 (E), Dated 4th January, 2017

(i) general meetings of the members;

(ii) meetings of the creditors

(iii) meetings of the Board; and

(iv) meetings of each of the committees of the Board.

Note: Resolutions passed by postal ballot shall be recorded in the minute book of general meetings as if it has been deemed to be passed in the general meeting.

- *Maximum time allowed for entering minutes of proceedings:* The minutes of proceedings of each meeting shall be entered in the books maintained for that purpose along with the date of such entry within thirty days of the conclusion of the meeting.
- *Data to be entered when a resolution is passed by Postal Ballot:* In case of every resolution passed by postal ballot, a brief report on the postal ballot conducted including the resolution proposed, the result of the voting thereon and the summary of the scrutinizer's report shall be entered in the minutes book of general meetings along with the date of such entry within thirty days from the date of passing of resolution.
- *Signing of Minute Books:* 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–

(i) in the case of minutes of proceedings of a meeting of the Board or of a committee thereof, by the chairman of the said meeting or the Chairman of the next succeeding meeting;

(ii) 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 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 thirty 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.

- *Place of keeping minute books of general meetings and their preservation*: The minute books of general meetings shall be kept at the registered office of the company and shall be preserved permanently and kept in the custody of the company secretary or any director duly authorised by the board.
- *Place of keeping minute books of Board and committee meetings and their preservation:* The minute books of the Board and committee meetings shall be preserved permanently and kept in the custody of the company secretary of the company or any director duly authorized by the Board for the purpose and shall be kept in the registered office or such place as Board may decide.

Exemption to Section 8 companies: In case of section 8 companies (companies formed with charitable objects, etc.), section 118 shall not apply as a whole except that minutes may be recorded within 30 days of the conclusion of every meeting in case of companies where the articles of association provide for confirmation of minutes by circulation.

The exceptions, modifications and adaptations, shall be applicable to a section 8 company which has not committed a default in filing its financial statements under 137 or Annual Return under section 92 with the Registrar. *Notification No. GSR 466 (E), dated 5th June, 2015 as amended by Notification No. GSR 584 (E), dated 13th June, 2017.*

12. INSPECTION OF MINUTES-BOOKS OF GENERAL MEETING [SECTION 119]

Section 119 of the Companies Act, 2013 contains the provisions in respect of inspection of minute-books of general meeting.

Accordingly, the books containing the minutes of the proceedings of any general meeting of a company shall–

- be kept at the registered office of the company; and

- be open for inspection, during business hours, by any member, without charge, subject to such reasonable restrictions as specified in the articles of the company or as imposed in the general meeting. However, at least 2 hours in each business day shall be allowed for inspection *[Section 119 (1)]*.

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. *[Section 119 (2)]*.

In other words, within 7 working days of making a request along with the requisite fees, the member shall be furnished with a copy of any minutes.

Penalty for contravention *[Section 119 (3)]*

If any inspection under sub-section (1), is refused by the company to the member, or if the copy of minute-book is not furnished within the time specified under sub-section (2), then the company shall be liable to a penalty of ₹ 25,000 and every officer of the company who is in default shall be liable to a penalty of ₹ 5,000 for each such refusal or default, as the case may be.

Power of Tribunal to order inspection *[Section 119 (4)]*

In case of any such refusal or default, the Tribunal may, without prejudice to any action being taken under sub-section (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.

Copy of minute book of general meeting *[Rule 26]*

Any member shall be entitled to be furnished, within seven working days after he has made a request in that behalf to the company, with a copy of any minutes of any general meeting, on payment of such sum as may be specified in the articles of association of the company, but not exceeding a sum of ten rupees for each page or part of any page:

Provided that a member who has made a request for provision of soft copy in respect of minutes of any previous general meetings held during a period immediately preceding three financial years shall be entitled to be furnished, with the same free of cost.

MAINTENANCE AND INSPECTION OF DOCUMENTS IN ELECTRONIC FORM [SECTION 120]

Section 120 of the Companies Act, 2013 seeks to provide that any document, record, register or minute, etc., required to be kept by a company or allowed to be inspected or copies 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 may be prescribed.

Provisions prescribed in *Rules 27, 28 and 29 of the Companies (Management and Administration) Rules, 2014* are relevant in this respect. *Rule 30* states the penalty in case of contravention.

Companies which may maintain records in electronic form: Rule 27 of the Companies (Management and Administration) Rules, 2014 states as under:

- Every listed company or a company having at least 1000 shareholders, debenture-holders and other security holders, may maintain its records, as required to be maintained under the Act or rules made thereunder, in **electronic form**.

  Explanation.- For the purposes of this sub- rule, it is hereby clarified that in case of existing companies, data 1[may] be converted from physical mode to electronic mode within six months from the date of notification of provisions of section 120 of the Act.

- The records in electronic form shall be maintained in such manner as the Board of directors may think fit:

  Provided that -

  (a) the records are maintained in the same formats and in accordance with all other requirements as provided in the Act or the rules made thereunder;

  (b) the information as required under the provisions of the Act or the rules made thereunder 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 under the provisions of the Act or the rules made thereunder;

(e) the records, once dated and signed digitally, shall not be capable of being edited or altered;

(f) the records shall be capable of being updated, according to the provisions of the Act or the rules made thereunder, 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 thereunder to be kept by a company.

Who is responsible for the maintenance and security of electronic records: *Rule 28* sets out that the Managing Director, Company Secretary or any other director or officer of the company as the Board may decide shall be responsible for the maintenance and security of electronic records.

The person who is responsible for the maintenance and security of electronic records shall-

(a) provide adequate protection against unauthorized access, alteration or tampering of records;

(b) ensure against loss of the records as a result of damage to, or failure of the media on which the records are maintained;

(c) ensure that the signatory of electronic records does not repudiate the signed record as not genuine;

(d) ensure that computer systems, software and hardware are adequately secured and validated to ensure their accuracy, reliability and consistent intended performance;

(e) ensure that the computer systems can discern invalid and altered records;

(f) ensure that records are accurate, accessible, and capable of being reproduced for reference later;

(g) ensure that the records are at all times capable of being retrieved to a readable and printable form;

(h) ensure that records are kept in a non-rewritable and non-erasable format like pdf. version or some other version which cannot be altered or tampered;

(i) ensure that at least one backup, taken at a periodicity of not exceeding one day, are kept of the updated records kept in electronic form, every backup is authenticated and dated and such backups shall be securely kept at such places as may be decided by the Board;

(j) limit the access to the records to the managing director, company secretary or any other director or officer or persons performing work of the company as may be authorized by the Board in this behalf;

(k) ensure that any reproduction of non-electronic original records in electronic form is complete, authentic, true and legible when retrieved;

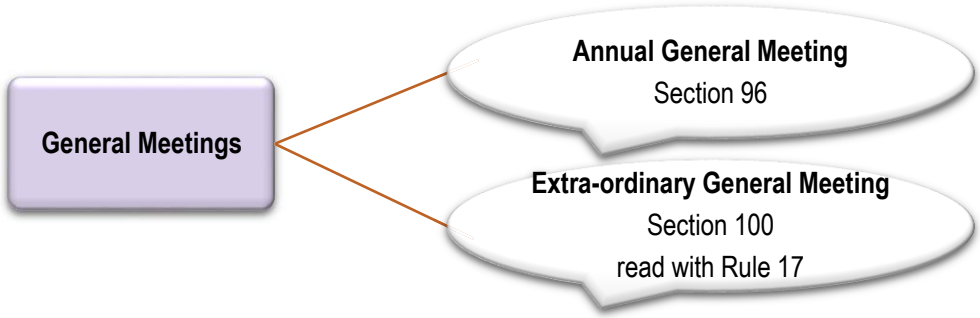
(l) arrange and index the records in a way that permits easy location, access and retrieval of any particular record; and

(m) take necessary steps to ensure security, integrity and confidentiality of records.

Inspection and copies of records maintained in electronic form: *Rule 29* states that the records maintained in electronic form shall be made available for inspection by the company in electronic form. Copies of the records maintained in electronic form, containing a clear reproduction of the whole or part thereof, shall be provided on payment of not exceeding ₹ 10 per page.

13. GENERAL MEETINGS

Now that we have understood the basic terms which are required to call, convene and conduct the meetings properly, let us discuss the provisions related to meetings given in the Companies Act, 2013. The Act describes two types of general meetings to be held by a company. They are–



ANNUAL GENERAL MEETING (AGM) [SECTION 96]

- Section 96(1) of the Companies Act, 2013 states that every company, whether public or private, except One Person Company, shall hold an annual general meeting every year and that the gap between two AGMs shall not be more than 15 months.
- The company shall specify the meeting as such [*i.e.* Annual General Meeting (AGM)] in the notices calling it.

Holding of Annual General Meeting (AGM)

- Annual general meeting should be held once every year.
- 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.
- Subsequent annual general meetings of the company should be held within 6 months from the closing of the financial year.
- The gap between two annual general meetings should not exceed 15 months.

Extension of validity period of AGM

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.

Illustration 13

Abbeys Grocers Private Limited closed its financial year on 31st March, 2022. When should it hold is Annual General Meeting (AGM) for the financial year 2021-22?

Answer: According to section 96 (1) of the Companies Act, 2013, Abbeys Grocers Private Limited should hold its annual general meeting for the financial year 2021-22 latest by 30th September 2022 unless an extension is granted by jurisdictional Registrar of Companies for any special reason.

Illustration 14

Abbyrush Mechanics Limited was incorporated on 12th July, 2022. When should the company hold its first Annual General Meeting (AGM)?

Answer: In the above case, the financial year of Abbyrush Mechanics Limited will close on 31st March, 2023. According to section 96 (1),the company must hold its first AGM latest by 31st December 2023 *i.e.* within 9 months of the close of its financial year on 31st March 2023. If Abbyrush Mechanics Limited holds its first AGM in this manner, it shall not be necessary for the company to hold any AGM in the year of its incorporation.

Time and place for holding an annual general meeting: Section 96 (2) states that every annual general meeting shall be called during business hours, *i.e.*, 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 annual general meeting 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.

Provided further that the Central Government may exempt any company from the provisions of this sub-section subject to such conditions as it may impose.

Explanation—For the purposes of this sub-section, "National Holiday" means and includes a day declared as National Holiday by the Central Government.

Exemption to Section 8 companies:

In case of Section 8 company- In Sub-section (2) of Section 96 after the proviso and before the explanation the following proviso shall be inserted;

Provided further that the time, date and place of each annual general meeting are decided upon before-hand by the board of directors having regard to the directions, if any, given in this regard by the company in its general meeting. - *Notification No. GSR 466 (E), dated 5th, June 2015.*

The above-mentioned exception shall be applicable to a section 8 company which has not committed a default in filing of its financial statements under section 137 or annual return under section 92 with the Registrar. - *Notification No. GSR 584 (E), dated 13th June, 2017.*

Exemption to Government companies:

In case of Government company, section 96(2) shall be read as:

'Every annual general meeting 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 such other place within the city, town or village in which the registered office of the company is situate or such other place as the Central Government may approve in this behalf. *Notification No. GSR 463 (E), dated 5th June, 2015 read with Notification Dated 13th June, 2017*

The above-mentioned exception/ modification/ adaptation shall be applicable to Government company which has not committed a default in filing of its financial statements under section 137 or annual return under section 92 with the Registrar. - *Notification No. GSR 582 (E), dated 13th June, 2017'*.

POWER OF TRIBUNAL TO CALL ANNUAL GENERAL MEETING [SECTION 97]

In case a company defaults in holding Annual General Meeting, then Section 97 of the Companies Act, 2013 empowers Tribunal to call AGM. The provisions of Section 97 are as under:

(1) If any default is made in holding the annual general meeting 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 annual general meeting, in any manner in which meetings of the

company may be called, or to hold or conduct the meeting of the company in the manner prescribed by this Act or the articles of the company, the Tribunal may, either *suo motu* 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.

PUNISHMENT FOR DEFAULT IN COMPLYING WITH THE PROVISIONS OF SECTION 96 TO 98 [SECTION 99]

Section 99 lists out the punishment for contravention of section 96 to 98.

Accordingly, if any default is made in holding a meeting of the company in accordance with section 96 (*i.e.* AGM) or section 97 (*i.e.* AGM called by Tribunal) or section 97 (a meeting of members other than AGM called by Tribunal) or in complying with any the directions issued by the Tribunal, then the company and every officer of the company who is in default shall be punishable with fine which may extend to ₹ 1,00,000 and in the case of a continuing default, with a further fine which may extend to ₹ 5,000 for every day during which the default continues.

REPORT ON ANNUAL GENERAL MEETING [SECTION 121]

According to Section 121 of the Companies Act, 2013, every listed public company shall prepare a report on each annual general meeting including the confirmation to the effect that the meeting was convened, held and conducted as per the provisions of the Act and the rules made thereunder.

A copy of the report is to be filed with the Registrar in Form No. MGT-15 within thirty days of the conclusion of AGM along with the prescribed fee. According to Rule 31 of the *Companies (Management and Administration) Rules, 2014,* the report shall be prepared in the following manner:

(a) the report under this section shall be prepared in addition to the minutes of the general meeting;

(b) the report shall be signed and dated by the Chairman of the meeting or in case of his inability to sign, by any two directors of the company, one of whom shall be the Managing Director, if there is one and company secretary of the company;

(c) the report shall contain the details in respect of the following, namely:-

  (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 thereunder 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, postponement of meeting, change in venue; and

  (viii) any other points relevant for inclusion in the report.

(d) the report shall contain fair and correct summary of the proceedings of the meeting.

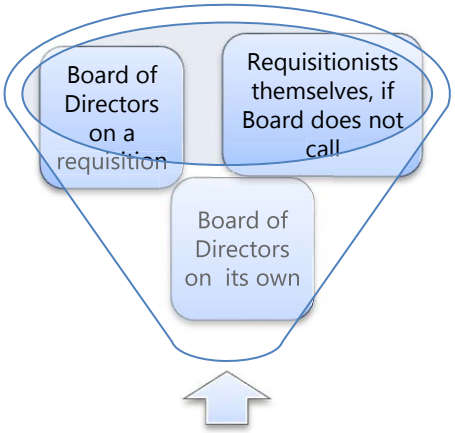
Penalty for default : If the company fails to file the report within 30 days of conclusion of AGM, such company shall be liable to a penalty of one lakh rupees and in case of continuing failure, with further penalty of five hundred rupees for each day after the first during which such failure continues, subject to a maximum of five lakh rupees and every officer of the company who is in default shall be liable to a penalty which shall not be less than twenty-five thousand rupees and in

case of continuing failure, with further penalty of five hundred rupees for each day after the first during which such failure continues, subject to a maximum of one lakh rupees.

EXTRA-ORDINARY GENERAL MEETINGS [SECTION 100]

All general meetings other than annual general meetings are called extra-ordinary general meetings (EGMs). Section 100 of the Companies Act, 2013 contains provisions regarding the calling of EGMs.

Calling of EGM



Who can call EGM

[22] & [23]1. **By Board of Directors on its own -**

The Board may, whenever it deems fit, call an extraordinary general meeting of the company.

[22] **In case of Specified IFSC Private Company** - In sub-section (1) of section 100, the following proviso shall be inserted, namely:-
"Provided that in case of a Specified IFSC private company, the Board may subject to the consent of all the shareholders, convene its extraordinary general meeting at any place within or outside India.".- *Notification No. 9 (E), Dated 4th January, 2017*.

[23]**In case of Specified IFSC Public Company**- In sub-section (1) of section 100, the following proviso shall be inserted, namely:-
"Provided that in case of a Specified IFSC public company, the Board may subject to the consent of all the shareholders, convene its extraordinary general meeting at any place within or outside India.". *Notification No. GSR 8 (E), Dated 4th January, 2017*.

Provided that an extraordinary general meeting of the company, other than of the wholly owned subsidiary of a company incorporated outside India, shall be held at a place within India. *[Section 100 (1)]*

2. **By the Board of Directors at the requisition of** –

(a) In the case of company having a share capital, such number of members who hold, on the date of receipt of requisition, at least 1/10th of such paid-up share capital of the company as on that date carries the right of voting;

(b) In the case of company not having a share capital, such number of members who have, on the date of receipt of requisition, at least 1/10th of total voting power of all the members having on the said date a right to vote. *[Section 100 (2)]*

The requisition 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. *[Section 100 (3)]*

Note: The Board must, within 21 days from the date of receipt of a valid requisition, proceed to call a meeting on a day not later than 45 days from the date of receipt of such requisition.

3. **By requisitionists themselves:** If the Board does not, within twenty-one 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 forty-five days from the date of receipt of such requisition, the meeting may be called and held by the requisitionists themselves within a period of three months from the date of the requisition. *[Section 100 (4)]*

A meeting under sub-section (4) by the requisitionists shall be called and held in the same manner in which the meeting is called and held by the Board. *[Section 100 (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. *[Section 100 (6)]*

Rule 17 of the *Companies (Management and Administration) Rules, 2014* contain provisions with regard to calling of EGM by requisitionists as under:

(1) The members may requisition convening of an extraordinary general meeting in accordance with sub-section (4) of section 100, by providing such requisition in writing or through electronic mode at least clear twenty-one days prior to the proposed date of such extraordinary general meeting.

(2) 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.- For the purposes of this sub-rule, it is hereby clarified that requisitionists 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.

(3) If the resolution is to be proposed as a special resolution, the notice shall be given as required by sub-section (2) of section 114.

(4) The notice shall be signed by all the requisitionists or by a requisitionist duly authorised in writing by all other requisitionists on their behalf or by sending an electronic request attaching therewith a scanned copy of such duly signed requisition.

(5) No explanatory statement as required under section 102 need be annexed to the notice of an extraordinary general meeting convened by the requisitionists and the requisitionists may disclose the reasons for the resolution(s) which they propose to move at the meeting.

(6) The notice of the meeting shall be given to those members whose names appear in the Register of members of the company within three days on which the requisitionists deposit with the Company a valid requisition for calling an extraordinary general meeting.

(7) Where the meeting is not convened, the requisitionists 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.

(8) 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.

Illustration 15

The members of Blumove Peacocks Appliances Private Limited, holding more than 1/10th voting power of the company, requisitioned the Board of Directors to call a general meeting on 14th July, 2022. However, the directors did not pay any heed to such a requisition and therefore, no general meeting was called. Discuss the consequences of the contravention of not calling a general meeting on the requisition of required number of members in accordance with the Companies Act, 2013.

Answer: In the above case, the requisition for calling a general meeting is made by the sufficient number of requisitionists and therefore, the Board Directors is required to initiate the process of calling the meeting. According to section 100 (4), if the Board does not, within 21 days from the date of receipt of a valid requisition, proceed to call a meeting within 45 days from the date of receipt of such requisition, then the requisitionists may themselves call and hold the meeting. This can be done within a period of three months from the date of the requisition. According to section 100 (5), a meeting by the requisitionists shall be called and held in the same manner in which the meeting is called and held by the Board of Directors.

Accordingly, the requisitionists being members of Blumove Peacocks Appliances Private Limited can call and hold the general meeting within a period of three months from the date of the requisition since the Board was not inclined to call such a meeting within the stipulated time after the requisition was made.

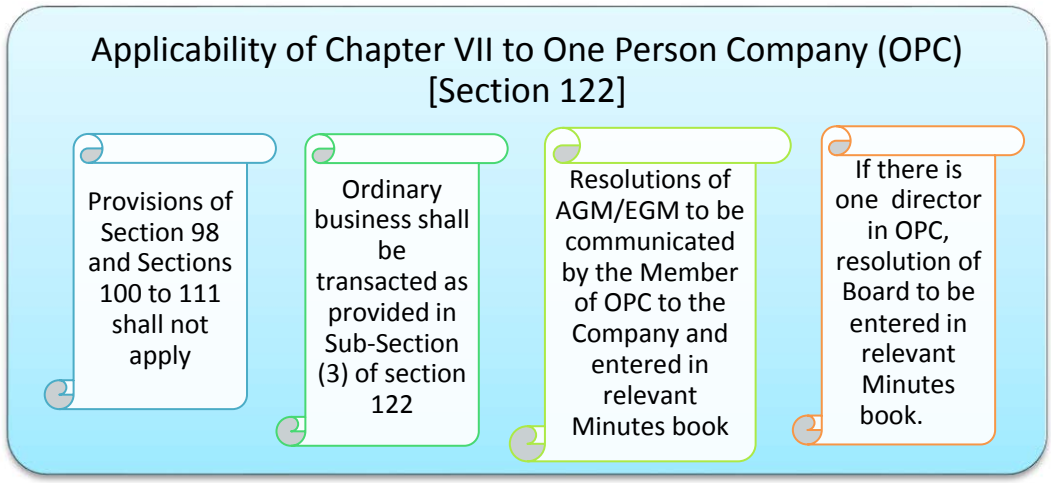
Illustration 16

The Board of Directors of Vishnu Orchards Limited, a company having its registered office in New Delhi, did not proceed to call a meeting despite receipt of a requisition from the required number of requisitionists. In view of this, requisitionists themselves decided to call the meeting to be held in Madrid, Spain on

2nd October, 2022. Discuss whether the general meeting can be convened on the said date and place.

Keeping in view the facts of the above case, the meeting cannot be convened as proposed to be held by the requisitionists. As per *Rule 17 (2) of the Companies (Management and Administration) Rules, 2014*, the requisitionists should hold the meeting at the registered office of the company or in the same city or town in which the registered office is situated. In addition, the day of holding the meeting should be a working day and not a National Holiday. It is to be noted that 2nd October, 2022 is a National Holiday.

14. APPLICABILITY OF THIS CHAPTER TO ONE PERSON COMPANY [SECTION 122]



(1) Section 122 (1) of the Companies Act, 2013 states that the provisions of section 98 and section 100 to 111 shall not apply to a One Person Company (OPC). An overview of these sections is as under:

Section No.	Heading of Section
Section 98	Power of Tribunal to call meetings of members, etc.
Section 100	Calling of EGM
Section 101	Notice of meeting

Section 102	Statement to be annexed to notice
Section 103	Quorum for meetings
Section 104	Chairman of meetings
Section 105	Proxies
Section 106	Restrictions on voting rights
Section 107	Voting by show of hands
Section 108	Voting through electronic means
Section 109	Demand for poll
Section 110	Postal ballot
Section 111	Circulation of Members' Resolution

(2) The ordinary businesses as mentioned under section 102 (2) (a), which a company is required to transact at an AGM, shall be transacted in the case of One Person Company, as provided in sub-section (3). *[Section 122 (2)]*

(3) For the purposes of section 114, any business which is required to be transacted at an annual general meeting or other general meeting of a company by means of an ordinary or special resolution, it shall be sufficient if, in case of One Person Company, 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. *[Section 122 (3)]*

In other words, following procedure shall be adopted for any business to be transacted at an AGM or any other meeting *(i.e. EGM)* of OPC:

(i) The resolution of AGM or EGM shall be communicated by the member to the company;

(ii) The said resolution shall be entered in the relevant minutes book.

(iii) The minutes book shall be signed and dated by the member.

Note: The date on which the minutes book is signed by the member shall be deemed to be the date of the meeting for all the purposes.

(4) Notwithstanding anything in this Act, where there is only one director on the Board of Director of a One Person Company, 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. *[Section 122 (4)]*

Simply stated, in case OPC has only one director, following procedure shall be adopted for any business to be transacted at the meeting of Board of Directors:

(i) The resolution by such director shall be entered in the relevant minutes book.

(ii) The minutes book shall be signed and dated by such director.

Note: The date on which the minutes book is signed by the director shall be deemed to be the date of the meeting for all the purposes.

Penalty

If any default is made in compliance with any of the provisions of this rule, the company and every officer or such other person who is in default shall be punishable with fine which may extend to five thousand rupees and where the contravention is a continuing one, with a further fine which may extend to five hundred rupees for every day after the first during which such contravention continues. [Rule 30]

SUMMARY

- The Chapter discusses about the registers and returns to be kept and maintained by the company as per the provisions of the Companies Act, 2013 and the types of meetings to be held in accordance with the Act. It also discusses the terms relevant to properly convening and conducting of the meetings.
- Section 89 states that a person holding beneficial interest in the shares of a company shall intimate the company about such interest in Form No. MGT–

4 or MGT-5, as applicable, and thereafter, the company shall intimate the RoC about the interest of member within 30 days in Form No. MGT–6.

- Section 90 requires a significant beneficial owner to make a declaration to the company specifying the nature of his interest and other prescribed particulars.
- Section 91 deals with the time limits within which the registers of the company are allowed to be closed and also mentions the penalty for contravention. It states that the registers may be closed for a maximum of 30 days at a time and 45 days in aggregate in a year.
- Section 92 provides that every company shall file its Annual Return in Form No. MGT-7 except 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 which is an abridged form of Annual Return.
- Section 92 provides that annual return is to be filed after the conclusion of each Annual General Meeting and specifies the contents to be included in the annual return.
- The annual return shall 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.
- In case of One Person Company and small company, the annual return shall be signed by the Company Secretary, or where there is no Company Secretary, by the director of the company.
- Section 94 describes that the registers and returns and other documents of the company shall be kept at the registered office of company. However, they can also be kept at any other place where more than $1/10^{th}$ of the total members reside but the same should be approved by way of a special resolution.
- There are two types of general meetings that are held within the company – Annual General Meeting as mentioned in section 96 and Extra-Ordinary General Meeting as stated in section 100.
- Section 96 discusses about the annual general meeting (AGM) to be held in a company every year and prescribes that the AGM shall be held within 6

months from the date of the closing of the financial year and that the gap between two AGMs shall not exceed 15 months.

- In case of a newly incorporated company, first Annual General Meeting shall be held within 9 months from the closing of the first financial year. Accordingly, the company is not required to hold any annual general meeting in the year of its incorporation.
- The AGM shall be held within the business hours and on a working day, i.e. other than National Holidays.
- In case of default in holding Annual General Meeting, the Tribunal is empowered to call, or direct the calling of, an annual general meeting of the company. The Tribunal may give such ancillary or consequential directions as it thinks expedient.
- If for any reason it is impracticable to call a meeting of a company other than AGM, the Tribunal may, either suo motu or on the application of any director or member, order a meeting of the company to be called, held and conducted in such manner as it thinks fit.
- Listed public companies shall file a report on AGM with the RoC in MGT–15 within 30 days of the AGM.
- Section 100 prescribes the provisions for holding an Extra-ordinary General Meeting (EGM) and states that either the board of directors or specified number of members making a requisition to the Board, are authorised to call an EGM.
- A notice is required to be sent to the members and others for calling the general meetings. The notice shall specify the place, date, day and the hour of the meeting and shall also contain a statement of the business to be transacted at such meeting.
- Quorum is the minimum number of members who must be personally present in order to constitute a valid meeting.
- Quorum needs to be present not only at the time of commencement of the meeting but also while transacting business.
- A Chairman needs to be appointed for the meetings. In the absence of any contrary provision in the Articles of a company, the members personally

present at the meeting shall elect one of themselves to be the Chairman thereof on a show of hands.

- 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. The appointment of proxy shall be in Form No. MGT-11.
- At any general meeting, a resolution put to vote of the meeting shall be decided on a show of hands except where a poll is demanded or the voting is carried out electronically.
- There are certain items of business which need to be transacted only by means of voting through 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.
- The members of a company have a right to propose resolutions for consideration at the general meetings.
- A resolution can be ordinary resolution or a special resolution. Ordinary resolution can be passed by simple majority whereas special resolution requires minimum 75% majority for its passing.
- A resolution passed at an adjourned meeting shall be treated as having been passed on the day on which it was actually passed and not on any earlier date.
- Copies of specified resolutions and agreements are required to be filed with the Registrar of Companies.
- As regards minutes, every company shall prepare, sign and keep minutes of every general meeting including the meeting called by the requisitionists, every resolution passed by postal ballot and every meeting of its Board of Directors or of every committee of the Board.
- The minutes kept in accordance with the prescribed provisions shall serve as the evidence of the proceedings recorded therein.

- The books containing the minutes of the proceedings of any general meeting shall be open for inspection during business hours by any member, without charge, subject to certain reasonable restrictions. At least 2 hours in each business day shall be allowed for inspection.
- Any document, record, register or minute, etc., required to be kept or allowed to be inspected or copies given to any person by a company, may be kept or inspected or copies given, as the case may be, in electronic form.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. *The Annual General Meeting (AGM) of Green Limited was held on 31.8.2022. Suppose the Chairman of the company after two days of AGM went abroad for next 31 days. Due to the unavailability of the Chairman, within time period prescribed for submission of copy of report of AGM with the registrar, the report as required was signed by two Directors of the company, of which one was additional Director of the company. Comment on the signing of this report of AGM.*

   (a) Yes, the signing is in order as the report can be signed by any director in the absence of Chairman.

   (b) No, the signing is not in order as only the Chairman is authorised to sign the report

   (c) Yes, the signing is in order, as in the absence of Chairman at least two directors should sign the report.

   (d) No, the signing is not in order, since in case the Chairman is unable to sign, the report shall be signed by any two directors of the company, one of whom shall be the Managing director, if there is one and company secretary of the company.

2. *The AGM shall be called by giving 21 clear days' notice. However, it can be called by giving shorter notice if members entitled to vote at that meeting give their consent in writing or by electronic mode. In such cases how many members have to give their consent?*

(a) *75% of members entitled*

(b) *90% of members entitled*

(c) *91% of members entitled*

(d) *95% of members entitled*

3. *Which among the following companies is not required to provide its members the facility to exercise right to vote by electronic mode under the provisions of the Companies Act, 2013?*

(a) *B Limited, whose equity shares (the company is having both equity as well as preference shares) are listed on a recognised stock exchange.*

(b) *A Limited, whose equity shares (only type of share the company is having) are listed on a recognised stock exchange*

(c) *C Limited, whose preference shares (the company is having both equity as well as preference shares) are listed on a recognised stock exchange*

(d) *D Limited, whose equity shares as well as preference shares are listed on a recognised stock exchange.*

Descriptive Questions

1. *In a General meeting of Alpha Software 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?*

2. *A General Meeting was scheduled to be held on Friday, 15th April, 2022 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 09-04-2022 was deposited by Mr. Y with the company at its registered Office on 11-04-2022. 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 12-04-2022 was deposited with the company on the same day*

and the proxy form in favour of Mr. N was deposited on 14-04-2022. 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 as proxies for members X and W respectively?

3. *M. H. Mechanics 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. Mechanics Company Limited complains that the issue of sweat equity shares was not specified fully in the notice. Is the notice issued by M. H. Mechanics Company Limited regarding issue of sweat equity shares valid according to the provisions of the Companies Act, 2013? Explain in detail.*

4. *Tulip Gardens Ltd. maintains its Register of Members at its registered office in Mumbai. A group of members residing in Kolkata wants to keep the register of members at Kolkata.*

   (i) Keeping in view the provisions of the Companies Act, 2013, explain whether Tulip Gardens Ltd. can keep the Registers and Returns at Kolkata.

   (ii) Whether Mr. Rich, a director holding only 400 shares of worth ₹ 4000, has the right to inspect the Register of Members?

5. *Examine the validity of the following situation with reference to the relevant provisions of the Companies Act, 2013:*

   The Board of Directors of Shreya Transporters and Logistics Ltd. called an extra-ordinary 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.

6. *Zorab Garments 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. Roshni, a shareholder of the company complained that the amount of the proposed increase was not specified in the notice. Is the notice valid?*

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.*

8. *Surya, 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 in respect of demand for inspection of proxies by Surya as per the provisions of the Companies Act, 2013*

9. *There are certain entities to which the Companies (Significant Beneficial Owners) Rules, 2018 are not applicable. List them.*

10. *Infotech Ltd. was incorporated on 1.4.2018. No General Meeting of the company has been held till 30.4.2020. 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.*

11. *The Articles of Association of DJA Water Tanks 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 general meeting to consider the appointment of Managing Director:*

(i) *A is the representative of Governor of Uttar Pradesh.*

(ii) *B and C are preference shareholders,*

(iii) *D is representing Y Ltd. and Z Ltd.*

(iv) *E, F, G and H are proxies of shareholders.*

Could it be said that the quorum was present in the meeting?

12. *What do you mean by Proxy? Explain the provisions relating to appointment of proxy under the Companies Act, 2013.*

13. *Super Mart Limited called its AGM in order to lay down the financial statements for the approval of the shareholders. 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 opinion 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?*

14. *Madurai Bakestry Ltd. issued a notice for holding of its Annual General Meeting on 7th September, 2022. The notice was posted to the members on 16th August, 2022. Some members of the company alleged 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 not 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?

15. *KMN Cables Ltd. scheduled its Annual General Meeting to be held on 15th September, 2022 at 11:00 A.M. The company has 900 members. On the scheduled date of AGM 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.

What happens if there is no Quorum at the adjourned meeting?

16. *As a matter of fact, the usual time allowed for making entries in the register of members or register of debenture-holders or register of other security holders is seven days after the Board of Directors or its committee grants its approval. There are certain events, on the happening of which the entries can be made even after seven days. Which are those events?*

17. *With a view to transact some urgent business, Ratna, Rimpi and Ratnesh, the three directors of Shilpkaar Constructions Limited are desirous of calling a general meeting of shareholders by giving shorter notice than 21 days' clear notice. The fourth director, Nilesh is of the opinion that such an action will attract penalty provisions since there is contravention. The paid-up share capital of the company is Rs. 30 crores divided into 3 crores shares of Rs. 10 each. Keeping in view the applicable provisions of the Companies Act, 2013, discuss regarding the possibility of calling a general meeting by giving shorter notice.*

18. *Miraj Sugar Mills Limited held its Annual General Meeting on September 15, 2022. The meeting was presided over by Mr. Venkat, the Chairman of the Board of Directors of the company. On September 17, 2022, 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.*

19. *Shikhar Cement Limited passed two resolutions by means of postal ballot. Keeping in view the relevant provisions of the Companies Act, 2013, you are required to advise the directors of the company regarding the provisions applicable for making entries in the minutes book including the time limit within which the entries must be made.*

20. *The paid-up share capital of Disha Home Appliances Limited is Rs. 8 crores divided into 80 lacs shares of Rs. 10 each. The directors of the company would like to know the circumstances under which the Annual Return of the company shall be required to be certified by a company secretary in practice.*

21. *Prince Auto-parts Limited, a listed company, has recently concluded its Annual General Meeting. As a statutory requirement, it is obligatory on its*

part to file with the jurisdictional Registrar of Companies a copy of the Report on its AGM.

(i) State within how much time it is required to file the said Report.

(ii) In case Prince Auto-parts Limited fails to file the Report on its AGM within the specified time, state the penalty to which the company and also its every officer who is in default shall be liable for such failure.

ANSWERS

Answer to MCQ based Questions

1.	**(d)**	No, the signing is not in order, since in case the Chairman is unable to sign, the report shall be signed by any two directors of the company, one of whom shall be the Managing director, if there is one and company secretary of the company.
2.	**(d)**	95% of members entitled
3.	**(c)**	C Limited, whose preference shares (the company is having both equity as well as preference shares) are listed on a recognised stock exchange

Answer to Descriptive Questions

1. 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) of section 118.

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 Proxy is an instrument in writing executed by a shareholder authorizing another person to attend a meeting and to vote thereat on his behalf 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 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 permissible time.

However, in the case of Member W, the proxy M (and not Proxy N) would be permitted to vote as the proxy authorizing N to vote was deposited in less than 48 hours before the meeting.

3. 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 were required to be sent with the notice of meeting. The notice is, therefore, cannot be said to be a valid one when the provisions of Section 102 of the Companies Act, 2013 are considered.

4. **(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. According to section 100 (2) of the Companies Act 2013, the Board of directors must convene a general meeting upon requisition made 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 and valid.

6. Under section 102 (2) (b) of the Companies Act, 2013, in the case of any general 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, namely:—

(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.

Thus, the objection of the shareholder is valid since the details of the item to be considered at the general meeting are not fully disclosed. 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 considering the provisions of section 102 of the Companies Act, 2013.

7. 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, section 109 (1) lays down as under:

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 of 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 for poll: According to section 109 (2), 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 the provisions contained in the articles of company.

(ii) The chairman cannot reject the request of the members for withdrawal of the demand for poll.

8. 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 twenty-four 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 three days' notice in writing of the intention so to inspect is given to the company.

In the given case, Surya has given a proper notice. Therefore, validity of notice cannot be denied.

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.

In view of above provision, Surya can undertake the inspection only during the above-mentioned period and not two days prior to the meeting.

9. Rule 8 of the Companies (Significant Beneficial Owners) Rules, 2018 *(as amended by the Companies (Significant Beneficial Owners) Amendment Rules, 2019, w.e.f. 8-2-2019)* states that the 'SBO' Rules shall not be made applicable to the extent the shares of the Reporting Company are held by following entities:

(a) the Investor Education and Protection Fund Authority [constituted under section 125 (5)];

(b) its holding reporting company provided that the details of such holding reporting company shall be reported in Form No. BEN-2;

(c) the Central Government, State Government or any local authority;

(d) (i) a reporting company; or

(ii) a body corporate; or

(iii) an entity,

controlled wholly or partly by the Central Government and/ or State Government(s);

(e) Securities and Exchange Board of India (SEBI) registered Investment Vehicles such as mutual funds, alternative investment funds (AIFs), Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InVITs) regulated by SEBI;

(f) Investment Vehicles regulated by Reserve Bank of India, or Insurance Regulatory and Development Authority of India, or Pension Fund Regulatory and Development Authority.

10. 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 2018 to 31st March 2019, the first Annual General Meeting (AGM) of the company should be held on or before 31st December, 2019.

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 Ltd. should have been held on or before 31st December, 2019. Further, in case of first AGM, the Registrar of Companies does not have the power to grant extension of any time limit.

11. 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 purpose 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 proxies representing the members.

Thus, it can be said that the requirement of quorum has not been met and the composition shall not constitute a valid quorum for the meeting.

12. A proxy is an instrument in writing executed by a shareholder authorising another person to attend a meeting and to vote thereat on his behalf in his absence. The term also applies to the person so appointed and in such case a proxy is a person appointed by a member of a company, to attend the general meeting of the company and vote thereat on his behalf.

The various provisions relating to the appointment of a proxy are contained in section 105 of the Companies Act, 2013. They 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 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. 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 ten 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 two lakh rupees in case of a company and fifty thousand rupees in case of an officer who is in default.

In the instant case, the opinion 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 not correct.

In the above case, the annual general meeting of Super Mart 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 return 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. 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. 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 as constituting 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 Cables 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 requirement of quorum and he reaches after 11:30 A.M. (*i.e.* after half an hour from the starting time of the meeting), the meeting will be adjourned as provided above.

(iii) In case of lack of quorum, the meeting will be adjourned as provided in section 103 of the Companies Act, 2013.

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.

16. In this respect Rules 5 (7) and 5 (8) of the Companies (Management and Administration) Rules, 2014 are relevant.

Rule 5 (7) specifies that in case of companies whose securities are listed on a stock exchange in or outside India, the particulars of any pledge, charge, lien or hypothecation created by the promoters in respect of any securities of the company held by the promoter including the names of pledgee/pawnee and any revocation therein shall be entered in the register within **fifteen days** from such an event.

According to Rule 5 (8), if promoters of any listed company, which has formed a joint venture company with another company, have pledged or hypothecated or created charge or lien in respect of any security of the listed company in connection with such joint venture company, the particulars of such pledge, hypothecation, charge and lien shall be entered in the register members of the listed company within **fifteen** days from such an event.

Thus, in the above two cases, it is permitted for the listed companies to make entries relating to pledge, charge, lien or hypothecation in the registers within fifteen days from the happening of such an event.

17. Normally, general meetings are to be called by giving at least 21 clear days' notice as required by Section 101 (1) of the Companies Act, 2013.

As an exception, first proviso to Section 101 (1) states that a general meeting may be called after giving shorter notice than that specified in sub-section (1) of Section 101, if consent, in writing or by electronic mode, is accorded thereto—

(i) in the case of an **annual general meeting**, by not less than ninety-five per cent. of the members entitled to vote thereat; and

(ii) in the case of **any other general meeting**, by members of the company—

(a) holding, if the company has a share capital, majority in number of members entitled to vote and who represent not less than ninety-five per cent. of such part of the paid-up share capital of the company as gives a right to vote at the meeting; or

(b) having, if the company has no share capital, not less than ninety-five per cent. of the total voting power exercisable at that meeting.

Second proviso to Section 101 (1) clarifies that where any member of a company is entitled to vote only on some resolution or resolutions to be moved at a meeting and not on the others, those members shall be taken into account for the purposes of sub section (1) of section 101 in respect of the former resolution or resolutions and not in respect of the latter.

In view of the above provisions, Shilpkaar Constructions Limited is permitted to call the requisite general meeting by giving a shorter notice. However, the members holding at least ninety-five per cent of the paid-up share capital of the company which gives them a right to vote at the meeting must consent to the shorter notice.

Hence, the opinion of Nilesh that there shall be contravention of relevant provisions attracting penalty if a general meeting is called at shorter notice than usually required is not correct.

18. 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 other director also who is authorized by the Board.

19. Section 118 of the Companies Act, 2013 requires a company to make entries of resolutions passed by means of postal ballot in the minutes book.

Rule 25 (1) (b) (ii) of the Companies (Management and Administration) Rules, 2014 states that in case of every resolution passed by postal ballot, a brief report on the postal ballot conducted including the resolution proposed, the result of the voting thereon and the summary of the scrutinizer's report shall be entered in the minutes book of general meetings along with the date of such entry within thirty days from the date of passing of resolution.

Accordingly, the directors of Shikhar Cement Limited are advised to keep following points under consideration while entering resolutions passed by means of postal ballot in the minutes book of general meetings:

(i) there should be entered a brief report on the postal ballot conducted including the resolution proposed.

(ii) there should be entered the result of the voting made by the shareholders in respect of resolution.

(iii) there should be entered the summary of the scrutinizer's report.

(iv) there should be entered the date of making entry.

Further, the directors must ensure that the entries in respect of resolutions are made within thirty days from the date of passing of resolution by means of postal ballot.

20. In respect of certification of Annual Return by a company secretary in practice, the directors of Disha Home Appliances Limited are advised to refer Section 92 (2) of the Companies Act, 2013 and also Rule 11 (2) of the Companies (Management and Administration) Rules, 2014 which state that the Annual Returns of following companies shall be certified by a company secretary in practice:

(i) a listed company; or

(ii) a company having paid-up share capital of Rs. 10 crores or more or turnover of Rs. 50 crores or more.

Accordingly, if Disha Home Appliances Limited gets listed or in case its paid-up share capital is increased to Rs. 10 crores or more or its turnover becomes Rs. 50 crores or more, it shall be required to get its Annual Return certified by a company secretary in practice. The certificate given by the company secretary in practice shall be in Form No. MGT-8. The certificate, *inter-alia*, shall state that the Annual Return discloses the facts correctly and adequately and that the company has complied with all the provisions of the Companies Act, 2013.

21. (i) In terms of Section 121 (2) of the Companies Act, 2013, Prince Auto-parts Limited is required to file with the jurisdictional Registrar of Companies a copy of the Report maximum within thirty days of the conclusion of its Annual General Meeting.

(ii) In terms of Section 121 (3) of the Companies Act, 2013, every listed company, which fails to file with the jurisdictional Registrar of

Companies a copy of the Report on its Annual General Meeting within the specified time limit, shall be liable to the following penalty:

- ***Company:*** Rs. one lakh and in case of continuing failure, with a further penalty of Rs. five hundred for each day after the first during which such failure continues subject to a maximum of Rs. five lakh.
- ***Every officer who is in default:*** Minimum Rs. twenty-five thousand and in case of continuing failure, with a further penalty of Rs. five hundred for each day after the first during which such failure continues subject to a maximum of Rs. one lakh.

Accordingly, if Prince Auto-parts Limited fails to file a copy of the report on its Annual General Meeting within the specified time limit of thirty days, it shall be liable to the above stated penalty which may go maximum up to Rs. five lakh in case of continuing default. In addition, its every officer who is in default shall also liable to the penalty maximum of which will be Rs. one lakh in case of continuing failure.

NOTES

CHAPTER 8

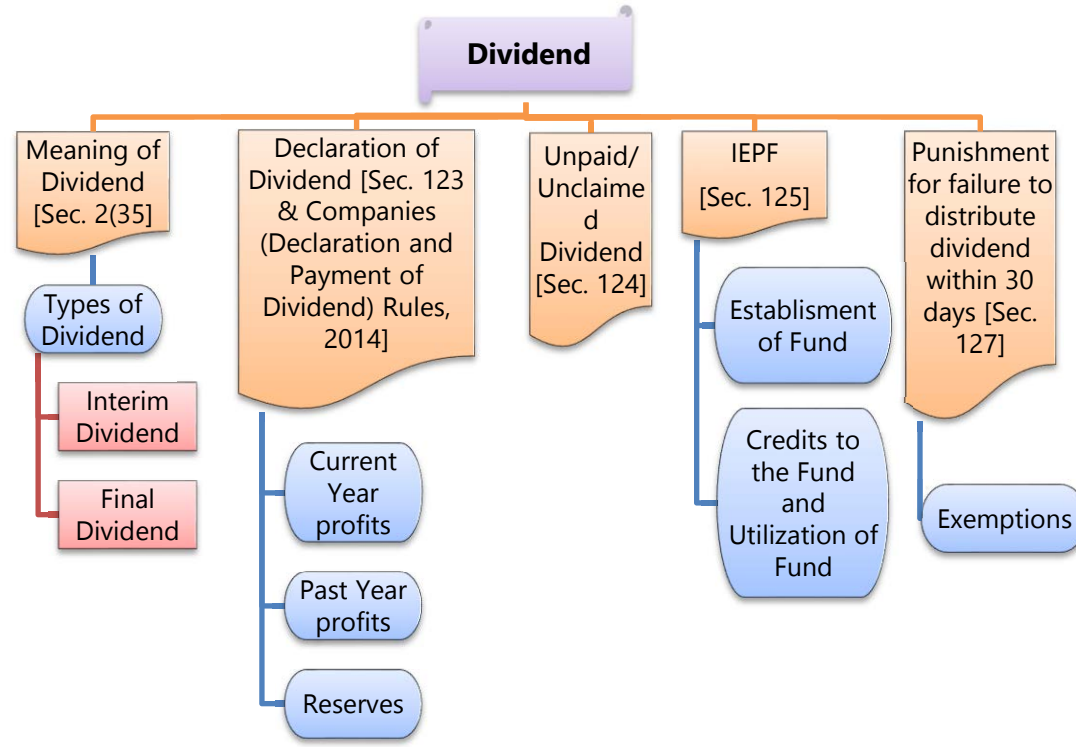
DECLARATION AND PAYMENT OF DIVIDEND

LEARNING OUTCOMES

At the end of this chapter, you will be able to:

- Comprehend the legal provisions relating to declaration and payment of dividend
- Identify about the conditions which need to be fulfilled before declaring dividend out of accumulated reserves.
- Appreciate the manner in which unpaid and unclaimed dividend is to be dealt with.
- Identify the nature and framework of the Investor Education and Protection Fund (IEPF).
- Appreciate the consequences for failure to distribute dividend.

CHAPTER OVERVIEW



1. MEANING OF DIVIDEND

Definition

Section 2(35) of the Companies Act, 2013, while defining the term dividend simply states that "dividend" includes any interim dividend. In common parlance, "Dividend" implies a distribution of any sums to members out of profits and wherever permitted out of free reserves available for the purpose.

Dividend is the shareholders return on their investment / capital in the company. Dividend is part of the distributable profits which has been paid out to them. In simple words, it is a distribution of profits *i.e.* a portion of profits earned and allocated as payable to the shareholders whenever declared.

The company in general meeting may declare dividends, but no dividend shall exceed the amount recommended by the Board. (Clause 80 of Table F in Schedule I)

Dividend is recommended by Board of Directors in the Board's Report[1] and approved by Shareholders at the Annual General Meeting. Dividend is not a liability unless it is declared by the shareholders at a validly constituted general meeting by passing an ordinary resolution[2] at the rates recommended by the Board or such lower rates as they may decide.

Declaration of dividend by the company at a rate higher than the rate recommended by the Board is not permitted.

Dividend is Declared as a proportion of Nominal or Face Value of a share.

Example 1: 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 2: 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, although the power to declare a dividend vests with the shareholders however under no circumstances they can declare dividend exceeding the amount recommended by the Board of Directors.

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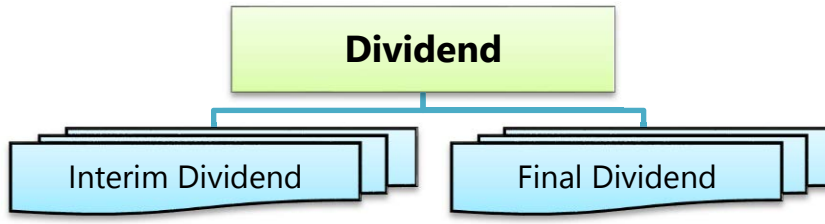
[1] As per Section 134 (3) (k).

[2] As per section 102 (2) declaration of any dividend at the AGM is an ordinary business requiring ordinary resolution. At any other general meeting it will be special business.

2. TYPES OF DIVIDEND

I. Classification based on time i.e. when declared



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 at any time during the period from closure of financial year till holding of the annual general meeting.

  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.

- 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 three financial years.

Example 3: 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%.

- The amount of the dividend, including interim dividend, shall be deposited in a separate account maintained with a scheduled bank within five days from the date of declaration.
- All provisions which are applicable to the payment of dividend shall also apply in case of interim dividend.

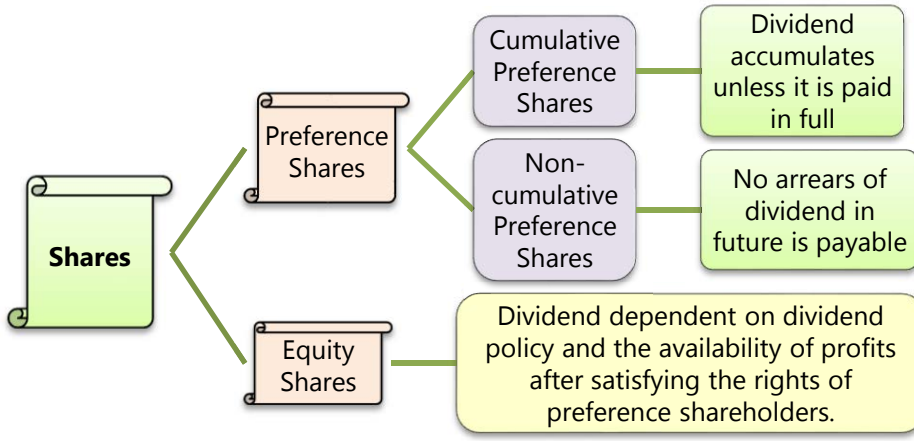
Final Dividend

- When the dividend is declared at the Annual General Meeting 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.

II. Classification based on Nature of Shares does not require any specific provision in the articles.



Shares can be classified into two categories *i.e.* preference shares and equity shares. The manner of payment of dividend is dependent upon the nature of shares.

(i) Preference Shares: According to Section 43 of the Companies Act, 2013, shareholders holding preference shares are assured of a preferential dividend at a fixed rate during the life of the company.

Preference dividend unless otherwise agreed as cumulative in nature need not be paid every year i.e. a company may decide not to declare any dividend where there is deficiency of profits.

Classification of preference shares on the basis of payment of dividend is as follows:

(a) Cumulative Preference Shares: A cumulative preference share is one in respect of which dividend gets accumulated and any arrears of such dividend arising due to insufficiency of profits during the current year is payable from the profits earned in the later years. Until and unless dividend on cumulative preference shares is paid in full, including arrears, if any, no dividend is payable on equity shares.

(b) Non-cumulative Preference Shares: A non-cumulative preference share is one where the dividend is payable only in a year of profit. There is no accumulation of profit as in the case of cumulative preference shares. In case no dividend is declared in a year due to any reason, the right to receive such dividend for that year lapses and the

holder of such a share is not entitled to be paid arrears of dividend out of future year profits.

(ii) **Equity Shares:** Equity shares are those shares, which are not preference shares. They do not enjoy any preferential rights in the matter of payment of dividend or repayment of capital. The rate of dividend on equity shares is recommended by the Board of Directors and may vary from year to year. Rate of dividend depends upon the dividend policy and the availability of profits after satisfying the rights of preference shareholders.

3. PROVISIONS REGARDING DECLARATION AND PAYMENT OF DIVIDEND

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 in accordance with Schedule II[3].

(b) **Profits of any previous financial year or years-** Profits of any previous financial year(s) arrived at after providing for depreciation in accordance with Schedule II and remaining undistributed *i.e.* credit balance in profit and loss account and free reserves. It is to be noted that only free reserves[4] and no other reserves are to be used for declaration or payment of dividend[5].

(c) Both (a) and (b).

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[3] As per Section 123 (2).

[4] Section 2 (43) defines the term 'free reserves' to mean such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend. However, following items shall not be treated as free reserves:

(a) any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise; or

(b) any change in carrying amount of an asset or of a liability recognised in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value.

[5] As per Third Proviso to Section 123 (1).

(d) Provision of money by the Government- Money provided by the Central Government or a State Government for the payment of dividend by the company in pursuance of a guarantee given by that Government.

Note 1: Before declaration of any dividend, carried over previous losses and depreciation not provided in previous year or years are required to be set off against profit of the company for the current year[6].

Note 2: In computing profits any amount representing unrealised gains, notional gains or revaluation of assets and any change in carrying amount of an asset or of a liability on measurement of the asset or the liability at fair value shall be excluded[7].

Note 3: Capital profits are not same as distributable profits because they are not earned in the normal course of business; and therefore, normally not available for distribution as dividend.

Need for providing for depreciation out of profits before declaring dividend

Dividend is an apportionment from revenue profits. Therefore, dividend should never be declared out of capital. This is also the reason for prohibition on issue of shares at a discount which you studied in the topic Share Capital and Debentures.

"Depreciation" is a notional estimate of the reduction in the value of an asset due to

i. wear and tear,

ii. efflux of time,

iii. improvements in technology etc.

If depreciation is not provided for there will be two consequences:

i. The value of the asset will be overstated in Balance Sheet

ii. The profits of the current year will be overstated.

[6] As per Fourth Proviso to Section 123 (1).
[7] As per Proviso to Section 123 (1) (a).

Let us take a hypothetical case where a company declares all the profits earned during any year as dividend.

At the time of winding up of the company the value of assets appearing in the Balance-sheet would appear to be sufficient to repay the capital of the shareholders but the actual realizable value thereof will be a paltry sum which may not be sufficient even to meet the expenses of winding up.

This is because the company has failed to retain the amount of wear and tear in the value of the asset by way of provision for depreciation. In a way the company would have declared dividend out of capital, which is prohibited.

Hence the law mandates provision for depreciation out of profits before declaration of dividend.

Example 4: 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, 2023. 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. Transfer to Reserves

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.

Illustration 1: *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.

Illustration 2: *Brix Shipyards Limited has earned a profit of ₹ 1,000 crores for the financial year 2018-19. It has proposed a dividend @ 8.75%. However, it does not intend to transfer any amount to the reserves out of the profits earned. Can the company do so?*

Answer: The amount to be transferred to reserves out of profits for any financial year has been left to the discretion of the company. The company is free to transfer any part of its profits to reserves as it may deem fit or it may even not transfer any profits to reserve if it is deemed appropriate before the declaration of dividend. Thus, Brix Shipyards Limited is justified in its action if it does not transfer any amount of profits to the reserves.

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 accumulated profits earned by it in previous years and 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*.

Free Reserves [8]means such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend:

The following shall not be treated as free reserves;

Any amount representing unrealized gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or

Any change in carrying amount of an asset or of a liability recognized in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value.

Under Rule 3 such declaration shall be subject to the following conditions:

[8] Section 2 (43)

CONDITION I

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 three years.

Rate of Dividend ≤ $(RD_1 + RD_2 + RD_3)/3$

Where, RD_1, RD_2, RD_3 are rates at which dividend was declared by the company in the immediately preceding three years.

However, **this condition shall not apply** if the company has not declared any dividend in each of the three preceding financial year.

CONDITION II

The total amount to be drawn from such accumulated profits shall not exceed 10% of its paid-up share capital and free reserves as appearing in the latest audited financial statement. In other words:

Total amount that can be drawn from accumulated profits	≤	*10% of (paid up share capital + free reserves)*

CONDITION III

The amount so drawn shall first be utilised to set off the losses incurred in the financial year in which dividend is declared and only thereafter, any dividend in respect of equity shares shall be declared.

CONDITION IV

The balance of reserves after such withdrawal shall not fall below 15% of its paid up share capital as appearing in the latest audited financial statement.

Free Reserves – Amount drawn for payment of dividend	>=	*15 % of paid up share capital*

It may be noted that all the above three conditions have to be satisfied.

The conditions prescribed by Rule 3 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 Governments or by the Central Government and one or more State Governments (vide Notification No. 463 (E), dated 05-06-2015).

Illustration 3: *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 declared at the following rates during the three years immediately preceding.*

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:

Average rate = $\frac{9+10+12}{3}$ =10.33%

Therefore, the rate of dividend shall not exceed 10.33%.

i.e. 10.3% of Paid up Capital i.e. ₹ 200 lakhs = ₹ 20.6 lakhs

Condition II:

Paid-up capital + Free reserves	=	₹ (200+240) Lakhs
(Assuming all reserves are free)		₹ 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.

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.

Illustration 4: *Shipra Sugar Mills Limited has been regularly declaring dividend at the rate of 20% on its equity shares for the past 3 years. However, the company has not made adequate profits during the current year ending on 31st March, 2020, but it has got adequate free reserves which can be utilized for maintaining the rate of dividend at 20%.*

Advise the company as to how it should proceed in the matter if it wants to declare dividend at the rate of 20% for the year 2019-20, as per the provisions of the Companies Act, 2013.

Answer: The company can declare a dividend out of its Accumulated Free Reserves subject to satisfaction of the following conditions:

- 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 three years.

  However, this condition shall not apply if the company has not declared any dividend in each of the three preceding financial year.

- The total amount to be drawn from free reserves shall not exceed 10% of its paid-up share capital and free reserves as per the latest audited financial statement.

- The amount so drawn shall first be utilised to set off the losses incurred in the current financial year and only thereafter, dividend at 20% shall be declared.

- After such withdrawal from free reserves, the residual reserves shall not fall below 15% of its paid-up share capital as per the latest audited financial statement.

The company is advised to get the desired dividend recommended by the Board of Directors and propose the same for the approval of the members at the ensuing

Annual General Meeting as the authority to declare dividend lies with the members of the company.

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[9].

Example 5: The authorised and paid-up share capital of Avantika Ayurvedic Products Limited is ₹ 50.00 lacs divided into 5,00,000 equity shares of ₹ 10 each. At its Annual General Meeting (AGM) held on 24th September, 2019, the company declared a dividend of ₹ 2 per share by passing an ordinary resolution. The amount of dividend must be deposited in a scheduled bank in a separate account latest by 29th September, 2019.

E. Payment of Dividend

Section 123(5) contains provisions regarding payment of dividend. These are stated as under:

(a) Dividend shall be payable only to the registered shareholder or to his order or to his banker.

In case a shareholder informs the company to pay dividend to a particular banker and if the payment is so made by the company, then it shall be deemed to be made to the shareholder himself.

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. In this regard we will, later in this chapter, see Section 126 which provides for keeping of dividend etc., in abeyance pending registration of transfer of shares, unless the registered holder has authorized the company to pay the dividend to the purchaser.

[9] In terms of *Notification No. 463 (E), dated 05-06-2015*, this requirement shall not apply to a Government Company in which the entire paid up share capital is held by the Central Government, or by any State Government or Governments or by the Central Government and one or more State Governments or by one or more Government Company.

Illustration 5: *The Directors of East West Limited proposed dividend at 15% on equity shares for the financial year 2022-2023. The company announced 28th September 2023 as the record date for payment of dividend. The dividend was approved in the Annual General Meeting held on 30th September 2023.*

Mr. Binoy was the holder of 2000 equity of shares on 31st March, 2018, but he transferred the shares to Mr. Mohan, whose name has been entered in the register of members on 18th June, 2023. Who will be entitled to the above dividend?

Answer: According to section 123, dividend shall be paid by a company only to the registered shareholder of such share.

Record date is the date announced by the company for determining entitlement to dividend. All those persons whose name is included in the register of members on that date shall be entitled to dividend.

In the instant case, on the date announced by the company as the record date, Mr. Mohan's name is present in the register of members (i.e. Mr. Binoy's name is NOT present therein). Therefore, the dividend should be paid to Mr. Mohan who is the registered shareholder on the record date.

Illustration 6: *The Board of Directors of Som Mechanical Toys Limited proposed a dividend at 12% on equity shares for the financial year 2022-23. The same was approved at the Annual General Meeting of the company held on 25th June, 2023.*

Mr. Nitin Jha was holding 1,000 equity shares as on 31st March, 2023, but the same were transferred by him to Mr. Raj, whose name was registered on 20th April, 2023 in the Register of Members. State as to who will be entitled to the dividend declared by the company.

Answer: According to section 123(5), dividend shall be payable only to the registered shareholder of the shares or to his order or to his banker. Facts in the given case state that Mr. Nitin Jha, the holder of equity shares transferred his shares to Mr. Raj whose name was registered on 20th April, 2023. Since, Mr. Raj became the registered shareholder before the declaration of the dividend in the Annual General Meeting of the company held on 25th June, 2023, he will be entitled to the dividend.

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. In case dividend is paid by issuing dividend warrants, such warrants must be posted at the registered addresses within the prescribed time.

