

CHAPTER 1 - PRELIMINARY

Company [Section 2 (20)]

Means a company incorporated under this Act or under any previous company law.

Public Company [Section 2(71)]

A company that:

- (a) Is not a private company, and
- (b) Has **minimum paid-up share capital** as prescribed (Nothing Prescribed so far).

Note: A **subsidiary of a public company** is deemed a **public company**, even if such subsidiary continues to be a private company in its articles.

Section 2(87): Subsidiary Company

A company is subsidiary of a holding company if:

- (i) Holding company **controls Board composition**, or
- (ii) Holds/controls more than **50% of voting power**, alone or with other subsidiaries.

Explanation:

- Control via another subsidiary is also considered.
- **Control of Board** = power to appoint/remove all/majority directors.
- "Company" includes **any body corporate**.

Fiduciary holdings (e.g. as trustee) **not counted** in determining subsidiary status (per Notification dated 27 Dec 2013).

Question: 1

Cross Limited is a company incorporated under the erstwhile Companies Act, 1956, while XYZ Private Limited is a company registered under the Companies Act, 2013.

XYZ Private Limited has issued:

- 1,00,000 **convertible preference shares** (carrying voting rights) of ₹100 each
- 10,00,000 **equity shares** of ₹10 each, fully paid-up.

Cross Limited holds **all the preference shares** and **1,00,000 equity shares** of XYZ Private Limited.

Based on the above facts, **examine** the following:

1. Whether the provisions of the Companies Act, 2013 are applicable to Cross Limited?
2. Whether XYZ Private Limited shall be regarded as a **public company** under the Companies Act, 2013? [MTP May 24 (2) – 5 Marks]

Answer:

1. Applicability of Companies Act, 2013:

As per **Section 1 (4)**, the Companies Act, 2013 applies to all companies incorporated under this Act or under any previous company law (including the Companies Act, 1956).

Hence, **Cross Limited is governed by the Companies Act, 2013.**

2. Status of XYZ Private Limited: Under **Section 2(87)**, a company is considered a **subsidiary** if another company controls **more than 50% voting power** in it.

- XYZ has total voting shares worth ₹2 crore (₹1 crore preference + ₹1 crore equity).
- Cross Limited holds ₹1 crore preference + ₹10 lakh equity = ₹1.10 crore → **more than 50%.**

Thus, **XYZ is a subsidiary of Cross Limited.**

Now, per **Section 2(71)**, if a private company is a subsidiary of a **public company**, it shall be **deemed to be a public company** under the Act.

So, **XYZ Private Limited is deemed to be a public company**, even if it remains private in its articles.

One Person company [Section 2(62)]

Means a company which has only one person as a member.

Small Company [Section 2(85)]

Means a **PRIVATE** company:

(i) Paid-up share capital of which does not exceed **₹4 crore; AND**

(ii) Turnover of which as per its last profit and loss account for immediately preceding financial year does not exceed **₹40 crore**

Exceptions (i.e., Not treated as Small Company):

- Holding or Subsidiary Company
- Company under Section 8
- Company/body corporate governed by any Special Act

Financial Statement [Section 2(40)]

1. **Financial Statement includes:**

1. **Balance sheet** as at end of financial year
2. **Profit & Loss Account** / Income & Expenditure Account (for not-for-profit company)
3. **Cash Flow Statement** for the financial year
4. Statement of Changes in **Equity** (if applicable)
5. **Explanatory notes** annexed to / forming part of above documents

2. **Exemption (General):** OPC, Small Company, and Dormant Company **need not include Cash Flow Statement** in financial statements.

3. **Exemption (Private Company Start-up):** Private company **recognized as Start-up** may also **omit Cash Flow Statement**.

4. **Condition for Private Company Exemption:** Private company **must not have defaulted** in filing:

- Financial statements (Section 137), or
- Annual return (Section 92)

5. A **start-up or start-up company** means a **private company** incorporated under the Companies Act, 2013 or Companies Act, 1956, and **recognised as a start-up** as per the notification issued by the **Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce & Industry**.

6. **Note:** Profit & Loss Account may also be called **Statement of Profit and Loss**.

Question: 2

Sankul (P) Ltd. is a private company. It has 40 members, is a subsidiary of a public company, is actively engaged in business, and is not a recognised start-up.

You are required to examine whether the company is required to prepare a **Cash Flow Statement** as part of its **financial statements** under the Companies Act, 2013. [RTP May 23] [RTP Jan 25]

Answer:

Sankul (P) Ltd. is **not OPC** (has 40 members), **not Small Co.** (it's a subsidiary), **not Dormant** (actively doing business), and **not Private Start-up** (explicitly mentioned).

Hence, **cash flow statement is mandatory**.

Question: 3

Whether **Resolution Pvt. Ltd.** (Paid-up capital ₹50 lakh: 5,00,000 equity shares of ₹10 each; Turnover ₹2 crore; 2,00,000 shares held by Yellow Ltd., a public company) qualifies as a small company and whether non-filing of the cash flow statement amounts to default. (MTP May 24 (I) 5 Marks) [July 21 – 6 Marks]

Answer:

Since it is **not a holding/subsidiary**, and both **paid-up capital (₹50 lakh)** and **turnover (₹2 crore)** are within **Section 2(85)** limits (₹4 crore & ₹40 crore), **Resolution Pvt. Ltd.** is a **Small Company**; hence, it's **exempt from filing the cash flow statement** under **Section 2(40)** and has **not committed any default**.

Listed Company [Section 2(52)]

Means a company having **any of its securities** listed on a **recognized stock exchange**.

Proviso: Certain classes of companies **may be excluded** from this definition as **prescribed in consultation with SEBI**.

Rule 2A: Companies *not considered* as Listed Companies

1. **Public Companies** (not listed equity) but listed the following on **private placement basis**:
 - (i) **Non-convertible debt securities** under SEBI Regulations.
 - (ii) **Non-convertible redeemable preference shares** under SEBI Regulations.
 - (iii) Both (i) and (ii) above
2. **Private Companies** having listed **non-convertible debt securities** on **private placement basis** under SEBI Regulations.
3. **Public Companies** whose **equity shares are listed** on a **foreign stock exchange** (as per **Section 23(3)** of the Act), but **not listed in India**.

Question: 5

Whether **ABC Ltd** (*listed NCDs on private placement basis*), **CHG Ltd** (*listed NCRPS on private placement basis*), and **PRS Ltd** (*equity listed only in a foreign jurisdiction*) are treated as **listed companies** under the **Companies Act, 2013**. (Nov 22 - 5 Marks)

Answer:

All three are **unlisted companies** as per **Rule 2A**, since:

- **Listing of NCDs/NCRPS on private placement basis**, and
- **Equity listed only on foreign stock exchanges**

does not amount to listing in India.

CHAPTER - 2 INCORPORATION OF COMPANY AND MATTERS INCIDENTAL THERETO

FORMATION OF COMPANY [SECTION 3]

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

- (a) **seven or more persons**, in case of **public company**;
- (b) **two or more persons**, in case of **private company**; or
- (c) **one person**, in case of **One Person Company** that is to say, a **private company**, by subscribing their names or his name to a memorandum and complying with the requirements of this Act:

Proviso 1: Nomination by Member of OPC

- 1. Memorandum of OPC shall indicate name of another person (**nominee**) in **Form No. INC-32 (SPICe)**
- 2. Nominee's **prior written consent** required in **Form INC-4**.
- 3. **Effect:** On **death or incapacity** of the sole member, nominee becomes member.
- 4. Consent of nominee to be **filed with ROC** at the time of incorporation along with MOA and AOA.

Proviso 2: Withdrawal of Consent by Nominee

- 1. Nominee may withdraw consent by **written notice** to the **sole member and OPC**.
- 2. Sole member shall **nominate another person within 15 days** of receiving the notice.
- 3. Sole member shall **send an intimation to the company in writing** and submit **written consent of the new nominee**.

Proviso 3: Change of Nominee by Member

- 1. Member of OPC may **change the nominee at any time** due to **any reason**, including **death or incapacity** of the existing nominee by written intimation to the company.
- 2. **Prior written consent** of the **new nominee** must be obtained before nomination.

Proviso 5: Any such change in the name of the person shall not be deemed to be an alteration of the memorandum.

Nomination by New Member (Cessation and Nomination)

- 1. On **death or incapacity** of sole member, **nominee becomes the new member** of OPC.
- 2. Such **new member** shall **nominate another person** within **15 days** of becoming a member.
- 3. The new nominee shall become member in case of **death or incapacity** of the new member.

Proviso 4: Intimation of change

- 1. **Duty of Company:** File notice with Registrar in case of –
 - Withdrawal of consent by nominee
 - Change of nominee by sole member
 - Cessation and new nomination
- 2. **Time Limit:** Within **30 days** of receipt of notice of withdrawal/change/cessation.
- 3. **Form:** **Form No. INC-4** along with **prior written consent** of the new nominee.

(2) A company formed under sub-section (1) may be either— (a) a company **limited by shares**; or (b) a company **limited by guarantee**; or (c) an **unlimited company**.

- **Specified IFSC Public/Private Companies can only be formed as company limited by shares.**

Rule 3 of The Companies (Incorporation) Rules, 2014

- (1) Only a **Natural Person** who is an **Indian citizen whether resident in India or otherwise** shall be
- (a) eligible to incorporate a One Person Company
 - (b) a nominee for the sole member of a One Person Company

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

- (2) A natural person shall not be
- member of more than a One-Person Company at any point of time and
 - a nominee of more than a One-Person Company.
- (3) Where a natural person becomes member in another OPC by virtue of his being a nominee in that OPC, he must comply with eligibility **within 180 days**.
- (4) **No minor** shall become member or nominee of the One-Person Company or can hold share with beneficial interest.
- (5) OPC cannot be incorporated or converted into a company under **section 8** of the Act.
- (6) OPC cannot carry out **Non-Banking Financial Investment activities including investment in securities** of any body corporates.

Question: 1

Mr. Raja formed an OPC with his brother Mr. King as nominee, who later withdrew consent—question is whether such **withdrawal is valid** and if **Mr. Shyam (minor son)**, **Ms. Devaki (non-resident Indian sister)**, and **Mr. Ashok (already OPC member)** are eligible to be nominees. [Nov 20 - 6 Marks]

Answer:

Yes, Mr. King can validly withdraw; Mr. Shyam is ineligible (minor), Ms. Devaki is eligible (Indian citizen, residency not mandatory), and Mr. Ashok is eligible (can be nominee in one OPC even if member in another).

Question: 2

The question presents a case where **Mr. Dan**, an Indian citizen, incorporates a **One Person Company (OPC)** for a software development business. He appoints his friend **Mr. Rohit** as the **nominee** at the time of incorporation. After **two years**, **Mr. Rohit wants to withdraw** his nomination, and **Mr. Dan nominates Mr. Akaram** in his place, submitting the required forms to the **Registrar of Companies (ROC)**.

The question requires an analysis of:

1. The legal process for withdrawal of a nominee,
2. The impact of nominee change on the MOA, and
3. Whether Mr. Dan can own another OPC simultaneously. [May 25 - II MTP]

Answer:

- **Mr. Rohit**, the nominee, must give **written notice** of withdrawal to both **Mr. Dan** (sole member) and the company.
- Within **15 days**, **Mr. Dan** must appoint a new nominee—**Mr. Akaram**—who must provide **written consent** and file **Form INC-4** with the **RoC**.
- **Change of nominee does not alter the Memorandum of Association (MOA)**, as per OPC provisions under the Companies Act, 2013.

- As per **Rule 3(2) of the Companies (Incorporation) Rules, 2014**:
 - **Mr. Dan** cannot be a member of more than **one OPC**, and
 - **Mr. Akaram** cannot be a nominee in **more than one OPC**.

MEMBERS SEVERALLY LIABLE IN CERTAIN CASES i.e. REDUCTION IN MINIMUM MEMBERSHIP [SECTION 3A]

If at any time:

1. No. of members falls below:
 - **7** in case of **Public Company**
 - **2** in case of **Private Company**
2. Company **continues business for more than 6 months** with reduced membership.
3. Person continuing business **knows** the company has fewer members.

Legal Consequence: Such aware member(s) shall be **severally liable** for **entire debts** incurred **after 6 months**.

- ❖ *"Severally liable" = can be individually sued for full debt.*
- ❖ *Protection of limited liability is lost in such case.*

Question: 3

Whether **Y and Z** are **personally liable** for ₹5 lakh loan taken in **Dec 2017** by **UMC Ltd.**, which had only **7 members**. On **30.04.2017**, **X's shares were sold to Y** (reducing the number of members to 6). **Z was abroad and unaware**. The company continued business and was later wound up. **[ACT]**

Answer:

Under **Section 3A**, **Y is personally liable** as he was **aware of reduced membership** and loan was taken **after 6 months** (i.e. post **31.10.2017**). **Z is not liable** as he was **unaware due to being overseas**.
If loan was taken in **March 2017** (before the 6-month period expired), **Y too would not be liable**.

Question: 4

Can **Mr. Abhi**, a **Chartered Accountant and MBA** appointed as **Executive Director** to advise on compliance, strategy, and risk, be classified as a **Promoter** under **Section 2(69)** of the Companies Act, 2013? **[MTP Jan 2025 – Series II - 5 Marks]**

Answer:

As per **Section 2(69)(c)**, a person in accordance with whose advice the Board is accustomed to act is deemed a **promoter, unless acting in a professional capacity**.
Since **Mr. Abhi** is advising the Board **purely in a professional capacity**, he **will not be considered a promoter** of XYZ Ltd.

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

WHO CAN GET A LICENSE UNDER SECTION 8?

- A **person or association of persons** may be licensed under Section 8 if:
 - a. Objects include promotion of commerce, art, science, sports, education, social welfare, etc.
 - b. **Intends to apply its profits/income** in promoting such objects.
 - c. **Intends to prohibit payment of any dividend** to members.

WHO CANNOT FORM SECTION 8 COMPANY:

- **One Person Company (OPC)** and **Small Company** cannot be registered or converted into a Section 8 Company.
- **Firms** can be members of a Section 8 Company.

NAMING EXCEPTION:

- The words "Limited" or "Private Limited" **shall not be added** to its name, though it enjoys all privileges of a limited company.

IMPORTANT NOTES:

1. Word "**person**" allows even a **single person** to form such company.
2. License may be issued **subject to such conditions as CG (ROC) deems fit**.

REGISTRATION PROCEDURE AFTER LICENSE [Rule 19]

- **Application in Form SPICe+ (INC-32)** with required fee and documents:
 - a. **MOA & AOA**
 - b. **Declaration** by Practicing Professional (Advocate/CA/CS/CMA) that MOA and AOA confirming compliance with Section 8 provisions.
 - c. **Estimated income & expenditure for next 3 years**, sources of income and objects of expenditure.
 - d. Declaration by all applicants

ALTERATION OF MOA & AOA

- **Prior approval required:**
 - **MOA:** Approval by *Regional Director*
 - **AOA:** Approval by *ROC*

CONVERSION TO OTHER KIND OF COMPANY [Rule 21 & 22]

1. Pass **Special Resolution** at General Meeting approving conversion.
2. **Explanatory Statement** to notice must state **reasons for conversion**.
3. Apply in **Form INC-18 to Regional Director** with:
 - Certified true copy of SR,
 - Notice & Explanatory Statement
 - Proof of serving notice by **registered post or hand delivery** to following authorities:
 - Chief Commissioner of Income Tax
 - Jurisdictional Income Tax Officer
 - Charity Commissioner
 - Chief Secretary of State
 - Any other concerned Central/State authority
4. Authorities may respond to RD **within 60 days** of receipt of notice.
5. **Intimation** of filing INC-18 to ROC via MCA system.
6. **Publication of Notice**
 1. Within **1 week** from the date of submitting application to **Regional Director (RD)**.
 2. **At company's own expense**.

3. A copy of the published notice shall be sent forthwith to the RD.
4. Notice shall be in **Form No. INC-19**.
5. **Mode of Publication:**
 - a. **At least once** in a **vernacular newspaper** (principal language of district where registered office is situated, having wide circulation).
 - b. **At least once** in an **English newspaper** with wide circulation in that district.
 - c. **On company's website**, if any as may be notified/directed by the **Central Government**.

