

CA Foundation

Paper 2 - Business Law

Chapter 6 (TCA)

The Companies Act, 2013

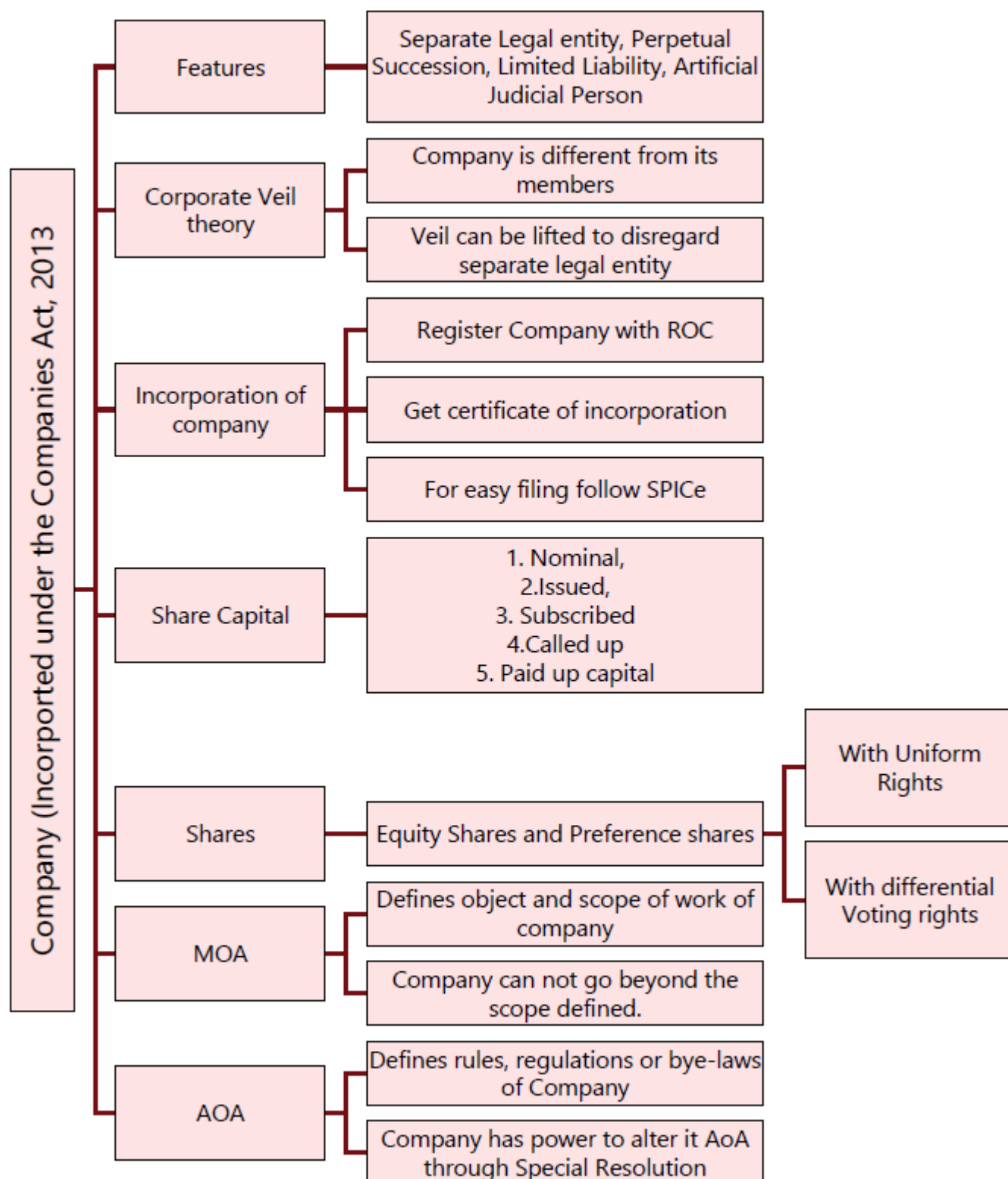
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INTRODUCTION



- The Companies Act, 2013 was enacted to -
Consolidate and Amend the law relating to the companies.
- Extent to the whole of India
- The Companies Act, 2013
 - The Companies Act, 1956 —-> 1942 —-> 1913
- The Act contains -
 - 470 sections and
 - 7 schedules.
 - 29 chapters.
 - A substantial part of this Act is in the form of Companies Rules.
- The Companies Act, 2013 aims to improve -
 - corporate governance,
 - simplify regulations,
 - strengthen the interests of minority investors and
 - for the first time legislates the role of whistle-blowers and provisions relating to class action suit.

APPLICABILITY OF THE COMPANIES ACT, 2013:

The provisions of the Act shall apply to-

Companies incorporated under this Act or under any previous company law.	Insurance companies except those provisions inconsistent with The Insurance Act, 1938 or the IRDA Act, 1999)	Banking companies except those provisions inconsistent with The Banking Regulation Act, 1949	Electricity Companies (generation or supply) except those provisions inconsistent with The Electricity Act, 2003	Companies governed by any special Act.
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COMPANY: MEANING AND ITS FEATURES

Meaning

Chief Justice Marshall -

1. A corporation is an artificial being, invisible, intangible, existing only in contemplation of law. Being a mere creation of law, it possesses only those properties which the charter of its creation confers upon it, either expressly or as accidental to its very existence.

2. Professor Haney -

A company is an incorporated association, which is an artificial person created by law, having a separate entity, with a perpetual succession and a common seal.

3. Section 2(20) of the Companies Act, 2013 -

"Company means a company incorporated under this Act or under any previous company law".

FEATURES OF A COMPANY

I
T.O.P.
C.L.A.S.S.

I	Incorporated Association	Registered group of members. Public 7 and Private 2
T	Transferability of Shares	As per the Articles as shares are movable property. In Pvt restricted but not prohibited & in Public freely transferable
O	Ownership - separate from its members	Members do not participate in day to day affairs. The company is managed by BOD elected by members. So ultimate control of members
P	Perpetual Succession	Members may come and go but company goes on forever.

C	Common Seal	Sign of a company as it's an artificial person. Now optional as per Co Act
L	Limited Liability	Limited by shares - Unpaid value
A	Artificial Legal Person	Yes, not a fictitious person. Exist only in the eyes of law.
S	Seperate Legal Entity	Distinct from its members having its own rights & obligations
S	Seperate Property and Sue	Can enjoy property in its own name. Members are neither owners or co-owners nor they have any insurable interest. Also company can sue and can be sued

Following features are described in detailed -

1. Separate Legal Entity:

This is the most distinctive and **striking feature** in the company form of organisation vis- à-vis the other forms of business organisations

- A **company is registered, it is clothed with a legal personality.**
- It comes to have **almost the same rights and powers as a human being.**
- Its **existence is distinct and separate from that of its members.**
- A company can **own property, have bank account, raise loans, incur liabilities and enter into contracts.**
 - a. It is at law, **a person which is different from the subscribers to the memorandum of association.**
 - b. **Even members can contract with company, acquire right against it or incur liability to it.**
 - c. For the debts of the company, only its creditors can sue it and not its members.
 - d. A company is **capable of owning, enjoying and disposing of property in its own name.**
 - e. Although the capital and assets are contributed by the shareholders,

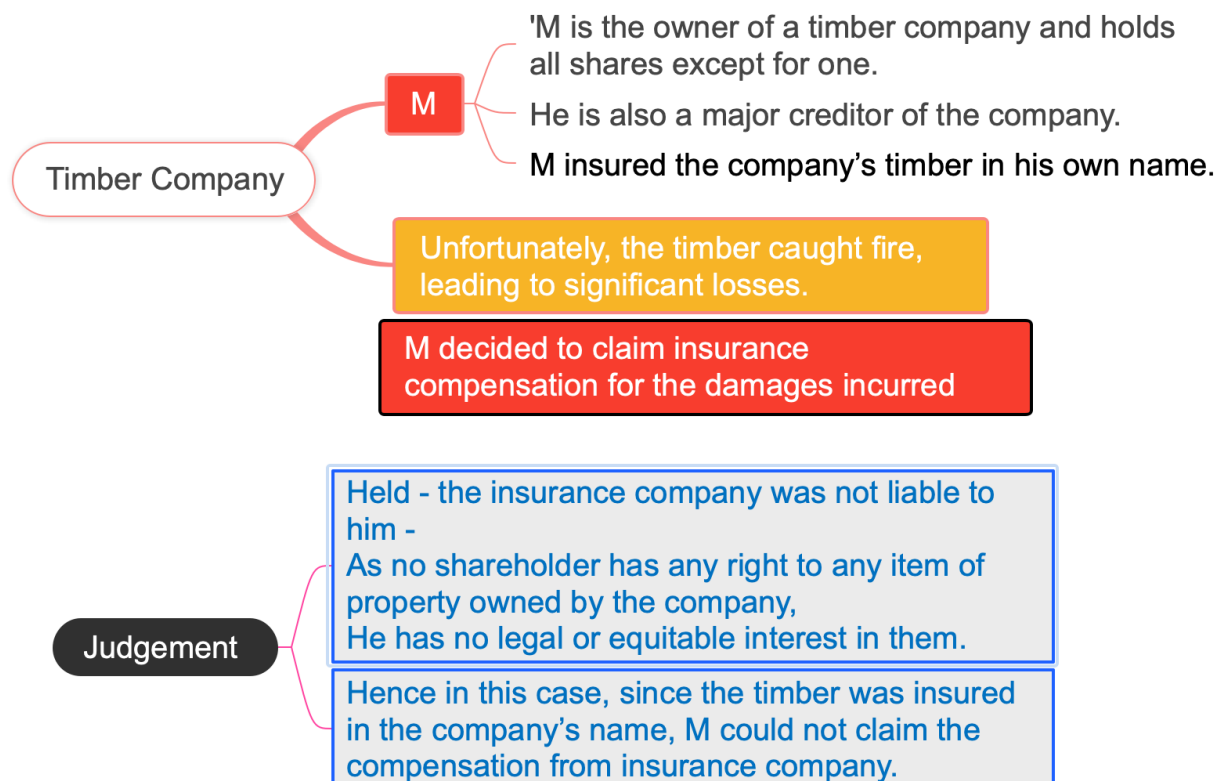
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the company becomes the owner of its capital and assets.

- f. The shareholders are not the private or joint owners of the company's property.

A member does not even have an insurable interest in the property of the company. The leading case on this point is of -

Macaura Vs. Northern Assurance Co. Limited (1925)



2. Perpetual Succession:

- Members may die or change, but the company goes on till it is wound up on the grounds specified by the Act.
- The shares of the company may change hands infinitely but that does not affect the existence of the company.
- Since a company is an artificial person created by law, law alone can bring an end to its life.
- Its existence is not affected by the death or insolvency of its members.

Example 1: Many companies in India are in existence for over 100 years. This is possible only due to the fact that the company has perpetual existence. There was a company which has 7 members and all of them died in an aircraft. Despite this the company still exists unlike partnership form of business.

3. Limited Liability:

- The liability of a member depends upon the kind of company of which he is a member.
 - In the case of a *limited liability company*,
 - the debts of the company in totality do not become the debts of the shareholders.
 - The liability of the members of the company is limited to the extent of the nominal value of shares held by them.
 - In no case can the shareholders be asked to pay anything more than the unpaid value of their shares.
 - In the case of a *company limited by guarantee*,
 - the members are liable only to the extent of the amount guaranteed by them and
 - that too only when the company goes into liquidation.
 - However, if it is an *unlimited company*, the liability of its members is unlimited as well.

4. Artificial Legal Person:

- I. A company is an *artificial person* as it is created by a *process other than natural birth*.
- II. It is *legal or judicial* as it is created by law. It is a person since it is clothed with all the rights of an individual.
- III. The *company being a separate legal entity* -
 - A. *can own property, have banking account, raise loans, incur liabilities and enter into contracts.*
 - B. Even *members can contract with company*, acquire right against it or incur liability to it.

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- C. It **can sue and be sued in its own name**.
 - D. It can do **everything** which any natural person can do **except be sent to jail, take an oath, marry or practice a learned profession**.
 - E. Hence, it is a legal person in its own sense.
- IV. As the company is an **artificial person**, it can **act only through** some human agency, viz., **directors**.
- V. The **directors can** act as its agency, but they are not the “agents” of the members of the company. The directors **can either on their own or through the common seal (of the company) can authenticate its formal acts**.

5. Common Seal:

- A company being an artificial person it needs to work through the agency of human beings.
- **Common seal is the official signature of a company**, which is affixed by the officers and employees of the company on its every document.
- The Companies (Amendment) Act, 2015 **has made the common seal optional by omitting the words “and a common seal”** from Section 9 so as to provide an **alternative mode of authorization** for companies who opt not to have a common seal.
- In case a company does not have a common seal, the **authorization shall be made by -**
 - **TWO directors or**
 - **By a director and the Company Secretary,**wherever the company has appointed a Company Secretary.

CORPORATE VEIL THEORY

1. Corporate Veil:

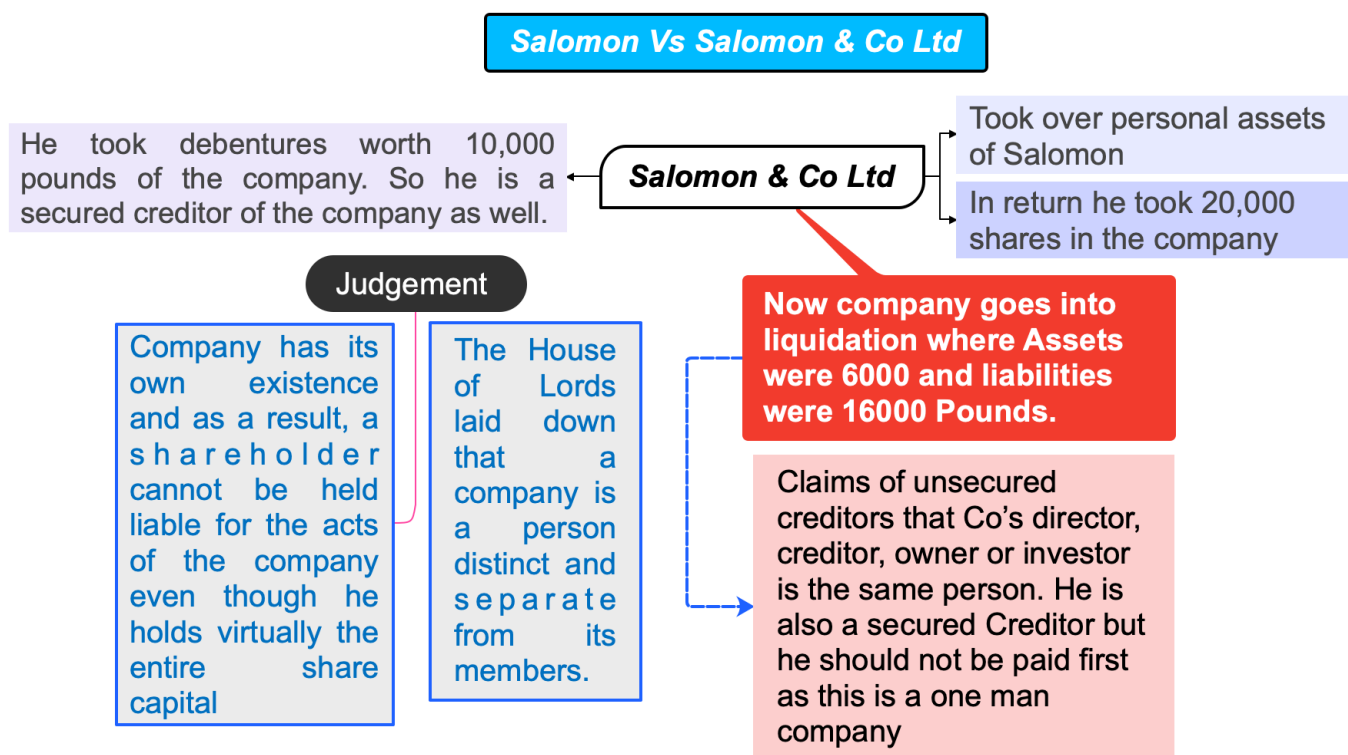
Corporate Veil refers to a **legal concept whereby the company** is identified separately from the members of the company.

The term Corporate Veil refers to the **concept that members of a company are shielded from liability connected to the company's actions**.

If the **company incurs any debts or contravenes any laws**, the corporate veil

concept implies that members should not be liable for those errors. In other words, they enjoy corporate insulation.

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



- The Company is at law a different person altogether from the subscribers to the memorandum, and
- though it may be that after incorporation the business is precisely the same as it was before and the same persons are managers, and the same hands receive the profits,
- the company is not in law the agent of the subscribers or trustees for them.
- Nor are the subscribers, as members, liable, in any shape or form, except to the extent and in the manner provided by the Act.

2. Lifting of Corporate Veil (पर्दा):

पीछे तो देखो

पर्दे के पीछे क्या है ?