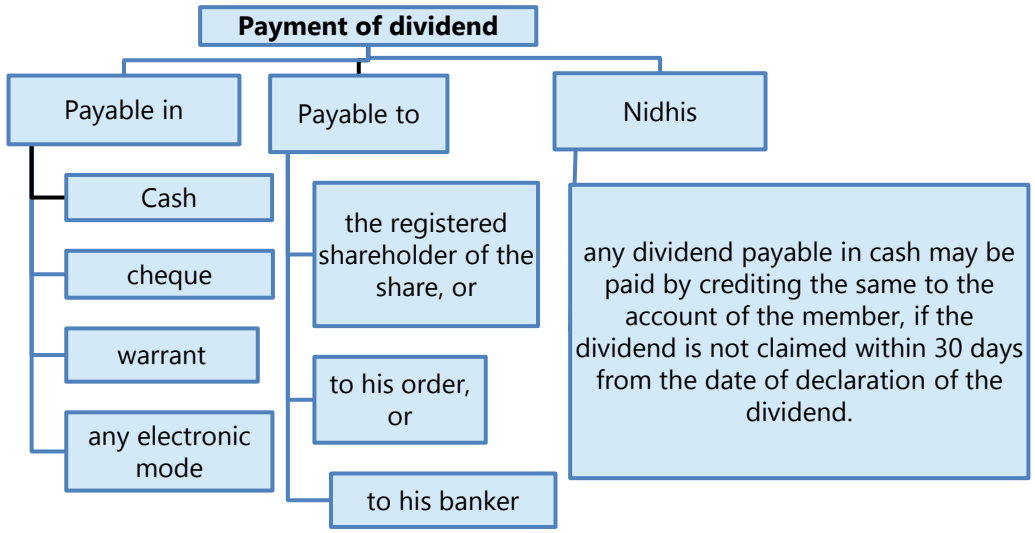
Note: Dividends shall be paid only in cash. The exception to this is the capitalization of profits or reserves of a company for the purpose of issuing fully paid-up bonus shares or paying up any amount for the time being unpaid on any shares held by the members of the company[10].

But you may note that while Declaration of dividend does not affect the company's power to issue fully paid up bonus shares, such shares cannot be issued in lieu of dividend.

(c) Applicability of Section 123 (5) to Nidhis: In terms of *Notification No. GSR 465 (E), dated 05-06-2015*, this sub-section shall apply to the Nidhis, subject to the modification that any dividend payable in cash may be paid by crediting the same to the account of the member, if the dividend is not claimed within 30 days from the date of declaration of the dividend.

[10] First Proviso to Section 123 (5)

Chart depicts the mode of payment and recipient of dividend



F. Prohibition on Declaration of Dividend

In the following cases declaration and payment of dividend is prohibited.

(i) Prohibition in case of any Defaulting Company:[11] 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, so long as such failure continues, declare any dividend on its equity shares.

No dividend for Co. which fails to comply with sec 74/74

(ii) Prohibition in case of Section 8 Companies: According to section 8 (1), a company having licence under Section 8 (*Formation of companies with charitable objects, etc.*) is prohibited from paying any dividend to its members. Its profits are intended to be applied only in promoting the objects for which it is formed.

No dividend for Section 8 Co.s

[11] Section 123 (6)

4. UNPAID DIVIDEND ACCOUNT (UDA)

Section 124 of the Act contains the provisions relating to Unpaid Dividend Account (UDA). These are as follows:

(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 paid or claimed within thirty (30) days from the date of declaration, the company shall, within seven (7) days from the expiry of the said period of 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 total unpaid dividend amount or any part thereof to the Unpaid Dividend Account, the company shall pay, from the date of such default, interest at the rate of twelve per cent per annum on the amount not so transferred to the said account. The interest accruing on such amount shall ensure i.e. be available to the benefit of the members of the company in proportion to the amount remaining unpaid to them.

(iv) Claimant to apply for payment of Claimed Amount- Any person claiming to be 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 of Unclaimed Amount to Investor Education and Protection Fund (IEPF)- Any money transferred to the Unpaid Dividend Account which remains unpaid or unclaimed for seven (7) years from the date of such transfer shall be transferred by the company along with interest accrued thereon to the Investor Education and Protection Fund.

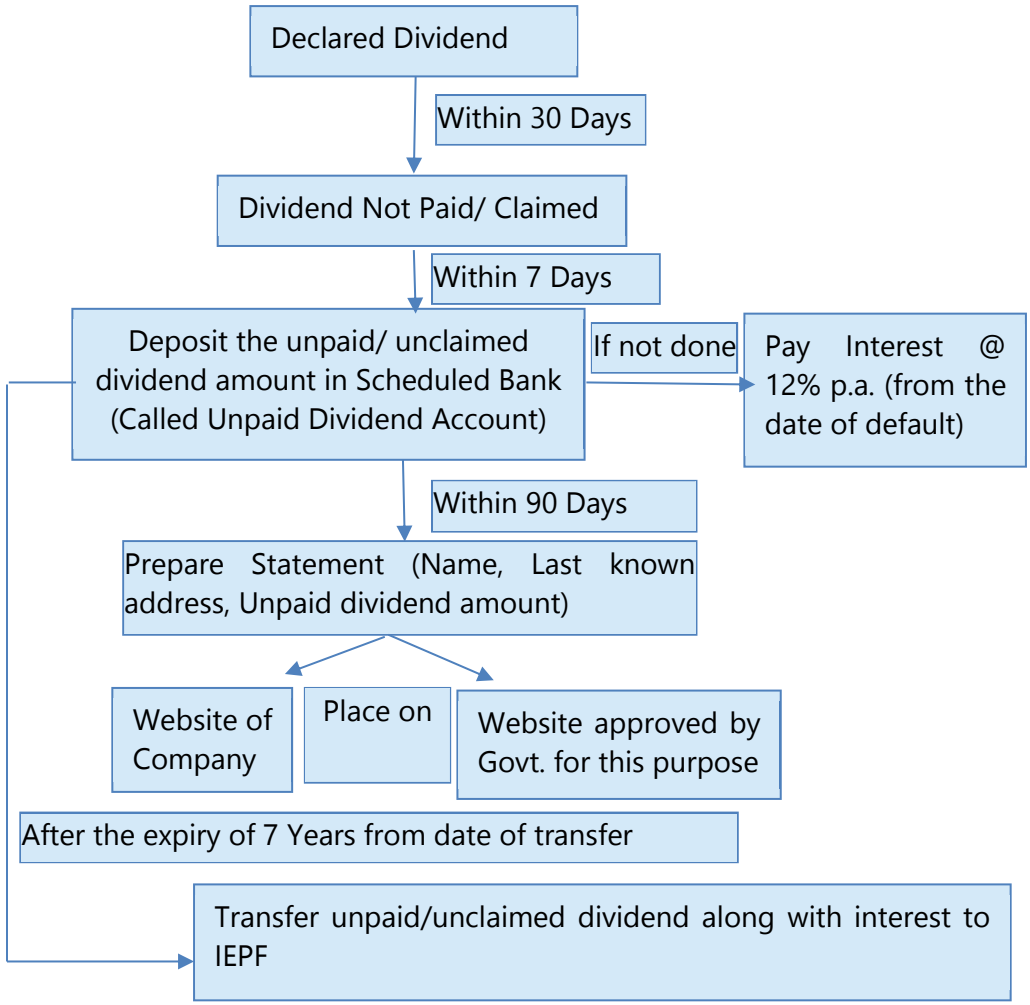
Further, the company shall send a prescribed statement containing the details of such transfer to the IEPF Authority and in turn, the Authority shall issue a receipt to the company as evidence of such transfer.

(vi) Transfer of Shares to IEPF- All shares in respect of which dividend has not been paid or claimed for 7 consecutive years or more shall be transferred by the company in the name of Investor Education and Protection Fund along with a statement containing the prescribed details.

By way of Explanation, it is clarified that in case any dividend is paid or claimed for any year during the said period of seven 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 of this section, such company shall be liable to a penalty of one lakh rupees and in case of continuing failure, with a further penalty of five hundred rupees for each day after the first during which such failure continues, subject to a maximum of ten lakh rupees and every officer of the company who is in default shall be liable to a penalty of twenty-five thousand rupees and in case of continuing failure, with a further penalty of one hundred rupees for each day after the first during which such failure continues, subject to a maximum of two lakh rupees.



5. INVESTOR EDUCATION AND PROTECTION FUND (IEPF)

Section 125 of the Act along with various Rules framed from time to time including [12]*Investor Education and Protection Fund 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, shall be credited with specified amounts and utilized for refund of unclaimed and unpaid amounts, promotion of investors' awareness and protection of the interests of investors, etc.

[12] Notified *vide* Notification No. GSR 854 (E), dated 05.09.2016 *w.e.f.* 07.09.2016.

The relevant provisions are discussed below:

1. **Credit of Specified Amounts to the Fund:** Following specified amounts shall be credited to the Fund:

(a) **Amount given by the Central Government-** The amount given by the Central Government by way of grants after due appropriation made by Parliament;

(b) **Donations by the Central Government-** Donations given by the Central Government, State Governments, companies or any other institution for the purposes of the Fund;

(c) **Amount lying in the Unpaid Dividend Account-** The amount lying in the Unpaid Dividend Account (UDA) of companies which is transferred by them to the Fund under section 124(5);

(d) **Amount in the General Revenue Account of the Central Government-** The amount in the General Revenue Account of the Central Government which had been transferred to that account under section 205A(5) of the Companies Act, 1956 as it stood immediately before the commencement of the Companies (Amendment) Act, 1999 and remaining unpaid or unclaimed on the commencement of the Act of 2013;

(e) **Amount in IEPF-** The amount lying in the Investor Education and Protection Fund under section 205C of the Companies Act, 1956;

(f) **Income from Investments-** The interest or other income received out of investments made from the Fund;

(g) **Amount received through disgorgement or disposal of Securities-** The amount received under section 38(4) *i.e.* amount received through disgorgement [13]or disposal of securities seized from a person who has been convicted for personation for acquisition of securities as provided in section 38(3);

(h) **Application Money-** 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 seven years from the date it became due for payment);

[13] 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.

(i) **Matured Deposits-** Matured deposits with companies other than banking companies (only if such amount has remained unclaimed and unpaid for a period of seven years from the date it became due for payment);

(j) **Matured Debentures-** Matured debentures with companies (only if such amount has remained unclaimed and unpaid for a period of seven years from the date it became due for payment);

(k) **Interest-** Interest accrued on the amounts referred to in clauses (h) to (j);

(l) **Amount received from Sale Proceeds-** 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-** Redemption amount of preference shares remaining unpaid or unclaimed for seven or more years; and

(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 amounts payable as mentioned in clause (a) to (n) of section 125 (2) of the Act [as stated above];

(b) all shares in accordance with section 124 (6) i.e. all those shares in whose case dividends have not been claimed or paid for seven consecutive years or more;

(c) all the resultant benefits arising out of shares held by the Authority under clause (b) above;

(d) all grants, fees and charges received by the Authority under these rules;

(e) all sums received by the Authority from such other sources as may be decided upon by the Central Government;

(f) all income earned by the Authority in any year;

(fa) all shares held by the Authority in accordance with proviso of sub-section (9) of section 90 of the Act and all the resultant benefits arising out of such shares, without any restrictions;

(g) all amounts payable as mentioned in sub-section (3) of section 10B of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, section 10B of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 sub-section (3) of section 38A of the State Bank of India Act, 1955 and section 40A of the State Bank of India (Subsidiary Bank) Act, 1959; and; and

(h) all other sums of money collected by the Authority as envisaged in the Act.

Further, according to Rule 3 (3), in case of term deposits and debentures of companies, due unpaid or unclaimed interest shall be transferred to the Fund along with the transfer of the matured amount of such term deposits and debentures.

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, in accordance with the orders made by the Court which had ordered disgorgement;

(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 incidental thereto in accordance with the rules framed under the Investor Education and Protection Fund Authority (Accounting, Audit, Transfer and Refund) Rules, 2016.

Refund of Amount- A person amounts referred to in clauses (a) to (d) of sub-section (2) of section 205C were transferred to IEPF, after the expiry of 7 years as per provisions of the Companies Act, 1956, shall be entitled to get refund out of

the fund in respect of such claims in accordance with rules made under this section.

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- In terms of Notification dated 13.01.2016[14], the Ministry of Corporate Affairs has notified sub-section (5), sub-section (6) (except with respect to the manner of administration of the Fund) and sub-section (7) of section 125 of the Act w.e.f. 13.01.2016. With this Notification, an Authority is being constituted for the administration and maintenance of accounts as well as other relevant records of the Fund.

Further, with the notification of *IEPF Authority (Appointment of Chairperson and Members, holding of Meetings and provision for Offices and Officers) Rules, 2016* on 13.01.2016, the Secretary, Ministry of Corporate Affairs shall be the ex-officio Chairperson of the Authority. In addition, there shall be six members (maximum limit seven) and a Chief Executive Officer who shall be the convenor of the Authority.

(ii) Provision of required Resources by the Central Government for Administration of the Fund- The Central Government may provide to the Authority such offices, officers, employees and other resources in accordance with the *IEPF Authority (Appointment of Chairperson and Members, holding of Meetings and provision for Offices and Officers) Rules, 2016*.

(iii) Authority to work in consultation with CAG of India- The Authority shall administer the Fund and maintain separate accounts and other relevant records in relation to the Fund in such form as may be

[14] Vide Notification No. GSR 26 (E), dated 13.01.2016.

prescribed 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) Preparation of Annual Report by the Authority- For each financial year, the Authority shall prepare in the prescribed form and at prescribed time its annual report giving full account of its activities during the financial year and forward a copy thereof to the Central Government. In turn, 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.

6. RIGHT OF DIVIDEND, RIGHTS SHARES AND BONUS SHARES TO BE HELD IN ABEYANCE PENDING REGISTRATION OF TRANSFER OF SHARES

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).

7. PUNISHMENT FOR FAILURE TO DISTRIBUTE DIVIDENDS WITHIN 30 DAYS

Section 127 of the Act contains time limit for distribution of dividends and punishment for failure to distribute dividend on time. Certain exemptions from punishments are also provided. These provisions are stated as under:

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. Posting of dividend warrants within 30 days absolves the company from any punishment irrespective of whether it is received by the shareholder concerned within this time or not. The offence is committed only when the company fails to post dividend warrants to the registered address of the members within 30 days of declaration. Non-receipt of dividend warrants by the shareholders within the prescribed time does not attract any punishment.

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 two 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.

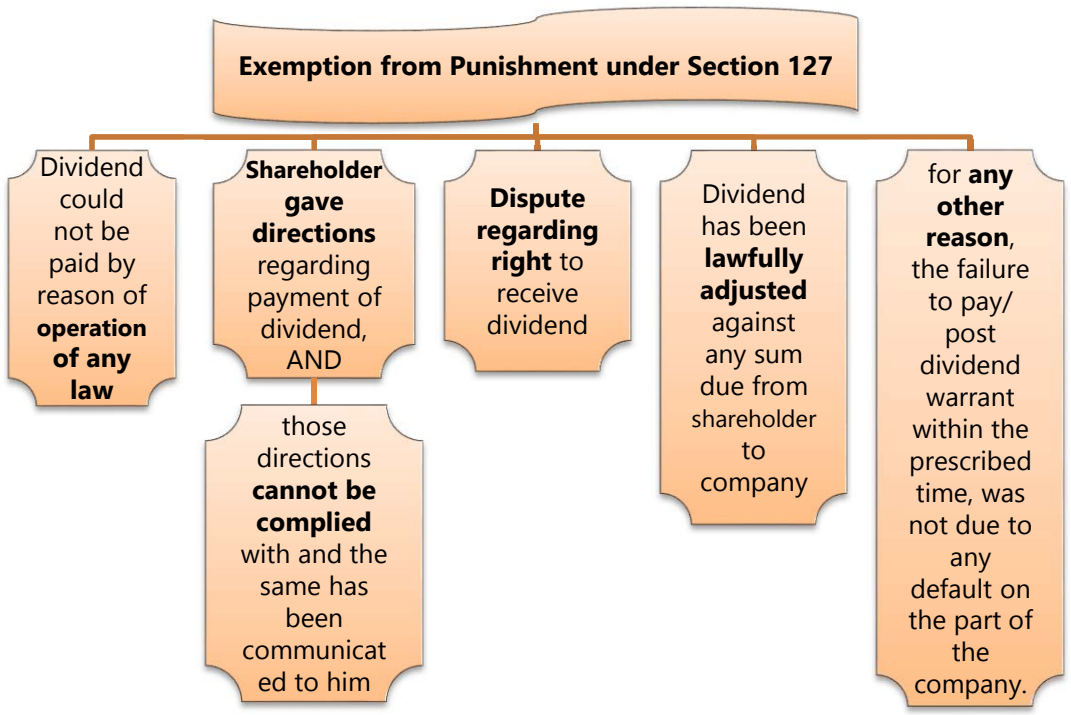


Illustration 7: Mr. Alok, holding equity shares of face value of ₹ 10 lakhs, has not paid ₹ 80,000 towards call money due on shares. Can the dividend amount payable to him be adjusted against such dues? Give reasons for your answer.

Answer: Yes. As per clause (d) of Proviso to Section 127, where the dividend is declared by a company and there remains calls in arrears or any other sum due from a member, then the dividend can be lawfully adjusted by the company against any such dues.

Thus, the action of the company adjusting dividend payable to Mr. Alok towards call money due on shares amounting to ₹ 80,000 is justified and therefore, no punishment is attracted.

Applicability of Section 127 to Nidhis

In terms of *Notification No. GSR 465 (E), dated 05-06-2015*, Section 127 dealing with punishment shall apply to the Nidhis, subject to the following modification:

In case the dividend payable to a member is ₹ 100 or less, it shall be sufficient compliance of the provisions of the section 127, if the declaration of the dividend is announced in the local language in one local newspaper of wide circulation and announcement of the said declaration is also displayed on the notice board of the Nidhis for at least 3 months.

SUMMARY

- Section 2(35) of the Companies Act, 2013, states that "dividend" includes any interim dividend.
- Dividend can be declared out of:
  - Profits of the current year after depreciation,
  - Profits for any previous financial year or years arrived at after providing for depreciation and remaining undistributed,
  - Both of the above,
  - Money provided by the Central Government or a State Government for the payment of dividend by the company in pursuance of a guarantee given by that Government.

[**Note:** Depreciation shall be provided in accordance with the provisions of Schedule II.]

- Before declaration of dividend, the company may, at its discretion, transfer any appropriate percentage of its profits to the reserves.
- When there is inadequacy or absence of profits, the company may declare dividend out of free reserves after following the conditions prescribed in the Rules.
- Amount of dividend (including interim dividend) shall be deposited in a separate bank account maintained with a scheduled bank within 5 days from the date of declaration of dividend.
- Payment of dividend-
  - Payable
    - in cash; or
    - by cheque; or
    - by dividend warrant; or
    - by any electronic mode
  - Payable
    - to the registered shareholder of the shares; or
    - to his order; or
    - to his banker.
  - In case of Nidhis
    - any dividend payable in cash may be paid by crediting the same to the account of the member, if the dividend is not claimed within 30 days from the date of declaration of the dividend.
- Unpaid Dividend Account (UDA)
  - Declared dividend not paid or claimed to be transferred to the Unpaid Dividend Account (UDA).
  - Prepare statement of particulars of the unpaid dividend.
  - Default in transferring of amount to UDA - Interest @ 12% p.a.
  - Entitled shareholders can apply for payment of amount from UDA.

- Transfer unpaid or unclaimed amount of dividend (and shares thereof) to Investor Education and Protection Fund (IEPF) after the expiry of seven years from the date of such transfer to UDA.
- Right of owner of shares transferred to IEPF to claim from IEPF: Claimant of transferred shares is entitled to reclaim the transfer of shares from IEPF by following the prescribed procedure and on submission of prescribed documents.
- In case any dividend is paid or claimed for any year during the said period of 7 consecutive years, the shares shall not be transferred to IEPF.
- Punishment: In case a company fails to pay declared dividends or fails to post dividend warrants within 30 days of declaration, company shall be liable to a penalty of one lakh rupees and in case of continuing failure, with a further penalty of five hundred rupees for each day after the first during which such failure continues, subject to a maximum of ten lakh rupees and every officer of the company who is in default shall be liable to a penalty of twenty-five thousand rupees and in case of continuing failure, with a further penalty of one hundred rupees for each day after the first during which such failure continues, subject to a maximum of two lakh rupees.

■ Exemptions from punishment under section 127

- dividend could not be paid by reason of operation of any law;
- shareholder gave directions regarding payment of dividend but those directions could not be complied with and the same had been communicated to him;
- dispute regarding right to receive dividend;
- dividend had been lawfully adjusted against any sum due from the shareholder to the company;
- for any other reason and the failure to pay/post dividend warrant within the prescribed time was not due to any default on the part of the company.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. *When the dividend is declared at the Annual General Meeting of the company, it is known as ....*

   (a) Final Dividend

   (b) Interim Dividend

   (c) Dividend on preference shares

   (d) Scrip Divided

2. *Amount to be transferred to reserves out of profits before any declaration of dividend is _____*

   (a) 5%

   (b) 7.5%

   (c) 10%

   (d) at the discretion of the company.

3. *The Board of Directors of Vidyut Limited are contemplating to declare interim dividend in the last week of July, 2022 but the company has incurred loss during the current financial year up to the end of June, 2022. However, it is noted that during the previous five financial years i.e., 2017-18, 2018-19, 2019-20, 2020-21 and 2021-22, the company had declared dividend at the rate of 8%, 9%, 12%, 11% and 10% respectively. Advise the Board as to the maximum rate at which they can declare interim dividend despite incurring loss during the current financial year.*

   (a) Maximum at the rate of 10%.

   (b) Maximum at the rate of 11%.

   (c) Maximum at the rate of 10.5%.

   (d) Maximum at the rate of 11.5%.

4. *The amount accumulated in the Investor Education and Protection Fund shall not be used for:*

   (a) refunds in respect of unclaimed dividends, matured deposits, matured debentures, application money due for refund and interest thereon.

   (b) reimbursement of legal expenses incurred in pursuing class action suits under section 37 and 245.

   (c) grants or donation to the Central Government for the purpose of investor's education and training.

   (d) distribution of any disgorged amount among eligible and identifiable applicants who have suffered losses.

5. *In case a company fails to pay declared dividends or fails to post dividend warrants within 30 days of declaration, company shall be liable to pay simple interest at the rate of .....during the period for which such default continues.*

   (a) 6% p.a.

   (b) 12% p.a.

   (c) 15% p.a.

   (d) 18% p.a.

Descriptive Questions

1. *The Annual General Meeting of ABC Bakers Limited held on 30th May, 2022, 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, 2022. 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.*

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 Annual General Meeting. 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.

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.

4. *Star Computers Limited declared and paid dividend in time to all its equity holders for the financial year 2021-22, 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.

5. *Alpha Herbals, a Section 8 company is planning to declare dividend in the Annual General Meeting for the Financial Year ended 31-03-2023. 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.*

6. *YZ Medical Instruments Limited is a manufacturing company & has proposed a dividend @ 10% for the year 2022-2023 out of the profits of current year. The company has earned a profit of ₹ 910 crores during 2022-2023. 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.

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.*

8. *Alex limited is facing loss in business during the financial year 2022-2023. 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?*

ANSWERS

Answer to MCQ based Questions

1.	**(a)**	Final Dividend
2.	**(d)**	at the discretion of the company.
3.	**(b)**	Maximum at the rate of 11%
4.	**(c)**	grants or donation to the Central Government for the purpose of investor's education and training.
5.	**(d)**	18% p.a

Answer to Descriptive Questions

1. 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. According to 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, 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.

Further, 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.

(i). 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.

(ii). 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. 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. **(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. 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. 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 2022-2023. 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.

7. 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. 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 2022-2023. 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 2022-2023 is not valid.

NOTES

CHAPTER 9

ACCOUNTS OF COMPANIES

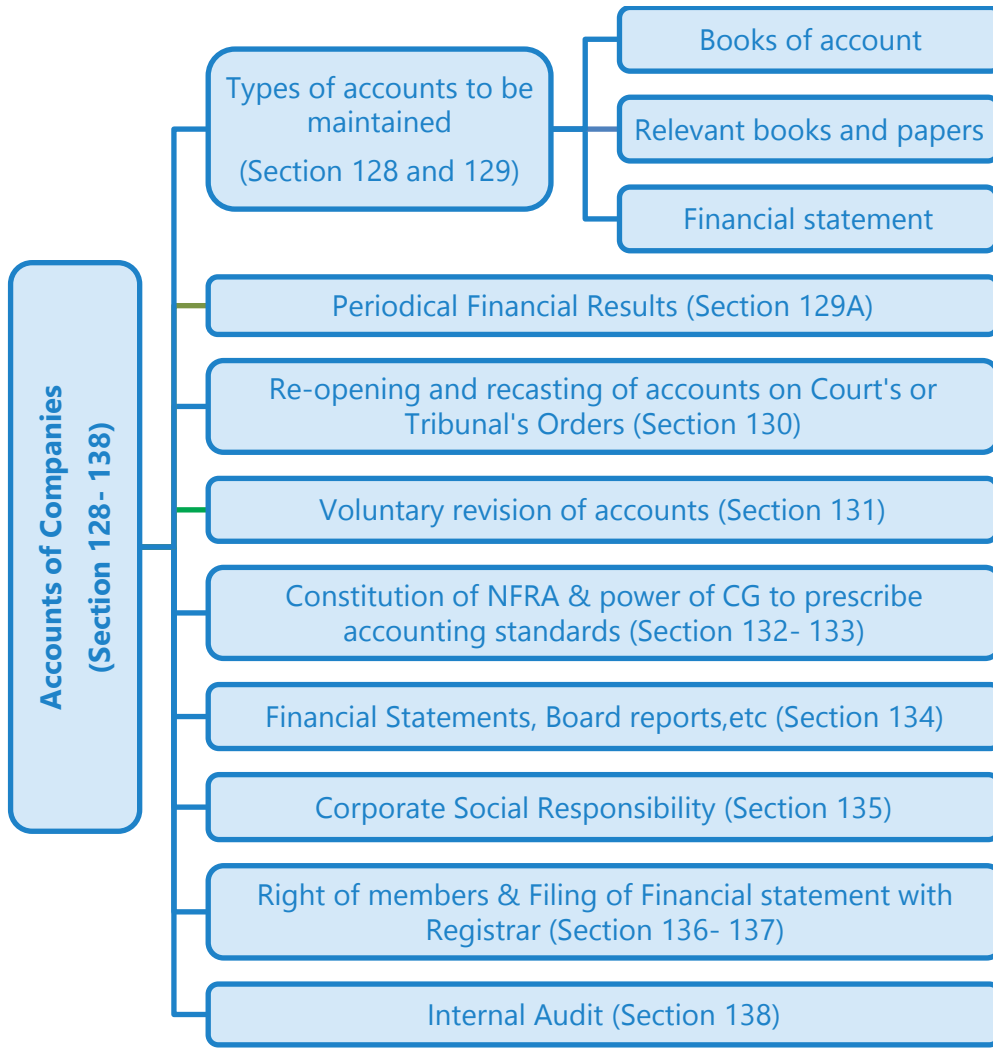
LEARNING OUTCOMES

At the end of this chapter, you will be able to:

- Gain knowledge about preparation and maintenance of books of account etc. to be kept by company.
- Identify the provisions as to preparation and filing of financial statements and other related matters.
- Explain about the re-opening and revision of financial statements.
- Gain knowledge about constitution, working and power of National Financial Reporting Authority (NFRA).
- Comprehend various concepts related to Corporate Social Responsibility (CSR).
- Explain procedure related to internal audit of companies.

CHAPTER OVERVIEW

This chapter explains the provisions of Chapter IX of the Companies Act, 2013 (hereinafter also referred to as "the Act" or "this Act"), consisting of Sections 128 to 138 dealing with the accounts of companies. Chapter will also explain procedural aspects described in relevant rules notified in this context. Following diagram depicts the arrangement of relevant sections.

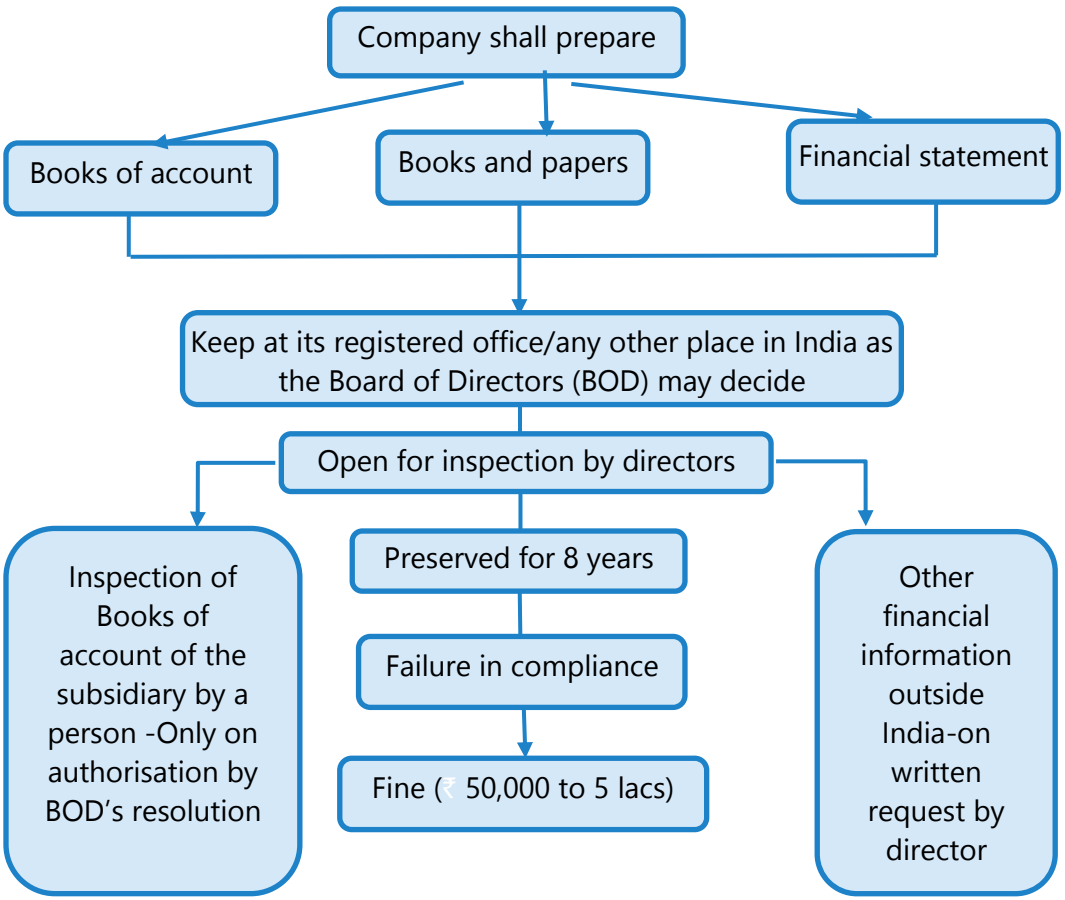


1. INTRODUCTION

Chapter IX	Consists of sections 128 to 138 as well as the Companies (Accounts) Rules, 2014.

Directors who are agents of shareholders and acting in fiduciary capacity, required to report in order to disclose financial results (financial performance and position through financial results) to shareholders so that the shareholders remain aware of the working and affairs of the company. As stated earlier also, chapter IX of the Companies Act, 2013, lays down various provisions related to maintenance of proper books of account of the companies and allied aspects that are explained in this chapter.

2. BOOKS OF ACCOUNT, ETC., TO BE KEPT BY COMPANY [SECTION 128]



Every company shall prepare **books of account** and other relevant **books and records** and **financial statement** for every **financial year**.

Note:

(Despite these definition clauses already covered in chapter 1, a quick reference shall be handy to recapitulate)

1. As defined in Section 2(13) of the Act, the **"books of account" includes** records maintained in respect of

- All sums of money received and expended by a company and matters in relation to which the receipts and expenditure take place;
- 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) of the Companies Act 2013 ("Act") in the case of a company which belongs to any class of companies specified under that section.

2. As per section 2(12) of this Act, the "**book and paper**" and "**book or paper**" **include** books of account, deeds, vouchers, writings, documents, minutes and registers maintained on paper or in electronic form.

3. Further as per section 2(40) of this Act, the "**financial statement"** in relation to a company, **includes-**

- A balance sheet as at the end of the financial year;
- 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;
- Cash flow statement for the financial year with **exception** in case of one person company, small company, dormant company and private company (if such private company is a start-up and has not committed a default in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar[1]);
- A statement of changes in equity, if applicable; and

[1] Vide exemption notification GSR 583(E) dated 13th June, 2017

- Any explanatory note annexed to, or forming part of, any document referred to in sub-clause (i) to sub-clause (iv)

  It is worth noting here that for the purposes of this Act, the term **'start-up'** or "start-up company" means a private company incorporated under the Companies Act, 2013 or the Companies Act, 1956 and **recognised** as start-up in accordance with the notification issued by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry.

4. As per **section 2(41)** of this Act, the **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.

Example 1 - Mahindra Limited was incorporated as a company on 22nd February 2022. Its first financial year shall comprises the period ending on the 31st day of the March of the following year i.e. 31st March 2023.

Two-year time from the date commencement of this Act was given to corporates to align their financial year to the provisions contained in 2(41).

Provided that on an application made by a company or body corporate, which is a holding company or a subsidiary or associate company of a company incorporated outside India and which is required to follow a different financial year for consolidation of its accounts outside India, the **Central Government** may, on the basis of such application made 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 worth noting that in case of a specified IFSC public company[2] and specified IFSC private company[3] that is a subsidiary of a foreign company, the financial year of the subsidiary may be same as the financial year of its holding company and approval of the Tribunal shall not be required.

[2] Vide notification GSR 08(E) dated 5th January, 2017
[3] Vide notification GSR 09(E) dated 5th January, 2017

Earlier the power to hear and decide upon the application regarding different financial year for consolidation of its accounts outside India was vested with tribunal, which was assumed by Central Government through the Companies (Amendment) Ordinance, 2018 dated 02.11.2018 (later repealed by the Companies (Amendment) Ordinance, 2019 dated 12.01.2019). This is the reason behind "why exemption notification specified above still carry the word tribunal" (which shall be read as Central Government now). Ordinance also provided that pending before the Tribunal shall be disposed of by the Tribunal in accordance with the provisions applicable to it before commencement of such ordinance.

BOOKS OF ACCOUNT SHOULD GIVE A TRUE AND FAIR VIEW AND MUST BE KEPT ON ACCRUAL BASIS AND DOUBLE-ENTRY SYSTEM OF ACCOUNTING

Section 128(1) requires 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) and explain the transactions effected both at the registered office and its branches.

Section 128(1) also requires such books of account shall be kept on **accrual basis** and according to the **double entry system of accounting**. **Students are advised to take note:**

1. A **True and fair view** of the **state of the affairs** means that the financial statements are free from material misstatements and faithfully represents the financial performance and positioning of an entity.
2. **Accrual basis of accounting** is an accounting assumption, or an accounting concept followed in preparation of the financial statements, which warrants recording income and expenses **as they accrue** (earned or incurred); opposite to cash system when they are received or paid.
3. **Double entry system of accounting** 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 and therefore, needs to be posted in at least two accounts. Double aspect enables an effective control of business because all the books of account must balance.

PLACE OF KEEPING BOOKS OF ACCOUNT

Section 128(1) further requires every company to prepare and keep the books of account and other relevant books and papers and financial statements at its registered office.

But first proviso to sub-section 1 provides that all or any of the books of account may be kept at such other place in India as the Board of directors may decide. Where such a decision is taken by the Board, the company shall within seven days thereof file with the registrar a notice in writing as per rule 2A of the *Companies (Accounts) Rules, 2014* in form AOC-5 giving full address of that other place.

MAINTENANCE OF BOOKS OF ACCOUNT IN ELECTRONIC FORM

Second proviso to section 128(1) allows company to keep books of account or other relevant papers in electronic mode as per manner specified in the **Rule 3** of the *Companies (Accounts) Rules, 2014*.

For the purposes of rule 3, the expression "**electronic mode**" includes **electronic form** and **electronic record** as defined in clause (r) and (t) respectively of sub-section (1) of section 2 of the Information Technology Act, 2000[4]

Remain accessible in India [Rule 3(1)]

The books of account and other relevant books and papers maintained in electronic mode shall remain accessible in India, **at all times**, so as to be usable for subsequent reference.

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,

[4] Act 21 of 2000

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.

BOOKS OF ACCOUNT - BRANCH OFFICE [SUB-SECTION 2]

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, and
- Proper summarised returns are sent on periodical basis by branch office to the company at its registered office or other place (referred to sub-section 1).

As per **Rule 4(1)** of the *Companies (Accounts) Rules, 2014,* the summarised returns of the books of account of the company 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.

INSPECTION BY DIRECTORS [SUB-SECTION 3 & 4]

In case of books of account and other books and papers maintained by the company within India.

Any director can inspect the books of account and other books and papers maintained by the company within India during business hours. Hence same shall be kept open for inspection at the registered office of the company or at such other place in India.

In the case of financial information, if any, maintained outside the country

Where any other financial information maintained outside the country is required by a director, the director shall furnish a request to the company setting out the full details of the financial information sought, the period for which such information is sought under **Rule 4(2)** of the *Companies (Accounts) Rules, 2014*

Sub-rule 3 requires the company shall produce such financial information to the director within **fifteen days** of the date of receipt of the written request.

Note:

1. The financial information (referred in sub-rule 2 and 3 above) shall be sought for by the director himself and not by or through his power of attorney holder or agent or representative.
2. As per **sub-section 4**, where an inspection is made under sub-section 3, the officers and other employees of the company shall give to the person making such inspection all assistance in connection with the inspection which the company may reasonably be expected to give.

Inspection in respect of any subsidiary company

The proviso to sub-section 3 provides that a person can inspect the books of account of the subsidiary, only on **authorisation** by way of the **board resolution.**

Period for preservation of books [Sub-section 5]

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.

Note:

1. In case of a company incorporated less than eight years before the financial year, the books of account for the entire period preceding the financial year together with the vouchers shall be so preserved.
2. As per proviso to sub-section 5, where an investigation has been ordered in respect of a company under Chapter XIV of the Act related to inspection, inquiry or investigation, the Central Government may direct that the books of account may be kept for such period longer than 8 years, as it may deem fit and give directions to that effect.

Persons responsible and Penalty [Sub-section 6]

Following shall be punishable with fine **not less than fifty thousand rupees**, which **may extend to five lakh rupees**; if duty-bound to comply with provisions of this section (Section 128 of this Act) but contravene such provisions:

- Managing Director defined under section 2(54),

- Whole-Time Director, in charge of finance defined under section 2(94),
- Chief Financial Officer defined under section 2(19), or
- Any other person of a company charged by the Board with duty of complying with provisions of section 128.

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.

Illustration 2

Can XYZ limited maintain its books of account on cash basis?

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 according to 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 account on cash basis.

3. FINANCIAL STATEMENT [SECTION 129]

As per sub-section 1, the financial statement shall:

- Give a **true and fair view** of the state of affairs of the company or companies,
- Comply with the **accounting standards notified under section 133**, further the items contained in such financial statements shall be in accordance with the accounting standards and

- Shall be in the **form** or forms as may be provided for different class or classes of companies in **Schedule III**.

Note

1. **Schedule III** has been amended vide *Notification No. G.S.R. 404(E)* dated 6th April 2016 according to which Schedule III has been divided into two divisions.

Division I deal with financial statement for a company whose financial statement are required to comply with the *Companies (**Accounting Standards**) Rules, 2021*[5].

Division II deals with financial statement for a company whose financial statement is required to comply with the *Companies (**Indian Accounting Standards**) Rules, 2015*[6].

2. Nothing contained in sub-section 1 to section 128 shall apply to any;

- Insurance company or
- Banking company or
- Company engaged in the generation or supply of electricity, or
- Other class of company for which a form of financial statement has been specified in or under the Act governing such class of company.

3. Further, if **matters which are not required to be disclosed** by Act governing the companies specified at point 2 above (such as *Insurance Act, 1938; Insurance Regulatory and Development Authority Act, 1999; Banking Regulation Act, 1949; or Electricity Act, 2003*), then **non-disclosure of such matters** shall **not be considered as not presenting a true and fair view** of the state of affairs of such company.

Note – Point 3 stated above can be further simplified in the sense that 'Despite **non-disclosure** of **matters which are not required to be disclosed** by applicable governing Act, the financial statement of companies specified at point 2 above are said to **present a true and fair view** of the state of affairs.'

[5] Vide notification GSR 432(E) dated 23rd June, 2021 as amended from time to time
[6] Vide notification GSR 111(E) dated 16th February, 2015 as amended from time to time

4. For the purposes of section 129, any reference to the financial statement shall include any notes annexed to or forming part of such financial statement, giving information required to be given and allowed to be given in the form of such notes under this Act.

LAYING OF FINANCIAL STATEMENTS AT AGM [SUB-SECTION 2]

At every annual general meeting of a company, the Board of Directors of the company shall lay before such meeting financial statements for the financial year.

CONSOLIDATED FINANCIAL STATEMENTS [SUB-SECTION 3]

Consolidation of financial Statement

Where a company has one or more subsidiaries or associate companies, it shall (in addition to financial statements provided under sub-section 2);

- Prepare a consolidated financial statement (CFS) of the company and of all the subsidiaries, associate companies and joint ventures in the same form and manner as that of its own and in accordance with applicable accounting standards,
- Which shall also be laid before the annual general meeting of the company along with the laying of its financial statement under sub-section (2).

Salient features of financial statement of Subsidiaries, Associates and JVs – Form [First proviso to Sub-section 3 read with rule 5]

The statement containing the salient feature of the financial statement of a company's subsidiary or subsidiaries, associate company or companies and joint venture or ventures under the first proviso to sub-section (3) of section 129 shall be in Form **AOC-1** as per Rule 5 of the *Companies (Accounts) Rules, 2014*.

Manner of consolidation of Accounts [Second proviso to Sub-section 3 read with rule 6]

Central Government may provide for the consolidation of accounts of companies in such manner as may be prescribed under Rule 6 of the *Companies (Accounts) Rules, 2014,* as explained below:

Manner of consolidation of Accounts - The consolidation of financial statements of the company shall be made in accordance with the provisions of **Schedule III** of the Act and the **applicable accounting standards**.

Exception to manner stated above

1. A company covered under sub-section (3) of section 129 which is not required to prepare consolidated financial statements under the Accounting Standards, it shall be sufficient if the company complies with provisions of consolidated financial statements provided in Schedule III of the Act.

2. For a company which does not have a subsidiary or subsidiaries but has one or more associate companies or Joint Ventures or both will not be required to comply with this rule of consolidation of financial statements in respect of associate companies or joint ventures or both, as the case may be, only for the financial year commencing from the 1st day of April, 2014 and ending on the 31st day of March, 2015.

3. Nothing in this rule shall apply in respect of consolidation of financial statement by a company having subsidiary or subsidiaries incorporated outside India commencing on or after 1st April 2014.

Exemptions from preparation of CFS

The preparation of consolidated financial statements by a company is not required if it meets the following conditions:

a. 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, having been intimated in writing and for which the proof of delivery of such intimation is available with the company, do not object to the company not presenting consolidated financial statements;

b. It is a company whose securities are not listed or are not in the process of listing on any stock exchange, whether in or outside India; and

c. Its ultimate or any intermediate holding company files consolidated financial statements with the Registrar which are in compliance with the applicable Accounting Standards.

Preparation, adoption and audit of consolidated financial statements [Sub-section 4]

The provisions applicable to the preparation, adoption and audit of the financial statements of a holding company shall, ***mutatis mutandis***, also apply to the consolidated financial statements.

DISCLOSURE OF DEVIATION FROM ACCOUNTING STANDARDS ALONG WITH REASON AND EFFECT THEREOF [SUB-SECTION 5]

Without prejudice to sub-section (1), 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.

EXEMPTION BY CENTRAL GOVERNMENT IN PUBLIC INTEREST [SUB-SECTION 6]

The Central Government may, on its own or on an application by a class or classes of companies, by notification, exempt any class or classes of companies from complying with any of the requirements of this section or the rules made thereunder, 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 in the notification.

Section 129 shall not apply to the **Government Companies engaged in defence production** to the extent of application of relevant Accounting Standard on segment reporting[7]

The exceptions, modifications and adaptations provided above shall be applicable only to those Government Companies which has not committed a default in filing its financial statements under section 137 of the said act or annual return under section 92 of the said act with the registrar[8]

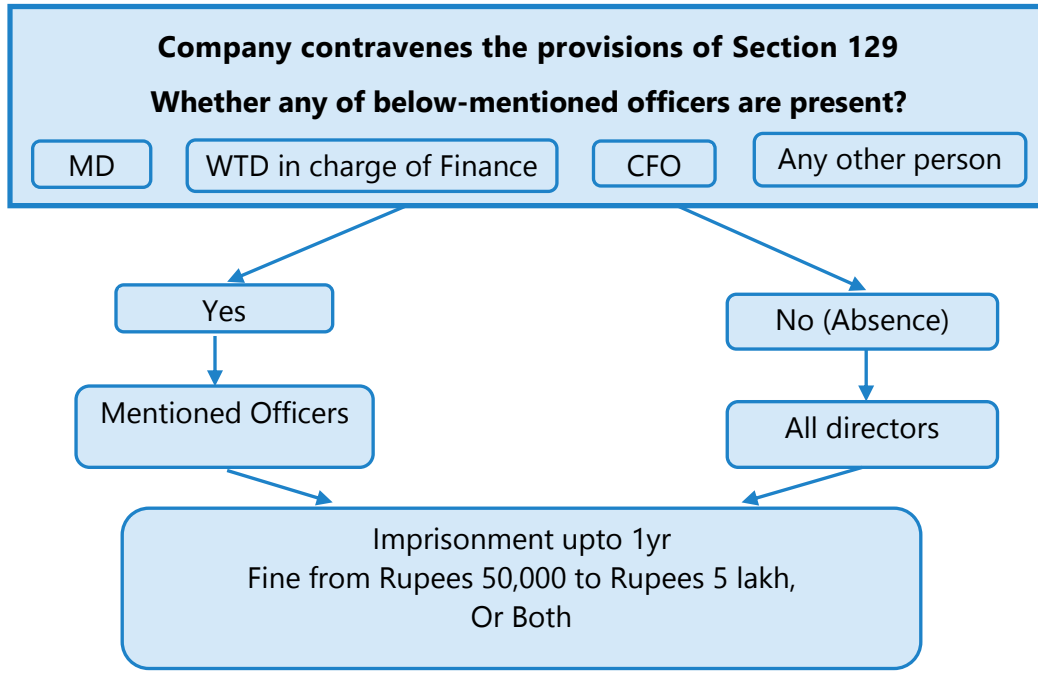
PENALTY [SUB-SECTION 7]

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

[7] Exemption originally granted vide notification number G.S.R. 463(E) dated the 5th June, 2015, later substituted vide notification number G.S.R. 802(E) dated 23.02.2018 to replace "AS-17" with relevant Accounting Standard

[8] Vide notification number G.S.R. 582(E) dated 13th June, 2017

year or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees, or with both. Penal provision can be summarised as;



Note: For listed companies, provisions contained in Regulation 33 and 52 of Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 are to be applied in addition to provisions of section 129 of this Act.

Illustration 3

Modern Furniture Limited (MFL) is required to prepare the financial statement that comply with accounting standards and shall be in form specified in schedule III. But the financial statement prepared and presented are not in compliance with applicable accounting standards, therefore MFL required to disclose which of following:

i. Deviation

ii. Reason of deviation

iii. Financial effects arise out of such deviation.

Options

a. Only i

b. Only i and ii

c. *Only i and iii*

d. *All of i, ii, and iii*

Answer – d

Reason – Where the financial statements of a company, which required to but do not comply with the accounting standards, 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.

4. PERIODICAL FINANCIAL RESULTS [SECTION 129A]

The Central Government may, require such class or classes of unlisted companies, as may be prescribed:

a. To prepare the financial results of the company on such **periodical basis** and in **such form** as may be prescribed;

b. To obtain approval of the Board of Directors and **complete audit** or **limited review** of such periodical financial results in such manner as may be prescribed;

c. File a copy with the Registrar within a period of **thirty days** of completion of the relevant period with such fees as may be prescribed.

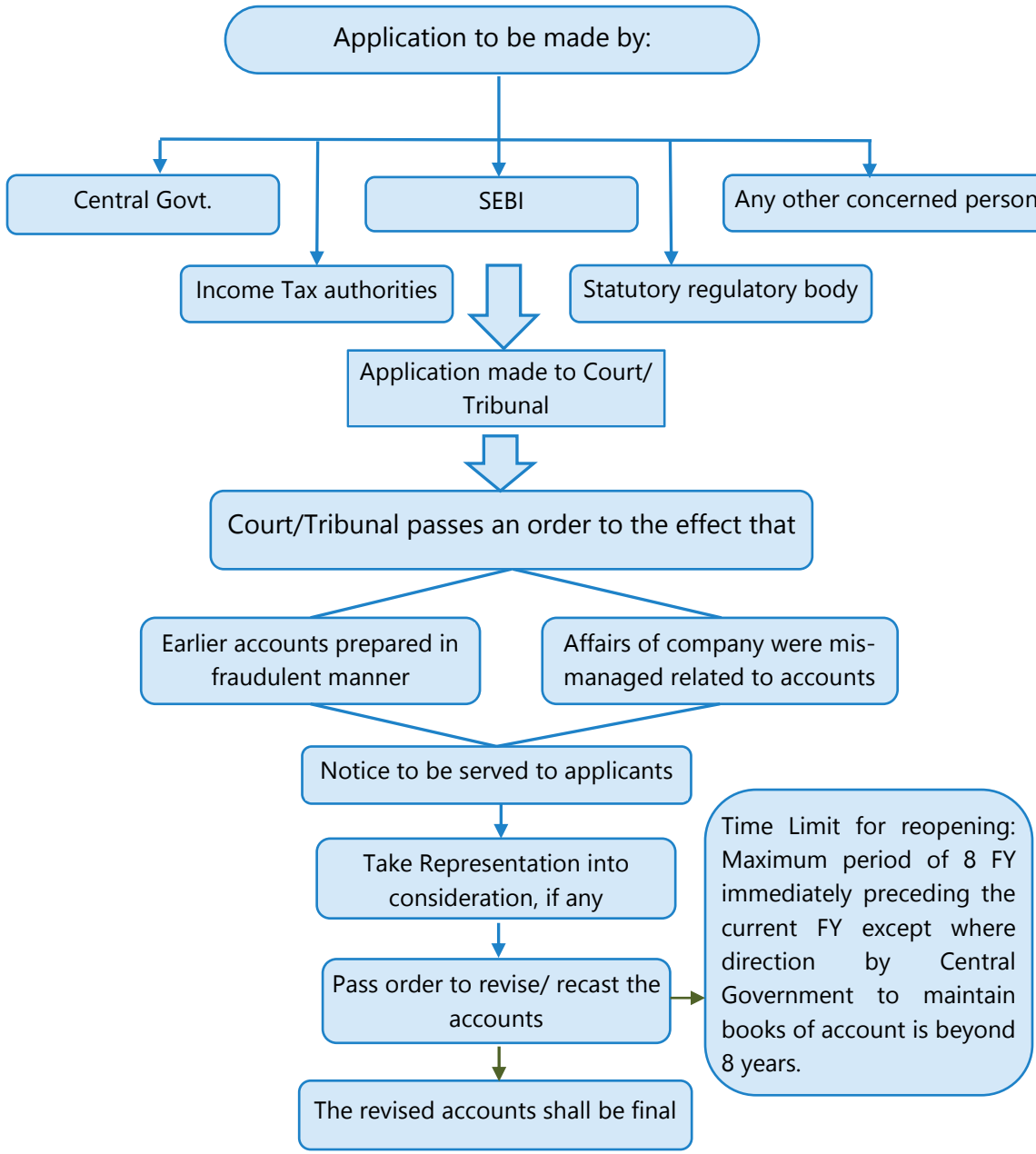
Students are advised to take note:

At present there are over 11 lakh unlisted companies actively operating in India. Some of these are really large enough with widely-spread interests [to name top 10 as on Dec 2022 - Serum Institute of India (Valued at ₹ 2,19,700 cr), Byju's (₹ 1,82,000 cr), NSE (₹ 1,39,000 cr), Swiggy (₹ 88,600 cr), OYO (₹ 77,800 cr), Dream 11 (₹ 66,200 cr), Parle Products (₹ 62,600 cr), Razorpay (₹ 62,100 cr), Ola (₹ 60,500 cr), and Intas Pharma (₹ 59,300 cr)] that make corporate governance critical issue in case of such unlisted companies as well. Hence this new section inserted vide Amendment Act of 2020 aims to improve corporate governance of certain class or classes of unlisted companies by requiring them to prepare financial results on 'periodic' basis in addition to annual submission of financial reports.

Mind it, no rule has been prescribed or notification has been made as on date (30.04.2023) under this recently inserted section.

5. RE-OPENING OF ACCOUNTS ON COURT'S OR TRIBUNAL'S ORDERS [SECTION 130]

This section seeks to provide for the re-opening of books of account and recasting of financial statements.



COURT/TRIBUNAL ORDER FOR RE-OPENING OF ACCOUNTS [SUB-SECTION 1]

A company **shall not**

a. **re-open** its books of account and

b. **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

e. any person concerned.

& an **order** is made by a **court of competent jurisdiction or tribunal** to the effect

a. That the relevant earlier accounts were prepared in a **fraudulent** manner; or

b. The affairs of the company were **mismanaged** during the relevant period, casting a doubt on the reliability of financial statements:

Proviso to section 130(1) requires the Court or Tribunal, as the case may be, **shall:**

- Give **notice** to the Central Government, Income-tax authorities, SEBI, or any other statutory regulatory body or authority concerned, or any other person concerned and
- Take into consideration the **representations**, if any, made by them **before passing any order under this section.**

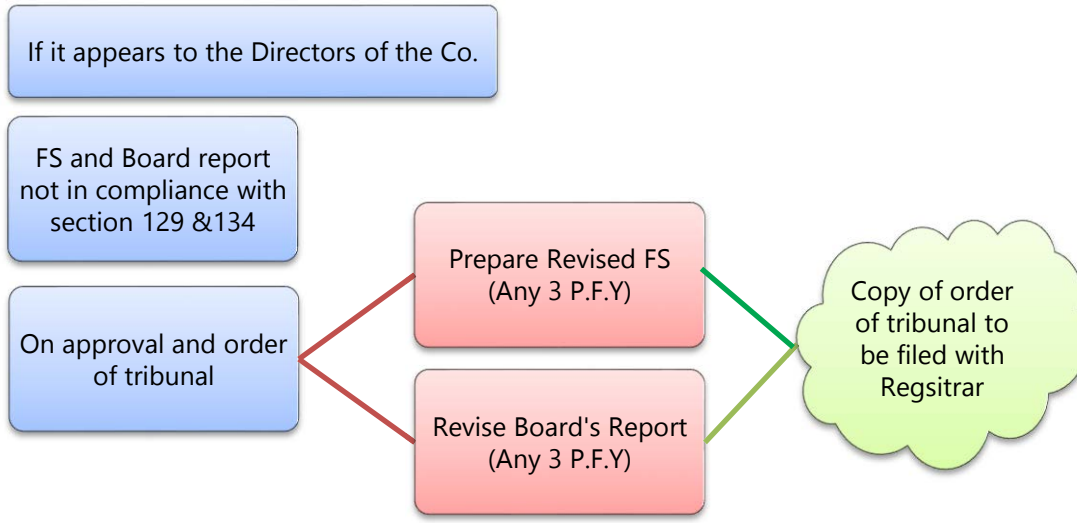
Sub-section 2 is sort of saving clause that provides, without prejudice to the provisions of this Act, the accounts so revised or re-casted; shall be final.

TIME LIMIT [SUB-SECTION 3]

Order of re-opening of books of account shall only relate to eight financial years immediately preceding the current financial year.

But where a direction has been issued by the Central Government (under the proviso to section 128(5) for keeping of books of account for a period longer than eight years, the books of account may be ordered to be re-opened within such longer period.

6. VOLUNTARY REVISION OF FINANCIAL STATEMENTS OR BOARD'S REPORT [SECTION 131]



VOLUNTARY REVISION OF FINANCIAL STATEMENT OR BOARD'S REPORT ON THE APPROVAL OF TRIBUNAL [SUB-SECTION 1]

If it appears to the **directors** of a company that:

a. the **financial statement** of the company does **not comply** with the provisions of **section 129**; or

b. the **report of the Board** does **not comply** with the provisions of **section 134**

They may prepare **revised** financial statement or board's report in respect of any of the **three preceding financial years.**

After obtaining **approval of the Tribunal** on an **application** made by the company in **Form No. NCLT 1** within fourteen days of the decision taken by the Board.

A **certified copy** of the **order** of the Tribunal shall be filed with the **Registrar of Companies within thirty days** of the date of receipt of the certified copy.

Note:

1. Section 131 deals with the revision of financial statement or boards report, as the case may be, on a **voluntary** basis, if the board of directors so opines, unlike section 130.

2. Such revised financial statement or report shall not be prepared or filed more than **once in a financial year.**

3. **Rule 77** of the *National Company Law Tribunal Rules, 2016* requires:

a. The **application** shall **contain** the following particulars/details, namely:

- Financial year or period to which such accounts relates;
- The name and contact details of the Managing Director, Chief Financial Officer, directors, Company Secretary and officer of the company responsible for making and maintaining such books of account and financial statement;
- Where such accounts are audited, the name and contact details of the auditor or any former auditor who audited such accounts;
- Copy of the Board resolution passed by the Board of Directors;
- Grounds for seeking revision of financial statement or Board's Report;
- In case the majority of the directors of company or the auditor of the company has been changed immediately before the decision is taken to apply under section 131, the company shall disclose such facts in the application.

b. The company shall **advertise the application** at least **fourteen days** before the date of hearing;

c. The Tribunal shall issue **notice to the auditor** of the original financial statement and heard him.

d. The Tribunal may pass **appropriate order** in the matter as may deem fit, after considering the application, hearing the auditor and/or any other person.

Note – As per first proviso to section 131(1), the tribunal shall also give **notice 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.

e. On receipt of approval from Tribunal a **general meeting** may be called and notice of such general meeting along with reasons for change in financial statements may be published in newspaper in English and in vernacular language.

Note – As per third proviso to section 131(1), the detailed reasons for revision of such financial statement or report shall also be disclosed in the Board's report in the relevant financial year in which such revision is being made.

f. In the general meeting, the **revised financial statements**, statement of directors and the statement of auditors may be **put up for consideration** before a decision is taken on **adoption of the revised financial statements**.

g. On approval in the general meeting, the revised financial statements along with the statement of auditors or revised report of the Board, as the case may be, shall be filed with the **Registrar** of Companies **within thirty days** of the date of approval by the general meeting.

SCOPE OF REVISIONS [SUB-SECTION 2]

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. **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**.

FRAMING OF RULES BY THE CENTRAL GOVERNMENT IN RELATION TO REVISED FINANCIAL STATEMENT/DIRECTOR'S REPORT [SUB-SECTION 3]

The **Central Government may make rules** as to the application of the provisions of this Act in relation to revised financial statement or a revised director's report and such rules may, **in particular**:

a. Make different provisions according to which the previous financial statement or director's report are replaced or are supplemented by a document **indicating the corrections** to be made;

b. Make provisions with respect to the **functions of the company's auditor** in relation to the revised financial statement or report;

c. **Steps required to be taken by the directors.**

Note:

Rule 77 of the *National Company Law Tribunal Rules, 2016*, notified in this regard by the Central Government.

7. CONSTITUTION OF NATIONAL FINANCIAL REPORTING AUTHORITY [SECTION 132]

CONSTITUTION OF NATIONAL FINANCIAL REPORTING AUTHORITY (REFEREED AS TO NFRA OR THE AUTHORITY) [SUB-SECTION 1]

The Central Government may, by notification, constitute the National Financial Reporting Authority (NFRA) to provide for matters relating to accounting and auditing standards under this Act.

Note:

The Central Government hereby appoints the 1st October 2018 as the date of constitution of National Financial Reporting Authority, with head office at New Delhi (as require by sub-section 12).

Extra Reading (only to lay the foundation)

Provisions pertaining to NFRA and Power vested with NFRA are applicable only in context of those companies and bodies corporate that are governed by the NFRA, hence at outset, it is essential to list-out them.

As per rule 3 of the *National Financial Reporting Authority Rules 2018*, the Authority 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 of the following class of companies and bodies corporate, namely:

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 five hundred crores or having annual turnover of not less than rupees one thousand crores or having, in aggregate, outstanding loans, debentures and deposits of not less than rupees five hundred 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 or bodies corporate incorporated by an Act in accordance with clauses (b), (c), (d), (e) and (f) of sub-section (4) of section 1 of the Act;

d. Body corporate or company or person, or any class of bodies corporate or companies or persons, on a reference made to the Authority 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), if the income or net worth of such subsidiary or associate company exceeds twenty percent of the consolidated income or consolidated net worth of such company or the body corporate, as the case may be, referred to in clauses (a) to (d).

FUNCTIONS AND DUTIES OF THE NFRA [SUB-SECTION 1A AND 2]

Sub-section 1A to section 132 provides that, National Financial Reporting Authority shall perform its functions through such divisions as may be prescribed.