7. Filing Compliance before Application

- Company must have filed all:
 - **Financial Statements and Annual Returns** up to the **preceding financial year**, and
 - **All other returns** required under the Act up to the date of submitting application to **Regional Director (RD)**.
- If application filed after 3 months from end of preceding FY →
 - Attach **CA-certified statement of financial position**,
 - Made up to a date **not preceding 30 days** of filing the application.

8. RD Approval

- On satisfaction, **Regional Director shall issue an order** approving the **conversion** into another kind of company.
- Approval may be **subject to terms and conditions** as RD deems fit based on facts of the case.

9. Opportunity of Hearing: Before imposing any conditions or rejecting the application, **RD must give a reasonable opportunity of being heard** to the company.

10. Post-Approval Actions by Company: After RD's approval → company shall:

- **Convene a General Meeting;**
- Pass **Special Resolution** to amend **MOA & AOA**;
- **File amended MOA & AOA** with Registrar along with **declaration** to comply with any RD-imposed conditions.

11. Final Step – Registration by ROC: On receipt of documents, **Registrar shall register** the same and **issue a fresh Certificate of Incorporation**.

REVOCATION OF LICENSE

1. Central Government (power **delegated to Regional Director**) may revoke license **by order**.

2. Grounds:

- Contravention of any **requirement or condition** of Section 8 license; or
- **Affairs conducted fraudulently**; or
- **Violation of company's objects**; or
- **Prejudicial to public interest**.

3. **Effect of Revocation:** Registrar shall add "**Limited**" or "**Private Limited**" to the company's name in the register.

4. Procedure:

- **Written notice** must be served to the company; and
- **Opportunity of being heard** must be given before revocation.

CONSEQUENCES AFTER REVOCATION (PUBLIC INTEREST CASES)

If **CG satisfied** that revocation is **essential in public interest**, after hearing the company, it may order—

(i) Winding Up of Company:

- Surplus assets (after paying debts/liabilities) may be:
 - a. **Transferred** to another **Section 8 company** having **similar objects** (as per Tribunal's conditions), or
 - b. **Sold** and proceeds **credited to the Insolvency and Bankruptcy Fund** (u/s 224 of IBC, 2016).

(ii) Amalgamation with Another Section 8 Company:

- CG may order **amalgamation** with another **Section 8 company** having similar objects.

PENALTY / PUNISHMENT IN CONTRAVENTION

1. Default in complying with Section 8 requirements:

- **Company:** Fine ₹10 lakh – ₹1 crore.
- **Directors / Officers in default:** Fine ₹25,000 – ₹25 lakh.

2. Where affairs of the company are conducted fraudulently:

- **Every officer in default** → Liable for action under **Section 447** (*Punishment for fraud*).

Matter	Delegated to
Issue of license	ROC
Alteration of AOA	ROC
Alteration of MOA	Regional Director
Revocation & amalgamation	Regional Director

Question: 5

Whether the alteration of Articles by *Dhimaan Foundation* (a Section 8 company) valid without prior ROC approval? Also, is *Dhwaj & Co.*, a **partnership firm**, eligible to object as a member? [RTP May 22]

Answer:

Under **Section 8**, alteration of Articles **requires prior approval** of the **Central Government (delegated to ROC)**. Since *Dhimaan Foundation* passed only a special resolution **without such prior approval**, the alteration is **invalid**, making *Dhwaj & Co.'s objection valid*.

Further, a **partnership firm can be a member** of a Section 8 company, hence *Dhwaj & Co.* is **eligible both as a member and to object**.

MEMORANDUM OF ASSOCIATION -MOA [SECTION 4]

1. Clauses of MOA

- a. Name Clause
- b. Situation Clause (Registered office)
- c. Objects Clause
- d. Liability Clause
- e. Capital Clause (if share capital)
- f. Association/Subscription Clause
- g. Nomination Clause (only for OPC)

2. Name Clause – [SECTION 4 (1) (a) READ WITH SUB-SECTION 2 TO 5]

- A **Public Ltd. Company** must end with "*Limited*"; a **Private Ltd. Company** with "*Private Limited*"
- **Section 8 companies** are **exempt** from using "*Limited*" or "*Private Limited*"
- **IFSC companies** (Public or Private) must suffix "*International Financial Service Company*" or "*IFSC*"

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

- **For new companies:** via **SPICE+ (INC-32)** + prescribed fee
- **For existing companies (name change):** via **RUN (Reserve Unique Name)** + fee
- **Resubmission** allowed within **15 days** for rectification

Restrictions [Sec 4(2), (3)]: Name shall *not* be:

- (a) **Identical/too nearly resembling** existing Co. name.
- (b) Such, use of which will **constitute offence** under any law.
- (c) **Undesirable** in the opinion of CG, power delegated to ROC.
- (d) Which contains any word or expression **implying patronage/connection** with Govt./local authority/corporation without CG approval. Unless the **previous approval of the Central Government** has been obtained; a company shall not be registered with that name;
- (e) Which includes certain words e.g. Board, Commission, Authority, Undertaking, National, Union, Central, Republic, President, PM, CM, Statute, Judiciary, etc.

Reservation period [Sec 4(5)]:

- **New companies:** 20 days from approval
- **Existing companies (change of name):** 60 days from approval

Note: ROC must comply with **Emblems & Names (Prevention of Improper Use) Act, 1950** while allotting names.

Extension under Rule 9A

- Apply before expiry of 20 days:
 - 20 more days for ₹1,000
 - Another 20 days for ₹2,000 (Total 60)
 - OR directly 40 days for ₹3,000 (Total 60)

Cancellation of name [Sec 4(5)]:

- If name reserved using false/incorrect info:
 - **Before incorporation** → Reservation **cancelled**, penalty **up to ₹1 lakh**
 - **After incorporation** → ROC may:
 - Direct Co. to change name (within **3 months**, by ordinary resolution).
 - Strike off Co. name.
 - File petition for winding up.

ARTICLES OF ASSOCIATION - AOA [SECTION 5]

Contents of Articles of Association (AOA) – Section 5(1) & (2)

1. **AOA Contain:** Regulations for **management of the company**.
2. **Flexibility:** Company **may include additional matters** it considers necessary for its management.

Entrenchment Provisions – Section 5(3) to (5)

► **Meaning of Entrenchment**

- Specified provisions of the articles may be altered only if conditions or procedures as that are more restrictive than those applicable in the case of a special resolution, are met or complied with.
- To provide **stronger protection** for certain internal regulations.

► **When Entrenchment Can Be Included [Section 5(4)]**

- **At the time of incorporation**, or
- **Later by amendment:**
 - **Private company** → With **consent of all members**

- **Public company** → Through a **special resolution**

Registrar Notification Requirement – Section 5(5)

1. **If included at incorporation:**
 - Reported via **SPICE+ (INC-32)** form
 - Fee as per **Companies (Registration Offices and Fees) Rules, 2014**
2. **If included later (in existing companies):**
 - Notify ROC using **Form MGT-14**
 - Must be filed **within 30 days** of passing the entrenchment amendment.

ALTERATION OF MEMORANDUM [SECTION 13]

General Rule for Alteration [Section 13(1)]

- **Alteration allowed by Special Resolution** passed by members.
- Special resolution to be **filed with ROC** [Section 13(6)(a)].

Change in Name of the Company [Section 13(2), (3), (6)(b)]

1. **Requires Approval of Central Government** (*delegated to ROC*)
→ Application in **Form INC-24** with fees.
2. **No Central Govt. approval required:**
 - If name change is **only addition or deletion of "Private"** due to conversion.
3. **Restrictions:**
 - Name change **not allowed** if:
 - Annual return or financials not filed.
 - Unpaid matured deposits/debentures or interest pending.
 - Allowed only **after compliance** with the above.
4. **Post-Approval Compliance:**
 - Central Govt. approval to be filed with ROC [Section 13(6)(b)].
 - ROC to issue **fresh Certificate of Incorporation** in **Form INC-25**.
 - Name change is **effective only on issue** of new certificate.

Change in Registered Office from One State to Another [Section 13(4), (5), (7)]

Application to Central Govt. (delegated to Regional Director) – Form INC-23 [Section 13(4)]:

Required Documents:

- a. Altered MOA
- b. Copy of GM minutes showing voting details
- c. Board Resolution / POA / Vakalatnama
- d. List of Creditors & Debenture Holders
- e. Proof of service of application to:
 - Registrar
 - Chief Secretary of the State or Union territory

Newspaper Advertisement (not more than 30 days prior to application)

- **Form INC-26** in:
 - Vernacular newspaper in the principal Vernacular language (district-wide)

- English newspaper (state-wide circulation)

Disposal by RD [Within 60 Days] [Section 13(5)]:

- RD ensures:
 - Consent of creditors/debenture holders, OR
 - Debts discharged, OR
 - Security given for discharge

Post-Approval Filings: [Section 13(7)]:

- **Form INC-28** to be filed with both old and new state ROCs **within 30 days** of receiving certified order.
- **ROC of new state issues fresh Certificate of Incorporation**

Change in Object Clause [Section 13(8), (9)]

- Company **raised funds via prospectus** AND
- Has **unutilised amount** from such funds.

Requirements:

- Special Resolution via **postal ballot**
- Notice must disclose:
 - a. Total amount raised
 - b. Amount utilized
 - c. Unutilized balance
 - d. Proposed object change
 - e. Justification
 - f. Amount to be used for new object
 - g. Estimated financial impact
 - h. Other necessary info
 - i. Place for accessing full notice

Advertisement of Change:

- Published **simultaneously** with postal ballot dispatch.
 - One **English** newspaper
 - One **vernacular** newspaper (where RO is situated)
- Also **hosted on company website**, if any.

Exit to Dissenting Shareholders:

- Exit offer by **promoters/controlling shareholders**
- As per **SEBI regulations**

Registrar's Role [Section 13(9)]:

- Must **register alteration** and **certify** within **30 days** of filing of SR.

Legal Effectiveness [Section 13(10)]:

- Alteration is **effective only after registration**.

Restriction for Company Limited Guarantee without Share Capital [Section 13(11)]:

- MOA alteration **void** if it gives **profit-sharing rights** to any non-member.

Question: 6

Can a Vintage Security Equipments Ltd divert **unutilized public issue proceeds (₹90 crores)** to a **new business (mobile app development)** by altering the **object clause of MOA**, when the original object (CCTV manufacturing) has become unviable? [RTP Nov 19]

Answer:

Yes, under **Section 13(8)** of the Companies Act, 2013, such change is allowed **if** the company:

1. **Passes a special resolution,**
2. **Publishes justification** in one English and one vernacular newspaper + on company website,
3. **Gives exit option to dissenting shareholders** as per **SEBI regulations**, and
4. **Files SR with ROC**, who issues a certificate within **30 days**, making the change effective.

Hence, Vintage Security Equipments Ltd. **can validly change its object clause** and divert funds **after complying with these steps.**

RECTIFICATION OF NAME OF COMPANY [SECTION 16]

When Rectification is Required

1. If **Central Government** (delegated to **Regional Director**) is of the opinion that the **name (original or revised)** of a company:
 - Is **identical** to, or
 - **Too nearly resembles** the name of an existing company,
→ It may **direct** the company to change its name.
2. Such direction can be issued:
 - **Suo motu** (on its own), or
 - On **application by a proprietor of a registered trademark** under the **Trade Marks Act, 1999**.
3. Application by registered trademark owner must be made **within 3 years** from:
 - Incorporation of the company, or
 - Registration or change of name (whichever applicable).

Compliance by Company

4. Company shall change its name **within 3 months** of direction by:
 - Passing an **Ordinary Resolution**.
5. After change of name:
 - **Notice** must be given to **Registrar** with the order of CG (RD),
 - Within **15 days** of such change.
6. Registrar shall:
 - Make changes in the **Certificate of Incorporation**, and
 - Update the **Memorandum of Association**.

Non-Compliance Consequences

7. If company fails to comply:
 - **Central Government shall allot a new name** (as prescribed),
 - Registrar shall:
 - Enter the new name in the **Register of Companies**,
 - Issue a **fresh Certificate of Incorporation**.
8. Company shall **use the new name thereafter**.
9. However, company may later **change its name voluntarily** as per **Section 13**.

Question: 7

Can *Nuts and Bolts Pvt. Ltd.* be compelled to change its name due to conflict with a registered trademark, when the trademark owner applied after 5 years of the company's incorporation? Can the company still change its name voluntarily? (RTP May 23)

Answer:

Under **Section 16(1)(b)** of the Companies Act, 2013, if a company's name is **identical to a registered trademark**, the trademark owner must apply **within 3 years of company incorporation**. Since the application was made **after 5 years**, **the company cannot be compelled** to change its name.

However, under **Section 13**, the company may **voluntarily change its name** at any time by **special resolution and Central Government approval**, if it agrees to the trademark owner's request.

Question: 8

Is **Vardhman Steels Ltd.**, incorporated on **01.09.2022**, liable to **change its name** merely because it **resembles** the name of an existing **partnership firm** "M/s Vardhimaan Steels", registered since 01.01.2000? [ACT Regular Test]

Answer:

No, under **Section 16** of the Companies Act, 2013, the **Central Government** can direct a company to change its name only if it **identically or nearly resembles**:

- An existing **registered company's name**, or
- A **registered trademark** (on application by the proprietor within 3 years).

Since **M/s Vardhimaan Steels** is **only a partnership firm** and **not a company or trademark**, Vardhman Steels Ltd. is **not liable** to change its name.

Question: 9

Whether the **Regional Director's direction dated 11.07.2024** to **UINA Infra Projects Pvt. Ltd.** (incorporated on 01.06.2022) to **change its name**—based on a complaint by Mr. X (registered trademark holder since 01.04.2018)—is **legally valid**, despite objections raised by **Director D**, and what is the **time limit** to comply if valid.

Director D's Two Objections:

1. Name of the company is **not too identical/too nearly resembles** any **other company**.
2. Complaint was filed **after 2 years** from incorporation — i.e., **beyond 31.05.2024**. [Jan 25 - 5 Marks]

Answer:

Objection 1 — Not Identical to Any Company:

Invalid. Under **Section 16(1)(b), Companies Act, 2013**, name resemblance with a **registered trade mark** (not just another company) is sufficient.

In this case, "UINA Infra Projects" is **identical** to the **registered trade mark** of Mr. X (since 01.04.2018).

Objection 2 — Complaint beyond 2 Years:

Also, invalid. Section 16 allows the **proprietor of a registered trademark** to file complaint **within 3 years** of company incorporation or name registration.

Here, complaint was filed on **10.07.2024**, well within **3 years** of incorporation (01.06.2022).

Compliance Requirement:

As the RD's direction is valid, the company must pass an **Ordinary Resolution** and **change its name within 3 months**, i.e., by **11.10.2024**.

Final Answer:

Both objections of Director D are **not tenable**. The direction of RD is **valid**, and **UINA Infra Projects Pvt. Ltd. must change its name by 11.10.2024** under Section 16 of the Companies Act, 2013.

REGISTERED OFFICE OF COMPANY [SECTION 12]

Sub-Section (1): Registered Office Requirement

1. **Within 30 days of incorporation** – Every company must establish a **registered office**.
2. The office must be capable of **receiving and acknowledging communications & notices**.
3. This requirement applies **at all times** after incorporation.

Sub-Section (2): Verification of Registered Office

4. Company must **furnish verification** of registered office to the **Registrar**:
 - Within **30 days** of incorporation.
5. For **Specified IFSC Public & Private Companies**:
 - Registered office must be in **IFSC** (approved multi-service SEZ).
 - Time limit = **60 days** (instead of 30).

Sub-Section (3): Labeling Requirements

6. Every company must:
 - **Affix or paint**:
 - Its **name and address of registered office** outside all offices in **legible and local characters**.
 - **Engrave name on seal** (if any).
 - Print on **letters, notices, billheads, etc.**:
 - Name, Registered Office address, **CIN, Tel. no., Fax, E-mail, and Website**.
 - Print name on **promissory notes, hundies, BoE, etc.**
7. **Additional Points**:
 - If name changed in last **2 years** → **All old and new names** must be printed/affixed.
 - For **One Person Company** → Mention “**(One Person Company)**” in brackets below the name.

Sub-Section (4): Notice of Change in Registered Office

8. Change in Registered Office (after incorporation):
 - Must be **notified to Registrar** via **Form INC-22** within **30 days**.
 - For **IFSC companies**, time limit = **60 days**.