- It means looking behind the company as a legal person, i.e.,

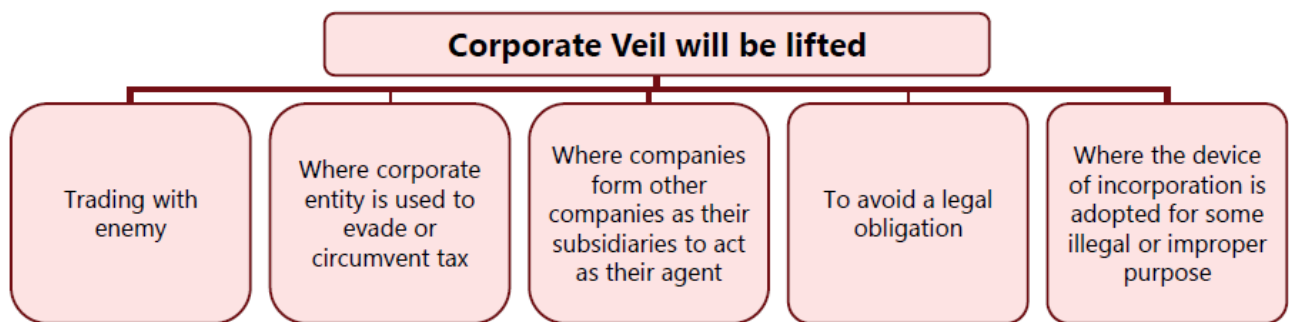
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- disregarding the corporate entity and paying regard,
- instead, to the realities behind the legal facade.

Where the Courts ignore the company and see directly with the members or managers, the corporate veil may be said to have been lifted.

- Only in appropriate circumstances, the Courts are willing to lift the corporate veil and that too,
- when questions of control are involved rather than merely a question of ownership. ★

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



- I. To determine the character of the company i.e. to find out whether co-enemy or friend:

Daimler Co. Ltd. vs. Continental Tyre & Rubber Co.

If the public interest is not likely to be in jeopardy, the Court may not be willing to crack the corporate shell. (अगर Public Interest की बात है तो court पर्दे को उठा देगी) to check whether a company is an enemy company.

Company = Unnatural person - No mind or conscience so cannot be a friend or enemy.

So a company = An enemy company,

If its affairs are under the control of people of an enemy country.

II. To protect revenue/tax:

When matters are =

Evasion of Taxes, duties and stamps means where corporate entity is used to evade or circumvent tax - the Court can disregard the corporate entity

Juggilal vs. Commissioner of Income Tax

Dinshaw Maneckjee Petit

Dinshaw incorporate: 4 Companies (doing no business & all the capital invested by Dinshaw)

4 Companies -- Investment

//

Dividend & Interest

//

Loan to Dinshaw (which was never repaid)

It was held that the company was not a genuine company at all but merely the assessee himself disguised under the legal entity of a limited company.

The assessee earned huge income by way of dividends and interest. So, he opened some companies and purchased their shares in exchange of his income by way of dividend and interest.

This income was transferred back to assessee by way of loan.

The Court decided that the private companies were a sham and the corporate veil was lifted to decide the real owner of the income.

III. To avoid a legal obligation:

- Where it was found that the sole purpose for the formation of the company

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was to use it as a device

- to reduce the amount to be paid by way of bonus to workmen,

Workmen of Associated Rubber Industry Ltd., v. Associated Rubber Industry Ltd.

Associated Rubber Industry bought shares of INARCO Ltd

Sometime in 1968 - Shares are transferred to its own subsidiary - This company has NO -

- Assets of its own except those transferred to it by the principal company,
- Business or income of its own except receiving dividends from shares transferred to it by the principal company and
- Purpose except to reduce the gross profit of the principal company so as to reduce the amount paid as bonus to workmen.

All the dividend income also went to the subsidiary

Issue -

The workmen of Associated Rubber Industries Ltd contended that the new subsidiary company was formed in order to pay lower bonuses to workmen as a result of transferring the dividend amount to the subsidiary company.

Here a company created a subsidiary and transferred to it, its investment holdings in a bid to reduce its liability to pay bonus to its workers.

Judgement -

Thus, the Supreme Court brushed aside the separate existence of the subsidiary company.

IV. Formation of subsidiaries to act as agents:

A company may sometimes be regarded as -

- An agent or trustee of its members, or of another company, and
- may therefore be deemed to have lost its individuality
- in favour of its principal.

- Here the principal will be held liable for the acts of that company.

Merchandise Transport Limited vs. British Transport Commission (1982) -

Transport company wanted to obtain licences for its vehicles but could not do so if applied in its own name.

It, therefore, formed a subsidiary company, and the application for licence was made in the name of the subsidiary.

The vehicles were to be transferred to the subsidiary company.

Held, the parent and the subsidiary were one commercial unit and the application for licences was rejected.

V. Company formed for fraud/improper conduct or to defeat law:

- Where the device of incorporation is adopted
- for some illegal or improper purpose,
- To defeat or circumvent law, to defraud creditors or to avoid legal obligations.

[Gilford Motor Co. vs. Horne] -

Mr. Horne - MD of a company - Under Non compete clause

Left the company and formed another company with the intent of creating competition and to conduct solicitation

He established a rival business to Gilford Motor, in which the sole shareholders were Mr. Horne's wife and one of his business associates.

Only Horne himself was subject to any legal restrictions imposed by Gilford; the new company itself was not.

Held, the Court saw through the corporate veil and held that Mr. Horne was the person behind it and that the non-compete clause in the employment contract should be interpreted as binding not only on Mr. Horne personally but also on the new company.

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CLASSES OF COMPANIES UNDER THE ACT.

Companies may be classified into various classes on the following basis:

LIABILITY	SIZE (Members)	CONTROL	LISTING	OTHERS
Unlimited	Public Co.	Holding Co.	Listed	Foreign Company
Limited	Private Co.	Subsidiar Co.	Unlisted	Gov. Company
1. By Guarantee	Opc	Associate Co.		Section 8 - Npo
2. By Shares	Small Co.			Dormant Co.
Both				Nidhi Co

1. On the basis of liability:

a. Company limited by shares:

- Section 2(22) -
- when the liability of the members of a company is limited by its memorandum of association to the amount (if any)
- unpaid on the shares held by them,
- it is known as a company limited by shares.
- It is implied that for meeting the debts of the company, the shareholder may be called upon to contribute only
- to the extent of the amount, which remains unpaid on his shareholdings.
- His separate property cannot be encompassed to meet the company's debt.
- Though a shareholder is a co-owner of the company, he is not a co-owner of the company's assets.

- The ownership of the assets remains with the company, because of its nature as a legal person.

b. Company limited by guarantee:

- Section 2(21) -
- As the company having the liability of its members limited by the memorandum to such amount
- as the members may respectively undertake by the memorandum
- to contribute to the assets of the company
- **in the event of its being wound up**
- Thus, the liability of the member of a guarantee company is limited upto a stipulated sum
- mentioned in the memorandum.
- Members cannot be called upon to contribute beyond that stipulated sum.
- The **common features** are -
 - legal personality and
 - limited liability.
 - To be stated in their memorandum that the members' liability is limited.
- The **point of distinction** between these two types of companies -

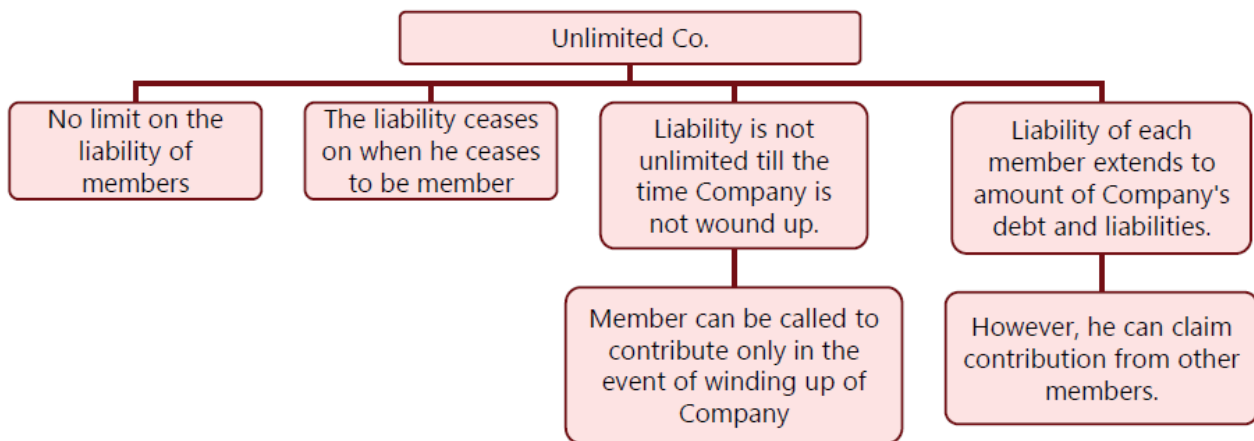
BASIS	GUARANTEE Company	SHARE CAPITAL Company
Meaning	When MOA says that liability of members shall be restricted to the amount they have guaranteed.	When memo says that liability of members shall be restricted to the unpaid amount on the shares held by them.
SC	May or may not have SC	Must have SC
Quantum of Liability	In case of Winding up liability of every member : - Guaranteed amount and If SC - Unpaid amount of	Liability of every member : Unpaid amount on the shares held by them.

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BASIS	GUARANTEE Company	SHARE CAPITAL Company
	shares	
When does liability arise ?	Only in the case of Winding up	When valid call is made by co.
Suitability	Where huge Initial capital is not required & funds can be arranged by way of borrowings, fees charged etc.	Where huge Initial capital is required & financial resources cant be arranged by way of borrowings

c. Unlimited company:

- Section 2(92) -
- Unlimited company as a company not having any limit on the liability of its members.
- In such a company, the liability of a member ceases when he ceases to be a member.
- The liability of each member extends to the whole amount of the company's debts and liabilities but he will be entitled to claim contribution from other members.
- In case the company has share capital, the Articles of Association must state the amount of share capital and the amount of each share.
- So as long as the company is a going concern the liability on the shares is the only liability which can be enforced by the company.
- The creditors can institute proceedings for winding up of the company for their claims.
- The official liquidator may call the members for their contribution towards the liabilities and debts of the company, which can be unlimited.



2. On the basis of members:

a. One person company:

- Section 2(62) - A new class of companies which can be incorporated by a **single person**.
- One person company (OPC) as a company which has **only one person as a member**.
- One person company has been introduced to encourage entrepreneurship and corporatization of business.
- OPC - A type of Company so it is a separate legal entity with a limited liability of the member
- Sole proprietary concern the liability of owner is not restricted and it extends to the owner's entire assets constituting of official and personal.
- Section 3(1)(c) - **OPC is a private limited company**
- **All OPCs are private but all private are not OPCs**
- with the minimum paid up share capital as may be prescribed and having one member.
- OPC (One Person Company) - significant points
 - Only one person as member.
 - **Minimum paid up capital – no limit prescribed.**

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Provisions related to Member and Nominee

- The memorandum of OPC shall have- the name of the other person, who in the event of -
 - the subscriber's death or
 - his incapacity to contract,become the member of the company.
- His prior written consent is required in prescribed form and the same shall be filed with Registrar of companies at the time of incorporation of the company along with its e-memorandum and e-articles.
- He has been given the right to withdraw his consent.
- Change in the name of such other person can be done by giving notice to -
 - the company and
 - the company shall intimate the same to the Registrar.
- Such change in the name of the person shall not be deemed to be an alteration of the memorandum.

Who can be a Member and Nominee ?

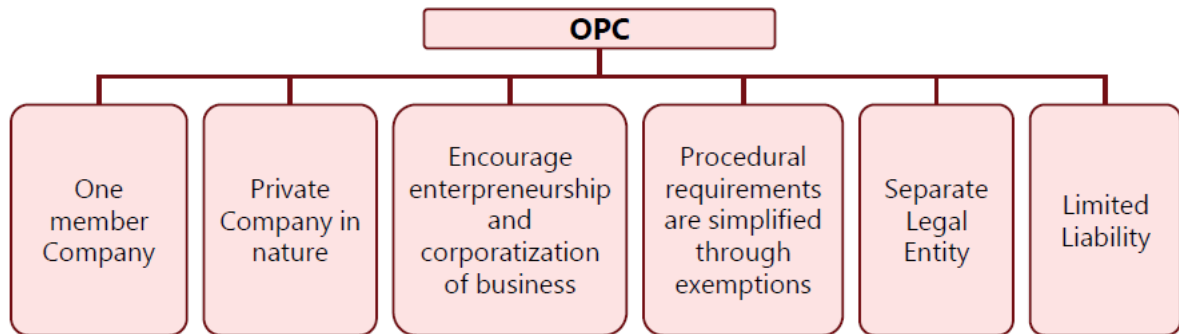
- Only a natural person
 - who is an Indian citizen
 - whether resident in India or otherwise and
 - has stayed in India for a period of not less than 120 days
 - during the immediately preceding financial year
- shall be eligible to incorporate a OPC; and shall be a nominee for the sole member of a OPC.

What are the DONT'S ?

- Involvement in TWO OPCs - NO means More than ONE not allowed - Neither for Member nor for Nominee.
- Minor ≠ Member or nominee.
- OPC ≠ cannot be incorporated or converted into a Section 8 NO

OPC = May be converted to private or public companies. **YES**

- OPC **≠** cannot carry out Non-Banking Financial Investment activities including investment in securities of any body corporate.
- Here the member can be the sole member and director as well.



b. Private Company [Section 2(68)]:

PP - **Prohibits** any invitation to the **public** to subscribe for any securities of the company

R - **Restricts** the right to transfer its shares

- Articles Restricts but do not Prohibit ★
- Uniform rights to all the members. No discrimination

Lim - **Limits** the number of its members to 200 (Except OPC) ★

- Joint members - Counted as ONE
- For counting 200 members - Do not include -
 - A. Existing employees cum members and
 - B. Former employees who were members of the company while in that employment and have continued to be members after the employment ceased. (employees cum members)
- Minimum members - 2 (except OPC) and Maximum - 200

Small Company:

- Small company is a private company.
- Section 2(85) which means a company —

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Paid up capital – not more than Rs. 4 Crores

Or

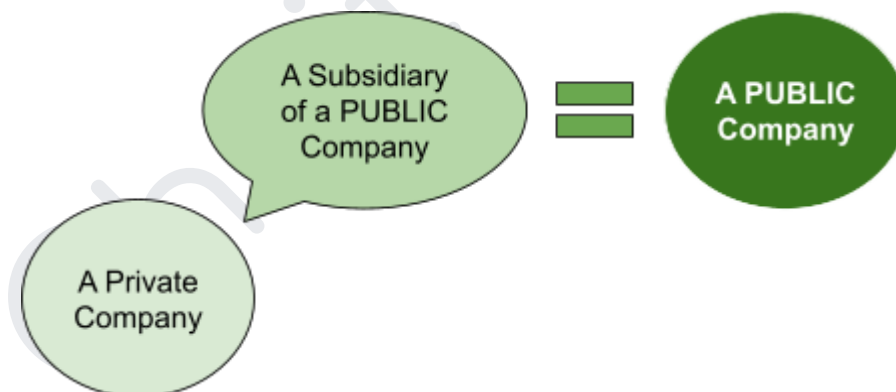
Turnover – not more than Rs. 40 crores.

Exceptions: This clause shall not apply to:

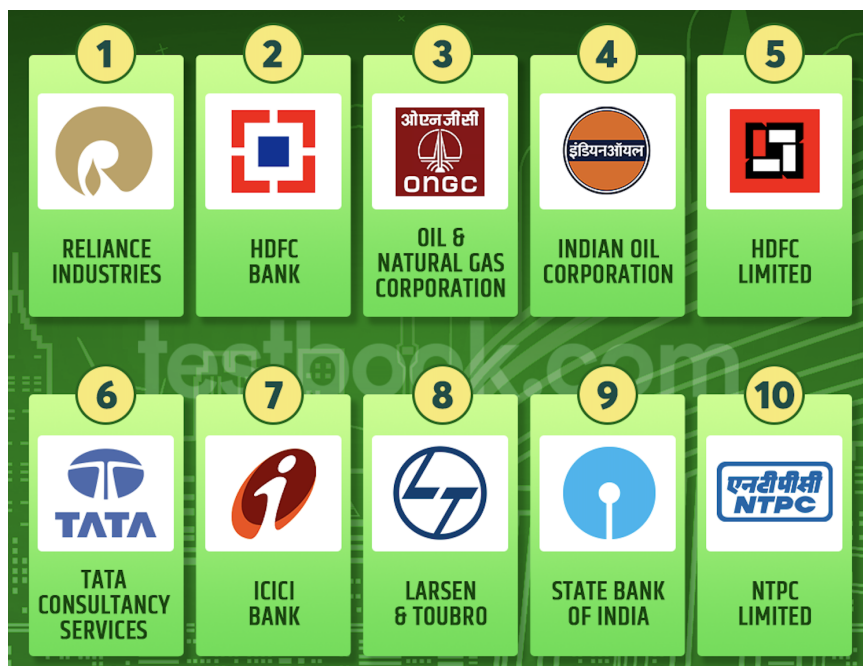
- a) a holding company or a subsidiary company;
- b) a company registered under section 8; or
- c) a company or body corporate governed by any special Act.

c. Public company [Section 2(71)]:

- “Public company” means a company which—
 - Is not a private company (Articles do not have the restricting clauses).
 - Shares are freely transferable.
 - No minimum paid up capital requirement.
 - Minimum number of members – 7.
 - Maximum numbers of members – No limit.
 - Status of private company, which is subsidiary to public company:



In view of Section 2(71) of the Companies Act, 2013 a Private company, which is subsidiary of a public company shall be deemed to be public company for the purpose of this Act, even where such subsidiary company continues to be a private company in its articles.



3. On the basis of control:

a. Holding and subsidiary companies: Definitions are in relation to each other.

- Holding means Who - (either a or b).
 - controls the composition of the Board of Directors

What do you mean by controlling BOD ?

HC at its discretion can appoint or remove all or a majority of the directors;

OR

- exercises or controls more than one-half of the total voting power or 50% or more of total Share Capital either at its own or together with one or more of its subsidiary companies.