Further sub-section 2 to section 132 read with **rule 4, 6 to 9** of the *National Financial Reporting Authority Rules 2018* lays down the functions and duties that NFRA shall perform, namely:

The Authority shall **protect the public interest** and the **interests of investors, creditors and others associated** with the companies or bodies corporate by establishing **high quality standards of accounting and auditing** and exercising effective **oversight of accounting functions** performed by the companies and bodies corporate and auditing functions performed by auditors.

Without prejudice to the generality, the Authority in particular shall: -

a. **Maintain** details of **particulars of auditors** appointed in the companies and bodies corporate governed by NFRA;

b. **Recommend accounting standards and auditing standards** for approval by the Central Government;

Note:

For the purpose of recommending accounting standards or auditing standards for approval by the Central Government, Rule 6 requires, the NFRA:

- Shall receive recommendations from the Institute of Chartered Accountants of India (ICAI) on proposals for new accounting standards or auditing standards or for Amendment to existing accounting standards or auditing standards;
- May seek additional information from the ICAI on the recommendations received under clause (a), if required.

The Authority shall consider the recommendations and additional information in such manner as it deems fit before making recommendations to the Central Government.

c. **Monitor and enforce compliance** with accounting standards and auditing standards;

Note:

For the purpose of monitoring and enforcing compliance with **accounting standards** under the Act by a company or a body corporate, Rule 7 requires NFRA:

1. May review the financial statements of such company or body corporate, as the case may be, and if so required, direct such company or body corporate or its auditor by a written notice, to provide further information or explanation or any relevant documents relating to such company or body corporate, within such reasonable time as may be specified in the notice.

2. May require the personal presence of the officers of the company or body corporate and its auditor for seeking additional information or

explanation in connection with the review of the financial statements of such company or body corporate.

3. Shall publish its findings relating to non-compliances on its website and in such other manner as it considers fit, unless it has reasons not to do so in the public interest and it records the reasons in writing.

4. Where the Authority finds or has reason to believe that any accounting standard has or may have been violated, it may decide on the further course of investigation or enforcement action through its concerned Division.

For the purpose of monitoring and enforcing compliance with **auditing standards** under the Act by a company or a body corporate, Rule 8 requires NFRA:

1. May review working papers (including audit plan and other audit documents) and communications related to the audit;

2. May evaluate the sufficiency of the quality control system of the auditor and the manner of documentation of the system by the auditor; and

3. May perform such other testing of the audit, supervisory, and quality control procedures of the auditor as may be considered necessary or appropriate.

4. 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.

5. May seek additional information or may require the personal presence of the auditor for seeking additional information or explanation in connection with the conduct of an audit.

6. Shall perform its monitoring and enforcement activities through its officers or experts with sufficient experience in audit of the relevant industry.

7. Shall publish its findings relating to non-compliances on its website and in such other manner as it considers fit, unless it has reasons not to do so in the public interest and it records the reasons in writing.

8. 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.

9. May send a separate report containing proprietary or confidential information to the Central Government for its information.

10. Where the Authority 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.

d. **Oversee** the **quality of service of the professions** associated with ensuring compliance with such standards and **suggest measures for improvement** in the quality of service;

Notes

1. Rule 9 provides, on the basis of its review, the NFRA may direct an auditor to take measures for improvement of audit quality including changes in their audit processes, quality control, and audit reports and specify a detailed plan with time-limits.

2. It shall be the duty of the auditor to make the required improvements and send a report to the NFRA explaining how it has complied with the directions made by the NFRA.

3. The NFRA shall monitor the improvements made by the auditor and take such action as it deems fit depending on the progress made by the auditor.

4. The NFRA may refer cases with regard to overseeing the quality of service of auditors of companies or bodies corporate referred to in rule 3 to the Quality Review Board constituted under the Chartered Accountants Act, 1949 or call for any report or information in respect of such auditors or companies or bodies corporate from such Board as it may deem appropriate.

5. The NFRA may take the assistance of experts for its oversight and monitoring activities.

e. **Promote awareness** in relation to the compliance of accounting standards and auditing standards;

f. **Co-operate** with **national and international organisations** of independent audit regulators in establishing and overseeing adherence to accounting standards and auditing standards; and

g. Perform such **other functions and duties** as may be **necessary or incidental** to the aforesaid functions and duties.

Note:

The Central Government may,

- By notification,
- Delegate any of its powers or functions under the Act to NFRA, **other than** the power to make rules;
- Subject to such conditions, limitations and restrictions as may be specified in such notification.

Sub-section 2 has overriding effects anything contained in any other law for the time being in force.

COMPOSITION OF NFRA [SUB-SECTION 3, 3A, 3B]

The NFRA shall consist of

a. **Chairperson**, who shall be a person of eminence and having expertise in accountancy, auditing, finance or law and

b. Such other members **not exceeding fifteen** consisting of **part-time and full-time members.**

Each division of the NFRA shall be presided over by the Chairperson or a full-time member authorised by the Chairperson.

There shall be an executive body of the NFRA consisting of the Chairperson and full-time members of such Authority for efficient discharge of its functions.

Chairperson and Members shall be appointed by the Central Government in the manner and on the terms as prescribed under the *National Financial Reporting Authority (Manner of Appointment and other Terms and Conditions of Service of Chairperson and Members) Rules, 2018*

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 National Financial Reporting Authority shall **not be associated with any audit firm** (including related consultancy firms) **during** the course of their appointment **and two years after** ceasing to hold such appointment.

The following persons **shall** be appointed as **part time members** of NFRA, namely:

a. One member to represent the MCA, who shall be an officer not below the rank of Joint Secretary, ex-officio;

b. One member to represent the CAG of India, who shall be an officer not below the rank of Accountant General or Principal Director, ex-officio;

c. One member to represent the RBI, who shall be an officer not below the rank of Executive Director, ex-officio;

d. One member to represent the SEBI, who shall be an officer not below the rank of Executive Director, ex-officio;

e. President, ICAI, ex-officio;

f. Chairperson, Accounting Standards Board, ICAI, ex-officio;

g. Chairperson, Auditing and Assurance Standards Board, ICAI, ex-officio; and

h. Two experts from the field of accountancy, auditing, finance or law.

Sub-section 11 empowers the Central Government to appoint a secretary and such other employees as it may consider necessary for the efficient performance of functions by the National Financial Reporting Authority under this Act and the terms and conditions of service of the secretary and employees shall be such as may be prescribed.

POWER TO INVESTIGATE [SUB-SECTION 4]

NFRA shall have the **power to investigate**,

a. Into the matters of professional or other misconduct committed by any member or firm of chartered accountants, registered under the Chartered Accountants Act, 1949.

b. Either *suo moto* **or** on a reference made to it by the Central Government in such manner as prescribed by rule 10 of the *National Financial Reporting Authority Rules, 2018*

Students are advised to take note:

No other institute or body shall initiate or continue any proceedings in such matters of misconduct where the NFRA has initiated an investigation under this section.

For the purposes of this sub-section, the expression "professional or other misconduct" shall have the same meaning assigned to it as given under section 22 of the Chartered Accountants Act, 1949.

Sub-section 4 has overriding effects anything contained in any other law for the time being in force.

Quasi-judicial powers [Section 132(4)(b)]

NFRA 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

a. Discovery and production of books of account and other documents, at such place and at such time as may be specified by the NFRA;

b. Summoning and enforcing the attendance of persons and examining them on oath;

c. Inspection of any books, registers and other documents of any person referred to in clause (b) at any place;

d. Issuing commissions for examination of witnesses or documents;

Power to make order [Section 132(4)(c)]

Where professional or other misconduct is proved, the NFRA shall have the power to **make order** for:

Imposing **penalty** as stated below:

Liable (in case of)	Minimum	Maximum
Individual	one lakh rupee	five times of the fees received
Firms	five lakh rupees	ten times of the fees received

Debarring the member or the firm

From	Minimum period	Maximum period
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** Performing any valuation as provided under Sec 247,	Six months	Ten years

APPEAL AGAINST ORDERS OF NFRA [SUB-SECTION 5]

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** in such manner and on payment of such fee as may be prescribed.

MEETINGS OF NFRA [SUB-SECTION 10]

The National Financial Reporting Authority shall meet at such times and places and shall observe such rules of procedure in regard to the transaction of business at its meetings in such manner as prescribed under **Rule 3** of the *National Financial Reporting Authority (Meeting for Transaction of Business) Rules, 2019*.

Note – NFRA may, meet at such other places in India as it deems fit.

MAINTENANCE OF BOOKS OF ACCOUNT BY NFRA & AUDIT THEREOF BY CAG [SUB-SECTION 13 & 14]

The National Financial Reporting Authority shall maintain such books of account and other books in relation to its accounts in such form and in such manner as the Central Government may, in consultation with the CAG of India prescribe.

The accounts of the NFRA shall be audited by the CAG of India at such intervals as may be specified by him.

Such accounts as certified by the CAG of India together with the audit report thereon shall be forwarded annually to the Central Government by the NFRA.

ANNUAL REPORT ON WORKING OF NFRA [SUB-SECTION 15]

The National Financial Reporting Authority 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.

Note:

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.

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.

8. CENTRAL GOVERNMENT TO PRESCRIBE ACCOUNTING STANDARDS [SECTION 133]

Section 133 of the Companies Act, 2013 empowers the Central Government to prescribe the accounting standards or any addendum thereto, as recommended by the ICAI in consultation with and after examination of the recommendations made by the NFRA.

Proviso to section 133 suggests, 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. Since NFRA constituted in 2018, hence this proviso lost it operating effects.

Note:

Exercising the powers conferred under section 133, the MCA on behalf of Central Government so far has notified:

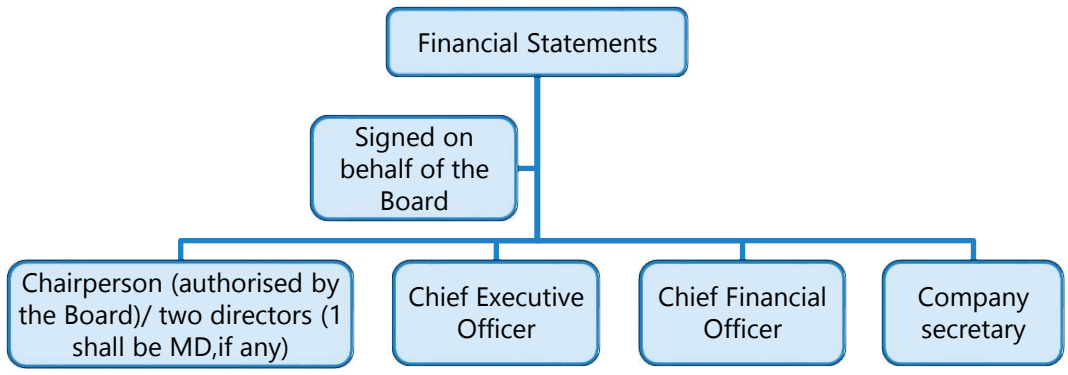
- Companies (Accounting Standards) Rules, 2021[9] and
- Companies (Indian Accounting Standards) Rules, 2015[10].

Regulation 48 of Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 supplement the provisions to section 133 of this Act by providing that, the listed entity shall comply with all the applicable and notified Accounting Standards from time to time.

9. FINANCIAL STATEMENT, BOARD'S REPORT, ETC. [SECTION 134]

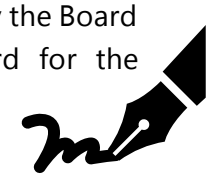
Section 134 deals with approval of financial statement by the Board of Directors in addition to report by the Board of Directors including Director's responsibility statement.

AUTHENTICATION OF FINANCIAL STATEMENTS [SUB-SECTION 1, 2, AND 7]



[9] Vide notification GSR 432(E) dated 23rd June, 2021 as amended from time to time
[10] Vide notification GSR 111(E) dated 16th February, 2015 as amended from time to time

As per sub-section 1, the financial statement shall be approved by the Board of Directors before they are signed on behalf of the Board for the submission to the auditor for his report thereon; at least by:



a. The chairperson of the company where he is authorised by the Board **OR** the two directors out of which one shall be managing director, if any, **and**

b. The Chief Executive Officer, **and**

c. The Chief Financial Officer **and**

d. The company secretary of the company, wherever they are appointed.

Consolidated financial statement, if any also need to be approved in similar manner.

In the case of **o**ne **p**erson **c**ompany financial statements shall be approved only by one director.

Sub-section 2 requires the auditors' report shall be attached to every financial statement.

Further sub-section 7 provides a signed copy of every financial statement, including consolidated financial statement, if any, shall be issued, circulated or published along with a copy of

a. Any notes annexed to or forming part of such financial statement:

b. The auditor's report; and

c. The Board's report referred to in sub section 3.

Illustration 4

The Board of Directors of ABC Ltd. wants to circulate unaudited accounts before the Annual General Meeting 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 annual general meeting 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.

BOARD'S REPORT [SUB-SECTION 3, 3A, AND 4 READ WITH RULE 8 OF THE COMPANIES (ACCOUNTS) RULES, 2014]

Board's report shall be attached to statements laid before a company in general meeting.

Content of Board's Report

Section 134(3) read with rule 8 prescribes, the board report shall include:

a. The **web address**, if any, where **annual return** referred to in sub-section (3) of section 92 (i.e., *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 sub-section (12) of section 143 (i.e. *Powers and duties of auditors*....), other than those which are reportable to the Central Government;

d. A **statement on declaration** given by **independent directors** under sub-section (6) of section 149 (i.e., *Company to have board of board of Directors in relation to independent director*);

e. In case of a company covered under sub-section (1) of section 178 (i.e., *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;

Clause (e) shall not apply to the **Government Companies**[11]

The exceptions, modifications and adaptations provided above shall be applicable only to those Government Companies which has not committed a default in filing its financial statements under section 137 of the said act or annual return under section 92 of the said act with the registrar[12]

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 **company secretary** in practice in his secretarial audit report;

g. Particulars of **loans, guarantees** or **investments** under section 186;

h. Particulars of **contracts or arrangements** with **related parties** referred to in section 188 (1) (i.e., *Related Party Transactions*) in the **form AOC-2**;

i. The **state of the company's affairs**;

j. The amounts, if any, which it **proposes** to carry to any **reserves**;

k. The amount, if any, which it **recommends** should be paid by way of **dividend**;

l. **Material changes** and commitments, if any, **affecting the financial position** of the company which have **occurred between** the **end of the financial year** of the company to which the financial statements relate and the **date of the report**;

m. The **conservation of energy**, **technology absorption**, **foreign exchange earnings and outgo**, in such manner as may be prescribed;

The Government companies engaged in producing defence equipment is exempted from disclosure under clause m.[13]

n. A statement indicating development and implementation of a **risk management policy** for the company including identification therein of

[11] Exemption granted vide notification number G.S.R. 463(E) dated the 5th June, 2015

[12] Vide notification number G.S.R. 582(E) dated 13th June, 2017

[13] Exemption granted vide Companies (Accounts) Second Amendment Rules, 2015 dated 4th September, 2015

elements of risk, if any, which in the opinion of the Board may threaten the existence of the company;

o. The details about the policy developed and implemented by the company on **corporate social responsibility** initiatives taken during the year;

p. In case of a listed company and every other public company having such **paid-up share capital of twenty five crore rupees or more** calculated at the end of the preceding financial year shall include, in the report by its Board of directors, a statement indicating the manner in which **formal annual evaluation of the performance of the Board, its Committees and of individual directors** has been made;

Clause (p) shall not apply to the **Government Companies**[14]

The exceptions, modifications and adaptations provided above shall be applicable only to those Government Companies which has not committed a default in filing its financial statements under section 137 of the said act or annual return under section 92 of the said act with the registrar[15]

q. Such other matters as prescribed Rule 8 of the *Companies (Accounts) Rules, 2014*, namely

i. The **financial summary** or highlights;

ii. The change in the **nature of business**, if any;

iii. The details of **directors** or **key managerial personnel** who were **appointed** or have **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 (i.e.,

[14] Exemption granted vide notification number G.S.R. 463(E) dated the 5th June, 2015

[15] Vide notification number G.S.R. 582(E) dated 13th June, 2017

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** such as **accepted** during the year; remained **unpaid or unclaimed** as at the end of the year; 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** at the beginning of the year, maximum during the year, and at the end of the year;

vi. The details of **deposits** which are **not in compliance with the requirements of Chapter V** (i.e., *Acceptance of Deposits by Companies*) of the Act;

vii. The details of **significant and material 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 disclosure, as to whether **maintenance of cost records** as specified by the Central Government under sub-section (1) of section 148 of this Act, is required by the Company and accordingly such accounts and records are made and maintained,

x. 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.***

xi. The details of application made or **any proceeding pending** under the ***Insolvency and Bankruptcy Code, 2016*** during the year along-with their status as at the end of the financial year.

xii. The details of **difference** between amount of the **valuation** done at the time of one-time settlement and the valuation done while taking loan from the Banks or Financial Institutions along with the reasons thereof.

Note - Rule 8 of the Companies (Accounts) Rules, 2014 shall not apply to One Person Company or Small Company. Instead rule 8A is applicable upon them that is detailed on next page.

Students are advised to take note:

1. Where disclosures referred to in sub-section 3 to section 134 have been included in the financial statements, such disclosures shall be referred to instead of being repeated in the Board's report. (It is worth noting earlier this benefit rest with specified IFSC public company[16] and specified IFSC private company[17]only, but w.e.f. 31.7.2018 extended to all)

2. Where the policy referred to in clause (e) or clause (o) of section 134(3) is made available on company's website, if any, it shall be sufficient compliance of the requirements under such clauses if the salient features of the policy and any change therein are specified in brief in the Board's report and the web-address is indicated therein at which the complete policy is available.

3. **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.

Abridged Board's report for One Person Company and Small Company [Sub-section 3A read with rule 8A of the Companies (Accounts) Rules, 2014]

The Board's Report of One Person Company and Small Company shall be prepared based on the stand-alone financial statement of the company, which shall be in abridged form and contain the following;

a. The web address, if any, where annual return referred to in sub-section (3) of section 92 has been placed;

b. Number of meetings of the Board;

c. Directors' Responsibility Statement as referred to in sub-section (5) of section 134;

d. Details in respect of frauds reported by auditors under sub-section (12) of section 143 other than those which are reportable to the Central Government;

[16] Vide notification GSR 08(E) dated 4th January, 2017

[17] Vide notification GSR 09(E) dated 4th January, 2017

e. Explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made by the auditor in his report;

f. The state of the company's affairs;

g. The financial summary or highlights;

h. Material changes from the date of closure of the financial year in the nature of business and their effect on the financial position of the company;

i. The details of directors who were appointed or have resigned during the year;

j. The details or significant and material orders passed by the regulators or courts or tribunals impacting the going concern status and company's operations in future.

k. The particulars of contracts or arrangements with related parties referred to in sub-section (1) of section 188 in the Form AOC-2.

Board's Report in case of OPC [Sub-section 4]

In case of a One Person Company, 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.

Students may note, after insertion of sub-section 3A to section 134 and rule 8A to *the Companies (Accounts) Rules, 2014* the importance of sub-section 4 reduced substantially.

DIRECTORS' RESPONSIBILITY STATEMENT [SUB-SECTION 5]

The Directors' Responsibility Statement referred to in 134(3)(c) shall state that:

a. In the preparation of the annual accounts, the **applicable accounting standards had been followed** along with proper explanation relating to material departures

b. 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;

c. 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**;

d. The directors had prepared the annual accounts on a **going concern basis**;

e. The directors, in the case of a listed company, had laid down **internal financial controls** to be followed by the company and that such internal financial controls are **adequate**, were **operating effectively;** and

> The term "internal financial controls" for clause e specified above means the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company's policies, 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.

f. 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**.

Illustration 5

Modern Furniture Limited a listed entity has internal financial controls in place, during the financial year a failure in control system has been reported; controls were reinstated soon after such incident. Whether directors in Director's Responsibility Statement can state that controls are adequate and operating efficiently?

Answer

Adequacy refers to the design of the control/system and signify whether the control/system that is in place, is fit for purpose or not.

Operating effectively refers to whether the control/system in place has the desired effect of mitigating the risk or not.

Here, adequacy and operating effectively together shall be read as adequate, operating effectively and applicable throughout also.

Therefore, directors of Modern Furniture Limited in Director's Responsibility Statement can't state that controls are adequate and operating efficiently.

SIGNING OF BOARD'S REPORT [SUB-SECTION 6]

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.

CONTRAVENTION [SUB-SECTION 8]

If a company is in default in complying with the provisions of this section, the company shall be liable to a penalty of three lakh rupees and every officer of the company who is in default shall be liable to a penalty of fifty thousand rupees. Penalty provisions are tabled below;

Persons liable	Punishment
Company	₹ 3,00,000
Every officer of the company who is in default	₹ 50,000

Illustration 6

ABC Company is a one-person company 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 One Person Company, 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.

10. CORPORATE SOCIAL RESPONSIBILITY [SECTION 135]

The corporate (as legal person) use variety of other capitals in blend with economic capital provided by shareholders to make revenue, earn profit, ensure survival and register growth. Hence instead of being responsible only towards fund providers, the corporate is responsible for wide range of stakeholders including the society within which it exists and operate (even to the environment as well, under the

concept of triple bottom line). India become torch bearer for rest of world by giving legal mandate to corporate social responsibility by incorporating legal provisions regarding same as section 135 in the Companies Act, 2013 that requires corporates to mandatorily spend a prescribed percentage of their profits on certain specified areas of social upliftment in discharge of their social responsibilities.

Broadly, Corporate Social Responsibility (CSR) implies a concept, whereby companies decide to contribute to a better society and a cleaner environment – a concept, whereby the companies integrate social and other useful concerns in their business operations for the betterment of its stakeholders and society in general.

The provisions that are enshrined under section 135 of the Act pertaining to Corporate Social Responsibility shall be referred in light of the Companies (Social Responsibility Policy) Rules, 2014 (herein after referred as to 'the CSR Rules').

DEFINITIONS

Corporate Social Responsibility (CSR) (Rule 2(d) of the CSR Rules)

CSR means the activities undertaken by a Company in pursuance of its statutory obligation laid down in section 135 of the Act in accordance with the provisions contained in these rules, but shall not include the following, namely: -

i. Activities undertaken in pursuance of normal course of business of the company

Note:

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 institutes or 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 directly or indirectly to any political party under section 182 of the Act

iv. Activities benefitting employees of the company as defined in clause (k) of section 2 of the Code on Wages, 2019

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.

CSR Committee (Rule 2(e) of the CSR Rules)

CSR Committee means the Corporate Social Responsibility Committee of the Board referred to in section 135 of the Act (i.e., constituted under sub-section 1 of section 135).

CSR Policy (Rule 2(f) of the CSR Rules)

CSR Policy means a statement containing;

a. The **approach** and **direction** given by the board of a company, taking into account the **recommendations of CSR Committee**, and

b. Includes **guiding principles** for selection, implementation and monitoring of activities as well as formulation of the annual action plan.

Administrative overheads (Rule 2(b) of the CSR Rules)

Administrative overheads means the expenses incurred by the company for 'general management and administration' of Corporate Social Responsibility functions in the company **but shall not** include the expenses directly incurred for the designing, implementation, monitoring, and evaluation of a particular Corporate Social Responsibility project or programme.

International Organisation (Rule 2(g) of the CSR Rules)

International Organisation means an organisation notified by the Central Government as an international organisation under section 3 of the United Nations

(Privileges and Immunities) Act, 1947, to which the provisions of the Schedule to the said Act apply.

Net Profit (Rule 2(h) of the CSR Rules read with explanation to section 135 of the Act)

Net profit means the net profit of a company as per its financial statement prepared in accordance with the applicable provisions (net profit shall be calculated in accordance with provisions of section 198) of the Act, and **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.

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.

Ongoing Project (Rule 2(i) of the CSR Rules read with explanation to section 135 of the Act)

Ongoing Project means:

a. 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

b. 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**.

Example 2

Modern Furniture Limited (MFL) undertake a CSR project in light of its CSR policy; of placing and installing benches as public parks and gardens in supervision of district administration. Initially it was estimated that project will be completed in a span of 8-10 months; but due to renovation of half a dozen of parks the task of

installing benches there postponed till the construction is completed (which was expected to take further couple of quarters). Board of MFL considering the circumstances declare the project an ongoing project, extend the duration beyond one year; and also provided reasonable justification. Whether board of MFL correctly re-categories the project as ongoing project or not?

Rule 2(i) of the CSR rules provides that projects which are initially of less than a year's time (therefore not registered as multi-year project) but duration of which extended beyond the one-year period, by board based on reasonable causes or justification; shall be re-categories as ongoing project. Hence, decision of board of MFL is legal and valid.

Public Authority (Rule 2(j) of the CSR Rules)

Public Authority means 'Public Authority' as defined in clause (h) of section 2 of the Right to Information Act, 2005.

COMPANIES THAT REQUIRED TO CONSTITUTE A CSR COMMITTEE AND COMPOSITION THEREOF [SUB-SECTION 1 and 9]

Criteria that mandate constitution of CSR committee:

A company shall constitute a Corporate Social Responsibility Committee of the Board if during the **immediately preceding financial year** such company having;

a. Net worth of rupees five hundred crore or more **or**

b. Turnover of rupees one thousand crore or more **or**

c. Net profit of rupees five crore or more.

As per Rule 3(1) of CSR Rules, 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 fulfils the criteria specified in sub-section (1) of section 135 of the Act shall comply with the provisions of section 135 of the Act and CSR rules

Further, proviso to rule 3(1) of CSR Rules states, a company having any amount/balance in its **Unspent Corporate Social Responsibility Account** as per section 135(6) shall constitute a CSR Committee and comply with the provisions contained in sub-sections (2) to (6) of the said section.

1.	Net-worth and Turnover is defined in clause (57) and (91) to section 2 of the Act, respectively; same are stated under chapter 1 of this module. Whereas Net Profit is defined under the Rule 2(h) of the CSR Rules read with explanation to section 135 of the Act.
2.	The net worth, turnover or net profit of a **foreign company** of the Act shall be computed in accordance with balance sheet and profit and loss account of such company prepared in accordance with the provisions of clause (a) of sub-section (1) of section 381 and section 198 of the Act.

Illustration 7

ABC Ltd is a company with a turnover of more than ₹ 1000 crores in each of the preceding three financial years and have incurred a loss in one of the preceding three financial years. Will it be required to constitute CSR committee?

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 constitute CSR committee and comply with other CSR provisions. Hence, ABC Ltd. will be required to constitute CSR committee and comply with other CSR provisions 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.

Exception

According to sub-section 9, where the amount to be spent by a company under sub-section 5 does **not exceed fifty lakh rupees**, the **requirement for constitution** of the Corporate Social Responsibility 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.

Composition of CSR committee

Corporate Social Responsibility Committee of the Board **consisting of three or more directors**, out of which **at least one director shall be an independent director.**

Proviso to section 135(1) of the Act read with **Rule 5 (1)** of the CSR Rule further states:

a. Where a company covered under section 135(1) but is not required to appoint an independent director under section 149(4), it shall have in its Corporate Social Responsibility Committee two or more directors, without such independent director.

b. A private company having only two directors on its Board shall constitute its CSR Committee with two such directors

c. A foreign company covered under these rules, the CSR Committee shall comprise of at least two persons of which one person shall be as specified under clause (d) of sub-section (1) of section 380 of the Act and another person shall be nominated by the foreign company.

Note:

1. Independent Director is defined under section 2(47) of the Act, same is stated under chapter 1 of this module.

2. As per section 135(2), the Board's report under sub-section (3) of section 134 shall disclose the composition of the Corporate Social Responsibility Committee.

Summary of the constitution of CSR Committee in different scenarios

Category	Sub-category	Constitution
Company covered under section 135(1)	not required to appoint an independent director under section 149(4)	Two or more directors, without independent director
	private company having only two directors	Two such directors
	a foreign company	Least two persons of which one person shall be as specified under clause (d) of sub-section (1) of section 380 of the Act and another person shall be nominated by the foreign company

	Not covered in any of sub-categories defined above	**Three or more directors**, out of which **at least one shall be an independent director.**

DUTIES OF CSR COMMITTEE [SUB-SECTION 3 READ WITH RULE 5(2)]

The Corporate Social Responsibility Committee shall:

a. Formulate and recommend to the Board, a **Corporate Social Responsibility 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 above clause; and

c. **Monitor** the Corporate Social Responsibility Policy of the company from time to time.

Further, according to Rule 5(2) of Companies (CSR) Rules, 2014, the CSR Committee shall formulate and recommend to the Board, an **annual action plan** in pursuance of its CSR policy, which **shall include** the following, namely:

a. The list of **CSR projects** or **programmes** that are approved to be undertaken in areas or subjects specified in Schedule VII of the Act

b. The **manner of execution** of such projects or programmes as specified in sub-rule (1) of rule 4 (itself or through other section 8 company, etc.)

c. The modalities of **utilisation of funds** and implementation schedules for the projects or programmes

d. **Monitoring** and **reporting mechanism** for the projects or programmes; and

e. Details of need and **impact assessment**, if any, for the projects undertaken by the company.

Note:

Board may alter such plan at any time during the financial year, as per the recommendation of its CSR Committee, based on the reasonable justification to that effect.

DUTIES OF THE BOARD IN RELATION TO CSR [SUB-SECTION 4 READ WITH RULE 9 OF THE CSR RULES]

The Board of every company referred to in sub-section (1) i.e., where CSR committee required to be constituted, shall,

a. After taking into account the recommendations made by the Corporate Social Responsibility Committee, **approve the Corporate Social Responsibility Policy** for the company and

b. Disclose contents of such Policy in its report and

c. Also place it (CSR Policy) along with composition of the CSR committee and project approved by board on the company's website; and

d. Ensure that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company.

AMOUNT AND FORM OF CSR EXPENDITURE [SUB-SECTION 5 AND 6 READ WITH RULE 4, 7, AND 10 OF CSR RULES]

The Board of every company referred to in sub-section (1) i.e., where CSR committee required to be constituted, shall ensure that the company spends, in every financial year, at least **two percent** of the **average net profits** of the company made during the **three immediately preceding financial years.**

Company shall give **preference to the local area** and **areas around it** where it operates, for spending the amount earmarked for Corporate Social Responsibility activities

The board shall ensure that the **administrative overheads shall not exceed five percent** of total CSR expenditure of the company for the financial year.

Where the company has not completed the period of three financial years since its incorporation

Where the company has not completed the period of **three financial years** since its incorporation, the company shall spend, in every financial year, at least **two percent** of the **average net profits** of the company made **during such immediately preceding financial years**, in pursuance of its Corporate Social Responsibility Policy.

Illustration 8

Compute the minimum amount that Modern Furniture Limited is required to spend on account of Corporate Social responsibility year 2022-2023. MFL was incorporated in August 2020. Net-profit made during the financial years 2020-2021 and 2021-2022 are ₹ 20 crore, and ₹ 38 crore respectively.

Options

a. *₹ 76 lac*

b. *₹ 1.16 crore*

c. *₹ 58 lac*

d. *Since the company has not completed the period of **three financial years** since its incorporation, hence no CSR spending is required.*

Answer – c

Reason – Section 135(5).

Surplus arising out of CSR activities [Rule 7(2) of CSR) Rules]

Any **surplus** arising out of the CSR activities shall:

✗ Not form part of the business profit of a company

And

✓ Be ploughed back into the same project or

✓ Be transferred to the Unspent CSR Account and spent in pursuance of CSR policy and annual action plan of the company or

✓ Transfer such surplus amount to a Fund specified in Schedule VII, within a period of six months of the expiry of the financial year.

Where the company spend in excess to minimum prescribed CSR amount [Second proviso to Section 135(5) read with Rule 7(1)

If the company spends an amount in excess of the requirements provided under this sub-section, such company may **set off such excess amount** against the requirement to spend under this sub-section for **up to immediate succeeding three financial years** subject to the conditions that:

a. The excess amount available for set off shall **not include the surplus** arising out of the CSR activities, if any, in pursuance of sub-rule (2) of this rule.

b. The **board resolution** shall pass to that effect.

Where the company fails to spend minimum prescribed CSR amount [Sub-section 6 read with Second proviso to Section 135(5)]

If the company fails to spend minimum prescribed CSR amount under section 135(5), the Board shall,

a. Specify the reasons for not spending the amount in board report prepared under section 134(3)(o), and

b. Where the unspent amount relates to **project/s other than ongoing project**, then such unspent amount shall be transferred to a **Fund specified in Schedule VII**, within a period of **six months of the expiry of the financial year**.

Or

Where any amount remaining unspent pursuant to any **ongoing project** (undertaken by a company in pursuance of its CSR Policy), then such unspent amount shall be transferred to **Unspent Corporate Social Responsibility Account** by the company within a period of **thirty days from the end of the financial year**.

Notes

1. Unspent Corporate Social Responsibility Account (referred as to Unspent CSR Account) shall be operated with Scheduled bank.

2. Any sum transferred to Unspent CSR Account, shall be spent by the company in pursuance of its obligation towards the Corporate Social Responsibility Policy within a period of three financial years from the date of such transfer.

3. In case of failure in spending the amount transferred in Unspent CSR Account in pursuance of its obligation towards the CSR Policy within a period of three financial years from the date of such transfer, the company shall transfer the same to a Fund specified in Schedule VII, within a period of thirty days from the date of completion of the third financial year.

4. As per rule 10 of CSR Rules, until a fund is specified in Schedule VII for the purposes of subsection (5) and (6) of section 135 of the Act, the unspent CSR amount, if any, shall be transferred by the company to any fund included in schedule VII of the Act.

CSR expenditure for creation or acquisition of a capital Asset [Rule 7(4) of CSR Rules)

CSR amount may be spent by a company for creation or acquisition of a capital asset, which shall be held by -

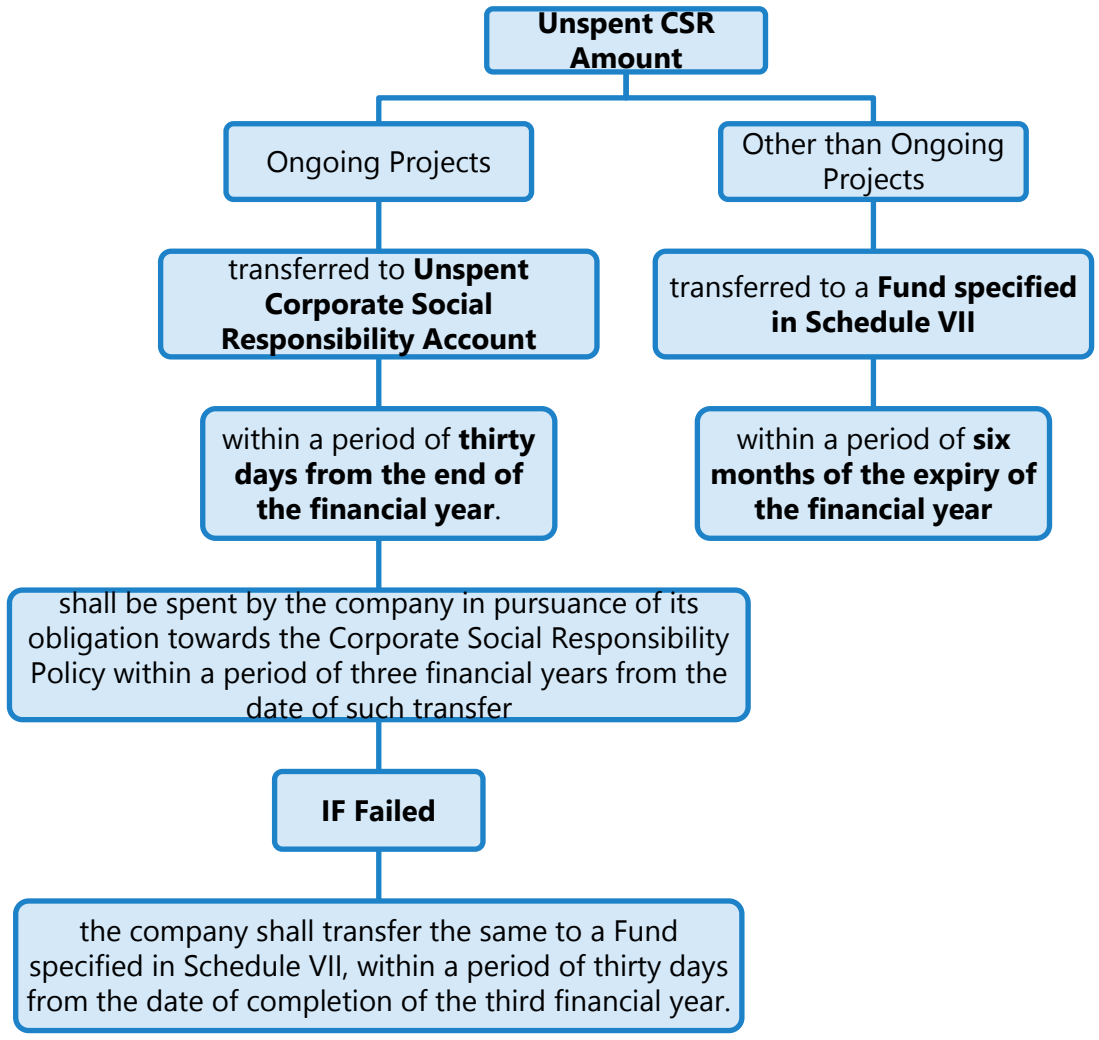
a. A company established under section 8 of the Act, or a Registered Public Trust or Registered Society, having charitable objects and CSR Registration Number under Rule 4(2); or

b. Beneficiaries of the said CSR project, in the form of self-help groups, collectives, entities; or

c. A public authority.

Note

Any capital asset created by a company prior to the commencement of the Companies (Corporate Social Responsibility Policy) Amendment Rules, 2021, shall within a period of 180 days from such commencement comply with the requirement of this rule, which may be extended by a further period of not more than 90 days with the approval of the Board based on reasonable justification.



CSR IMPLEMENTATION [RULE 4 OF THE CSR RULES]

CSR activities can be undertaken by company itself or through specified entities – Onus (or ultimate responsibility) lies on Board [Sub-rule 1]

The Board shall ensure that the CSR activities are undertaken by the **company itself or through**:

a. **Connected charitable entity** - 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, established by the company, either singly or along with any other company; or

b. **Entity established by Government** – A company established under section 8 of the Act or a registered trust or a registered society, established by the Central Government or State Government; or

c. **Statutory entity** - Any statutory body established under an Act of Parliament or a State legislature to undertake activities covered in Schedule VII of the Act; or

d. **Any Charitable entity with three year of experience -** 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.

Notes:

1. CSR activities should be undertaken by the companies in project/ programme mode. One-off events such as marathons/ awards/ charitable contribution/ advertisement/ sponsorships of TV programmes etc. would not be qualified as CSR expenditure.[18]

[18] MCA vide General Circular No. 21/2014 dated 18th June 2014

2. Expenses incurred by companies for the fulfillment of any Act/ Statute of regulations (such as Labour Laws, Land Acquisition Act etc.) would not count as CSR expenditure under the Companies Act.

3. Registered Trust would include Trusts registered under Income Tax Act 1961, for those states where registration of Trust is not mandatory.

4. Contribution to Corpus of a Trust/ society/ section 8 companies etc. will qualify as CSR expenditure as long as (a) the Trust/ society/ section 8 companies etc. is created exclusively for undertaking CSR activities or (b) where the corpus is created exclusively for a purpose directly relatable to a subject covered in Schedule VII of the Act.

Registration of undertake CSR activity [Sub-rule 2]

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.

The provisions of this sub-rule shall not affect the CSR projects or programmes approved prior to the 01st day of April 2021.

Form CSR-1 shall be signed and submitted electronically by the entity and shall be verified digitally by a Chartered Accountant in practice or a Company Secretary in practice or a Cost Accountant in practice.

On the submission of the Form CSR-1 on the portal, a unique CSR Registration Number shall be generated by the system automatically.

International Organisations may be engaged [Sub-rule 3]

A company may engage international organisations for **designing, monitoring** and **evaluation** of the CSR projects or programmes as per its CSR policy as well as for **capacity building** of their own personnel for CSR.

Note:

Expenditure incurred by Foreign Holding Company for CSR activities in India will qualify as CSR spending 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.

CSR projects can be undertaken in collaboration [Sub-rule 4]

A company may also **collaborate** with other companies for undertaking projects or programmes or CSR activities in such a manner that the CSR committees of respective companies are **in a position to report separately** on such projects or programmes in accordance with these rules.

Onus to ensure application fund lies on Board [Sub-rule 5]

The Board of a company shall satisfy itself that the **funds so disbursed have been utilised** for the purposes and in the manner as approved by it and the **Chief Financial Officer** or **the person responsible** for financial management shall **certify to the effect**.

Board shall monitor ongoing projects [Sub-rule 6]

In case of **ongoing project**, the Board of a Company shall **monitor the implementation** of the project with reference to the approved timelines and year-wise allocation and shall be competent to **make modifications**, if any, **for smooth implementation** of the project within the overall permissible time period.

Illustration 9

Can an international organisation be engaged for implementation of CSR project?

Answer

Yes, an international organisation may be engaged for implementation of CSR projects; but engagement shall be restricted to the designing, monitoring and evaluation of the CSR projects or programmes as per its CSR policy as well as for capacity building of their own personnel for CSR, as per rule 4(3) of CSR rules.

CSR REPORTING [RULE 8 OF CSR RULES]

Annual Reporting on CSR as part of Board Report [Sub-Rule 1 and 2]

The Board's Report of a company (that covered under these rules, basically those required to constitute CSR committee) pertaining to any financial year shall include an annual report on CSR containing particulars.

While as per sub-rule 2, in case of a foreign company, the balance sheet filed under clause (b) of sub-section (1) of section 381 of the Act, shall contain an annual report on CSR.

Note:

Annexure I and II are provided to the CSR rules as format for such annual reporting.

Annexure I provides the format for the annual report on CSR activities to be included in the board's report for financial year commencing before the 1st day of April, 2020.

While Annexure II prescribes the format for the annual report on CSR activities to be included in the board's report for financial year commencing on or after the 1st day of April, 2020.

Impact Assessment [Sub-Rule 3]

Every company having average CSR obligation of ten crore rupees or more in pursuance of section 135(5) of the Act, in the three 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 Corporate Social Responsibility for that financial year, which shall not exceed two percent of the total CSR expenditure for that financial year or fifty lakh rupees, whichever is higher.

Penal Provisions [Sub-section 7]

If a company is in default in complying with the provisions of sub-section (5) or sub-section (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, as the case may be, or one crore rupees, whichever is less, and every officer of the company who is in default shall be liable to a penalty of one-tenth 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 two lakh rupees, whichever is less.

Summary of penalties, if a company is in default in complying with the provisions of sub-section (5) or sub-section (6) to section 135:

Liable	Penalty
Company	**twice** the amount required to be transferred by the company to the Fund specified in Schedule VII or the Unspent Corporate Social Responsibility Account, as the case may be, **or one crore rupees**, whichever is **less**
Every officer, who is in default	**one-tenth** 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 two lakh rupees**, whichever is **less**

SPECIAL INSTRUCTIONS OF THE CENTRAL GOVERNMENT [SUB-SECTION 8]

The Central Government may give such general or special directions to a company or class of companies as it considers necessary to ensure compliance of provisions of this section and such company or class of companies shall comply with such directions.

Activities specified under the Schedule VII

Activities which may be included by companies in their CSR Policies (i.e., Activities as specified under Schedule VII) are as follows:

i. 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;

ii. Promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly, and the differently abled and livelihood enhancement projects;

iii. 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;

iv. Ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agroforestry, 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;

v. Protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional arts and handicrafts;

vi. 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;

vii. Training to promote rural sports, nationally recognised sports, paralympic sports and Olympic sports;

viii. Contribution to the Prime Minister's National Relief Fund or Prime Minister's Citizen Assistance and Relief in Emergency situations Fund (PM CARES FUND) any other fund set up by the Central Government for socio-economic development and relief and welfare of the Scheduled Castes, Tribes, other backward classes, minorities and women;

ix. **(a)** Contribution to incubators or research development projects in the field of science, technology, engineering and medicine, funded by Central Government or State Government or any agency or Public Sector Undertaking of 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 Defense Research and Development Organisation (DRDO);Indian Council of Agricultural Research (ICAR); Indian Council of Medical Research (ICMR) Council of Scientific and Industrial Research (CSIR), engaged in conducting research in science, technology, engineering and medicine aimed at promoting Sustainable Development Goals (SDGs);

x. Rural development projects;

xi. 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.

xii. Disaster management, including relief, rehabilitation and reconstruction activities.

Students are advised to take note:

The statutory provision and provisions of CSR Rules, 2014, is to ensure that while activities undertaken in pursuance of the CSR policy must be relatable to Schedule VII of the Companies Act 2013, the entries in the said Schedule VII must be interpreted liberally so as to capture the essence of the subjects enumerated in the said Schedule. The items enlisted in the amended Schedule VII of the Act, are broad-based and are intended to cover a wide range of activities[19]

Practical Insight

Clarifications with respect to CSR on COVID

Outbreak of novel corona virus (COVID-19 or COVID) threatened the entire mankind with severe social and economic consequences. COVID was declared pandemic by WHO and national disaster by GoI. The prevention from widespread of COVID and combating against same was possible only with war-footing efforts of all including businesses and corporates. Hence CSR funds/expenditure required to be channelised towards activities that are part of prevention and support mechanism; therefore in order to give effect to the same following clarifications in form of circulars are issued by MCA;

General Circular No. 10/2020, dated 23rd March, 2020

The spending of CSR funds for COVID-19 is eligible CSR activity. Funds may be spent for **various activities related to COVID-19** under item nos. (i) and (xii) of Schedule VII of the Act, relating to promotion of health care, including preventive health care and sanitation, and, disaster management.

[19] MCA vide General Circular No. 21/2014 dated 18th June 2014

General Circular No. 01/2021, dated 13th January, 2021

The spending of CSR funds for **awareness campaigns/ programmes** and **public outreach on COVID-19 Vaccination programme** is an eligible CSR activity under item no. (i), (ii) and (xii) of Schedule VII of the Act, relating to promotion of health care, including preventive health care and sanitization, promoting education, and, disaster management respectively.

General Circular No. 05/2021, dated 22nd April, 2021

The spending of CSR funds for setting up **makeshift hospitals** and **temporary COVID Care facilities** is an eligible CSR activity under item nos. (i) and (xii) of Schedule VII of the Companies Act, 2013 relating to promotion of health care, including preventive health care, and, disaster management respectively.

General Circular No. 09/2021, dated 5th May, 2021

The spending of CSR funds for '**creating health infrastructure for COVID care', 'establishment of medical oxygen generation and storage plants', 'manufacturing and supply of Oxygen concentrators, ventilators, cylinders and other medical equipment for countering COVID-19'** or similar such activities are eligible CSR activities under item nos. (i) and (xii) of Schedule VII of the Companies Act, 2013 relating to promotion of health care, including preventive health care, and, disaster management respectively.

Reference is also drawn to item no. (ix) of Schedule VII of the Companies Act, 2013 which permits contribution to specified research and development projects as well as contribution to public funded universities and certain Organisations engaged in conducting research in science, technology, engineering, and medicine as eligible CSR activities.

The companies including Government companies may undertake the activities or projects or programmes using CSR funds, directly by themselves or in collaboration as shared responsibility with other companies, subject to fulfilment of CSR Rules and the guidelines issued by MCA from time to time.

General Circular 13/2021, dated 30th July, 2021

The 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 Act relating to promotion of health care including preventive health care and item no. (xii) relating to disaster management.

MCA Office Memorandum Dated 28th March 2021

Any contribution made to **PM CARES Fund** shall qualify as CSR expenditure for purpose of section 135 of this Act.

Practical Insight

Clarifications with respect to CSR on '*Har Ghar Tiranga*' campaign

General Circular 08/2022, dated 26th July, 2022

'*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.

In case of specified IFSC public company[20] and specified IFSC private company[21] the section 135 shall not apply for period of **5 years** from the commencement of business of a specified IFSC public company and specified IFSC private company.

After reading the provisions pertaining to CSR, a genuine question may strike in your mind: why were a plethora of changes introduced in 2020-2021? CSR rules almost re-written; but why?

The COVID management to some extent highlighted the pitfalls in public infrastructure facilities, whereas CSR could play a drastic role in improving such facilities, provided accountability is tagged with a full-proof mechanism, hence need to consolidate the CSR provisions was felt and secondly, the CSR numbers

[20] Vide notification GSR 08(E) dated 4th January, 2017
[21] Vide notification GSR 09(E) dated 4th January, 2017

(tabled below)[22] didn't show convincing and steady growth.

Year	No. of CSR Projects	No. of Corporates	CSR Expenditure (in Cr. ₹)
2020-21	8,009	1,619	8,828
2019-20	34,828	22,531	24,689
2018-19	32,248	25,099	20,150
2017-18	26,858	21,517	17,098
2016-17	23,076	19,552	14,344

11. RIGHT OF MEMBERS TO COPIES OF AUDITED FINANCIAL STATEMENT [SECTION 136]

Section 136 read with Rule 10 and 11 of the *Companies (Accounts) Rules 2014*, confirms a right of members to copies of audited financial statements and prescribe the manner of circulation of financial statement. Relevant provisions are detailed below:

WHAT, TO WHOM, WHEN & HOW [SUB-SECTION 1 AND 2 READ WITH RULE 10 AND 11 OF THE *COMPANIES (ACCOUNTS) RULES 2014*]

What required to be circulated?

A copy of financial statements including

a. Consolidated financial statement, if any,

b. Auditor's report and

c. Every other document required by law to be annexed or attached to the financial statements, which are to be laid before a company in its general meeting.

Proviso to sub-section 2 provides 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**.

[22] Only for information of the students.

To whom copies shall be sent?

a. To every member of the company,

b. To every trustee for the debenture-holder of any debentures issued by the company, and

c. To all persons other than such member or trustee, being the person so entitled.

When (timing) to send?

At least **twenty-one days** before the date of the meeting.

First proviso to section 136(1) provides, even if the copies of the documents are sent less than twenty-one days before the date of the meeting, they shall be **deemed to have been duly sent** if it is **so agreed by members**:

a. **if the company has a share capital** – holding **majority in number** entitled to vote and who represent not less than **ninety-five percent of** such part of the **paid-up share capital** of the company as gives a right to vote at the meeting;

Or

b. **if the company has no share capital** - having not less than **ninety-five percent of the total voting power** exercisable at the meeting

Students are advised to take note:

In case of **section 8 company** the words "twenty-one days", shall be substituted by the words "**fourteen days**".[23]

Mode and Manner of Circulation [Rule 11 of the Companies (Accounts) Rules, 2014]

Third Proviso to Section 136 (1) empowers central government to prescribe the manner of circulation of financial statements of companies having such net worth and turnover.

In this regard, Rule 11 of the *Companies (Accounts) Rules, 2014* states the financial statements, in case of all **listed companies,** and

[23] Vide Notification No. GSR 466 (E), dated 5th June, 2015

Such **public companies** which have a **net worth of more than one crore rupees** and **turnover of more than ten crore rupees**, may be sent:

a. By **electronic mode** to such members only whose

Shareholding is in **dematerialized format**	Whose **email are registered** with Depository for communication purposes
Shareholding is in **Otherwise than by dematerialized format**	But they 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)

b. By **dispatch of physical copies** through any recognised mode of delivery as specified under section 20 of the Act, **in all other cases**.

Statement containing Silent Features may be circulated by Listed Company

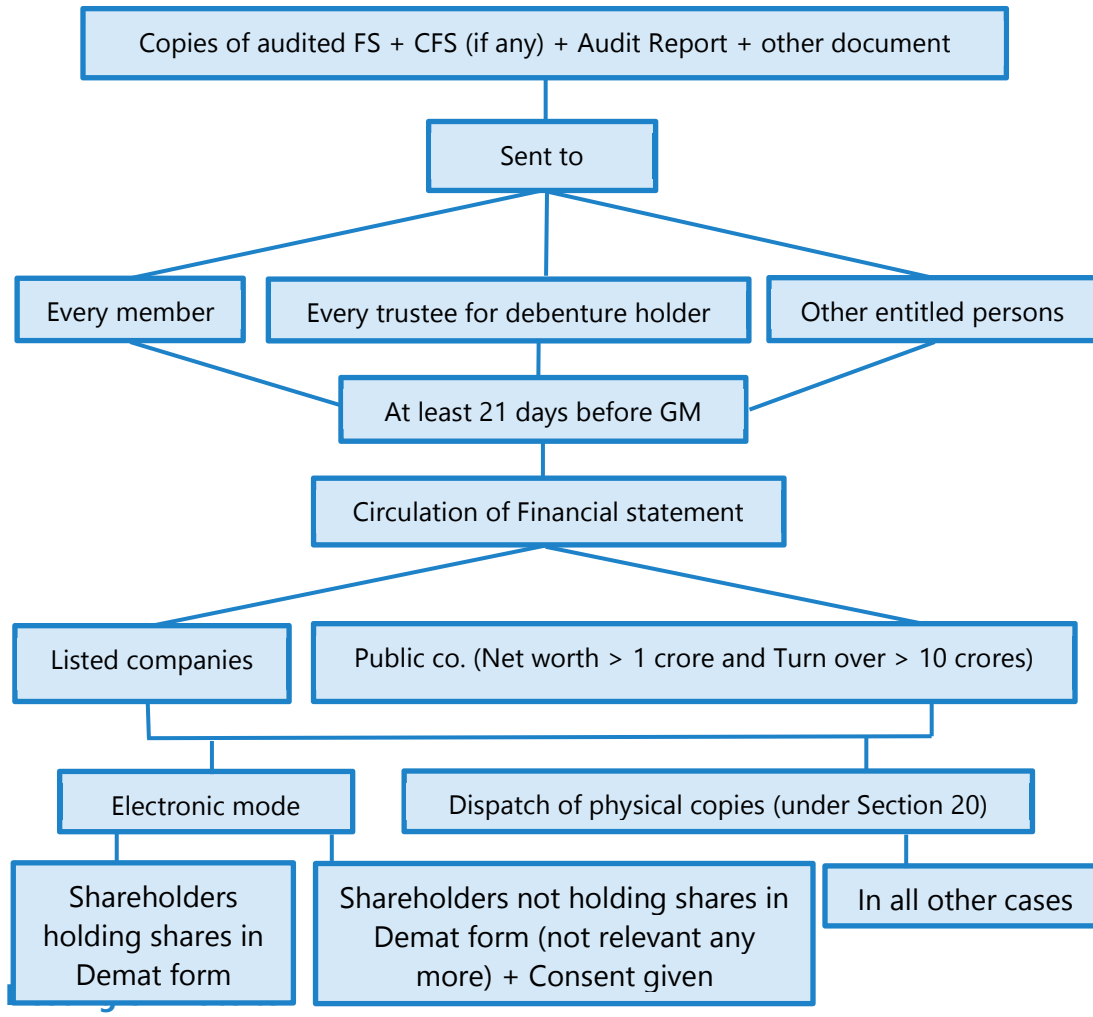
Second proviso to section 136(1) provides that in the case of a listed company, the provisions of this sub-section shall be **deemed to be complied with**:

a. If the copies of the documents are made **available for inspection** at its **registered office** during working hours for a period of **twenty-one days before** the date of the meeting and

b. A statement containing the **salient features** of such documents in the Form AOC-3 (Form AOC-3A in case of companies which are required to comply with *Companies (Indian Accounting Standards) Rules, 2015*) or copies of the documents, as the company may deem fit, is **sent to every member of the company and to every trustee** for the holders of any debentures issued by the company not less than **twenty-one days before** the date of the meeting

c. **Unless** the shareholders ask for **full** financial statements.

Summary



Fourth and Fifth Proviso to section 136(1) provides that a **listed company** shall also on its website, (which is maintained by or on behalf of the company) place its **financial statements** including:

a. Consolidated financial statements, if any,

b. Separate audited accounts in respect of each of subsidiary, if any

c. All other documents required to be attached thereto,

Students are advised to take note that **sixth proviso to Section 136(1)** in this context provides that a listed company that has a subsidiary incorporated outside India (referred as to foreign subsidiary),

Category	Requirement
a. Where such foreign subsidiary is **statutorily required to prepare consolidated financial statement** under any law of the country of its incorporation	The requirement of this proviso shall be met if **such consolidated financial statement** 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.

Illustration 10

RELM Industries Limited, a company incorporated under the Companies Act, 2013, has its shares listed on a recognized Stock Exchange in India. One of the subsidiaries of RELM Industries Limited is a foreign company incorporated outside India. In the annual general meeting of the company, RELM Industries Limited has placed its audited financial statement including consolidated financial statement on its website. RELM Industries Limited has also placed on its website separate audited accounts of all its subsidiaries located in India except one subsidiary, which is a foreign company and located outside India on the grounds that such foreign company is not required to get its financial statement audited under the company law of its country of incorporation. You are required to examine whether RELM Industries Limited has complied with the provisions of section 136?

Answer

No, RELM Industries Limited has not complied with the provisions of section 136 because RELM Industries Limited is also required to place unaudited financial statement of its foreign subsidiary on its website even if such foreign subsidiary is not required to get its financial statement audited as per the provisions of section 136. The holding Indian listed company (RELM Industries Limited in this case) 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.

In case of Nidhi company[24]

Section 136 (1) shall apply, subject to the modification that, in the case of members who do not individually or jointly hold shares of more than one thousand rupees in face value or more than one per cent, of the total paid-up share capital, whichever is less, it shall be sufficient compliance with the provisions of the section if an intimation is sent by public notice in newspaper circulated in the district in which the Registered Office of the company is situated stating the date, time and venue of AGM and the financial statement with its enclosures can be inspected at the registered office of the company and the financial statement with enclosures are affixed in the notice board of the company and a member is entitled to vote either in person or through proxy

INSPECTION [SUB-SECTION 2]

A company shall also 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.

CONTRAVENTION [SUB-SECTION 3]

If any default is made in complying with the provisions of section 136,

a. The company shall be liable to a penalty of 25,000 rupees and

b. Every officer of the company who is in default shall be liable to a penalty of 5,000 Rupees.

Vide ***General Circular No. 11/2015, dated 21 July 2015***, clarification was issued by MCA with regard to circulation and filing of financial statement.

1. A company holding general meeting after giving shorter notice as provided under section 101 of the Act may also circulate financial statements (to be laid/ considered in the same general meeting) at such shorter notice.

2. The format of accounts of foreign subsidiaries should be, as far as possible, in accordance with requirements under the Companies Act, 2013. In case this

[24] Vide Notification No. GSR 465 (E), dated 5th June, 2015

is not possible, a statement indicating the reasons for deviation may be placed/ filed along with such accounts.

12. COPY OF FINANCIAL STATEMENT TO BE FILED WITH REGISTRAR [SECTION 137]

This section provides that copies of financial statement including consolidated financial statement, if any, along with all the documents annexed to financial statement shall be filed with Registrar.

WHERE AGM CONVENED [SUB-SECTION 1 READ WITH RULE 12 OF THE COMPANIES (ACCOUNTS) RULES 2014 AND RULE 3 OF THE COMPANIES (FILING OF DOCUMENTS AND FORMS IN EXTENSIBLE BUSINESS REPORTING LANGUAGE) RULES, 2015

What is required to be filed with registrar?

A copy of financial statements including

a. Consolidated financial statement, if any,

b. Along with all the documents which are required to be or attached to such financial statements under this Act,

c. **Duly adopted at the annual general meeting** of the company, shall be filed with the Registrar.

By when required to be filed?

Within thirty days of the date of annual general meeting except in case of OPC.

One Person Company (not require to conducted AGM) 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 one hundred eighty days from the closure of the financial year.

Mode, Manner and Form of filing

Every company shall file the financial statement with Registrar together with applicable form as specified below along-with such fee or additional fee as prescribe by *Companies (Registration Offices and Fees) Rules, 2014:*

a. **Rule 12(1)** of the ***Companies (Accounts) Rules, 2014*** states every company shall file the financial statement with Registrar together with Form AOC-4 and the consolidated financial statement, if any with Form AOC-4. CFS.

b. Further **rule 12(1A)** states every Non-Banking Financial Company (NBFC) 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 consolidated financial statement, if any, with Form AOC-4 CFS NBFC (Ind AS).

c. **Rule 12 (1B)** requires that 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.

d. **Rule 3(1)** of the ***Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2015*** states that, the following class of companies shall file their financial statements & 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*

The companies which have filed their financial statements under Rule 3(1) of *the Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2015* and erstwhile rules (i.e., *the Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2011*) 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. Meaning thereby **once company started reporting in XBRL format shall continue to report in XBRL format in succeeding years also, even if criteria mentioned above is not met in succeeding years.**

Example 3

Amazon Company Limited, a company incorporated under the Companies Act, 2013, has a turnover of ₹ 150 crore and ₹ 90 crore during the financial year ended 31st March 2020 and 31st March 2021 respectively. Now Amazon Company Limited shall continue to file the financial statements and other documents under section 137 in e-form AOC-4 XBRL for the financial year ended 31st March 2021 even if the company does not fall in the class of companies provided under Rule 3 of the Companies (Filing of documents and forms in Extensible Business Reporting Language) Rules, 2015.