Sub-Section (5): Approval/Confirmation of Change

9. If change is **outside city/town/village limits** → **Special Resolution** required.
10. If change is **within same state but different ROC jurisdiction**:
 - Requires **Regional Director's confirmation**.
 - File **Form INC-23**.
11. For **IFSC companies**:
 - **Board resolution is sufficient**, provided the new address is within the same IFSC.

Sub-Section (6): Communication & ROC Filing

12. **Regional Director** must **communicate confirmation** to the company within **30 days** of receipt of application.
13. Company must **file confirmation with Registrar** within **60 days** of receiving it.

14. Registrar shall issue **certificate** within **30 days** of filing.

15. Certificate = Conclusive Evidence of compliance: **Sub-Section (7)**

- Change effective **from the date of certificate**.

Penalties in case of default of this section - Sub-Section (8)

- Company and every officer in default.
- **Maximum limit: ₹1,00,000** (one lakh rupees).

Physical Verification & Consequences Sub-Section (9)

16. If Registrar believes company is not operational, he may:

- Conduct **physical verification** of registered office.
- If default is found under sub-section (1), he may:
 - Initiate action for **removal of name** from register under **Chapter XVIII**.

Question: 10

Examine the validity of the following proposals by *A Ltd.* under **Section 12 of the Companies Act, 2013**—

(i) Shifting **registered office** from **Thane (one district) to Dadar (another district)** within **same ROC jurisdiction (Mumbai)** by passing a **special resolution**, but **without RD approval**.

(ii) Shifting **corporate office** from **Pune to Mumbai** by **Board resolution**.

(iii) Shifting **registered office within the same city** by **Board resolution**. [July 21 – 5 Marks]

Answer:

(i) **Valid** – As per **Section 12(5)**, inter-district shift within same ROC (e.g., Thane to Dadar under ROC–Mumbai) **requires only special resolution**. **RD approval not required**.

(ii)

- If it is **corporate office only**: **Valid**, as **Board resolution suffices**.

- If it implies shifting **registered office across ROC jurisdictions** (e.g., ROC–Pune to ROC–Mumbai): **Invalid**, since **RD approval is mandatory**, and **only Board resolution** was passed.

(iii) **Valid** – Shifting registered office **within local city limits** can be done by **Board resolution alone**, no special resolution or RD approval required.

COMMENCEMENT OF BUSINESS ETC. [SECTION 10A]

Applicability Sub-Section (1)

1. Applies to companies:

- **Incorporated after** the *Companies (Amendment) Ordinance, 2019*.
- Having **share capital**.

Conditions to Commence Business / Borrow Money

2. A company shall not commence business or exercise any borrowing powers unless:

a. Verification of Registered Office filed with Registrar

- As per **Section 12(2)**

b. Declaration in Form INC-20A is filed:

- By a **director**, within **180 days** of incorporation.
- Must confirm that **every subscriber** to the Memorandum has paid **the value of shares** agreed.
- To be **verified by CS / CA / CMA in practice**.

Additional Condition (if applicable)

3. If company's object requires **approval from sectoral regulators** (e.g. RBI, SEBI):
 - Such **registration/approval** must be **obtained** and **attached** with the declaration.

Penalties in case of default of this section - Sub-Section (2)

- **Company - ₹50,000**
- **Every officer in default - ₹1,000 per day** during which default continues.
- **Maximum for officer: ₹1,00,000.**

Non-Compliance Consequences

4. If no declaration filed within **180 days**, and Registrar has **reasonable cause** to believe company is **not carrying on business**, he may:
 - **Initiate removal of name** from Register of Companies (under **Chapter XVIII**).
5. **Penalty and removal proceedings** may run **simultaneously**.

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

General Prohibition - Sub-Section (1)

1. A **subsidiary company** cannot hold shares in its **holding company**, either **directly** or through nominees.
2. Any **allotment or transfer of shares** by the holding company to its subsidiary is **void**.

Exceptions – When Holding Allowed

3. When subsidiary holds shares:
 - a. **As legal representative** of a deceased member of the holding company.
 - b. **As trustee** (for someone else).
 - c. **Before becoming a subsidiary** (already held shares prior to becoming subsidiary).

Additional Notes

4. **Voting rights** allowed only:
 - In capacity as **legal representative** or **trustee**.
5. Prohibition **not applicable**:
 - To shares held **before the commencement** of Companies Act, 2013.
 - If shares are acquired **under a court/tribunal-approved amalgamation scheme**.

Also applies to **guarantee or unlimited companies** (without share capital) – prohibition on holding **any form of interest**. [Sub-Section (2)]

Question: 11

Examine **whether AB Ltd. becomes a subsidiary of RS Ltd., whether AB can hold shares in RS Ltd., and whether it can vote at RS Ltd.'s AGM held on 30.09.2020** — considering AB issued 10,000 shares on **01.04.2020** (out of which XY Ltd. got 4000 and PQ Ltd. got 2000 shares), and RS Ltd. began controlling XY & PQ's Boards from **01.08.2020**. AB already held 20% shares in RS Ltd. **before 01.04.2020**. [Nov 23 – 5 Marks] [RTP Nov 21]

Answer:

- (i) **Yes**, AB Ltd. becomes a **subsidiary of RS Ltd. from 01.08.2020**, as from that date RS Ltd. controls **XY & PQ**, who jointly hold **60% voting power** in AB Ltd. → indirect control under **Explanation to Section 2(87)**.
- (ii) **Yes**, AB Ltd. can continue to hold **20% shares** in RS Ltd., since it acquired them **before 01.08.2020**, i.e., **before it became RS Ltd.'s subsidiary** → covered under **exception to Section 19**.

(iii) **No**, AB Ltd. **cannot vote** at RS Ltd.'s AGM on **30.09.2020**, as it does **not hold shares as a legal representative or trustee** — **Section 19** prohibits voting in such cases.

Question: 12

Whether **Star Furnishing Ltd.**, a **subsidiary** of **Home Decor Ltd.** (holding **60% shares**), can make **further investment** in its holding company and **vote** on **7% shares** already held, including **2% as legal representative**? [Sep 24 - 5 Marks]

Answer:

As per **Section 19**, Star **cannot invest further** in its holding company; it can **vote only on 2% shares** held **as legal representative**, but **not on the remaining 5%**, as **voting rights are restricted** once it becomes a **subsidiary**.

SERVICE OF DOCUMENTS [SECTION 20]

1. Service To Company or Officer

Documents may be served at **registered office** by:

- Registered post
- Speed post
- Courier service
- Leaving it at the registered office
- Electronic or other prescribed mode

Note: Where **securities are held in depository**, depository may serve **beneficial ownership records** electronically.

2. Service To Registrar or Members

Documents may be served by:

- Post
- Registered post
- Speed post
- Courier
- By hand delivery at office/address
- Electronic or other prescribed mode

Member can request a **specific mode**, subject to **fees decided in AGM**.

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

3. Special Provision for Nidhi Company (Section 20(2))

Applies with modifications:

- Documents may be served **only to members** holding:
 - **Share of more than ₹1,000 face value**, or
 - **More than 1% of paid-up capital**, whichever is **less**
- Others: Service via **public notice in newspaper circulated** in registered office district + **notice board** of the Nidhi.

Step 1 — Take a simple paid-up capital

Paid-up share capital of Nidhi = **₹10,00,000**

Step 2 — Find 1%

1% = ₹10,000

Step 3 — Compare two limits

- Fixed limit in law = **₹1,000**
- 1% of paid-up capital = **₹10,000**

Whichever is LESS = ₹1,000

So ₹1,000 becomes the cutoff.

Step 4 — Apply to 4 simple members

Member Shares held (face value) > ₹1,000? Gets personal service?

A	₹500	✗ No	NO
B	₹1,200	✓ Yes	YES
C	₹9,000	✓ Yes	YES
D	₹15,000	✓ Yes	YES

Question: 13

Can *AB Ltd.* refuse documents sent by courier (as per AOA it allows only Speed Post), and can *Suresh* claim damages for losses suffered due to such refusal? **[Nov 22 – 5 Marks]**

Answer:

As per **Section 20(1)** of the Companies Act, 2013, service of documents on a company is valid if done via **registered post, speed post, courier, delivery at registered office, or prescribed electronic means**. Hence, courier is a valid mode.

(i) The company's **refusal is invalid**—AOA cannot override statutory provisions.

(ii) Since *AB Ltd.* wrongfully refused valid service, **Suresh can claim damages** for the loss suffered.

Question: 14

Is *Vijay's* contention valid that *Mayur Electricals Ltd.* failed to serve notice properly despite his written request (with fees) for **registered post-delivery** at Kanpur? Does the answer change if he was abroad during that time? What is the valid mode of serving documents? **[MTP Sep 2024 – Series II - 5 Marks] [RTP NOV 20]**

Answer:

(i) As per **Section 20(2)**, a member can request a specific mode (e.g., **registered post**) by paying prescribed fees. Since *Vijay* deposited sufficient money, **notice must have been sent by registered post**. Sending it by **ordinary mail** is invalid. Hence, **Vijay's contention is valid**.

(ii) Even if *Vijay* was in **London**, the company must serve notice at the **Kanpur address** as per his request.

(iii) Valid modes of service to members/Registrar include **post, registered post, speed post, courier, delivery at address, or electronic mode**.

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

1. Bills, Hundis, Promissory Notes [Sub-section 1]

Such instruments shall be **deemed to be made on behalf of company** if:

- Made / accepted / drawn / endorsed
- In the name of / on behalf of / on account of the company
- By a person acting under **authority** (express or implied)

2. Formal Execution via Power of Attorney [Sub-section 2]

A company may **authorize** any person by a written document:

- Under its **common seal** (if any), or
- If no seal: By **2 directors** or **1 director + Company Secretary**

3. Purpose of Authorization

The person may be authorized:

- **Generally** or for **specific matters**
- To act in **India or abroad**
- To **execute deeds** on company's behalf

4. Binding Effect [Sub-section 3]

Deeds executed by such attorney:

- With his seal
 - On behalf of company
- Shall bind the company.**

Question: 20

Can *Parag Constructions Ltd.* deny liability as a partner when *Mr. Parag*, a director known for regularly signing contracts on the company's behalf, entered into a partnership deed with *Firozbhai* for a project?

Answer:

Under **Section 22 of the Companies Act, 2013**, execution of deeds on behalf of a company requires **formal written authority**, either through:

- common seal, or
- signature by **two directors**, or
- one director and company secretary.

Here, despite *Mr. Parag's apparent/implied authority*, there is **no mention of such formal authorization**. Hence, **the company can deny liability** as a partner, and the deed is **not binding** on the company.

CHAPTER 3 - PROSPECTUS AND ALLOTMENT OF SECURITIES

Meaning of Securities – Section 2(81)

As per **Section 2(81)** of the Companies Act, 2013 → refers to **Section 2(h)** of the **Securities Contracts (Regulation) Act, 1956**

“Securities” include:

1. **Shares, Scrips, stocks, bonds, debentures**, or other **marketable securities** of a company/body corporate.
2. **Derivatives**.
3. **Units/instruments** issued by a **collective investment scheme**.
4. **Security receipts under** Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002. (SARFAESI Act, 2002).
5. **Units/instruments** issued under **mutual fund schemes**.
6. **Certificates/instruments** issued by **special purpose entities** acknowledging beneficial interest in **debt/receivables** (like mortgage-backed securities).
7. **Government securities**.
8. **Other instruments** declared by the **Central Government** as securities.
9. **Rights or interests** in securities.

Explanation: Excludes: Unit Linked Insurance Policies (ULIPs) or similar instruments combining **life risk + investment** issued by insurers under the **Insurance Act, 1938**.

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

Sub-section (1)] Mandatory Requirements

- Prospectus must be **dated, signed**, and include:
 - **Information and reports** as specified by **SEBI** (in consultation with Central Government)
 - **Declaration of compliance** with:
 - Companies Act, 2013
 - Securities Contract (Regulation) Act, 1956
 - SEBI Act, 1992
 - Rules/regulations under the above Acts

SEBI's regulations prevail until specific formats/reports are notified under Sec. 26(1)

[Sub-section (2)] Exemptions from Sec 26(1):

Section 26(1) **does not apply** to a prospectus:

- a. Issued to **existing members or debenture-holders**
- b. Relating to securities **uniform with those already quoted on stock exchange**

[Explanation to Sub-section (3)]

- **Date indicated on the prospectus** is treated as **date of publication**.

[Sub-section (4)] Filing signed copy with ROC

- Prospectus **cannot be issued** unless:
 - **Signed copy** delivered to ROC

- Signed by **every person** named as director or proposed director in the prospectus (or via authorised attorney)
- **Importance:** Date of filing is relevant for the **validity of the prospectus** under **Section 26(8)**.

[Sub-section (5)] Experts' Statements

Prospectus **cannot include** expert's statement if:

- a. Expert is interested/involved in company's formation or management
- b. Expert **did not consent** in writing
- c. **Consent withdrawn** before filing with ROC

Mandatory disclosure: Prospectus must state that **none of these conditions exist** if expert's statement is included.

Expert defined in Sec 2(38): includes: Engineer, Valuer, Chartered Accountant, Company Secretary, Cost Accountant, or **any person authorised to issue certificates** under law.

[Sub-section (6)] Face Disclosure Requirements

Prospectus must **state on face**:

- a. That copy delivered to ROC under sub-section (4)
- b. Documents required by this section to be attached to the copy so delivered or refer to statements included in the prospectus which specify these documents.

[Sub-section (8)] Validity of Prospectus

- Valid for **90 days** from the **date of filing with ROC**
- **Post 90 days:** File **fresh prospectus** to avoid penalty

[Sub-section (9)] Penalty for Contravention

- If prospectus issued **without fulfilling Sec 26 requirements**:
 - **Company & responsible persons** punishable with fine:
₹50,000 to ₹3,00,000

True/False Clarification:

Statement: Copy filed with Registrar signed by **majority of directors**

Answer: False – Correct Provision:

- Prospectus copy must be **signed by every person** named as **director or proposed director** in such prospectus.
- A **duly authorised attorney** may sign **on their behalf**.

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

Sub-section (1): Variation Allowed Only If—

- **Approved via Special Resolution** at a **general meeting**
- **Notice to shareholders** must include justification and be:
 - Published in **2 newspapers** (1 English + 1 Vernacular)
 - Circulating in city of registered office **indicating clearly the justification for such variation**.

Restriction: Company **cannot use funds raised** through prospectus to **buy, trade, or deal in equity shares of any other listed company**.

Sub-section (2): Exit Offer to Dissenting Shareholders

- Promoters/controlling shareholders must give **exit offer**
- **Exit price & conditions** as per **SEBI regulations**

Procedural Rules (Rule 7 of Companies (PAS) Rules, 2014)

1. **Special Resolution via Postal Ballot**
2. **Advertisement of Notice:**
 - In Form PAS-1
 - Publish **simultaneously with dispatch** of postal ballot
3. **Notice to be placed on company website**, if any

Question: 1

Whether the objections of shareholders are valid when:

- (i) PQR Ltd. diverted ₹60 lakhs (from funds raised via prospectus for life-saving drugs) to **AI software development**,
- (ii) invested ₹5 lakhs in **equity shares of X Ltd. (a listed company)**,
- (iii) passed resolutions in EGM **without proper majority**, and
- (iv) **did not publish justification in newspapers**. [Jan 25 - 5 Marks]

Answer:

Sec 27(1): Variation in objects via prospectus needs **special resolution through postal ballot**.

1st Proviso to Sec 27(1): Justification must be published in **English & vernacular newspapers** of the city of registered office.

2nd Proviso to Sec 27(1): Company **cannot invest** such funds in **listed equity shares**.

Sec 27(2): **Exit offer** to dissenting shareholders as per **SEBI regulations**.

All three objections are valid:

- (i) Resolution not passed with **required special majority** → **Invalid**.
- (ii) Required **publication** in newspapers not done → **Violation**.
- (iii) Investment of ₹5 lakhs in equity of X Ltd. → **Expressly prohibited** under law.
The company's actions are **not legally valid** under Section 27.