- Company includes any body corporate (Means includes foreign companies as well).
- Total Share Capital = Equity SC + Convertible Preference SC

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- Explanation —



Example 2: A will be subsidiary of B, if B controls the composition of the Board of Directors of A, i.e., if B can, without the consent or approval of any other person, appoint or remove a majority of directors of A.

Example 3: A will be subsidiary of B, if B holds more than 50% of the share capital of A.

Example 4: B is a subsidiary of A and C is a subsidiary of B. In such a case, C will be the subsidiary of A. In the like manner, if D is a subsidiary of C, D will be subsidiary of B as well as of A and so on.

Associate company [Section 2(6)]: A company where holding company has a **significant influence**, but which is not a subsidiary company of the company and includes a joint venture company.

Atleast 20% but Max 50% of Total Voting Powers

Explanation. — For the purpose of this clause —

- Significant influence** = Control of at least 20% of total voting power, or control of or participation in business decisions under an agreement;
- Joint venture** = A joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

4. On the basis of access to capital:

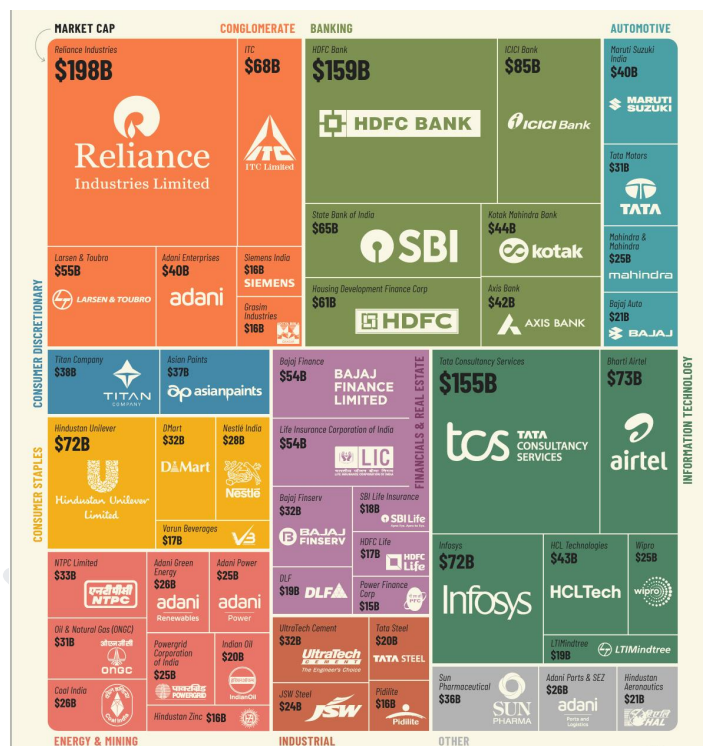
a. Listed company:

It is a company which has any of its securities listed on any recognised stock exchange.

b. Unlisted company

Means company other than listed company.

Example 5: Scan Steel Rods Limited is a Public Limited Company whose shares are listed in the Stock Exchange, Kolkata. Hence Scan Steel Rods Limited is a Listed Company. The reason for calling it "Listed" is because the company and the Stock Exchange have signed a Listing Agreement for trading of shares in the capital market.



5. Other companies:

a. Government company [Section 2(45)]:

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- Government Company means any company in which -

Not less than 51% of the paid-up share capital (with Voting rights) is held by-

- Central Government, or
- State Government or Governments, or
- Partly by the CG and partly by one or more SG, and
- Includes a company which is a subsidiary company of such a Government company.

Explanation:

The “paid up share capital” shall be construed as “total voting power”, where shares with differential voting rights (DVRs) have been issued.

b. Foreign Company [Section 2(42)]:

- It means any company or body corporate
- incorporated outside India
- which has a place of business in India
- whether by itself or through an agent, physically or through electronic mode; and
- conducts any business activity in India in any other manner.

c. Section 8 company -

Formation of companies with charitable objects etc.

Section 8 are formed to -

- promote the charitable objects of commerce, art, science, sports,

education, research, social welfare, religion, charity, protection of environment etc.

- Such company **intends to apply its profit in**
- **promoting** its objects and
- **prohibiting** the payment of **any dividend to its members.**

Examples -

of section 8 companies are FICCI, ASSOCHAM, National Sports Club of India, CII, Reliance Research Institute, Reliance Foundation, TATA Foundation, and Infosys Foundation etc.

Power of Central government to issue the license-

- Central Government registers -
 - such person or association of persons
 - as a company with limited liability
 - without the addition of words 'Limited' or 'Private limited' to its name,
 - by issuing licence on such conditions as it deems fit.
 - On registration the company shall enjoy same privileges and obligations as of a limited company.

Revocation of license:

- **Yes**, 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 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.

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Order of the Central Government:

- After a licence is revoked -
- Central Government may in the public interest
- order that the company to be amalgamated with another company registered under this section
- having similar objects,
- 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, or the company be wound up.

Penalty/punishment in contravention:

- If a company makes any default in complying with this section be punishable with -

Fine on the company - 10 lakh to 1 crore rupees

and

Fine on the directors and every officer of the company Rs 25,000 to 25 lakh rupees.

- If proved that the affairs of the company were conducted fraudulently then Section 447 on every officer in default.

Significant points to sum up -

- Requirement of minimum share capital does not apply.
- Uses its profits for the promotion of the objective for which it is formed.
- Does not declare dividend to members.
- Need not use the word Ltd./ Pvt. Ltd. in its name and adopt a more suitable name such as club, chambers of commerce etc.
- Licence revoked if conditions contravened.
- On revocation, Central Government may direct it to
 - a. Converts its status and change its name

- b. Wind – up
- c. Amalgamate with another company having similar object.
- Can call its general meeting by giving a clear 14 days' notice instead of 21 days.
- Requirement of minimum number of directors, independent directors etc. does not apply.
- Need not constitute Nomination and Remuneration Committee and Shareholders Relationship Committee.
- A partnership firm can be a member of Section 8 company.

Formation	
•To promote Charitable objects	
Application of profits	
•To promote its objects	
•No payment of dividends out of profits	
Type of Co.	
•Limited Liability	
•Without the addition of words "Ltd" or "Pvt Ltd."	
How status is granted	
•The CG can grant such status	
•However, CG has delegated the power to grant licence to ROC	
Revocation of licence	
•CG may revoke licence	
•If conditions of section 8 are contravened, or	
•affairs of the company are conducted fraudulently, or prejudicial to public interest	
Effect of revocation of licence	
•Co has to use words "Ltd." or "Pvt Ltd."	

d. Dormant company (Section 455):

- Where a company is formed for a **future project or**
- **to hold an asset or intellectual property** and
- has **no significant accounting transaction** or
- **an inactive company**
- may make an application to the Registrar
- for obtaining the status of a dormant company.

Inactive company =

A company which **has not been** -

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- carrying on any business or operation, or
- has not made any significant accounting transaction during
- the last two financial years, or
- has not filed financial statements and annual returns
- during the last two financial years

“Significant accounting transaction -

Any transaction other than— (ये Significant accounting transaction नहीं है)

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

e. Meaning of Nidhi Companies - Section 406(1) -

- Nidhi” or “Mutual Benefit Society” -
- A company which the CG may
- by notification in the Official Gazette,
- declare to be a Nidhi or Mutual Benefit Society.

Nidhi Companies are created mainly for cultivating the habit of thrift and savings amongst its members.

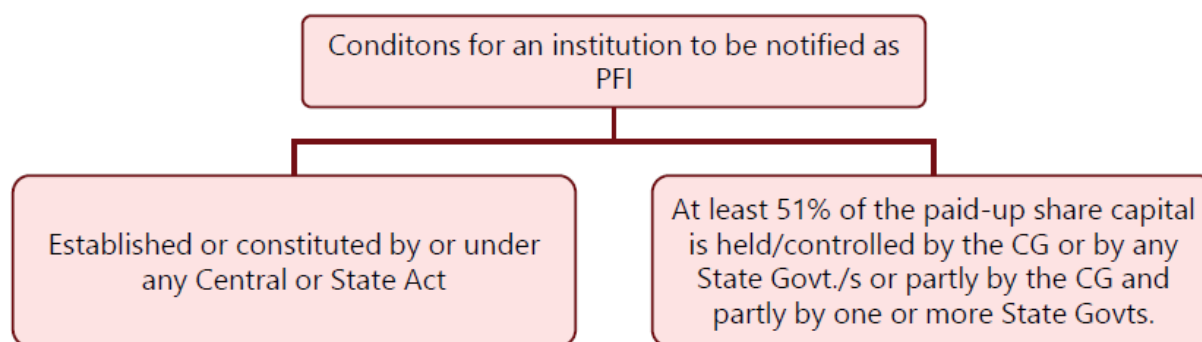
f. Public Financial Institutions (PFI) - Section 2(72)

The following institutions are to be regarded as PFI :-

- a. The Life Insurance Corporation of India (LIC),
- b. The Infrastructure Development Finance Company Limited, (IDFC Ltd)
- c. Company in Unit Trust of India (UTI)
- d. Institutions under section 4A(2) of the Companies Act, 1956
- e. Such other institution as may be notified by the CG in consultation with the RBI

- Conditions -

- a. Established or constituted by or under any Central or State Act other than this Act or the previous Companies Law;
or
- b. Not less than 51% per cent of the paid-up share capital is held or controlled by the CG or by any SG or partly by the CG and partly by one or more SGs.



MODE OF REGISTRATION/INCORPORATION OF COMPANY

PROMOTERS under Section 2(69) -

- Who has been **named** as such in a **prospectus** or in the **annual return** referred to in section 92; or
- who has **control over the affairs of the company**, directly or indirectly whether as a shareholder, director or otherwise; or
- in accordance with **whose advice, directions, or instructions** the **Board of Directors** of the company is accustomed to **act**.
- Persons who **form the company** are known as promoters.
- It is they who **conceive the idea** of forming the company.
- They take **all necessary steps** for its registration.

Idea दे रहा हूँ	Form the company दोस्तों का साथ सही	सारे Affair Control करलो	Prospectus (रिश्ते) annual return हर साल - वापस ए जाते है	मेरी यही - advice, कहलौं या directions, or या हुक्म instructions
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	कार्लो			
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- It should, however, be noted that persons acting only in a professional capacity e.g., the solicitor, banker, accountant etc. are not regarded as promoters.
- Duty of a promoter -
 - Not to make secret profit, He can make a profit but not a secret one and should make full and fair disclosure
 - Full and fair disclosure of his interest in every transaction or contract with company in which he is interested

FORMATION OF COMPANY:

- Section 3 of the Companies Act, 2013 -
- In the case of a **public company**, - **Any 7** or more persons
- In case of a **private company** - **2 or more** persons
- In case of one person company - **1 person** can form
 - for any lawful purpose
 - by subscribing their names to memorandum and
 - complying with the requirements of this Act in respect of registration.

INCORPORATION OF COMPANY - Section 7 -

Registration Process



1. Obtain DSC	5. Application
2. DIN	6. ROC scrutiny
3. Name availability for proposed company	7. COI by ROC
4. MOA & AOA	

1. Filing of the documents and information with the registrar: Document LIST

e-MOA and e-AOA INC 33-34	2 types of Declarations	Proposed RO Address	Know Your Subscribers and Directors
------------------------------	-------------------------	---------------------	-------------------------------------

To the registrar within whose jurisdiction the registered office (RO) of the company is proposed to be situated -

- a. **MOA and AOA** - Duly signed by all the subscribers to the memorandum
- b. **A declaration** -
 - By person who is engaged in the formation of the company (an advocate, a CA, cost accountant or CS in practice), **and**
 - by a person named in the articles (director, manager or secretary of the company),

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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.

c. **A declaration - From first director(s) and each subscriber -**

Stating that-

1. **Not convicted** of any offence in connection with the promotion, formation or management of any company, or
2. **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,
3. and 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;**

d. **The address** for correspondence till its registered office is established;

e. **The particulars** of every subscriber to the memorandum -

- Names, including surnames or family names,
- residential address,
- nationality along with proof of identity, and
- DIN in case of Directors
- in the case of a subscriber being a body corporate, such particulars as may be prescribed and

f. **Interest in other entities** and consent to act as a director from the first directors of the company

g. Particulars provided in this provision shall be of the individual subscriber and not of the professional engaged in the incorporation of the company
[The Companies (Incorporation) Rules, 2014].

2. 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 prescribed form
- to the effect that the proposed company is incorporated under this Act.


सत्यमेव जयते
GOVERNMENT OF INDIA
MINISTRY OF CORPORATE AFFAIRS
Central Registration Centre

Certificate of Incorporation

[Pursuant to sub-section (2) of section 7 and sub-section (1) of section 8 of the Companies Act, 2013 (18 of 2013) and rule 18 of the Companies (Incorporation) Rules, 2014]

I hereby certify that [REDACTED] LIMITED is incorporated on this Tenth day of October Two thousand twenty under the Companies Act, 2013 (18 of 2013) and that the company is limited by shares.

The Corporate Identity Number of the company is XXXX99DL202XXXX37XXXX

The Permanent Account Number (PAN) of the company is [REDACTED] *

The Tax Deduction and Collection Account Number (TAN) of the company is [REDACTED] *

Given under my hand at Manesar this Thirteenth day of October Two thousand twenty .


Digital Signature Certificate
SHIVARAJ C RANJERI
ASST. REGISTRAR OF COMPANIES
For and on behalf of the Jurisdictional Registrar of Companies
Registrar of Companies
Central Registration Centre

3. 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, (CIN)
- which shall be a distinct identity for the company and
- which shall also be included in the certificate.

4. Maintenance of copies of all documents and information:

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

5. Furnishing of false or incorrect information or suppression of material fact at the time of incorporation (i.e. at the time of Incorporation):

- If any person furnishes any false or incorrect particulars of
- any information or suppresses any material information,

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- 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.

6. 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 furnishing any false or incorrect information or representation or
- by suppressing any material fact or information in any documents or
- declaration filed or made for incorporating such company, or
- 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.

7. Order of the Tribunal (Power) -

In the case above - The Tribunal may on an application made to it, on being satisfied that the situation so warrants — Pass orders for -

- a. Regulation of the management of the company
- b. Changes, if any, in its MOA and AOA
 - i. In public interest or
 - ii. In the interest of the company and its members and creditors; or
- c. Make members liability unlimited; or
- d. Removal of the name of the company from the ROC or
- e. Winding up of the company; or
- f. pass such other orders as it may deem fit

Provided that before making any order the company shall be given a reasonable opportunity of being heard in the matter.

[Pursuant to sections 4, 7, 8(1), 12, 152 and 153 of the Companies Act, 2013 read with rules made thereunder] - FORM NO. INC-32

SPICE

(Simplified Proforma for Incorporating Company Electronically)

☒ English ☐ Hindi

Refer the instruction kit for filing the form.

*Whether name is already approved by Registrar of Companies ☐ Yes ☒ No

1. (a) *State the type of company New company (others)

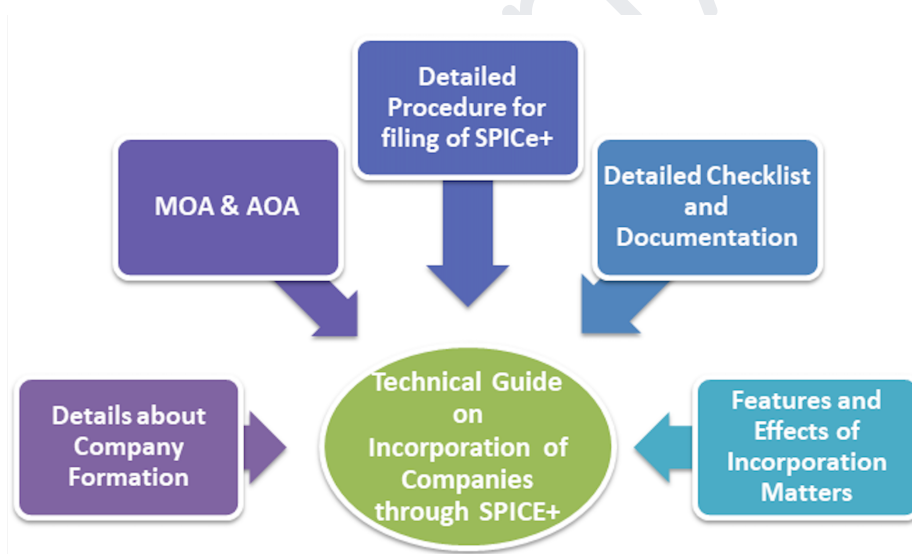
(b) *State the class of company ☐ Public ☒ Private ☐ One Person Company

(c) *State the category of company Company limited by shares

(d) *State the sub-category of company Non-government company

(e) *Whether proposed company is an IFSC company ☐ Yes ☐ No

Simplified Proforma for Incorporating Company Electronically (SPICE) - MCA has simplified the process of filing of forms for incorporation of a company through Simplified Proforma for incorporating company electronically.



Section 9 - EFFECT OF REGISTRATION:

From the **date of incorporation** (mentioned in the certificate of incorporation),

- SUBSCRIBERS —————>> MEMBER OF THE COMPANY
- COMPANY —————>> BODY CORPORATE

The subscribers to the memorandum and all other persons who may from time to

6 ► The Companies Act, 2013

time become members of the company, shall be a body corporate by the name contained in the memorandum.

- Such a registered company shall be capable of exercising all the functions of an incorporated company under this Act and
 - having perpetual succession with
 - power to acquire, hold and dispose of property, both movable and immovable, tangible and intangible,
 - to contract and
 - to sue and be sued, by the said name
- Some important case laws -

Hari Nagar Sugar Mills Ltd. vs. S.S. Jhunjhunwala

State Trading Corporation of India vs. Commercial Tax Officer

- The company becomes a legal person separate from the incorporators.
- A binding contract between the company and its members as evidenced by the Memorandum and Articles of Association
- It has perpetual existence until it is dissolved by liquidation or struck out of the register.
- A shareholder who buys shares, does not buy any interest in the property of the company.