Summary of Form and Manner of Filing

Category	Standalone	Consolidated Financial Statement (if any)
1. Companies listed with stock exchanges in India and their Indian subsidiaries; **2.** Companies having paid up capital of five crore rupees or above; **3.** Companies having turnover of one hundred crore rupees or above; **4.** All companies which are required to prepare their financial statements in accordance with the *Companies (Indian Accounting Standards) Rules, 2015* **Note** - 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 *the Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2015* i.e., in XBRL format	Shall mandatorily file their financial statement in Extensible Business Reporting Language (XBRL) format in e-form AOC-4 XBRL Using the Taxonomy provided in Annexure-II of *the Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2015*, if preparing their financial statements as per *the Companies (Accounting Standards) Rules, 2021* Using the Taxonomy provided in Annexure-II A of *the Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2015*, if preparing their financial statements as per *Companies (Indian Accounting Standards) Rules, 2015*	

Non-Banking Financial Company that is required to comply with Indian Accounting Standards	AOC-4 NBFC (Ind AS)	AOC-4 CFS NBFC (Ind AS)
Every Other Company not covered above	Form AOC-4	Form AOC-4 CFS
Every company covered under the provisions of sub-section (1) to section 135 i.e., Corporate Social Responsibility (CSR)	Shall furnish a report on CSR in Form CSR-2 as an addendum to the applicable form (out of those stated above, as the case may be).	

If the financial statements are not adopted:

First proviso to Section 137(1) provides that where the financial statements are not adopted at AGM or adjourned AGM, such un-adopted financial statements along with the required documents shall be filed with the Registrar within 30 days of the date of AGM.

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.

Further, **second proviso to Section 137(1)** provides, 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.

Company having subsidiaries:

Fourth proviso to Section 137(1) provides a company shall, along with its financial statements to be filed with the Registrar, attach the accounts of its subsidiary or subsidiaries which have been incorporated outside India and which have not established their place of business in India.

Fifth proviso to Section 137(1) provides in the case of a subsidiary which has been incorporated outside India (herein referred to as "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.

But where such financial statement is in a language other than English, along with a translated copy of the financial statement in English.

The format of accounts of foreign subsidiaries should be, as far as possible, in accordance with requirements under the Companies Act, 2013. In case this is not possible, a statement indicating the reasons for deviation may be placed/ filed along with such accounts.[25]

Illustration 11

Vandana Ltd., based in India, has many subsidiaries in India and outside India. It also had associates and joint ventures. For the purpose of finalization of the consolidated financial statements of the company for the year ended 31 March 2021, the company's management requested its foreign subsidiary, based out of Italy, to provide its standalone financial statements. The Italian subsidiary company prepares its financial statements in the local language of the country and the same is provided to the Indian parent company as unaudited as the audit is not required by the Italian subsidiary company. Please advise how the Indian parent should deal with this financial statement.

Answer

Vandana Ltd. Would have to get the standalone financial statements of Italian subsidiary company translated in English language and also get those aligned as per its accounting policies for the purpose of consolidation.

Further, as per the requirements of section 137(1) of the Companies Act 2013, Vandana Ltd. would need to file such unaudited financial statement of Italian subsidiary company along with a declaration to this effect along with a translated copy of the financial statement in English.

Further, the format of accounts of Italian subsidiary company should be, as far as possible, in accordance with requirements under the Companies Act, 2013. In case this is not possible, a statement indicating the reasons for deviation may be placed/ filed along with such accounts.

ANNUAL GENERAL MEETING NOT HELD [SUB-SECTION 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 thirty days of the last date before which the AGM should have

[25] vide General Circular no. 11/2015 dated 21 July 2015

been held and in such manner, with such fees or additional fees as may be prescribed.

Illustration 12

The AGM of R Ltd., for laying the Annual Accounts there at for the year ended 31 March 2022, 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 2022 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 2022 along with such fees or additional fees as may be prescribed.

Summary of Sub-section 1 and 2 to section 137

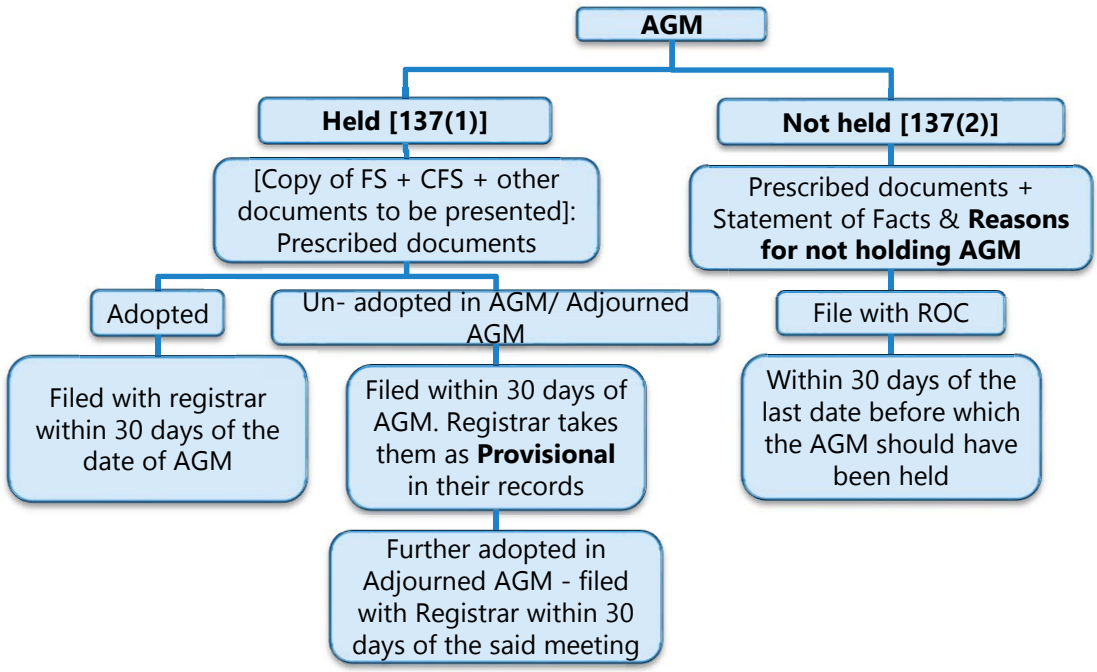


Illustration 13 *(In continuation to above illustration)*

Will it make any difference in case the Annual Accounts were duly laid before the AGM held on 27 September 2022 but the same were not adopted by the shareholders?

Answer

Since the AGM has been held in time on 27 September 2022, 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.

PENALTY [SUB-SECTION 3]

If any of the provisions of section 137 is contravened, then;

The company shall be liable to a penalty of **ten thousand rupees** and in case of continuing failure, with a further penalty of **one hundred rupees for each day** during which such failure continues, subject to a **maximum of two lakh rupees**; **and**

The managing director and the Chief Financial Officer of the company, if any, and, in the absence of the managing director and the Chief Financial Officer, any other director who is charged by the Board with the responsibility of complying with the provisions of this section, and, in the absence of any such director, all the directors of the company, shall be liable to a penalty of **ten thousand rupees**, and in case of continuing failure, with further penalty of **one hundred rupees for each day** after the first during which such failure continues, subject to a **maximum of fifty thousand rupees**.

Summary of penalty provisions

Person liable	Penalty
Company	Fine of ₹ 10,000 and In case of continuing failure, with a **further penalty** of ₹ 100 for each day during which such failure continues, subject to a maximum of ₹ **2 lakh.**

MD and CFO of the company, if any; *In their absence* Any other director who is charged by the Board with the responsibility; *In its absence* All the directors of the company.	Fine of ₹ 10,000 and In case of continuing failure, with a **further penalty** of ₹ 100 for each day during which such failure continues, subject to a maximum of ₹ **50,000.**

13. INTERNAL AUDIT [SECTION 138]

Section 138 read with Rule 13 of the Companies (Accounts) Rules 2014, provides for internal audit in a company.

COMPANIES REQUIRED TO APPOINT INTERNAL AUDITOR [SUB-SECTION 1 READ WITH RULE 13(1) OF COMPANIES (ACCOUNTS) RULES, 2014]

a. Every listed company;

b. Every unlisted public company having;

   i. **Paid up share capital** of **fifty crore rupees or more** during the preceding financial year; or

   ii. **Turnover** of **two hundred crore rupees or more** during the preceding financial year; or

   iii. **Outstanding loans or borrowings** from banks or public financial institutions exceeding **one hundred crore rupees or more** at any point of time during the preceding financial year; or

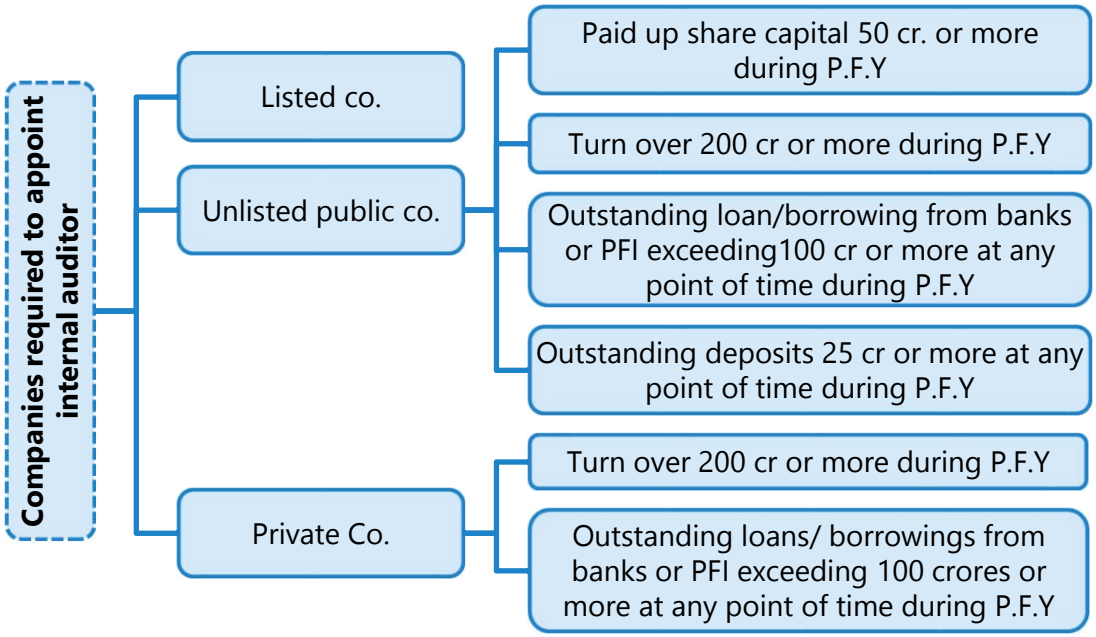
   iv. **Outstanding deposits** of **twenty-five crore rupees or more** at any point of time during the preceding financial year; and

c. Every private company having

   i. **Turnover** of **two hundred crore rupees or more** during the preceding financial year; or

   ii. **Outstanding loans or borrowings** from banks or public financial institutions exceeding **one hundred crore rupees or more** at any point of time during the preceding financial year.

Summary of Rule 13(1) of the Companies (Accounts) Rules, 2014



Note: An existing company covered under any of the above criteria shall comply with the requirements of section 138 and this rule within 6 months of commencement of such section.

WHO CAN BE APPOINTED AS INTERNAL AUDITOR? [SUB-SECTION 1 READ WITH RULE 13(1) OF COMPANIES (ACCOUNTS) RULES, 2014]

Sub-section 1 to section 138 states that internal auditor shall either be-

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.

Students are advised to take note:

The term "Chartered Accountant" or "Cost Accountant" shall mean a "Chartered Accountant" or a "Cost Accountant", as the case may be, whether **engaged in practice or not**'.

The internal auditor **may or may not be an employee** 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.

In case of a specified IFSC public company[26] and specified IFSC private company[27] the section 138 shall apply if the articles of the company provide for the same.

Illustration 14

Perfect Ltd is a listed company. The company is in the business of manufacturing of steel and had its head office at Karnataka. The company's operations are spread out across India. The company appointed a firm of Chartered Accountants, N & Co. LLP, as its internal auditors for the year ended 31st March 2023. However, for the financial year 2023-24, the company is planning to have an in-house internal audit system commensurate with its size and operations. If the company does that then it is planning not to continue with N & Co. LLP as its internal auditors. Please advise.

Answer

In the given situation, if the internal audit function of the company is fine as per its size and operations then it may decide not to continue with N & Co. LLP.

SUMMARY

- Every company shall prepare and keep at its registered office books of account 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

[26] Vide notification GSR 08(E) dated 4th January, 2017
[27] Vide notification GSR 09(E) dated 4th January, 2017

and such books shall be kept on accrual basis and according to the double entry system of accounting.

- The financial statement shall give a true and fair view of the state of affairs of the company or companies, comply with the accounting standards notified under section 133 and shall be in the form or forms as may be provided for different class or classes of companies in Schedule III. Provided that the items contained in such financial statements shall be in accordance with the accounting standards.
- A company shall not re-open its books of account and not recast its financial statement, unless an application in this regard is made by the Central Government, the Income-tax authorities, the Securities and Exchange Board of India, 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.
- If it appears to the directors of a company that the financial statement of the company; or 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 three preceding financial years after obtaining approval of the Tribunal on an application made by the company in such form and manner as may be prescribed and a copy of the order passed by the Tribunal shall be filed with the Registrar.
- National Financial Reporting Authority is an independent regulator set up to oversee the auditing profession and to provide for the matters pertaining to Accounting and Auditing Standards
- The Central Government may prescribe the standards of accounting or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, 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.
- 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. The auditors' report shall be attached to every financial statement. A report by its Board of Directors shall be attached to statements laid before a company in general meeting.

- Every company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year the immediately preceding financial year shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director. The Board of every such company, shall ensure that the company spends, in every financial year, at least two percent of the average net profits of the company made during the three immediately preceding financial year, or where the company has not completed the period of three financial years since its incorporation, during such immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy:
- A copy of the financial statement, 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, which are to be laid before a company in its general meeting, shall be sent to every member of the company , to every trustee for the debenture-holder of any debenture issued by the company, and to all persons other than such member or trustee, being the person so entitled, not less than twenty-one days before the date of the meeting.
- A copy of the financial statement, including consolidated financial statement, if any, along with all the documents which are required to be or attached to such financial statements under this Act, duly adopted at the annual general meeting of the company, shall be filed with the Registrar within thirty days of the date of annual general meeting in such manner, with such fees or additional fees as may be prescribed.
- Every listed company; every unlisted public company (having paid up share capital of fifty crore rupees or more during the preceding financial year; or turnover of two hundred crore rupees or more during the preceding financial year; or Outstanding loans or borrowings from banks or public financial

institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or Outstanding deposits of twenty five crore rupees or more at any point of time during the preceding financial year); and every private company (having turnover of two hundred crore rupees or more during the preceding financial year; or outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year) shall be required to appoint an internal auditor, who shall either be a chartered accountant or a cost accountant , or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the company.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. *ABC Limited has its shares listed on a recognized stock exchange in India. During the current financial year ending on 31st March 2023, the Securities and Exchange Board of India (SEBI) has found some irregularities in the filings made by the company. Accordingly, SEBI proposes to make an application to the Tribunal for reopening of the books of account of the Company. You, as an expert, are called upon by SEBI to advise the earliest financial year to be quoted in application for reopening of books of account may be granted by Tribunal?*

   (a) 2018-2019

   (b) 2016-2017

   (c) 2013-2014

   (d) 2014-2015

2. *During the half year ended September 2022, the board of directors (BOD) of New Era Limited has made an application to the Tribunal for revision in the accounts of the company for the financial year ended on March 2020. Further during the year ended March 2023, the BOD has again made an application to the Tribunal for revision in the board's report pertaining to the year ended March 2022. You are required to state the validity of the acts of the Board of directors.*

(a) *The act of the BOD is valid only to the extent of application made for revisions in accounts as board's report are not eligible for revision.*

(b) *The act of the BOD is valid as application made for revision in the accounts and board's report pertains to two different financial year.*

(c) *The act of the BOD is invalid as the law provides for only one time application to be made in a financial year for revision of accounts and boards report.*

(d) *The act of the BOD is invalid as to the application made for revision in accounts pertains to a period beyond 2 years immediately preceding the year 2023. The application made for revision in the Board report is however valid in law.*

3. *As per the provisions of the Companies Act, 2013, which of the following statement is correct with respect to the surplus arising out of the CSR activities:*

(a) *The surplus cannot exceed five percent of total CSR expenditure of the company for the financial year.*

(b) *The surplus shall not form part of the business profit of a company*

(c) *The surplus cannot exceed 10 percent of total CSR expenditure of the company for the financial year.*

(d) *The surplus shall form part of the business profit of a company*

4. *Shri Limited (a company having CSR Committee as per the provision of Section 135 of the Companies Act, 2013) decides to spend and utilize the amount of Corporate Social Responsibility on the activities for the benefit of all the employees of Shri Limited. As per the provision of Companies Act, 2013 this would mean that:*

(a) *This is the total amount spent on Corporate Social Responsibility activities by Shri Limited for that financial year*

(b) *No amount spent on Corporate Social Responsibility activities by Shri Limited for that financial year*

(c) *Only half of the total amount spent, shall be considered to be spent on Corporate Social Responsibility activities by Shri Limited for that financial year*

(d) *Only the amount that has been spent on the employees having salary of ₹ 20,000 per month or less, shall be considered be considered to be spent on Corporate Social Responsibility activities by Shri Limited for that financial year.*

Descriptive Questions

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. Advice.*

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 Company Secretary.*

   The financial statements 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?

3. *A Housing Finance Ltd. is a housing finance company having a paid-up share capital of ₹ 11 crore and a turnover of ₹ 145 crore during the financial year 2022-23. 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.*

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.*

5. (i) *Ravi Limited maintained its books of account 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 Account of a Company.*

   (iii) *Whether a Company can 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 2021-22 were placed at its annual general meeting held on 31st August 2022. 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, 2022 whereat the accounts were adopted. Thereafter, Sun Ltd. filed its financial statements relevant to the financial year 2021-22 with the Registrar of Companies on 12th November, 2022. 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?*

7. *The Income Tax Authorities in the current financial year 2022-23 observed, during the assessment proceedings, a need to re-open the accounts of Chetan Ltd. for the financial year 2011-12 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 2011-12. Examine the validity of the application filed by the Income Tax Authorities to NCLT*

ANSWERS

Answer to MCQ based Questions

1.	**(d)**	2014-2015
2.	**(b)**	The act of the BOD is valid as application made for revision in the accounts and board's report pertains to two different financial year.
3.	**(b)**	The surplus shall not form part of the business profit of a company
4.	**(b)**	No amount spent on Corporate Social Responsibility activities by Shri Limited for that financial year

Answer to Descriptive Questions

1. 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 account 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 above-mentioned procedure.

2. According to section 134(1) of the Companies Act, 2013, the financial statements, 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 Company Secretary, he should also sign the financial statements.

3. As per Rule 3(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. 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)** 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) The books of account and other relevant books and papers maintained in electronic mode shall remain accessible in India so as to be usable for subsequent reference.

Provided that for the financial year commencing on or after the 1st day of April, 2022, every company which uses accounting software for maintaining its books of account, shall use only such accounting software which has a feature of recording audit trail of each and every transaction, creating an edit log of each change made in books of account along with the date when such changes were made and ensuring that the audit trail cannot be disabled.

(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. 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 un-adopted 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, 2022 and filing of financial statements with Registrar was done on 12th November, 2022 i.e. within 30 days of the date of adjourned AGM. But Sun Ltd. has not filed its un-adopted financial statements within 30 days of the date of the annual general meeting held on 31st August 2022.

Hence, Sun Ltd. has not complied with the statutory requirement regarding filing of un-adopted accounts with the Registrar, but has certainly complied with the provisions by filing of adopted accounts within the due date with the Registrar.

7. 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 2011-2012 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. 2022-2023, is invalid.

NOTES

CHAPTER 10

AUDIT AND AUDITORS

LEARNING OUTCOMES

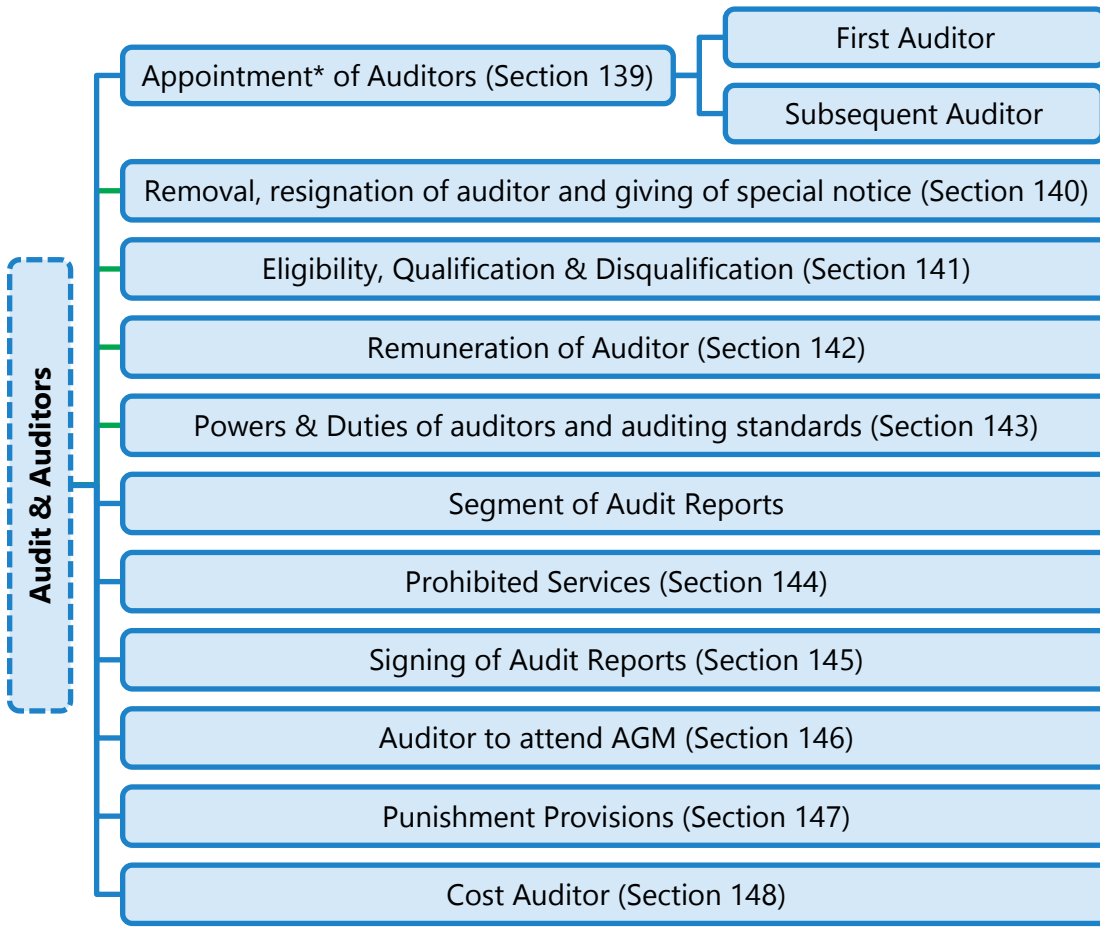
At the end of this chapter, you will be able to:

- Comprehend the procedure for appointment of auditors, their removal, resignation, eligibility, qualifications, disqualifications and remuneration.
- Identify the powers and duties of auditors.
- Explain about auditing services and certain services which an auditor cannot render.

CHAPTER OVERVIEW

This chapter explains the provisions of Chapter X of the Companies Act, 2013 (hereinafter also referred to as "the Act" or "this Act"), consisting of Sections 139 to 148 dealing with the Audit and Auditors. The provisions contained in chapter X of the Act are supplemented by the *Companies (Audit and Auditors) Rules, 2014*.

The relevant aspects (and arrangement of sections) to be covered in this book chapter are presented below;



*** Appointment includes re-appointment**

1. INTRODUCTION

Chapter X	**Consists of sections 139 to 148 as well as the Companies (Audit and Auditors) Rules, 2014.**

Large business corporations are managed by the directors who represent the members who are the real owners of the company through board. In the absence of any check, the directors may mismanage the finances of the organisation. Thus, members appoint auditor/auditors to look into the true and fair view of the financial affairs of the company. Large business corporations are managed by the directors, who act as fiduciaries (a person who prudently takes care of finances or other assets for another person) to the members (the real owners). This is the reason that the board of directors is responsible for the preparation of the financial statement and laying it out at the general meeting of members.

Despite assuming a fiduciary role, in the absence of proper checks and balances, the directors may indulge in mismanagement of the finances and other assets of the corporation. Hence, financial statements prepared and laid down by the board need to be audited by an independent auditor.

Thus, members appoint auditors to have an independent professional opinion on the financial affairs of the company, who examine such financial statements to frame opinion to report; whether they reflect a true and fair view of financial position and performance or not.

2. APPOINTMENT[1] OF AUDITORS [SECTION 139]

APPOINTMENT OF AUDITOR [SUB-SECTION 1 READ WITH RULE 3 AND 4 OF THE COMPANIES (AUDIT AND AUDITORS) RULES, 2014]

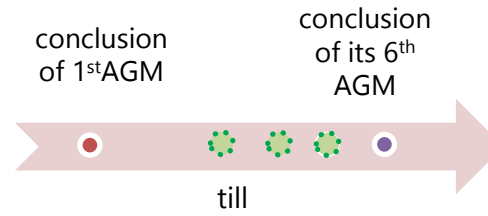
Who can be appointed as Auditor and when?

Every company shall appoint **an individual** or **a firm** ("firm" shall include a limited liability partnership incorporated under the Limited Liability Partnership Act, 2008) as an auditor of the company at the first Annual General Meeting (AGM).

[1] Appointment includes re-appointment

Tenor of appointment as Auditor

The auditor shall hold office from the conclusion of 1st AGM (or the AGM in which he is appointed) till the conclusion of its 6th AGM (and thereafter till the conclusion of every sixth AGM).



Example 1: Rashail Tech Labs Private Limited was incorporated during the financial year 2019-20. First 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.

Manner and procedure of selection and appointment of auditors [Rule 3 of the Companies (Audit and Auditors) Rules, 2014]

The manner and procedure of selection of auditors by the members of the company at AGM has been prescribed under the Rule 3 of the *Companies (Audit and Auditors) Rules, 2014*; tabled and stated below.

Categories of Companies	Competent authority	Responsibility of the competent authority
A company which is **required** to constitute an Audit Committee under section 177	Audit Committee*	The competent authority **shall take into consideration the qualifications and experience** of the individual or the firm proposed to be considered for appointment as auditor and such qualifications and experience are commensurate with the size and requirements of the company. 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. It may call for **such other information** from the proposed auditor as it may deem fit.
A Company which is **not required** to constitute an Audit Committee under section 177	Board of Directors	

* **Where competent authority is audit committee,** the committee shall recommend the name of an individual or a firm as auditor to the Board for consideration; the Board shall consider and recommend an individual or a firm as auditor to the members in the AGM for appointment.

If the **Board agrees** with the recommendation of the Audit Committee - It shall further recommend the appointment of an individual or a firm as auditor to the members in the annual general meeting.

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.

Example 2: Audit Committee recommended KPM & Associates, Chartered Accountants firm for appointment as statutory auditor to the board of Surya Solar Limited. However, board of the company disagreed with the recommendation of the audit committee. In such condition, board shall refer back the recommendation to the committee for reconsideration citing reasons for such disagreement.

If the Audit Committee, after considering the reasons given by the Board, 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.

Note:

Companies that require to constitute an audit committee

Section 177[2] of the Act, read with *Companies (Meetings of Board and its Powers) Rules, 2014* provides Audit Committee shall be constituted by Board of directors in case of;

i. Every **listed public companies** and

ii. Those **public companies** which having:

a. **Paid up capital** of **ten crore rupees or more**; or

b. **Turnover** of **one hundred crore rupees or more**; or

[2] Not a part of syllabus at Intermediate level, but necessary to build understanding of the students.

c. Aggregate, **outstanding loans or borrowings or debentures or deposits** exceeding **fifty crore rupees** or more.

The paid up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited financial statements shall be taken into account for the purposes of this rule.

It is also worth noting that where a company ceases to fulfil any of three conditions laid down above for three consecutive years, it shall not be required to comply with the provisions pertaining to audit committee until such time as it meets any of such conditions.

Consent of auditors (proposed/selected auditor) for appointment, certificate from such auditor and notice to Registrar [Sub-section 1 read with rule 4 of the Companies (Audit and Auditors) Rules, 2014]

Written consent

Before the appointment is made, the **written consent** of the auditor to such appointment shall be obtained.

Certificate

A **certificate** shall be also obtained from the auditor stating that;

a. The individual or the firm (as the case may be to be, appointed as auditor) is eligible for appointment and is not disqualified for appointment under the Act, the Chartered Accountants Act, 1949 and the rules or regulations made thereunder;

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.

Note

The certificate shall also indicate whether the auditor satisfies the criteria provided in section 141 [i.e. eligibility, qualification and disqualification of Auditor which will be discussed later] of this Act.

Notice to Registrar

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.

Students are advised to take note;

Intimation to NFRA under the National Financial Reporting Authority Rules, 2018 (here-in-after referred as to NFRA Rules)

As per Rule 3 (2) of NFRA Rules, every existing body corporate other than a company governed by NFRA rules, shall inform the National Financial Reporting Authority (NFRA) within 30 days of the commencement of the NFRA rules, in Form NFRA-1, the particulars of the auditor as on the date of commencement of the NFRA rules.

According to Rule 3(3) of NFRA Rules, every body corporate, other than a company as defined in clause (20) of section 2 of the Act, formed in India and governed under NFRA Rules shall, 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 appointed by such body corporate, provided that a body corporate governed under clause (e) of sub-rule (1) of NFRA Rules shall provide details of appointment of its auditor in Form NFRA-1.

TERM OF AUDITOR [SUB-SECTION 2 READ WITH RULE 5 OF COMPANIES (AUDIT & AUDITORS) RULES, 2014]

Maximum terms and length thereof in case of individual and firm

Section 139(2) provides that:

i. Listed companies and

ii. All companies (excluding one person companies & small companies), which are

- **a.** Unlisted public companies and having paid up share capital of rupees ten crore or more;
- **b.** Private limited companies and having paid up share capital of rupees fifty crore or more;
- **c.** Having public borrowings from financial institutions, banks or public deposits of rupees fifty crore or more.

Shall **not appoint or re-appoint**

i. An individual as auditor for more than **one term** of **five consecutive years**;

ii. An audit firm as auditor for more than **two terms** of **five consecutive years**

Students are advice to take note;

Noting contained in sub-section 2, shall prejudice the right of the;

a. Company to remove an auditor or

b. Auditor to resign from such office of the company.

Example 3: XYZ Ltd. which is a listed company appoints individual Mr. Raghav as an auditor in its AGM dated 29th September, 2022. 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 2027. Now as per sub-section (2), Mr. Raghav shall not be re-appointed as Auditor in XYZ Ltd at 6th AGM (i.e. 2027).

Example 4: 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 at 11th AGM (i.e. 2026).

Cooling Period (to ensure re-instatement of independence)

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 **five years** from the completion of his term;

An **audit firm** which has completed its terms (i.e. two terms of five consecutive years) shall **not be eligible for re-appointment** as auditor in the same company for **five years** from the completion of second term.

Summary

Auditor	Appointed/Reappointed for	Not eligible for re-appointment
Individual	One term of five consecutive years (1st AGM to 6th AGM)	For **five years** from the completion of his term (till 11th AGM)
Firm	Two terms of five consecutive years (1st AGM to 11th AGM)	For **five years** from the completion of its second term (till 16th AGM)

Example 5: 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 6: 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.

Note: On the date of appointment, an audit firm shall not have any partner or partners who are/were also the partner/s to the other audit firm, whose tenure has been expired in a company immediately preceding the financial year.

It means, the audit firm with **common partner/s** shall **not be appointed** as succeeding auditor of same company after two terms of five consecutive years.

Example 7: 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 cooling period of 5 years, Golden Smith Ltd. may appoint M/s Kukreja & Associates or M/s. Krishna & Associates as its auditors.

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 (a) to (d) (i.e. provisions of this sub-section), shall comply with those provisions within a period which shall not be later than the date of the first AGM of the company held, within the period specified under sub-section (1) of section 96, after three years from the date of commencement of this Act.

ROTATION OF AUDITOR [SUB-SECTION 3 AND 4 READ WITH RULE 6 OF COMPANIES (AUDIT & AUDITORS) RULES, 2014]

Power to Members [Sub-section 3]

Members of a company may resolve to provide that;

a. In the audit firm appointed by them, the auditing partner and his team shall be rotated at such intervals as may be resolved by members; or

b. The audit shall be conducted by more than one auditor.

Manner of rotation of auditors by the companies on expiry of their term [Sub-section 4 read with Rule 6 (2) and (3)]

The Central Government may, by rules, prescribe the manner in which the companies shall rotate their auditors. The manner of rotation of auditors by the companies on expiry of their term as provided under Rule 6 of the *Companies (Audit and Auditors) Rules, 2014*, as stated below;

a. Where a company is **required to constitute an Audit Committee**

- **i.** Such Audit Committee shall recommend to the Board, the **name of an individual auditor or of an audit firm** who may **replace the incumbent auditor** on expiry of the term of such incumbent
- **ii.** The **Board shall consider the recommendation** of such committee, and make its recommendation for appointment of the next auditor by the members in annual general meeting.

b. In **other cases**, the **Board shall itself consider the matter of rotation of auditors** and make its recommendation for appointment of the next auditor by the members in annual general meeting.

Note

Most of provisions of Rule 6 are either complementary, or in confirmation/ conformance to Rule 3.

In case where Audit committee is not required to be constituted under section 177, but constituted by the company voluntarily, then such audit committee shall recommend to the Board, the **name of an individual auditor or of an audit firm** who may **replace the incumbent auditor** on expiry of the term of such incumbent; but in such cases **board may or may not consider the recommendation** of such committee.

Manner of rotation in case of auditors appointed prior to commencement of this Act and continuing after such commencement [Rule 6(3)]

For the purpose of the rotation of auditors in case of an auditor (whether an individual or audit firm), the period for which the individual or the firm has held office as auditor prior to the commencement of the Act shall be taken into account for calculating the period of five consecutive years or ten consecutive years, as the case may be.

Example 8: Dass & Dass Co, a Chartered Accountants firm was appointed as auditor of Modern Furniture since 28th September 2012. The firm can continue to assume the office of auditor till AGM conducted for financial year 2021-22.

Illustration explaining rotation in case of individual auditor

Number of consecutive years for which an individual auditor has been functioning as auditor in the same company [till 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

Here,

a. Individual auditor shall include other individuals or firms whose name or trademark or brand is used by such individual, if any.

b. Consecutive years shall mean all the preceding financial years for which the individual auditor has been the auditor until there has been a break by five years or more.

Illustration explaining rotation in case of audit firm

Number of consecutive years for which an audit firm has been functioning as auditor in the same company [till the first AGM held after the commencement of provisions of section 139(2)]	Maximum number of consecutive years for which the firm may be appointed in the same company (including transitional period)	Aggregate period which the firm would complete in the same company in view of column I and II
I	**II**	**III**
10 years (or more than 10 years)	3 years	13 years or more
9 years	3 years	12 years
8 years	3 years	11 years
7 years	3 years	10 years
6 years	4 years	10 years
5 years	5 years	10 years
4 years	6 years	10 years
3 years	7 years	10 years
2 years	8 years	10 years
1 year	9 years	10 years

Here,

a. Audit Firm shall include other firms whose name or trade mark or brand is used by the firm or any of its partners.

b. Consecutive years shall mean all the preceding financial years for which the firm has been the auditor until there has been a break by five years or more.

Manner of rotation in case of same network and common partner [Rule 6(3)]

The incoming auditor or audit firm shall not be eligible if such auditor or audit firm is associated with the outgoing auditor or audit firm under the **same network** of audit firms. The term **same network** includes the firms operating or functioning, hitherto or in future, under the same brand name, trade name or common control.

For the purpose of **rotation of auditors,** a break (**cooling period**) in the term for a continuous period of five years shall be considered as **fulfilling the requirement of rotation**. But if a partner (**common partner**), who is in charge of an audit firm and also certifies the financial statements of the company, retires from the said firm and joins another firm of chartered accountants, such other firm **shall also be ineligible to be appointed** for a period of five years i.e. cooling period.

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**.

Illustration 1

Modern Furniture Limited (MFL), despite not mandated by Section 177 of the Act, read with Companies (Meetings of Board and its Powers) Rules, 2014 to constitute audit committee; on their own on voluntary basis constitute such audit committee.

Such committee recommend to the Board, the name of an individual auditor or of an audit firm who may replace the incumbent auditor on expiry of the term of such incumbent; but board didn't consider the recommendation of such committee. Examine the legal validity of act of audit committee and board of MFL.

Answer – Rule 6(1) read in conjunction with rule 6(2) of the Companies (Audit & Auditors) Rules, 2014 provides that in case where Audit committee not required to be constituted under section 177, but constituted by company, then also such audit

committee shall recommend to the Board, the name of an individual auditor or of an audit firm who may replace the incumbent auditor on expiry of the term of such incumbent; but in such cases board may or may not consider the recommendation of said audit committee.

Hence, act of audit committee and board at MFL is legally valid.

FIRST AUDITORS [SUB-SECTION 6]

The **first auditor** of a company, **other than a Government Company**, shall be;

a. Appointed by the **Board of directors**

b. Within **30 days of the date of registration** of the company and

c. The auditor so appointed shall **hold office until the conclusion of the first AGM.**

Illustration 2

Unicorn Steel Private Limited is incorporated as on 02.06.2022, board of directors of the company held board meeting as on 15.06.2022 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. Evaluate the legal validity;

Options

a. *Valid*

b. *Invalid*

c. *Valid after approval of shareholder in General Meeting*

d. *Valid only after approval of Central Government*

Answer - b

Reason – As per section 139(6), the first auditor so appoint by Board of Director shall hold office until the conclusion of the first AGM.

If the **Board fails to exercise its powers** i.e. appointment of first auditor, it shall

a. Inform the members of the company and

b. The company may appoint the first auditor within 90 days at an extra ordinary general meeting (EGM) and

c. Such auditor shall hold office till the conclusion of the first AGM.

Illustration 3

Managing Director of PQR Limited wanted to appoint Mr. Ganpati, a practicing Chartered Accountant, as first auditor of company. He himself without consulting the board, appointed Shri Ganpati as auditor. Evaluate legal validity

Answer - 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". Hence in the instant case, the appointment of Mr. Ganpati by the Managing Director himself is invalid due to violation of Section 139(6) of the Companies Act, 2013.

AUDITOR OF GOVERNMENT COMPANY [SUB-SECTION 5 & 7]

First Auditor [Sub-section 7]

The first auditor is to be appointed by **Comptroller and Auditor General** of India (CAG) **within 60 days** from the **date of registration** of the company, who shall hold office **till the conclusion of the first annual general meeting**; in case 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.

Note

If Comptroller and Auditor General of India fails in this respect, the Board is to appoint the auditor within next 30 days

Further if the Board also fails to do so, it has to inform the members of the company who have to make the appointment within 60 days at an extraordinary general meeting (EGM).

Mind it, even appointed by Board or by embers at EGM, the first auditor shall hold office till the conclusion of the first annual general meeting

Subsequent Auditor [Sub-section 5]

In respect of **financial year**, the **Comptroller and Auditor General** of India shall appoint a duly qualified auditor **within 180 days** from the **commencement of the financial year**, who **shall hold office till conclusion of annual general meeting**; in case of:

a. A Government company or

b. 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.

FILLING UP CASUAL VACANCY [SUB-SECTION 8]

Other than company whose accounts are subject to audit by an auditor appointed by the CAG

The **Board may** fill any casual vacancy in the office of an auditor **within 30 days**. Any auditor appointed in a casual vacancy shall **hold office until** the conclusion of the **next annual general meeting**.

Note

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 three months** of the recommendation of the Board

Company whose accounts are subject to audit by an auditor appointed by the CAG

Casual vacancy of an auditor shall be filled by the **Comptroller and Auditor General** of India within **30 days**.

Further, in case the **CAG does not fill the vacancy** within the said period, the **Board of Directors** shall fill the vacancy within **next 30 days**.

Example 9: Prakash Carriers Limited appointed Mr. Raman as its auditor in the Annual General Meeting held on 30th September, 2022. Initially, he accepted the appointment. But he resigned from his office on 31st October, 2022 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.

RE-APPOINTMENT OF RETIRING AUDITOR [SUB-SECTION 9 AND 10]

As per sub-section 9, a retiring auditor may be re-appointed at an AGM if;

a. He is not disqualified for re-appointment;

b. He has not given a notice in writing to the company of his unwillingness to be re-appointed; and

c. A special resolution has not been passed at that meeting appointing some other auditor or providing expressly that he shall not be re-appointed.

Further as per sub-section 10, 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.

3. 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. According to this section:

REMOVAL OF AUDITOR BEFORE HIS TERM [SUB-SECTION 1 READ WITH RULE 7 OF THE COMPANIES (AUDIT & AUDITORS) RULES, 2014]

Manner and Procedure

The auditor appointed under section 139 may be removed from his office **before the expiry of his term** only by—

a. A **special resolution** of the company[3] **and**

b. After obtaining the **previous approval** of the Central Government (powers are delegated to **Regional Director**)[4] by making an application in Form ADT-2 that shall be accompanied with the prescribed fees as provided for this purpose under *the Companies (Registration Offices and Fees) Rules, 2014*.

Note

The application shall be made to the Central Government within 30 days of the resolution passed by the Board.

The Company shall hold the general meeting within 60 days of receipt of approval of the Central Government for passing the special resolution.

Example 10: Mr. Suresh, a Chartered Accountant, 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.

In case of a **Specified IFSC public company**[5] and **Specified IFSC private company**[6], where, **within a period of sixty days** from the date of submission of the application to the Central Government under this sub-section, **no decision is communicated by the Central Government to the company**, it would be **deemed that the Central Government has approved** the application and the company shall appoint new auditor at a general meeting convened within three months from the date of expiry of sixty days period.

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[3] ***Basant Ram & Sons v Union of India***, (2002) 110 Comp Gas 38 (Del), after approval of the Central Government, general body approval is necessary to make the removal effective.

[4] Vide notification S.O. 4090(E) dated 19th December 2016 (in supersession to notification S.O. 1352(E) dated 21st may 2014)

[5] Inserted vide Exemption Notification to specified IFSC Public Companies, GSR 08 (E) dated 04.01.2017

[6] Inserted vide Exemption Notification to specified IFSC Private Companies, GSR 09 (E) dated 04.01.2017

Giving opportunity of being heard (*Audi Alteram Partem*)

Before taking any action for removal of auditor before the expiry of his term, the auditor concerned shall be given a reasonable opportunity of being heard.

The Latin maxim, 'Audi Alteram Partem' is the principle of natural justice where every person gets a chance of being heard to respond to the charge, evidence or action against them.

Illustration 4

Special Resolution to remove auditor at general meeting shall be passed within _____, form the approval from central government.

a. *30 days*

b. *1 month*

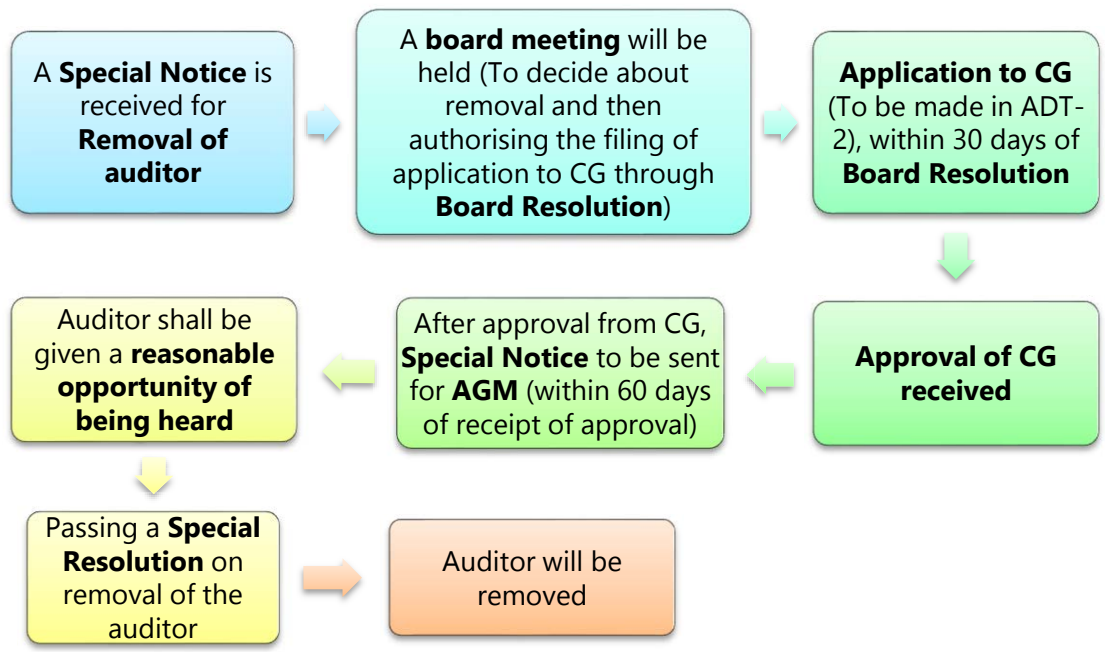
c. *60 days*

d. *3 months*

Answer - c

Reason – Rule 7(3) of the Companies (Audit & Auditors) Rules, 2014 that states the company shall hold the general meeting within sixty days of receipt of approval of the Central Government for passing the special resolution.

Summary of steps for removal of auditor



RESIGNATION BY AUDITOR [SUB-SECTION 2 & 3 READ WITH RULE 8 OF COMPANIES (AUDIT AND AUDITORS) RULES, 2014]

File a statement [Sub-section 2 read with rule 8]

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 a period of 30 days from the date of such resignation.

The auditor shall indicate the reasons and other facts as may be relevant with regard to 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.

Summary

Particulars	In case of Government Co.	In other Cases
Form of statement	ADT-3	ADT-3
Time Period for filling	Within 30 days of resignation	Within 30 days of resignation
Statement filled with	Company, Registrar & CAG	Company and Registrar

Penalty for contravention [Sub-section 3]

If the auditor does not comply with aforesaid provision of filling statement then;

a. He or it shall be liable to a penalty of ₹ 50,000 **or** an amount equal to the remuneration of the auditor, **whichever is less**,

and

b. In case of continuing failure, with a **further penalty** of ₹ 500 for each day after the first during which such failure continues, subject to a maximum of ₹ 2 lakh.

APPOINTING AUDITOR OTHER THAN THE RETIRING AUDITOR [SUB-SECTION 4]

Special notice for resolution

If the retiring auditor has not completed a consecutive tenure of 5 years (or 10 years in case of firm, as the case may be), **special notice shall be required** for a resolution at an annual general meeting appointing as auditor a person other than a retiring auditor, or providing expressly that a retiring auditor shall not be re-appointed.

Copy of special notice to retiring auditor

On receipt of notice of such a resolution, the company **shall** forthwith send a copy thereof to the retiring auditor.

Representation of auditor

Where notice is given of such a resolution and the retiring auditor makes with respect thereto representation in writing to the company (not exceeding a reasonable length) and requests its notification to members of the company, the company shall, unless the representation is received by it too late for it to do so,

a. In any **notice** of the resolution given to members of the company, **state the fact of the representation** having been made; and

b. **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.

If a copy of the representation is not sent to members

If a copy of representation is not sent to member as aforesaid,

a. Either because it was received too late or of the company's default, the auditor may (without prejudice to his right to be heard orally) require that the representation shall be **read out at the meeting**.

b. A copy of such representation shall be **filed with the Registrar**.

Second proviso to **section 140(4)** read with Rule 78 of *the National Company Law Tribunal Rules, 2016*, provides, if the Tribunal i.e. NCLT is satisfied;

a. On an application in Form No. NCLT. 1 may be filed by the director on behalf of the company or the aggrieved auditor to the Tribunal

b. That the **rights** conferred by the provisions of section 140 are **being abused** by the auditor,

c. Then, the **copy of the representation need not be sent** and the representation need not be **read out** at the meeting.

AUDITOR ACTS IN A FRAUDULENT MANNER OR ABETTED OR COLLUDED IN ANY FRAUD [SUB-SECTION 5]

Tribunal may order the company to change its auditor/s.

Without prejudice to any action under the provisions of this Act or any other law for the time being in force, the **Tribunal** (i.e. NCLT) either on

a. Its own (**Suo-moto**); or

b. An application (in Form No. NCLT 9) made to it by the **Central Government**; or

c. An application (in Form No. NCLT 9) made to it by **any person concerned**,

If it is satisfied that the **auditor** of a company has, whether **directly or indirectly**, **acted in a fraudulent manner** or **abetted** or **colluded in any fraud** by, or in relation to, the company or its directors or officers, it may, by order, direct the company to **change its auditors**.

Rule 78(3) of the National Company Law Tribunal Rules, 2016 provides exactly similar provision to what is stated as first proviso to Sub-section 5 of Section 140, 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 **fifteen days of receipt of such application** make an **order** that the auditor **shall not function as an auditor** and the **Central Government may appoint another auditor** in his place.

Ineligibility of auditor to be appointed and criminal liability

An auditor, whether individual or firm, against whom final order has been passed by the Tribunal under section 140, shall;

a. **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

b. Also be liable for **action under section 447** of the Companies Act 2013.

Note

In 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.

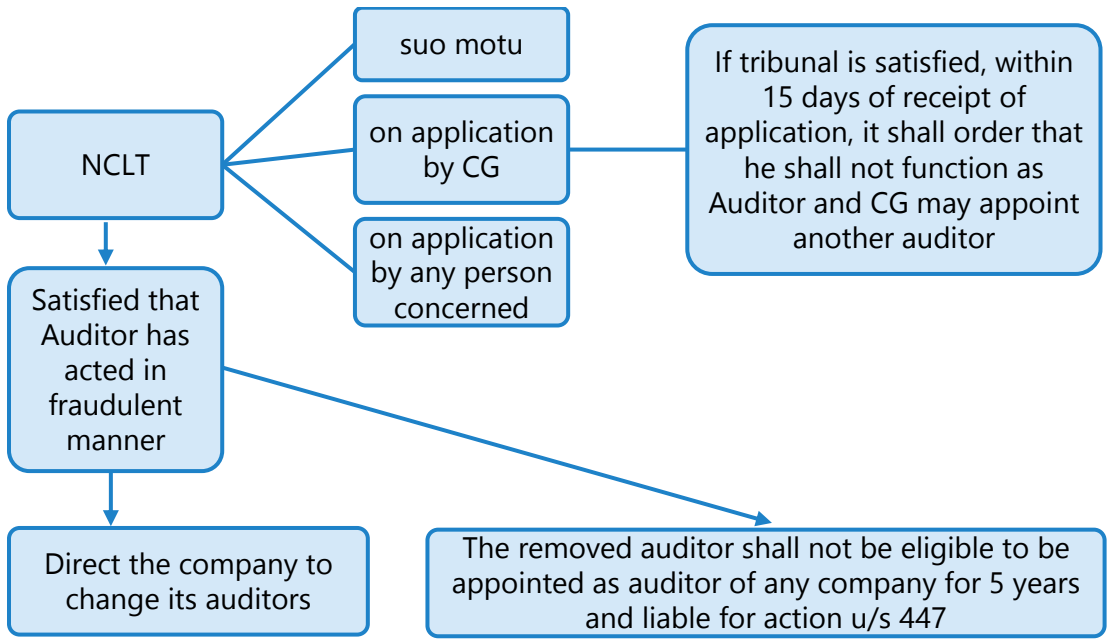
The word "auditor" also includes a firm of auditors.

Illustration 5

FLP Ltd, engaged in the business of real estate and energy, defaulted on its borrowings which amounted to thousands of crore. During the year ended 31st March 2023, 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.

Summary of Sub-section 5



4. ELIGIBILITY, QUALIFICATIONS AND DISQUALIFICATIONS OF AUDITORS [SECTION 141]

Section 141 of the Companies Act, 2013 provides for eligibility, qualifications and disqualifications of auditors.

QUALIFICATION OF AN AUDITOR [SUB-SECTION 1 AND 2]

Auditor shall be CA in Practice [Sub-section 1]

A person shall be eligible to be appointed as an auditor of a company only if he is 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.

Note

Since section 139 allows a firm also to be appointed as an auditor, hence proviso to section 141(1) prescribe clearly that only those firms wherein majority of partners practicing in India, are qualified for appointment by its firm name.

Who shall sign if firm appointed as Auditor [Sub-section 2]

Where a firm including a Limited Liability Partnership is appointed as an auditor of a company, only the partners who are Chartered Accountants shall be authorized to act and sign on behalf of the firm.

DISQUALIFICATIONS OF AUDITORS [SUB-SECTION 3 READ WITH RULE 10 OF COMPANIES (AUDIT AND AUDITORS) RULE, 2014]

Following persons shall not be qualified for appointment as auditor of a company

a. A body corporate other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008;

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;

Illustration 6

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 2022 in which he accepted the assignment. Subsequently, in January 2023, he offered Bharat, another Chartered Accountant, who is the Manager Finance of Laxman Ltd., to join the firm of Anil as a partner.

Answer

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.

In the present case, Anil is auditor of M/s Laxman Limited and any employee of Laxman Limited 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 Limited.

d. A **person** who himself or his partner 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 (i.e. fellow subsidiary) or **his relative or partner**

Illustration 7

"Mr. Ashish", a practicing Chartered Accountant, 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 partner is holding any security 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 XYZ Ltd, therefore he is not eligible for appointment as an Auditor of "XYZ Ltd".

Note – In earlier act i.e. Companies Act 1956 the holding securities of par value upto the limit of ₹1000 by auditor was not the disqualification criteria. Under current Act i.e. Companies Act 2013, not a single rupee of holding by auditor is allowed.

e. A **person** whose relative (defined u/s 2(77) 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 (i.e. fellow subsidiary) of face value exceeding ₹1,00,000.

Illustration 8

"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

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. 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.

Though rule 10(1) says, a relative of an auditor may hold securities in the company of face value not exceeding rupees one lakh but here rather than a literal interpretation, reasonable construction is required. And holding of all the relatives together shall be checked against the threshold.

Further, even if relative of one of the partners of any firm hold securities or interests exceeding the threshold then, not only such partner even firm shall not be eligible to appointed as auditor.

The threshold condition specified above shall, wherever relevant, be also applicable in the case of a company not having share capital or other securities.

If the relative acquires any security or interest above the prescribed threshold i.e. ₹1,00,000, the corrective action to maintain the limits as specified above shall be taken by the auditor within 60 days of such acquisition or interest.

Illustration 9

"BC & Co." is an audit firm having partners "Mr. B" and "Mr. C" and "Mr. A", relative of "Mr. C", is holding securities of "MWF Ltd." having face value of ₹1,10,000. Whether "BC & Co." is qualified for appointment as auditor of "MWF 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. 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 instant case, BC & Co, will be disqualified for appointment as an auditor of MWF Ltd as the relative of Mr. C i.e. partner of BC & Co., is holding the securities in MWF Ltd which is exceeding the limit mentioned in proviso to section 141(3)(d)(i).

f. A person who himself, or whose partner or relative is **indebted** to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in **excess of ₹5 Lakh**

g. A person who or whose relative or partner 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 one lakh rupees**

h. 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.

The term "business relationship" shall be construed as **any transaction entered into for a commercial purpose**, but **except**–

- Commercial transactions which are in the nature of **professional services** permitted to be rendered by an auditor or audit firm under the Act and the Chartered Accountants Act, 1949 and the rules or the regulations made under those Acts;
- 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.

i. A person whose relative is a director or is in the employment of the company as a director (as defined u/s 2(34) or key managerial personnel (as defined u/s 2(51);

j. A person who is in full time employment elsewhere

k. A person or a partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than 20 companies.

Note

While calculating the ceiling limit of 20, the one person companies, small companies and private companies having paid-up share capital less than 100 crore rupees shall be excluded.[7]

The exceptions provided above shall be applicable only to those Private Companies which has not committed a default in filing its financial statements under section 137 of the said act or annual return under section 92 of the said act with the registrar[8]

Before appointment is given to any auditor, the company must obtain a certificate from him to the effect that the appointment, if made, will not result in an excess holding of company audit by the auditor concerned over the limit laid down in section141(3)(g) of the Companies Act, 2013.

[7] Vide Notification no. G.S.R. 464(E) dated 5th June 2015

[8] Vide notification no. G.S.R. 583(E) dated 13th June, 2017

Illustration 10

"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.*

Answer

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) of the Companies Act, 2013, a person shall not be eligible for appointment as an auditor if he is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than ₹100 crore.

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 Chartered Accountant 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.

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

With reference to above provisions, an auditor can hold more appointment as auditor (i.e. ceiling limit as per section 141(3)(g) - already holding appointments as an auditor). Hence

i. Mr. A can hold: 20 – 4 = 16 more audits.

ii. Mr. B can hold 20 - 6 = 14 more audits and

iii. Mr. C can hold 20-10 = 10 more audits.

Note - It has been assumed that the companies given in the question are not one person companies, dormant companies, small companies and private companies having paid-up share capital less than ₹100 crore.

l. 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;

m. A person who, directly or indirectly, renders any service referred to in section 144 to the company or its holding company or its subsidiary company.

VACATION OF OFFICE BY AN AUDITOR [SUB-SECTION 4]

If a person appointed as an auditor of a company incurs any of the disqualifications specified in Section 141(3) after his appointment, he shall vacate his office as Auditor. Such vacation shall be deemed to be a casual vacancy in the office of the auditor.

5. REMUNERATION OF AUDITORS [SECTION 142]

Section 142 of the Companies Act, 2013 provides for remuneration of auditors.

WHO WILL FIX THE REMUNERATION?

Subsequent auditors

The remuneration of auditors has to be fixed by the company in general meeting or in such manner as the general meeting may determine.

First Auditor

While the remuneration of first auditor shall be fixed by the board, which appointed him.

INCLUSION AND EXCLUSIONS

Components

a. The remuneration so fixed is, in addition to the fee payable to an auditor to,

Includes

b. The expenses, if any, incurred by him in connection with the audit of the company (i.e. out of pocket expense) and

c. Any facility extended to him.

Exclusion

It is not to include any remuneration paid to him for any other service rendered by him at the request of the company.

Example 11: SHRD Private Ltd is engaged in the business of software and consultancy. The company has an annual turnover of ₹ 2,000 crore but its profit margins are not very good as compared to the industry standards. For the financial year ended 31st March 2019, the company proposed appointment of its statutory auditors at its Board meeting, however, the remuneration was not finalized. The statutory auditors completed the engagement formalities including the engagement letter between the company and the auditors and it was decided that the engagement letter be signed without fee i.e. with the clause that the fee to be mutually decided. In this situation, engagement letter with such arrangement is valid.

6. POWERS AND DUTIES OF AUDITORS AND AUDITING STANDARDS [SECTION 143]

POWERS OF AUDITORS [SUB-SECTION 1]

Access to books of account and vouchers

Every auditor of a company shall have a right of access at all times to the books of accounts and vouchers of the company, whether kept at the registered office of the company or at any other place.

Entitled to have necessary information and explanation

He shall be entitled to require from the officers of the company such information and explanations as the auditor may consider necessary for the performance of his duties as auditor.

Access to record of all its subsidiaries

The auditor of a company which is 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 with that of its subsidiaries and associate companies.

DUTIES OF AUDITORS

Matters of inquiry [Sub-section 1]

The auditor shall inquire into the following matters, namely

a. Whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members;

b. Whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company;

c. Where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company;

d. Whether loans and advances made by the company have been shown as deposits;

e. Whether personal expenses have been charged to revenue account;

f. 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

g. account books and the balance sheet is correct, regular and not misleading.

Report to members [Sub-section 2 and 3]

The auditor shall make a report to the members of the company on the following;

a. On the accounts examined by him; and

b. On every financial statements which are required by or under this Act to be laid before the company in general meeting; and

Note

The auditor while making the report shall take into account the provisions of the Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of this Act or any rules made thereunder or under any order made under section 143(11).

The auditor shall express his opinion on the accounts and financial statements examined by him. He shall express an opinion, according to him and to the best of his information and knowledge, whether 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 and such other matters as may be prescribed.

Further, sub-section 3 requires, the auditors' 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 and if not, the details thereof and the effect of such information on the financial statements;

b. Whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him;

c. Whether the report on the accounts of any branch office of the company audited under sub-section (8) by a person other than the company's auditor has been sent to him under the proviso to that sub-section 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. Any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;

i. Whether the company has adequate internal financial controls with reference to financial statements in place and the operating effectiveness of such controls;

j. Such other matters as **may be prescribed**.

In context of clause j stated above, Rule 11 of the Companies (Audit & Auditors) Rules,2014 i.e. Other Matters to be Included in Auditors Report requires the 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.

(iv) Whether the management has represented that, to the best of it's knowledge and belief, other than as disclosed in the notes to the accounts, no funds have been;

1. Advanced or loaned or invested (either from borrowed funds or share premium or any other sources or kind of funds) by the company to or in any other person(s) or entity(ies), including foreign entities ("Intermediaries"), with the understanding, whether recorded in writing or otherwise, that the Intermediary

shall, whether, directly or indirectly lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the company ("Ultimate Beneficiaries") or provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries;

2. Received by the company from any person(s) or entity(ies), including foreign entities ("Funding Parties"), with the understanding, whether recorded in writing or otherwise, that the company shall, whether, directly or indirectly, lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the Funding Party ("Ultimate Beneficiaries") or provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries; and

3. Based on such audit procedures that the auditor has considered reasonable and appropriate in the circumstances, nothing has come to their notice that has caused them to believe that the representations under sub-clause (i) [i.e. pt 1] and (ii) [i.e. pt 2] contain any material mis-statement.