MIS-STATEMENTS IN PROSPECTUS – Sections 34 & 35

General Principle

- **Contract for shares** is of **Uberrimae Fides** (utmost good faith).
- All **material facts must be fully and truthfully disclosed** in the prospectus.
- Omission or misstatement = **serious offence** under the Act.

Judicial Pronouncements (Illustrative)

1. Henderson v. Lacon –

False statement about directors subscribing to large portion of capital = **Misleading**.

2. Rex v. Kysant –

True statement about dividend paid, but **concealed losses** = Misleading.

3. Smith v. Chadwick –

Misleading/ambiguous statement in prospectus.

Statement: "Present value of turnover is £1 million per annum."

Fact: True if referring to *capacity*, false if referring to *actual production*.

Held: If directors know a statement may bear multiple meanings and one is false — it amounts to **misleading statement**.

Illustration-based Key Point

- Dividend paid out of **capital profits**, not trading profits = **Material misrepresentation**.
- Prospectus must disclose such facts—failure = **right to avoid contract**.

CIVIL LIABILITY – SECTION 35

Triggering Condition: Loss or damage to subscriber **due to misleading inclusion/omission** in the prospectus.

Persons Liable:

1. **The Company**
2. **Every person who is/was:**
 - a **director** at the time of issue
 - **Authorized to be named** as a director or agreed to become one
 - Was a **promoter**
 - **Authorized** the issue of the prospectus
 - Was an **expert** referred under Section 26(5)

Nature of Liability:

- Liable to pay **compensation** for loss or damage.

Exceptions (Section 35(2)):

Person is **not liable** if he proves:

1. **Consent withdrawn** to be director of company and **prospectus issued without his consent/authority**.
2. **Public notice** – Gave reasonable public notice that issue of prospectus was without his knowledge/consent.
3. **Expert opinion** – Statement made on authority of a competent expert whose consent was given and not withdrawn.
4. **Bona fide belief** – Had reasonable ground to believe and did believe statement was true till allotment.
5. **Official document** – Statement was true extract/copy of an official document believed to be correct.

Sub-section 3: Personal Liability for Fraud

- **Unlimited personal liability** where it is proved prospectus was issued:
 - **With intent to defraud** or
 - For any **fraudulent purpose**

CRIMINAL LIABILITY – SECTION 34

Triggering Condition:

- Prospectus issued, circulated, or distributed with:
 - **Untrue or misleading statement**, or
 - **Omission/inclusion** likely to mislead

Persons Liable:

- **Every person who authorized** the issue of the prospectus

Nature of Liability:

- Punishable under **Section 447** (Fraud: imprisonment + fine)

Exceptions [Proviso to Section 34]:

No liability if person proves:

- a. The misstatement/omission was **immaterial**, or
- b. He had **reasonable grounds to belief** in the truth or necessity of inclusion/omission

Special Notes:

- **Loss/damage is NOT essential** to hold a person guilty
- **Strict liability:** Intentional or unintentional misstatement → both punishable under Section 34

Director's Liability for Misstatement in Prospectus

1. Director's Reliance on Promoters' Statements

- **Not a valid defence** under Section 34 or Section 35.
- A director **cannot escape liability** merely by claiming reliance on promoters.

2. Applicable Provisions:

- **Section 34: Criminal liability** imposed on *every person who authorises* the issue of the prospectus.
- **Section 35: Civil liability** specifically includes *director of the company* at the time of issue.

3. No Exception for Blind Reliance:

- Section 35(2) **does not provide exemption** from liability merely because the director relied on information from promoters.

4. Due Diligence Expected from Directors:

- Directors are expected to verify the accuracy of statements in the prospectus.

Peek v. Gurney

- 1. No Liability:** Directors not liable as shares were bought **from stock exchange**, not via **prospectus**.
- 2. No Reliance:** For deceit, buyer must have **relied on the prospectus** at the time of purchase.
- 3. Legal Principle: Secondary market** purchases don't attract liability for misstatements in prospectus.

Question: 2

Can Mr. C and Mr. D rescind the contract for shares, given that Spark Services Ltd.'s prospectus falsely stated that Mr. T—a renowned social worker for poor children in Rajasthan—was a director and that a portion of funds would be used for community service? **[May 25 - 5 Marks]**

Answer:

As per Section 34 of the Companies Act, 2013 and principles under the Indian Contract Act, 1872, **a subscriber misled by untrue statements in a prospectus can seek rescission. Mr. C, who subscribed to 1,000 shares relying on Mr. T's falsely stated directorship and the promised charitable use of funds, can rescind the contract.** However, Mr. D, who purchased 250 shares from Mr. C in the secondary market—not on the basis of the misleading prospectus—cannot claim rescission.

Question: 3

Whether Mr. Diwakar, who subscribed to shares of MBL Pharmaceutical Ltd. on the basis of an expert report in the prospectus (which turned out to be untrue), has a remedy under Section 35 of the Companies Act, 2013. Also, under what circumstances an expert can escape liability. **[May 23 – 5 Marks]**

Answer:

Mr. Diwakar can claim compensation under Section 35 for loss due to a misleading expert report in the prospectus. However, the expert won't be liable if consent was withdrawn before issue, prospectus was issued without knowledge, or all Section 35 defence conditions are met.

Question: 4

Whether Mr. Andrew, who bought shares of Green Ltd. based on a false expert report in the prospectus but suffered no loss, has any remedy. **[RTP May 20]**

Answer:

Under Section 35, remedy arises only if loss is suffered; hence, **he cannot claim compensation.**

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

1. **Applicability:** Covers **false, misleading, deceptive statements**, promises, forecasts, or **concealment of material facts by any person**.
2. **Intention:** Must be made **knowingly or recklessly** to induce a person into:
 - Buying/selling/subscribing/underwriting securities,
 - Profit-based agreements from security yields or value changes,
 - Agreements for credit facilities from banks/FIs.
3. **Punishment:** Liable under **Section 447** (Fraud punishment).
4. **Example Reference:** NRIs misled with a “Project Overview” — money diverted, shares not allotted — **prima facie Section 36 offence**.

Question: 5

Y Ltd. obtained ₹10 Cr loan from banks with help of CA Raman, who charged 5% commission and arranged falsified financials to secure funds. Can banker take legal action? **[ACT Regular Test]**

Answer:

Yes, both Raman and Y Ltd. committed fraud under **Section 36** (false statements to obtain credit), punishable under **Section 447** of Companies Act, 2013. Banker can initiate penal action accordingly.

ALLOTMENT OF SECURITIES BY COMPANY [SECTION 39]

Where forfeited shares are re-issued, it is not the same thing as an allotment.

Minimum Subscription Requirement [Section 39(1)]

- **No allotment unless:**
 - Minimum subscription (as stated in prospectus) is subscribed, **and**
 - Amount payable on application **received by cheque/instrument** at the time of application.
- As per **SEBI ICDR Regulation**: Minimum subscription = **90%** of entire issue.

- **Only cleared funds** count toward valid subscription.
- **Application without money = Invalid offer.**

Amount Payable on Application [Section 39(2)]

- Minimum:
 - **5% of nominal amount** of security; or
 - As per SEBI regulations.
- **SEBI ICDR Regulation:**
 - Application money shall be at least **25% of issue price**.
 - In case of **Offer for Sale: 100% issue price** payable at application.

Return of Application Money [Section 39(3)]

- If minimum subscription not received within **30 days** (or as prescribed by SEBI) from issue of prospectus:
 - Company must refund the money received.
 - Refund to be made within **15 days** of issue closure.
 - **Default:** Directors/officers **jointly and severally liable** with **15% p.a. interest**.
 - **Refund Source:** Only to the **bank account from which subscription was remitted**.

Return of Allotment [Section 39(4)]

- Mandatory filing of **Form PAS-3** within **30 days** of allotment.

Attachments to PAS-3:

- List of allottees with name, address, occupation, number of securities.
- **If consideration ≠ cash:**
 - Stamped copy of contract for consideration.
 - Property/service contract if applicable.
 - If no written contract: Full particulars with applicable stamp duty.
 - **Registered valuer's report** mandatory.
- **If issued u/s 62(1)(c):**
 - Valuation report of registered valuer to be attached (non-listed companies).

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

Application to Recognised Stock Exchange [Section 40(1)]

- Before public offer, company **must apply** to one or more **recognised stock exchanges**.
- **Permission** must be obtained for securities to be dealt with in such exchange(s).
- The above provision is very clear that not only the company has to apply for listing of the securities at a recognized stock exchange, but also **obtain permission thereof from all the stock exchanges** where it has applied, before making the public offer

Disclosure in Prospectus [Section 40(2)]

- **Name(s) of stock exchange(s)** where securities will be listed must be clearly stated in the **prospectus**.

Separate Bank Account for Public Application Money [Section 40(3)]

- All application money received:
 - To be kept in **separate bank account** in a **scheduled bank**.
 - Can only be used for:
 - **Adjustment** against allotment (if permission from stock exchange obtained), or
 - **Refund** (if allotment not made for any reason) as per SEBI timelines.

Note: Refund only to the **same bank account** from which money was received.

Waiver Prohibited [Section 40(4)]

- Any clause requiring **waiver of compliance** with this section is **void**.

Fine for Default [Section 40(5)]

- Company:** Fine: ₹5 lakh – ₹50 lakh
- Officer in default:** Fine: ₹50,000 – ₹3 lakh

Payment of Commission [Section 40(6)]

- Commission can be paid for getting subscription to securities.

Conditions for Payment

- No commission** to underwriter for private placement. i.e. securities not offered to public for subscription.
- Authorisation** must be in Articles of Association.
- Payment can be from:
 - Proceeds of issue**, or
 - Profits**, or
 - Both**

Maximum Limits

- Shares: **5% of issue price** or lower as per Articles
- Debentures: **2.5% of issue price** or lower as per Articles

Example: If Articles allow **only 2%**, max payable = 2%, even though legal limit is 5%.

Disclosures in Prospectus

- Name of underwriters
- Rate and amount of commission
- Number of securities underwritten (absolutely or conditionally)

Registrar Filing Requirement

- A **copy of contract** for commission must be filed with Registrar along with the **prospectus**.

Irregular Allotment

An allotment is **irregular** if any of the following conditions under the Companies Act, 2013 are violated:

- Section 23** – No prospectus issued in a public issue.
- Section 26(1)/ (4)** – Prospectus missing required disclosures or not filed with RoC.
- Section 39** – Minimum subscription not received or application money < 5% of nominal value.
- Section 40** – No stock exchange listing approval or failure to maintain a separate bank account.
- Section 39(4)** – Return of allotment not filed with the Registrar.

PRIVATE PLACEMENT [SECTION 42]

Definition (Explanation I to Section 42(3)): Private placement = Offer/invitation to subscribe to securities to a **select group** of persons (not a public offer) via **private placement offer-cum-application**.

Offer to Identified Persons Only [Sub-section 2]

- Private placement can be made **only to a select group of max 200 persons** in a financial year.
- Such persons are **identified by the Board** and **after passing a special resolution**.
- These persons are called **“identified persons.”**

- **Excluded from 200 limit:**
 - a. Qualified Institutional Buyers (QIBs)
 - b. Employees under ESOP (Section 62(1)(b))
- **QIB** as per SEBI (ICDR) Regulations, 2009.
- Limit applies **separately for each kind of security** (equity, preference, debentures).
- **Exemption:** NBFCs (RBI-registered) and Housing Finance Companies (National Housing Bank-registered) complying with their respective regulations are **exempt** from the 200-limit rule.

Private Placement Deemed Public Offer

- If offer/invitation/allotment/agreement to allot is made to **more than 200 identified persons**, it is **deemed a public offer**.
- Applies to **both listed and unlisted companies**.
- Irrelevant whether:
 - Payment is received or not, or
 - Company intends to list securities or not.
- In such cases, **Sections 23–41** (public offer provisions) apply.
- Additionally, **Companies Act, SCRA, 1956**, and **SEBI Act, 1992** provisions become applicable.
- **Penalties under Section 42(9) & 42(10)** can still be imposed.

Private Placement Offer & Application [Sub-section 3]

- Must be made via **PAS-4** to identified persons.
- **No right of renunciation**.
- Must get **special resolution** in advance (except for QIBs or NCDs within Sec 180(1)(c) limits).

Manner of Issuing Private Placement Offer & Application [Section 42(3)]:

- Offer to be made **only to identified persons** whose details are recorded by the company.
- **No right of renunciation** allowed.

Shareholders' Approval:

- **Special Resolution** required for **each private placement offer/invitation**.
- **Explanatory statement** must disclose:
 - a. Date of Board resolution
 - b. Kind & price of securities
 - c. Basis/justification of price & valuer details
 - d. Amount to be raised
 - e. Material terms, schedule, purpose, promoter/director contribution, and asset details

Exceptions:

- For **non-convertible debentures (NCDs)**:
 - **Board resolution** under Sec 179(3)(c) sufficient if amount does not exceed Sec 180(1)(c) limit.
 - If above limit – **one special resolution per year** sufficient.
- For **QIBs** – one special resolution per year for all offers/allotments.

Filing Requirement: Copy of resolution to be **filed with Registrar before issue** of offer letter.

Restriction (2022 Amendment):

- No offer/invitation to **entities (Body Corporate or Person)** from countries sharing land border with India (China, Bhutan, Nepal, Pakistan, Bangladesh, Myanmar) **without prior Govt. approval under FEMA Rules, 2019.**

Offer-cum-Application Form:

- Must be in **Form PAS-4**
- **Serially numbered, addressed specifically,** and sent **in writing/electronic mode**
- Sent **within 30 days** of recording name
- Only the **addressed person** can apply; others' applications **invalid**

Record Maintenance: Complete record of offers to be maintained in **Form PAS-5.**

Subscription Money [Sub-section 4]

- Identified person applies through **application-cum-offer letter** along with **subscription money.**
- To be paid via **cheque/DD/banking channel**, not cash.
- Payment must be from **subscriber's bank account**, company to **maintain record** of such account.
- For **joint holders**, payment must come from **first-named person** in the application.
- Company **cannot use subscription money** until
 - **Allotment is made** and
 - **Return of allotment (PAS-3)** is filed with **ROC.**

No Fresh Offer Until Previous Completed [Sub-section 5]

- **No fresh offer/invitation** under this section shall be made **until previous offer's allotment is completed, withdrawn, or abandoned.**
- Company may make **multiple issues** to **identified persons**, provided the **total number does not exceed 200** in a financial year per security class.

Allotment Timeline [Sub-section 6]

- **Allotment period:** Within **60 days** from receipt of application money.
- If not allotted, refund within **15 days** after 60 days.
- If refund not made → **12% p.a. interest** from expiry of 60th day.
- **Application money:** To be kept in a **separate bank account** in a **scheduled bank.**
- **Utilisation allowed only for:**
 - (a) **Adjustment against allotment,** or
 - (b) **Repayment** if allotment not made.

Prohibition on Public Advertisement [Sub-section 7]: No **public advertisement** or use of media/marketing/distribution channels/agents to inform about the issue.

Return of Allotment [Sub-section 8]

- File **Form PAS-3** with RoC within **15 days** of allotment.
- **Details to be attached (list of allottees):**
 - Name, address, **PAN**, and **email ID**
 - **Class of security**

- **Date of allotment**
- **No. of securities, nominal value, amount paid, and consideration details** (if other than cash).

Penalties for Delay in PAS-3 Filing [Sub-section 9]

- ₹1,000/day per default (company + promoters + directors)
- Max penalty = ₹25 lakhs

Contravention Penalty [Sub-section 10]

- **Applicability:** If company makes offer or accepts money **in contravention of Sec. 42**.
- **Penalty:** On **company, promoters, and directors** – up to **amount raised** or **₹2 crore**, whichever is **lower**.
- **Refund obligation:** Company must **refund all monies with 12% interest within 30 days** of the penalty order.

Question: 6

Whether it is correct to state that the 200-person limit in private placement under Section 42 does **not apply to QIBs but does apply to employees under ESOP**, and whether private placement can be made **only once** in a financial year.
[Jan 21 - 4 Marks]

Answer:

The limit of 200 identified persons is rightly said to **not apply to QIBs**, but **wrongly said to apply to ESOP allottees**, who are also excluded under Section 62(1)(b). Also, private placement **can be made multiple times** in a year, within the 200-person cap per security type.