Spencer & Co. Ltd. Madras vs. CWT Madras

- A company may purchase shares of another company and thus become a controlling company.
- However, merely because a company purchases ALL shares of another company it will not serve as a -
- means of putting an end to the corporate character of another company and
- Each company is a separate juristic entity

Heavy Electrical Union vs. State of Bihar

- *The mere fact that the entire share capital has been contributed by the Central Government and*
- *all its shares are held by the President of India and other officers of the Central Government*

Does not make any difference in the position of registered company and it does not make a company an agent either of the President or the Central Government

Section 10 - BINDING FORCE OF MOA & AOA :-

MOA/AOA shall bind the company and the members as if they respectively had been signed by the company.

COMPANY IS BOUND TO MEMBERS -

1. Company cannot deprive any member of its rights
2. If company is about to commit a breach then members may obtain an injunction from court and
3. If co has already committed a breach then members can sue the company/director/responsible persons

MEMBERS ARE BOUND TO COMPANY -

1. All monies payable by any member to the company under the memorandum or articles shall be a debt due from him to the company.
2. To observe all the provisions of the memorandum and of the articles.

CLASSIFICATION OF CAPITAL

In relation to a Company limited by shares,

The word CAPITAL means Share-Capital, i.e. **the capital or figure in terms of so many rupees divided into shares of fixed amount.**

The contributions of persons to the common stock of the company form the capital of the company.

SHARE - (to be discussed in detail later)

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The proportion of the capital to which each member is entitled, is his share.

Borland Trustees vs. Steel Bors. & Co. Ltd.

A share is not a sum of money; it is rather an interest measured by a sum of money and made up of various rights contained in the contract.

TYPES -

a. Nominal or authorised or registered capital:

- “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.
- Thus the MAXIMUM sum the company is authorised to raise by issuing shares, and upon which it pays the stamp duty.
- It is usually fixed at the amount - the company will need including the working capital and reserve capital, if any.

b. Issued capital:

- Such capital as the company issues from time to time for subscription.
- It is that part of authorised capital which is offered by the company
- for subscription and
- includes the shares allotted for consideration other than cash.
- Schedule III to the Companies Act, 2013, makes it obligatory for a company to disclose its issued capital in the balance sheet.

c. Subscribed capital:

- Such part of the Issued capital which is for the time being subscribed by the members of a company.
- It is the nominal amount of shares taken up by the public.
- Paid-up capital must be stated in equally conspicuous characters as the authorised capital, the subscribed capital on -
- Any notice, advertisement or other official communication or any business letter, bill head or letter paper of a company
- A default in this regard will make the company and every officer who is in default liable to pay penalty extending Rs. 10,000 and Rs. 5,000 respectively. [Section 60].

d. Called-up capital:

- Such part of the Issued capital, which has been called for payment.
- It is the total amount called up on the shares issued.

e. Paid-up capital:

- The total amount paid or credited as paid up on shares issued.
- It is equal to called up capital less calls in arrears.

SHARES

1. Nature of shares:

- Share which means a share in the share capital of a company and includes stock.
- A share thus represents such proportion of the interest of the shareholders as the amount paid up thereon bears to the total capital payable to the company.
- Shareholders are not in the eyes of law part owners of the undertaking.
- Shareholder has not only contractual rights against the company but also certain other rights as per the provisions of the Companies Act.

Shares are a movable property:

- According to section 44 of the Companies Act, 2013, -
- the shares or debentures or other interests of any member in a company
- shall be movable property transferable
- in the manner provided by the articles of the company.

Shares shall be numbered:

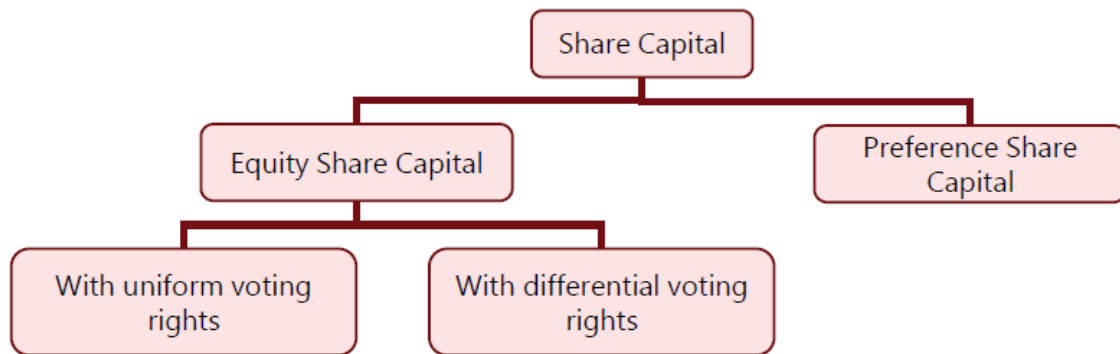
- Section 45 provides,
- every share in a company having a share capital,
- shall be distinguished by its distinctive number.
- This implies that every share shall be numbered.
- However, this shall not apply to a share held by a person whose name is entered as holder of beneficial interest in such share in the records of a depository.

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Kinds of share capital:-

Section 43 -

The share capital of a company limited by shares shall be of two kinds -



1. Equity share capital —

Equity share capital means all share capital which is not preference share capital but can be divided into two types -

- a. with voting rights; or
- b. with differential rights as to dividend, voting or otherwise in accordance with prescribed rules (DVRs)

Example 6: It is to be noted that, Tata Motors in 2008 introduced equity shares with differential voting rights called 'A' equity shares in its rights issue.

In the issue, every 10 'A' equity shares carried only one voting right but would get 5 percentage points more dividend than that declared on each of the ordinary shares.

Since 'A' equity share did not carry the similar voting rights, it was being traded at discount to other common shares having full voting.

Other companies which have issued equity shares with differential

voting rights (popularly called DVRs) are Future Retail, Jain Irrigation among others.

2. Preference share capital:

Preference share capital means that part of the issued share capital of the company which carries or would carry a preferential right with respect to —

a. Payment of dividend

- Either as a fixed amount or an amount calculated at a fixed rate,
- which may either be free of or subject to income-tax; and

b. Repayment (In winding up) or Repayment of Capital of that -

- Amount of the share capital paid-up or deemed to have been paid-up,
- whether or not ★
- there is a preferential right to the payment of any fixed premium or premium on any fixed scale,
- specified in the memorandum or articles of the company;

★ Exception: In case of private company - Section 43 shall not apply where memorandum or articles of association of the private company so provides.

MEMORANDUM OF ASSOCIATION

Statutory definition - As originally framed or altered from + + + under the act or any previous law/Act.

- The Memorandum of Association of company is in fact its **charter**;
- it defines its **constitution** and
- the **scope** of the **powers** of the company
- with which it has been established under the Act.
- It is the very **foundation** on which the whole edifice of the company is built.
- **Object** of registering a memorandum of association :- (Question expected)

1. POWERS & SCOPE OF THE COMPANY

It contains the object for which the company is formed -

- a. It identifies the possible scope of its operations
- b. beyond which its actions cannot go

2. KNOWLEDGE FOR SHAREHOLDER & OTHER PARTIES -

It enables shareholders, creditors and all those who deal with company to know what its powers are and what activities company can engage in. (Outsider point of view)

3. SHAREHOLDER should know where their money is utilised for ?

The shareholders must know the purposes for which his money can be used by the company and what risks he is taking in making the investment. (Investor point of view)

4. MOA IS A PUBLIC DOCUMENT -

A memorandum is a public document under Section 399 of the Companies Act, 2013. ★

Consequently, every person entering into a contract with the company is presumed to have the knowledge of the conditions contained therein. ★

• WHAT COMPANY CAN'T DO BASED ON MOA ?

- A company cannot depart from the provisions contained in the memorandum however imperative may be the necessity for the departure.
 - It cannot enter into a contract or engage in any trade or business, which is beyond the power confessed on it by the memorandum.
 - If it does so, it would be **ultra vires** the company and void.
- As per Section 4, Memorandum of a company shall be drawn up in such form as is given in Tables A, B, C, D and E in Schedule I of the Act -
Form for MOA of a company -
 1. Table A - Company limited by shares.

Forms for Memorandum

- Table A - L - S
- Table B - L - G - SC
- Table C - L - G + SC

2. Table B - Company limited by guarantee and not having a share capital.
3. Table C - Company limited by guarantee and having a share capital.
4. Table D - Unlimited company.
5. Table E - Unlimited company and having share capital.

Content of the memorandum:

★ The clauses listed below are compulsory clauses, or “Conditions”.

In addition to these a memorandum may contain other provisions, for example rights attached to various classes of shares.

★ The MOA of a company cannot contain anything contrary to the provisions of the Companies Act. (बाप से पंगा नहीं)

If it does, the same shall be devoid of any legal effect.

Similarly, all other documents of the company must comply with the provisions of the Memorandum.

S.No.	Clause	Description
1	Name Clause	• “Limited” = Public limited company, • “Private Limited” = Private limited. • Not applicable to Section 8 of the Act. • ‘Electoral Trust’ may be allowed for Registration of companies to be formed under section 8 of the Act • Section 8 of the Act shall include the words - foundation, Forum, Association, Federation, Chambers, Confederation, council, Electoral trust and the like etc. • A Government company’s = Must end with the word “Limited”. • In the case of OPC, the words “One Person Company”, should be included below its name.
2	Registered Office or Situation	The State in which the registered office of the company is to be situated

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S.No.	Clause	Description
	clause	
3	Object Clause	• The objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof. • If any company has changed its activities which are not reflected in its name, ☐ it shall change its name in line with its activities within a period of six months ☐ from the change of activities ☐ after complying with all the provisions as applicable to change of name.
4	Liability clause	• The liability of members of the company , whether limited or unlimited, and also state,— • Limited by shares - Liability of its members is limited to the amount unpaid, if any, on the shares held by them • 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

S.No.	Clause	Description
5	Capital Clause	• Amount of authorized capital divided into share of fixed amounts and • The number of shares with the subscribers to the memorandum have agreed to take, indicated opposite their names, which shall not be less than one share. • A company not having share capital need not have this clause.
6	Subscription or Association Clause	• The detail of the subscribers to be formed into a company. • The Memorandum shall conclude with the association clause. • Every subscriber to the Memorandum shall take atleast one share, and shall write against his name, the number of shares taken by him.
7	Nomination clause (OPC)	• In the case of OPC, the name of the person who, in the event of death of the subscriber, shall become the member of the company.

Some Rules related to MOA -

1. It must be printed, divided into paragraphs, numbered consecutively, and
2. Signed by at least -
 - a. 7 persons in case of a public company
 - b. 2 in the case of a private company
 - c. 1 in the case of One Person Company
3. in the presence of at least one witness, who will attest the signatures.
4. The particulars about the signatories to the memorandum as well as the witness, as to their address, description, occupation etc., must also be entered.
5. It is to be noted that a company being a legal person can through its agent, subscribe to the memorandum.
6. A minor cannot be a signatory to the memorandum as he is not competent

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to contract. The guardian of a minor, who subscribes to the memorandum on his behalf, will be deemed to have subscribed in his personal capacity.

DOCTRINE OF ULTRA VIRES

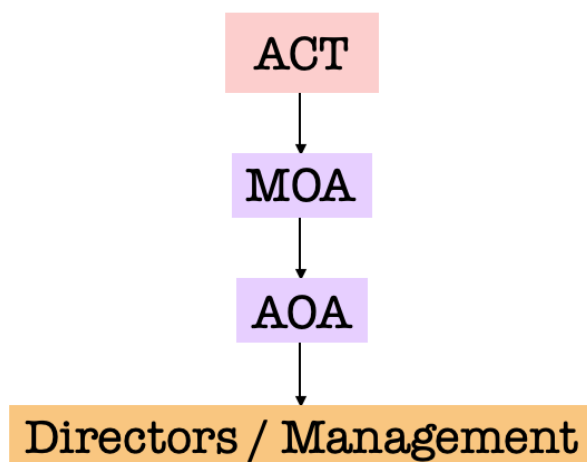
Doctrine of ultra vires:

- Doctrine = Theory
- Ultra = Beyond
- Vires = Power

Meaning -

Any act(s) done BEYOND THE POWERS or in excess of the legal powers of the company.

WHY Something like this needs to be discussed ? Because - The powers in their nature are limited



The objects of a company in its memorandum can be departed from only to the extent permitted by the Act, thus far and no further.

Consequences or Impact of Ultra vires acts :-

Acts or contracts → Beyond the powers of not only of the directors but → company also

❖ **Void-ab-initio** and **Inoperative** in law and

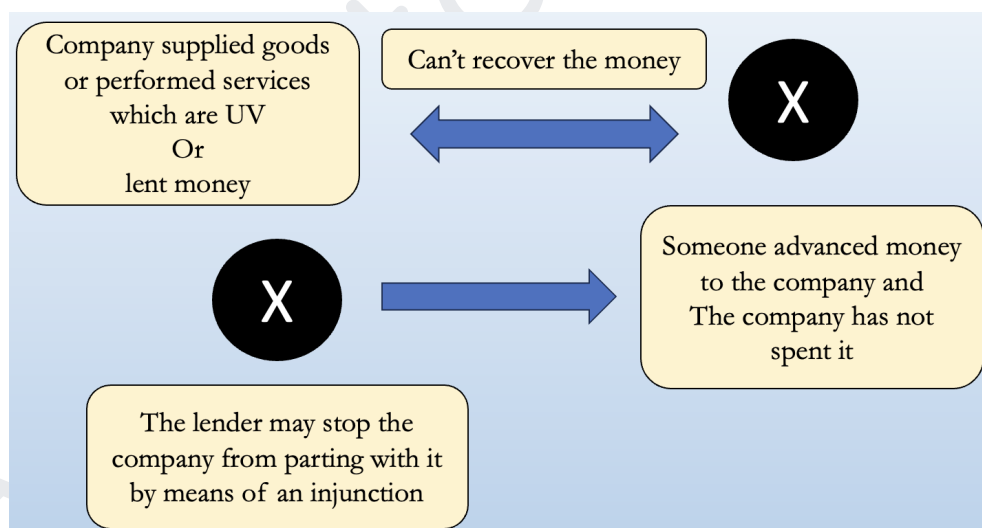
- ❖ **Not binding** on the company.
- ❖ Can't **MISAPPLY** the **funds** for purposes **other than** those **sanctioned** by the MOA. If done then directors are personally liable.
- ❖ Can't carry on a **trade different** from the one it is **authorised** to carry on.
- ❖ A company can neither be **sued** on an ultra vires transaction, **nor can it sue on it**.

Since the memorandum is a "public document", it is open to public inspection.

Therefore, when someone deals with a company - it is deemed (presumed) to know about the powers of the company.

If in spite of this you enter into a transaction which is ultra vires the company, you cannot enforce it against the company.

Example 7:



This is because the company does not become the owner of the money, which is ultra vires the company.

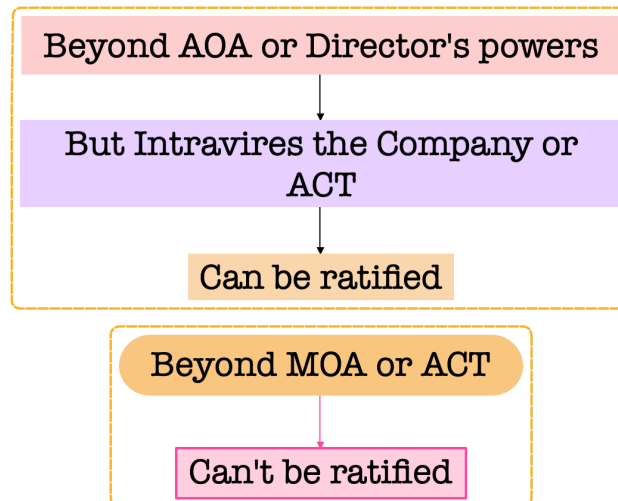
As the lender remains the owner, he can take back the property in specie.

If the ultra vires loan has been utilised in meeting lawful debt of the company, then the lender steps into the shoes of the debtor paid off

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and consequently he would be entitled to recover his loan to that extent from the company.

• WHEN CAN BE RATIFIED ? - (Approval through voting)



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

Sometimes - YES, When ?

- If the act is UV the power of the directors
----->> YES, the shareholders can ratify it;
- If it is ultra vires the articles of the company
----->> The company can alter the articles
- If the act is within the power of the company but is done irregularly
----->> shareholder can validate it.

The leading case through which the doctrine was enunciated -

Directors of the company entered into a contract with Riche, for financing the construction of a railway line in Belgium, and the company further ratified this act of the directors by passing a special resolution.

The company however, repudiated the contract as being ultra- vires.

Ashbury Railway Carriage and Iron Company Limited vs Riche- (1875)

Ashbury Railway Carriage and Iron Company Limited

Riche brought an action for damages for breach of contract.

RICHES

Judgement

Object of the Company

His contention was that the contract was well

in

- Acts and their impact -

Legal ACT but Not authorized by the object clause of the memorandum, or by the statute,	Ultravires the company and hence Null and void.
Ultravires the company means object clause or MOA	Cannot be ratified even by the unanimous consent of all the shareholders.
Ultravires the directors but Intravires the company	Can be ratified by the members of the company through a resolution passed at a general meeting.
Ultravires the Articles	Can be ratified by altering the Articles by a Special Resolution at a general meeting.