(v) Whether the dividend declared or paid during the year by the company is in compliance with section 123 of the Companies Act, 2013.

(vi) Whether the company, in respect of financial years commencing on or after the 1st April, 2022, has used such accounting software for maintaining its books of account which has a feature of recording audit trail (edit log) facility and the same has been operated throughout the year for all transactions recorded in the software and the audit trail feature has not been tampered with and the audit trail has been preserved by the company as per the statutory requirements for record retention.

Note

As per sub-section 4 to section 143, where any of the matters is answered in the negative or with a qualification, the auditor's report shall state the reason for the same.

Clause (i) of Sub-Section (3) of Section 143 (i.e. Whether the company has adequate internal financial controls with reference to financial statements in place and the operating effectiveness of such controls) shall not apply[9] to a private company,

i. which is a one person company or a small company; or

ii. Which has turnover less than rupees fifty crore as per latest audited financial statement and which has aggregate borrowings from banks or financial institutions or anybody corporate at any point of time during the financial year less than rupees 25 crore.

The aforesaid exceptions, modifications and adaptations shall be applicable to a Private company which has not committed a default in filing of its financial statements under section 137 or annual return under section 92 of the said Act with the Registrar.

Illustration 11

MNO Ltd. is a listed company engaged in the business of trading of various products. The company also plans to start manufacturing of certain products which are currently traded.

During the course of its audit, the auditors completed all the procedures related to audit of financial statements. However, the auditor got stuck on one procedure because of which audit has not got concluded.

Auditors are waiting for certain additional information – Directors report and Management Discussion and Analysis (MD&A) for their review. However, the management is not ready with this information and wants the auditors to complete their work without review of this information. Please advise as per the legal requirements.

Answer

In the given case, the requirement of the auditors regarding additional information i.e. Directors report and MD&A without which they have not been able to conclude the audit doesn't look valid. The auditor is required to audit the financial statements and express an opinion on the same. The auditor does not audit these additional information.

[9] Inserted Vide Exemption Notification No. G.S.R. 583(E) Dated 13th June, 2017.

Hence the auditor should conclude the work without delaying because of this additional information.

Compliance with auditing standards [Sub-section 9 and 10]

Every auditor shall comply with the auditing standards.

The Central Government may prescribe the standards of auditing or any addendum thereto, as recommended by the ICAI, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority (NFRA).

It is further provided that until any auditing standards are notified, any standard or standards of auditing specified by the ICAI shall be deemed to be the auditing standards.

Additional matters to be reported in case of specified companies [Sub-section 11]

In respect of such class or description of companies, as may be specified in the general or special order by the Central Government, may in consultation with the NFRA direct, the auditor's report shall also include a statement on such matters as may be specified therein.

Note

CARO 2020 issued by MCA should be complied by the statutory auditor of every company, on which it applies.

REPORTING OF FRAUDS BY AUDITORS [SUB-SECTION 12, 13 AND 15 READ WITH RULE 13 OF THE COMPANIES (AUDIT AND AUDITORS) RULES, 2014]

Fraud involving amount of one crore or more [Sub-section 12 read with Rule 13(2)]

Notwithstanding anything contained in this section, if an auditor of a company, in the course of the performance of his duties as auditor,

a. Has reason to believe that an **offence involving fraud**

b. Which involves or is expected to involve individually an amount of **rupees one crore or above**

c. Is being or has been committed **against the company** by officers or employees of the company,

d. He shall **immediately report** the matter to the **Central Government** within such **time** and in such **manner** as may be **prescribed**.

In this regards Rule 13(2) 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.

Fraud involving amount less than one crore

Report to Audit Committee or Board [First Proviso to Sub-section 12 read with Rule 13(3)]

In case of a fraud involving lesser than an amount of rupees one crore, the auditor shall report the matter to the **audit committee** (if constituted under section 177)

or to the **Board** (in other cases) immediately but **not later than two days** of his knowledge of the fraud and he shall report the matter specifying the following;

a. Nature of Fraud with description;

b. Approximate amount involved; and

c. Parties involved.

Disclosure in Board's Report [Second Proviso to Sub-section 12 read with Rule 13(4)]

The audit committee or the Board shall disclose the following details about such frauds (reported to them, but not to the Central Government i.e. when amount involved is less than ₹1 crore), in the **Board's report**;

a. Nature of fraud with description;

b. Approximate amount involved;

c. Parties involved, if remedial action not taken; and

d. Remedial actions taken.

Exception of *bonafide* faith [Sub-section13]

No duty to which an auditor of a company may be subject to shall be regarded as having been contravened by reason of his reporting the matter referred to in sub-section (12) if it is done in good faith.

Penalty for non-compliance of section 143(12) [Sub-section 15]

If any auditor, cost accountant, or company secretary in practice does not comply with the provisions of sub-section (12), he shall

a. Be liable to a penalty of five lakh rupees in case of a listed company; and

b. Be liable to a penalty of one lakh rupees in case of any other company.

Summary of quantum of penalty

Liable	In case of	Quantum
auditor, cost accountant, or company secretary in practice does not comply with the provisions of section 143(12)	listed company	five lakh rupees
	any other company	one lakh rupees

Illustration 12

NSH Ltd is engaged in the business of retail and is listed on National stock exchange. The company recently acquired a business undertaking to expand its business. During the year, certain transactions amounting to thousands of rupees were carried out by the employees/ directors of the company which the management found suspicious and appointed a forensic consultant to carry out their review. Pursuant to this review process, certain suspicious transactions were identified by the management and the management reported these transactions to the appropriate authorities. During the course of statutory audit, such transactions were also made known to the statutory auditors. How should the auditor deal with such matter?

Answer

As per Section 143(12) of the Companies Act, 2013, the auditor is required to report to the Audit Committee or to the Board of Directors and, where applicable, to the Central Government an offence of fraud in the company by its officers or employees only if he is the first person to identify/note such instance in the course of performance of his duties as an auditor. In this case, the suspicious transactions have been identified by the management first and information about the same has been given by the management to the auditor. Accordingly, the auditor should report about this matter to the Audit Committee/ Board of Directors but the auditor would not be required to report the same to Central Government.

Note - The auditors need to report about this matter appropriately in their CARO report.

AUDIT OF GOVERNMENT COMPANIES [SUB-SECTION 5, 6 & 7]

Powers vested with CAG [Sub-section 5]

Sub-section 5 provides, in the case of a Government company or 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;

a. **CAG shall appoint the auditor** under section 139(5) or 139(7) and

b. Direct such auditor the **manner in which the accounts** of the Government company are **required to be audited** and

c. Thereupon the **auditor so appointed shall submit a copy of the audit report to the CAG.**

The audit report among other things, shall include the following

a. The directions, if any, issued by the CAG;

b. The action taken thereon; and

c. Its impact on the accounts and financial statement of the company.

Comment by CAG and Supplementary Audit [Sub-section 6]

Sub-section 6 provides that, the CAG shall within 60 days from the date of receipt of the audit report have a right to;

a. Conduct a supplementary audit of the financial statement of the company by such person or persons as he may authorize in this behalf; and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorized, on such matters, by such person or persons, and in such form, as the CAG may direct; and

b. Comment upon or supplement such audit report.

Note

Any comments given by the CAG upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements under section 136(1) and also be placed before the AGM of the company at the same time and in the same manner as the audit report.

Test Audit [Sub-section 7]

For Government Company or Company controlled by State Government or Central Government, the CAG may, if he considers necessary, by an order, cause test audit to be conducted of the accounts of such company, without prejudice to the provisions related to Audit and Auditors. The provisions of section 19A of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of such test audit.

AUDIT OF ACCOUNTS OF BRANCH OFFICE OF COMPANY [SUB-SECTION 8 READ WITH RULE 12 OF THE COMPANIES (AUDIT & AUDITORS) RULES, 2014]

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.

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.

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.

APPLICATION OF PROVISIONS OF SECTION 143 TO COST ACCOUNTANTS AND COMPANY SECRETARY [SUB-SECTION 14]

The provisions of this section shall mutatis mutandis apply to:

a. The **cost accountant** conducting **cost audit** under section 148; or

b. The **company secretary in practice** conducting **secretarial audit** under section 204.

Sub-rule 5 to rule 13 of the Companies (Audit & Auditors) Rules, 2014 provide exactly confirmatory provision.

7. AUDITOR NOT TO RENDER CERTAIN SERVICES [SECTION 144]

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** any of the following services (whether such services are rendered **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;

e. 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

Snapshot of prohibited services

Accounting and book keeping services	Investment advisory services	Investment banking services
Internal audit	Actuarial services	Management services
Rendering of outsourced financial services	Design and implementation of any financial information system	Any other kind of services as may be prescribed

Students are advised to take note;

1. However no other kind of services has been prescribed till date under clause i specified above.

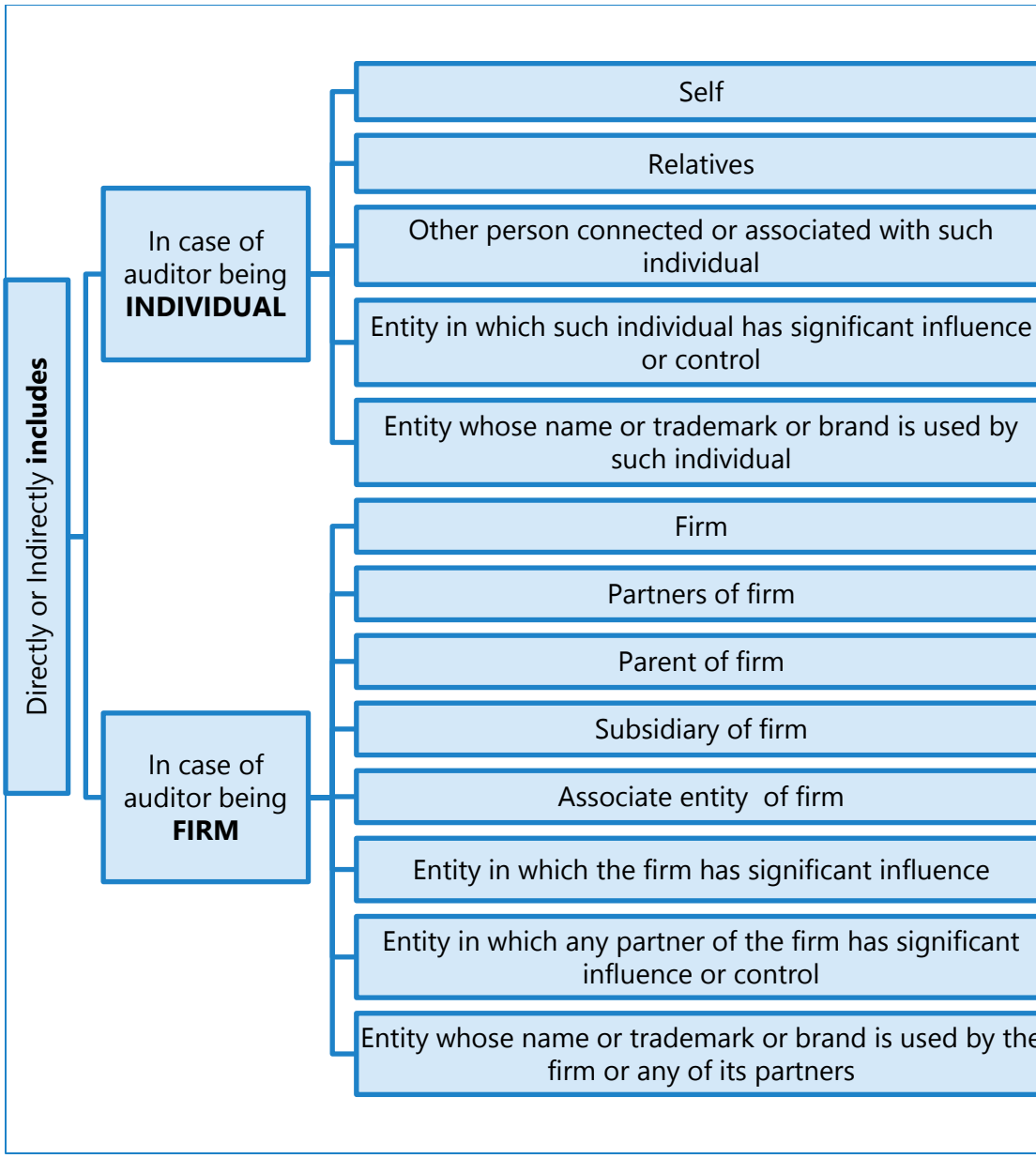
2. Here it is worth noting that as per proviso to section 148(3), no person (or firm including LLP) appointed under section 139 as an auditor of the company shall be appointed for conducting the audit of cost records or vice-versa.

3. The term "directly or indirectly" shall include rendering of services by the auditor

- In case of **auditor being an individual**, either himself or through his relative or any other person connected or associated with such individual or through any other entity, whatsoever, in which such individual has significant influence or control, or whose name or trademark or brand is used by such individual;
- In case of **auditor being a firm**, either itself or through any of its partners or through its parent, subsidiary or associate entity or through any other entity, whatsoever, in which the firm or any partner of the firm has significant influence or control, or whose name or trademark or brand is used by the firm or any of its partners.

Example 12: 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.

Summary of what shall be included in directly and indirectly



8. AUDITORS TO SIGN AUDIT REPORTS, ETC. [SECTION 145]

Section 145 of the Companies Act, 2013 provides for auditors to sign audit reports, etc.

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 in accordance with the provisions of sub-section (2) of section 141 (i.e. in case of firm including LLP is appointed as an auditor of a company, only the partner who are Chartered Accountants shall be authorized to act and sign on behalf of the firm).

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.

Illustration 13

Whether entire audit report need to read before the company in general meeting?

Answer

No, as per section 145 of the Companies Act 2013, **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.

9. AUDITORS TO ATTEND GENERAL MEETING [SECTION 146]

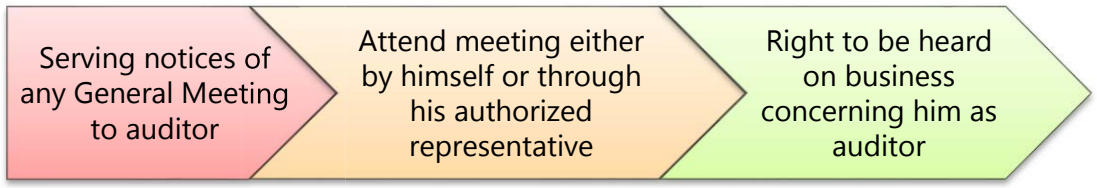
Section 146 of the Companies Act, 2013 provides for auditors to attend general meeting.

All **notices** of, and **other communications** relating to, **any general meeting** shall be **forwarded to the auditor** of the company.

The **auditor shall**, unless otherwise exempted by the company, **attend either by himself or through his authorized representative**, who shall also be qualified to be an auditor, any general meeting.

The auditor shall have **right to be heard** at such meeting on any part of the business which concerns him as the auditor.

Summary of the section 146



Example 13

Modern Furniture Limited (MFL) convened its general meeting on 21st March 2023, the notice of same was not served at auditor. Since company is obligated under section 146 to forward a notice of general meeting to auditor as well, hence non-serving of notice to auditor by MFL is in contravention to section 146 and liable for penalty under section 147.

Illustration 14

Regarding the general meeting for which notice is served on auditor;

i. Whether auditor is mandatorily required to be attend the said general meeting?

ii. If yes, whether he is required to attend the meeting personally?

Answer

Answer to first part is yes, while no in case of second, because as per section 146 of the Companies Act 2013, the auditor shall, unless otherwise exempted by the company, attend either by himself or through his authorized representative, who shall also be qualified to be an auditor, any general meeting.

10. PUNISHMENT FOR CONTRAVENTION [SECTION 147]

Section 147 of the Companies Act, 2013 provides for punishment for contravention.

CONTRAVENTION BY COMPANY [SUB-SECTION 1]

Penalty on company

If any of the provisions of sections 139 to 146 (both inclusive) is contravened, the company shall be punishable with fine which shall not be less than twenty five thousand rupees but which may extend to five lakh rupees.

Penalty on officer/s who is/are in default

If any of the provisions of sections 139 to 146 (both inclusive) is contravened, every officer of the company who is in default shall be punishable with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees.

Summary of quantum of penalty

Liable	Minimum (in ₹)	Maximum (in ₹)
Company	25,000	5,00,000
Every officer of the company who is in default	10,000	1,00,000

CONTRAVENTION BY AUDITOR [SUB-SECTION 2 AND 3]

Penalty on auditor [Sub-section 2]

If an auditor of a company contravenes any of the provisions of section 139, section 144 or section 145, the auditor shall be punishable with fine which shall not be less than twenty five thousand rupees but which may extend to five lakh rupees or four times the remuneration of the auditor, whichever is less.

Summary of quantum of penalty

Liable	Liable for	Minimum (in ₹)	Maximum (in ₹)
Auditor	Contravenes any of the provisions of section 139, 144 or 145, Company	25,000	**Lower** of i. 5,00,000 or ii. 4 times the remuneration

Penalty for knowing/willful contravention [Proviso to Sub-section 2]

If an auditor has contravened any of the provisions of section 139, section 144 or section 145, knowingly or willfully with the intention to deceive the company or its shareholders or creditors or tax authorities, he shall be punishable with the imprisonment for a term which may extend to 1 year and with the fine which shall not be less than fifty thousand rupees but which may extend to twenty-five lakh rupees or eight times the remuneration of the auditor, whichever is less.

Summary of quantum of penalty

<table>
<tr><th>Liable</th><th>Liable for</th><th>Minimum</th><th>Maximum</th></tr>
<tr><td rowspan="3">Auditor</td><td rowspan="3">**Knowing or willful contravenes** any of the provisions of section 139, 144 or 145, Company</td><td>Fine of ₹ 25,000</td><td>Fine, **Lower** of
₹ 5,00,000
Or
8 times the remuneration</td></tr>
<tr><td colspan="2">**and**</td></tr>
<tr><td colspan="2">Imprisonment for a term which **may extend to** 1 year</td></tr>
</table>

Refund of remuneration and payment of damages [Sub-section 3]

Where an auditor has been convicted under sub-section 2, he shall be liable to;

a. Refund the remuneration received by him to the company; and

b. 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.

Note:

For operation of sub-section 3, the sub-section 4 empowers the Central Government, to specify any statutory body or authority or an officer for ensuring prompt payment of damages to the company or the persons, by notification.

Such body, authority or officer shall after payment of damages to such company or persons file a report with the Central Government in respect of making such damages in such manner as may be specified in the said notification.

CONTRAVENTION BY AUDIT FIRM [SUB-SECTION 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 or have acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to or by, the company or its directors or officers, the liability,

Whether civil or criminal as provided in the Companies Act, 2013, or in any other law for the time being in force,

For such act shall be of the partner or partners concerned of the audit firm and of the firm jointly and severally.

Note

1. 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.

2. Since act constitute to fraud, hence shall also be liable under section 447. Provisions of section 447, explained and decoded under book chapter 3 i.e. 'Prospectus and allotment of securities' of this module. Students may refer the same.

11. CENTRAL GOVERNMENT TO SPECIFY AUDIT OF ITEMS OF COST IN RESPECT OF CERTAIN COMPANIES [SECTION 148]

COST RECORDS [SUB-SECTION 1 READ WITH RULE 3 AND 5 OF THE COMPANIES (COST RECORDS AND AUDIT) RULES, 2014]

Who shall prepare cost records? [Rule 3]

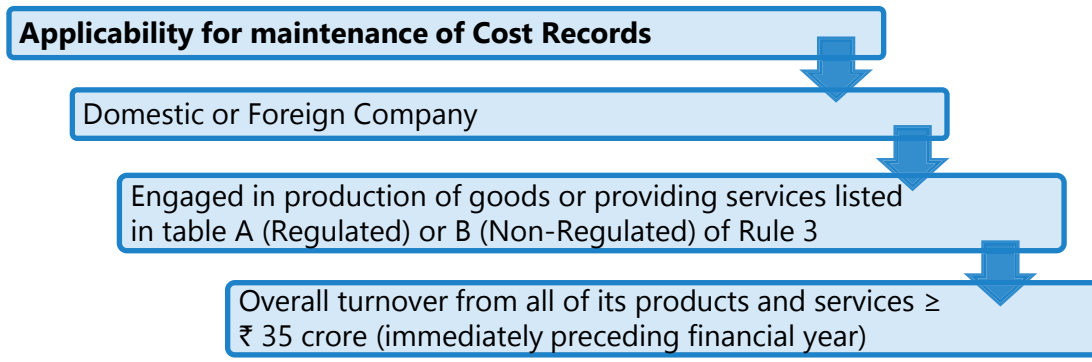
Notwithstanding anything contained in the provisions related to audit and auditor (Chapter X), the Central Government may, by order, in respect of such class of companies engaged in the production of such goods or providing such services as may be prescribed, direct that particulars relating to the utilisation of material or labour or to other items of cost as may be prescribed shall also be included in the books of account kept under section 128 by that class of companies.

The Central Government shall, before issuing such order in respect of any class of companies regulated under a special Act, consult the regulatory body constituted or established under such special Act.

For the purposes of sub-section (1) of section 148 of the Act**, rule 3** of *the Companies (Cost Records and Audit) Rules, 2014* provides, the class of companies (including foreign companies defined in clause (42) of section 2 of the Act) engaged in the production of the goods or providing services, specified in the Table A (6 Regulated Sectors) and/or Table B (33 Non-Regulated Sector), having an overall turnover from all its products and services of **rupees thirty five crore or more** during the immediately preceding financial year, shall include cost records for such products or services in their books of account

Note

Nothing contained in Rule 3 shall apply to a company which is classified as a micro enterprise or a small enterprise including as per the turnover criteria under sub-section (9) of section 7 of the Micro, Small and Medium Enterprises Development Act, 2006.



Example 14

Case	Turnover (Figures in Crore)					Applicability of Cost Records
	Table A Products	Table B Products	Table A+B Products	Other Products	Total	
1	10	10	20	10	30	No
2	10	10	20	20	40	Yes
3	0	10	10	30	40	Yes
4	10	0	10	30	40	Yes
5	20	20	40	0	40	Yes
6	0*	0*	0	40	40	No

* Not-engaged in the production of the goods or providing services, specified in the Table A (6 Regulated Sectors) and/or Table B (33 Non-Regulated Sector)

Form and manner of Cost Records [Rule 5]

Every company covered by rule 3 explained above under these rules including all units and branches thereof, shall, in respect of each of its financial year maintain cost records in form CRA-1.

The cost records shall be maintained on **regular basis** in such manner as to facilitate **calculation of per unit cost of production** or **cost of operations**, **cost of sales and margin** for each of its products and activities for every financial year on monthly or quarterly or half-yearly or annual basis.

The cost records shall be maintained in such manner so as to enable the company to exercise, as far as possible, **control over the various operations and costs to achieve optimum economies** in utilisation of resources and these records shall also provide necessary data which is required to be furnished under these rules.

COST AUDIT [SUB-SECTION 2 TO 7 READ WITH RULE 4 OF THE COMPANIES (COST RECORDS AND AUDIT) RULES, 2014]

If the Central Government is of the opinion, that it is necessary to do so, it may, by order, direct that the audit of cost records of class of companies, which are covered aforesaid (under sub-section 1 i.e. required to prepare cost records) 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.

As per sub-section 4, an audit conducted under this section (cost audit u/s 148) shall be in addition to the audit conducted under section 143.

The cost statements, including other statements to be annexed to the cost audit report, shall be approved by the Board of Directors before they are signed on behalf of the Board by any of the director authorised by the Board, for submission to the cost auditor to report thereon.

Sub-rule 1 to rule 4 provides every company **specified in the item (A) of rule 3** shall be required to **get its cost records audited** in accordance with these rules if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is **rupees fifty crore or more** and the aggregate turnover of the individual product or products or service or services for which cost records are required to be maintained under rule 3 is rupees **twenty five crore or more**.

Whereas sub rule 2 provides every company **specified in item (B) of rule 3** shall get its **cost records audited** in accordance with these rules if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is **rupees one hundred crore or more** and the aggregate turnover of the individual product or products or service or services for which cost records are required to be maintained under rule 3 is **rupees thirty five crore or more**.

Further sub-rule 3 to rule 4 provides exception from cost audits. The requirement for cost audit shall not apply to a company which is covered in rule 3, and

a. Whose revenue from exports, in foreign exchange, exceeds seventy five percent of its total revenue; or

b. Which is operating from a special economic zone.

c. Which is engaged in generation of electricity for captive consumption through Captive Generating Plant. For this purpose, the term "Captive Generating Plant" shall have the same meaning as assigned in rule 3 of the Electricity Rules, 2005.

Example 15

Case	Turnover (Figures in Crore)					Applicability of	
	Table A Products	Table B Products	Table A+B Products	Other Products	Total	Cost Records	Cost Audit
1	10	10	20	10	30	No	No
2	10	10	20	20	40	Yes	No
3	20	20	40	0	40	Yes	No
4	10	20	30	10	40	Yes	No
5	10	20	30	20	50	Yes	Yes, but only for table A
6	0	20	20	20	40	Yes	No
7	20	10	30	80	110	Yes	Only Table A Product
8	20	20	40	70	110	Yes	Both Tables A & B Products
9	10	10	20	80	100	Yes	No
10	15	15	30	10	40	Yes	No
11	20	20	40	8	48	Yes	No

Summary of Rule 4 i.e. Applicability of Cost Audit

<table>
<tr><th colspan="7">Companies that are covered under rule 3 and engaged in any of</th></tr>
<tr><th colspan="4">6 Regulatory Sectors (Table A)</th><th colspan="3">33 Non-Regulatory Sectors (Table B)</th></tr>
<tr><td>Overall annual turnover from all its products and services during the immediately preceding financial year is rupees fifty crore or more</td><td rowspan="2">Revenue from exports, in foreign exchange, exceeds 75%</td><td rowspan="2">Operating from a special economic zone</td><td rowspan="2">Engaged in generation of electricity for captive consumption.</td><td rowspan="2">Revenue from exports, in foreign exchange, exceeds 75%</td><td rowspan="2">Operating from a special economic zone</td><td rowspan="2">Engaged in generation of electricity for captive consumption.</td></tr>
<tr><td>Aggregate turnover of the individual product or products or service or services for which cost records are required to be maintained under rule 3 is rupees twenty five crore or more</td><td>Overall annual turnover from all its products and services during the immediately preceding financial year is rupees one hundred crore or more

Aggregate turnover of the individual product or products or service or services for which cost records are required to be maintained under rule 3 is rupees thirty five crore or more</td></tr>
<tr><td>Cost Audit is required</td><td colspan="5">Rule 4 i.e. Cost Audit shall not apply; only Rule 3 i.e. Cost Records will apply</td><td>Cost Audit is required</td></tr>
</table>

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.

Clause (b) of sub-section (1) of section 2 of the Cost and Works Accountants Act, 1959 defines "Cost Accountant". It means a Cost Accountant who holds a valid certificate of practice under sub-section (1) of section 6 of the Cost and Works Accountants Act, 1959 and is in whole-time practice. Cost Accountant includes a Firm of Cost Accountants and a LLP of cost accountants.

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.

Illustration 15

Can a professional LLP which have CAs and CMAs as its partners, appointed as Cost Auditor u/s 148 as well as Statutory Independent Auditor u/s 139

Answer

No, because as per proviso to section 148(3), no person (or firm including LLP) appointed under section 139 as an auditor of the company shall be appointed for conducting the audit of cost records or vice-versa.

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.

Who shall appoint cost auditor? [Sub-section 3 read with Rule 14 of the Companies (Audit and Auditors) Rules, 2014]

Rule 14 of the *Companies (Audit and Auditors) Rules, 2014* provides that in the case of companies which are required to constitute an audit committee

a. The Board shall appoint an individual, who is a cost accountant, or a firm of cost accountants in practice, as cost auditor on the recommendations of the

Audit committee, which shall also recommend remuneration for such cost auditor;

b. The remuneration recommended by the Audit Committee under (A) shall be considered and approved by the Board of Directors and ratified subsequently by the shareholders.

Whereas in the case of other companies which are not required to constitute an audit committee, the Board shall appoint an individual who is a cost accountant or a firm of cost accountants in practice as cost auditor and the remuneration of such cost auditor shall be ratified by shareholders subsequently.

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 auditor to comply with cost auditing standards [Second Proviso to Sub-section 3]

The auditor conducting the cost audit shall comply with the cost auditing standards.

Here, the expression "cost auditing standards" mean such standards as are issued by the Institute of Cost Accountants of India (erstwhile ICWAI), constituted under the Cost and Works Accountants Act, 1959, with the approval of the Central Government.

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.

Note

The Companies which have got extension of time of holding Annual General Meeting under section 96 (1) of the Companies Act, 2013, may file form CRA-4 within resultant extended period of filing financial statements under section 137 of the Companies Act, 2013.

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 sub-section 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.

Summary of different form pertaining to cost records and cost audits

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 AND PUNISHMENT THEREOF [SUB-SECTION 8]

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.

Note: The provision of the section 147 explained in details under heading 10, earlier in this chapter.

12. NFRA [NATIONAL FINANCIAL REPORTING AUTHORITY] AND AUDITOR

MONITORING AND ENFORCING COMPLIANCE WITH AUDITING STANDARDS

Rule 8 of ***The National Financial Reporting Authority Rules, 2018*** empowers NFRA for the purpose of monitoring and enforcing compliance with auditing standards under the Act by a company or a body corporate governed under rule 3.

NFRA may;

a. **Review working papers** (including audit plan and other audit documents) and communications related to the audit;

b. Evaluate the sufficiency of the **quality control system** of the auditor and the manner of **documentation** of the system by the auditor; and

c. Perform such other **testing of the audit**, supervisory, and quality control procedures of the auditor as may be considered necessary or appropriate.

Rule 8 further provides that:

NFRA may require:

1. **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.

2. Seek **additional information** or may require the personal presence of the auditor for seeking additional information or explanation in connection with the conduct of an audit.

3. Send a **separate report containing proprietary or confidential information** to the Central Government for its information.

4. 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.

NFRA shall;

1. Perform its **monitoring and enforcement activities** through its **officers or experts** with sufficient experience in audit of the relevant industry.

2. **Publish its findings** relating to non-compliances on its website and in such other manner as it considers fit, unless it has **reasons not to do so in the public interest** and it records the reasons in writing.

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.

OVERSEEING THE QUALITY OF SERVICES AND SUGGESTING MEASURES FOR IMPROVEMENT

Further Rule 9 of ***The National Financial Reporting Authority Rules, 2018*** empowers NFRA for **overseeing the quality of services and suggesting measures for improvement**

a. On the basis of its review, the NFRA may direct an auditor to take measures for improvement of audit quality including changes in their audit processes, quality control, and audit reports and specify a detailed plan with time-limits.

b. It shall be the duty of the auditor to make the required improvements and send a report to the NFRA explaining how it has complied with the directions made by the NFRA.

c. The NFRA shall monitor the improvements made by the auditor and take such action as it deems fit depending on the progress made by the auditor.

d. The NFRA may refer cases with regard to overseeing the quality of service of auditors of companies or bodies corporate referred to in rule 3 to the Quality Review Board constituted under the Chartered Accountants Act, 1949 or call for any report or information in respect of such auditors or companies or bodies corporate from such Board as it may deem appropriate.

e. The NFRA may take the assistance of experts for its oversight and monitoring activities.

FILLING OF RETURN WITH NFRA

Rule 5 requires every auditor of classes of companies and bodies corporate governed by the NFRA, shall file a **return** with the Authority i.e. NFRA on or before 30th November every year in Form NFRA-2.

SUMMARY

- **First Auditor** shall be appointed by **Board of directors** within thirty days from the date of registration of the company, who **hold office till first annual general meeting**. Thereafter every 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 and so on.

- Whereas, in case of **Government Company or those controlled by Government** (central or state or any combination thereof) auditor shall be appointed by **CAG** (Comptroller and Auditor-General of India).
- 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
- Only a **Chartered Accountants in practice can be appointed as auditor**, where firm is appointed then only a Chartered Accountants in practice shall be authorised by the firm to act and sign on behalf of the firm. Section 141 (3) list out certain disqualifications that bar an individual or firm to appointed as auditor.
- The **remuneration** of the auditor of a company shall be **fixed in its general meeting** or in such manner as may be determined therein. **Board** may fix remuneration of the **first auditor** appointed by it.
- Every auditor shall **comply with the auditing standards**. Rights and duties of auditor are prescribed in section 143. The person appointed as an auditor of the company shall **sign the auditor's report**.
- All **notices of any general meeting shall be forwarded to the auditor** of the company, and the **auditor shall,** unless otherwise exempted by the company, **attend** either by himself or through his authorised representative. Auditor shall have **right to be heard** at such meeting on any part of the business which concerns him as the auditor.
- An auditor appointed under this Act shall provide the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be, but **certain services are specifically prohibited** to render either directly or indirectly. These are; (a) accounting and book keeping services; (b) internal audit; (c) design and implementation of any financial information system; (d) actuarial services; (e) investment advisory services; (f) investment banking services; (g) rendering of outsourced financial services; and (h) management services.
- Penalties for contravention of the applicable provisions by **company, auditor, and audit firm** is provided under section 147. In case, it is proved that the partner or partners of the audit firm has or have acted in a **fraudulent manner** or **abetted** or **colluded in any fraud** by, or in relation to or by, the company or its directors or officers; then in addition to **section 147**, such

offence is punishable under **section 447**; even liable for **civil or criminal liability** under **any other law for the time being in force**.

- Central Government may, by order, in respect of such class 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 such other items of cost** as may be prescribed shall also be included in the books of account kept by such class of companies. Further if the Central Government is of the opinion, in relation to any such company, that it is necessary to do so, it may, by order, direct that the **audit of cost records** of such company shall be conducted in the manner specified therein.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. *Birthday Card Limited, a listed company can appoint or re-appoint, Mishra & Associates (a firm of Chartered Accountants), as their statutory auditors for:*

   (a) One year only

   (b) One term of 3 consecutive years only

   (c) One term of 4 consecutive years only

   (d) Two terms of 5 consecutive years

2. *Every 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:*

   (a) Second annual general meeting

   (b) Fourth annual general meeting

   (c) Sixth annual general meeting

   (d) Eight annual general meeting

3. *For appointing an auditor other than the retiring auditor,*

   (a) Special notice is required.

   (b) Ordinary notice is required.

   (c) Neither ordinary nor special notice is required

   (d) Approval of Central Government is required.

Descriptive Questions

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.

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.*

3. *EF Limited appointed an individual firm, Naresh & Company, Chartered Accountants, as Auditors of the company at the Annual General Meeting held on 30 September 2022. Mrs. Kamala, wife of Mr. Naresh, invested in the equity shares face value of ₹ 1 lakh of EF Limited on 15 October 2022. But Naresh & Company continues to function as statutory auditors of the company. Advice.*

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.

5. *Examine the following situations in the light of the Companies Act, 2013*

   "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.?

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 Chartered Accountant 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

7. *The Board of Directors of A Limited 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 a Statutory Auditor of A Ltd., taking into account the consequences, if any, of accepting this proposal?*

ANSWERS

Answer to MCQ based Questions

1.	**(d)**	Two terms of 5 consecutive years
2.	**(c)**	Sixth annual general meeting
3.	**(a)**	Special notice is required.

Answer to Descriptive Questions

1. (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*, 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. 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. 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 2022 i.e. after the investment made by his wife in the equity shares of EF Limited.

4. (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. 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. (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 Lakh. 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 Lakh.

(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. 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.

NOTES

CHAPTER 11

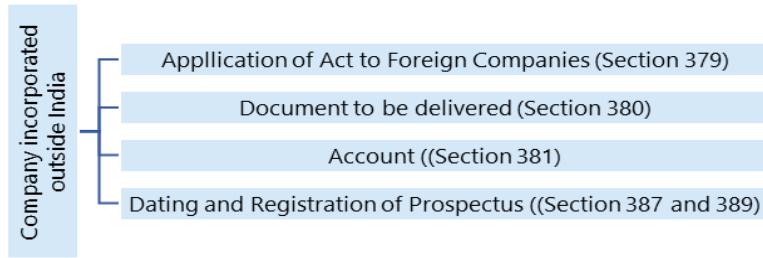
COMPANIES INCORPORATED OUTSIDE INDIA

Learning Outcomes

After reading this chapter, you will be able to:

- Know the meaning of the Foreign Company and application of Act to it.
- Explain the provisions related to Accounts of Foreign company, service on foreign company.
- Comprehend the provisions of debentures, annual return, registration of charges, books of account and their inspection in Foreign companies.
- Analyse dating of prospectus and particulars to be contained therein, provisions as to expert's consent and allotment and registration of prospectus.
- Know about offer of Indian Depository Receipts.
- Merger or amalgamation of Company with foreign company.

CHAPTER OVERVIEW



1. INTRODUCTION

Chapter XXII	**Consists of sections 379 to 393A as well as the Companies (Registration of Foreign Companies) Rules, 2014.**

Foreign Company [Section 2(42)]: "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.

Example 1: ABC Entertainment Limited (Indian Company) having foreign subsidiary UVW Limited rendering satellite services to the group will be covered under the definition of Foreign Company under the Companies Act, 2013.

Example 2: Airline companies who operate through their booking agents in India will be covered under the definition of Foreign Company under the Companies Act, 2013.

According to the [1]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 –

[1] Rule 2(1)(h) of the Companies (Specification of Definitions Details) Rule, 2014

(a) business to business and business to consumer 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.

Explanation- 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 shall not be construed as 'electronic mode' for the purpose of clause (42) of section 2 of the Act.

Example 3: Zakpak Ltd. is a shipping company incorporated in Japan. The Company has set up a branch office in India after obtaining necessary approvals from RBI. Branch Offices are generally considered as a reflection of the Parent Company's 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.

[2]**Facts:** Union Minister of State for Corporate Affairs Shri Rao Inderjit Singh in a written reply to a question in Rajya Sabha stated that 320 foreign companies were registered in India between 2018 and 2021.

[2] Press release dated July 27, 2021 published by Press Information Bureau Delhi

2. APPLICATION OF ACT TO FOREIGN COMPANIES [SECTION 379]

According to this section:

(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)]

Note: Chapter XXII referred to above deals with the legal provisions for companies incorporated outside India.

Example 4: 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. Citizens of Dubai: Remaining holding

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.

3. 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, [3]the 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;

(2) any former name or names and surname or surnames in full;

(3) [4]father's name or mother's name or spouse's name;

(4) date of birth;

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[3] Rule 3 of the Companies (Registration of Foreign Companies) Rules, 2014

[4] Substituted by Companies (Registration of Foreign Companies) Rules, 2014 dated 20th January, 2023

(5) residential address;

(6) nationality;

(7) if the present nationality is not the nationality of origin, his nationality of origin;

(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)

(9) income-tax permanent account number (PAN), if applicable;

(10) occupation, if any;

(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);

(12) other directorship or directorships held by him;

(13) Membership Number (for Secretary only); and

(14) e-mail ID.

(d) the **name and address or the names and addresses 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 or occasions;

(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* along with prescribed fees and documents required to be furnished as provided in section 380(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. [5]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[6].
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.

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[5] Rule 8 of the Companies (Registration of Foreign Companies) Rules, 2014

[6] Rule 12 of the Companies (Registration Offices and Fees) Rules, 2014

(v) **Form, procedure and time within which alteration in documents shall be intimated to Registrar:** Section 380(3) provides that 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 the prescribed form. The Companies (Registration of Foreign Companies) Rules, 2014, has prescribed that the return containing the particulars of the alteration shall be filed in form *FC-2* along with prescribed fees.

Illustration 1: *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.

4. 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 in such form, containing such particulars and including or having attached or annexed thereto such documents as may be prescribed, and

(b) deliver a copy of those documents to the Registrar.

According to the [7]Companies (Registration of Foreign Companies) Rules, 2014, every foreign company shall prepare financial statement of its Indian business operations in accordance with Schedule III or as near thereto as possible for each financial year including:

(1) documents that are required to be annexed should be in accordance with Chapter IX i.e. Accounts of Companies.

(2) The 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 under the applicable laws there.

Note: "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 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.

Provided further that 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.

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.

[7] Rule 4 of the Companies (Registration of Foreign Companies) Rules, 2014

Example 5:

ROK Limited, is a company incorporated outside India having a place of business in India. ROK Limited is a subsidiary of HOK Limited (Holding company), registered in Australia and is required to consolidate its accounts with HOK Limited. Accordingly, if HOK Limited is required to follow financial year other than 31st day of March every year, ROK can make an application to Central Government to follow the financial year as per HOK Limited.

(ii) The Central Government is empowered to direct that, in the case of any foreign company or class of foreign companies, the requirements of clause (a) given above shall not apply, or shall apply subject to such exceptions and modifications as may be specified in notification in that behalf [Section 381(1)].

(iii) If any of the specified documents are not in the English language, a certified translation thereof in the English language shall be annexed. [Section 381 (2)]

(iv) Every foreign company shall send to the Registrar along with the documents required to be delivered to him, a copy of a list in the prescribed form, of all places of business established by the company in India as at the date with reference to which the balance sheet referred to in section 381(1) is made.

[8]According to the Companies (Registration of Foreign Companies) Rules, 2014, every foreign company shall file with the Registrar, along with the financial statement, in Form FC-3 with such fee as provided under Companies (Registration Offices and Fees) Rules, 2014 a list of all the places of business established by the foreign company in India as on the date of balance sheet.

According to the [9]Companies (Registration of Foreign Companies) Rules, 2014, if any foreign company ceases to have a place of business in India, it

[8] Rule 6 of the Companies (Registration of Foreign Companies) Rules, 2014

[9] Rule 8 of the Companies (Registration of Foreign Companies) Rules, 2014

shall forthwith give notice of the fact to the Registrar, and as from the date on which notice is so given, the obligation of the company to deliver any document to the Registrar shall cease, if it does not have other place of business in India.

(v) According to the [10]Companies (Registration of Foreign Companies) Rules, 2014,

(a) Further, every foreign company shall, along with the financial statement required to be filed with the Registrar, 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)

The above statements shall include such other particulars as are prescribed in the Companies (Registration of Foreign Companies) Rules, 2014.

(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.

Provided that the Registrar may, for any special reason, and on application made in writing by the foreign company concerned, extend the said period by a period not exceeding three months.

Example 6: Mukesh & Jordan LLC is a foreign company and is required to file its financial statements within six months of the close of the financial year with Registrar on an annual basis alongwith following additional documents:

(1) Statement of related party transaction

(2) Statement of repatriation of profits

(3) Statement of transfer of funds (including dividends, if any)

[10] Rule 4 of the Companies (Registration of Foreign Companies) Rules, 2014

However, where the Central Government has exempted or specified different documents for any foreign company or a class of foreign companies, then documents as specified shall be submitted.

(vi) **Audit of accounts of foreign company:** According to the [11]Companies (Registration of Foreign Companies) Rules, 2014,

(a) **Every foreign company shall get its accounts, pertaining to the Indian business operations** prepared in accordance with section 381(1) and Rules thereunder, shall be audited by a practicing Chartered Accountant in India or a firm or limited liability partnership of practicing chartered accountants.

(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.

5. 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, in letters easily legible in English characters, and also in the characters of the language or one of the languages in general use in the locality in which the office or place is situate;

(b) cause the name of the company 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—

[11] Rule 5 of the Companies (Registration of Foreign Companies) Rules, 2014

(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.

6. 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.

7. 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) 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. Further, as per Rule 3 of the Companies (Corporate Social Responsibility Policy) Rules 2014, a foreign company which fulfils the criteria specified under Section 135(1) of the Companies Act 2013 is required to comply with Section 135 of the Companies Act, 2013, 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.

[12]According to the Companies (Registration of Foreign Companies) Rules, 2014, 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.

8. FEE FOR REGISTRATION OF DOCUMENTS [SECTION 385]

There shall be paid to the Registrar for registering any document required by the provisions of this Chapter to be registered by him, such fee, as may be prescribed.

[13]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.

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[12] Rule 7 of the Companies (Registration of Foreign Companies) Rules, 2014
[13] Rule 8 of the Companies (Registration of Foreign Companies) Rules, 2014

9. 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.

Illustration 2: *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.

Answer: 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.

According to section 386 of the Companies Act, 2013, for the purposes of Chapter XXII of the Companies Act, 2013 (Companies incorporated outside India), expression "Place of business" includes a share transfer or registration office.

Further, to qualify as a 'foreign company' a company must have the following features:

(a) it must be incorporated outside India; and

(b) it should have a place of business in India.

(c) That place of business may be either in its own name or through an agent or may even be through the electronic mode; and

(d) It must conduct a business activity of any nature in India.

(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.

10. 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, or when formed will or will not establish, 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 constituting or defining the constitution of the company;

(2) the enactments or provisions by or under which the incorporation of the company was effected;

(3) address in India where the said instrument, enactments or provisions, or copies thereof, and if the same are not in the

English language, a certified translation thereof in the English language 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 7: 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.

It is to be understood that section 387 (2) does not provides any exception with respect to the non-compliance of the requirements stated under section 387 (1) by any person responsible for issuing or circulating prospectus.

(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 or intended company as is 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 with a *bona fide* invitation to a person to enter into an underwriting agreement with respect to securities.

(iv) Section 387(4) further provides that the provisions of section 387—

(a) shall not apply to 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 or are to be in all respects uniform with securities previously issued and for the time being dealt in or quoted on a recognised stock exchange,

but, subject as aforesaid, section 387 shall apply to a prospectus or form of application whether issued on or with reference to the formation of a company or subsequently.

According to section 387(4), the provisions of section 387 shall not apply to the issue of prospectus or form of application relating to securities of the company to existing member or debenture holders of a company; and

The provisions of section 387 shall not apply in respect of issue of prospectus dealing with offer for securities which are uniform in all respects with securities previously issued and such previously issued securities are listed on a recognised stock exchange. However, provisions relating to dating of prospectus shall continue to apply.

(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.

11. PROVISIONS AS TO EXPERT'S CONSENT AND ALLOTMENT [SECTION 388]

According to this section:

(i) 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 been established, or when formed will or will not establish, a place of business in India,—

(a) if, where the prospectus includes a statement purporting 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 there does not appear in the prospectus a statement that he has given and has not withdrawn his consent as aforesaid; 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.

12. 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, 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.

[14]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 and in case of a contract not reduced into writing, a memorandum giving full particulars thereof;

(c) a copy of any other material contracts, not entered in the ordinary course of business, but entered within preceding 2 years;

[14] Rule 11 of the Companies (Registration of Foreign Companies) Rules, 2014

(d) a copy of underwriting agreement; and

(e) a copy of power of attorney, if prospectus is signed through duly authorized agent of directors.

13. OFFER OF INDIAN DEPOSITORY RECEIPTS [SECTION 390]

For the purposes of this section, and according to the [15]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 Rule 13 of the Companies (Registration of Foreign Companies) Rules, 2014, no company incorporated or to be incorporated outside India, whether the company has or has not established, or may or may not establish, any place of business in India shall make an issue of Indian Depository Receipts

[15] Rule 13 of the Companies (Registration of Foreign Companies) Rules, 2014

(IDRs) unless it complies with the conditions mentioned under this rule, in addition to the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 and any directions issued by the Reserve Bank of India.

The Rules relating to offer, disclosure requirements and manner of transfer, sale etc., related to IDR are contained in Companies (Registration of Foreign Companies) Rules, 2014.

Standard Chartered PLC was the first global company to file for an issue of IDR in India in 2010.

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 not.

14. APPLICATION OF SECTIONS 34 TO 36 AND CHAPTER XX [SECTION 391]

Section 391 of the Companies Act, 2013 provides for Application of sections 34 to 36 and Chapter XX. According to this section:

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.

Sub-section (2) provides that, subject to the provisions of section 376 (Power to wind up Foreign companies although dissolved), 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.

15. PUNISHMENT FOR CONTRAVENTION [SECTION 392]

Without prejudice to the provisions of section 391, if a foreign company contravenes the provisions of Chapter XXII of the Companies Act, 2013 (i.e. Chapter on Companies incorporated outside India), the foreign company shall be punishable with fine which shall not be less than 1,00,000 rupees but which may extend to 3,00,000 rupees and in the case of a continuing offence, with an additional fine which may extend to 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 shall be punishable with fine which shall not be less than 25,000 rupees but which may extend to ***5,00,000 rupees.***

Thus, the punishment for contravention may be summed up as under:

1. Fine on defaulting foreign company in the range of 1 lac rupees to 3 lac rupees.
2. In case of continuing default an additional fine on the foreign company to the tune of 50,000 rupees per day after the first during which the contravention continues.
3. Punishment for every officer of the foreign company who is in default shall be imposition of a fine of a minimum amount of 25,000 rupees, but which may extend to 5,00,000 rupees.

16. 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 of the Companies Act, 2013, 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.

17. 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.

18. EXEMPTIONS UNDER THIS CHAPTER

The Central Government may, by notification, exempt any class of-

(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,

in so far 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.

SUMMARY

- 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.
- Every foreign company shall, in every calendar year,—
  - (a) make out a balance sheet and profit and loss account in prescribed format, and
  - (b) deliver a copy of those documents to the Registrar.
- The punishment for contravention is as under:
  1. Fine on defaulting foreign company in the range of 1 lac rupees to 3 lac rupees.

2. In case of continuing default an additional fine on the foreign company to the tune of 50,000 rupees per day after the first during which the contravention continues.

3. Punishment for every officer of the foreign company who is in default shall be imposition of a fine of a minimum amount of 25,000 rupees, but which may extend to 5,00,000 rupees.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. *Jackson Communications LLC, incorporated in Arizona, USA, has established a principal place of business at Kolkata, West Bengal. It is required to deliver requisite documents to the specified authority. You are required to select an appropriate option from the four given below which indicates the number of days within which such documents shall be delivered:*

   (a) *Jackson Communications LLC shall, within 10 days of the establishment of a principal place of business in India, deliver the requisite documents to the specified authority.*

   (b) *Jackson Communications LLC shall, within 15 days of the establishment of a principal place of business in India, deliver the requisite documents to the specified authority.*

   (c) *Jackson Communications LLC shall, within 30 days of the establishment of a principal place of business in India, deliver the requisite documents to the specified authority.*

   (d) *Jackson Communications LLC shall, within 45 days of the establishment of a principal place of business in India, deliver the requisite documents to the specified authority.*

2. *Morgen Stern Digi Cables GmbH incorporated in Berlin, Germany, established a place of business at Mumbai to conduct its business of data interchange and other digital supply transactions online. However, Morgen Stern Digi Cables GmbH failed to deliver certain documents to the jurisdictional Registrar of Companies within the prescribed time period in compliance with the respective*

statutory provisions. Which option, out of the four given below, shall correctly indicate the amount of fine with which Morgen Stern Digi Cables GmbH shall be punishable for its failure to deliver certain documents:

(a) *Morgen Stern Digi Cables GmbH is punishable with fine which shall not be less than 50,000 rupees but which may extend to 5,00,000 rupees and in the case of a continuing offence, with an additional fine upto 25,000 rupees for every day after the first during which the contravention continues.*

(b) *Morgen Stern Digi Cables GmbH is punishable with fine which shall not be less than 1,00,000 rupees but which may extend to 5,00,000 rupees and in the case of a continuing offence, with an additional fine upto 20,000 rupees for every day after the first during which the contravention continues.*

(c) *Morgen Stern Digi Cables GmbH is punishable with fine which shall not be less than 2,00,000 rupees but which may extend to 5,00,000 rupees and in the case of a continuing offence, with an additional fine upto 50,000 rupees for every day after the first during which the contravention continues.*

(d) *Morgen Stern Digi Cables GmbH is punishable with fine which shall not be less than 1,00,000 rupees but which may extend to 3,00,000 rupees and in the case of a continuing offence, with an additional fine upto 50,000 rupees for every day after the first during which the contravention continues.*

3. *Radix Healthcare Ltd., a company registered in Thailand, although has no place of business established in India, yet it is engaged in online business through remote delivery of healthcare services in India. Select the incorrect statement from those given below as to the nature of the Radix Healthcare Ltd. in the light of the applicable provisions of the Companies Act, 2013:*

(a) *Radix Healthcare Ltd. is not a foreign company as it has no place of business established in India.*

(b) *Radix Healthcare Ltd. is a foreign company being involved in business activity through telemedicine.*

(c) *Radix Healthcare Ltd. is a foreign company for conducting business through electronic mode.*

(d) *Radix Healthcare Ltd. is a foreign company as it conducts business activity in India.*

4. *Fam Software Company Inc., a company incorporated in Australia, proposes to establish a place of business at Mumbai. The list of the Directors includes (i) Mr. Arjun – Managing Director, (ii) Mr. Ranveer – Director, (iii) Mr. Ramesh Malik - Director and (iv) Mr. Arbaaz - Director. Ms. Lavina has been appointed as the Secretary of Fam Software Company Inc. It is to be noted that Mr. Ramesh Malik and Mr. Arbaaz, resident in India, are the persons who have been authorised by Fam Software Company Inc. to accept on behalf of the company service of process, notices or other documents required to be served on Fam Software Company Inc. In relation to the company's establishment, you are required to enlighten the Fam Company Inc. with respect to whose, a declaration will be required to be submitted to the Registrar of Companies by Fam Software Company Inc. for not being convicted or debarred from formation of companies in or outside India.*

(a) *Mr. Arjun, Mr. Ranveer, Mr. Ramesh Malik, Mr. Arbaaz and Ms. Lavina.*

(b) *Mr. Arjun, Mr. Ramesh Malik, Mr. Arbaaz and Ms. Lavina.*

(c) *Mr. Ramesh Malik and Mr. Arbaaz.*

(d) *Mr. Arjun, Mr. Ranveer, Mr. Ramesh Malik and Mr. Arbaaz.*

5. *5K Cosmetic Shop plc., a company incorporated in Switzerland, is involved in digital supply services through electronic mode, the server of which is located outside India. The company follows calendar year as its financial year. Every year the company is required to prepare a balance sheet and profit and loss account. You are required to choose the correct timeline within which such documents shall be filed with the Registrar of Companies considering the provisions of Chapter XXII of the Companies Act, 2013:*

(a) *Within a period of 30 days from the close of the financial year of 5K Cosmetic Shop plc.*

(b) *Within a period of 3 months from the close of the financial year of 5K Cosmetic Shop plc.*

(c) *Within a period of 60 days from the close of the financial year of 5K Cosmetic Shop plc.*

(d) *Within a period of 6 months from the close of the financial year of 5K Cosmetic Shop plc.*

Descriptive Questions

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*

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.*

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.*

4. *In the light of the provisions of the Companies Act, 2013, examine whether the following Companies can be considered as a 'Foreign Company':*

   (i) *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) *Xen 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.*

5. *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.*

6. *Jackson & Jackson LLC, incorporated in Germany, is proposing to establish a business in Mumbai, India. Its official documents are in German language. Whether Jackson & Jackson LLC can file the required documents with Registrar in the same language.*

7. *Swift Pharmaceuticals, a Company registered in Singapore, has started its business in India during the financial year 2016. The Company has submitted all the required documents with registrar within the due date. On March 1, 2023, Swift Pharmaceuticals has shifted its principal office in Singapore. Does the Company required to undertake any steps due to change in address of principal office.*

ANSWERS

Answer to MCQ based Questions

1.	**(c)**	Jackson Communications LLC shall, within 30 days of the establishment of a principal place of business in India, deliver the requisite documents to the specified authority.
2.	**(d)**	Morgen Stern Digi Cables GmbH is punishable with fine which shall not be less than 1,00,000 rupees but which may extend to 3,00,000 rupees and in the case of a continuing offence, with an additional fine upto 50,000 rupees for every day after the first during which the contravention continues.
3.	**(a)**	Radix Healthcare Ltd. is not a foreign company as it has no place of business established in India.

4.	**(d)**	Mr. Arjun, Mr. Ranveer, Mr. Ramesh Malik and Mr. Arbaaz.
5.	**(d)**	Within a period of 6 months from the close of the financial year of 5K Cosmetic Shop plc.

Answer to Descriptive Questions

1. **(i)** 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. **(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) Under section 380(1) of the Companies Act, 2013 every foreign company shall, within 30 days of the establishment of place of business in India, deliver to the Registrar for registration the following documents:

(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 instruments are 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, the 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;

(2) any former name or names and surname or surnames in full;

(3) father's name or mother's name or spouse's name;

(4) date of birth;

(5) residential address;

(6) nationality;

(7) if the present nationality is not the nationality of origin, his nationality of origin;

(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)

(9) income-tax permanent account number (PAN), if applicable;

(10) occupation, if any;

(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);

(12) other directorship or directorships held by him;

(13) Membership Number (for Secretary only); and

(14) e-mail ID.

(d) the name and address or the names and addresses 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 or occasions;

(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.

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.

3. Preparation and filing of financial statements by a foreign company:

According to section 381 of the Companies Act, 2013:

(i) Every foreign company shall, in every calendar year,—

(a) make out a balance sheet and profit and loss account in such form, containing such particulars and including or having attached or annexed thereto such documents as may be prescribed, and

(b) deliver a copy of those documents to the Registrar.

According to the Companies (Registration of Foreign Companies) Rules, 2014, every foreign company shall prepare financial statement of its Indian business operations in accordance with Schedule III or as near thereto as possible for each financial year including:

(1) documents that are required to be annexed should be in accordance with Chapter IX i.e. Accounts of Companies.

(2) The 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 under the applicable laws there.

(ii) The Central Government is empowered to direct that, in the case of any foreign company or class of foreign companies, the requirements of clause (a) of section 381(1) shall not apply, or shall apply subject to such exceptions and modifications as may be specified in notification in that behalf.

(iii) If any of the specified documents are not in the English language, a certified translation thereof in the English language shall be annexed. [Section 381 (2)]

(iv) Every foreign company shall send to the Registrar along with the documents required to be delivered to him, a copy of a list in the prescribed form, of all places of business established by the company

in India as at the date with reference to which the balance sheet referred to in section 381(1) is made.

According to the Companies (Registration of Foreign Companies) Rules, 2014, every foreign company shall file with the Registrar, along with the financial statement, in Form FC-3 with such fee as provided under Companies (Registration Offices and Fees) Rules, 2014 a list of all the places of business established by the foreign company in India as on the date of balance sheet.

According to the Companies (Registration of Foreign Companies) Rules, 2014, 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 as from the date on which notice is so given, the obligation of the company to deliver any document to the Registrar shall cease, if it does not have other place of business in India.

(v) According to the Companies (Registration of Foreign Companies) Rules, 2014,

(a) Further, every foreign company shall, along with the financial statement required to be filed with the Registrar, 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)

The above statements shall include such other particulars as are prescribed in the Companies (Registration of Foreign Companies) Rules, 2014.

(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.

4. 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.

According to the 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) business to business and business to consumer 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.

(i) In the given situation, Red Stone Limited is registered in Singapore. However, it does not have a place of business in India whether by itself or through an agent, physically or through electronic mode; and does not conduct any business activity in India in any other manner. Mere holding of board meetings and executing business decisions in India cannot be termed as conducting business activity in India. Hence, M/s Red Stone Limited is not a foreign company as per the Companies Act, 2013.

(ii) In the given situation, Xen Limited Liability Company is registered in Dubai and has installed its main server in Dubai for maintaining office automation software by Cloud Computing for its client in India. Thus, it can be said that M/s Xen Limited Liability Company has a place of business in India through electronic mode and is conducting business

activity in India. Hence, Xen Limited Liability Company is a foreign company as per the Companies Act, 2013.

5. 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.

6. Every foreign company shall, within 30 days of the establishment of its place of business in India, deliver the documents to the Registrar as per Section 380 of the Companies Act, 2013. Further, if the original instruments/ documents are not in the English language, a certified translation in the English language is required for the same and submitted to Registrar.

7. Section 380 (3) provides that 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 the prescribed form. The Companies (Registration of Foreign Companies) Rules, 2014, has prescribed that the return containing the particulars of the alteration shall be filed in form *FC-2* along with prescribed fees. Accordingly, Swift Pharmaceuticals is required to submit the full address of the new registered or principal office of the company by March 30, 2023.

NOTES

CHAPTER 1

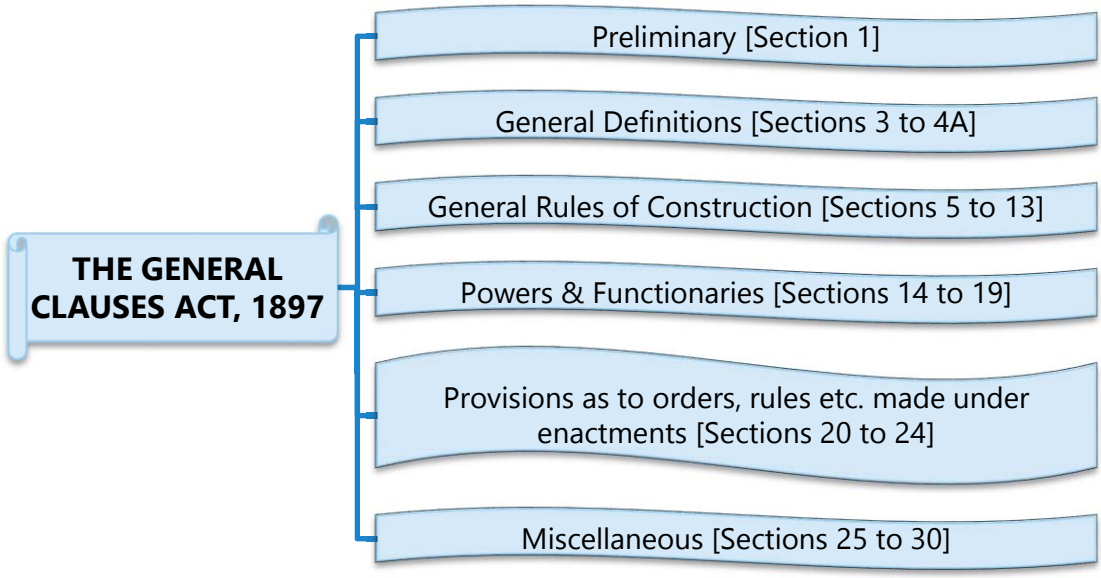
THE GENERAL CLAUSES ACT, 1897

LEARNING OUTCOMES

At the end of this Chapter, you will be able to:

- Explain the purpose of the General Clauses Act.
- Acquire some basic understanding of the legislation.
- Know the general definitions under the Act.
- Identify general rules of construction.
- Explain powers as to orders, rules etc. made under enactments.
- Gain knowledge of other miscellaneous provisions.