Question: 7

Whether PQR Bakers Ltd., a public company, can validly issue private placement offers for **equity shares to 55 persons (including 4 QIBs)** and **debentures to 155 individuals**, where the **debenture offer is made before completion of equity allotment**, and what if the debenture offer is made **after equity allotment but within the same financial year**.

Answer:

The equity offer is valid as it's effectively to **51 persons** (excluding 4 QIBs). However, issuing the **debenture offer before completing equity allotment** violates Section 42. If the **debenture offer is made after equity allotment**, both qualify as valid **private placements**, since the **200-person limit applies per security type per financial year**.

Question: 8

Whether the objection raised by members is valid when A Ltd. made a private placement offer on 1st April 2022, received application money on 15th April 2022, did not allot shares till 31st July 2022, and used the money to pay dividends. Members are demanding interest at 15% p.a. [Nov 23 - 5 Marks]

Answer:

As per Section 42(6), the company must allot securities **within 60 days** of receiving application money (i.e., by 14th June 2022), and if not, refund it **within 15 days** (by 29th June 2022), failing which it must pay **12% p.a. interest**. Hence, members' objection is valid, but interest at **15% is not justified**. Also, using application money to pay dividends is **not permitted**; it must be held in a separate bank account and used only for allotment or refund.

Question: 9

Whether Stuti Ceramic Pvt. Ltd., which does not wish to convert into a public company, can raise ₹500 lakh through **private placement** after raising ₹100 lakh via **rights issue**, and whether there are any statutory **limits** on such fresh offers and the **time limit** for allotment. [Sep 24 - 5 Marks]

Answer:

Yes, under Section 23(2)(b) read with Section 42 and Rule 14, a **private company** like SCPL can raise funds via **private placement** to up to **200 identified persons** in a financial year. However, as per Section 42(5), it must complete allotment or withdraw any previous offer (e.g. rights issue) before making a fresh one. As per Section 42(6), **allotment must be made within 60 days** of receiving application money; else refund must be done within 15 days, failing which **12% interest** is payable.

Question: 10

A Ltd. issued shares to:

- 10 directors + 100 employees (via ESOP)
- 200 Foreign Institutional Investors (QIBs)
- 50 ex-employees
- 100 other persons

It also used agents to attract foreign investors and others.

Is this a valid **private placement** under Section 42 of Companies Act, 2013? [ACT regular Test]

Answer:

As per Section 42:

- **Excluded from 200 limit:**
 - 110 ESOP (10 directors + 100 employees)
 - 200 QIBs
- **Included in 200 limit:**
 - 50 ex-employees
 - 100 other persons

Total counted = 150 (< 200) → Valid private placement

But using agents/public channels for promotion **violates Sec 42(7) → Not permitted → Attracts penal consequences.**

CHAPTER 4 - SHARE CAPITAL AND DEBENTURES

KINDS OF SHARE CAPITAL - EQUITY SHARES WITH DIFFERENTIAL RIGHTS [SECTION 43]

A company limited by shares can have:

1. Equity Share Capital

- a. With **voting rights** (plain vanilla)
- b. With **differential rights** (dividend, voting, etc.)

2. Preference Share Capital

Defined as share capital that has preferential rights regarding:

- a. **Right to Dividend** — fixed amount or at a fixed rate (may be with or without income tax).
- b. **Right to Repayment of Capital** — in case of winding up or repayment of capital.

Presumptions & Clarifications:

- Preference shares are **presumed cumulative**, unless clearly stated otherwise.
- **Participating rights** must be mentioned explicitly in AOA or terms of issue.
- **Company cannot issue only preference shares**; equity must also exist.

Equity Shares with Differential Rights

Conditions for Issue: – Rule 4, Share Capital Rules

(Sub-Rule 1)

1. **AOA** must authorize the issue.
2. **Ordinary resolution** in GM (**postal ballot if listed**).
3. Differential voting power shall not exceed **74% of total voting power**.
4. **No default** in filing annual accounts/returns for 3 preceding F.Y.
5. The company must have **no existing (subsisting) default** in:
 - **Payment of declared dividend** to shareholders.
 - **Repayment of matured deposits**.
 - **Redemption of preference shares or debentures** that have become due.
 - **Payment of interest** on such deposits or debentures.
 - **Payment of dividend** in general.
6. The company must **not have defaulted in**:
 - **Payment of dividend** on preference shares.
 - **Repayment of term loan** (principal or interest) taken from:
 - Public Financial Institution (PFI)
 - State Level Financial Institution (SFI)
 - Scheduled Bank
 - **Statutory dues of employees** (like PF, ESI, gratuity, etc.) to any authority.
 - **Crediting amount to the Investor Education and Protection Fund (IEPF)**.

Note: The company can issue **equity shares with differential rights (DVRs)** only after **5 years** from the **end of the financial year** in which the **default was rectified** (made good).

7. No penalty by court/tribunal in last 3 years under:

- RBI Act, SEBI Act, SCRA, FEMA, or any special regulator law.

Explanatory Statement (Sub-Rule 2): Must contain: size, details of differential rights, reasons, etc.

Prohibition on Conversion (Sub-Rule 3): No conversion between ordinary equity and differential equity shares.

Board's Report Disclosure (Sub-Rule 4): Must disclose details of issue in the financial year of issuance.

Rights of Differential Equity Shareholders (Sub-Rule 5): Entitled to all rights like bonus, rights shares (except to extent of differentials).

Register of Members (Sub-Rule 6): Must record details of equity shares with differential rights.

Section 43 Not Applicable To:

1. **Specified IFSC Public Companies** (if MoA/AoA allows)
2. **Private Companies** (if MoA/AoA provides so)

Question: 1

To prevent excessive concentration of control among a group of shareholders, describe with the help of an example how the Companies Act, 2013, imposes limits and regulates the voting power of shares with differential rights (equity shares)? **(MTP May 25 - II)**

Answer:

As per **Section 43(a)(ii)** and **Rule 4 of the Companies (Share Capital and Debentures) Rules, 2014**, companies may issue DVR shares, but **total voting power of DVR shareholders must not exceed 74%** of total voting rights, ensuring **at least 26%** remains with regular equity shareholders.

Example:

Hind Ltd. has:

- **600 regular equity shareholders** = 600 votes
 - **400 DVR shareholders**, each with **2 votes** = 800 votes
 - **Total voting rights** = **600 + 800 = 1,400 votes**
 - **74% of 1,400 = 1,036 votes** (maximum DVR votes allowed)
- ✓ Since DVR votes = 800 < 1,036, the company complies with the rule.

This ensures **DVR holders can't dominate** decision-making and **26% control** remains with regular equity shareholders, preserving balanced governance.

Sec 48 - Variation Of Shareholders' Rights

Legal Requirements [Section 48(1)]

1. **MOA/AOA must permit variation**, or **terms of issue** should not prohibit it.
2. **Consent of holders of at least 75%** of the **issued shares** of that class (in **writing** or by **special resolution** in Separate class meeting).
 - *Not 75% of holders — it's 75% of issued share capital of that class.*
3. If variation **affects rights of another class**, consent of **75% holders of that other class** is also required.

Right to Appeal [Section 48(2)]

- Holders of at least **10%** of that class who **did not consent or vote** may apply to **Tribunal**.
- Variation shall not take effect unless **confirmed by Tribunal**.
- Application must be made **within 21 days** from date of resolution/consent.

- It can be made by one (or more of their number) as they may appoint in writing; on behalf of the shareholders entitled to make the application.

Post-Tribunal Procedure

- Tribunal decision is **binding** on shareholders of that class. **[Section 48(3)]**
- Company must **file Tribunal order with ROC within 30 days**. **[Section 48(4)]**

Key Judicial Interpretations:

- **Issuing new preference shares pari-passu** with existing ones = **Not variation**.
- **Cancellation of shares or reduction of capital** = **Not variation**.

Question: 2

The question tests the validity of variation of rights under Section 48, where a company has two classes of equity shareholders and its MOA/AOA permits such variation; 40,000 out of 50,000 Class 2 shareholders (i.e., 80%) have consented in writing, while 4,500 dissent. **(May 24 – 5 Marks)**

Answer:

As per Section 48(1), variation is valid since 75% consent was obtained and rights of Class 1 are unaffected; under Section 48(2), 4,500 dissenters (i.e., less than 10% of Class 2) cannot approach Tribunal for cancellation.

ISSUE OF SWEAT EQUITY SHARES [SECTION 54]

Definition – *Sweat Equity Shares* [Section 2(88)]

‘Sweat equity shares’ means such **equity shares** as are issued by a company —

- **to its directors or employees,**
- **at a discount or for consideration other than cash,**
- **for providing their know-how, or**
- **for making available rights in the nature of intellectual property rights, or**
- **for providing value additions,**
by whatever name called.

Conditions for Issue of Sweat Equity Shares [Section 54(1)]

- Shares of that class must be **already issued**.
- Issue must be **approved by Special Resolution**.
- **Resolution must specify:**
 - No. of shares to be issued
 - Current market price
 - Consideration (if any)
 - Class of directors/employees to whom issued

Status of Sweat Equity Shares & Holders [Section 54(2)]

- **Equal Treatment:** All **rights, limitations, and restrictions** applicable to equity shares also apply to **sweat equity shares**.
- **Ranking:** Holders of sweat equity shares **rank pari passu** (on equal footing) with other equity shareholders.

Omitted Clause:

Condition of **one-year business commencement** removed w.e.f. **7 May 2018**

Eligible Employees:

- **Permanent employee** (India or abroad)
- **Director** (whole-time or not)
- **Employee/director of holding or subsidiary** (India or abroad)

Validity of Special Resolution: Valid for **12 months** from passing

Limits on Issue:

- Max per year: Higher of **15% of paid-up equity capital** or **₹5 crore**
- Overall limit: **25% of paid-up equity capital**
- For **startups**: **50% paid-up capital** up to **10 years** from incorporation

Lock-in Period: **3 years** from allotment

Valuation: By **registered valuer** as **fair price** with **justification**

Valuation of IPR / Know-how / Value Additions

- Must be **valued by a registered valuer**.
- Valuer to give a **report addressed to the Board** with **justification of valuation**.

Disclosure in Directors' Report: Board must **disclose prescribed details** of sweat equity shares issued in the **Directors' Report** for year.

Register (Form SH-3): Maintain at **registered office** or other place as decided by **Board**.

Question: 3

Innovative Ltd., a **startup public company** incorporated in **2014**, proposes to issue **15 lakh sweat equity shares** of ₹10 each at a **discounted price of ₹5** (FMV ₹25), amounting to **30% of paid-up capital**, with a **lock-in period of 5 years**; examine whether the **quantum of issue and lock-in period** comply with **Section 54 and Rule 8** of the Companies Act, 2013. **[May 23 – 6 Marks]**

Answer:

As a **public company**, it **cannot claim startup exemption** (available only to private companies), so the issue must comply with the regular limit of **15% or ₹5 crore**, whichever is higher — hence, **30% issue is invalid**; additionally, **lock-in cannot exceed 3 years** (as per Rule 8(5)); however, **issue at discounted price is permitted** for sweat equity.

Question: 4

XYZ Tech Solutions Ltd., with **₹20 crore paid-up equity capital**, proposes to issue **sweat equity shares worth ₹4 crore** (face value) for the first time to select employees/directors via **special resolution** and seeks advice on legal permissibility under **Section 54**. **[RTP Jan 25]**

Answer:

As per **Section 54**, the company may issue sweat equity shares if prior class exists, special resolution is passed with required details, and limits are adhered to—i.e., max of **₹5 crore (higher of 15% or ₹5 crore)** in one year and **25% overall cap**; hence, **₹4 crore issue is valid**.

Question: 5

The question seeks to determine whether X Ltd., with ₹40 crore paid-up equity capital and prior issuance of ₹8 crore sweat equity shares, can legally issue an additional ₹7 crore worth of sweat equity shares, as per the Companies Act, 2013. **(MTP May 25 - II)**

Answer:

Sweat equity shares (Sec 54, read with Rule 8 of Companies (Share Capital and Debentures) Rules, 2014) are issued to employees/directors for non-cash contributions like technical know-how or IP.

✓ **Annual limit:** Higher of 15% of paid-up capital (₹6 crore) or ₹5 crore → **Limit = ₹6 crore**

✓ **Overall limit:** Max 25% of paid-up capital → 25% of ₹40 crore = **₹10 crore**

Already issued = ₹8 crore → **Remaining permissible = ₹2 crore**

Thus, the proposed issue of ₹7 crore **exceeds both** the **annual** (by ₹1 crore) and **overall** (by ₹5 crore) limits. The company **must increase paid-up capital** to legally proceed.

Question: 6

Manorama Travels Pvt. Ltd. had an **authorized capital of ₹100 lakh** and **paid-up capital of ₹80 lakh** as on **31.03.2021**; it **cancelled 2 lakh issued but unsubscribed shares** in FY 2021–22 and amended its MOA, but the **practicing Company Secretary refused to certify the e-form**, claiming NCLT approval was needed—examine validity of the company's action and resolution required. **[May 22 - 5 Marks]**

Answer:

Company's decision is valid as per **Section 61(1)(e)** since **cancellation of unsubscribed shares is not a reduction**, hence **NCLT confirmation not required**; **PCS's objection is incorrect**, and a **ordinary resolution under Section 13 read with section 61** is required to amend the MOA.

FURTHER ISSUE OF SHARE CAPITAL RIGHTS ISSUE; PREFERENTIAL ALLOTMENT [SECTION 62]

[Section 62(1)]: Applicable When: Company having share capital proposes to increase **subscribed capital** by issue of further shares.

(a) Offer to Existing Equity Shareholders – Rights Issue

1. Offer to existing equity shareholders **in proportion** to paid-up capital held.
2. **By sending Letter of Offer in the form of notice**, such notice must:
 - i. Specify **number of shares** offered.
 - ii. Specify **time period** for acceptance –
 - **Not less than 15 days** and **not exceeding 30 days** from date of offer.
 - **Rule 12A:** Minimum **7 days** (for faster issues).

iii. State that if offer not accepted within period → deemed declined.

iv. Mention **right of renunciation** all or any shares by existing holders in favour of some other person (unless articles restrict).

3. If offer declined or time expires → Board may dispose of shares in a **non-disadvantageous (to shareholders)** manner.
4. **Proportion** may be adjusted “as nearly as circumstances admit.”
5. **Private Co./IFSC Public Co.** – shorter acceptance period allowed if **90% members consent** in writing/e-mode.

(b) Offer to Employees – ESOP

1. Allowed **under ESOP scheme** subject to:
 - **Special Resolution**, and
 - **Rule 12** conditions.
2. **ESOP Definition [Sec. 2(37)]**: Means **option** given to:
 - **Directors, officers, or employees** of
 - the company, or
 - its holding company, or
 - its subsidiary company/companies.
 - To purchase or subscribe for shares at a **future date** at a **pre-determined price**.
3. **Ordinary Resolution** sufficient for:
 - Private Co. (no default in filing Sec. 92/137),
 - Specified IFSC Public Co.
4. **Listed Co.** must follow **SEBI (SBEB) Regulations, 2014**.

(c) Offer to Any Other Persons

1. Allowed if **authorised by Special Resolution** (even to non-members).
2. Can be **for cash or consideration other than cash**.
3. For **non-cash consideration** → **valuation by Registered Valuer**.

Dispatch of Notice [Section 62(2)]:

Notice shall be dispatched to existing shareholders **at least 3 days before issue opens** via:

- **Registered post**
- **Speed post**
- **Courier**
- **Electronic mode**
- **Any other mode with proof of delivery**

In case of a **private company**, **shorter notice** is allowed if **90% members consent** in writing or electronic mode.

Exception to Section 62 [Section 62(3)]:

Section 62 **not applicable** on **conversion of loan/debenture into equity** leads to **increase in subscribed capital** if:

- a. **Terms of conversion** approved by **special resolution** in general meeting,
- b. Approval given **before** issue of debenture or grant of loan.

Compulsory Govt. Conversion [Section 62(4)]:

1. **Government** may **order** conversion of its **loan/debentures** into **shares** in **public interest**, even if original terms **don't provide** for conversion.
2. Conversion on terms deemed **reasonable by Government**.
3. If company **disagrees**, it may **appeal to Tribunal within 60 days from the date of order**.