- An ultra vires* contract can never be made binding on the company. It cannot become "Intravires" by reasons of estoppel, acquiescence, lapse of time, delay or ratification.

- Benefit of the Doctrine -

- restraining the activities of the directors,
 - It prevents the company from changing its activities in a direction which is not agreed by all.

- The purpose of doctrine of ultravires has been defeated

As now the **object clause** can be easily **altered**, by **passing just a special**

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resolution of the shareholders.

ARTICLES OF ASSOCIATION

Statutory definition - As originally framed or altered from + + + under the act or any previous law/Act

Section 5 of the Act - WHY AOA ?

- Rules and regulations which are framed to manage its internal affairs.
- The bye-laws of the company according to which -
 - director and other officers are required to perform their functions as regards the management of the company, its accounts and audit.
- A company may adopt all or any of the regulations contained in the model articles applicable to such company.

Guinness vs. Land Corporation of Ireland

- *The articles are the internal regulations of the company.*

Ashbury Carriage Co. vs. Riches

- *The articles play a part subsidiary to memorandum of association.*
- *They accept the memorandum as the charter of incorporation*
- *The articles proceed to define the duties, the rights and powers of the governing body as between themselves and the company and*
- *How the business of the company is to be carried on, and*
- *How changes in the internal regulation of the company may from time to time be made.*

S.S. Rajkumar vs. Perfect Castings (P) Ltd

- *The document containing the articles of association of a company (the Magna Carta) is a business document; hence it has to be construed strictly.*

- *It regulates domestic management of a company and*
- *creates certain rights and obligations between the members and the company*

The contents and model of articles of association -

S.N o.	Clause	Description
1	Contains regulations	The Rules and regulations for internal management of the company.
2	Inclusion of matters	A company may also include such additional matters in its articles as may be considered necessary for its management.
3	Entrenchment provision (सख्ती)	To protect something or to have extra additional safeguards - Certain specified provisions can be altered to make them more restrictive and tough to override. Entrenchment may be made :- • At the time of formation • By amendment – Through consent of all in Private and SR in case of Public company. Shall give notice to ROC for such provision.

- The articles of a company shall be in respective forms specified in Tables, F, G, H, I and J in Schedule I as may be applicable to such company.

Forms for Articles

- Table F – L by S
- Table G – L by G + SC
- Table H – L by G
- Table I – UL + SC
- Table J – UL - SC

6 ► The Companies Act, 2013

Key differences between the MOA vs. AOA :-

Basis	MOA	AOA
Objectives	Defines and delimits the objectives of the company.	Lays down the rules and regulations for the internal management of the company. Articles determine how the objectives of the company are to be achieved.
Relationship	Company ----->> outside world	Company ----->> its members.
Alteration	Can be altered only under certain circumstances and in the manner provided for in the Act. In most cases permission of the Regional Director, or the Tribunal is required.	The articles can be altered simply by passing a special resolution
Ultra Vires	Acts done by the company beyond the scope of the MOA are ultra-vires and void. These cannot be ratified even by the unanimous consent of all the shareholders.	The acts ultra-vires the articles can be ratified by a special resolution of the shareholders, provided they are not beyond the provisions of the memorandum .

DOCTRINE OF INDOOR MANAGEMENT

For us to understand Doctrine of Indoor we need to understand -

Doctrine of Constructive Notice:

In the favour of company
Creates a presumption in the favour of the company

Section 399 - Since MOA and AOA is a "public document", it is open to public inspection - For electronic check, copy, extract including COI of the company on payment of prescribed fees

It is therefore, the duty of every person dealing with a company to inspect its documents and make sure that his contract is in conformity with their provisions but whether a person reads them or not, it will be presumed that he knows the contents of the documents.

This kind of presumed/implied notice is called constructive notice.

This also means that -

- This is presumed that the person has **read** the documents and also **understood** them in their true perspective.
- Every person dealing with the company not only has the constructive notice of the memorandum and articles, but **also** of **all** the other **related documents**, such as **Special Resolutions** etc., which are required to be registered with the Registrar.

Final Verdict as per this Doctrine -

- ❖ If a person enters into a contract which is
- ❖ **beyond** the **powers** of the **company** as defined in the memorandum, or
- ❖ **outside** the **authority** of **directors** as per memorandum or articles,
- ❖ he **cannot acquire** any **rights** under the **contract against** the **company**.

Kotla Venkataswamy Vs Rammurthi (1934)

6 ► The Companies Act, 2013

- *AOA required every document to be signed by 3 persons : MD, working director and secretary*
- *A mortgage deed was not signed by MD*
- *It was held that plaintiff cannot enforce the contract as the deed was invalid.*

Doctrine of Indoor Management (Turquand Rule) :-

**In the favour of outsiders
Creates a presumption in the favour of the outsiders**

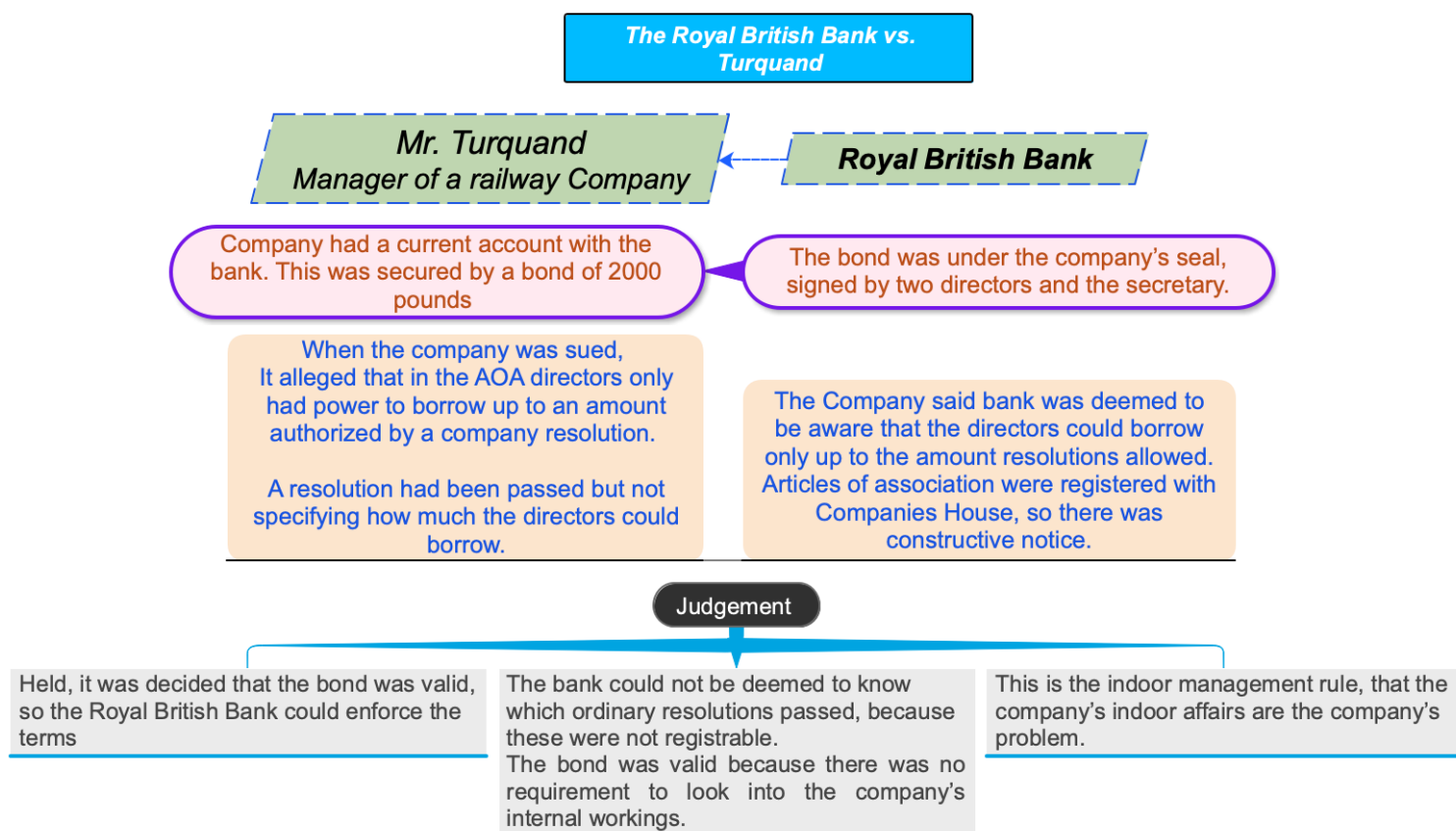
The Doctrine of Indoor Management is the exception to the doctrine of constructive notice.

An outsiders are NOT deemed to have notice of the internal affairs of the company.

An outsider is entitled to assume and presume that all the detailed internal formalities for doing any act have been observed and taken care of.

Thus doctrine protects innocent outsiders from any irregularities in company

FACTS of the Royal British Bank vs. Turquand



EXCEPTIONS TO THE DOCTRINE OF INDOOR MANAGEMENT:

- Doctrine of Indoor Management is important -
- To persons dealing with a company through its directors or other persons.
- They are entitled to assume that the acts of the directors or other officers of the company are validly performed - if they are within the scope of their apparent authority.

The above-mentioned doctrine of Indoor Management or Turquand Rule has limitations of its own.

That is to say, it is **inapplicable to the following cases, namely :-**

1. Actual or constructive knowledge of irregularity:

The rule does not protect any person when the person dealing with the company has notice, whether actual or constructive, of the irregularity. (आपको कमी या गलती का पहले से पता था तो आप इस Doctrine को खुदके प्रोटेक्शन के लिए use नहीं कर सकते)

Howard vs. Patent Ivory Manufacturing Co.

6 ► The Companies Act, 2013

- *The directors could not defend themselves where they lent money and*
- *got issued debentures to themselves without the resolution because*
- *they should have known that the extent to which they were lending money to the company*
- *required the assent of the general meeting which they had not obtained.*

Morris v Kansseen

- *A director could not defend himself where*
- *an allotment of shares to him*
- *as he participated in the meeting, which made the allotment.*
- *His appointment as a director also fell through because none of the directors appointed him was validly in office.*

2. Suspicion of Irregularity:

The doctrine in no way, rewards those who behave negligently. (बेवकूफी के लिए कोई जगह नहीं है)

- Where the person dealing with the company is put upon an inquiry,
- for example, where the transaction is unusual or
- not in the ordinary course of business,
- it is the duty of the outsider to make the necessary enquiry.
- the circumstances surrounding the contract are suspicious and therefore invite inquiry.
- Suspicion should arise from the fact that an officer who is acting in the matter which is apparently outside the scope of his authority.

Anand Bihari Lal vs. Dinshaw & Co.

- *A person accepted a transfer of a company's property from its accountant,*
- *the transfer was held void.*
- *The plaintiff could not have supposed, in absence of a power of attorney that the accountant had authority to transfer of the company's property.*

Haughton & Co. v. Nothard, Lowe & Wills Ltd

- where a person holding directorship in two companies
- agreed to apply the money of one company in payment of the debt to other,
- the court said that it was something so unusual
- that the plaintiff were put upon inquiry
- to ascertain whether the persons making the contract
- had any authority in fact to make it

3. Forgery - (चोरी और ऊपर से सीना जोरी) - धौके के लिए use नहीं कर सकते

- The doctrine of indoor management applies only to irregularities
- which might otherwise affect a transaction
- but it cannot apply to forgery
- which must be regarded as nullity.
- Forgery may in circumstances exclude the 'Turquand Rule'.

Ruben v Great Fingall Consolidated.

- In this case the plaintiff was the transferee of a share certificate
- issued under the seal of the defendant's company.
- The company's secretary, who had affixed the seal of the company and forged the signature of the two directors, issued the certificate.
- The plaintiff contended that whether the signature were genuine or forged was a part of the internal management, and
- therefore, the company should be estopped from denying genuineness of the document.
- But it was held, that the rule has never been extended to cover such a complete forgery.

-----XX-----XX-----

“ PROBLEM KYA HAI ? ”

Question Bank for the Chapter

*This section is complied with questions and suggested answers
for the chapter - TCA, 2013*

- ❖ *ICAI Study material*
- ❖ *Previos year Question Papers (PYQPs)*
- ❖ *Mock Test Papers (MTPs)*
- ❖ *Revision Test Papers (RTPs)*

Compiled by - CA Chaitanya Jain

Question 1

What is meant by a Guarantee Company? State the similarities and dissimilarities between a Guarantee Company and a Company having Share Capital.

(MODULE)

Answer 1

Company limited by guarantee: Section 2(21) of the Companies Act, 2013 defines it as the company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake by the memorandum to contribute to the assets of the company in the event of its being wound up. Thus, the liability of the member of a guarantee company is limited upto a stipulated sum mentioned in the memorandum. Members cannot be called upon to contribute beyond that stipulated sum.

Similarities and dis-similarities between the Guarantee Company and the Company having share capital:

The common features between a 'guarantee company' and 'share company' are legal personality and limited liability. In the latter case, the member's liability is limited by the amount remaining unpaid on the share, which each member holds. Both of them have to state in their memorandum that the members' liability is limited.

However, the point of distinction between these two types of companies is that in the former case the members may be called upon to discharge their liability only after commencement of the winding up and only subject to certain conditions; but in the latter case, they may be called upon to do so at any time, either during the company's life-time or during its winding up.

Question 2

Briefly explain the doctrine of "ultra vires" under the Companies Act, 2013. What are the consequences of ultra vires acts of the company?

(MODULE)

Answer 2

Doctrine of ultra vires: The meaning of the term ultra vires is simply "beyond (their) powers". The legal phrase "ultra vires" is applicable only to acts done in excess of

the legal powers of the doers. This presupposes that the powers are in their nature limited. To an ordinary citizen, the law permits whatever does the law not expressly forbid.

It is a fundamental rule of Company Law that the objects of a company as stated in its memorandum can be departed from only to the extent permitted by the Act - thus far and no further [Ashbury Railway Company Ltd. vs. Riche]. In consequence, any act done or a contract made by the company which travels beyond the powers not only of the directors but also of the company is wholly void and inoperative in law and is therefore not binding on the company. On this account, a company can be restrained from employing its fund for purposes other than those sanctioned by the memorandum. Likewise, it can be restrained from carrying on a trade different from the one it is authorised to carry on.

The impact of the doctrine of ultra vires is that a company can neither be sued on an ultra vires transaction, nor can it sue on it. Since the memorandum is a "public document", it is open to public inspection.

Therefore, when one deals with a company one is deemed to know about the powers of the company. If in spite of this you enter into a transaction which is ultra vires the company, you cannot enforce it against the company. For example, if you have supplied goods or performed service on such a contract or lent money, you cannot obtain payment or recover the money lent. But if the money advanced to the company has not been expended, the lender may stop the company from parting with it by means of an injunction; this is because the company does not become the owner of the money, which is ultra vires the company. As the lender remains the owner, he can take back the property in specie. If the ultra vires loan has been utilised in meeting lawful debt of the company then the lender steps into the shoes of the debtor paid off and consequently he would be entitled to recover his loan to that extent from the company.

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

Sometimes, act which is ultra vires can be regularised by ratifying it subsequently. For instance, if the act is ultra vires the power of the directors, the shareholders can ratify it; if it is ultra vires the articles of the company, the company can alter the articles; if the act is within the power of the company but is done irregularly, shareholder can validate it.

Question 3

Explain clearly the doctrine of 'Indoor Management' as applicable in cases of companies registered under the Companies Act, 2013. Explain the circumstances in which an outsider dealing with the company cannot claim any relief on the ground of 'Indoor Management'. (MODULE)

Answer 3

Doctrine of Indoor Management (the Companies Act, 2013): According to the "doctrine of indoor management" the outsiders, dealing with the company though are supposed to have satisfied themselves regarding the competence of the company to enter into the proposed contracts are also entitled to assume that as far as the internal compliance to procedures and regulations by the company is concerned, everything has been done properly. They are bound to examine the registered documents of the company and ensure that the proposed dealing is not inconsistent therewith, but they are not bound to do more.

They are fully entitled to presume regularity and compliance by the company with the internal procedures as required by the Memorandum and the Articles. This doctrine is a limitation of the doctrine of "constructive notice" and popularly known as the rule laid down in the celebrated case of *Royal British Bank v. Turquand*. Thus, the doctrine of indoor management aims to protect outsiders against the company.

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

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

In *Howard vs. Patent Ivory Manufacturing Co.* where the directors could not defend the issue of debentures to themselves because they should have known that the extent to which they were lending money to the company required the assent of the general meeting which they had not obtained.

Likewise, in *Morris v Kanssen*, a director could not defend an allotment of shares to him as he participated in the meeting, which made the allotment. His appointment as a director also fell through because none of the directors appointed him was validly in office.

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

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

Similarly, in the case of *Haughton & Co. v. Nothard, Lowe & Wills Ltd.* where a person holding directorship in two companies agreed to apply the money of one company in payment of the debt to other, the court said

that it was something so unusual "that the plaintiff were put upon inquiry to ascertain whether the persons making the contract had any authority in fact to make it." Any other rule would "place limited companies without any sufficient reasons for so doing, at the mercy of any servant or agent who should purport to contract on their behalf."

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

Forgery may in circumstances exclude the 'Turquand Rule'. The only clear illustration is found in the *Ruben v Great Fingall Consolidated*. In this case the plaintiff was the transferee of a share certificate issued under the seal of the defendant's company. The company's secretary, who had affixed the seal of the company and forged the signature of the two directors, issued the certificate.

The plaintiff contended that whether the signatures were genuine or forged was a part of the internal management, and therefore, the company should be estopped from denying genuineness of the document. But it was held, that the rule has never been extended to cover such a complete forgery.