CHAPTER OVERVIEW



1. INTRODUCTION

Why we study General Clauses Act?

The General Clauses Act, 1897 (Act) was enacted on 11th March, 1897 to consolidate and extend the General Clauses Act, 1868 and 1887.

The General Clauses Act, 1897 contains 'definitions' of certain terms and general principles of interpretation. The general definitions provided are applicable to all Central Acts and Regulations in the absence of definition of a particular word in any Central Act or Regulation, unless there is anything repugnant in the subject or context.

The General Clauses Act, 1897 also comes for a rescue in the 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.

Example 1: Wherever the law provides that court will have the power to appoint, suspend or remove a receiver, the legislature simply enacted that wherever convenient the court may appoint receiver and it was implied within that language that it may also remove or suspend him. *(Rayarappan V. Madhavi Amma, A.I.R. 1950 F.C. 140)*

2. OBJECT, PURPOSE AND IMPORTANCE OF THE GENERAL CLAUSES ACT

The objects of the Act are several, namely:

(1) to shorten the language of Central Acts;

(2) to provide, as far as possible, for uniformity of expression in Central Acts, by giving definitions of a series of terms in 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 General Clauses Act, thus, makes provisions as to construction of General Acts and other laws of all- India application. Its importance, therefore, in point of the number of enactments to which it applies, is obvious.

Purpose- 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 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.

So, whatever General Clauses Act says whether as regards to the meaning of words or as regards legal principles, has to be read in every statute to which it applies.

Example 2: A claim of the right to catch fish came under the consideration of court in *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.

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 Section 3 of 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 as a *profit a prendre*[1] 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.

3. APPLICATION OF THE GENERAL CLAUSES ACT

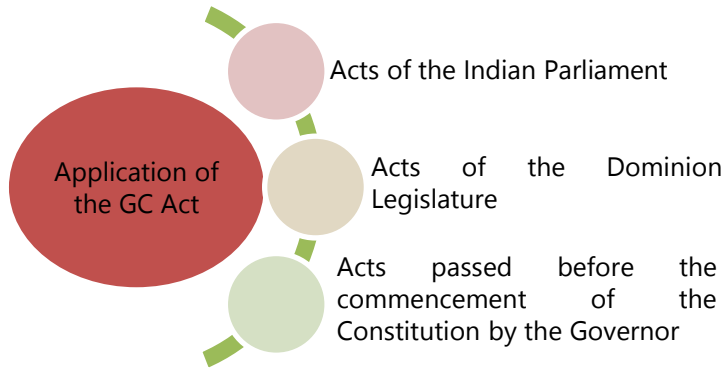
The Act does not define any "territorial extent" clause. Its application is primarily with reference to all Central legislation and also to rules and regulations made under a Central Act. It is in a sense a part of every Central Acts or Regulations. If a Central Act is extended to any territory, the 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;

[1] French- Right of taking. The right of persons to share in the land owned by another. A profit a prendre enables a person to take part of the soil or produce of land that someone else owns.

(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.



Article 367 of the Constitution of India authorises use of the 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.

In many countries, Legislatures similar to the General Clauses Act are called Interpretation Acts. But, as the provisions of the General Clauses Act (whether relating to definitions and meanings of words and terms or dealing with construction and interpretation) are, so far as may be necessary, common to every Central Act, the title "General Clauses Act" is not less appropriate than the title "Interpretation Act". **The Supreme Court had observed in the case of *Chief Inspector of Mines v. K. C. Thapar*** "Whatever the General Clauses Act says, whether as regards the meanings of words or as regards legal principles, has to be read into every Act to which it applies."

The scope and effect of each section depends upon the text of the particular section.

Example 3: Section 3 of the General Clauses Act, which deals with the definitional clause, applies to the General Clauses Act itself and to all Central Acts and Regulations made after the commencement of the General Clauses Act in 1897.

Similarly, **section 4** of the General Clauses Act which deals with the application of foregoing definitions to previous enactment, applies to Central Acts and after January 3, 1868 and to regulations made after January 14, 1887.

So, there is a difference in the applicability of each section as regards the statutes to which it applies.

The language of each section of the General Clauses Act has to be referred to ascertain to which class of instruments or enactment it applies. In certain cases, even if no section of the General Clauses Act applies to particular case, the court applies the general principles of the General Clauses Act.

It may also be noted that the Act also serves as a model for State General Clauses Act. It is evident that the State General Clauses Acts should conform to the General Clauses Act of 1897, for, otherwise, divergent rules of construction and interpretation would apply and as a result, great confusion might ensue.

Before delving into the saddle of the provisions under General Clauses Act, 1897 let's have some basic understanding of law.

4. SOME BASIC UNDERSTANDING OF LEGISLATION

"Preamble": Every Act has a preamble which expresses the scope, object and purpose of the Act. It is the main source for understanding the intention of lawmaker behind the Act. Whenever there is ambiguity in understanding any provision of Act, Preamble is accepted as an aid to construction of the Act.

The Preamble of a Statute is a part of the enactment and can legitimately be used for construing it. However, the Preamble does not over-ride the plain provisions 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 4: Preamble of the Negotiable Instruments Act, 1881 states - "An Act to define and amend the law relating to Promissory Notes, Bills of Exchange and Cheque."

Example 5: Preamble of the Companies Act, 2013 states – "An Act to consolidate and amend the law relating to companies."

In order to understand Preamble of the Act, it is important to know the 'Act'. Act is a bill passed by both the houses of Parliament and assented to by the President. Whereas 'Bill' is a draft of a legislative proposal put in the proper form which, when passed by both houses of Parliament and assented to by the President becomes an Act. On getting assent from President, an Act is notified on the Official Gazettes of India.

"Definitions": Every Act contains definition part for the purpose of that particular Act and that definition part are usually mentioned in the Section 2 of that Act but in some other Acts, it is also mentioned in Section 3 or in other initial sections. Hence, definitions are defined in the Act itself. The object of the definition clause is to avoid the necessity of frequent repetitions in describing all the subject matter to which the word or expression so defined is intended to apply.

However, if there may be words which are not defined in the definitions of the Act, the meaning of such words may be taken from General Clauses Act, 1897.

Words are defined in the respective Act. Sometimes, definitions are referred in other statutes. If words are not defined in the respective Acts, such words are to be taken from General Clauses Act.

Example 6: The word 'Company' used in the Companies Act, 2013, is defined in section 2(20) of the respective Act.

Example 7: Word 'Security' used in the Companies Act, 2013, is not defined in the respective Act. It has been defined under section 2(h) of the Securities Contracts (Regulations) Act, 1956. This word is equivalently applicable on the Companies

Act, 2013. Similarly, the word 'Digital signature' used in the Companies Act, shall be construed as per the section 2(1) (p) of the Information Technology Act, 2000.

Clause 95 of Section 2 of the Companies Act, 2013 clearly says that -

Words and expressions used and not defined in this Act but defined in the Securities Contracts (Regulation) Act, 1956 or the Securities and Exchange Board of India Act, 1992 or the Depositories Act, 1996 shall have the meanings respectively assigned to them in those Acts.

Example 8: The word 'Affidavit' used in section 7 during the incorporation of company, in the Companies Act, 2013, shall derive its meaning from the word 'Affidavit' as defined in the General Clauses Act, 1897.

"Means" and/or "include": Some definitions use the word "means". Such definitions are exhaustive definitions and exactly define the term.

Example 9: Definition of 'Company' as given in section 2(20) of the Companies Act, 2013. It states, "Company" means a company incorporated under this Act or under any previous company law.

Example 10: Section 2(34) of the Companies Act, 2013 defines the term director as "director" means a director appointed to the Board of a company.

Some definitions use the word "include". Such definitions do not define the word but are inclusive in nature. Where the word is defined to 'include' such and such, the definition is 'prima facie' extensive. 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 11: Word 'debenture' defined in section 2(30) of the Companies Act, 2013, states that "debenture" includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not". This is a definition of inclusive nature.

Example 12: "Body Corporate" or "Corporation" includes a company incorporated outside India. [Section 2(11) of the Companies Act, 2013]

The above definition of Body Corporate does not define the term Body Corporate, but just states that companies incorporated outside India will also cover under

the definition of Body Corporate, apart from other entities which are called as Body Corporate.

We may also find a word being defined as 'means and includes' such and such, here again the definition would be exhaustive.

Example 13: Share defined under section 2(84) of the Companies Act, 2013, states that "Share" means a share in the share capital of a company and includes stock.

On the other hand, if the word is defined 'to apply to and include', the definition is understood as extensive.

"Shall" and "May": The word 'shall' is used to raise a presumption of something which is mandatory or imperative while the word 'may' is used to connote something which is not mandatory but is only directory or enabling. However, sometimes the words "may and shall" can be interpreted interchangeably depending on the intention of the legislator.

Example 14: Section 3 of the Companies Act, 2013 states that "A company may be formed for any lawful purpose by....."

Here the word used "may" shall be read as "shall". Usage of word 'may' here makes it mandatory for a company for the compliance of section 3 for its formation.

Example 15: Section 21 of the Companies Act, 2013, provides that documents/proceeding requiring authentication or the contracts made by or on behalf of the company, may be signed by any Key Managerial Personnel or an officer of the company duly authorised by the Board in this behalf.

Usage of the 'may' shall be read as 'may'.

The use of word 'shall' with respect to one matter and use of word 'may' with respect to another matter in the same section of a statute, will normally lead to the conclusion that the word 'shall' imposes an obligation, whereas word 'may' confers a discretionary power *(Labour Commr., M.P.V. v. Burhanpur Tapti Mill, AIR, 1964 SC1687).*

In *Sainik Motors v. State of Rajastan J. Hidyatullah* observed "the word Shall is ordinarily mandatory but it is sometimes not so interpreted if the context or the intention otherwise demands.

Our approach in this text is to provide basic understanding of law while studying any legislation. These are few concepts which every student should keep in mind while studying law. You will read the following concepts in detail in the chapter of 'Interpretation of Statutes'.

5. PRELIMINARY [SECTION 1]

"Short title" [Section 1(1)]: This Act may be called the General Clauses Act, 1897.

Preliminary is the introductory part of any law which generally contains Short Title, extent, commencement, application etc. The title although the part of the Act is in itself not an enacting provision. Every Act is given a title to carve out its own identity just like people are given their names to identify them.

The General Clauses Act, 1897 contains only short title in the Preliminary part of the Act.

Note: Section 2 of the General Clauses Act, 1897 has been repealed.

6. 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.

Here in this chapter, we shall be discussing some of the relevant definitions or terms which are by and large seen in the Acts.

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.

Bartley in his commentary on the General Clauses Act, 1897 has pointed out that a definition may be explanatory, restrictive or extensive.

Section 3 reads as – "*In this Act, and in all Central Acts and Regulations made after the commencement of this Act, unless there is anything repugnant in the subject or context,-*

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;

An act required to be done cannot necessarily mean a positive act only and may also include acts which one is precluded from doing from decree. This definition is based on sections 32 and 33 of the Indian Penal Code and applies to civil wrongs as well as crimes. 'Act' includes illegal omissions as well but it does not include an omission which is not illegal.

In the illustration to section 36 of the Indian Penal Code, 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.

There are two important points derived from the above definition:

1. Affirmation and declaration,
2. In case of persons allowed affirming or declaring instead of swearing.

The above definition is inclusive in nature. It states that Affidavit shall include affirmation and declarations. This definition does not define affidavit. 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 or to be done after the commencement of the constitution 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 given to him or it under article 239 or article 243 of the Constitution, as the case may be; and

(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 date of commencement of the Constitution (Seventh Amendment) Act, 1956 is 01st January, 1956.

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.

The sole **Part D** territory was the Andaman and Nicobar Islands, which were administered by a Lieutenant Governor appointed by the Central Government.

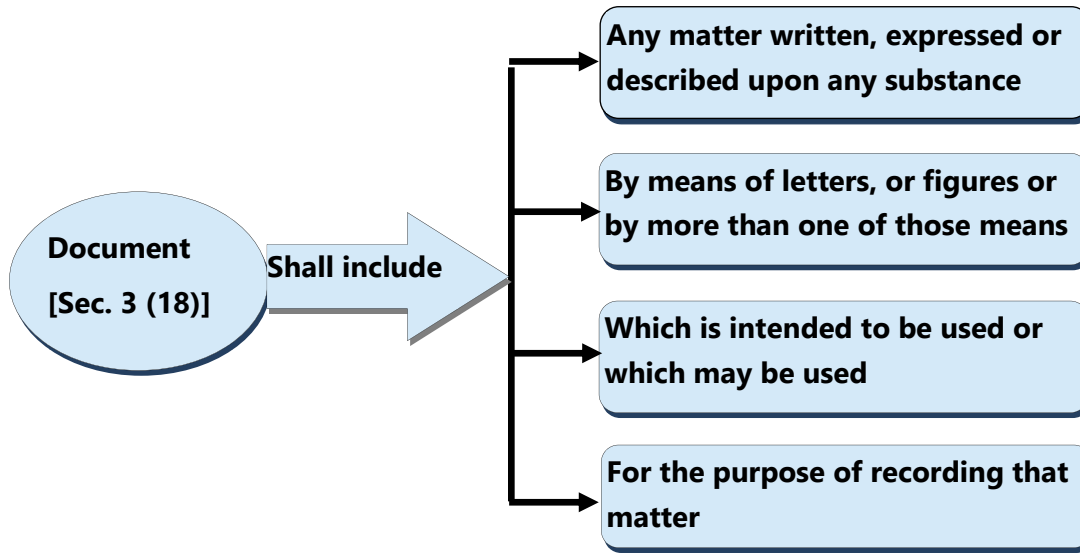
5. 

"Commencement" [Section 3(13)]: 'Commencement' used with reference to an Act or Regulation, shall mean the day on which the Act or Regulation comes into force;

Coming into force or entry into force (also called commencement) refers to the process by which legislation; regulations, treaties and other legal instruments come to have legal force and effect.

A Law cannot be said to be in force unless it is brought into operation by legislative enactment, or by the exercise of authority by a delegate empowered to bring it into operation. The theory of a statute being "in operation in a constitutional sense" though it is not in fact in operation has no validity. *[State of Orissa Vs. Chandrasekhar Singh Bhoi, Air 1970 SC 398]*

6. **"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.



Thus, the term "Document" includes any substance upon which any matter is written or expressed by means of letters or figures for recording that matter.

For example, book, file, painting, inscription and even computer files are all documents. However, it does not include Indian currency notes.

7. 

"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;

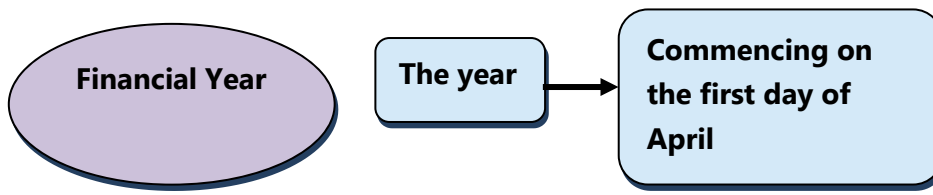
It has been held that an "enactment" would include any Act (or a provision contained therein) made by the Union Parliament or the State Legislature. Again, since "enactment" is defined to include also any provision of an Act, section 6 (Effect of repeal) would apply to a case where not only the entire Act is repealed, but also where any provision of an Act is repealed. *[State of Punjab Sukh Deo Sarup Gupta A.LR. 1970 SC 1661, 1942, para 3, affirming A.I.R. 1965 Punj. 399 and Godhra Electricity Co. v. Somalal, A.I.R. 1967 Guj. 772, 776, para 6.]*

Rules and regulation are nothing but a species of legislation. The legislature instead of enacting the same itself delegates the power to other person. Whatever is enacted by the delegate of legislature is also enactment.

8. **"Financial Year" [Section 3(21)]:** 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.

Difference between Financial Year and Calendar Year: Financial year starts from first day of April but Calendar Year starts from first day of January.



9. 

"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 question of good faith under the General Clauses Act, 1897 is one of fact. It is to determine with reference to the facts and circumstances of each case. Thus, anything done with due care and attention, which is not *malafide* is presumed to have been done in good faith. For eg: An authority is not acting honestly where it had a suspicion that there was something wrong and did not make further enquiries

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 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.

In *Maung Aung Pu Vs. Maung Si Maung,* it was pointed out that the expression "good faith" is not defined in the Indian Contract Act, 1872 and the definition given here in the General Clauses Act, 1897 does not expressly apply the term on the Indian Contract Act. The definition of good faith as is generally understood in the civil law and which may be taken as a practical guide in understanding the expression in the contract Act is that nothing is said to be done in good faith which is done without due care and attention as is expected with a man of ordinary prudence. An honest purchase made carelessly without making proper enquiries cannot be said to have been made in good faith so as to convey good title.

10. **"Government" [Section 3(23)]:** 'Government' or 'the Government' shall include both the Central Government and State Government.

Hence, wherever, the word 'Government' is used, it will include Central Government and State Government both.

The object of this definition is to make it clear that the word 'Government', frequently used as a convenient abbreviation, may be construed according to the context in either of the two senses indicated. Government generally

connotes three wings, the Legislature, the Executive and the Judiciary; but in a narrow sense it is used to connote the Executive only. Meaning to be assigned to that expression, therefore, depends on the context in which it is used.

11. 

"Government Securities" [Section 3(24)]: 'Government securities' shall mean securities of the Central Government or of any State Government, but in any Act or Regulation made before the commencement of the Constitution shall not include securities of the Government of any Part B state.

By virtue of section 4A, this definition applies to all Indian laws.

12. **"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:

a. land,

b. benefits to arise out of land,

c. things attached to the earth and

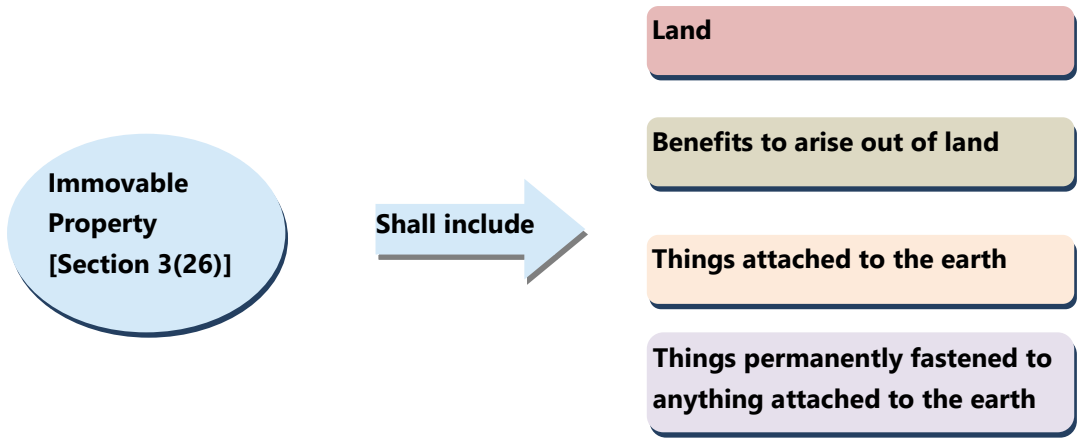
d. things permanently fastened to anything attached to the earth.

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.

Example 16: In *Shantabai v. State of Bombay, the Supreme Court* pointed out that **trees must be regarded as immovable property** because they are attached to or rooted in the earth.

An agreement to convey forest produce like tendu leaves, timber, bamboos etc., the soil for making bricks, the right to build on and occupy the land for business purposes and the right to grow new trees and to get leaves from trees that grow in further are all included in the term immovable property.

Example 17: 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.



13. 

"Imprisonment" [Section 3(27)]: 'Imprisonment' shall mean imprisonment of either description as defined in the Indian Penal Code;

By section 53 of the Indian Penal Code, the punishment to which offenders are liable under that Code are imprisonment which is of two descriptions, namely, rigorous, that is with hard labor and simple. So, when an Act provides that an offence is punishable with imprisonment, the Court may, in its discretion, make the imprisonment rigorous or simple.

14. **"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;

15. 

"Month" [Section 3(35)]: 'Month' shall mean a month reckoned according to the British calendar;

16. **"Movable Property" [Section 3(36)]:** 'Movable Property' shall mean property of every description, except immovable property.

Thus, any property which is not immovable property is movable property. Debts, share, electricity are moveable property.

17. 

"Oath" [Section 3(37)]: 'Oath' shall include affirmation and declaration in the case of persons by law allowed to affirm or declare instead of swearing.

18. **"Offence" [Section 3(38)]:** 'Offence' shall mean any act or omission made punishable by any law for the time being in force.

Any act or omission which is if done, is punishable under any law for the time being in force, is called as offence.

19. **"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.

20. **"Person" [Section 3(42)]:** "Person" shall include:

(i) any company, or

(ii) association, or

(iii) body of individuals, whether incorporated or not

21. 

"Registered" [Section 3(49)]: 'Registered' used with reference to a document, shall mean registered in India under the law for the time being force for the registration of documents.

22. **"Rule" [Section 3(51)]:** 'Rule' shall mean a rule made in exercise of a power conferred by any enactment, and shall include a Regulation made as a rule under any enactment;

23. 

"Schedule" [Section 3(52)]: 'Schedule' shall mean a schedule to the Act or Regulation in which the word occurs;

24. **"Section" [Section 3(54)]:** 'Section' shall mean a section of the Act or Regulation in which the word occurs;

25. 

"Sub-section" [Section 3(61)]: 'Sub-section' shall mean a sub-section of the section in which the word occurs;

26. **"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.

27. 

"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 [2]visible forms.

28. **"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.

[3]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.

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[2] Reference of relevant definitions of section 3 is given in section 4.
[3]Reference of relevant definitions of section 3 is given in section 4A.

(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.

7. 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.

Example 18: 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.

Example 19: 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.

The Supreme Court in *A.K. Roy v. UOI, AIR 1982 SC 710*, observed that where 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.

However, in *Altemeis Rein v. UOI AIR 1988 SC 1768*, it was held that if a sufficient time has elapsed since an Act or any of its provisions has been passed and it has not been brought into force (operation) by the Government, the Court through a writ can direct the Government to consider the question as to when the same should begin to operate.

In the case of *State of Uttar Pradesh v. Mahesh Narain, AIR 2013 SC 1778,* Supreme Court held that effective date of Rules would be when the Rules are published vide Gazette notification and not from date when the Rules were under preparation.

Also, law takes no cognizance of fraction of day, 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.

PRESUMPTION AGAINST RETROSPECTIVITY

All laws which affect substantive vested rights generally operate prospectively and there is a presumption against their retrospectivity till there are express words giving retrospective effect or where the language used necessarily implies that such retrospective operation is intended. 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:

- **Revive anything not enforced** or prevailed during the period at which repeal is effected or;
- **Affect the previous operation** of any enactment so repealed or anything duly done or suffered thereunder; or
- **Affect any right**, privilege, obligation or liability acquired, accrued or incurred under any enactment so repealed; or
- **Affect any penalty**, forfeiture or punishment incurred in respect of any offence committed against any enactment so repealed; or
- **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.

In *State of Uttar Pradesh v. Hirendra Pal Singh, (2011), 5 SCC 305,* SC held that whenever an Act is repealed, it must be considered as if it had never existed. Object of repeal is to obliterate the Act from statutory books, except for certain purposes as provided under Section 6 of the Act.

In *Kolhapur Canesugar Works Ltd. v. Union of India, AIR 2000, SC 811,* Supreme Court held that Section 6 only applies to repeal and not to omissions and applies when the repeal is of a Central Act or Regulation and not of a Rule.

In *Navrangpura Gam Dharmada Milkat Trust v. Ramtuji Ramaji, AIR 1994 Guj 75:* 'Repeal' of provision is in distinction from 'deletion' of provision. 'Repeal' ordinarily brings about complete obliteration 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. For the purpose of this section, the above distinction between the two is essential.

"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.

"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 other words, to revive a repealed statute, it is necessary to state an intention to do so.

"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 construed as references to the provision so re-enacted.

(2) Where before the fifteenth day of August, 1947, any Act of Parliament of the United Kingdom repealed and re-enacted, with or without modification, any provision of a former enactment, then reference in any Central Act or in any Regulation or instrument to the provision so repealed shall, unless a different intention appears, be construed as references to the provision so re-enacted.

In *Gauri Shankar Gaur v. State of U.P., AIR 1994 SC 169,* it was held that every Act has its own distinction. If a later Act merely makes a reference to a former Act or existing law, it is only by reference and all amendments, repeals new law subsequently made will have effect unless its operation is saved by the relevant provision of the section of the Act.

Example 20: 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.

"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 21: A company declares dividend for its shareholder in its Annual General Meeting held on 30/09/2022. 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 01/10/2022 to 30/10/2022. In this series of 30 days, 30/09/2022 will be excluded and last 30th day i.e. 30/10/2022 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.

In *K. Soosalrathnam v. Div. Engineer, N.H.C. Tirunelveli,* it was held by Madras High Court that since the last date of the prescribed period was subsequent to the date

of notification, declared to be a holiday on the basis of the principles laid down in this section the last date of prescribed period for obtaining the tender schedules was extended to the next working day.

"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.

Pro rata is a Latin term used to describe a proportionate allocation.

Example 22: Where several debtors are liable for the whole debt and each is liable for his own share or proportion only, they are said to be bound pro rata.

Example 23: 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 ₹ 2 per share, the total amount of dividends paid will be ₹ 200. No matter how many shareholders there are, the total dividend payments cannot exceed this limit. In this case, ₹ 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. This is calculated by dividing the ownership of each person by the total number of shares and then multiplying the resulting fraction by the total amount of the dividend payment.

The majority shareholder's portion, therefore, is (50/100) x ₹ 200 = ₹ 100. This makes sense because the shareholder owns half of the shares and receives half of the total dividends. The remaining shareholders get ₹ 50, ₹ 30, and ₹ 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.

In accordance with the rule that the words importing the masculine gender are to be taken to include females, the word men may be properly held to include women, and the pronoun 'he' and its derivatives may be construed to refer to any person whether male or female. So, the words 'his father and mother' as they occur in Section 125(1) (d) of the CrPC, 1973 have been construed to include 'her father and mother' and a daughter has been held to be liable to maintain her father unable to maintain himself.

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.

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'.

8. POWER AND FUNCTIONARIES [SECTION 14 TO SECTION 19]

"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.

Relying on Section 14, the SC has held that the power under Section 51(3) of the States Reorganisation Act, 1956 can be exercised by the Chief Justice as and when the occasion arose for its exercise.

"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 or execute any function is conferred, then unless it is otherwise expressly provided, any such appointment, 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.

"Power to appoint to include power to suspend or dismiss" [Section 16]: The authority having for the time being power to make the appointment shall also have power to suspend or dismiss any person appointed whether by itself or any other authority in exercise of that power.

Order 40, Rule 1(a) of CPC, 1908, which authorises a court to appoint a receiver, has been construed to embrace power of removing a receiver.

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.

"Substitution of functionaries" [Section 17]: (1) In any Central Act or Regulation made after the commencement of this Act, 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.

"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 Central Acts made after the third day of January, 1868, and to all Regulations made on or after the fourteenth day of January, 1887.

In *K.G. Krishnayya v. State, AIR 1959* 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.

Similarly, in case under the Preventive Detention Act, where there is a change in the Advisory Board after service of the detention order, the new Advisory Board can consider the case pending before the earlier board.

9. PROVISION AS TO ORDERS, RULES ETC. MADE UNDER ENACTMENTS [SECTION 20 TO SECTION 24]

"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 repugnant in the subject or context, have the same respective meaning as in the Act or regulation conferring power.

Example 24: The term 'collector' used in Rule 4 of the Land Acquisition (Companies) Rule, 1963, will have the same meaning as in Section 3(c) of the Land Acquisition Act, 1894.

In *Subhash Ram Kumar v. State of Maharashtra, AIR 2003 SC 269,* it was held that 'Notification' in common English acceptation mean and imply a formal announcement of a legally relevant fact and "notification publish in Official Gazette" means notification published by the authority of law. It is a formal declaration and should be in accordance with the declared policies or statute. Notification cannot be substituted by administrative instructions.

"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.

In *Rasid Javed v. State of Uttar Pradesh, AIR 2010 SC 2275,* Supreme Court held that under Section 21 of the Act, an authority which has the power to issue a notification has the undoubted power to rescind or modify the notification in the like manner.

In *Shreesidhbali Steels Ltd. v. State of Uttar Pradesh, AIR 2011 SC 1175,* Supreme Court held that power under section 21 of the Act is not so limited as to be exercised only once power can be exercised from time to time having regard to exigency of time.

"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 Regulation or with respect to the establishment of any Court or the appointment of any Judge or officer thereunder, or with respect to the person by whom, or the time when, or the place where, or the manner in which, 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.

It is an enabling provision, its content and purpose being to facilitate the making of rules, bye laws and orders before the commencement of the enactment in anticipation of its coming into force. In other words, it validates rules, bye laws and orders made before the coming into force of the enactment, provided they are made after its passing and as preparatory to the enactment coming into force.

"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 to be given subject to the condition of the rules or bye-laws being made after previous publication, then the following provisions shall apply, namely:-

(1) The authority having power to make the rules or bye-laws shall, before making them, 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, if the condition with respect to previous publication so requires, in such manner as the Government concerned prescribes;

(3) There shall be published with the draft a notice specifying a date on or after which the draft will be taken into consideration;

(4) The authority having power to make the rules or bye-laws, and, where the rules or bye-laws are to be made with the sanction, approval or concurrence of another authority, that authority also shall consider any objection or suggestion which may be received by the authority having power to make the rules or bye-laws 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 purporting to have been made in exercise of a power to make rules or bye-laws after previous publication shall be conclusive proof that the rule or bye-laws has been duly made.

Section 23(5) raises a conclusive presumption that after the publication of the rules in the Official Gazette, it is to be inferred that the procedure for making the rules had been followed. Any irregularities in the publication of the draft cannot therefore be questioned.

It is also open to the authority publishing the draft and entitled to make the rules 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 and when any Central Act or Regulation, which, by a notification under section 5 or 5A of the Scheduled District Act, 1874, or any like law, has been extended to any local area, has, by a subsequent notification, been withdrawn from the re-extended to such area or any part thereof, the provisions of such Act or Regulation shall be deemed to have been repealed and re-enacted in such area or part within the meaning of this section.

This section accords statutory recognition to the general principle that if a statute is repealed and re-enacted in the same or substantially the same terms, the re-enactment neutralizes the previous repeal and the provisions of the repealed Act which are re-enacted, continue in force without interruption. If however, the statute is repealed and re-enacted in somewhat different terms, the amendments and modifications operate as a repeal of the provisions of the repealed Act which are changed by and are repugnant to the repealing Act.

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.

10. MISCELLANEOUS [SECTION 25 TO SECTION 30]

"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.

According to the Supreme Court, a plain reading of section 26 shows that 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. In other words, the section provides that where an act or omission constitutes an offence under two enactments, the offender may be prosecuted and punished under either or both the enactments but shall not be liable to be punished twice for the same offence.

In State of *M.P. v. V.R. Agnihotri, AIR 1957 SC 592* it was held that when there are two alternative charges in the same trial, e.g., section 409 of the Indian Penal Code and section 5(2) of the Prevention of Corruption Act, the fact that the accused is acquitted of one of the charges will not bar his conviction on the other.

Provisions of Section 26 and Article 20(2) of the Constitution apply only when the two offences which form the subject of prosecution is the same, i.e., the ingredients which constitute the two offences are the same. If the offences under the two enactments are distinct and not identical, none of these provisions will apply.

"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 *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 neither tenable not based upon sound exposition of law.

In *Jagdish Singh.v Natthu Singh, AIR 1992 SC 1604,* 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.

In *Smt. Vandana Gulati v. Gurmeet Singh alias Mangal Singh, AIR 2013 All 69,* it was held that where notice sent by registered post to person concerned at proper address is deemed to be served upon him in due course unless contrary is proved. Endorsement 'not claimed/not met' is sufficient to prove deemed service of notice.

"Citation of enactments" [Section 3(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.

(2) In this Act and in any Central Act or Regulation made after the commencement of this Act, a description or citation of a portion of another enactment shall, unless a different intention appears, be construed as including the word, section or other part mentioned or referred to as forming the beginning and as forming the end of the portion comprised in the description or citation.

"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.

"Application of Act to Ordinances" [Section 30]: In this Act the expression Central Act, wherever it occurs, except in Section 5 and the word 'Act' in clauses (9), (13), (25), (40), (43), (53) and (54) of section 3 and in section 25 shall be deemed to include Ordinance made and promulgated by the Governor General under section 23 of the Indian Councils Act, 1861 or section 72 of the Government of India Act, 1915, or section 42 of the Government of India Act, 1935 and an Ordinance promulgated by the President under Article 123 of the Constitution.

SUMMARY

- The General Clauses Act, 1897 intends to provide general definitions which shall be applicable to all Central Acts and Regulations where there is no definition in those Acts.
- Every Act has a preamble which expresses the scope, object and purpose of the Act. It is the main source for understanding the intention of lawmaker behind the Act.
- Financial year shall mean the year commencing on the first day of April.
- Where legislation has not specifically mentioned the date to come into force, it shall be implemented on the day it receives the assent of the President of India.
- Whenever an Act is repealed, it must be considered as if it had never existed.
- Where by any legislation, 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, 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.
- In any legislation, words importing the masculine gender shall be taken to include females, and words in singular shall include the plural and vice versa.
- Power to appoint includes power to appoint ex-officio.
- Power to appoint includes power to suspend or dismiss.

- 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.
- 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 properly addressing, pre-paying, and posting by registered post.

TEST YOUR KNOWLEDGE

MCQ based Questions

1. *Which of the following is not an Immovable Property?*

   (a) Land

   (b) Building

   (c) Timber

   (d) Machinery permanently attached to the land

2. *Where an act of parliament does not expressly specify any particular day as to the day of coming into operation of such Act, then it shall come into operation on the day on which:*

   (a) It receives the assent of the President

   (b) It receives the assent of the Governor General

   (c) It receives assent of both the houses of Parliament

   (d) It receives assent of the Prime Minister

3. *An act or omission constitutes an offence under two enactments. Referring to the provisions of the General Clauses Act, 1897, state which among the following is correct in such a situation:*

   (a) The offender shall be liable to be prosecuted and punished under that enactment only, which was enacted last and not under the other enactment.

   (b) The offender shall be liable to be prosecuted and punished under that enactment only, which was enacted first and not under the other enactment.

(c) *The offender shall be liable to be prosecuted and punished under both the enactments.*

(d) *The offender shall be liable to be prosecuted and punished under that either or any of those enactments, but shall not be punished twice for the same offence.*

4. *Every Act has a ..... which expresses the scope, object and purpose of the Act. It is the main source for understanding the intention of lawmaker behind the Act.*

(a) *Definition*

(b) *Preamble*

(c) *Affidavit*

(d) *Document*

5. *What among the following could be considered in the term 'Immovable Property' as defined under section 3(26) of the General Clauses Act, 1897?*

(i) *The soil for making bricks*

(ii) *Right to catch fish*

(iii) *Right to drain water*

(iv) *Doors and Windows of the house*

(a) *Only (i) and (iv)*

(b) *Only (i), (ii) and (iv)*

(c) *Only (i) and (ii)*

(d) Only (ii), (iii) and (iv)

Descriptive Questions

1. *What is "Financial Year" under the General Clauses Act, 1897?*
2. *What is "Immovable Property" under the General Clauses Act, 1897?*
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?*

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.*

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 the General Clauses Act, 1897.*

6. *What is the meaning of service by post as per provisions of the General Clauses Act, 1897?*

7. *Komal Ltd. declares a dividend for its shareholders in its AGM held on 27th September, 2022. Referring to provisions of the General Clauses Act, 1897 and the 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?

8. *'Repeal' of provision is different from 'deletion' of provision. Explain as per the General Clauses Act, 1897.*

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 30.10.2022, 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?*

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.

ANSWERS

Answer to MCQ based Questions

1.	**(c)**	Timber
2.	**(a)**	It receives the assent of the President
3.	**(d)**	The offender shall be liable to be prosecuted and punished under that either or any of those enactments, but shall not be punished twice for the same offence
4.	**(b)**	Preamble
5.	**(b)**	Only (i), (ii) and (iv)

Answer to Descriptive Questions

1. 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 the General Clauses Act, 1897, Year means calendar year which starts from January to December.

Hence, in view of both the 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. 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

(iv) 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. 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 the 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. 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. "**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. **"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. 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 27/09/2022. 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 28/09/2022 to 27/10/2022. In this series of 30 days, 27/09/2022 will be excluded and last 30th day, i.e. 27/10/2022 will be included. Accordingly, Komal Ltd. will be required to pay dividend within 28/09/2022 and 27/10/2022 (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, 2022 to 3rd November, 2022 (both days inclusive).

8. In *Navrangpura Gam Dharmada Milkat Trust v. 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.

9. 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, 2022 will be excluded and 6th November 2022 shall be included, i.e. 31st October, 2022 to 6th November, 2022 (both days inclusive).

10. (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.

NOTES

CHAPTER 2

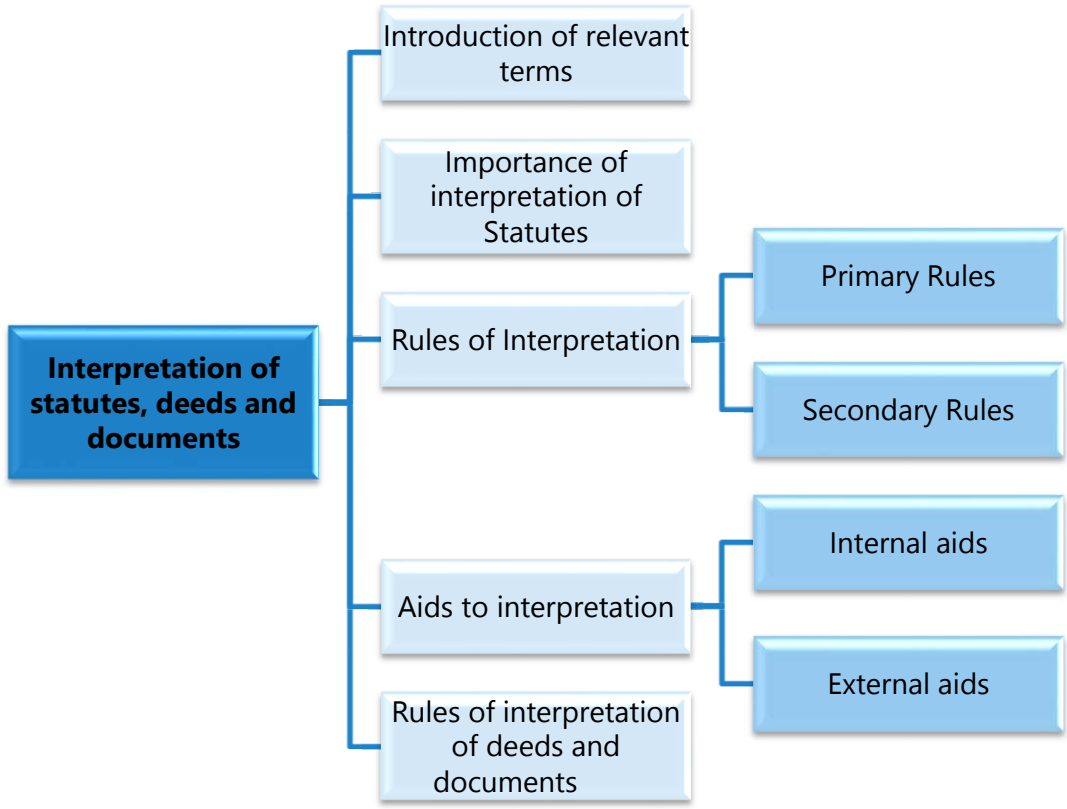
INTERPRETATION OF STATUTES

LEARNING OUTCOMES

At the end of this chapter, you will be able to:

- Gain knowledge about the need for interpretation of statutes.
- Explain the various Rules of Interpretation of Statutes.
- Describe about the various internal and external aids to interpretation.
- Comprehend the Rules of Interpretation of Deeds and Documents.

CHAPTER OVERVIEW



1. INTRODUCTION

As a Chartered Accountant in practice or in service, you will be required to read various laws and statutes. Often these enactments may be capable of more than one interpretation. It is in this context that awareness of interpretation as a skill becomes relevant. This chapter will enable you to understand certain rules of interpretation as well as the various internal and external aids to interpretation. We shall also discuss the art of interpreting deeds and documents.

This study relates to **'Interpretation of Statutes, Deeds and Documents'**. So, it is necessary that we understand what these words and certain other terms denote.

'Statute': To the common man the term **'Statute'** generally means laws and regulations of various kinds irrespective of the source from which they emanate.

The word "statute" is now synonymous with an Act of Parliament. Broadly speaking it is the written law that the legislature establishes directly. 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.

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.

Thus, that which originates through legislation is called "enacted law" or statute as against "unenacted" or "unwritten law".

However, the Constitution does not use the terms 'statute' though one finds the terms 'law' used in many places. The term 'law' is defined as including any ordinance, order, bye- law, rule, regulation, notification, and the like.

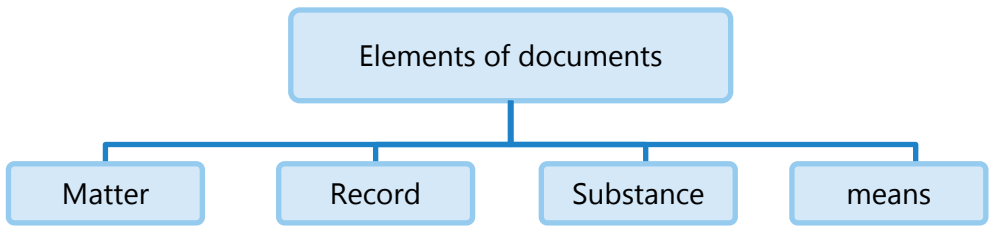
In short 'statute' signifies written law as against unwritten law.

'Document': Generally understood, a document is a paper or other material thing giving information, proof or evidence of anything. The Law defines 'document' in a more technical form. 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.

Example 1: A writing is a document; any words printed, photographed are documents.

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**—This is the first element. Its usage with the word "any" shows that the definition of document is comprehensive.

(ii) **Record**—This second element must be certain mutual or mechanical device employed on the substance. It must be by writing, expression or description.

(iii) **Substance**—This is the third element on which a mental or intellectual elements comes to find a permanent form.

(iv) **Means**—This represents forth element by which such permanent form is acquired and those can be letters, any figures, marks, symbols which can be used to communicate between two persons.

'Instrument': In common parlance, 'instrument' means a formal legal document which creates or confirms a right or records a fact. It is a formal writing of any kind, such as an agreement, deed, charter or record, drawn up and executed in a technical form. It also means a formal legal document having legal effect, either as creating a right or liability or as affording evidence of it.

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.

'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. However, in India no distinction seems to be made between instruments and deeds.

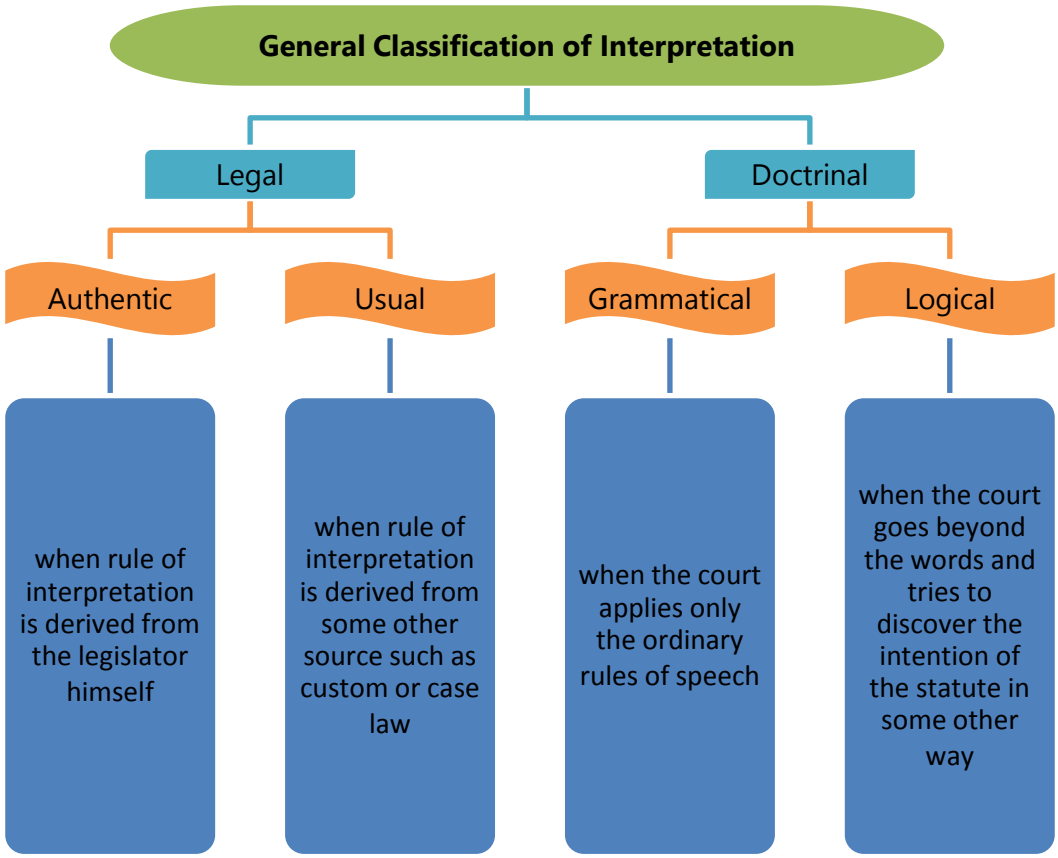
'Interpretation': By interpretation is meant the process by which the Courts seek to ascertain the meaning of the legislature through the medium of the words in which it is expressed. Simply stated, 'interpretation' is the process by which the real meaning of an Act (or a document) and the intention of the legislature in enacting it (or of the parties executing the document) is ascertained.

Interpretation is resorted to in order to resolve any ambiguity in the statute. It is the art of finding out the true sense of words that is to say the sense in which their author intended to convey the subject matter.

Importance of Interpretation: Interpretation, thus, process of considerable significance. In relation to statute law, interpretation is of importance because of the inherent nature of legislation as a source of law. The process of statute making and the process of interpretation of statutes take place separately from

each other, and two different agencies are concerned. Interpretation serves as the bridge of understanding between the two.

Classification of Interpretation:



Jolowicz, in his **Lectures on Jurisprudence** (1963 ed., p. 280) speaks of interpretation thus:

Interpretation is usually said to be either 'legal' or 'doctrinal'. It is 'legal' when there is an actual rule of law which binds the Judge to place a certain interpretation of the statute. It is 'doctrinal' when its purpose is to discover 'real' and 'true' meaning of the statute.

'Legal' interpretation is sub-divided into 'authentic' and 'usual'. It is 'authentic' when rule of interpretation is derived from the legislator himself; it is 'usual' when it comes from some other source such as custom or case law. Thus, when Justinian ordered that all the difficulties arising out of his legislation should be

referred to him for decision, he was providing for 'authentic' interpretation, and so also was the Prussian Code, 1794, when it was laid down that Judges should report any doubt as to its meaning to a Statute Commission and abide by their ruling.

'Doctrinal' interpretation may again be divided into two categories: '**grammatical'** and '**logical'**. 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. On the other hand, when the court goes beyond the words and tries to discover the intention of the statute in some other way, then it is said resort to what is called a 'logical' interpretation.

According to **Fitzerald**, interpretation is of two kinds – 'literal' and 'functional'. The literal interpretation is that which regards conclusively the verbal expression of the law. It does not look beyond the 'literaligis'. The duty of the Court is to ascertain the intention of the legislature and seek for that intent in every legitimate way, but first of all in the words and the language employed. 'Functional' interpretation, on the other hand, is that which departs from the letter of the law and seeks elsewhere for some other and more satisfactory evidence of the true intention of the legislature. In other words, it is necessary to determine the relative claims of the letters and the spirit of the enacted law. In all ordinary cases, the Courts must be content to accept the letter of the law as the exclusive and conclusive evidence of the spirit of the law **(Salmon: Jurisprudence**, 12th ed., pp. 131-132). It is essential to determine with accuracy the relations which subsist between the two methods.

'Construction' as applied to a written statute or document means to determine from its known elements its true meaning or the intention of its framers. Construction involves drawing conclusions beyond the actual expressions used in the text. This is done by referring to other parts of the enactment and the context in which the law was made. Thus, when you construe a statute you are attempting to ascertain the intention of the legislature.

Difference between Interpretation and Construction:

It would also be worthwhile to note, at this stage itself, the difference between the terms **'Interpretation' and Construction**. While more often the two 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.

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 drawing of conclusions from a statute that lie beyond the direct expression of the words used therein. *[Bhagwati Prasad Kedia v. C.I.T, (2001)]*

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. Words of legal import occurring in a statute which have acquired a definite and precise sense, must be understood in that sense. *(State of Madras v. Gannon Dunkerly Co. AIR 1958)*

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.

2. WHY DO WE NEED INTERPRETATION/ CONSTRUCTION?

While every care is taken to ensure that laws framed for passing by the legislature are free from ambiguity and absurdity, it is scarcely possible to express them in such terms as shall be free from all ambiguity. Such a degree of precision is perhaps unattainable. Similarly, the legislators cannot foresee all contingencies at the time of the passing of the law. This is further compounded by the want of views sufficiently comprehensive as to the "intention of the legislation". It is quite possible that the words of a statute are vague, ambiguous or reasonably capable of more than one meaning. It is then that a need for interpretation or construction arises.

Hence rules of interpretation are required in order to ensure just and uniform decisions.

No better explanation can be given for the need for interpretation than that provided by Denning L.J., that ultimate repository of legal erudition:

"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. The English language is not an instrument of mathematical precision. Our literature would be much the poorer if it were. This is where the draftsmen of Acts of Parliament have often been unfairly criticized. A judge, believing himself to be fettered by the supposed rule that he must look to the language and nothing else, laments 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, and of the mischief which it was passed to remedy, and then he must supplement the written word so as to give 'force and life' to the intention of the legislature".

It has been rightly said that a statute is the will of the legislature. The fundamental rule of interpretation of a statute is that it should be expounded according to the intent of those that made it. In the event of the words of the statute being precise and unambiguous in themselves it is only just necessary to expound those words in their natural and ordinary sense. Thus far and no further. This is because these words distinctly indicate the intention of the legislature. The purpose of interpretation is to discern the intention which is conveyed either expressly or impliedly by the language used. If the intention is express, then the task becomes one of 'verbal construction' alone. But in the absence of any intention being expressed by the statute on the question to which it gives rise and yet some intention has to be, of necessity, imputed to the legislature regarding it, then the interpreter has to determine it by inference based on certain legal principles. In such a case, the interpretation has to be one which is commensurate with the public benefit. Consequently, if a statute levies a penalty without expressly mentioning the recipient of the penalty, then, by implication, it goes to the coffers of the State.

As we have noted earlier, 'interpretation' may be either **'grammatical' or 'logical'.** Grammatical or literal interpretation concerns itself with the words and expressions used in a statute and only that. In other words, the emphasis in grammatical interpretation is on "what the law says." The Logical interpretation, on the other hand, seeks to ascertain "what the law means".

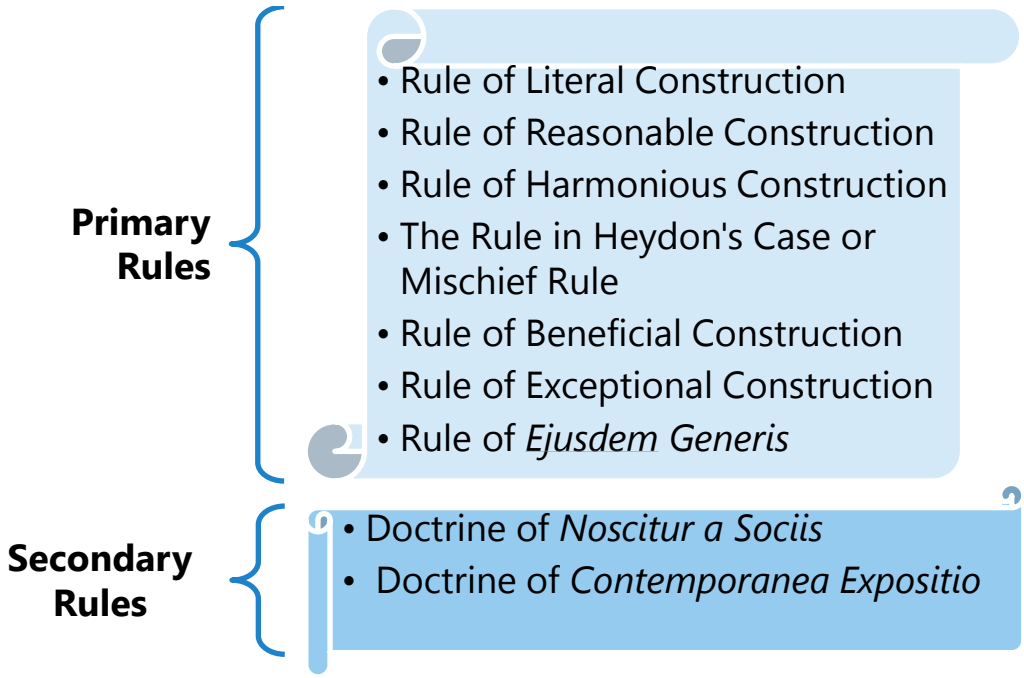
Normally, grammatical interpretation is the only approach to be adopted. The court cannot add to or modify a single word or phrase used in an enactment. This is based on the principle of *absoluta sententia expositore non indiget* meaning "clear words need no explanation."

However, where the grammatical interpretation leads to a manifest absurdity or is logically flawed, the courts can adopt the logical interpretation that will advance the true purpose or intention of the legislation rather than reduce it to a futility. Where there are two constructions reasonably applicable to a provision, one of which is mechanical and based on the rules of grammar, while the other is vibrant and more in tune with the basic intention of the Act of Parliament, the latter shall be preferred to the former. (*Arora v. State of UP*)

But where the law is clear and unambiguous the court shall construe it based on the strict grammatical meaning. The law when clear shall be strictly applied, however harsh or burdensome it may be. The court shall administer the law as it stands and shall not attempt an alternative interpretation based on logic that is ostensibly just or reasonable.

3. RULES OF INTERPRETATION/ CONSTRUCTION

Over a period, certain rules of interpretation/construction have come to be well recognized. However, these rules are considered as guides only and are not inflexible. These rules can be broadly classified as follows:



(A) PRIMARY RULES

(1) Rule of Literal Construction:

The first and primary rule of construction is that the intention of the legislature must be found in the words used by the legislature itself. Thus, if the words of a statute are capable of one construction only, then it would not be open to the courts to adopt any hypothetical construction on the ground that such hypothetical construction is more consistent with the alleged object and policy of the Act.

It is a cardinal rule of construction that a statute must be construed literally and grammatically giving the words their ordinary and natural meaning. Therefore, the language used in the statute must be construed in its grammatical sense. The correct course is to take the words themselves and arrive if possible, at their meaning without reference to cases, in the first instance.

If the phraseology of a statute is clear and unambiguous and capable of one and only one interpretation, then it would not be correct to extrapolate these words out of their natural and ordinary sense. When the language of a statute is plain and unambiguous it is not open to the courts to adopt any other hypothetical

construction simply with a view to carrying out the supposed intention of the legislature.

Thus, it is the primary duty of the court to interpret the words used in legislation according to their ordinary grammatical meaning in the absence of any ambiguity or doubt.

Normally, where the words of a statute are in themselves clear and unambiguous, then these words should be construed in their natural and ordinary sense and it is not open to the court to adopt any other hypothetical construction. This is called the rule of literal construction.

This principle is contained in the Latin maxim "*absoluta sententia expositore non indiget*" which literally means "an absolute sentence or preposition needs not an expositor". In other words, **plain words require no explanation**.

Sometimes, occasions may arise 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.

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 without reservation or suppression, as, for instance 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.

Similarly, when a matter which should have been, but has not been, provided for in a statute cannot be supplied by courts as to do so would amount to legislation and would not be construction.

This Rule of literal interpretation can be read and understood under the following headings:

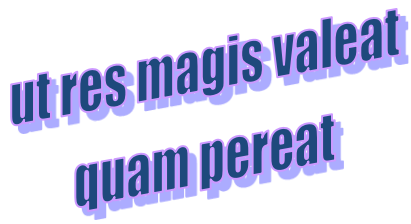
Natural and grammatical meaning: Statutes are to be first understood in their natural, ordinary, or popular sense and must be construed according to their plain, literal and grammatical meaning. If there is an inconsistency with any express intention or declared purpose of the statute, or it involves any absurdity, repugnancy, inconsistency, the grammatical sense must then be modified, extended or abridged only to avoid such an inconvenience, but no further. *[(State of HP v. Pawan Kumar (2005)]*

Example 2: In a question before the court whether the sale of betel leaves was subject to sales tax. The Supreme Court 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)*

Technical words are to be understood in technical sense: This point of literal construction is that technical words are understood in the technical sense only.

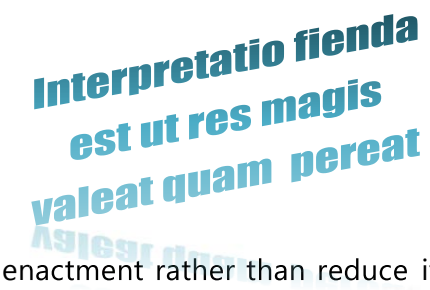
In construing the word 'practice' in the Supreme Court Advocates Act, 1951, it was observed that practice of law generally involves the exercise of both the functions of acting and pleading on behalf of a litigant party. When legislature confers upon an advocate the right to practice in a court, it is 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)*

(2) Rule of Reasonable Construction:



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.



Similarly, when the grammatical interpretation leads to a manifest absurdity then the courts shall interpret the statute so as to resolve the inconsistency and make the enactment a consistent whole. This principle is based on the rule that the words of a statute must be construed reasonably so as to give effect to the enactment rather than reduce it to a futility. This principle is contained in the Latin maxim, ***Interpretatio fienda est ut res magis valeat quam pereat***. In short, Statutes should be construed grammatically.

Thus, when grammatical interpretation leads to certain absurdity, it is permissible to depart there from and to interpret the provision of the statutes in a manner so as to avoid that absurdity. This departure from the grammatical construction is permissible only to the extent it avoids such absurdity and no further. This is also called the Golden Rule of Interpretation.

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 provided the Court does not have to resort to conjecture or surmise. A reasonable construction will be adopted in accordance with the policy and object of the statute.

(3) Rule of Harmonious Construction:

It is a recognized rule of interpretation of statutes and deeds that the expressions used therein should ordinarily be understood in a sense in which they best harmonize with the object of the statute. The opposite of "harmony" is conflict. Thus, this rule is applied when there is a conflict between two provisions of a statute. Similarly, 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.

Thus, where an expression is susceptible of a narrow or technical meaning, as well as a popular meaning, the court would be justified in assuming that the legislature used the expression in the sense, which would carry out its objects and

reject that which renders it invalid. (*New India Sugar Mills Ltd., v. Commissioner, Sales Tax*)

It is a basic rule of interpretation that if it is possible to avoid a conflict between two provisions on a proper construction thereof, then it is the duty of the court to so construe them that they are in harmony with each other. The statute must be read as a whole and every provision in the statute must be construed with reference to the context and other clauses in the statute so as to make the statute a consistent enactment and not reduce it to a futility. But where 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"***.

But remember that this rule can be adopted only when there is a real and not merely apparent conflict between provisions, where the words of a statute, on a reasonable construction thereof, admit of one meaning only then such natural meaning will prevail. The court shall not attempt an interpretation based on equity and harmonious construction.

In some cases, the statute may give a clear indication as to which provision is subservient and which overrides. This is done by the use of the terms "subject to", "notwithstanding" and "without prejudice".

Subject to

The impact of 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. This limitation cannot operate, when the subject matter of the two provisions is not the same. Thus, a clause that uses the words "subject to" is subservient to another.

Example 3: Section 13(2) of the Companies Act, 2013, "Any change in the name of a company shall be subject to the provisions of sub-sections (2) and (3) of section 4 and shall not have effect except with the approval of the Central Government in writing."

This implies that the any change in the name of the company has to in accordance with the provisions of the section 4(2) and section 4(3) of the Companies Act, 2013.

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. (*K. Parasurammaiah v. Pakari Lakshman AIR 1965 AP 220)*

Example 4: A notwithstanding clause can operate at four levels.