4. Tribunal's decision after hearing both parties shall be **final**.

Govt. to Consider [Section 62(5)]:

While deciding conversion terms, Govt. shall consider:

- a. **Financial position** of the company
- b. **Terms of issue** of debentures/loans
- c. **Interest rate** on such debentures/loans
- d. **Other relevant factors** as deemed necessary.

Automatic Increase in Capital [Section 62(6)]:

On Govt. order for conversion, **authorised share capital increases automatically** by the **converted amount**, and the **MOA stands altered** accordingly.

Nidhi Company Exemption:

Section 62 does not apply to **Nidhi Companies**, but they must **ensure shareholder interests are protected**.

Question: 7

Shilpi Developers India Ltd. owed **Rs. 10,000** to Sunil and allotted him **100 fully paid-up shares of Rs. 100 each** in settlement—whether such **issue of shares against debt** is valid under the Companies Act, 2013. [ICAI Module]

Answer:

The allotment is valid **only if** approved by **special resolution** and backed by a **valuation report** from a registered valuer, as per **Section 62(1)(c)** (issue for consideration other than cash).

**RESTRICTION ON PURCHASE BY COMPANY OR GIVING OF LOANS BY IT FOR PURCHASE
OF ITS SHARES [SECTION 67]**

Sub-sec (1):

Company limited by shares or by guarantee (having share capital) **shall not buy its own shares** unless reduction is done as per the Act.

Sub-sec (2):

Public company shall not give **any financial assistance** (loan, guarantee, security) **for purchase/subscription** of its or its **holding company's shares**.

Section 67(3) – Exceptions to Restriction on Financial Assistance

A **company may give financial assistance** for purchase of its own shares or those of its holding company **only** in the following **three cases**:

a. Banking Company Exception:

Lending of money by a **banking company** in the **ordinary course of business**.

Note: The term “ordinary course of business” is not defined.

Courts have held: if money is given *specifically* to buy bank's own shares, it will not be treated as "ordinary course".

b. Trustee for Employee Share Scheme:

Provision of money for purchase of **fully paid-up shares** of the company or its holding company by **trustees**,

- for and on behalf of company's **employees**,
- under any **scheme** (e.g., Employee Stock Purchase Plan – ESOP),
- approved by **special resolution** in general meeting,
- and subject to compliance with **Relevant Rule**:
 1. **Listed Company**: Shares to be purchased **only through recognized stock exchange**, not via private offers.
 2. **Unlisted Company**: Share **valuation by registered valuer**.
 3. **Limit**: Aggregate purchase/subscription shall not **5% of paid-up capital + free reserves**.
 4. **Disclosure in Board's Report (re: voting rights not exercised directly)**:
 - (a) Names of employees not voting directly
 - (b) Reasons for not voting directly
 - (c) Name of person voting
 - (d) No. & % of shares held in favour of such employees
 - (e) Date of general meeting
 - (f) Resolutions voted upon
 - (g) % of such voting power on each resolution
 - (h) Whether votes cast **for/against** the resolution

c. Loan to Employees (other than Directors/KMP):

- **Loan by company to employees** (excluding directors/KMP),
- **not exceeding six months' salary** of such employee,
- for **buying or subscribing fully paid shares** of the company or its holding company,
- such shares to be **held in beneficial ownership** by the employee.

Section 67(4) – Redemption of Preference Shares Permitted:

This section **does not restrict** a company from **redeeming its preference shares** issued under the **Companies Act** (current or previous).

Section 67(5) - Punishment for Contravention

- **Company**: Fine ₹1 lakh – ₹25 lakh.
- **Officer in default**:
 - Imprisonment up to **3 years**, and
 - Fine ₹1 lakh – ₹25 lakh.

Section 67 – Exceptions:

1. Private Companies & Specified IFSC Public Companies:

Section 67 **shall not apply** if all below conditions are fulfilled:

- a. **No body corporate** has invested in its share capital
- b. **Borrowings** is less than twice of paid-up capital or ₹50 crore (whichever is lower)
- c. **No default** in repayment of such borrowings at transaction time
(Also, company must have filed financials u/s 137 & return u/s 92)

2. Nidhi Companies: Section 67(1) **not applicable** where company **buys back shares** of a member who **ceases to be a depositor/borrower**.

- Such purchase **won't be considered capital reduction** u/s 66

- Must ensure **shareholder interests** are protected

Question: 8

Rajesh Exports Ltd., a subsidiary of Manish Ltd., proposes to give a **loan of ₹3 lakhs** to **Bhaskar**, an **employee (Finance Manager) of holding company (Manish Ltd.)** drawing **₹40,000/month**, to purchase **500 partly paid-up shares** of Rajesh Exports; validity of this decision is to be examined under **Section 67** of the Companies Act, 2013. **[Jan 21 – 2 Marks]**

Answer:

The Board's decision is **not valid** as the loan violates **all three conditions** of the **Section 67(3)(c) exemption**—Bhaskar is **not an employee of the lending company**, amount **exceeds 6 months' salary**, and shares are **not fully paid-up**.

Question: 9

MNO Private Limited, a **subsidiary of public company PQR Ltd.**, proposes to give a **loan of ₹4,00,000** to its **HR Manager** (not a KMP, earning ₹30,000/month) for purchase of **500 partly paid-up equity shares** of MNO. The question asks whether this decision is valid under the **Companies Act, 2013**.

Answer:

The decision is **not valid**—since MNO is **deemed a public company** [Sec. 2(71)], the loan violates **Section 67(3)(c)** as it **exceeds 6 months' salary** and is for **partly paid-up shares**, both of which disqualify the transaction from the exemption.

Question: 10

Whether Silk Segment Pvt. Ltd. (SSPL), a wholly owned subsidiary of listed company Silk Block Ltd (SBL), can disburse loans of ₹15,00,000 to Mr. Sohan (Deputy Manager, salary ₹1,00,000/month) and ₹20,00,000 to Ms. Subarna (CFO) for purchasing its own shares, and whether the answer changes if SBL holds only 25% shares. **[Jan 25 - 5 Marks]**

Answer:

- Under Sec 67(2) & (3), a deemed public company cannot give loans for purchase of its own shares except to employees (not KMPs/directors) and up to 6 months' salary.
- Mr. Sohan can be given loan only up to ₹6,00,000; proposal of ₹15,00,000 is invalid.
- Ms. Subarna, being CFO (KMP under Sec 2(51)), is disqualified — full loan invalid.
- Even if SBL holds only 25% (not a subsidiary), SSPL still doesn't qualify as exempt private company since body corporate has invested — Sec 67 remains applicable. Hence, result remains unchanged.

Buy Back [Section 68]

Section 68(1) – Buy-Back: Sources of Funds:

- A company may **buy back its own shares/securities** using:
 - a. **Free reserves**
 - b. **Securities premium account**
 - c. **Proceeds of issue of any shares/ Specified securities (other than same kind)**
- **✗ Proceeds of same kind of securities cannot** be used for buy-back.

- **Specified securities** include **ESOPs** or **others notified** by CG.

Section 68(2) – Buy-Back Conditions:

1. **Articles must authorize** buy-back.
2. **Special Resolution** in General Meeting is mandatory, except when:
 - Buy-back **not exceeding 10%** of total **paid-up EQUITY capital + free reserves**
 - And **Board Resolution** is passed
3. Max buy-back limit = **25%** of:
 - Aggregate **PAID-UP capital + free reserves**
 - (For equity shares: max 25% of **PAID-UP EQUITY CAPITAL** in a FY)
4. Post buy-back: **Debt: (PUC + Free Reserves)** should not be more than **2:1** (or as prescribed)
5. Only **fully paid-up** shares/securities can be bought back
6. Must comply with:
 - **Rule 17** (for unlisted) or
 - **SEBI Regulations** (for listed securities)
7. **✗** No new offer of buy-back within **1 year** of closure of last buy-back
8. **Free reserves** include **Securities Premium A/c**

Section 68(3), (5) & (6) –:

Before Special Resolution (Sec 68(3)):

Notice must include **Explanatory Statement** disclosing:

1. All material facts
2. Reason/necessity for buy-back
3. Class of securities to be bought back
4. Amount to be invested
5. Time limit for buy-back

Modes of Buy-Back (Sec 68(5)):

Buy-back can be from:

- a. Existing shareholders (proportionate basis)
- b. Open market
- c. ESOP/sweat equity issued to employees

Declaration of Solvency (Sec 68(6)):

1. Must be filed **before buy-back implementation**
 2. Filed with **Registrar** and with **SEBI** (if listed)
 3. In **Form SH-9**, verified by **affidavit**
 4. Declare company is solvent and can meet liabilities for next **12 months**
 5. Signed by **at least 2 directors**, one being **Managing Director (if any)**
- Declaration **Period Invalid** – Solvency must be declared for **12 months**, not 6 months.
 - MD's **Signature Mandatory** – If **Managing Director is appointed**, his **signature is compulsory** on Form SH-9, even if other directors have signed.

Buy-Back: Time Limit & Procedure

1. **Completion Timeline** – Buy-back must be completed **within 12 months** from the date of passing **SR/Board resolution. (Sec 68(4))**
2. **Form SH-8** – Letter of offer in **Form SH-8** to be filed with RoC **before buy-back**.
3. **Dispatch Timeline** – Letter of offer to be **dispatched to shareholders within 20 days** of filing with RoC.
4. **Offer Period** – Offer shall remain open **15 to 30 days** (may be less than 15 days if **all members agree**).
5. **Oversubscription Handling** – If shares offered is more than shares to be bought back, acceptance shall be **on proportionate basis**.
6. **Verification** – Offers to be verified **within 15 days** from closure of offer.
7. **Deemed Acceptance** – If no rejection is communicated within **21 days**, offers are **deemed accepted**.
8. **Payment Timeline** – Company shall make **payment in cash within 7 days** of verification.
9. **Return of Shares – Share certificates** must be returned to:
 - Those whose shares are **not accepted**, or
 - Return **balance** if partially accepted.

Extinguishment, Cooling Period, Register & Return (Sec 68 subs. 7–10)

1. **Extinguishment [Sub-sec 7]:**
Bought-back securities shall be **extinguished & physically destroyed within 7 days** from **last date of buy-back completion**.
2. **Cooling Period [Sub-sec 8]:**
No **fresh issue of same kind** of shares/securities **within 6 months** of buy-back completion.
Exception: Bonus issue, stock options, sweat equity, conversion of warrants/preference shares/debentures.
3. **Register of Buy-Back [Sub-sec 9]:**
Maintain **Form SH-10** at registered office with details of:
 - Securities bought,
 - Consideration paid,
 - Cancellation date,
 - Destruction date, etc.
 - Custody & authentication by company secretary or Board-authorized person.
4. **Return of Buy-Back [Sub-sec 10]:**
File **Form SH-11** with ROC & SEBI (if listed) **within 30 days** of buy-back completion.
Must attach **Form SH-15 certificate** signed by **2 directors (incl. MD, if any)**, confirming compliance.

Penalty for Default [Sub-sec 11]:

- **Default:** Non-compliance with this section or SEBI regulations u/s 68(2)(f).
- **Company:** Fine ₹1 lakh – ₹3 lakh.
- **Officer in default:** Fine ₹1 lakh – ₹3 lakh.

Question: 11

XYZ, an unlisted company whose **AOA permits buy-back**, passed a **special resolution on Jan 5, 2019** to buy back **30% equity shares** using **proceeds of earlier equity issue**, despite an earlier buy-back resolution dated **Jan 15, 2018**; alternatively, it proposes **25% buy-back on Jan 25, 2019** from the same source. **[Nov 19 – 5 Marks]**

Answer:

The **first proposal is invalid** due to exceeding **25% limit**, falling **within 1 year** of earlier buy-back, and using a **prohibited source**; the **second proposal is invalid only due to the use of proceeds from earlier issue of same kind of shares**.

Question: 12

*London Ltd., whose **Articles of Association empower buy-back**, passed an **ordinary resolution** at a general meeting to buy back **30% of its equity share capital**. Later, it considered reducing the buy-back to **20%** under the same resolution. Based on the provisions of the **Companies Act, 2013**, examine whether the company's proposal is in order in both cases. [Nov 19 – 5 Marks]*

Answer:

The company's proposal is **not in order** in either case. As per **Section 68(2)(b)**, a **special resolution** is mandatory for any buy-back exceeding **10%** of paid-up equity capital and free reserves. Since only an **ordinary resolution** was passed, the initial **30% buy-back** is invalid. Even if reduced to **20%** (which is within the **25% cap** under **Section 68(2)(c)**), a **special resolution** is still required. Hence, the proposal remains **invalid in both scenarios**.

Question: 13

The question tests the validity of a statement claiming that a company cannot make a **buy-back offer within 6 months** of a previous one, and cannot issue **same kind of shares** for **1 year** post buy-back, subject to exceptions. (MTP May 24 (1) – 5 Marks) [July 21 - 3 Marks]

Answer:

The statement is **not valid**—under **Section 68(2) proviso**, the **cooling period for buy-back** is **1 year**, while under **Section 68(8)**, the restriction on **fresh issue** of same kind of shares is **6 months**, with exceptions like **bonus issue** or **conversion obligations**.

Debenture [Section 71]

Definition [Sec 2(30)]

- Includes debenture stock, bonds, or any instrument **evidencing a debt**, whether or not it creates a charge on assets.
- **Exclusions:**
 - a. Instruments under **Chapter III-D, RBI Act, 1934**.
 - b. Other instruments **prescribed by Central Govt. in consultation with RBI**.

Issuance [Sec 71]

1. **Convertible Debentures (Sub-sec 1):** Can be issued with conversion option into shares, if authorised by **special resolution**.
2. **No Voting Rights (Sub-sec 2):** Debentures cannot carry voting rights.
3. **Secured Debentures [Sub-sec 3]:**
 - a. **Maximum Tenure of Secured Debentures**
 - **Normal Tenure:** Max **10 years** from date of issue.
 - **Extended Tenure (up to 30 years)** allowed for:
 1. Companies setting up **infrastructure projects**
 2. **Infrastructure Finance Companies (IFCs)**

3. **Infrastructure Debt Fund NBFCs (IDF-NBFCs)**

4. Companies **permitted by Govt./RBI/NHB/statutory authority**

b. Debenture Trustee Appointment

- **Mandatory** before issuing **prospectus** or **letter of offer** for subscription.

c. Creation of Security (Charge)

- Charge/Mortgage must be created in favour of **Debenture Trustee** on:
 - Specified movable** assets of company/holding/subsidiary/associate.
 - Specified immovable** properties wherever situate or any interest therein.

Notes:

1. **Asset value** must be **adequate** to cover debentures + interest.
2. For **NBFCs**: Charge may be created on **any movable property**.
3. **Government Companies** with **Central/State Govt. guarantee** are **exempt** from charge creation.

- d. Debenture Trust Deed Debenture trust deed shall be executed in **Form SH-12** to protect the interest of the debenture holders, **within three months** of closure of the issue or offer.

Creation of Debenture Redemption Reserve (DRR) Account [Sub-section 4]

Creation & use: Out of company's profits available for dividend; used **only** for redemption of debentures.

Restrictions on Issue of Prospectus / Offer / Invitation [Section 71(5)]

- Before issuing a **prospectus** or making an **offer or invitation** to the **public or to its members exceeding 500** for the subscription of debentures:
 - The company **shall appoint one or more debenture trustees**.
- Except in case of **public offer**, appointment/removal governed by **Rule 18(2)** of Companies (Share Capital & Debentures) Rules, 2014.

a. Name and Consent of Debenture Trustee

- **Trustee's name** must appear in all offer letters/notices.
- **Written consent** shall be obtained **before appointment**, and disclosed in the letter of offer.

b. Disqualified Persons (Who cannot be a Debenture Trustee)

1. **Beneficiary holders of shares** the company.
2. **Promoter / Director / KMP / Employee** of the company, holding, subsidiary, or associate.
3. **Relative** of Promoter/Director/KMP of company.
4. **A beneficiary entitled to moneys to be paid by company** (other than remuneration)
5. **Indebted** to the company or its subsidiary, holding or associate company or a subsidiary of such holding company.
6. **Guarantee provider** for the debenture debt/interest.
7. **Person who has pecuniary relationship** with the company amounting to 2% or more of its turnover or income OR ₹50 lakhs (whichever lower) during the last 2 immediately preceding financial years or current year.

c. Removal of Debenture Trustee Before Term: Can be removed **only with consent of not less than ¾** in value of debenture outstanding at their meeting.

d. Filling Vacancy of Debenture Trustee

Nature of Vacancy	How to Fill
Casual Vacancy	Board may fill

Resignation by Trustee	With written consent of majority of debenture holders
Till new appointment is made	Remaining trustee(s) may act

Debenture Trustee to protect Interest of Debenture Holders [Sub-section 6]

- **Trustee's Duty:** Protect interests & redress grievances of debenture holders.
- **Rules:** Duties under Rule 18(3); meeting requirements under Rule 18(4).
- **Meeting to be called:**
 - a. On request (Duly Signed and Writing) from holders of **at least 1/10th in value** of debentures, or
 - b. On breach/default affecting debenture holders' interests.
- **Not applicable:** In case of public offer of debentures.
- **Example:** Trustee must call meeting if company breaches covenant (e.g., loan against debt-equity ratio).