Question 4

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

Answer 4

The House of Lords in *Salomon Vs Salomon & Co. Ltd.* laid down that a company is a person distinct and separate from its members, and therefore, has an independent separate legal existence from its members who have constituted the company.

But under certain circumstances the separate entity of the company may be ignored by the courts. When that happens, the courts ignore the corporate entity of the company and look behind the corporate façade and hold the persons in control of the management of its affairs liable for the acts of the company. Where a company is incorporated and formed by certain persons only for the purpose of evading taxes, the courts have discretion to disregard the corporate entity and tax the income in the hands of the appropriate assessee.

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

In the instant case, the four private limited companies were formed by A, the assessee, purely and simply as a means of avoiding tax and the companies were nothing more than the façade of the assessee himself.

Therefore, the whole idea of Mr. A was simply to split his income into four parts with a view to evade tax.

No other business was done by the company.

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

Question 5

Sound Syndicate Ltd., a public company, its articles of association empowers the managing agents to borrow both short and long term loans on behalf of the company, Mr. Liddle, the director of the company, approached Easy Finance Ltd., a non banking finance company for a loan of ' 25,00,000 in name of the company. The Lender agreed and provided the above said loan. Later on, Sound Syndicate Ltd. refused to repay the money borrowed on the pretext that no resolution authorizing such loan have been actually passed by the company and the lender should have enquired about the same prior providing such loan hence company not liable to pay such loan.

Analyse the above situation in terms of the provisions of Doctrine of Indoor Management under the Companies Act, 2013 and examine whether the contention of Sound Syndicate Ltd. is correct or not? **(MODULE)**

Answer 5

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

Thus,

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

In the given question, Easy Finance Ltd. being external to the company, need not enquire whether the necessary resolution was passed properly. Even if the

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

Question 6

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

- (a) If Navita is leaving India permanently, is it mandatory for her to withdraw her nomination in the said One Person Company?
- (b) If Navita maintained the status of Resident of India after her marriage, then can she continue her nomination in the said One Person Company?

(MODULE)

Answer 6

(Answer has been changed as per latest amendment and information. This is the latest answer. Follow this)

(a) No, it is not mandatory for Navita to withdraw her nomination in the said OPC even if she is leaving India permanently as only a natural person who is an Indian citizen can be a member and nominee in the OPC whether or not resident in India.

(b) Yes, Navita can continue her nomination in the said OPC, irrespective of the fact that she maintains the status of Resident of India after her marriage.

Question 7

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

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

(MODULE)

Answer 7

(a) A company being an artificial person cannot own property and cannot sue or be sued incorrect: A company is an artificial person as it is created by a process

other than natural birth. It is legal or judicial as it is created by law. It is a person since it is clothed with all the rights of an individual.

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

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

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

Questions from RTPs, MTPs and PYQPs

Question 1

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

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

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

(RTP May' 22) (MTP 4 Marks, Nov'21)

Answer 1

Question Bank —> Chap 6 - The Companies Act, 2013

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

- (i) restricts the right to transfer its shares;
- (ii) except in case of One Person Company, limits the number of its members to two hundred:

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

Provided further that-

- A. persons who are in the employment of the company; and
 - B. persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased, shall not be included in the number of members; and
- (iii) prohibits any invitation to the public to subscribe for any securities of the company;
- A. Following the provisions of Section 2(68), 25 members were employees of the company but not during present membership which was started from 1st December 2016 i.e. after the date on which these 25 members were ceased to be employee in Jagannath Oils Limited. Hence, they will be considered as members for the purpose of the limit of 200 members. The company is required to reduce the number of members before converting it into a private company.
 - B. On the other hand, if those 25 members were ceased to be employee on 28th June 2017, they were employee at the time of getting present membership. Hence, they will not be counted as members for the purpose of the limit of 200 members and the total number of members for the purpose of this sub-section will be 195. Therefore, Jagannath Oils Limited is not required to reduce the number of members before converting it into a private company.

Question 2

A, B and C has decided to set up a new club with name of ABC club having objects to promote welfare of Christian society. They planned to do charitable work or

social activity for promoting the art work of economically weaker section of Christian society. The company obtained the status of section 8 company and started operating from 1 st April, 2017 onwards.

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

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

(RTP May' 22) (MTP 3 Marks, Mar 21)

Answer 2

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

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

1. 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 register. But before 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.
2. 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.
3. Where a licence is revoked and where the Central Government is satisfied that it is essential in the public interest that the company registered under this section should be amalgamated with another company registered

under this section and having similar objects, then, notwithstanding anything to the contrary contained in this Act, the Central Government may, by order, provide for such amalgamation to form a single company with such constitution, properties, powers, rights, interest, authorities and privileges and with such liabilities, duties and obligations as may be specified in the order.

Question 3

An employee Mr. Karan signed a contract with his employer company ABC Limited that he will not solicit the customers after leaving the employment from the company.

But after Mr. Karan left ABC Limited, he started up his own company PQR Limited and he started soliciting the customers of ABC Limited for his own business purposes.

ABC Limited filed a case against Mr. Karan for breach of the employment contract and for soliciting their customers for own business. Mr. Karan contended that there is corporate veil between him, and his company and he should not be personally held liable for this.

In this context, the company ABC Limited seek your advice as to the meaning of corporate veil and when the veil can be lifted to make the owners liable for the acts done by a company?

(RTP May 22)

Answer 3

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

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

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

However, under certain exceptional circumstances the courts lift or pierce the corporate veil by ignoring the separate entity of the company and the promoters and other persons who have managed and controlled the affairs of the company. Thus, when the corporate veil is lifted by the courts, the promoters and persons

exercising control over the affairs of the company are held personally liable for the act and debts of the company.

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

1. To determine the character of the company i.e. to find out whether co-enemy or friend.
2. To protect revenue/tax
3. To avoid a legal obligation
4. Formation of subsidiaries to act as agents
5. Company formed for fraud/ improper conduct or to defeat law

Based on the above provisions and leading case law of *Gilford Motor Co. Vs Horne*, the company PQR Limited was created to avoid the legal obligation arising out of the contract, therefore that employee Mr. Karan and the company POR Limited created by him should be treated as one and thus veil between the company and that person shall be lifted. Karan has formed the only for fraud/improper conduct or to defeat the law. Hence, he shall be personally held liable for the acts of the company.

Question 4

A transport company wanted to obtain licences for its vehicles but could not obtain licences if applied in its own name. It, therefore, formed a subsidiary company and the application for licence was made in the name of the subsidiary company. The vehicles were to be transferred to the subsidiary company.

Will the parent and the subsidiary company be treated as separate commercial units? Explain in the light of the provisions of the Companies Act, 2013.

(RTP Nov'22)

Answer 4

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

The facts of the case are similar to the case of *Merchandise Transport Limited vs. British Transport Commission* (1982), wherein a transport company wanted to obtain licences for its vehicles but could not do so, if applied in its own name. It,

therefore, formed a subsidiary company, and the application for the licence was made in the name of the subsidiary. The vehicles were to be transferred to the subsidiary company. Held, the parent and the subsidiary were held to be one commercial unit and the application for licences was rejected.

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

Question 5

ABC Pvt Ltd, has been overstating expenditures in their Profit & Loss account for the past few years.

On Inquiry, it was found that the mere purpose was to avoid tax. However, there was no fraudulent intentions. Should the corporate veil of the company be lifted? Kindly justify.

(RTP Nov'22)

Answer 5

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

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

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

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

Question 6

A Company registered under Section 8 of the Companies Act, 2013, has been consistently making profits for the past 5 years after a major change in the management structure. Few members contented that they are entitled to receive dividends. Can the company distribute dividend? If yes, what is the maximum

percentage of dividend that can be distributed as per provisions of the Companies Act, 2013? Also, to discuss this along with other regular matters, the company kept a general meeting by giving only 14 days' notice. Is this valid?

(RTP Nov'22)

Answer 6

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

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

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

Question 7

No limit Private Company is incorporated as unlimited company having share capital of \$ 10,00,000.

One of its creditors, Mr. Samuel filed a suit against a shareholder Mr. Innocent for recovery of his debt against No limit Private Company. Mr. Innocent has given his plea in the court that he is not liable as he is just a shareholder. Explain, whether Mr. Samuel will be successful in recovering his dues from Mr. Innocent?

(RTP Nov'22)

Answer 7

Section 2(92) of Companies Act, 2013, provides that an unlimited company means a company not having any limit on the liability of its members. The liability of each member extends to the whole amount of the company's debts and liabilities, but he will be entitled to claim contribution from other members. In case the company has share capital, the Articles of Association must state the amount of share capital and the amount of each share. So long as the company is a going concern the liability on the shares is the only liability which can be enforced by the company. The creditors can institute proceedings for winding up of the company for their claims. The official liquidator may call the members for their contribution towards the liabilities and debts of the company, which can be unlimited.

On the basis of above, it can be said that Mr. Samuel cannot directly claim his dues against the company from Mr. Innocent, the shareholder of the company even the company is an unlimited company. Mr. Innocent is liable upto his share

capital. His unlimited liability will arise when official liquidator calls the members for their contribution towards the liabilities and debts of the company at the time of winding up of company

Question 8

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

- (i) Is Flower Fans Private Limited no longer in existence?
- (ii) Further is it correct to say that a company being an artificial person cannot own property and cannot sue or be sued?

(RTP May'23) (MTP Jun'22 3 Marks) (MTP 3 Marks, Oct'21)

Answer 8

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

Question 9

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

With reference to the same, briefly explain the doctrine of "ultravires" under the Companies Act, 2013.

What are the consequences of ultravires acts of the company?

(RTP May 23) (MTP Mar'22 6 Marks) (MTP May' 23 6 Marks)

Answer 9

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

The impact of the doctrine of ultra vires is that a company can neither be sued on an ultra vires transaction, nor can it sue on it. Since the memorandum is a "public document", it is open to public inspection.

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

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

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

Question 10

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

(RTP May'23) (MTP Nov'22 4 Marks)

Answer 10

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

In the instant case, XYZ Private Limited have taken loan from reputed bank for * 10,00,000 by passing Board Resolution while Special Resolution was necessary for such amount. BOD gave an undertaking to bank that Special Resolution has been passed for such loan. The bank on believing on such undertaking lends the money. On demanding the repayment of loan, company denied the payment as act was ultra vires to company.

On the basis of provisions of doctrine of indoor management, the bank can claim the amount of his loan from the company. The bank can believe on the undertaking given by board and no need to enquire further.

Question 11

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

(RTP May 23)

Answer 11

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

- A. Holding and subsidiary companies: 'Holding and subsidiary' companies are relative terms.

A company is a holding company in relation to one or more other companies, means a company of which such companies are subsidiary companies. [Section 2(46)]

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

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

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

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

- B. Associate company [Section 2(6)]: In relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company.

Explanation. — For the purpose of this clause

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

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

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

Question 12

BC Private Limited and its subsidiary KL Private Limited are holding 90,000 and 70,000 shares respectively in PQ Private Limited. The paid-up share capital of PQ Private Limited is \$ 30 Lakhs (3 Lakhs equity shares of R 10 each fully paid). Analyse with reference to provisions of the Companies Act, 2013 whether PQ Private Limited is a subsidiary of BC Private Limited. What would be your answer if

KL Private Limited is holding 1,60,000 shares in PQ Private Limited and no shares are held by BC Private Limited in PQ Private Limited?

(RTP Nov'23)

Answer 12

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

1. controls the composition of the Board of Directors; or
2. exercises or controls more than one-half of the total voting power either at its own or together with one or more of its subsidiary companies:

For the purposes of this section -

1. 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;
2. "layer" in relation to a holding company means its subsidiary or subsidiaries.

In the instant case, BC Private Limited together with its subsidiary KL Private Limited is holding 1,60,000 shares (90,000+70,000 respectively) which is more than one half in nominal value of the Equity Share Capital of PQ Private Limited. Hence, PQ Private Limited is subsidiary of BC Private Limited.

In the second case, the answer will remain the same. KL Private Limited is a holding 1,60,000 shares i.e., more than one half in nominal value of the Equity Share Capital of PQ Private Limited (i.e., holding more than one half of voting power). Hence, KL Private Limited is holding company of PQ Private Company and BC Private Limited is a holding company of KL Private Limited.

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

Question 13

Narendra Motors Limited is a Government Company. Shah Auto Private Limited have share capital of

* 10 crore in the form of 10,00,000 shares of \$ 100 each. Narendra Motors Limited is holding 5,05,000 shares in Shah Auto Private Limited. Shah Auto Private Limited claimed the status of Government Company. Advise as legal advisor, whether Shah Auto Private Limited is government company under the provisions of Companies Act, 2013?

(RTP Nov' 23) (RTP Nov'21)

Answer 13

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

1. the Central Government, or
2. by any State Government or Governments, or
3. partly by the Central Government and partly by one or more State Governments, and the section includes a company which is a subsidiary company of such a Government company.

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

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

Question 14

Mr. Dhruv was appointed as an employee of Sunmoon Timber Private Limited on the condition that if he were to leave his employment, he will not solicit customers of the company. After some time, he was fired from company. He set up his own business under proprietorship and undercut Sunmoon Timber Private Limited's prices. On the legal advice from his legal consultant and to refrain from the

provisions of breach of contract, he formed a new company under the name Seven Stars Timbers Private Limited. In this company, his wife and a friend of Mr. Dhruv were the sole shareholders and directors.

They took over Dhruv's business and continued it. Sunmoon Timber Private Limited filed a suit against Seven Stars Timbers Private Limited for violation of contract. Seven Stars Timbers Private Limited argued that the contract was entered into between Mr. Dhruv and Sunmoon Timber Private Limited and as company has separate legal entity, Seven Stars Timbers Private Limited has not violated the terms of agreement. Explain with reasons, whether separate legal entity between Mr. Dhruv and Seven Stars Timbers Private Limited will be disregarded?

(RTP Jun'24)

Answer 14

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

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

Question 15

AK Private Limited has borrowed 7 36 crore from BK Finance Limited. However, as per memorandum of AK Private Limited, the maximum borrowing power of the company is \$30 crore. Examine whether AK Private Limited is liable to pay this debt? State the remedy, if any available to BK Finance Limited.

(RTP Jun'24)

Answer 15

This case is governed by the 'Doctrine of Ultra Vires'. According to this doctrine, any act done, or a contract made by the company which travels beyond the powers of the company conferred upon it by its Memorandum of Association is

wholly void and inoperative in law and is therefore not binding on the company. This is because the Memorandum of Association of the company is, in fact, its charter; it defines its constitution and the scope of the powers of the company. Hence, a company cannot depart from the provisions contained in the

memorandum however imperative may be the necessity for the departure. Hence, any agreement ultra vires the company shall be null and void.

1. Whether AK Private Limited is liable to pay the debt?

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

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

2. Remedy available to BK Finance Limited:

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

Question 16

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

(RTP Jun'24) (MTP Nov'23 3 Marks) (PYP Nov'22 3 Marks)

Answer 16

Foreign Company [Section 2(42) of the Companies Act, 2013]: It means any company or body corporate incorporated outside India which—

1. has a place of business in India whether by itself or through an agent, physically or through electronic mode; and
2. conducts any business activity in India in any other manner.

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As Mike LLC is incorporated in Singapore and having a place of business in Pune, India, it is a foreign Company.

Question 17

Rohan incorporated a "One Person Company". The memorandum of OPC indicates the name of his brother Vinod as the nominee of OPC. However, Vinod is starting his new business abroad and needs to leave India permanently. Due to this fact, Vinod is withdrawing his consent of nomination in the said One Person Company. Taking into consideration the provisions of the Companies Act, 2013 answer the questions given below:-

- I. Is it mandatory for Vinod to withdraw his nomination in the said OPC
- II. Can Rohan make his 17 year old son as a nominee in such a case.

(MTP Mar'22 4 Marks)

Answer 17

Yes, it is mandatory for Vinod to withdraw his nomination in the said OPC as he is leaving India permanently as only a natural person who is an Indian citizen and resident in India or otherwise and has stayed in India for a period of not less than 120 days during the immediately preceding financial year shall be a nominee in OPC.

Since Vinod will not satisfy this condition, so he needs to withdraw his nomination. No, Rohan cannot make his 17 year old son as a nominee of his OPC as no minor shall become member or nominee of the OPC or can hold beneficial interest.

Question 18

The paid-up capital of Ram Private Limited is ₹ 10 Crores in the form of 7,00,000 Equity Shares of ₹ 100 each and 3,00,000 Preference Shares of ₹ 100 each. Lakhan Private Limited is holding 3,00,000 Equity Shares and 3,00,000 Preference Shares in Ram Private Limited. State with reason, Whether Ram Private Limited is subsidiary of Lakhan Private Limited?

(MTP Jun'22 4 Marks) (MTP 4 Marks, Oct'21)

Answer 18

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

1. controls the composition of the Board of Directors; or

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

For the purposes of this section

1. 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;
2. the expression "company" includes anybody corporate;

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

In the instant case, Ram Private Limited is having paid-up capital of R10 Crores in the form of 7,00,000 Equity Shares of *100 each and 3,00,000 Preference Shares of R100 each. Lakhan Private Limited is holding 3,00,000 Equity Shares and 3,00,000 Preference Shares in Ram Private Limited.

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

Question 19

"The Memorandum of Association is a charter of a company". Discuss. Also explain in brief the contents of Memorandum of Association.

(MTP Jun'22 6 Marks) (MTP 6 Marks, Oct'21)

Answer 19

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

Object of registering a memorandum of association:

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

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

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

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

Content of the memorandum: The memorandum of a company shall state -

(a) the name of the company (Name Clause) with the last word "Limited" in the case of a public limited company, or the last words "Private Limited" in the case of a private limited company. This clause is not applicable on the companies formed under section 8 of the Act.