	Clause	***Effect***	***Example***
1.	Notwithstanding any thing contained in another section or sub– section of that statute.	The clause will override such other section(s) / sub-section(s)	Section 42(11) of the Companies Act, 2013 "(11) Notwithstanding anything contained in sub-section (9) and sub-section (10), any private placement issue not made in compliance of the provisions of sub-section (2) shall be deemed to be a public offer and all the provisions of this Act and the Securities Contracts (Regulation) Act, 1956 and the Securities and Exchange Board of India Act, 1992 shall be applicable."
2.	Notwithstanding anything contained in a statute.	The clause will override the entire enactment.	Section 8(8) of the Companies Act, 2013

			"(8) ..... amalgamated with another company registered under this section and having similar objects, then, notwithstanding anything to the contrary contained in this Act, the Central Government may, by order, provide for such amalgamation to form a single company with such constitution....."
3.	Notwithstanding anything contained in specific section(s) or sub-section(s) or all the provisions contained in another statute.	The clause will prevail over the other enactment.	(i) Section 7A of the Securities Contracts (Regulation) Act, 1956 "...and on such publication, the rules as approved by the Central Government shall be deemed to have been validly made notwithstanding anything contained in the Companies Act, 1956." (ii) Section 183 of the Companies Act, 2013 "183(1) The Board of Directors of any company or any person or authority exercising the powers of the Board of Directors of a company, or of the company in general meeting, may, notwithstanding anything contained in sections 180, 181 and section 182 or any other provision of this Act or in the memorandum, articles or any other instrument relating to the company, contribute such amount as it thinks fit to the National Defence Fund or any

			other Fund approved by the Central Government for the purpose of national defence."
4.	Notwithstanding anything contained in any other law for the time being in force.	The clause will override all other laws.	(i) Section 8 of the Securities Contracts (Regulation) Act,1956 "... the rules so made are amended shall, notwithstanding anything to the contrary contained in the Companies Act, 1956, or in any other law for the time being in force, have effect...". (ii) Section 243(1B) of the Companies Act, 2013 "Notwithstanding anything contained in any other provisions of this Act, or any other law for the time being in force, or any contract, memorandum or articles, on the removal of a person from the officer of a director or any other officer connected with the conduct and management of the affairs of the company, that person shall not be entitled to, or be paid, any compensation for the loss or termination of officer."

Without prejudice

When certain particular provisions follow general provisions and when it is stated that the particular provisions are without prejudice to those general provisions the particular provisions would not restrict or circumscribe the operation and generality of the preceding general provisions. In other words, the particular provisions shall operate in addition to and not in derogation of the general provisions.

Example 5: Section 4(3) of the Companies Act, 2013, "Without prejudice to the provisions of sub-section (2), a company shall not be registered with a name which contains……"

This implies that while registering (and deciding) the name of the company [as per section 4(3)], provisions of section 4(2) shall also be operative.

(4) The Rule in Heydon's Case 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 *Heydon's case*.

The intention of this rule is always to make such construction as shall suppress the mischief and advance the remedy according to the true intention of the legislation.

In *Heydon's case (1584 3 Co Rep 79 P. 637), i*t was laid down by the Barons of the Exchequer that "for the true and sure interpretation of all Statutes in general, four things are to be discerned and considered.

1. What was the law before the making of the act?
2. What was the defect, mischief, hardship caused by the earlier law?
3. How does the act of Parliament seek to resolve or cure the mischief or deficiency?
4. What are the true reasons for the remedy?

And then the courts shall make such construction as will suppress the mischief and advance the remedy and suppress the subtle inventions and evasions for the continuance of the mischief."

Thus, applying Heydon's case courts will be bound to look at the state of the law at the time of the passing of the enactment and not only as it then stood, but under previous Statutes too.

In India, in *Kanai Lal Paramnidhi, 1957 S.C.A 1033*, the Hon'ble Supreme Court held that the observations made by the Chief Baron and Barons of the Exchequer in *Heydon's Case 1584 3 Co Rep. 79*, have been so frequently cited with approval by the courts administering provisions of welfare enactments that they have now attained the status of a classic on the subject and their validity cannot be challenged.

But the mischief rule can be applied only if there is any ambiguity in the present law. *(CIT Vs. Sodra Devi, 1957 SC 823 at 832 – 835).*

Example 6: Application of this mischief rule is also well-found in the construction of section 2(d) of the Prize Competition Act, 1955. This section 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 was whether the Act applies to competitions which involve substantial skill and are not in the nature of gambling. Supreme Court, after referring to the previous state of law, 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 has stated as follows: "having regard to the history of the legislation, the declared object thereof and the wording of the statute, we are of opinion 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).*

(5) Rule of Beneficial Construction:

This is strictly speaking not a rule but a method of interpreting a provision liberally so as to give effect to the declared intention of the legislation. Beneficial construction will be given to a statute, which brings into effect provisions for improving the conditions of certain classes of people who are under privileged or who have not been treated fairly in the past. In such cases it is permissible to give an extended meaning to words or clauses in enactments. But this can only be done when two constructions are reasonably possible and not when the words in a statute are quite unequivocal.

(6) Rule of Exceptional Construction:

We have already seen that the words of a statute must be construed so as to give a sensible meaning to them if possible. They ought to be construed *ut res magis valeat quam pereat.*

In fact, Maxwell goes to the extent of stating, "notwithstanding the general rule that full effect must be given to every word, yet if no sensible meaning can be given to a word or phrase, or if it would defeat the real object of the enactment, it may, or rather it should, be eliminated."

"And" and "Or"

"And" is a particle joining words and sentences and expressing the relation of connection or addition. The word "and" is normally conjunctive. In its conjunctive sense the word is used to conjoin words, clauses or sentences, signifying that something is to follow in addition to that, which precedes.

The word "or" is a disjunctive particle that marks an alternative, generally corresponding to "either", as "either this or that".

Can "and" be read as "or" and vice versa?

The word "and" is normally conjunctive, while "or" is disjunctive. But sometimes "and" is read as "or" and vice versa to give effect to the manifest intention of the legislature as disclosed from the context. (*Municipal Council v. Bishandas Nathumal AIR 1969 MP 147).*

"And" may legitimately be construed as "or" when the intention of the legislature is clear and when any other construction would tend to defeat such intention. *(Amulya Chandra Roy v. Pashupathi Nath AIR 1951 Cal 48).*

Not only in Statutes but also in documents the two words "and" and "or" are sometimes used synonymously and in the same sense. That would depend on the context and meaning of other provisions in the same statute or document. Similarly, where statements or stipulations are coupled by "and/or" they are to read either disjunctively or conjunctively.

"May", "Must" and "Shall"

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.

The words 'may', 'shall', and 'must' should initially be deemed to have been used in their natural and ordinary sense.

'May' signifies permission and implies that the authority has been allowed discretion. "Shall" in the normal sense imports a command. 'Must' is doubtlessly a word of command. In all cases, however, the intention of the legislature will guide the interpreter in his search of meaning.

The question as to whether a statute is mandatory depends upon the intent of the legislature and not upon the language in which the intent is clothed.

- 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.

Where the word 'may' has been used as implying a requisite condition to be fulfilled, the court will and ought to exercise the powers which it should and in such a case the word 'may' will have a compulsory force.

"May," observed Cotton, L.J., "can never mean 'must' so long as the English language retains its meaning; but it gives a power and then it may be a question, in what case, when any authority or body has a power given to it by the word 'may' it becomes its duty to exercise that power." [*In re Baker Nichols v. Baker (1890) 44 Ch. D. 262*].

"Shall" though mandatory is to be read as may.

It is well – settled that the use of the word 'shall' does not always mean that the enactment is obligatory or mandatory; it depends upon the context in which the word 'shall' occurs and the other circumstances.

The employment of the auxiliary verb 'shall' is inconclusive and similarly the mere absence of the imperative is not conclusive either.

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.

(7) Rule of Ejusdem Generis:

The term 'ejusdem generis' means 'of the same kind or species'. Simply stated, the rule is as follows:

Where specific words pertaining to a class or category or genus are followed by general words, the general words shall be construed as limited to the things of the same kind as those specified.

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.

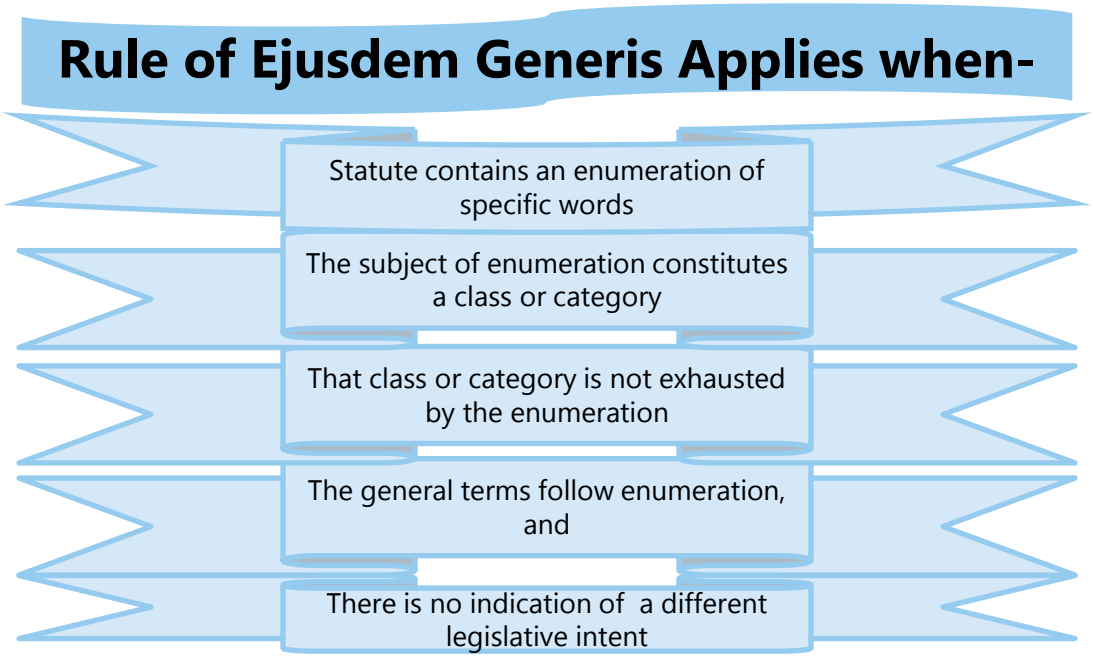
The rule of ejusdem generis is not an absolute rule of law but only a part of a wider principle of construction and therefore this rule has no application where the intention of the legislature is clear.

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.



(B) OTHER (SECONDARY) RULES OF INTERPRETATION

(1) Doctrine of *Noscitur a Sociis*

Noscitur a Sociis means that when two or more words that are susceptible of analogous meaning, are coupled together they are understood to be used in their cognate sense. They take, as it were, their colour from each other, that is the meaning of the more general word being restricted to a sense analogous to that of the less general.

Examples of the principal of *Noscitur a Sociis* are as follows:

Fresh orange juice is not a fruit juice.

While dealing with a Purchase Tax Act, which used the expression "manufactured beverages including fruit-juices and bottled waters and syrups".

It was held that the description 'fruit juices' as occurring therein should be construed in the context of the preceding words and that orange-juice unsweetened and freshly pressed was not within the description. (*Commissioners. v. Savoy Hotel, (1966) 2 All. E.R. 299)*

Private Dispensary of a doctor is not a commercial establishment

In dealing with the definition of commercial establishment in Section 2 (4) of the Bombay Shops and Establishments Act, 1948, which reads, "commercial establishment means an establishment which carries on any business, trade or profession", the word 'profession' was construed with the associated words 'business' and 'trade' and it was held that a private dispensary of a doctor was not within the definition. (*Dr. Devendra M. Surti v. State of Gujrat, A.I.R. 1969 SC 63*)

(2) Doctrine of *Contemporanea Expositio*

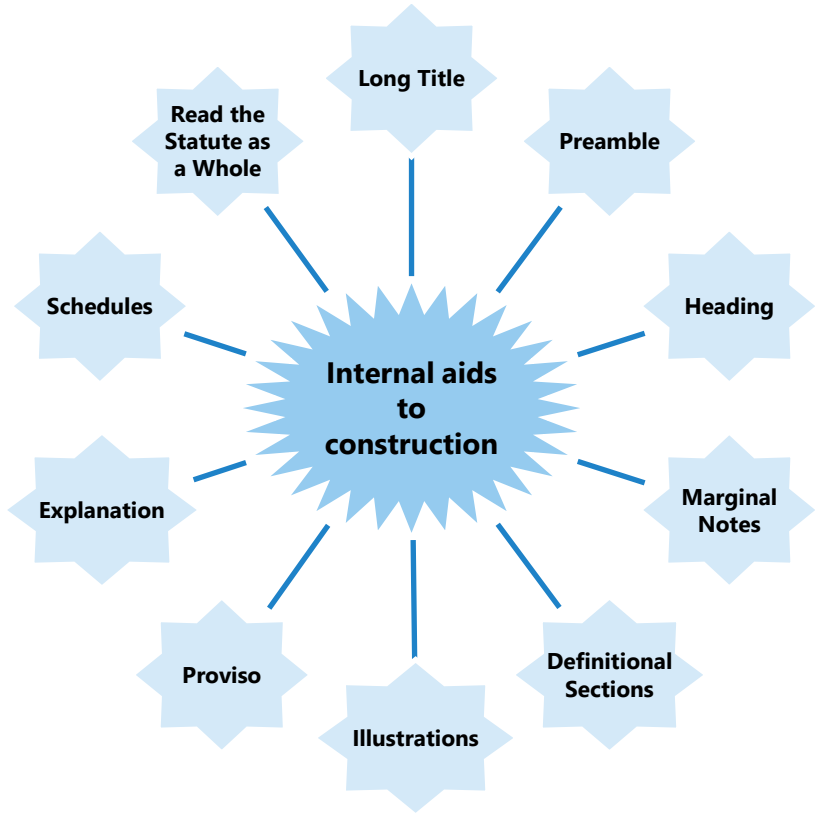
This doctrine is based on the concept that a statute or a document is to be interpreted by referring to the exposition it has received from contemporary authority. The maxim "*Contemporanea Expositio est optima et fortissinia in lege*" means "contemporaneous exposition is the best and strongest in the law." This means a law should be understood in the sense in which it was understood at the time when it was passed.

The maxim "*optima legum interpres est consuetude*" simply means, "Custom is the best interpreter of law". Thus, the court was influenced in its construction of a statute of Anne by the fact that it was that which had been generally considered as the true one for one hundred and sixty years. *(Cox Vs. Leigh 43 LJQB 123).*

But remember that this maxim is to be applied for construing ancient statutes, but not to Acts that are comparatively modern.

4. INTERNAL AIDS TO INTERPRETATION/ CONSTRUCTION

The various parts of an enactment enumerated below may be referred to while interpreting or construing an enactment. They are referred to as internal aids to interpretation and can be of immense help in interpreting/construing the enactment or any of its parts.



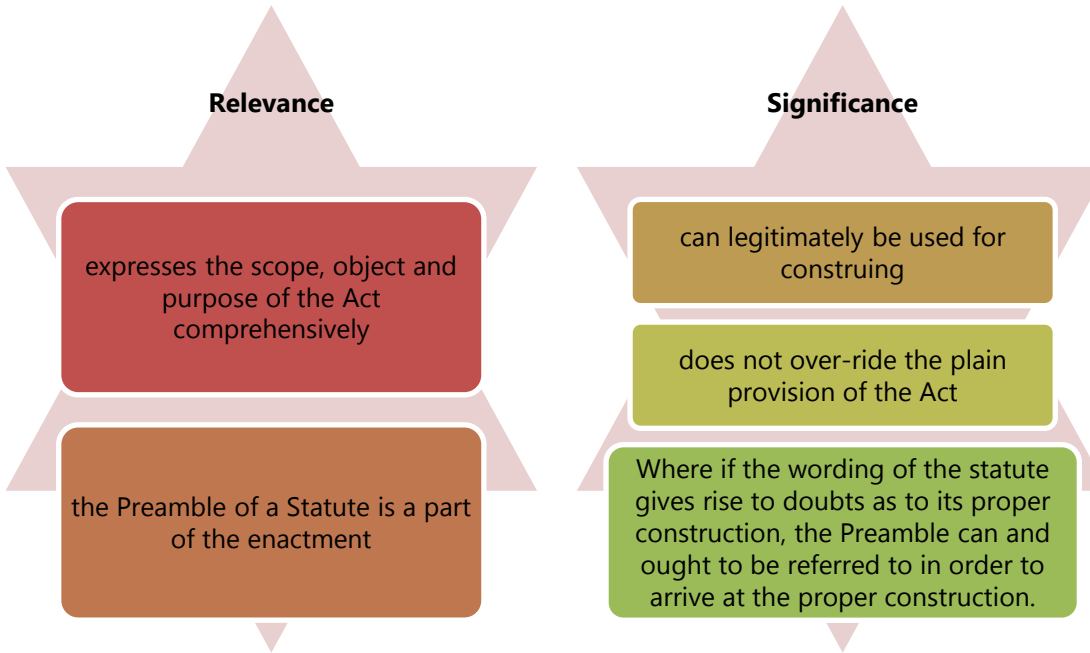
(a) Long Title:

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.

Example 7: Full title of the Supreme Court Advocates (Practice in High Courts) Act, 1951 specify that this is an Act to authorize Advocates of the Supreme Court to practice as of right in any High Court.

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.

Like the Long Tile, the Preamble of a Statute is a part of the enactment and can legitimately be used 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 have 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 8: 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]*

(c) Heading and Title of a Chapter:

If we glance through any Act, we would generally find that a number of its sections referring to a particular subject are grouped together, sometimes in the form of chapters, prefixed by headings 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.

The headings of different portions of a Statute can be referred to determine the sense of any doubtful expression in a section ranged under any particular heading.

They cannot control the plain meaning of the words of the enactment though, they may, in some cases be looked at in the light of preamble if there is any ambiguity in the meaning of the sections on which they can throw light.

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. (*Official assignee v. chuni ram AIR 1933 BOM 51)*

(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. v. 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]*

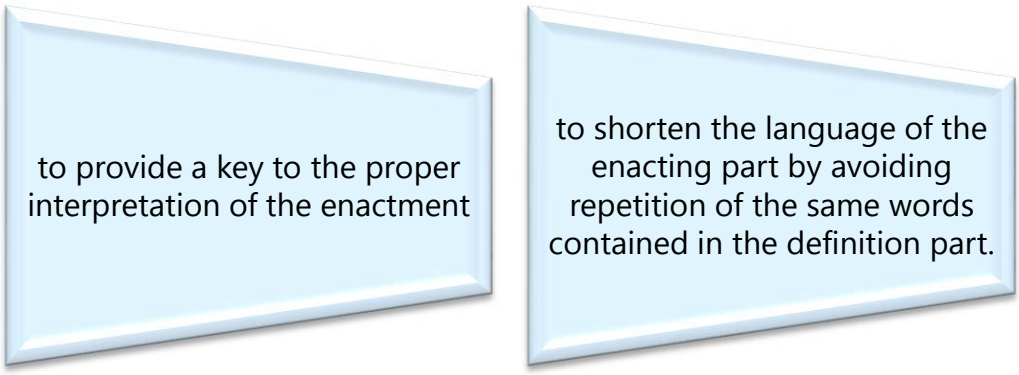
However, marginal notes appended to Articles of the Constitution have been held to be part of the Constitution as passed by the Constituent Assembly and therefore have been used in construing the Articles.

(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 unless there be anything repugnant in the context. This is called an exhaustive definition. The Court cannot ignore an exhaustive 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.

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.

We may also find a word being defined as **'means and includes'** such and such. In this case, the definition would be exhaustive.

On the other hand, if the word is defined '**to apply to and include',** the definition is understood as extensive.

Example 9: The usage of word 'any' in the definition connotes extension for 'any' is a word of every wide meaning and prima facie the use of it excludes limitation.

It has been a universally accepted principle that where an expression is defined in an Act, it must be taken to have, throughout the Act, the meaning assigned to it by the definition, unless by doing so any repugnancy is created in the subject or context.

Example 10: Inclusive definition of lease given under section 2(16)(c) of the Stamp Act, 1899 has been widely construed to cover transaction for the purpose of Stamp Act which may not amount to a lease under section 105 of the Transfer of property Act, 1882. *[State of Uttarakhand v. Harpal Singh Rawat, (2011) 4 SCC 575]*

Section 2(m) of the Consumer Protection Act, 1986 contains an inclusive definition of 'person'. 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]*

A definition section may also be worded as '**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 11: If A is deemed to be B, compliance with A is in law compliance with B and contravention of A is in law contravention of B.

(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, realising that the function of a definition is to give accuracy and certainty to a word or phrase which would otherwise be vague and uncertain but not to contradict it or depose it altogether.

Example 12: 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. These illustrations follow the text of the Sections and, therefore, do not form a part of the Sections. 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.

Example 13: In holding that section 73 of the Indian Contract Act, 1872 does not permit the award of interest as damages for mere detention of debt, the privy Council rejected the argument that illustration given in the Act can be used for arriving at a contrary result. It was observed that nor can an illustration have the effect of modifying the language of the section which alone forms the enactment.

(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. Usually, a proviso is embedded in the main body of the section and becomes an integral part of it. Provisos that are so included begin with the words, "provided that". The effect of the proviso is to qualify the preceding enactment which is expressed in terms which are too general. As a general rule, a proviso is added to an enactment to qualify or create an exception to what is in the enactment. Ordinarily a proviso is not interpreted as stating a general rule.

- Exception clauses are intended to restrain the enacting clause to particular cases.
- Savings clause is used to preserve from destruction certain rights, remedies, or privileges already existing.

It is a cardinal rule of interpretation that a proviso or exception to a particular provision of a statute only embraces the field which is covered by the main provision. It carves out an exception to the main provision to which it has been enacted as a proviso and to no other. *(Ram Narain Sons Ltd. vs. Assistant Commissioner of Sales Tax, AIR 1955 SC 765)*.

Distinction between Proviso, exception and saving Clause		
'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

(h) Explanation:

An Explanation is at times appended to a section to explain the meaning of certain words or phrases used in the section or of the purport 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:

- Explain the meaning and intendment of the Act itself
- Clarify any obscurity and vagueness (if any) in the main enactment to make it consistent with the object
- Provide an additional support to the object of the Act to make it meaningful and purposeful
- Fill up the gap which is relevant for the purpose of the explanation to suppress the mischief and advance the object of the Act
- Cannot take away a statutory right

However, it would be wrong to always construe an explanation as limited to the aforesaid objects. The meaning to be given to an explanation will really depend upon its terms and not on any theory of its purpose.

(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. They often contain details and forms for working out the policy underlying the sections of the statute **for example** schedules appended to the Companies Act, 2013, to the Constitution of India.

(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.

One of the safest guides to the construction of sweeping general words is to examine other words of like import in the same enactment or instrument to see what limitations must be imposed on them. If we find that a number of such expressions have to be subjected to limitations and qualifications and that such limitations and qualifications are of the same nature,that circumstance forms a strong argument for subjecting the expression in dispute to a similar limitation and qualification.

Example 14: 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.

5. 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 apply to enactments as well. 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. These matters are called external aids. Some of these factors are enumerated below:

External Aids					
Historical Setting	Consolidating Statutes & Previous Law	Usage	Earlier & Later Acts and Analogous Acts	Dictionary Definitions	Use of Foreign Decisions

(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, for this purpose, to take help from all those external or historical facts which are necessary in the understanding and comprehension of 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. We have also to consider whether the statute in question was intended to alter the law or leave it where it stood before.

(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:

Usage is also sometimes taken into consideration in construing an Act. 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. It has been emphasized that when a legislative measure of doubtful meaning has, for several years, received an interpretation which has generally been acted upon by the public, the Courts should be very unwilling to change that interpretation, unless they see cogent reasons for doing so.

(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. in an analogous case), 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 be 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.

Where the later of the two Acts provides that the earlier Act should, so far as consistent, be construed as one with it then an enactment in the later statute that nothing therein should include debentures was held to exclude debentures from the earlier statute as well.

Where a single section of one Act (say, Act 'A') is incorporated into another statute (say Act 'B'), it must be read in the sense which it bore in the original Act from which it is taken consequently, it would be legitimate to refer to all the rest of Act 'A' to ascertain what that Section means, though one Section alone is incorporated in the new Act (Act 'B').

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, the later bye-law would be so construed as to harmonise and not to conflict with the earlier 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.

- **Earlier Act Explained by the Later Act:** Not only may the later Act be construed in the light of the earlier Act but it (the later Act) sometimes furnishes a legislative interpretation of the earlier one, if it is '*pari materia*' and if, but only if, the provisions of the earlier Act are ambiguous.

  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. 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.

(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. However, prime importance is always to be given to the language of the Indian statute. Further, where guidance can be obtained from Indian decisions, reference to foreign decisions may become unnecessary.

6. RULES OF INTERPRETATION/ CONSTRUCTION OF DEEDS AND DOCUMENTS

The first and foremost point that has to be borne in mind 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 principle of construction in case of a document and a deed, as of statute, does not differ so much except in some minor details. A 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 in harmony with other provisions if that interpretation does no violence to the meaning of which they are naturally susceptible. – Lord Watson. In all cases endeavour shall be made to find out how a reasonable and well-informed person would understand by the words used in the deed or document.

The golden rule of construction is to ascertain the intention of the parties to the instrument after considering all the words in their ordinary, natural sense. To ascertain this intention the Court has to consider the relevant portion of the document as a whole and also to take into account the circumstances under which the particular words were used. Very often the status and the training of the parties using the words have to be taken into consideration.

It has to be borne in mind that very many words are used in more than one sense and that sense differs in different circumstances. Again, even where a particular word has to a trained conveyancer a clear and definite significance and one can be sure about the sense in which such conveyancer would use it, it may not be reasonable and proper to give the same strict interpretation of the word when

used by one who is not so equally skilled in the art of conveyancing. (*Ramkishorelal v. Kamalnarayan, 1963 (Sup.) 2 S.C. R. 417*).

It is inexpedient to construe the terms of one deed by reference to the terms of another. (*Nirmala Bala Ghose v. Balai Chand Ghose (1965) 2 S.C. W.R. 988*). It is an elementary rule of construction that the same word cannot have two different meanings in the same document, unless the context compels the adoption of such a course. (*Kultar Singh v. Mukhtiar Singh, 1964, 7 S.C.R. 790*). The document must be read as a whole and the intention deduced therefrom as to what the actual term the parties intended to agree.

It may also happen that there is a conflict between two or more clauses 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.

Similarly, if one part of the document is in conflict with another part, an attempt should always be made to read the two parts of the document harmoniously, if possible. If that is not possible, then the earlier part will prevail over the latter one which should, therefore, be disregarded.

SUMMARY

Enacted laws, Acts and Rules are drafted by legal experts and so it is expected that the language used will leave little room for interpretation of construction. Interpretation or construction of Statutes helps in finding of the meaning of ambiguous words and expressions given in the Statutes and resolving inconsistency lying therein. If any provision of the statute is open to two interpretations, the Court has to choose that interpretation which represents the true intention of the legislature. The best interpretation of Statutes is possible by adoption of various guiding rules of construction and aids to construction of Statutes. The courts are the best interpreters. They strongly lean against a construction which reduces the statute to a futility. A statute or any enacting provision therein must be so construed as to make it effective and operative on the principle expressed in the maxim: *ut res magis valeat quam pereat*.

TEST YOUR KNOWLEDGE

MCQ based Questions

1. *The Rule in Heydon's case is also known as—*

   (a) Purposive construction

   (b) Mischief Rule

   (c) Golden Rule

   (d) Exceptional Construction

2. *Pick the odd one out of the following aids to interpretation—*

   (a) Preamble

   (b) Marginal Notes

   (c) Proviso

   (d) Usage

3. *_____ is the cardinal rule of construction that words, sentences and phrases of a statute should be read in their ordinary, natural and grammatical meaning so that they may have effect in their widest amplitude.*

   (a) Rule of Literal Construction

   (b) Rule of Harmonious Construction

   (c) Rule of Beneficial Construction

   (d) Rule of Exceptional Construction

4. *An internal aid that may be added to include something within the section or to exclude something from it, is—*

   (a) Proviso

   (b) Explanation

   (c) Schedule

   (d) Illustrations

5. *When there is a conflict between two or more statues or two or more parts of a statute then which rule is applicable:*

   (a) Welfare construction

   (b) Strict construction

   (c) Harmonious construction

   (d) Mischief Rule

Descriptive Questions

1. *Explain the rule in 'Heydon's Case' while interpreting the Statutes quoting an example.*

2. *Explain the principles of "Grammatical Interpretation" and "Logical Interpretation" of a Statute. What are the duties of a court in this regard?*

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?

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?*

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.

6. *Differentiate Mandatory Provision from a Directory Provision. What factors decide whether a provision is directory or mandatory?*

7. *Define Grammatical Interpretation. What are the exceptions to grammatical interpretation?*

8. *When can the Preamble be used as an aid to interpretation of a statute?*

9. *Explain how 'Dictionary Definitions' can be of great help in interpreting/ constructing an Act when the statute is ambiguous.*

10. *Preamble does not over-ride the plain provision of the Act. Comment. Also give suitable example.*

11. *At the time of interpreting a Statute what will be the effect of 'Usage' or 'customs and Practices'?*

ANSWERS

Answer to MCQ based Questions

1.	**(b)**	Mischief Rule
2.	**(d)**	Usage
3.	**(a)**	Rule of Literal Construction
4.	**(b)**	Explanation
5.	**(c)**	Harmonious construction

Answer to Descriptive Questions

1. 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. **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)** 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. v. 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. 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. **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. 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. 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:

(i) 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.

(ii) 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. 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. **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:** 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. **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 Expositio 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 expositio* to interpret not only ancient but even recent statutes in India.

NOTES

CHAPTER 3

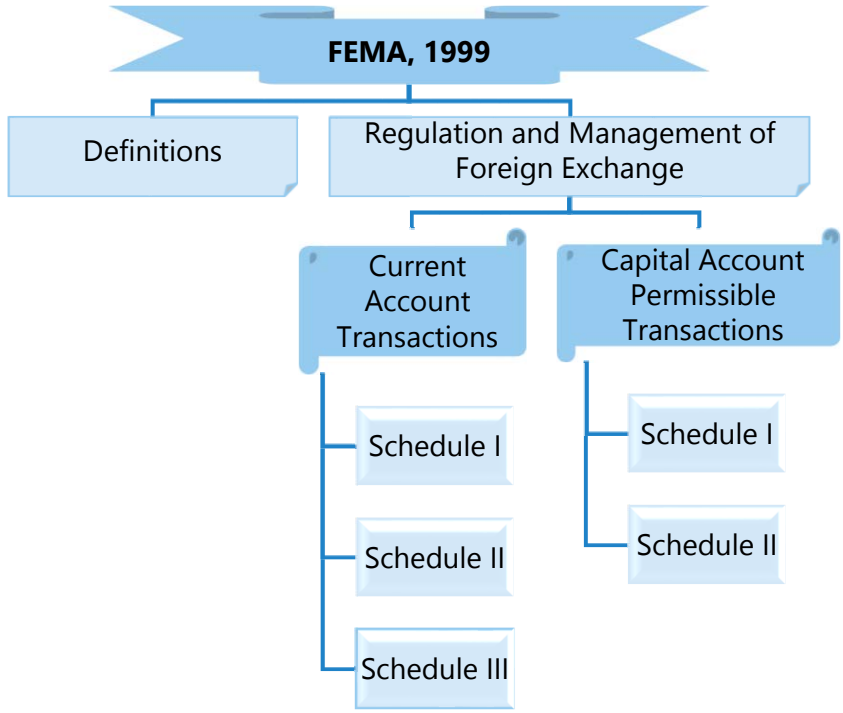
THE FOREIGN EXCHANGE MANAGEMENT ACT, 1999

LEARNING OUTCOMES

At the end of this Chapter, you will be able to:

- Comprehend certain important terms and definitions under the Foreign Exchange Management Act, 1999
- Gain knowledge about the concept of Residential Status under the Foreign Exchange Management Act, 1999
- Identify the meaning of Current and Capital Account Transactions and the Rules and Regulations governing them

CHAPTER OVERVIEW



1. INTRODUCTION

Need for the Act

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. To facilitate cross border trade and cross border capital flows, exchange control law was required. Foreign exchange control led to introduction of exchange control law through Defense of India rules by the Britishers in 1939. Subsequently, Foreign Exchange Regulation Act (FERA) was enacted in 1947 which was later replaced with 'the Foreign Exchange Regulation Act, 1973' (FERA).

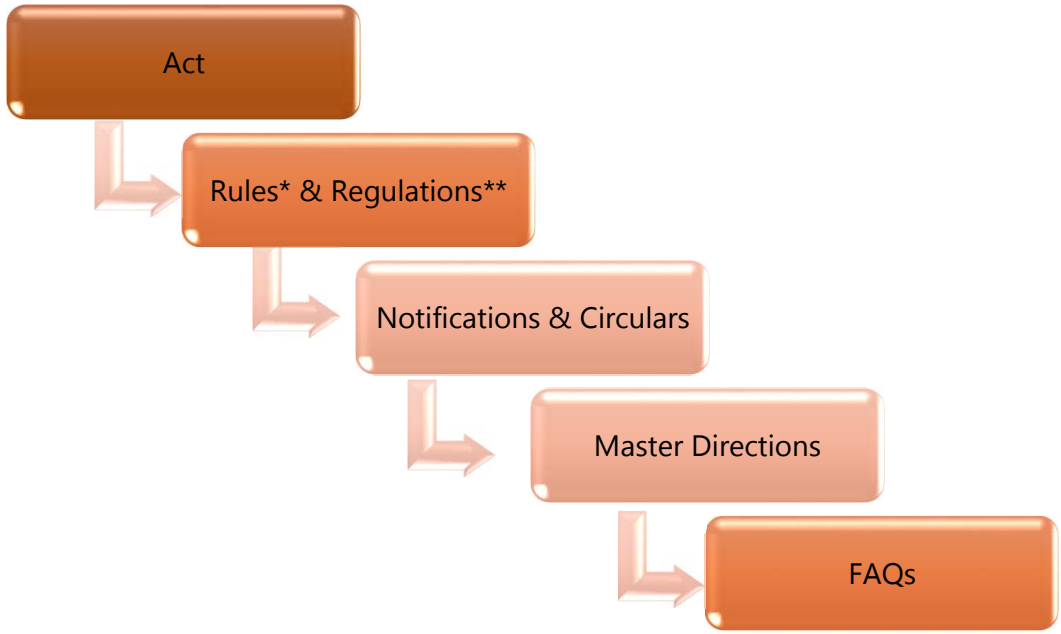
Government as part of its agenda of liberalization of the Indian economy in 1991, permitted free movement of foreign exchange in connection to trade related receipts and payments as well as Foreign Investment in various sectors. This increased the flow of foreign exchange to India and consequently foreign exchange reserves increased substantially. The Foreign Exchange Management Act, 1999 was enacted and 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.

Enforcement of FEMA: Though RBI exercises overall control over foreign exchange transactions, enforcement of FEMA has been entrusted to a separate 'Directorate of Enforcement' formed for this purpose. [Section 36].

How to Read FEMA:



*Rules are notified by the Ministry of Finance, Government of India

** Regulations are notified by the Reserve Bank of India

Broad Structure of FEMA

Now let us have a glance at the broad structure the Act. The Act consists of 7 Chapters dealing with following areas:

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

2. PREAMBLE, EXTENT, APPLICATION AND COMMENCEMENT OF FEMA, 1999

(A) Preamble: 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.

(B) Extent and Application [Section 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.

The scope of the Act has been extended to include branches, offices and agencies outside India. The scope is thus wide enough because the emphasis is on the words "Owned or Controlled". Contravention of the FEMA committed outside India by a person to whom this Act applies will also be covered by FEMA.

(C) Commencement: The Act, 1999 came into force with effect from 1st June, 2000 vide Notification *G.S.R. 371(E), dated 1.5.2000*.

3. DEFINITIONS [SECTION 2]

In this Act, unless the context otherwise requires:

(1) *"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)]

(2) *"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, and includes transactions referred to in [1]Section 6(3); [Section 2(e)]

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[1] Section 6(3) has been deleted with effect from 15th October 2019.

(3) *"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)]

(4) "*Currency Notes*" means and includes cash in the form of coins and bank notes; [Section 2(i)]

(5) "*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)]

(6) *"Export"*, with its grammatical variations and cognate expressions means;

(i) the taking out of India to a place outside India any goods.

(ii) provision of services from India to any person outside India;[Section 2(l)]

(7) *"Foreign Currency"* means any currency other than Indian currency; [Section 2(m)]

(8) *"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)]

(9) *"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)]

(10) *"Import"*, with its grammatical variations and cognate expressions, means bringing into India any goods or services; [Section 2(p)]

(11) *"Person"* includes:

(i) an individual,

(ii) a Hindu undivided family,

(iii) a company,

(iv) a firm,

(v) an association of persons or a body of individuals, whether incorporated or not,

(vi) every artificial juridical person, not falling within any of the preceding sub-clauses, and;

(vii) any agency, office or branch owned or controlled by such person; [Section 2(u)]

(12) *"Person resident in India"* means:

(i) a person residing in India for more than 182 days during the course of the preceding financial year but does not include—

(A) a person who has gone out of India or who stays outside India, in either case—

(a) for or on taking up employment outside India, or

(b) for carrying on outside India a business or vocation outside India, or

(c) for any other purpose, in such circumstances as would indicate his intention to stay outside India for an uncertain period;

(B) a person who has come to or stays in India, in either case, otherwise than:

(a) for or on taking up employment in India, or

(b) for carrying on in India a business or vocation in India, or

(c) for any other purpose, in such circumstances as would indicate his intention to stay in India for an uncertain period;

(ii) any person or body corporate registered or incorporated in India,

(iii) an office, branch or agency in India owned or controlled by a person resident outside India,

(iv) an office, branch or agency outside India owned or controlled by a person resident in India; [Section 2(v)]

(13) *"Person Resident Outside India"* means a person who is not resident in India; [Section 2(w)]

(14) *"Transfer"* includes sale, purchase, exchange, mortgage, pledge, gift, loan or any other form of transfer of right, title, possession or lien. [Section 2(ze)]

4. RESIDENTIAL STATUS UNDER FEMA, 1999

The definition of "person" is similar to the definition contained in the Income-tax Act, 1961. The term **'person'** includes entities such as companies, firms, individuals, HUF, Association of Persons (AOP), artificial juridical persons agencies, as well as offices and branches. Agencies, offices and branches do not have independent status separate from their owners. Yet these have been considered as persons. Under FEMA such offices and branches are included in definition of Person Resident in India. Therefore, they have been included in the definition of "Person".

The term '**person resident in India**' means the following entities:

1. **A person who resides in India for more than 182 days during the preceding financial year;**

   The following persons are NOT persons resident, in India even though they may have resided in India for more than 182 days.

   A. A person who has gone out of India or stays outside India for any of the three purposes given below,

   B. A person who has come to or stays in India OTHERWISE THAN for any of the three purposes given below;

   Three Purposes

   (i) For or on taking up Employment

   (ii) For carrying on a business or Vacation

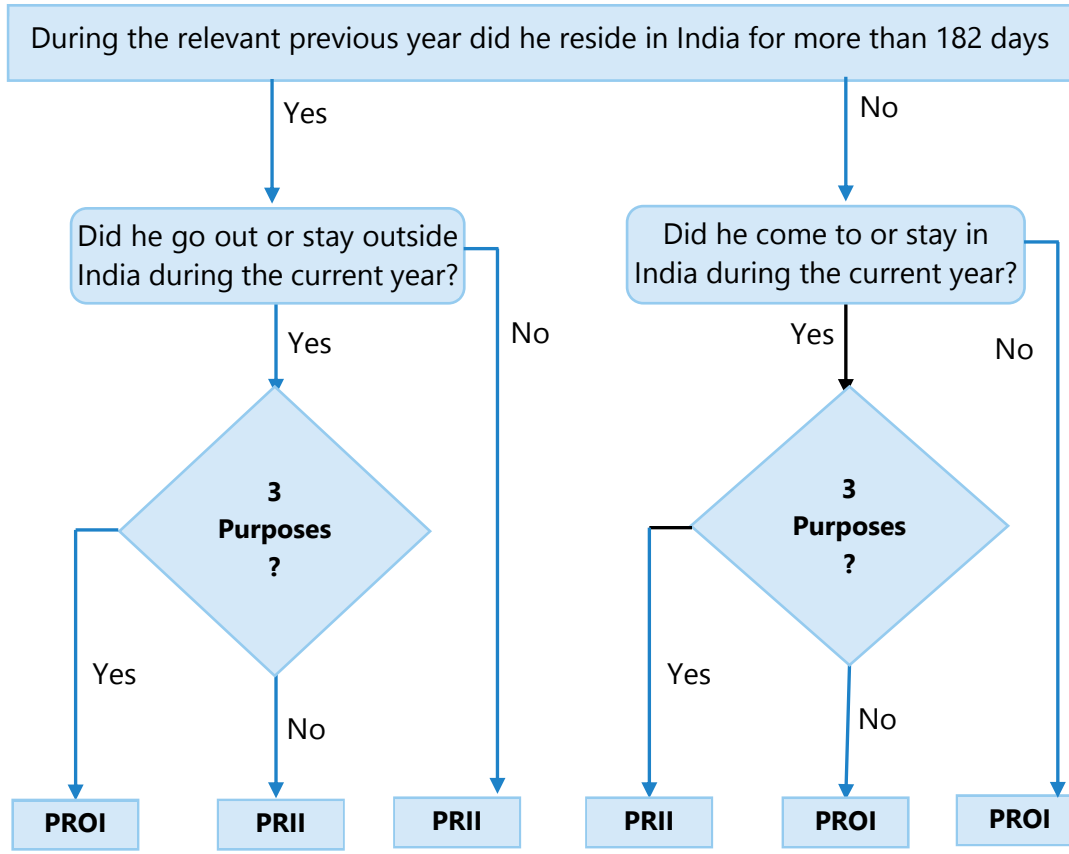
   (iii) For any other purpose in such circumstances as would indicate stay for an uncertain period.

2. Any person or body corporate registered or incorporated in India;

3. An office, branch or agency in India owned or controlled by a person resident outside India;

4. An office, branch or agency outside India owned or controlled by a person resident in India.

Person resident outside India means a person who is **not** resident in India.



As the definitions of Person Resident in India (PRII) and Person Resident outside India (PROI) are quite relevant for determining the applicability of the Act on an entity, let us analyse and understand it better.

In the case of individuals, to be considered as "resident", the person should have resided in India in the preceding financial year for more than 182 days. **Citizenship is not the criteria for determining whether or not a person is resident in India.**

There are three limbs in the definition. The first limb prescribes the number of days stay. Then there are two limbs which are exceptions to the first limb.

First limb – It states that a person who is in India for more than 182 days in the "preceding year" will be a Person Resident in India. Thus, at the threshold or basic level, one has to consider the period of stay during the preceding year.

Example 1: If a person resides in India for more than 182 days during FY 2020-21, then for the FY 2021-22, the person will be an Indian resident. For FY 2020-21, one will have to consider residence during FY 2019-20, and so on.

There are two exceptions provided in clauses (A) and (B). Clause (A) is for persons going out of India. Clause (B) is for persons coming into India. Exceptions carve out situations that do not fall under the main body of a section, even though they satisfy the criteria. This means that even if a person is an Indian resident based on the test provided in the first limb, the person will be a "Person Resident Outside India (PROI) if he falls within limb (A) or limb (B).

Clause (A) – second limb – It states that if a person leaves India in any of the THREE PURPOSES we saw above, he will not be a PRII. He will be a PROI.

Thus, in the **example** given for the first limb above, if a person leaves India on 1st November 2021, he will be a non-resident from 2nd November 2021 – even though his number of days in India was more than 182 days in FY 2020-2021. Similarly, if a person goes and stays out of India for carrying on any business, he will be a PROI from that date. For FY 2021-2022 the person will be a PRII till 1st November 2021. He will then be a PROI. From 1st April 2022, the person will continue to be a PROI as long as he stays out of India for employment.

An **example** for clause (iii) can be a person who has a green card in the USA. The green card entitles a person to stay in the USA and eventually become a US citizen. If a person goes abroad and starts staying in the USA, he will be a non-resident from that date as his stay abroad indicates that he is going to stay there for an uncertain period.

Clause (B) – third limb – This is a complex clause as first limb read with third limb has two exceptions. Limb one uses the phrase "but does not include". Third limb uses the phrase "otherwise than". Use of two exceptions make it complex reading.

It states that if a person has come to India **for any reason otherwise than** for - employment, business or circumstances which indicate his intention to stay for uncertain period – he will be a non-resident. This will be so even if the person has stayed in India for more than 182 days in the preceding year.

For **example**, if a person comes to India on 1st June 2021 for visiting his parents. However, his parents fall sick and he stays till 31st March 2022. Thereafter he continues to stay in India. It is however certain that he will leave India in next 6

months when his parents recover. His stay in India is neither for employment, nor for business, nor for circumstances which show that he will stay in India for an uncertain period. In such a case, even if he has resided in India for more than 182 days in FY 2021-2022, he will continue to be a non-resident from 1st April 2022 also. In FY 2021-2022, he is of course a PROI as he did not reside in India for more than 182 in FY 2020-2021.

If a person comes to India on 1st June 2021 for employment, business or circumstances which indicate his intention to stay in India for an uncertain period, he will be a PRII from 1st June 2021.

Residential status is not for a year. It is from a particular date. This is different from income-tax law. Under income-tax law, a person has to pay tax in respect of the income of the previous year. Therefore, it is possible to look at a complete year for determining residential status under the Income Tax Act, 1961. FEMA is a regulatory law. One has to know the person's status at the time of undertaking a transaction. If for **example**, a person comes to India for employment, and if his status can be known only when the year is completed, how will he and other people enter into commercial transactions with each other? If he is considered as a PROI till the year is over, then people will not be able to enter into transactions with him. This is the reason why the residential status is not for a year but from particular date.

It is understood that this condition applies only to individuals. It will not apply to HUF, AOP or artificial juridical person as they cannot get employed, cannot go out of India or come to India. Hence, they do not come within the ambit of the second and third limbs. These entities like HUF and AOP are not required to be registered or 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.

Person or Body corporate: Any person or body corporate registered or incorporated in India, will be considered a PRII. This definition too, does not apply to AOP, BOI etc.

Office, branch or agency: Any agency, branch or agency outside India but **owned or controlled by PRII** will be considered as person resident in India (PRII). Thus, one cannot set up a branch outside India and attempt to avoid FEMA provisions.

Any agency, branch or agency in India but **owned or controlled by a person resident outside India (PROI)** will be considered as a person resident in India. This is relevant as Indian residents can deal with such branch in India without considering FEMA. If such branch is considered as a PROI then it will be difficult to undertake several transactions.

Illustration 1

Mr. X had resided in India during the financial year 2019-2020 for less than 182 days. He had come to India on April 1, 2020 for carrying on business. He intends to leave the business on April 30, 2021 and leave India on June 30, 2021. Determine his residential status for the financial years 2020-2021 and 2021-2022 up to the date of his departure?

Answer

As explained in the above illustration, Mr. X will be considered as a 'person resident in India' from 1st April 2020. As regards, financial year 2021-2022, Mr. X would continue to be an Indian resident from 1st April 2021.

If he leaves India for the purpose of taking up employment or for business/vocation outside India, or for any other purpose as would indicate his intention to stay outside India for an uncertain period, he would cease to be person resident in India from the date of his departure. It may be noted that even if Mr. X is a foreign citizen, has not left India for any of these purposes, he would be considered, 'person resident in India' during the financial year 2021-2022. Thus, it is the purpose of leaving India which will decide his status from 1st July 2021.

Illustration 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 three years. What would be his residential status during financial year 2020-2021 and during 2021-2022?

Answer

Mr. Z had resided in India during financial year 2019-2020 for more than 182 days. After that he has gone to USA for higher studies. He has not gone out of or stayed outside India for or on taking up employment, or for carrying a business or for any other purpose, in circumstances as would indicate his intention to stay outside India

for an uncertain period. Accordingly, he would be 'person resident in India' during the financial year 2020-2021. RBI has however clarified in its AP 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.

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.

Illustration 3

Toy Ltd. is a Japanese company having several business units all over the world. It has a robotic unit with its head quarters 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?

Answer

Toy Ltd. being a Japanese company would be a person resident outside India. [Section 2(w)]. Section 2(u) defines 'person'. Under clause (viii) thereof person would include any agency, office or branch owned or controlled by such 'person'. The term such 'person' appears to refer to a person who is included in clauses (i) to (vi). Accordingly, robotic unit in Mumbai, being a branch of a company, would be a 'person'.

Section 2(v) defines 'person resident in India'. Under clause (iii) thereof 'person resident in India' would include an office, branch or agency in India owned or controlled by a person resident outside India. Robotic unit in Mumbai is owned or controlled by a person 'resident outside India'. Hence, it would be 'person resident in India'.

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 'person resident in India'.

Illustration 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?

Answer

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.

If however she has been employed in Mumbai branch of British Airways, then she will be considered a Person Resident in India.

5. REGULATION AND MANAGEMENT OF FOREIGN EXCHANGE

❖ 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 person resident outside India in any manner;

(c) receive otherwise than through an authorised person, any payment by order or on behalf of any person resident outside India 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 carried on:

(a) as otherwise provided in this Act; or

(b) with the general or special permission of the Reserve Bank.

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.

Consider following examples:

(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.

❖ 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 2: 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.

❖ 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 3: 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 4: 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 [Section 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.

Example 5: 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 accounts and income-tax law, gift is a "capital receipt". However, 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 gift is a current account transaction, why is there a restriction under Current Account regulations? It is because while there is no restriction on Current Account transactions, some reasonable restrictions can be imposed. Otherwise, people may transfer funds abroad under the garb of current account transactions.

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.

In a similar manner, if a PROI gives a gift to a 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.

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 Reserve Bank, impose such **reasonable restrictions** for current account transactions as prescribed under the FEM (Current Account Transactions) Rules, 2000.

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.

Section 5 of the Act permits any person to sell or draw Foreign Exchange to or from an Authorised person to undertake any current account transaction. The Central Government has the power to impose reasonable restrictions, in consultation with the RBI and in public interest on current account transactions. The Central Government has in exercise of this power issued the Foreign Exchange Management (Current Account Transactions) Rules, 2000.

Let us now see the various schedules to the Rules that lay down the restrictions:

I. SCHEDULE I

[2]Transactions for which drawal of foreign exchange is prohibited:

(i) Remittance out of lottery winnings.

(ii) Remittance of income from racing/riding, etc., or any other hobby.

(iii) Remittance for purchase of lottery tickets, banned/prescribed magazines, football pools, sweepstakes etc.

(iv) Payment of commission on exports made towards equity investment in Joint Ventures/Wholly Owned Subsidiaries abroad of Indian companies.

(v) Remittance of dividend by any company to which the requirement of dividend balancing is applicable.

(vi) Payment of commission on exports under Rupee State Credit Route, except commission up to 10% of invoice value of exports of tea and tobacco.

(vii) Payment related to "Call Back Services" of telephones.

(viii) Remittance of interest income on funds held in Non-resident Special Rupee Scheme a/c.

[2]Schedule I (Transactions which are prohibited)-Foreign Exchange Management (Current Account Transactions) Rules, 2000 as amended from time to time.

II. SCHEDULE II

[3]Transactions, which require prior approval of the Government of India for drawal of foreign exchange:

Purpose of Remittance	Ministry/Department of Govt. of India whose approval is required
Cultural Tours	Ministry of Human Resources Development (Department of Education and Culture)
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.	Ministry of Finance, Department of Economic Affairs
Remittance of freight of vessel charted by a PSU	Ministry of Surface Transport (Chartering Wing)
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)	Ministry of Surface Transport (Chartering Wing)
Multi-modal transport operators making remittance to their agents abroad	Registration Certificate from the Director General of Shipping
Remittance of hiring charges of transponders by (a) TV Channels (b) Internet service providers	Ministry of Information and Broadcasting Ministry of Communication and Information Technology.
Remittance of container detention charges exceeding the rate prescribed by Director General of Shipping	Ministry of Surface Transport (Director General of Shipping)

[3]Schedule II (Transactions which require prior approval of the Central Government) - Foreign Exchange Management (Current Account Transactions) Rules, 2000 as amended from time to time

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	Ministry of Finance (Insurance Division)

[4]Transactions which require RBI's prior approval for drawal of foreign exchange:

SCHEDULE III

1. **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

   Any additional remittance in excess of the said limit for the said purposes shall require prior approval of the Reserve Bank of India.

   However, for the purposes mentioned at item numbers (iv), (vii) and (viii) above, the individual may avail of exchange facility for an amount in excess

[4] Schedule III- Notification no G.S.R. 426(E) dated 26th May 2015

of the limit prescribed under the Liberalised Remittance Scheme as provided in regulation 4 to FEMA Notification 1/2000-RB, dated the 3rd May, 2000 (here in after referred to as the said Liberalised Remittance Scheme) if it is so required by a country of emigration, medical institute offering treatment or the university, respectively:

Further, if an individual remits any amount under the said Liberalised Remittance Scheme in a financial year, then the applicable limit for such individual would be reduced from USD 250,000 (US Dollars Two Hundred and Fifty Thousand Only) by the amount so remitted:

Further, that 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 (irrespective of length thereof) or for a specific job or assignments, the duration of which does not exceed three years, is a resident but not permanently resident:

Further, a person other than an individual may also avail of foreign exchange facility, *mutatis mutandis*, within the limit prescribed under the said Liberalised Remittance Scheme for the purposes mentioned herein above.

2. **Facilities for persons other than individual—The following remittances by persons other than individuals shall require prior approval of the Reserve Bank of India:**

(i) Donations exceeding one per cent. of their foreign exchange earnings during the previous three financial years or USD 5,000,000, whichever is less, for-

a. creation of Chairs in reputed educational institutes,

b. contribution to funds (not being an investment fund) promoted by educational institutes; and

c. contribution to a technical institution or body or association in the field of activity of the donor Company.

(ii) Commission, per transaction, to agents abroad for sale of residential flats or commercial plots in India exceeding USD 25,000 or five percent of the inward remittance whichever is more.

(iii) Remittances exceeding USD 10,000,000 per project for any consultancy services in respect of infrastructure projects and USD 1,000,000 per project, for other consultancy services procured from outside India.

Explanation—For the purposes of this sub-paragraph, the expression "infrastructure' shall mean as defined in explanation to para 1(iv)(A)(a) of Schedule I of FEMA Notification 3/2000-RB, dated the May 3, 2000.

(iv) Remittances exceeding five per cent 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.

3. **Procedure—**The procedure for drawal or remittance of any foreign exchange under this schedule shall be the same as applicable for remitting any amount under the said Liberalised Remittance Scheme.

If the transaction is not listed in any of the above three schedules, it can be freely undertaken.

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 Resident Foreign Currency (RFC) account.

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 Exchange Earners' Foreign Currency (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 five per cent

of the inward remittance whichever is more. Remittances exceeding five per cent 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.

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.

Note: Liberalised Remittance Scheme (LRS): Under the Liberalised Remittance Scheme (LRS), all resident individuals, including minors, are allowed to freely remit up to USD 250,000 per financial year (April – March) for any permissible current or capital account transaction or a combination of both. This is inclusive of foreign exchange facility for the purposes mentioned in Para 1 of Schedule III of Foreign Exchange Management (CAT) Amendment Rules 2015, dated May 26, 2015.

In case of remitter being a minor, the LRS declaration form must be countersigned by the minor's natural guardian. The Scheme is not available to corporates, partnership firms, HUF, Trusts etc.

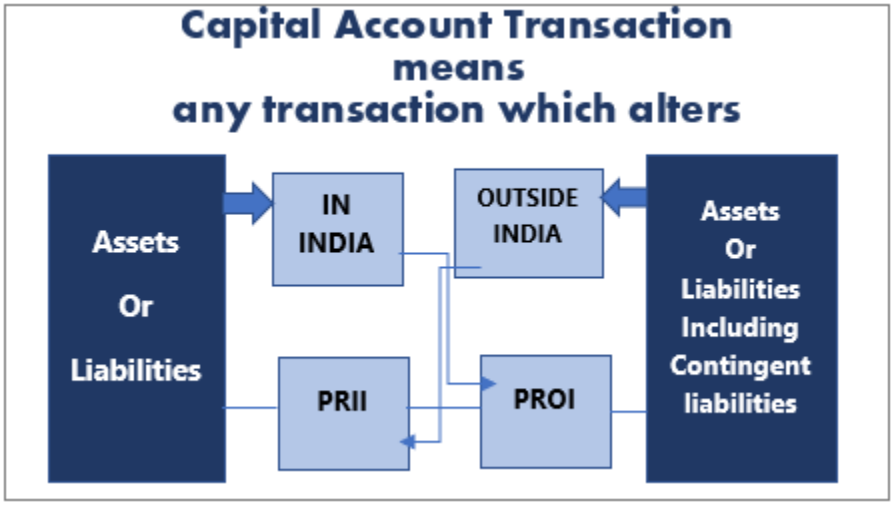
Consolidation of remittance of family members - Remittances under the Scheme can be consolidated in respect of family members subject to individual family members complying with its terms and conditions.

Exception: 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.

❖ Capital account transactions [Section 6]

The definitions of "Capital Account Transactions" and its opposite "current account transactions are contained in clauses (e) and (j) of Section 2. The regulations under FEMA apply to a transaction based on whether the transaction is "Capital Account Transaction" or a "Current Account Transaction". These transactions broadly outline the basics and whole approach of the Act. Basically these two transactions have to be understood as being similar to the concepts of items relating to the profit and loss account or revenue items (with respect to current account transactions) and of Balance Sheet or capital items (with respect to capital account transactions).

Capital Account Transactions means "A transaction which alters the assets or liabilities including contingent liabilities outside India of persons resident in India or assets or liabilities in India of persons resident outside India would be a capital account transaction."



Capital Accounts Transaction in India can be carried out only to the extent permitted because Indian Rupee is not yet fully convertible. Capital and current account transactions are intended to be mutually exclusive. **A transaction which alters the asset or liabilities in India of non-residents falls under the category of capital account.** However, as far as residents are concerned **transactions which alter the contingent liabilities outside India are also capital account transactions.** The Reserve Bank of India may by regulations place restrictions on various specified capital account transactions. In simple terms, cross border transactions pertaining to investments, loans, immovable property, transfer of assets are Capital Account Transactions.

(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. The amendments

have however been made effective from 15th October 2019. Now the regulations are as under:

The Reserve Bank may, in consultation with the Central Government, specify:

(a) any class or classes of capital account transactions,[5]involving debt instruments, which are permissible;

(b) the limit up to which foreign exchange shall be admissible for such transactions;

(c) any conditions which may be placed on such transactions;

Provided that the Reserve Bank or the Central Government shall not impose any restrictions on the drawal of foreign exchange for payment due on account of amortisation of loans or for depreciation of direct investments in the ordinary course of business.

RBI has issued notification for Debt instruments specifying the terms and conditions. These regulations for foreign investment in debt instruments. For investment by Indian residents outside India, RBI continues to have power to regulate the transactions for equity and debt.

(2A) The Central Government may, in consultation with the Reserve Bank, prescribe— (a) any class or classes of capital account transactions, not involving debt instruments, which are permissible; (b) the limit up to which foreign exchange shall be admissible for such transactions; and (c) any conditions which may be placed on such transactions.

Central Government has issued notification for Non-debt instruments specifying the terms and conditions. RBI has issued notification for mode of payment and reporting of Non-debt instruments.

(3) Before 15th October 2019, Section 6(3) specified a list of capital account transactions which could be regulated by RBI [apart from the general powers which it had under Section 6(2)]. **This list has now been deleted from 15th October 2019.**

[5] Amended w.e.f. 15-10-2019

(4) **A person resident in India** may **hold, own, transfer or invest** in foreign currency, foreign security or any immovable property situated outside India if such currency, security or property was **acquired, held or owned** by such person **when he was resident outside India** or **inherited from a person who was resident outside India**.

The RBI vide A.P. (DIR Series) Circular No. 90 dated 9thJanuary, 2014 has issued a clarification on section 6(4) of the Act. This circular clarifies that section 6(4) of the Act 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 which 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;

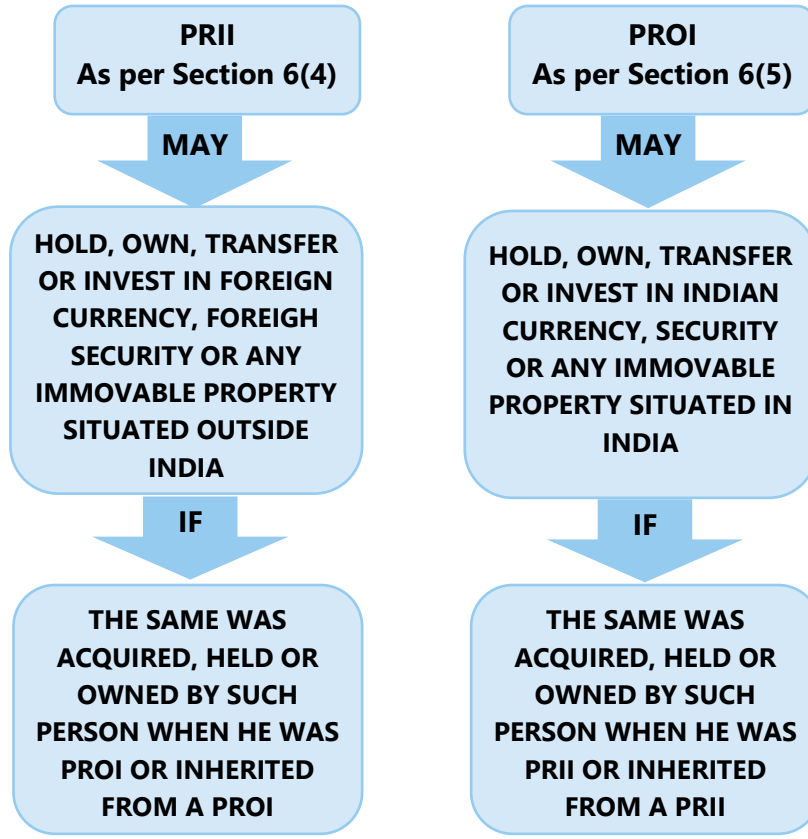
(iii) Foreign exchange including any income arising therefrom, and conversion or replacement or accrual to the same, held outside India by a person resident in India acquired by way of inheritance from a person resident outside India.