Liability of Debenture Trustee [Sub-section 7]

- **Trustee Liability:** Liable if fails to exercise due care & diligence.
- **Void Provisions:** Any clause exempting/indemnifying trustee from breach of trust is void.
- **Exception:** Allowed only if approved by holders of at least 75% in value at a meeting.
- **Care Standard:** Determined with reference to powers, authority & duties in trust deed.
- **Example:** Failure to monitor asset value = lack of due diligence.

Sub-sec (8): Company shall pay interest & redeem debentures as per issue terms.

Sub-sec (9): Trustee may file petition before Tribunal if assets are/will be insufficient to repay principal.

Tribunal Powers:

- a. Impose restrictions on further liabilities of company.
- b. Pass orders after hearing company/concerned parties.

Sub-sec (10): On failure to redeem/pay interest, Tribunal may after hearing the parties order company to pay principal & interest forthwith on application by debenture holders/trustee.

Sub-sec (12): Contract to take up/pay for debentures enforceable by decree for **specific performance** under *Specific Relief Act, 1963 & CPC*.

- **Note 1:** Public company shall get **special resolution** approval before issue if total borrowings (including debentures) exceed paid-up share capital + free reserves + securities premium.
Exclusion: Short-term or temporary loans not counted as borrowings.
- **Rule 12(1):** Company with share capital must file **Return of Allotment (Form PAS-3)** within **30 days** of debenture allotment with Registrar.

Question: 14

SRD Ltd. (with Paid-up Capital ₹40L, Share Premium ₹50L, General Reserve ₹30L, P&L Balance ₹20L, Capital Reserve (Profit on sale of fixed asset)- ₹30L. Company has already borrowed ₹50L (8% Debentures ₹30L + 9.5% Term Loan ₹20L); Short-term Cash Credit is ₹50L (Repayable on demand) ; company now proposes to issue further debentures and also considers issue of convertible debentures — is shareholder approval required or board resolution is sufficient? [Nov 22 – 6 Marks]

Answer:

As per **Sec 180(1)(c)**, Board can borrow up to ₹90L (₹1.4 Cr – ₹50L) without special resolution; borrowing beyond this, or issuing convertible debentures (Sec 71(1)), mandatorily requires shareholders' approval by special resolution, irrespective of amount.

Question: 15

Whether three specific persons — (i) an investor with advantageous stake, (ii) a lender with ₹1,000 due, and (iii) a guarantor for debenture repayment — can be appointed as a Debenture Trustee. **(Nov 23 - 5 Marks)**

Answer:

None of them can be appointed — all three are disqualified under Rule 18(2) due to **beneficial interest**, **indebtedness** (irrespective of amount), and **having given a guarantee**, respectively.

CHAPTER 5 - ACCEPTANCE OF DEPOSITS BY COMPANIES

PROVISIONS REGARDING ACCEPTANCE OF DEPOSITS FROM MEMBERS - SEC 73

1. Passing of Resolution [Sec. 73(2)]:

A company shall **pass a resolution in general meeting** authorising acceptance of deposits from its members.

2. Issuance of Circular containing Statement [Sec. 73(2)(a) & Rule 4]:

- The company shall **issue a circular** to its members in **Form DPT-1**, containing a **statement** showing –
 - (a) **financial position** of the company,
 - (b) **credit rating** obtained,
 - (c) **total number of depositors and amount due** towards previous deposits, and
 - (d) such other particulars as may be prescribed.
- The circular shall be sent to members by **registered post with acknowledgment due, speed post, or electronic mode**.
- It **may** also be **published** in an **English newspaper** (English language) and a **vernacular newspaper** (vernacular language) having wide circulation in the State where the registered office is situated.
- The circular shall be **issued under the authority and in the name of the Board of Directors**.

3. Auditor's Certificate: A certificate of the statutory auditor shall be attached to **Form DPT-1** stating that – - (a) the company has **not committed any default** in repayment of deposits or interest thereon, **or** - (b) where default was made, it has been **made good**, and **five years have lapsed** since the date of making good such default.

4. Validity of Circular:

The circular shall remain valid **till the earliest** of –

- (a) **six months from the close of the financial year** in which it is issued; **or**
- (b) **date on which the financial statements are laid before the company at the AGM** (or the last date on which the AGM should have been held).

Thereafter, a **fresh circular** must be issued for inviting deposits in the succeeding financial year.

Example: If Ray Pharmaceuticals Ltd. issued a circular on **14.02.2023** and held AGM on **07.09.2023**, since six months from FY closure (30.09.2023) ends after AGM, the circular remains valid **till 07.09.2023** only.

5. Filing of Circular with Registrar [Sec. 73(2)(b) & Rule 5]:

A copy of the circular containing the statement shall be **filed with the Registrar at least 30 days before** the date of its issue to members.

6. Deposit Repayment Reserve Account [Sec. 73(2)(c) & Rule 13]:

- The company shall, **on or before 30th April each year**, **deposit at least 20%** of the amount of deposits **maturing during the following financial year** in a **scheduled bank** in a separate account called the **Deposit Repayment Reserve Account**.
- The amount so deposited shall **not be utilised for any purpose** other than **repayment of deposits**.
- The balance in such account shall **not at any time fall below 20%** of the amount of deposits maturing during the financial year.

7. Certification of No Default [Sec. 73(2)(e)]:

The company shall **certify that it has not committed any default** in repayment of deposits or interest thereon.

Where a default had occurred, the company must **certify that the default was made good and five years have lapsed** since such rectification.

8. Provision of Security [Sec. 73(2)(f)]:

- The company **may provide security** for due repayment of deposits and interest and **create a charge** on its property or assets.
 - Where the deposits are **not secured or partially secured**, they shall be **termed as “Unsecured Deposits”**, and this fact shall be **clearly stated in every circular, form, advertisement, or document** inviting or accepting deposits.
9. **Repayment of Deposits [Sec. 73(3)]**: Every deposit accepted by a company shall be **repaid with interest** in accordance with the **terms and conditions of the agreement**.
10. **Application to NCLT on Default [Sec. 73(4)]**: Where a company **fails to repay** the deposit or part thereof or **any interest thereon**, the **depositor concerned** may **apply to the National Company Law Tribunal (NCLT)** for an **order directing the company to pay** the sum due or **for any loss or damage** suffered due to such non-payment, and for **such other orders as the Tribunal may deem fit**.
11. **Restriction on Use of Deposit Repayment Reserve Account [Sec. 73(5) & Rule 13]**: The amount deposited in the **Deposit Repayment Reserve Account** shall **not be utilized for any purpose other than the repayment of deposits**.

PROVISIONS REGARDING ACCEPTANCE OF DEPOSITS FROM PUBLIC BY COMPANIES [SECTION 76]

Acceptance of deposits from public by eligible companies only: A company may accept deposits from person other than its members, only if it is an **eligible company**, i.e. -

- (a) it is a **public company**;
- (b) its **net worth is Rs. 100 crore or more** or its **turnover is Rs. 500 crore or more**;
- (c) it has obtained the prior **consent of the members** by means of-
 - (i) an **ordinary resolution**, if the deposits are **within the limit specified u/s 180(1)(c)** (i.e. 100% of the aggregate of its paid-up share capital, free reserves and securities premium account); or
 - (ii) a **special resolution**, in any **other case**;
 - (iii) it has **filed a copy of the ordinary resolution / special resolution with the Registrar**, before making any invitation to the public for acceptance of deposits.

Compliance of Sec. 73(2): The company shall **comply** with all the **legal requirements contained in Sec. 73(2)**, i.e. conditions for accepting deposits from the members.

Rating of deposits: The company shall obtain rating with respect to its deposits.

- (a) The rating shall include the **net worth** of the company, **liquidity and ability** of the company to repay the deposits on the due date.
- (b) The rating **ensures adequate safety**.
- (c) The rating shall be obtained from a **recognised credit rating agency**.
- (d) The rating given to the company shall be **informed to the public at the time of inviting deposits**.
- (e) The rating shall be **obtained every year** during the tenure of deposits.
- (f) A copy of the credit rating which is being obtained **at least once in a year** shall be **sent to the Registrar** of Companies along **with the Return of Deposits in Form DPT-3**.
- (g) Rating shall not be below **minimum investment grade** and shall be from agencies approved for NBFCs under the **RBI Directions, 1998**.

Registration of charge, in case of secured deposits: Where a company accepts secured deposits from the public, -

- (a) It shall, **within 30 days of such acceptance**, create a charge on its **tangible assets only** in the favour of deposit-holders on **specific movable or immovable property**.

- (b) The company **cannot create charge on intangible assets** (i.e. goodwill, trade-marks, etc.).
- (c) The **value of the assets** so charged shall **not be less than the amount of deposits accepted and interest payable** thereon by it.
- (d) The **market value of assets** shall be **assessed by a registered valuer**.

EXEMPTIONS

Prohibition [Sec. 73(1)]: On and after the commencement of this Act, no company shall invite, accept or renew deposits under this Act from the public except as per **Chapter V** provisions.

Exemptions to banking companies, NBFCs, etc. [Sec. 73(1)]:

1. **Banking Company**
2. **NBFC** (as per RBI Act, 1934)
3. **Housing Finance Company (HFC)** registered with NHB
4. **Other companies** notified by Central Govt. after consultation with RBI

Applicability: Deposit provisions apply only to **non-banking, non-financial companies** (e.g., manufacturing or trading companies, etc.).

Exemptions to private companies: The conditions for acceptance of deposits from members as contained in **clauses (a) to (e) of sub-section (2) of section 73** shall not apply to -

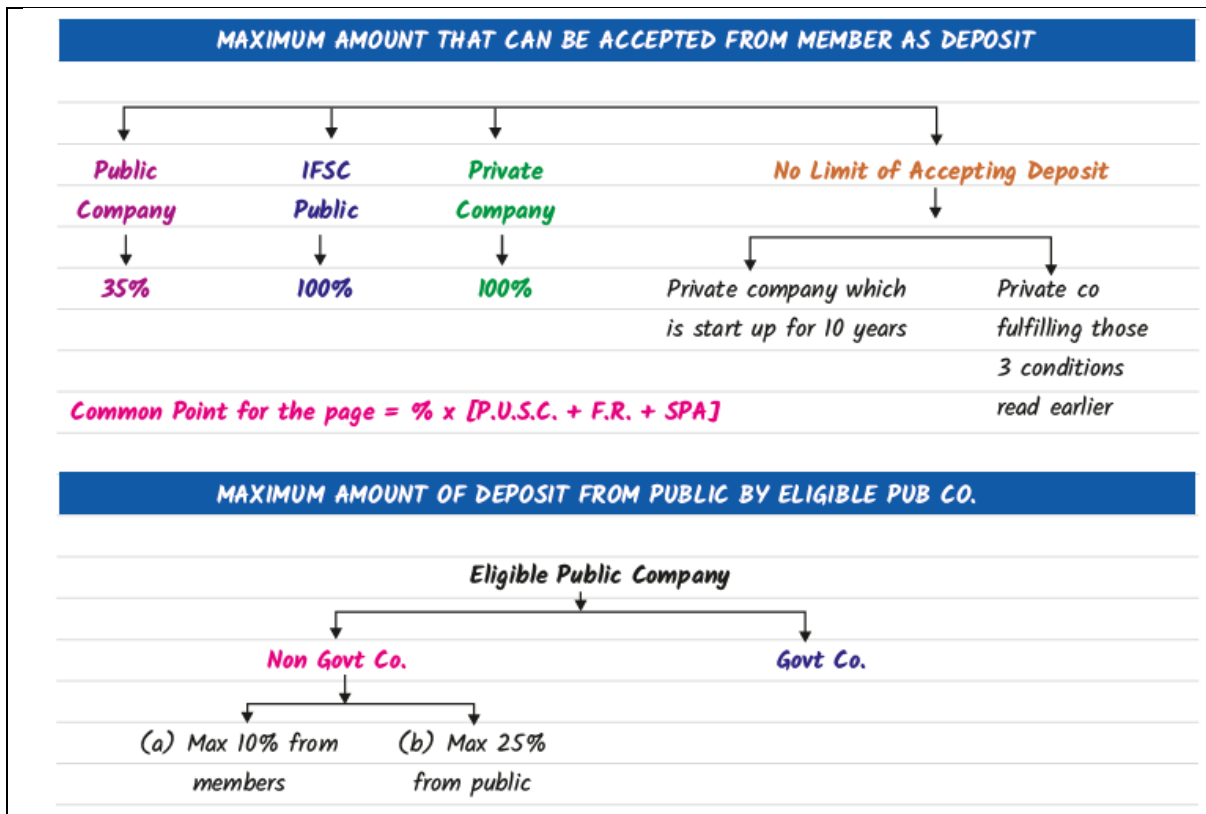
- (i) a **private company** which **accepts** from its members **deposits not exceeding 100%** of aggregate of the paid-up share capital, free reserves and securities premium account; or
- (ii) a **private company** which is a **start-up, for 5 years** from the date of its incorporation; or
- (iii) a **private company** which fulfils all of the following conditions, namely:
- (a) It is **not an associate or a subsidiary company** of any other company;
- (b) The **borrowings** of such a company from banks or financial institutions or any body corporate is **less than:**
- twice of its paid-up share capital; or
 - Rs. 50 crore, whichever is lower; and
- (c) It has **not defaulted in the repayment** of such borrowings subsisting at the time of accepting deposits.

A private company as referred to in Points (i), (ii) or (iii) above -

(i) shall file the details of deposits accepted by it to the Registrar **(in Form DPT-3)**; and

(ii) shall be eligible to claim the exemption only if it has not committed any default in filing its FS u/s 137 or AR u/s 92.

Exemptions to Specified IFSC Public Companies: The **conditions** for acceptance of deposits from members as contained in **clauses (a) to (e) of sub-section (2) of section 73** shall not apply to a **Specified IFSC public company** which **accepts from its members, deposits not exceeding 100%** of aggregate of the paid up share capital and free reserves, provided such company shall **file the details of deposits so accepted to the Registrar (in Form DPT-3)**.



TENURE FOR WHICH DEPOSITS CAN BE ACCEPTED (RULE 3)

1. Normal Tenure Limit:

- No company shall accept or renew deposits **repayable on demand** or in **less than 6 months**.
- Maximum tenure** of any deposit shall **not exceed 36 months**.

2. Exception – Short-term Deposits:

A company may accept or renew deposits for a period **less than 6 months** to meet **short-term fund requirements**, subject to:

- Such deposits **shall not exceed 10%** of the aggregate of **paid-up share capital + free reserves + securities premium account**; and
- Such deposits shall be **repayable only on or after 3 months** from the date of acceptance or renewal.

Question: 1

The question tests the **treatment of share application money as “deposit”** under **Rule 2(1)(c) of the Companies (Acceptance of Deposits) Rules, 2014**, where:

- RS Ltd. received **₹50 lakh** as share application money on **01.06.2019**,
- failed to allot shares within **60 days**,
- ₹5 lakh** belonging to **Mr. Khanna (a customer)** was adjusted by **book entry** against his dues on **30.07.2019**, and
- the Company Secretary treated the **entire ₹50 lakh as deposit as on 31.07.2019**. [Jan 21 - 4 Marks]

Answer:

As per **Rule 2(1)(c) read with its Explanation**, share application money becomes a **deposit only if it is not refunded within 15 days after expiry of 60 days** from receipt. Since **60 days ended on 31.07.2019**, the company still had **15**

more days to refund, hence ₹50 lakh cannot be treated as deposit on 31.07.2019, making the CS's reporting incorrect. However, ₹5 lakh adjusted by book adjustment is not a valid refund, as adjustment for any other purpose is expressly excluded and will be treated as deposit if not refunded properly within the allowed time.