(b) the State in which the registered office of the company (Registered Office clause) is to be situated;

(c) the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof (Object clause);

(d) the liability of members of the company (Liability clause), whether limited or unlimited,

(e) the amount of authorized capital (Capital Clause) divided into share of fixed amounts and the number of shares with the subscribers to the memorandum have agreed to take, indicated opposite their names, which shall not be less than one share. A company not having share capital need not have this clause.

(f) the desire of the subscribers to be formed into a company. The Memorandum shall conclude with the association clause. Every subscriber to the Memorandum shall take at least one share, and shall write against his name, the number of shares taken by him.

Question 20

Can a non-profit organization be registered as a company under the Companies Act, 2013? If so, what procedure does it have to adopt?

(MTP Nov'22 6 Marks)(SM)

Answer 20

Yes, a non-profit organization can be registered as a company under the Companies Act, 2013 by following the provisions of section 8 of the Companies Act, 2013. Section 8 of the Companies Act, 2013 deals with the formation of companies which are formed to

- promote the charitable objects of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment etc.

Such company intends to apply its profit in

- promoting its objects and
- prohibiting the payment of any dividend to its members.

The Central Government has the power to issue license for registering a section 8 company.

1. Section 8 allows the Central Government to register such person or association of persons as a company with limited liability without the addition of words 'Limited' or 'Private limited' to its name, by issuing licence on such conditions as it deems fit.
2. The registrar shall on application register such person or association of persons as a company under this section.
3. On registration, the company shall enjoy same privileges and obligations as of a limited company.

Question 21

Mr. Sunny sold his business of cotton production to a cotton production company CPL Private Limited in which he held all the shares except one which was held by his wife. He is also the creditor in the company for a tain amount. He also got the insurance of the stock of cotton of CPL Private Limited but in his own name not in the name of company. After one month, all the stocks of the

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cotton of CPL Private Limited were destroyed by fire . Mr. Sunny filed the claim for such loss with the Insurance company. State with reasons that whether the insurance company is liable to pay the claim?

(MTP Nov'22 3 Marks)

Answer 21

According to the decision taken in case of Salomon v/s Salomon & Co. Ltd., a company has separate legal entity. A company is different from its members. Further, according to the decision taken in case of Macaura v/s Northern Assurance Co. Ltd., a member or creditor does not have any insurable interest in the property of company. Members or creditors of the company cannot claim ownership in the property of company.

On the basis of above provisions and facts, it can be said Mr. Sunny and CPL Private Limited are separate entities. Mr. Sunny cannot have any insurable interest in the property of CPL Private Limited neither as member nor as creditor. Hence, the insurance company is not liable to pay to Mr. Sunny for the claim for the loss of stock by fire.

Question 22

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

(MTP Nov'22 4 Marks) (PYP May'22 3 Marks)

Answer 22

As per the provisions of the Companies Act, 2013, only a natural person who is an Indian citizen and resident in India (person who stayed in india for a period of not less than 120 days during immediately preceding financial year) -

- Shall be eligible to incorporate an OPC
- Shall be a nominee for the sole member.

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

Also, even though Mr. S's name is mentioned in the Memorandum of Association as nominee and his stay in india during the immediately preceding financial year is more than 120 days, is a foreign citizen and not an indian citizen. Hence, S's name cannot be given as nominee in the memorandum.

Question 23

What do you mean by the term Capital? Describe its classification in the domain of Company Law.

(MTP Nov'22 6 Marks) (PYP Dec 21 6 Marks)

Answer 23

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

Question 24

BC Private Limited and its subsidiary KL Private Limited are holding 90,000 and 70,000 shares respectively in PQ Private Limited. The paid-up share capital of PQ Private Limited is 7 30 Lakhs (3 Lakhs equity shares of \$ 10 each fully paid). Analyse with reference to provisions of the Companies Act, 2013 whether PQ Private Limited is a subsidiary of BC Private Limited. What would be your answer if KL Private Limited is holding 1,60,000 shares in PQ Private Limited and no shares are held by BC Private Limited in PQ Private Limited?

(MTP Nov'22 3 Marks)

Answer 24

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

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

For the purposes of this section -

1. 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 (i) is of another subsidiary company of the holding company;

2. "layer" in relation to a holding company means its subsidiary or subsidiaries.

In the instant case, BC Private Limited together with its subsidiary KL Private Limited is holding 1,60,000 shares (90,000+70,000 respectively) which is more than one half in nominal value of the Equity Share Capital of PQ Private Limited. Hence, PQ Private Limited is subsidiary of BC Private Limited.

3. in the second case, the answer will remain the same. KL Private Limited is a holding 1,60,000 shares i.e., more than one half in nominal value of the Equity Share Capital of PQ Private Limited (i.e., holding more than one half of voting power). Hence, KL Private Limited is holding company of Q Private Company and BC Private Limited is a holding company of KL Private Limited.

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

Question 25

Mr. Mohan had purchased some goods from Sunflower Limited on credit. A credit period of one month was allowed to Mr. Mohan. Before the due date, Mr.

Mohan went to the company and wanted to repay the amount due from him. He found only Mr. Ramesh there, who was the factory supervisor of the company. Mr. Ramesh told Mr. Mohan that the Accountant and the cashier are on leave, he is in-charge of receiving money and he may pay the amount to him. Mr. Ramesh issued a money receipt under his signature. After two months, Sunflower limited issued a notice to Mr. Mohan for nonpayment of the dues within the stipulated period. Mr. Mohan informed the company that he had already cleared the dues and he is no more responsible for the same. He also contended that Mr. Ramesh is an employee of the company whom he had made the payment and being an outsider, he trusted the words of Mr. Ramesh as duty distribution is a job of the internal management of the company. Analyse the situation and decide whether Mr. Mohan is free from his liability.

(MT Apr'23 4 Marks) (MTP 4 Marks, Apr'21)

Answer 25

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

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

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

Question 26

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

Decide, for what purpose the three companies were established? Whether the legal personality of all the three companies may be disregarded. (MT Apr'23 6 Marks)

(MTP 4 Marks, Mar'21) (MTP 6 Marks, Apr'21)

Answer 26

The House of Lords in *Salomon Vs. Salomon & Co. Ltd.* laid down that a company is a person distinct and separate from its members, and therefore, has an independent separate legal existence from its members who have constituted the company. But under certain circumstances the separate entity of the company may be ignored by the courts. When that happens, the courts ignore the corporate entity of the company and look behind the corporate facade and hold the persons in control of the management of its affairs liable for the acts of the company. Where a company is incorporated and formed by certain persons only for the purpose of evading taxes, the courts have discretion to disregard the corporate entity and tax the income in the hands of the appropriate assessee.

1. The problem asked in the question is based upon the aforesaid facts. The three companies were formed by the assessee purely and simply as a means of avoiding tax and the companies were nothing more than the facade of the assessee himself. Therefore, the whole idea of Mr. Rajeev was simply to split his income into three parts with a view to evade tax. No other business was done by the company.
2. The legal personality of the three private companies may be disregarded because the companies were formed only to avoid tax liability. It carried on no other business, but was created simply as a legal entity to ostensibly receive the dividend and interest and to hand them over to the assessee as pretended loans. The same was upheld in *Re Sir Dinshaw Maneckjee Petit and Juggilal vs. Commissioner of Income Tax*.

Question 27

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

- 1) Directors and their relatives - 190
- 2) Employees - 15
- 3) Ex-Employees (Shares were allotted when they were employees - 10
- 4) 5 couples holding shares jointly in the name of husband and wife (5*2) - 10
- 5) Others - 5

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

(MTP Apr'23 3 Marks) (MTP 3 Marks, Apr'21)

Answer 27

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, Aqua Limited may be converted into a private company only if the total members of the company are limited to 200.

Total Number of members

Directors and their relatives	190
5 couples holding shares jointly in the name of husband and wife (5*1)	5
Others	5
Total	200

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

Question 28

A company registered under section 8 of the Companies Act, 2013, earned huge profit during the financial year ended on 31st March, 2023 due to some favorable policies declared by the Government of India and implemented by the company. Considering the development, some members of the company wanted the company to distribute dividends to the members of the company. They approached you to advise them about the maximum amount of dividend that can be declared by the company as per the provisions of the Companies Act, 2013.

(MTP May'23 4 Marks)

Answer 28

Section 8 of the Companies Act, 2013 deals with the formation of companies which are formed to promote the charitable objects of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment etc. Such company intends to apply its profit in promoting its objects and prohibiting the payment of any dividend to its members.

Hence, a company that is registered under section 8 of the Companies Act, 2013, is prohibited from the payment of any dividend to its members.

In the present case, the company in question is a section 8 company and hence it cannot declare dividend. Thus, the contention of members is incorrect.

Question 29

Mr. Raj formed a company with a capital of Rs. 5,00,000. He sold his business to another company for Rs. 4,00,000. For the payment of sale, he accepted shares worth Rs. 3,00,000 (30,000 shares of Rs. 10 each).

The balance 1,00,000 was considered as loan and Mr. Raj secured the amount by issue of debentures. His wife and three daughters took one share each. Owing to strike the company was wound up. The assets of the company were valued at Rs. 60,000. The debts due to unsecured creditors were Rs. 80,000.

Mr. Raj retained the entire sum of Rs. 60,000 as part payment of loan. To this, the other creditors objected. Their contention was that a man could not own any money to himself, and the entire sum of Rs. 60,000 should be paid to them.

Examine the rights of Mr. Raj and other creditors. Who will succeed?

(MTP May 23 3 Marks) (MTP Mar 22 3 Marks)

Answer 29

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

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

Thus, the shareholders are protected from the acts of the company. The leading case law of Saloman Vs Saloman and Co. Limited, laid the foundation of concept of corporate veil or independent corporate personality. A company is a person distinct and separate from its members.

Based on the above discussion and provisions, Mr. Raj was entitled to the assets of the company as he was a secured creditor of the company and the contention of the creditors that Mr. Raj and the company are one and same person is wrong.

Question 30

Parasnath Infra Height Limited is a public company having 215 members. Out of 215 members, 20 members were employee in the company during the period 1st June, 2021 to 30th June, 2023. They were allotted shares in Parasnath Infra Height Limited on 1st April, 2017 which are held by them till today i.e. 31st October, 2023. Now, company wants to convert itself into a private company.

State with reasons, whether Parasnath Infra Height Limited is required to reduce the number of members under the provisions of Companies Act, 2013?

(MTP Nov'23 4 Marks)

Answer 30

Question Bank —> Chap 6 - The Companies Act, 2013

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

1. restricts the right to transfer its shares;
2. except in case of One Person Company, limits the number of its members to two hundred:

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

Provided further that-

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

(B) persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased, shall not be included in the number of members; and

3. prohibits any invitation to the public to subscribe for any securities of the company;

In the given problem, 20 members were employees of the company but they were not employee at the time of getting membership i.e. 1st April, 2017 and nor on existing date i.e. 31st October, 2023.

Hence, they will be considered as members for the purpose of the limit of 200 members.

Hence, taking into account the provisions of Section 2(68) of the Act, the company is required to reduce the number of members to 200 before converting it into a private company.

Question 31

The Articles of Association (AOA) of Avenue International Private Limited contained a clause that in case of insolvency of any member, his shares in the company should be sold to other person and at the price fixed by directors of the company. Mr. Neeraj, a shareholder was adjudicated insolvent. His official assignee in insolvency claimed that he was not bound by the provisions of AOA and is free to sell the shares at their true value. Referring the provisions of the Companies Act 2013, whether official assignee is bound by AOA?

(MTP Nov'23 6 Marks)

Answer 31

The Articles of Association (AOA) of a company are its rules and regulations, which are framed to manage its internal affairs. Just as the Memorandum contains the fundamental conditions upon which the company is allowed to be incorporated, so also the articles are the internal regulations of the company (Guinness vs. Land Corporation of Ireland). Further according to the decision taken in case of S.S. Rajkumar vs. Perfect Castings (P) Ltd., the document containing the AOA of a company (the Magna Carta) is a business document; hence it has to be construed strictly. It regulates the domestic management of a company and creates certain rights and obligations between the members and the company. On the basis of above, it can be said that Official assignee of Mr. Neeraj is bound by the AOA.

Question 32

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

(MTP Dec'23 4 Marks) (PYP Jun'23 3 Marks)

Answer 32

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

- (i) **paid-up share capital** of which does not exceed Rs. 4 crore or such higher amount as may be prescribed which shall not be more than Rs. 10 crore; and
- (ii) **turnover** of which as per profit and loss account for the immediately preceding financial year does not exceed Rs. 40 Crore or such higher amount as may be prescribed which shall not be more than Rs. 100 crore.

Exceptions: This clause shall not apply to:

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

In the instant case, since the paid-up capital of ABC Private Limited is Rs. 35 Lakhs and turnover is Rs. 2.5 crore, it can avail the status of a small company as both the requirements with regard to paid-up share capital as well as turnover are fulfilled by the Company.

Question 33

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

(MTP Dec'23 6 Marks) (PYP Jun'23 6 Marks)

Answer 33

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

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

1. To determine the character of the company i.e. to find out whether co-enemy or friend: It is true that, unlike a natural person, a company does not have mind or conscience; therefore, it cannot be a friend or foe. It may, however, be characterised as an enemy company, if its affairs are under the control of people of an enemy country. For this purpose, the Court may examine the character of the persons who are really at the helm of affairs of the company.
2. To protect revenue/tax: In certain matters concerning the law of taxes, duties and stamps particularly where question of the controlling interest is in issue. Where corporate entity is used to evade or circumvent tax, the Court can disregard the corporate identity.
3. To avoid a legal obligation: Where it was found that the sole purpose for the formation of the company was to use it as a device to reduce the amount to be paid by way of bonus to workmen, the Supreme Court upheld the piercing of the veil to look at the real transaction.

4. Formation of subsidiaries to act as agents: A company may sometimes be regarded as an agent or trustee of its members, or of another company, and may therefore be deemed to have lost its individuality in favour of its principal. Here the principal will be held liable for the acts of that company.
5. Company formed for fraud/improper conduct or to defeat law: Where the device of incorporation is adopted for some illegal or improper purpose, e.g., to defeat or circumvent law, to defraud creditors or to avoid legal obligations.

Question 34

Mr. R, a manufacturer of toys approached MNO Private Limited for supply of raw material worth ₹ 1,50,000/-. Mr. R was offered a credit period of one month. Mr. R went to the company prior to the due date and met Mr. C, an employee at the billing counter, who convinced the former that the payment can be made to him as the billing-cashier is on leave.

Mr. R paid the money and was issued a signed and sealed receipt by Mr. C. After the lapse of due date, Mr. R received a recovery notice from the company for the payment of ₹ 1,50,000/-.

Mr. R informed the company that he has already paid the above amount and being an outsider had genuine reasons to trust Mr. C who claimed to be an employee and had issued him a receipt.

The Company filed a suit against Mr. R for non-payment of dues. Discuss the fate of the suit and the liability of Mr. R towards company as on current date in consonance with the provision of the Companies Act 2013? Would your answer be different if a receipt under the company seal was not issued by Mr. C after receiving payment?

(MTP Dec'23 3 Marks) (PYP Nov'22 4 Marks)

Answer 34

1. Fate of the suit and the liability of Mr. R towards the company: Doctrine of the Indoor Management According to the Doctrine of the Indoor Management, the outsiders are not deemed to have notice of the internal affairs of the company. They are entitled to assume that the acts of the directors or other officers of the company are validly performed, if they are within the scope of their apparent authority.

So long as an act is valid under the articles, if done in a particular manner, an outsider dealing with the company is entitled to assume that it has been done in the manner required. This is the indoor management rule, that the company's indoor affairs are the company's problem. This rule has been laid down in the landmark case-the Royal British Bank vs. Turquand. (Known as "Turquand Rule") In the instant case, Mr. R is not liable to pay the amount of \$ 1,50,000 to MNO Private Limited as he had genuine reasons to trust Mr. C, an employee of the company who had issued him a signed and sealed receipt.

2. Liability of Mr. R in case no receipt is issued by Mr. C:

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

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

Question 35

AK Private Limited has borrowed 7 36 crores from BK Finance Limited. However, as per memorandum of AK Private Limited the maximum borrowing power of the company is \$ 30 crores. Examine, whether AK Private Limited is liable to pay this debt? State the remedy, if any available to BK Finance Limited.

(PYP Dec'21 4 Marks)

Answer 35

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

memorandum however imperative may be the necessity for the departure. Hence, any agreement ultra vires the company shall be null and void.

1. Whether AK Private Limited is liable to pay the debt?

As per the facts given, AK Private Limited borrowed \$ 36 crores from BK Finance Limited which is beyond its borrowing power of R 30 crores.

Hence, contract for borrowing of R 36 crores, being ultra vires the memorandum of association and thereby ultra vires the company, is void. AK Private Limited is not, therefore, liable to pay the debt.

2. Remedy available to BK Finance Limited:

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

Question 36

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

(PYP Dec'21 3 Marks)

Answer 36

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

1. controls the composition of the Board of Directors; or
2. exercises or controls more than one-half of the total voting power either at its own or together with one or more of its subsidiary companies:

For the purposes of this section -

Question Bank —> Chap 6 - The Companies Act, 2013

- 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. "layer" in relation to a holding company means its subsidiary or subsidiaries.

In the instant case, BC Private Limited together with its subsidiary KL Private Limited is holding 1,60,000 shares (90,000+70,000 respectively) which is more than one half in nominal value of the Equity Share Capital of PQ Private Limited. Hence, PQ Private Limited is subsidiary of BC Private Limited.