(iv) A person resident in India 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 Reserve Bank, 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 **person resident outside India 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 Reserve Bank may, by regulation, prohibit, restrict, or regulate establishment in India of a branch, office or other place of business by a person resident outside India, for carrying on any activity relating to such branch, office or other place of business.

Capital Account Transactions [Sec. 6(4) & 6(5)]



(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 Reserve Bank.

A capital account transaction as stated earlier is a transaction, which alters the assets or liabilities, including contingent liabilities, outside India of persons resident in India or assets or liabilities in India of persons resident outside India would be a capital account transaction. The section gives a liberty by providing that any person

may sell or draw foreign exchange to or from an authorised person for capital account transactions. However, the liberty to do so is subject to the provisions of sub-section (2) and (2A), which states that the Reserve Bank and the Central Government may specify class or classes of capital account transactions, which are permissible limit upto, which the foreign exchange shall be admissible for such transactions and the conditions which may be placed on such transactions.

Capital account transaction is basically split into the following categories under **Foreign Exchange Management (Permissible capital account transactions) Regulations, 2000[6] -:**

(I) transaction, which are permissible in respect of persons resident in India and outside India.

(II) transaction on which restrictions cannot be imposed; and

(III) transactions, which are prohibited.

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 persons resident in India in Schedule-I and the classes of capital account transactions of persons resident outside India 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

The list of permissible classes of transactions made by **persons resident in India** is:

(a) Investment by a person resident in India in foreign securities.

[6]Notification No. FEMA 1 /2000-RB dated 3rd May 2000

(b) Foreign currency loans raised in India and abroad by a person resident in India.

(c) Transfer of immovable property outside India by a person resident in India.

(d) Guarantees issued by a person resident in India in favour of a person resident outside India.

(e) Export, import and holding of currency/currency notes.

(f) Loans and overdrafts (borrowings) by a person resident in India from a person resident outside India.

(g) Maintenance of foreign currency accounts in India and outside India by a person resident in India.

(h) Taking out of insurance policy by a person resident in India from an insurance company outside India.

(i) Loans and overdrafts by a person resident in India to a person resident outside India.

(j) Remittance outside India of capital assets of a person resident in India.

(k) Undertake derivative contracts

SCHEDULE II

The list of permissible classes of transactions made by **persons resident outside India** is:

(a) Investment in India by a person resident outside India, that is to say,

  (i) issue of security by a body corporate or an entity in India and investment therein by a person resident outside India; and

  (ii) investment by way of contribution by a person resident outside India to the capital of a firm or a proprietorship concern or an association of a person in India.

(b) Acquisition and transfer of immovable property in India by a person resident outside India.

(c) Guarantee by a person resident outside India in favour of, or on behalf of, a person resident in India.

(d) Import and export of currency/currency notes into/from India by a person resident outside India.

(e) Deposits between a person resident in India and a person resident outside India.

(f) Foreign currency accounts in India of a person resident outside India.

(g) Remittance outside India of capital assets in India of a person resident outside India.

(h) Undertake derivative contracts

Transactions with no restriction

They are:

(1) For amortisation of loan and

(2) For depreciation of direct investments in ordinary course of business.

Also, restrictions cannot be imposed when drawal is of the purpose of repayments of loan installments.

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) subject to the provisions of the Act or the rules or regulations or directions or orders made or issued thereunder, **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.

(ii) Where the **drawal of foreign exchange** by a resident individual for any capital account transaction specified in Schedule I **exceeds USD 250,000 per financial year, or as decided by Reserve Bank** from time to time as the case may be, the limit specified in the regulations relevant to the transaction shall apply with respect to such drawal.

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 **person resident outside India 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 Reserve Bank of India from time to time

(ii) As **Nidhi company;**

(iii) In **agricultural or plantation activities**;

(iv) In **real estate business**, or **construction of farm houses** or

Explanation: In "real estate business" the term 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) **No person resident in India shall undertake** any capital account transaction which is not permissible in terms of Order S.O. 1549(E) dated April 21, 2017, as amended from time to time, of the Government of India, Ministry of External Affairs, **with any person who is, a citizen of or a resident of Democratic People's Republic of Korea, or an entity incorporated or otherwise, in Democratic People's Republic of Korea,** until further orders, unless there is specific approval from the Central Government to carry on any transaction.

(d) The **existing investment transactions, with any person** who is, a citizen of or resident of Democratic People's Republic of Korea, or an entity incorporated or otherwise in Democratic People's Republic of Korea, or any existing representative office or other assets possessed in Democratic People's Republic of Korea, **by a person resident in India**, which is not permissible in terms of Order S.O. 1549(E) dated April 21, 2017, as amended from time to time, of the Government of India, Ministry of External Affairs **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."

Thus, a capital account transaction is permitted only if it is specifically permitted under the regulations. If the transaction is not stated as generally permitted, a prior specific approval is required.

SUMMARY

- FEMA makes provisions in respect of dealings in foreign exchange.
- FEMA regulates transactions between residents and non-residents.
- Broadly, all current account transactions are free. However, Central Government can impose reasonable instructions by issuing rules.
- Capital account transactions are regulated by Reserve Bank of India (RBI) and Central Government.
- FEMA envisages that RBI will have a controlling role in management of foreign exchange.

TEST YOUR KNOWLEDGE

MCQ Based Questions

1. *In September, 2021, Mr. Purshottam Saha visited Atlanta as well as Athens and thereafter, London and Berlin on a month-long business trip, for which he withdrew foreign exchange to the extent of US$ 50,000 from his banker State Bank of India, New Delhi branch. In December, 2021 he further, withdrew US$ 50,000 from SBI and remitted the same to his son Raviyansh Saha who was studying in Toronto, Canada. In the first week of January, 2022, he sent his ailing mother Mrs. Savita Saha for a specialised treatment along with his wife Mrs. Rashmi Saha to Seattle where his younger brother Pranav Saha, holder of Green Card, is residing. For the purpose of his mother's treatment and to help Pranav Saha to meet increased expenses, he requested his banker SBI to remit US$ 75,000 to Pranav Saha's account maintained with Citibank, Seattle. In February, 2022, Mr. Purshottam Saha's daughter Devanshi Saha got engaged and she opted for a 'destination marriage' to be held in August, 2022 in Zurich, Switzerland. While on a trip to Dubai in the last week of March, 2022, he again withdrew US$ 35,000 to be used by him and Devanshi Saha for meeting various trip expenses including shopping in Dubai. Later, the event manager gave an estimate of US$ 2,50,000 for the wedding of Devanshi Saha at Zurich, Switzerland. Which option do you think is the correct one in the light of applicable provisions of Foreign Exchange Management Act, 1999 including obtaining of prior approval, if any, from Reserve Bank of India since Mr. Purshottam Saha withdrew foreign exchange on various occasions from his banker State Bank of India.*

   (a) *In respect of withdrawal of foreign exchange on various occasions from his banker State Bank of India and remitting the same outside India during the financial year 2021-22, Mr. Purshottam Saha is not required to obtain any prior approval.*

   (b) *In respect of withdrawal of US$ 35,000 in the last week of March, 2022, for a trip to Dubai, Mr. Purshottam Saha must have obtained prior approval of Reserve Bank of India since the maximum amount of foreign exchange that can be withdrawn in a financial year is US$ 1,75,000.*

(c) *After withdrawing US$ 1,00,000, Mr. Purshottam Saha must have obtained prior approval of Reserve Bank of India for the remaining remittances made during the financial year 2021-22, otherwise SBI would not have permitted further withdrawals.*

(d) *After withdrawing US$ 50,000, Mr. Purshottam Saha must have obtained prior approval of Reserve Bank of India for the remaining remittances made during the financial year 2021-22, otherwise SBI would not have permitted further withdrawals.*

2. *M/s. Kedhar Sports Academy, a private coaching club, provides coaching for cricket, football and other similar sports. It coaches sports aspirants pan India. It also conducts various sports events and campaigns, across the country. In 2022, to mark the 25th year of its operation, a cricket tournament (akin to the format of T-20) is being organized by M/s. Kedhar Sports Academy in Lancashire, England, in the first half of April. The prize money for the 'winning team' is fixed at USD 40,000 whereas in case of 'runner-up', it is pegged at USD 11,000. You are required to choose the correct option from the four given below which signifies the steps to be taken by M/s. Kedhar Sports Academy for remittance of the prize money of USD 51,000 (i.e. USD 40,000+USD 11,000) to England keeping in view the relevant provisions of Foreign Exchange Management Act, 1999:*

(a) *For remittance of the prize money of USD 51,000, M/s Kedhar Sports Academy is required to obtain prior permission from the Ministry of Human Resource Development (Department of Youth Affairs and Sports).*

(b) *For remittance of the prize money of USD 51,000, M/s Kedhar Sports Academy is required to obtain prior permission from the Reserve Bank of India.*

(c) *For remittance of the prize money of USD 51,000, M/s Kedhar Sports Academy is not required to obtain any prior permission from any authority, whatsoever, and it can proceed to make the remittance.*

(d) *For remittance of the prize money of USD 51,000, M/s Kedhar Sports Academy is required to obtain prior permission from the Ministry of Finance (Department of Economic Affairs).*

3. *Akash Ceramics Limited, an Indian company, holds a commercial plot in Chennai which it intends to sell. M/s. Super Seller, a real estate broker with its Head Office in the USA, has been appointed by Akash Ceramics Limited to find some suitable buyers for the said commercial plot in Chennai which is situated at a prime location. M/s. Super Seller identifies Glory Estate Inc., based out of USA, as the potential buyer. It is to be noted that Glory Estate Inc. is controlled from India and hence, is a 'Person Resident in India' under the applicable provisions of Foreign Exchange Management Act, 1999. A deal is finalised and Glory Estate Inc. agrees to purchase the commercial plot for USD 600,000 (assuming 1 USD = ₹ 70). According to the agreement, Akash Ceramics Limited is required to pay commission @ 7% of the sale proceeds to M/s. Super Seller for arranging the sale of commercial plot to Glory Estate Inc. and commission is to remitted in USD to the Head Office of M/s. Super Seller located in USA. Considering the relevant provisions of Foreign Exchange Management Act, 1999, which statement out of the four given below is correct (ignoring TDS implications arising under the Income-tax Act, 1961):*

   (a) *There is no requirement of obtaining prior permission of Reserve Bank of India (RBI) for remittance of commission upto USD 25,000 by Akash Ceramics Limited to M/s. Super Seller but for the balance commission of USD 17,000, prior permission of RBI is required to be obtained.*

   (b) *There is no requirement of obtaining prior permission of Reserve Bank of India (RBI) for remittance of commission upto USD 30,000 by Akash Ceramics Limited to M/s. Super Seller but for the balance commission of USD 12,000, prior permission of RBI is required to be obtained.*

   (c) *There is no requirement of obtaining prior permission of Reserve Bank of India (RBI) for remittance of entire commission of USD 42,000 by Akash Ceramics Limited to M/s. Super Seller.*

   (d) *It is mandatory to obtain prior permission of Reserve Bank of India (RBI) for remittance of entire commission of USD 42,000 by Akash Ceramics Limited to M/s. Super Seller.*

4. *Mohita Periodicals and Mags Publications Limited, having registered office in Chennai, has obtained consultancy services from an entity based in France for setting up a software programme to strengthen various aspects relating to*

publications. The consideration for such consultancy services is required to be paid in foreign currency. The compliance officer of Mohita Periodicals and Mags Publications Limited, Mrs. Ritika requires your advice regarding the foreign exchange that can be remitted for the purpose of obtaining consultancy services from abroad without prior approval of Reserve Bank of India. Out of the following four options, choose the one which correctly portrays the amount of foreign exchange remittable for the given purpose after considering the provisions of the Foreign Exchange Management Act, 1999 and regulations made thereunder:

(a) *Permissible amount of foreign exchange that can be remitted by Mohita Periodicals and Mags Publications Limited for obtaining consultancy services from an entity based in France without prior approval of RBI is US$ 50,000,000.*

(b) *Permissible amount of foreign exchange that can be remitted by Mohita Periodicals and Mags Publications Limited for obtaining consultancy services from an entity based in France without prior approval of RBI is US$ 10,000,000.*

(c) *Permissible amount of foreign exchange that can be remitted by Mohita Periodicals and Mags Publications Limited for obtaining consultancy services from an entity based in France without prior approval of RBI is US$ 5,000,000.*

(d) *Permissible amount of foreign exchange that can be remitted by Mohita Periodicals and Mags Publications Limited for obtaining consultancy services from an entity based in France without prior approval of RBI is US$ 1,000,000.*

5. *After five years of stay in USA, Mr. Umesh came to India at his paternal place in New Delhi on October 25, 2021, for the purpose of conducting business with his two younger brothers Rajesh and Somesh and contributed a sum of ₹ 10,00,000 as his capital. Simultaneously, Mr. Umesh also started a proprietary business of selling artistic brass ware, jewellery, etc. procured directly from the manufacturers based at Moradabad. Within a period of two months after his arrival from USA, Mr. Umesh established a branch of his proprietary business at Minnesota, USA. You are required choose the appropriate option with respect to residential status of Mr. Umesh and his branch for the financial year 2022-*

23 after considering the applicable provisions of the Foreign Exchange Management Act, 1999:

(a) *For the financial year 2022-23, Mr. Umesh and his branch established at Minnesota, USA, are both persons resident outside India.*

(b) *For the financial year 2022-23, Mr. Umesh is a resident in India but his branch established at Minnesota, USA, is a person resident outside India.*

(c) *For the financial year 2022-23, Mr. Umesh and his branch established at Minnesota, USA, are both persons resident in India.*

(d) *For the financial year 2022-23, Mr. Umesh is a person resident outside India but his branch established at Minnesota, USA, is a person resident in India.*

Descriptive Questions

1. *'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?*

2. *Mr. Sane, an Indian National desires 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 100,000 for sending a cultural troupe on a tour of U.S.A.

   Advise him whether he can get Foreign Exchange and if so, under what conditions?

3. *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 drawal to the extent of US dollars 20,000 is required for this purpose.

   (ii) R wants to get his heart surgery done at United Kingdom. Up to what limit Foreign Exchange can be drawn by him and what are the approvals required?

4. *Referring to the provisions of the Foreign Exchange Management Act, 1999, state the kind of approval required for the following transactions:*

   (i) M requires U.S. $ 5,000 for remittance towards hiring charges of transponders.

   (ii) P requires U.S. $ 2,000 for payment related to call back services of telephones.

5. *Suresh resided in India during the Financial Year 2020-2021. He left India on 15th July 2021 for Switzerland for pursuing higher studies in Biotechnology for 2 years. What would be his residential status under the Foreign Exchange Management Act, 1999 during the Financial Years 2021-2022 and 2022-2023?*

   Mr. Suresh requires every year USD 25,000 towards tuition fees and USD 30,000 for incidental and stay expenses for studying abroad. Is it possible for Mr. Suresh to get the required Foreign Exchange and, if so, under what conditions?

6. *(i) Mr. P has won a big lottery and wants to remit US Dollar 20,000 out of his winnings to his son who is in USA. Advise whether such remittance is possible under the Foreign Exchange Management Act, 1999.*

   (ii) Mr. Z is unwell and would like to have a kidney transplant done in USA. He would like to know the formalities required and the amount that can be drawn as foreign exchange for the medical treatment abroad.

7. *Mr. Rohan, an Indian Resident individual desires to obtain Foreign Exchange for the following purposes:*

   (A) US$ 120,000 for studies abroad on the basis of estimates given by the foreign university.

   (B) Gift Remittance amounting US$ 10,000.

   Advise him whether he can get Foreign Exchange and if so, under what condition(s)?

ANSWERS

Answers to MCQ based Questions

1.	**(a)**	In respect of withdrawal of foreign exchange on various occasions from his banker State Bank of India and remitting the same outside India during the financial year 2021-22, Mr. Purshottam Saha is not required to obtain any prior approval.
2.	**(c)**	For remittance of the prize money of USD 51,000, M/s Kedhar Sports Academy is not required to obtain any prior permission from any authority, whatsoever, and it can proceed to make the remittance.
3.	**(d)**	It is mandatory to obtain prior permission of Reserve Bank of India (RBI) for remittance of entire commission of USD 42,000 by Akash Ceramics Limited to M/s. Super Seller.
4.	**(d)**	Permissible amount of foreign exchange that can be remitted by Mohita Periodicals and Mags Publications Limited for obtaining consultancy services from an entity based in France without prior approval of RBI is US$ 1,000,000.
5.	**(c)**	For the financial year 2022-23, Mr. Umesh and his branch established at Minnesota, USA, are both persons resident in India.

Answer to Descriptive Questions

1. Printex Computer being a Singapore based company would be person resident outside India [(Section 2(w)]. Section 2 (u) defines 'person' under clause (viii) thereof, as person would include any agency, office or branch owned or controlled by such person. The term such person appears to refer to a person who is included in clause (i) to (vi). Accordingly, Printex unit in Pune, being a branch of a company would be a 'person'.

Section 2(v) defines a person resident in India. Under clause (iii) thereof person resident in India would include an office, branch or agency in India owned or controlled by a person resident outside India. Printex unit in Pune

is owned or controlled by a person resident outside India, and hence it, would be a 'person resident in India.'

However, Dubai Branch though not owned is controlled by the Printer unit in Pune which is a person resident in India. Hence, the Dubai Branch is a person resident in India.

2. Under provisions of section 5 of the Foreign Exchange Management Act, 1999 certain Rules have been made for drawal of Foreign Exchange for Current Account transactions. As per these Rules, Foreign Exchange for some of the Current Account transactions is prohibited. As regards some other Current Account transactions, Foreign Exchange can be drawn with prior permission of the Central Government while in case of some Current Account transactions, prior permission of Reserve Bank of India is required.

(i) In respect of item No.(i), i.e., remittance out of lottery winnings, such remittance is prohibited and the same is included in First Schedule to the Foreign Exchange Management (Current Account Transactions) Rules, 2000. Hence, Mr. Sane cannot withdraw Foreign Exchange for this purpose.

(ii) Foreign Exchange for meeting expenses of cultural tour can be withdrawn by any person after obtaining permission from Government of India, Ministry of Human Resources Development, (Department of Education and Culture) as prescribed in Second Schedule to the Foreign Exchange Management (Current Account Transactions) Rules, 2000. Hence, in respect of item (ii), Mr. Sane can withdraw the Foreign Exchange after obtaining such permission.

In all the cases, where remittance of Foreign Exchange is allowed, either by general or specific permission, the remitter has to obtain the Foreign Exchange from an Authorised Person as defined in Section 2(c).

3. Approval to the following transactions under FEMA, 1999:

(i) Foreign Exchange drawals for cultural tours require prior permission/approval of the Ministry of Human Resources Development (Department of Education and Culture) irrespective of the amount of foreign exchange required. Therefore, in the given case X, the Film Star is required to seek permission of the said Ministry of the Government of India.

(ii) Individuals can avail of foreign exchange facility within the limit of USD 2,50,000 only. Any additional remittance in excess of the said limit for the expenses requires an approval from RBI. However, in connection with medical treatment abroad, no approval of the Reserve Bank of India is required. Therefore, R can draw foreign exchange up to amount estimated by a medical institute offering treatment.

4. Under section 5 of the Foreign Exchange Management Act, 1999, and Rules relating thereto, some current account transactions require prior approval of the Central Government, some others require the prior approval of the Reserve Bank of India, some are freely permitted transactions and some others are prohibited transactions. Accordingly,

(i) It is a current account transaction, where M is required to take approval of the Central Government for drawal of foreign exchange for remittance of hire charges of transponders.

(ii) Withdrawal of foreign exchange for payment related to call back services of telephone is a prohibited transaction. Hence, Mr. P cannot obtain US $ 2,000 for the said purpose.

5. **Residential Status:** According to section 2(v) of the Foreign Exchange Management Act, 1999, 'Person resident in India' means a person residing in India for more than 182 days during the course of preceding financial year [Section 2(v)(i)]. However, it does not include a person who has gone out of India or who stays outside India for employment outside India or for any other purpose in such circumstances as would indicate his intention to stay outside India for an uncertain period.

Generally, a student goes out of India for a certain period. In this case, Mr. Suresh who resided in India during the financial year 2020-2021 left on 15.7.2021 for Switzerland for pursuing higher studies in Biotechnology for 2 years, he will be resident as he has gone to stay outside India for a 'certain period'. RBI has however clarified in its AP 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.

Mr. Suresh will be treated as person resident in India for Financial Year 2021-2022 till 16th July 2021 and from 17th July 2021, he will be considered as person resident outside India.

However, during the Financial Year 2022-2023, Mr. Suresh will be considered as person resident outside India as he left India on 15th July 2021.

Foreign Exchange for studies abroad: According to Para I of Schedule III to Foreign Exchange Management (Current Account Transactions), Amendment Rule, 2015 dated 26th May, 2015, individuals can avail of foreign exchange facility for the studies abroad within the limit of USD 2,50,000 only. Any additional remittance in excess of the said limit shall require prior approval of the RBI. Further proviso to Para I of Schedule III states that individual may be allowed remittances (without seeking prior approval of the RBI) exceeding USD 2,50,000 based on the estimate received from the institution abroad. In this case the foreign exchange required is only USD 55,000 per academic year and hence approval of RBI is not required.

6. **Remittance of Foreign Exchange (Section 5 of the Foreign Exchange Management Act, 1999):** According to section 5 of the FEMA, 1999, any person may sell or draw foreign exchange to or from an authorized person if such a sale or drawal is a current account transaction. Provided that Central Government may, in public interest and in consultation with the reserve bank, impose such reasonable restrictions for current account transactions as may be prescribed.

As per the rules, drawal of foreign exchange for current account transactions are categorized under three headings-

1. Transactions for which drawal of foreign exchange is prohibited,
2. Transactions which need prior approval of appropriate government of India for drawal of foreign exchange, and
3. Transactions which require RBI's prior approval for drawl of foreign exchange.

(i) Mr. P wanted to remit US Dollar 20,000 out of his lottery winnings to his son residing in USA. Such remittance is prohibited and the same is included in the Foreign Exchange Management (Current Account Transactions) Rules, 2000.

Hence Mr. P cannot withdraw foreign exchange for this purpose.

(ii) "Remittance of foreign exchange for medical treatment abroad" requires prior permission or approval of RBI where the individual requires withdrawal of foreign exchange exceeding USD 250,000. The Schedule also prescribes that for the purpose of expenses in connection with medical treatment, the individual may avail of exchange facility for an amount in excess of the limit prescribed under the Liberalized Remittance Scheme, if so required by a medical institute offering treatment.

Therefore, Mr. Z can draw foreign exchange up to the USD 250,000 and no prior permission/ approval of RBI will be required. For amount exceeding the above limit, authorised dealers may release foreign exchange based on the estimate from the doctor in India or hospital or doctor abroad.

7. **(A)** **Remittance of Foreign Exchange for studies abroad:** Foreign exchange may be released for studies abroad up to a limit of US $ 250,000 for the studies abroad without any permission from the RBI. Above this limit, RBI's prior approval is required. Further proviso to Para I of Schedule III states that individual may be allowed remittances exceeding USD 250,000 based on the estimate received from the institution abroad. In this case since US $ 120,000 is the drawal of foreign exchange, so permission of the RBI is not required.

(B) **Gift remittance exceeding US $ 10,000:** Under the provisions of section 5 of FEMA 1999, certain Rules have been made for drawal of foreign exchange for current account transactions. Gift remittance is a current account transaction. Gift remittance exceeding US $ 250,000 can be made after obtaining prior approval of the RBI. In the present case, since the amount to be gifted by an individual, Mr. Rohan is USD 10,000, there is no need for any permission from the RBI.

NOTES

CHAPTER 12

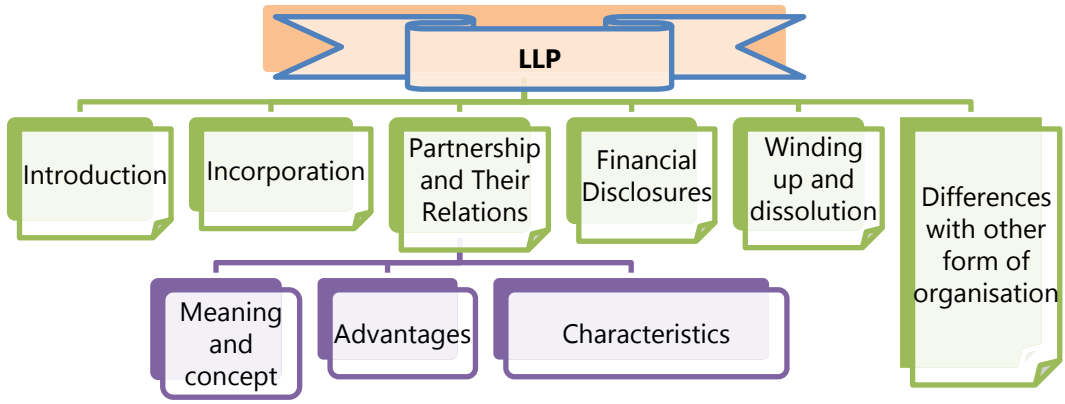
THE LIMITED LIABILITY PARTNERSHIP ACT, 2008

LEARNING OUTCOMES

At the end of this chapter, you will be able to:

- Comprehend the meaning of the term 'Limited Liability Partnership', its need, scope and advantages
- Know about the Incorporation of LLP, Partners and their relations, financial disclosures, conversions, winding up and dissolution.
- Differentiate between 'Limited Liability Partnership' and other forms of organization.

CHAPTER OVERVIEW



1. INTRODUCTION

The Ministry of Law and Justice on 9th January 2009 notified the Limited Liability Partnership Act, 2008.

The Parliament passed the Limited Liability Partnership Bill on 12th December, 2008 and the President of India has assented the Bill on 7th January, 2009 and called as the Limited Liability Partnership Act, 2008 (the "LLP Act, 2008").

The LLP Act, 2008 is applicable to the whole of India

This Act has been enacted to make provisions for the formation and regulation of Limited Liability Partnerships and for matters connected there with or incidental thereto.

The LLP Act, 2008 has 81 sections (of which section 81 is now omitted with effect from 1st April 2022) and 4 schedules.

The First Schedule deals with mutual rights and duties of partners and limited liability partnership and its partners where there is absence of a formal agreement amongst them.

The Second Schedule deals with conversion of a firm into LLP.

The Third Schedule deals with conversion of a private company into LLP.

The Fourth Schedule deals with conversion of unlisted public company into LLP.

The Ministry of Corporate Affairs and the Registrar of Companies (ROC) are entrusted with the task of administrating the LLP Act, 2008. The Central Government has the authority to frame the Rules with regard to the LLP Act, 2008, and can amend them by notifications in the Official Gazette, from time to time.

It is also to be noted that the Indian Partnership Act, 1932 is not applicable to LLPs.

Note

The Limited Liability Partnership Act, 2008 has been recently amended through the Limited Liability Partnership (Amendment) Act, 2021 dated 13th August, 2021.

Need of new form of Limited Liability Partnership

The lawmakers envisaged the need for bringing out a new legislation for creation of the Limited Liability Partnership to meet with the contemporary growth of the Indian economy. A need has been felt for a new corporate form that would provide an alternative to the traditional partnership with unlimited personal liability on the one hand and the statute-based governance structure of the limited liability company on the other hand. In order to enable professional expertise and entrepreneurial initiative and to combine and operate in flexible, innovative and efficient manner, the LLP Act, 2008 was enacted.

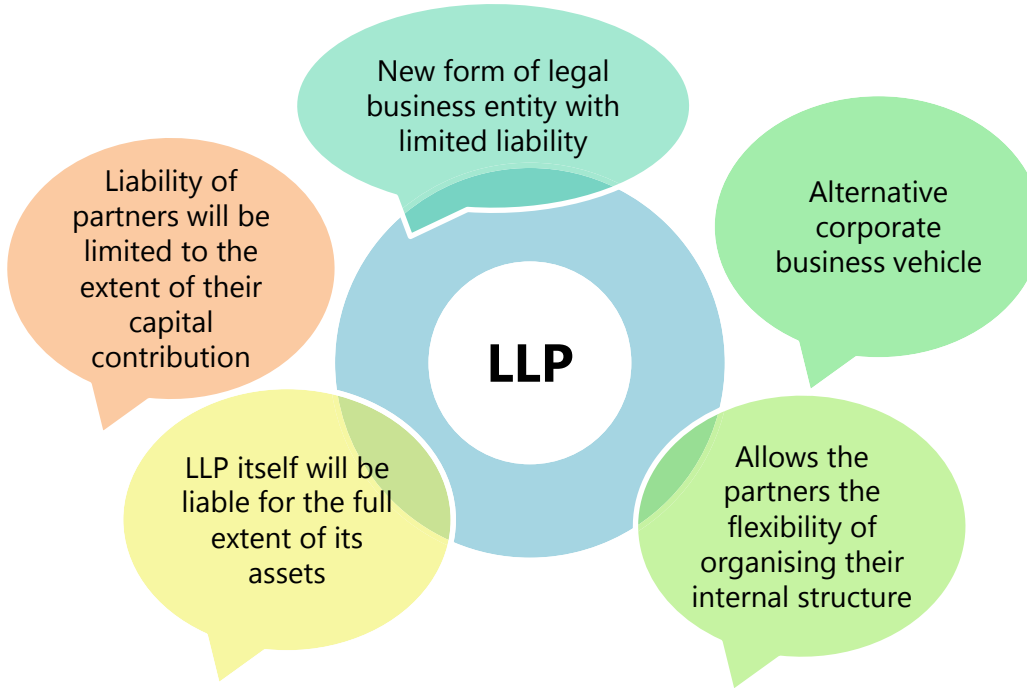
Thus, LLP as a form of business organization is an alternative corporate business vehicle. It provides the benefits of limited liability but allows its members the flexibility of organizing their internal structure as a partnership based on a mutually arrived agreement. The LLP form enables entrepreneurs, professionals and enterprises providing services of any kind or engaged in scientific and technical disciplines, to form commercially efficient vehicles suited to their requirements. Owing to flexibility in its structure and operation, the LLP is a suitable vehicle for small enterprises and for investment by venture capital.

2. LIMITED LIABILITY PARTNERSHIP- MEANING AND CONCEPT

Meaning: 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 organising their internal structure as a traditional partnership. The LLP is a separate legal entity and, while the LLP itself will be liable to the full extent of its assets, the liability of the partners will be limited to the extent of their capital contribution.

LLP as a separate legal entity and business organisation 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.



DEFINITIONS

1. **Address [(Section 2(1)(a)]:** "Address" in relation to a partner of a limited liability partnership, means—

   (i) if an individual, his usual residential address; and

   (ii) if a body corporate, the address of its registered office.

2. **Body Corporate [(Section 2(1)(d)]:** It means a company as defined in clause (20) of section 2 of the Companies Act, 2013 and includes—

   (i) a LLP registered under this Act;

   (ii) a 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 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.

Means

A company & **includes** - LLP, foreign LLP, foreign company,

Does not include – corporation sole; co-operative society & any other body corporate notified by Central Government.

3. **Business [Section 2(1)(e)]:** "Business" includes every trade, profession, service and occupation except any activity which the Central Government may, by notification, exclude.

4. **Chartered Accountant [Section 2(1)(f)]:** means a Chartered Accountant as defined in clause (b) of sub-section (1) of section 2 of the Chartered Accountants Act, 1949 and who has obtained a certificate of practice under sub-section (1) of section 6 of that Act.

5. **Designated Partner [Section 2(1)(j)]:** "Designated partner" means any partner designated as such pursuant to section 7.

6. **Entity [Section 2(1)(k)]:** ''Entity" means any body corporate and includes, for the purposes of sections 18, 46, 47, 48, 49, 50, 52 and 53, a firm setup under the Indian Partnership Act, 1932.

7. **Financial Year [Section 2(1)(l)]:** "Financial year", in relation to a LLP, means the period from the 1st day of April of a year to the 31st day of March of the following year.

   However, in the case of a LLP incorporated after the 30th day of September of a year, the financial year may end on the 31st day of March of the year next following that year.

   Example 1: If a LLP has been incorporated on 15th October, 2022, then its financial year may be from 15th October, 2022 to 31st March, 2024. However, the LLP can always maintain its first accounts from 15th October, 2022 to 31st March, 2023 i.e. for a period of less than 12 months. The period for which the first accounts of LLP are prepared shall not exceed 18 months.

   The Income Tax department has prescribed uniform financial year from 1st April to 31st March of next year. In keeping with the Income tax law, the financial year for LLP should always be from 1st April to 31st March each year.

8. **Foreign LLP [section 2(1)(m)]:** It means a LLP formed, incorporated or registered outside India which establishes a place of business within India.

9. **Limited liability partnership [Section 2(1)(n)]:** Limited Liability Partnership means a partnership formed and registered under this Act.

10. **Limited Liability partnership agreement [Section 2(1)(o)]:** It means any written agreement between the partners of the LLP or between the LLP and its partners which determines the mutual rights and duties of the partners and their rights and duties in relation to that LLP.

The First Schedule shall be applicable for all matters not covered by the Agreement w.r.t the mutual rights and duties of the partners and their rights and duties in relation to the LLP.

11. **Name [Section 2(1)(p)]:** in relation to a partner of a limited liability partnership, means—

    (i) if an individual, his forename, middle name and surname; and

    (ii) if a body corporate, its registered name;

12. **Partner [Section 2(1)(q)]:** Partner, in relation to a LLP, means any person who becomes a partner in the LLP in accordance with the LLP agreement.

13. **Regional Director [Section 2(1)(ra)]:** means a person appointed as such by the Central Government for the purpose of this Act or the Companies Act 2013, as the case may be.

14. **Registrar [Section 2(1)(s)]:** means a person appointed by Central Government as Registrar, an Additional Registrar, a Joint Registrar, a Deputy Registrar or an Assistant Registrar, for the purpose of this Act or the Companies Act, 2013, as the case may be.

15. **Small limited liability partnership [Section 2(1)(ta)]:** It means a limited liability partnership—

    (i) the contribution of which, does not exceed twenty-five lakh rupees or such higher amount, not exceeding five 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 forty 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;

Contribution	Up to ₹ 25L, &
Turnover for immediately preceding F.Y	Up to ₹ 40 L, or
Fulfills	prescribed terms and conditions

16. **Tribunal [Section 2(1)(u)]:** means the National Company Law Tribunal constituted u/s 408 of Companies Act 2013.

Note:

Applicability of the Companies Act, 2013: Words and expressions used and not defined in this Act but defined in the Companies Act, 2013 shall have the meanings respectively assigned to them in that Act. **[Section 2(2)]**

Non-applicability of the Indian Partnership Act, 1932: Save as otherwise provided, the provisions of the Indian Partnership Act, 1932 shall not apply to a LLP. **[Section 4]**

CHARACTERISTIC OF LLP

- Body Corporate
- Perpetual Succession
- Separate legal entity
- Mutual Agency
- LLP Agreement
- Artificial Legal person
- Common Seal
- Limited liability
- Management of business
- Minimum & maximum number of members
- Business for profit only
- Investigation
- Compromise or Arrangement
- Conversion into LLP
- E-filing of documents
- Foreign LLPs

1. **LLP is a body corporate:** Section 2(1)(d) of the LLP Act, 2008 provides that a LLP is a body corporate formed and incorporated under this Act. Section 3 of the LLP Act provides that LLP is a legal entity separate from that of its partners and shall have perpetual succession. Therefore, any change in the partners of a LLP shall not affect the existence, rights or liabilities of the LLP.

2. **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. It is capable of entering into contracts and holding property in its own name.

3. **Separate Legal Entity:** Section 3 of LLP Act provides that a LLP is a body corporate formed and incorporated under this Act and is a legal entity separate from that of its partners. The LLP is liable to the full extent of its assets but liability of the partners is limited to their agreed contribution in the LLP. In other words, creditors of LLP shall be the creditors of LLP alone.

4. **Mutual Agency:** 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.

5. **LLP Agreement:** Mutual rights and duties of the partners within a LLP are governed by an agreement between the partners. The LLP Act, 2008 provides flexibility to partner to devise the agreement as per their choice. In the absence of any such agreement, the mutual rights and duties shall be governed by Schedule I of the LLP Act, 2008.

6. **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, except of course that, it cannot be sent to jail, cannot take an oath, cannot marry or get divorce nor can it practice a learned profession like CA or Medicine. A LLP is invisible, intangible, immortal (it can be dissolved by law alone) but not fictitious because it really exists.

7. **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. It shall remain under the custody of some responsible official and it shall be affixed in the presence of at least 2 designated partners of the LLP.

8. **Limited Liability:** Every partner of a LLP is, for the purpose of the business of LLP, the agent of the LLP, but not of other partners (Section 26). The liability of the partners will be limited to their agreed contribution in the LLP. Such contribution may be of tangible or intangible nature or both.

Example 2: The professionals like Engineering consultants, Legal Advisors and Accounting Professional are afraid of entering into business due to unlimited liability. Hence, the LLP Act provides an avenue for these professionals to enter into Limited Liability Partnership firms which restrict their liability to the agreed amount. This has encouraged Professionals to form LLP.

9. **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.

10. **Minimum and Maximum number of Partners:** Every LLP shall have at least two partners and shall also have at least 2 individuals as designated partners, of whom at least one shall be resident in India. There is no maximum limit on the partners in LLP.

11. **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.

12. **Investigation:** The Central Government shall have powers to investigate the affairs of an LLP by appointment of competent authority for the purpose.

13. **Compromise or Arrangement:** Any compromise or agreements including merger and amalgamation of LLPs shall be in accordance with the provisions of the LLP Act, 2008.

14. **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.

15. **E-Filling of Documents:** Every form or application of document required to be filed or delivered under the act and rules made thereunder, shall be filed

in computer readable electronic form on its website www.mca.gov.in and authenticated by a partner or designated partner of LLP by the use of electronic or digital signature.

16. **Foreign LLPs:** Section 2(1)(m) defines foreign limited liability partnership "as a limited liability partnership formed, incorporated, or registered outside India which established a place of business within India". Foreign LLP can become a partner in an Indian LLP.

ADVANTAGES OF LLP FORM

LLP form is a form of business model which:

1. Is organised and operates on the basis of an agreement.
2. Provides flexibility without imposing detailed legal and procedural requirements.
3. Easy to form.
4. All partners enjoy limited liability.
5. Easy to dissolve.

Partners [Section 5]

Any individual or body corporate may be a partner in a LLP. However, an individual shall not be capable of becoming a partner of a LLP, if—

(a) he has been found to be of unsound mind by a Court of competent jurisdiction and the finding is in force;

(b) he is an undischarged insolvent; or

(c) he has applied to be adjudicated as an insolvent and his application is pending.

The following persons can become partner in LLP:

(i) Individuals (Resident Indians including Non Resident Indians & Overseas Citizen of India as well as foreign nationals)*

(ii) Limited Liability Partnerships

(iii) Companies (including foreign companies)*

(iv) Foreign Limited Liability Partnerships*

(v) Limited Liability Partnerships incorporated outside India

(vi) Foreign Companies.

Co-operative society and corporation sole cannot become partner in a LLP.

*In case of introduction of capital / acquisition of existing stake in LLP by Persons resident outside India (other than NRIs & OCIs investing on a non-repatriation basis), the Foreign Direct Investment (FDI) compliances shall have to be undertaken by the LLP in which such investment is made.

Minimum number of Partners [Section 6]

(i) Every LLP shall have at least two 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 six 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.

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.

Example 3: A LLP has three partners, one individual i.e. Mr. X and two bodies corporates viz. M/s XYZ Ltd and M/s ABC Ltd. In this case Mr. X and one nominee of any body's corporate shall be designated partners.

Example 4: A LLP by the name SMY LLP has three partners namely 1. SI Limited, 2. MIS Limited, 3. YI Private Limited. As there is no individual as partner in LLP, nominees of any two said body corporates shall act as designated partners.

Resident in India: 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 one hundred twenty days during the financial year.

Example 5: There is a LLP by the name Indian Helicopters LLP having 5 partners namely Mr. A (Non Resident), Mr. B (Non Resident) Ms. C (resident), Ms. D (resident) and Ms. E (resident). In this case, at least 2 should be named as Designated Partner out of which 1 should be resident. Hence, if Mr. A and Mr. B are designated then it will not serve the purpose. One of the designated partners should be there out of Ms. C, Ms. D and Ms. E.

2. (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 LLP is to be designated partners, every partner shall be a designated partners;

   (ii) any partner may become a designated partner by and in accordance with the LLP Agreement and a partner may cease to be a designated partners in accordance with LLP agreement.

3. An individual shall not become a designated partner in any LLP unless he has given his prior consent to act as such to the LLP 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 partners 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 the LLP shall obtain a Designated Partner Identification Number (DPIN) from the Central Government and the provisions of sections 153 to 159 of the Companies Act, 2013 shall apply mutatis mutandis for the said purpose.

Liabilities of Designated Partners [Section 8]

Unless expressly provided otherwise in this Act, a designated partner shall be—

(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

₹100 per day subject to maximum ₹1,00,000 for LLP and ₹50,000 for every partner of such LLP.

3. INCORPORATION OF LLP

Incorporation Document [Section 11]

The most important document needed for registration is the incorporation document.

(1) For a LLP to be incorporated:

(a) two or more persons associated for carrying on a lawful business with a view to earn profit shall subscribe their names to an incorporation document;

(b) the incorporation document shall be filed in such manner and with such fees, as may be prescribed with the Registrar of the State in which the registered office of the LLP is to be situated (Incorporation documents are now processed electronically by Registrar, Central Registration Centre since 2nd October 2018); and

(c) **Statement to be filed:**

- there shall be filed along with the incorporation document, a statement in the prescribed form:
  - 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
  - by any one who subscribed his name to the incorporation document,
  - that all the requirements of this Act and the rules made thereunder have been complied with,
  - in respect of incorporation and matters precedent and incidental thereto.

(2) The incorporation document shall—

(a) be in a form as may be prescribed;

(b) state the name of the LLP;

(c) state the proposed business of the LLP;

(d) state the address of the registered office of the LLP;

(e) state the name and address of each of the persons who are to be partners of the LLP on incorporation;

(f) state the name and address of the persons who are to be designated partners of the LLP on incorporation;

(g) 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,

shall be punishable (Penalty for false declaration)

- 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.

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 sub-section (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.

Effect of registration [Section 14]

On Registration, LLP shall by its name, be capable of -

i. Suing and being sued;

ii. Acquiring, owning, holding and developing or disposing of property, whether movable or immovable, tangible or intangible;

iii. Having a common seal, if it decides to have one; and

iv. Doing and suffering other acts and things as bodies corporate may lawfully do and suffer.

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 sub-section (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.

STEPS TO INCORPORATE LLP

Step1 **Reservation of name of LLP:** Applicant has to file e-Form RUNLLP, for ascertaining availability and reservation of the name of a LLP.

Step2 **File e- Form FiLLiP for incorporating a new LLP:** contains the details of proposed LLP, details of partners/designated partners and their consent.

Step3 Execution of **LLP Agreement** is mandatory as per Section 23 of Act. It will be filed in **e-Form 3** within 30 days of incorporation of LLP.

4. 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 in such form, manner and accompanied by such fees as may be prescribed.

(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.

(4) In the absence of agreement as to any matter, the mutual rights and duties of the partners and the mutual rights and duties of the LLP and the partners shall be determined by the provisions relating to that matter as are set-out in the First Schedule.

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 with the other partners as to cessation of being a partner, 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.

(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 from the LLP does not by itself 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 partner.

(5) Where a partner of a LLP ceases to be a partner, unless otherwise provided in the LLP agreement, 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—

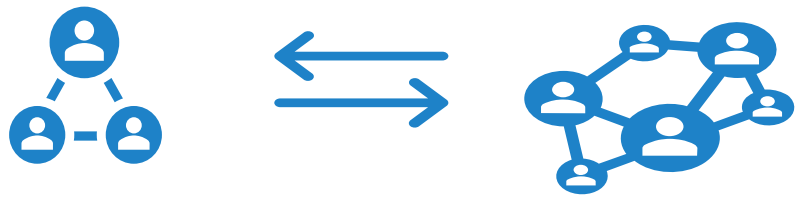
(a) an amount equal to the capital contribution of the former partner actually made to the LLP; and

(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 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

(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 LLP contravenes the provisions of sub-section (2), the LLP and every designated partner of the LLP shall be 'liable to penalty of ₹10,000.

(5) If any partner contravenes the provisions of sub-section (1), such partner shall be 'liable to penalty of ₹10,000.

(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

Partner as agent [Section 26]: Every partner of a LLP is, for the purpose of the business of the LLP, the agent of the LLP, but not of other partners.

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 a 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.

(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.

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) The provisions of sub-section (3) of section 27 and sub-section (1) of this section 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.

Holding out [Section 29]

(1) Any person,

- who by words spoken or written or by conduct,
- represents himself, or knowingly permits himself to be represented 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, whether the person representing himself or represented to be a partner does or does not know that the representation has reached the person so giving credit.

However,

- where any credit is received by the LLP as a result of such representation,
- the LLP shall,
- without prejudice to the liability of the person so representing himself or represented to be a partner,
- 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 by itself make his legal representative or his estate liable for any act of the LLP done after his death.

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 five 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, then without prejudice to any criminal proceedings which may arise under any law for the time being in force, 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.

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 an LLP has provided useful information during investigation of such LLP; or
- when any information given by any partner or employee (whether or not during investigation) 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).

CONTRIBUTIONS

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.

5. FINANCIAL DISCLOSURES

1. Maintain proper books of account in presribed manner.
2. File Statement of Account and Solvency within 6 months from end of each F.Y.
3. Statement of Account and Solvency shall be filed with the Registrar every year in prescribed form and manner and with prescribed fees.
4. Audit of Accounts. Central Government may exempt.

Maintenance of books of account, other records and audit, etc. [Section 34]

(1) Proper Books of account:

- The LLP shall maintain such proper books of account as may be prescribed
- relating to its affairs for each year of its existence
- on cash basis or accrual basis and
- according to double entry system of accounting and
- shall maintain the same at its registered office
- for such period as may be prescribed.

(2) Statement of Account and Solvency:

- Every LLP shall,
- within a period of 6 months from the end of each 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) Every LLP shall file within the prescribed time, the Statement of Account and Solvency prepared pursuant to sub-section (2) with the Registrar every year in such form and manner and accompanied by such fees as may be prescribed.

(4) The accounts of LLP shall be audited in accordance with such rules as may be prescribed. However, the Central Government may, by notification in the Official Gazette, exempt any class or classes of LLP from the requirements of this sub-section.

(5) Penalty for non-compliance of provisions of sub-section 3-

LLP – ₹100 per day subject to maximum ₹1,00,000

Every Designated Partners - ₹100 per day subject to maximum ₹50,000.

(6) Penalty for non-compliance of provisions of sub-section 1, 2 & 4 -

LLP – not less than ₹25,000 which may extend to ₹ 5 Lakhs.

Every designated partner –not less than ₹10,000 which may extend to ₹1 Lakh.

Accounting and auditing standards [Section 34A]

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 ICAI.

Annual Return [Section 35]

(1) 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 accompanied by such fee as may be prescribed.

Example 6: Suppose, the financial year of a LLP closes on 31st March, 2022 then the LLP has to file an annual return with the Registrar latest by 30th May, 2022.

Note

The LLP contra-distinct from Partnership Act, 1932 has prescribed the filing of Annual Return in accordance with Companies Act, 2013. This is a new feature of the LLPs.

(2) Penalty for non-filing of annual return –

LLP – ₹100 per day subject to maximum ₹1,00,000

Every Designated Partners - ₹100 per day subject to maximum ₹50,000

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.

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.

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.

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 sub-section (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.

6. 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.

7. CONVERSION INTO LLP

Conversion from firm into LLP [Section 55]: A firm may convert into an LLP in accordance with the provisions of this Chapter and the Second Schedule.

Conversion from private company into LLP [Section 56]: A private company may convert into an LLP in accordance with the provisions of this Chapter and the Third Schedule.

Conversion from unlisted public company into LLP [Section 57]: An unlisted public company may convert into an LLP in accordance with the provisions of this Chapter and the Fourth Schedule.

Registration and effect of conversion [Section 58]

(i) The Registrar, on satisfying that a firm, private company or an unlisted public company, as the case may be, has complied with the respective Schedules, provisions of this Act and the rules made thereunder, register the documents submitted under such schedules and issue a certificate of registration in such form as the Registrar may determine stating that the LLP is, on and from the date specified in the certificate, registered under this Act.

(ii) The LLP shall, within 15 days of the date of registration, inform the concerned Registrar of Firms or Registrar of Companies, as the case may be, with which it was registered under the provisions of the Indian Partnership Act, 1932 or the Companies Act, 1956 (Now Companies Act, 2013) as the case may be, about the conversion and of the particulars of the LLP in such form and manner as may be prescribed.

(iii) Upon such conversion, the partners of the firm, the shareholders of private company or unlisted public company, as the case may be, the LLP to which such firm or such company has converted, and the partners of the LLP shall be bound by the respective Schedules, as the case may be, applicable to them.

(iv) Upon such conversion, on and from the date of certificate of registration, the effects of the conversion shall be such as specified in the respective schedules, as the case may be.

Effect of Registration: Notwithstanding anything contained in any other law for the time being in force, on and from the date of registration specified in the certificate of registration issued under the respective Schedule, as the case may be,—

(a) there shall be a LLP by the name specified in the certificate of registration registered under this Act;

(b) all tangible (movable or immovable) and intangible property vested in the firm or the company, as the case may be, all assets, interests, rights, privileges, liabilities, obligations relating to the firm or the company, as the case may be, and the whole of the undertaking of the firm or the company, as the case may be, shall be transferred to and shall vest in the limited liability partnership without further assurance, act or deed; and

(c) 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, the provisions of the Companies Act, 2013 or such regulatory mechanism with such composition as may be prescribed.

8. 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'.

Explanation: (i) In this section "property" includes property, rights and powers of every description; and "liabilities" includes duties of every description.

(ii) a LLP shall not be amalgamated with a company.

9. WINDING UP AND DISSOLUTION

Winding up and dissolution [Section 63]: The winding up of a LLP may be either voluntary or by the Tribunal and LLP, so wound up may be dissolved.

Circumstances in which LLP may be wound up by Tribunal [Section 64]: 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 six months, the number of partners of the LLP is reduced below two;

(c) if the LLP has acted against the interests of the sovereignty and integrity of India, the security of the State or public order[1];

(d) if the LLP has made a default in filing with the Registrar the Statement of Account and Solvency or annual return for any five consecutive financial years; or

[1] Omitted by the Insolvency and Bankruptcy Code, 2016 (w.e.f. 15.11.2016)

(e) 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.

10. 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*)

- shall 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.

11. DIFFERENCES WITH OTHER FORMS OF ORGANISATION

Distinction between LLP and Partnership Firm: The points of distinction between a limited liability partnership and partnership firm are tabulated as follows:

	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 up to the personal assets of the partners.
9.	**Mutual agency**	Each partner can bind the LLP by his own 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 two designated partners and at least 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: (i) Statement of accounts and solvency (to be filed annually) (ii) 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.
15.	**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" as suffix.
5.	**No. of members/ partners**	Minimum – 2 members 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. 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 is 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 2 designated partners	Pvt. Co. – 2 directors Public co. – 3 directors

SUMMARY

- **Applicability:** From 31st March, 2009 (Extends whole of India)
- **Non- Applicability:** The Indian Partnership Act, 1932 to LLPs.
- **Who can be a partner in LLP:** Any individual or body corporate may be a partner in a LLP. But not, person of unsound mind, undischarged insolvent; or who has applied to be adjudicated as an insolvent.
- **Minimum partners:**
  1. Two partners.
  2. If LLP carries on business for more than 6 months with only one partner, he shall be liable personally for the obligations of the LLP incurred during that period.
- **Designated Partners:**
  1. At least two designated partners who are individuals and at least one of them shall be a resident in India.
  2. Resident in India: a person who has stayed in India for a period of not less than 120 days during the immediately preceding one year.
- **Registration of conversion to LLP**
  1. Registrar, on satisfying, will register the documents and issue a certificate of registration.
  2. Information of conversion to Registrar of Firms or Companies by LLP, within 15 days from registration.
  3. Upon such conversion, provisions of LLP will be applicable.
- **Effect of Registration of conversion**
  1. There shall be a LLP by name specified in certificate of registration.
  2. All tangible (movable or immovable) and intangible property of firm or the company, shall vest in LLP 3. Firm or company shall be deemed to be dissolved.

- **Name of LLP:**
  1. Use of words **"limited liability partnership"** or **"LLP"** as the last words of its name.
  2. **No LLP** registration by a name which, **in the opinion of the CG** is—
     a) undesirable; or
     b) identical or too nearly resembles to any other partnership firm or LLP or company or a registered trade mark.
- **Change of name of LLP:** If name of registered LLP is **identical or too nearly resembles** to any other partnership firm or LLP or company or a registered trade mark, **CG may direct such LLP to change its name within 3 months.** (On Application)
- Extent & Limitation of Liability of LLP & Partner
  - **Partner as agent:** Agent of the LLP, but not of other partners.
  - **Liability of LLP:**
    1. LLP not bound by anything done by a partner if Partner has no authority.
    2. Obligation of the LLP shall be solely the obligation of the LLP.
    3. Liabilities of LLP shall be met out of the property of LLP.
  - **Liability of partner:**
    1. Partner is not personally liable for obligations of the LLP.
    2. Partner is personally liable for his own wrongful act or omission
  - **Unlimited liability in case of Fraud:**
    1. If act carried out by a LLP or partner to defraud creditors, liability of LLP and partners shall be unlimited.
    2. Penalty: imprisonment upto 5 years and fine of ₹50,000 to ₹5 Lakhs.
    3. Defaulted person also liable to pay compensation.

TEST YOUR KNOWLEDGE

MCQ Based Questions

1. *Which of the following cannot be converted into LLP?*
   - *(a) Partnership firm*
   - *(b) Private company*
   - *(c) Listed company*
   - *(d) Unlisted company*
2. *The approved name of LLP shall be valid for a period of ___ from the date of approval:*
   - *(a) 1 Month*
   - *(b) 2 Months*
   - *(c) 3 months*
   - *(d) 6 months*
3. *Name of the Limited Liability Partnership shall be ended by:*
   - *(a) Limited*
   - *(b) Limited Liability partnership or LLP*
   - *(c) Private Limited*
   - *(d) OPC*
4. *Which one of the following statements about limited liability partnerships (LLPs) is incorrect?*
   - *(a) An LLP has a legal personality separate from that of its members.*
   - *(b) The liability of each partner in an LLP is limited.*
   - *(c) Members of an LLP are taxed as partners.*
   - *(d) A listed company can convert to an LLP.*
5. *For the purpose of LLP, Resident in India means:*
   - *(a) Person who has stayed in India for a period of not less than 182 days during the current year.*

(b) *Person who has stayed in India for a period of not less than 180 days during the immediately preceding one year.*

(c) *Person who has stayed in India for a period of not less than 181 days during the immediately preceding one year*

(d) *Person who has stayed in India for a period of not less than 120 days during the financial year.*

Descriptive Questions

1. *"LLP is an alternative corporate business form that gives the benefits of limited liability of a company and the flexibility of a partnership". Explain.*

2. *Mr. Ankit Sharma wants to form a LLP taking him, his wife Mrs. Archika Sharma and One HUF as partners for that. Whether this LLP can be incorporated under LLP Act, 2008? Explain.*

3. *There is an LLP by the name Ram Infra Development LLP which has 4 partners namely Mr. Rahul, Mr. Raheem, Mr. Kartar and Mr. Albert. Mr. Rahul and Mr. Albert are non – resident while other two are resident. LLP wants to take Mr. Rahul and Mr. Raheem as Designated Partner. Explain in the light of Limited Liability Partnership Act, 2008 whether LLP can do so?*

4. *Mr. Mudit is the creditor of Devi Ram Food Circle LLP. He has a claim of ₹10,00,000 against the LLP but the worth of the assets of LLP are only ₹7,00,000. Now Mr. Mudit wants to make the partners of LLP personally liable for the deficiency of ₹3,00,000. Whether by virtue of provisions of Limited Liability Act, 2008, Mr. Mudit can claim the deficiency from the partners of Devi Ram Food Circle LLP?*

5. *M/s Vardhman Steels LLP was incorporated on 01.09.2022. On 01.01.2023, one partner of a partnership firm named M/s Vardhimaan Steels is registered with Indian Partnership Act, 1932 since 01.01.2000 requested ROC that as the name of LLP is nearly resembles with the name of already registered partnership firm, the name of LLP should be changed. Explain whether M/s Vardhman Steels LLP is liable to change its name under the provisions of Limited Liability Act, 2008?*

6. *Kanik, Priyansh, Abhinav and Bhawna were partners in Singh Jain & Associates LLP. Abhinav resigned from the firm w.e.f. 01.11.2022 but this was not informed to ROC by LLP or Abhinav. Whether Abhinav will still be liable for the loss of firm of the transactions entered after 01.11.2022?*

ANSWERS

Answers to MCQ based Questions

1	(c)	Listed company
2	(a)	3 months
3	(b)	Limited Liability partnership or LLP
4	(b)	A listed company can convert to an LLP
5	(d)	Person who has stayed in India for a period of not less than 120 days during the financial year

Answers to Descriptive Questions

1. LLP is an alternative corporate business form that gives the benefits of limited liability of a company and the flexibility of a partnership

Limited Liability: Every partner of a LLP is, for the purpose of the business of LLP, the agent of the LLP, but not of other partners (Section 26 of the LLP Act, 2008). The liability of the partners will be limited to their agreed contribution in the LLP, while the LLP itself will be liable for the full extent of its assets.

Flexibility of a partnership: The LLP allows its members the flexibility of organizing their internal structure as a partnership based on a mutually arrived agreement. The LLP form enables entrepreneurs, professionals and enterprises providing services of any kind or engaged in scientific and technical disciplines, to form commercially efficient vehicles suited to their requirements. Owing to flexibility in its structure and operation, the LLP is a suitable vehicle for small enterprises and for investment by venture capital.

2. Section 5 of Limited Liability Partnership Act, 2008 provides any individual or body corporate may be a partner in an LLP. However, an individual shall not be capable of becoming a partner of a LLP, if—

(a) he has been found to be of unsound mind by a Court of competent jurisdiction and the finding is in force;

(b) he is an undischarged insolvent; or

(c) he has applied to be adjudicated as an insolvent and his application is pending.

Further, Section (2)(1)(e) provides that a **Body Corporate** it means a company as defined in 'clause (20) of section 2 of the 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 'clause (20) of section 2 of the Companies Act, 2013[2]' 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.

Therefore, HUF is not covered in the definition of body corporate and cannot be partner in LLP.

3. According to Section 7 of LLP Act, 2008 every LLP shall have at least two designated partners who are individuals and at least one of them shall be a resident in India. Further, explanation to the section provides, the term "resident in India" means a person who has stayed in India for a period of not less than one hundred twenty days during the financial year. Hence, in the given problem, besides Mr. Ram and Mr. Raheem, Mr. Albert should also be designated partners.

4. A limited liability partnership is a body corporate formed and incorporated under this Act and is a legal entity separate from that of its partners. The LLP itself will be liable for the full extent of its assets but the liability of the partners will be limited. Creditors of LLP shall be the creditors of LLP alone. In other words, creditors of LLP cannot claim from partners. The liability of the partners will be limited to their agreed contribution in the LLP. Hence the creditors of Devi Ram Food Circle LLP are the creditors of Devi Ram Food Circle LLP only. Partners of LLP are not personally liable towards creditors. Mr. Mudit can not claim his deficiency of ₹ 3,00,000 from the partners of Devi Ram Food Circle LLP.

5. Section 15 of LLP Act, 2008 provides 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 trade mark of any other person under the Trade Marks Act, 1999'.

Further, section 17 provides, if the name of LLP 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

then on an application of such LLP or proprietor referred to in clauses (a) and (b) respectively or a company, the CG may direct that such LLP to change its name within a period of 3 months from the date of issue of such direction.

Following the above provisions, LLP need not change its name if its name resembles with the name of a partnership firm. These provisions are applicable only in case where name is resembles with LLP, company or a registered trade mark of a proprietor.

Hence, M/s Vardhman Steels LLP need not change its name even it resembles with the name of partnership firm.

6. According to section 24(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.

Hence, by virtue of the above provisions, as no notice of resignation was given to ROC, Abhinav will still be liable for the loss of firm of the transactions entered after 01.11.2022.

NOTES