In the second case, the answer will remain the same. KL Private Limited is a holding 1,60,000 shares i.e., more than one half in nominal value of the Equity Share Capital of PQ Private Limited (i.e., holding more than one half of voting power). Hence, KL Private Limited is holding company of PQ Private Company and BC Private Limited is a holding company of KL Private Limited.

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

Question 37

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

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

(PYP May'22 4 Marks)

Answer 37

Doctrine of Indoor Management

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

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

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

Thus,

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

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

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

Question 38

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

(PYP May' 22 6 Marks)

Answer 38

Doctrine of ultra vires:

The meaning of the term ultra vires is simply "beyond (their) powers". The legal phrase "ultra vires" is applicable only to acts done in excess of the legal powers of the doers. This presupposes that the powers in their nature are limited. To an ordinary citizen, the law permits whatever does the law not expressly forbid. It is a fundamental rule of Company Law that the objects of a company as stated in its memorandum can be departed from only to the extent permitted by the Act,

thus far and no further [Ashbury Railway Company Ltd. vs. Riche]. In consequence,

any act done or a contract made by the

company which travels beyond the powers not only of the directors but also of the company is wholly void and inoperative in law and is therefore not binding on the company. On this account, a company can be restrained from employing its funds for purposes other than those sanctioned by the memorandum.

Likewise, it can be restrained from carrying on a trade different from the one it is authorized to carry on.

Consequences of ultra vires' acts of the company:

The impact of the doctrine of ultra vires is that a company can neither be sued on an ultra vires transaction, nor can it sue on it. Since the memorandum is a "public document", it is open to public inspection. Therefore, when one deals with a company one is deemed to know about the powers of the company. If in spite of this one enters into a transaction which is ultra vires the company, he/she cannot enforce it against the company.

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

However, some ultra vires acts can be regularised by ratifying them subsequently. For instance, if the act is ultra vires the power of the directors, the shareholders can ratify it; if it is ultra vires the articles of the company, the company can alter the articles; if the act is within the power of the company but is done irregularly, shareholders can validate such acts.

Question 39

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

(PYP Nov 22 4 Marks)

Answer 39

Section 2(62) of the Companies Act, 2013 defines one person company as a company which has only one person as a member. However, a private company shall have minimum 2 members without any restriction on the share capital or turnover. If OPC is converted into private company Mr. Anil and Mr.

Sunil both can be the members of the company and investment from Mr. Sunil can be accepted.

A One Person Company can voluntarily convert itself into a private company by following the compliances given under the Companies Act, 2013.

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

Question 40

Explain listed company and unlisted company as per the provisions of the Companies Act, 2013.

(PYP Nov 22 2 Marks)

Answer 40

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

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

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

Unlisted company means company other than listed company.

Question 41

ABC Limited has allotted equity shares with voting rights to XYZ Limited worth * 15 crores and convertible preference shares worth & 10 crores during the financial year 2022-23. After that the total share capital of the company is R 100 crores.

Comment on whether XYZ Limited would be called an Associate Company as per the provisions of the Companies Act, 2013? Also define an Associate Company.

(PYP Jun' 23 4 Marks)

Answer 41

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

The 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.

The term "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.

In the instant case, ABC Limited has allotted equity shares with voting rights to XYZ Limited worth Rs. 15 crore and convertible preference shares worth Rs. 710 crore during the financial year 2022-23 out of the total share capital of ABC Limited of Rs. 100 crore.

Since XYZ Limited is holding only 15% significant influence (Rs. 15 crore equity shares with voting rights) in ABC Limited, which is less than twenty per cent, XYZ Limited is not an Associate company of ABC Limited.

Note:

It can be assumed that the convertible preference shareholders are having voting rights and due to this, XYZ Limited is holding overall 25% paid up share capital in ABC Limited (with voting rights), Hence, XYZ limited is having significant control over ABC Limited and therefore XYZ is an Associate company of ABC Limited

Question 42

The State Government of X, a state in the country is holding 48 lakh shares of Y Limited. The paid up capital of Y Limited is \$ 9.5 crore (95 lakh shares of \$ 10 each). Y Limited directly holds 2,50,600 shares of 2 Private Limited which is having share capital of 7.5 crore in the form of 5 lakh shares of 7.100 each.

Z Private Limited claimed the status of a subsidiary company of \$ 100 each. Z Private Limited claimed the status of a subsidiary company of Y Limited as well as a Government company. Advise as a legal advisor, whether Z Private Limited is a subsidiary company of Y Limited as well as a Government company under the provisions of the Companies Act, 2013?

(PYP Dec' 23 4 Marks)

Answer 42

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

- a. the Central Government, or
- b. by any State Government or Governments, or
- c. partly by the Central Government and partly by one or more State Governments, and the section includes a company which is a subsidiary company of such a Government company.

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

- a. controls the composition of the Board of Directors;
- b. or exercises or controls more than one-half of the total voting power either at its own or together with one or more of its subsidiary companies.

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

Further, Y Limited directly holds 2,50,600 shares in Z Private Limited, which is more than one-half of the total shares of Z Limited i.e. 2,50,000 shares (50% of 5 Lakh shares). Thus, the Company controls more than one-half of the total voting power of Z Limited. Hence Z Private Limited is a subsidiary of Y Limited.

Therefore, we can conclude that Z Private Limited is a subsidiary of Y Limited but not a Government Company since Y Limited is not a Government Company.

Question 43

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

(PYP Dec'23 6 Marks)

Answer 43

Kinds of share capital: Section 43 of the Companies Act, 2013 provides the kinds of share capital.

According to the said provision, the share capital of a company limited by shares shall be of two kinds, namely

1. "Equity share capital", with reference to any company limited by shares, means all share capital which is not preference share capital;

Equity share capital— can be

- a. with voting rights; or
 - b. with differential rights as to dividend, voting or otherwise in accordance with such rules as may be prescribed;
2. "Preference share capital", with reference to any company limited by shares, means that part of the issued share capital of the company which carries or would carry a preferential right with respect to
 - (a) **payment of dividend**, either as a fixed amount or an amount calculated at a fixed rate, which may either be free of or subject to income-tax; and
 - (b) **repayment**, in the case of a winding up or repayment of capital, of the amount of the share capital paid-up or deemed to have been paid-up, whether or not, there is a preferential right to the payment of any fixed premium or premium on any fixed scale, specified in the memorandum or articles of the company;

Capital shall be deemed to be preference capital, despite that it is entitled to either or both of the following rights, namely:-

- (a) that in respect of dividends, in addition to the preferential rights to the amounts specified as above, it has a right to participate, whether fully or to a limited extent, with capital not entitled to the preferential right aforesaid;
- (b) that in respect of capital, in addition to the preferential right to the repayment, on a winding up, of the amounts specified above, it has a right to participate, whether fully or to a limited extent, with capital not entitled

to that preferential right in any surplus which may remain after the entire capital has been repaid.

Question 44

MTK Private Limited is a company registered under the Companies Act, 2013 on 5th January, 2021.

The company has not started its business till now. On 7th April, 2023, a notice has been received from ROC for non-filing of FORM No-INC-20A. Identify under which category MTK Private Limited company is classified. Explain the definition of the category of the company in detail.

(PYP Dec'23 3 Marks)

Answer 44

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

"Significant accounting transaction" means any transaction other than -

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

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

In the instant case, MTK Private Limited was registered on 5th January, 2021 and has not started its business till now. On 7th April 2023, a notice has been received from ROC for non-filing of Form No. INC 20A. Since the company has not started its business and a period of more than 2 years have already elapsed, it will be treated as Inactive Company.

Question 45

SK Infrastructure Limited has a paid up share capital divided into 6,00,000 equity shares of \$ 100 each. 2,00,000 equity shares of the company are held by Central Government and 1,20,000 equity shares are held by Government of

Maharashtra. Explain with reference to relevant provisions of the Companies Act, 2013, whether SK Infrastructure Limited can be treated as Government Company.

(RTP May' 21)

Answer 45

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

1. the Central Government, or
2. by any State Government or Governments, or
3. partly by the Central Government and partly by one or more State Governments,

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

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

Hence, SK Infrastructure Limited is a Government company.

Question 46

Mr. Anil formed a One Person Company (OPC) on 16th April, 2018 for manufacturing electric cars.

The turnover of the OPC for the financial year ended 31st March, 2019 was about & 2.25 Crores. His friend Sunil wanted to invest in his OPC, so they decided to convert it voluntarily into a private limited company. Can Anil do so?

(RTP May' 21)

Answer 46

As per the provisions of Sub-Rule (7) of Rule 3 of the Companies (Incorporation) Rules, 2014, an OPC cannot convert voluntarily into any kind of company unless two years have expired from the date of its incorporation, except threshold limit (paid up share capital is increased beyond fifty lakh rupees or its average

annual turnover during the relevant period exceeds two crore rupees. In the instant case, Mr. Anil formed an OPC on 16th April, 2018 and its turnover for the financial year ended 31st March, 2019 was Rs. 2.25 Crores. Even though two years have not expired from the date of its incorporation, since its average annual turnover during the period starting from 16th April, 2018 to 31st March, 2019 has exceeded Rs. 2 Crores, Mr. Anil can convert the OPC into a private limited company along with Sunil.

Question 47

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

(RTP Nov'21)

Answer 47

It was decided by the court in the case of *Gilford Motor Co. Vs. Horne*, that if the company is formed simply as a mere device to evade legal obligations, though this is only in limited and discrete circumstances, courts can pierce the corporate veil. In other words, if the company is mere sham or cloak, the separate legal entity can be disregarded. On considering the decision taken in *Gilford Motor Co. Vs. Horne* and facts of the problem given, it is very much clear that Seven Stars Timbers Private Limited was formed just to evade legal obligations of the agreement between Mr. Dhruv and Sunmoon Timber Private Limited. Hence, Seven Stars Timbers Private Limited is just a sham or cloak and

separate legal entity between Mr. Dhruv and Seven Stars Timbers Private Limited should be disregarded.

Question 48

Mr. A is an Indian citizen and his stay in India during immediately preceding financial year is for 115 days. He appoints Mr. B as his nominee who is a foreign citizen but has stayed in India for 130 days during immediately preceding financial year. Is Mr. A eligible to be incorporated as a One Person Company (OPC). If yes, can he give the name of Mr. B in the memorandum of Association as his nominee to become the member after Mr. A's incapacity to become a member.

(RTP Nov'21)

Answer 48

(Answer has been changed as per latest amendment and information. This is the latest answer. Follow this)

As per the provisions of the Companies Act, 2013, only a natural person who is an Indian citizen and whether or not a resident in India (person who stayed in India for a period of not less than 120 days during immediately preceding financial year) -

- Shall be eligible to incorporate an OPC
- Shall be a nominee for the sole member.

1. In the given case, though Mr. A is an Indian citizen, his stay in India during the immediately preceding previous year is only 115 days which is below the requirement of 120 days. (Which is immaterial)
Hence Mr. A is eligible to incorporate an OPC.

Also, even though Mr. B's name is mentioned in the memorandum of Association as nominee and his stay in In during the immediately preceding financial year is more than 120 days, he is a foreign citizen and not an Indian citizen. Hence B's name cannot be given as nominee in the memorandum.

Question 49

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

Directors and their relatives - 190

Employees - 15

Ex-employees (shares were allotted when they were employees) - 20

Others - 20

(Including 10 joint holders holding shares jointly in the name of father and son)

The Board of directors of the company propose to convert it into a private company. Advice whether reduction in the number of members is necessary for conversion.

(PYP 4 Marks, Jan 21)

Answer 49

In the given case, ABC Limited was having 245 members in the company. The Board of Directors of said company proposes to convert it into private company. In lines with Section 2 (68) of the Companies Act, 2013, a private company by its Articles, limits the number of its members to 200.

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. It is further provided that, following persons shall not be included in the number of members-

1. Persons who are in the employment of the company: and
2. 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.

As per the facts, ABC Limited has members constituting of Directors & their relatives, employees, Ex-employees and others including 10 joint holders. In line with the requirement for being a private company, following shall be restricted to be as members i.e., Directors & their relatives & joint holders holding shares jointly constituting 200 members **(190+10)**.

Accordingly, ABC Limited when converted to private company shall not be required to reduce the number of members as the number of members as per requirement of a private company, is fulfilled that is of maximum 200 members.

Question 50

Explain Doctrine of 'Indoor Management' under the Companies Act, 2013. Also state the circumstances where the outsider cannot claim relief on the ground of 'Indoor Management'.

(PYP 6 Marks, Jan'21)

Answer 50

Doctrine of Indoor Management (The Companies Act, 2013): According to the "doctrine of indoor management" the outsiders, dealing with the company though are supposed to have satisfied themselves regarding the competence of the company to enter into the proposed contracts are also entitled to assume that as far as the internal compliance to procedures and regulations by the company is concerned, everything has been done properly. They are bound to examine the registered documents of the company and ensure that the proposed dealing is not inconsistent therewith, but they are not bound to do more. They are fully entitled to presume regularity and compliance by the company with the internal procedures as required by the Memorandum and the Articles. This doctrine is a limitation of the doctrine of "constructive notice" and popularly known as the rule laid down in the celebrated case of *Royal British Bank v. Turquand*. Thus, the doctrine of indoor management aims to protect outsiders against the company.

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

- (a) Actual or constructive knowledge of irregularity: The rule does not protect any person when the person dealing with the company has notice, whether actual or constructive, of the irregularity.
- (b) Suspicion of Irregularity: The doctrine in no way, rewards those who behave negligently. Where the person dealing with the company is put upon an inquiry, for example, where the transaction is unusual or not in the ordinary course of business, it is the duty of the outsider to make the necessary enquiry.
- (c) Forgery: The doctrine of indoor management applies only to irregularities which might otherwise affect a transaction but it cannot apply to forgery which must be regarded as nullity.

Question 51

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

(PYP 3 Marks, Jan 21)

Answer 51

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

1. The Central Government, or
2. By any State Government or Governments, or
3. Partly by the Central Government and partly by one or more State Governments, and the section includes a company which is a subsidiary company of such a Government company.

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

Hence, SK Infrastructure Limited is a Government company.

Question 52

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

- (i) Is it mandatory for Z to withdraw her nomination in the said OPC, if she is leaving India permanently?
- (ii) Can Z continue her nomination in the said OPC, if she maintained the status of Resident of India after her marriage?

(PYP 4 Marks, Jul'21)

Answer 52

(Answer has been changed as per latest amendment and information. This is the latest answer. Follow this)

(a) No, it is not mandatory for Z to withdraw her nomination in the said OPC even if she is leaving India permanently as only a natural person who is an Indian citizen can be a member and nominee in the OPC whether or not resident in India.

(b) Yes, Z can continue her nomination in the said OPC, irrespective of the fact that she maintains the status of Resident of India after her marriage.

Question 53

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

(PYP 6 Marks, Jul'21)

Answer 53

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

Explanation. — For the purpose of this clause

1. 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;
2. the expression "joint venture" means a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

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

- a. Paid-up equity share capital; and
- b. Convertible preference share capital.

Question 54

What is the main difference between a Guarantee Company and a Company having Share Capital?

(PYP 3 Marks, Jul'21)

Answer 54

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

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

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

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

Question 55

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.

(MTP 6 Marks, Mar 21)

Answer 55

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)

- a. 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.
- 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.

Question 56

Briefly explain the doctrine of "ultravires" under the Companies Act, 2013. What are the consequences of ultravires acts of the company?

(MTP 6 Marks, Nov'21)

Answer 56

Doctrine of ultra vires: The meaning of the term ultra vires is simply "beyond (their) powers". The legal phrase "ultra vires" is applicable only to acts done in

excess of the legal powers of the doers. This presupposes that the powers are in their nature limited. To an ordinary citizen, the law permits whatever does the law not expressly forbid.

It is a fundamental rule of Company Law that the objects of a company as stated in its memorandum can be departed from only to the extent permitted by the Act - thus far and no further [Ashbury Railway Company Ltd. vs. Riche]. In consequence, any act done or a contract made by the company which travels beyond the powers not only of the directors but also of the company is wholly void and inoperative in law and is therefore not binding on the company. On this account, a company can be restrained from employing its fund for purposes other than those sanctioned by the memorandum. Likewise, it can be restrained from carrying on a trade different from the one it is authorised to carry on.

The impact of the doctrine of ultra vires is that a company can neither be sued on an ultra vires transaction, nor can it sue on it. Since the memorandum is a "public document", it is open to public inspection. Therefore, when one deals with a company one is deemed to know about the powers of the company. If in spite of this you enter into a transaction which is ultra vires the company, you cannot enforce it against the company. For example, if you have supplied goods or performed service on such a contract or lent money, you cannot obtain payment or recover the money lent. But if the money advanced to the company has not been expended, the lender may stop the company from parting with it by means of an injunction; this is because the company does not become the owner of the money, which is ultra vires the company. As the lender remains the owner, he can take back the property in specie. If the ultra vires loan has been utilised in meeting lawful debt of the company then the lender steps into the shoes of the debtor paid off and consequently he would be entitled to recover his loan to that extent from the company.

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

Sometimes, act which is ultra vires can be regularised by ratifying it subsequently. For instance, if the act is ultra vires the power of the directors, the shareholders can ratify it; if it is ultra vires the articles of the company, the company can alter the articles; if the act is within the power of the company but is done irregularly, shareholder can validate it.

Question 57

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

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

(MTP 3 Marks, Nov'21) (RTP May'21)

Answer 57

As per Section 2(6) of the Companies Act, 2013, an Associate Company in relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company. The term "significant influence" means control of at least 20% of total share capital, or control of business decisions under an agreement.

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

- a. Paid-up equity share capital; and
- b. Convertible preference share capital.

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

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