Question: 2

The question tests **eligibility and limits for acceptance of public deposits** under **Section 76 of the Companies Act, 2013 read with Rules 2(1)(e), 3(1), 3(4) and 3(5) of the Companies (Acceptance of Deposits) Rules, 2014**, based on the financial position of **Viki Limited** as on **31.03.2020**:

- Paid-up share capital: ₹70 crore
- Securities premium: ₹20 crore
- Free reserves: ₹20 crore
- Long-term borrowings: ₹50 crore

The company invited **public deposits for the first time** under:

- **Plan A:** 4 months (short-term)
- **Plan B:** 36 months (long-term)

and further examined a **variation where the company is a wholly owned Government company**. [Nov 20 – 6 Marks]

Answer:

(i) Viki Ltd. qualifies as an **“eligible company”** since its **net worth exceeds ₹100 crore**.

- Short-term deposits (less than 6 months) for **Plan A** are restricted to **10% of ₹110 crore = ₹11 crore** (repayable after minimum 3 months).
- Total public deposits (non-members) can be up to **25% of ₹110 crore = ₹27.5 crore**;
- Hence **Plan B deposits = ₹27.5 – ₹11 = ₹16.5 crore**.

(ii) If Viki Ltd. is a **wholly owned Government company**, then it can accept public deposits up to **35% of ₹110 crore = ₹38.5 crore** under **Plan B**.

Question: 3

The question tests the **ability of a private company to accept deposits from its members**.

Facts of **BUI Private Limited**:

- Not a start-up
 - Not an associate or subsidiary of any other company
 - Authorized capital: ₹10 crore
 - Paid-up share capital: ₹8 crore
 - Securities premium: ₹2 crore
 - General reserves: ₹5 crore
 - Total borrowings: ₹17 crore (Term loan ₹12 crore + Cash credit ₹5 crore)
 - No default in deposits or statutory filings
 - Intends to accept deposits from **members only** for a housing project
 - Board does **not want to create a Deposit Repayment Reserve Account**
- Two proposals were placed before the Board:
- Proposal 1: ₹20 crore @ 7% p.a.
 - Proposal 2: ₹14 crore @ 8% p.a.

Answer:

Exemptions available to private companies for acceptance of deposits, which relaxes certain requirements of **Section 73(2) of the Companies Act, 2013** such as issue and filing of circular, creation of Deposit Repayment Reserve,

and certification of no default. These exemptions apply if a private company satisfies **any one** of the prescribed conditions:

(A) accepts deposits from members not exceeding **100% of paid-up share capital, free reserves and securities premium**, or

(B) is a **start-up** within five years of incorporation, or

(C) is neither an associate nor subsidiary, has borrowings **less than twice its paid-up share capital or ₹50 crore (whichever is lower)**, and has **no default** in repayment of such borrowings.

In the given case, **BUI Private Limited** does not qualify under condition (C) because its total borrowings of **₹17 crore** exceed **twice its paid-up share capital of ₹8 crore (₹16 crore)**, and it is also not a start-up. Hence, it can accept deposits **only under condition (A)**, limiting member deposits to **₹15 crore** (₹8 crore paid-up capital + ₹5 crore free reserves + ₹2 crore securities premium). Consequently, **Proposal 1 of ₹20 crore is not permissible**, and the company must opt for **Proposal 2 of ₹14 crore at 8% interest**, which falls within the statutory limit.

Question: 4

The question tests the **validity of charge created for secured public deposits**.

Perfect Limited accepted **secured public deposits of ₹100 crore on 30 June 2021 at 12% p.a.**, repayable after **3 years**, and created a charge in favour of the **deposit trustees** on the following assets:

- Land & Building: ₹60 crore
- Plant & Machinery: ₹20 crore
- Factory Shed: ₹20 crore
- Trade Mark: ₹20 crore
- Goodwill: ₹25 crore

Answer:

As per the **second proviso to Section 76(1)**, security for secured deposits must be created **only on tangible assets**, and the **value of security must not be less than the total deposits plus interest payable thereon**, based on **market value assessed by a registered valuer**.

Intangible assets such as **trade mark and goodwill cannot be charged**. Hence, only **₹100 crore** (₹60 + ₹20 + ₹20) of tangible assets are valid security. However, total liability equals **₹136 crore** [₹100 crore + (₹100 crore × 12% × 3 years)]. Since the **value of valid security (₹100 crore) is less than the total deposits and interest (₹136 crore)**, the **charge created is not valid under the Deposit Rules**.

Question: 5

Amount of Rs. 3,00,000 received by a private company from a relative of a Director, declared by the depositor as out of gift received from his mother. **[Nov 19-6 Marks]**

Answer:

The amount of **₹3,00,000 received by a private company from a relative of a director is not treated as a deposit** under **Rule 2(1)(c)(viii) of the Companies (Acceptance of Deposits) Rules, 2014**, provided the required declaration is furnished. In this case, the relative has given a **written declaration** stating that the money is **out of a gift received from his mother** and **not sourced from borrowed funds, loans, or deposits**. Hence, the receipt qualifies for the exemption and does **not constitute a deposit**.

Question: 6

Whether following receipts by company amount to 'deposit' as per Rule 2(1) (c) under the Companies (Acceptance of Deposits) Rules, 2014.

1. Amount received from Central Government.
2. Amount received as loan from baking company.
3. Amount received on issue of commercial paper
4. Deposits received from another company.
5. Amount received from HUF.
6. Amount received as share application money for 90 days or more and still no shares are allotted to the applicant.
7. Amount received from Mr. Neel, a director of company who in turn has borrowed amount from his relative.
8. Amount received on issue of secured debentures.
9. Amount received on issue of convertible debentures which are to be converted in to shares after 12 years.
10. Amount received as advance against supply of goods where goods is to be supplied after 15 months.
11. Security deposit received from the employee Rs. 1,50,000. Salary of the employee is Rs. 10,000 p.m. **[6 Marks]**

Answer:

Particulars	Deposit or not	Reason
Amount received from Central Government	No	Specially excluded under the definition of 'Deposit' as per Rule 2(l)(c)(i).
Amount received as loan from baking company.	No	Specially excluded under the definition of 'Deposit' as per Rule 2(1) (c) (iii).
Amount received on issue of commercial paper	No	Specially excluded under the definition of 'Deposit' as per Rule 2(l)(c)(v).
Deposits received from another company.	No	Specially excluded under the definition of 'Deposit' as per Rule 2(l)(c)(vi).
Amount received from HUF	Yes	Not excluded under the definition of 'Deposit'.
Amount received as share application money for 90 days or more and still no shares are allotted to the applicant.	Yes	If the securities for which application money or advance for such securities was received cannot be allotted within 60 days from the date of receipt of the application money or advance for such securities and such application money or advance is not refunded to the subscribers within 15 days from the date of completion of 60 days, such amount shall be treated as a deposit under these rules.
Amount received from Mr. Neel, a director of company who in turn has borrowed amount from his relative.	Yes	Any amount received from director of the company does not to 'deposit'. However, the director from whom money is received, furnishes to the company at the time of giving the money, a declaration in writing to the effect that the amount is not being given

Arjun Chhabra
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		<p>out of funds acquired by him by borrowing or accepting loans or deposits from others.</p> <p>As director as deposited money with company by borrowing from relative, it amounts to 'deposit' as per Rule 2(l)(c)(viii).</p>
Amount received on issue of secured debentures	No	Specially excluded under the definition of 'Deposit' as per Rule 2(l)(c)(ix).
Amount received on issue of convertible debentures which are to be converted in to shares after 10 years.	Yes	Amount received on issue of convertible debentures which are to be converted with in a period of 10 years does not amount to 'deposit'. In given case conversion period is more than 10 years and hence it amounts to 'deposit'.
Amount received as advance against supply of goods where goods is to be supplied after 15 months	Yes	Amount received as advance against supply of goods up to 1 year does not amount to deposit. In given case advance is received for period exceeding 1 year and hence it will amount to 'deposit'.
Security deposit received from the employee Rs. 1,50,000. Salary of the employee is Rs. 10,000 p.m.	Yes	Security deposit received from an employee not exceeding his annual salary does not amount to deposit. In given case since security deposit exceeds his annual salary it amounts to 'deposit'.

CHAPTER 6 - REGISTRATION OF CHARGES

DUTY TO REGISTER CHARGES, ETC. [SECTION 77]

(1) It shall be the **duty of every company** creating a charge

- ✓ within or outside India,
- ✓ on its property or assets or any of its undertakings,
- ✓ whether tangible or otherwise, and
- ✓ situated in or outside India,

to register the particulars of the charge signed by the company and the charge-holder together with the instruments, if any, creating such charge in **Form No.CHG-1(for other than Debentures)** or **Form No.CHG-9 (for debentures including rectification)**, with the Registrar **within thirty days** of its creation.

Note: Deposit of Title Deeds: Charge created **by deposit of title deeds** (equitable mortgage) is **also registrable by borrowing company**.

Proviso 1 and 2: Registrar may, on an application by the company, allow such registration to be made within extended period:

Type of Charge	Normal Period	Extended Period (on application)	Further Extension (on payment of higher/ad valorem fees)
1. Charges created <i>before</i> the Companies (Amendment) Act, 2019 i.e. before 02-11-2018	30 days from creation (Normal Fees)	Up to 300 days from creation (with additional fees)	If not registered within 300 days → may be registered within 6 months from commencement of the Amendment Act, 2019 i.e. 02-11-2018 (with prescribed additional fees — different for different classes of companies)
2. Charges created <i>on or after</i> the Companies (Amendment) Act, 2019 i.e. on or after 02-11-2018	30 days from creation (Normal Fees)	Up to 60 days from creation (with additional fees)	If not registered within 60 days → Registrar may allow further 60 days (on payment of ad valorem fees as prescribed)

PROCEDURE FOR EXTENSION OF TIME LIMIT (FOR REGISTRATION OF CHARGE):

- Company must **apply to the Registrar** in **Form CHG-1** (for other than debentures) or in **Form CHG-9** (for debentures) for extension.
- Application must be **supported by a declaration** signed by the **Company Secretary or a Director** stating that **belated filing will not affect rights of other creditors**.
- **Registrar may allow extension** if satisfied that the company had **sufficient cause** for delay in filing particulars/instruments of charge.
- **Additional fee or ad valorem fee**, as applicable, must be **paid** for such delayed registration.

VERIFICATION OF INSTRUMENT OF CHARGE

A copy of every instrument creating or modifying a charge filed with the Registrar shall be **verified**.

1. Property situated *outside India* only: Verification may be by **certificate issued**:

- under the **company seal**, if any or
- **director or company secretary** of the company, or **authorised officer of charge-holder**, or
- **any person other than the company** interested in the mortgage/charge.

2. Property situated *in India* (wholly or partly): Verification **shall be by certificate issued**:

- **director or company secretary** of the company, or
- **authorised officer of the charge-holder**.

3. Key point:

- For **outside India property**, verification can include a **person other than the company** interested in the charge.
- For **in India property (whether wholly or partly)**, such third-party verification is **not allowed**.

Proviso 3: Any subsequent registration of a charge (i.e. even if it is registered within the extended period instead of original thirty days) shall not prejudice any right acquired in respect of any property before the charge is actually registered.

In simple words, where a charge is not registered within 30 days of its creation, but is registered subsequently, any such subsequent registration shall not prejudice any right acquired by any person before the charge is actually registered, in respect of the property which is the subject matter of charge. To be more precise, if the company creates a subsequent charge which is registered, such **subsequent registered charge shall have priority over the previous unregistered charge**.

Proviso 4: **Section 77 shall not apply** to such charges as may be prescribed in consultation with the Reserve Bank of India.

Rule 3(5): Charges **created or modified by a banking company** under Section 77 in favour of the **RBI** are **not required to be registered** when **any loan or advance** has been made under **sub-clause (d) of clause (4) of Section 17 of the RBI Act, 1934**.

(2) Certificate of Registration: On registration under sub-section (1), **Registrar shall issue a certificate of registration** of charge, in **Form No.CHG-2**, to the **company** and to the **charge-holder**.

The **certificate issued by the Registrar** is **conclusive evidence** that the **requirements of Chapter VI** of the Companies Act, 2013, and the **Rules** regarding registration of charge have been **complied with**.

(3) Effect of non-registration (overrides any other law): **No charge** created by a company shall be taken into account by the **liquidator** (under Companies Act or IBC, 2016) or **any creditor**, **unless it is duly registered under Section 77(1)** and **certificate of registration** is issued under **Section 77(2)** by the Registrar.

In simple words, it means that the charge will become void against the liquidator and other creditors of the company. Simply stated, at the time of winding up, the creditor whose charge has not been registered will be reduced to the level of an unsecured creditor. Neither the liquidator nor any other creditor will give legal recognition to a charge that is not registered.

(4) Saving: Nothing in sub-section (3) shall **prejudice any contract or obligation** for **repayment of the money** secured by such charge.

In simple words, it implies that the debt is valid and may be enforced against the company through the courts by filing a suit, but the security is lost.

Question: 1

When the obligation to register a charge under Section 77(1) of the Companies Act, 2013 arises—on sanction of a ₹200 lakh mortgage-backed credit limit on 1 March 2023 or on actual utilisation in August 2023, and who is responsible for registration. [Sep 24 - 5 Marks]

Answer:

The trigger point is **creation of charge (1 March 2023)** when equitable mortgage was created by deposit of title deeds, not utilisation; **duty to register lies on the company**, and **non-registration makes the charge void against liquidator/creditors, causing loss of secured status and priority** under **Sections 77(3) & (4)**.

Question: 2

Whether **charges are required** for (a) a **₹30 lakh working capital loan secured by stock and receivables** and (b) a **₹5 lakh ad-hoc overdraft backed only by a director's personal guarantee**, and the **time-extension procedure for delayed registration**. [RTP Jan 26]

Answer:

A charge **must be created and registered** for the ₹30 lakh loan (security is company assets) but **no charge is required** for the ₹5 lakh overdraft (personal guarantee ≠ company asset); if not registered within **30 days**, **Section 77** allows **another 30 days** on application to ROC with declaration, sufficient cause, and payment of **additional fee**.

Question: 3

A company created a charge on its assets in favour of Laxmi Bank Ltd. on 1st October, 2019. This charge was filed with the ROC on 10th October, 2019. The ROC issued certificate of registration of charge on 15th October, 2019. The same company also created charge on the same assets in favour of Saraswati Bank Ltd. on 9th October, 2019 and filed the charge with the ROC on 10th October, 2019. The ROC issued certificate of registration of charge on 12th October, 2019. Which bank will have priority in recovering its dues by disposing the assets? **[4 Marks]**

Answer:

As per Section 77 of The Companies Act, 2013, for given case following two principals should be noted:

- A registered charge has priority over un-registered charge and
- When charge is registered it becomes effective from the date of registration of charge and not from the date of creation.

Since, charge in favour of Saraswati Bank Ltd. was registered first on 12.10.2019 it gets priority and is effective from the date of registration i.e. 12.10.2019.

However, charge in favour of Laxmi Bank Ltd. was registered on 15.10.2019 and it become effective from the date of creation i.e. 15.10.2019.

Considering above views, it can be said that Saraswati Bank Ltd. will have priority in recovering its dues by disposing the assets.

Considering the above facts and provisions it can be concluded that it does not matter when charge was created what matters is when charge was registered since registered charge has priority over un-registered charge.

ACQUISITION OF PROPERTY SUBJECT TO CHARGE AND MODIFICATION OF CHARGE [SECTION 79]

- **Section 77 provisions** on registration of charges apply to:
 - a. **Company acquiring property** already subject to a charge.
 - b. **Any modification** in the terms, conditions, extent, or operation of an existing registered charge.
- Hence, **registration requirements under Section 77** apply **equally** in both these cases.

Section 79(a) – Company Acquiring Property Subject to Charge:

- If a property with an existing registered charge is sold **with charge-holder's consent**,
- The **acquiring company must register** the charge under **Section 77**.
- The **old charge is vacated**, and a **new charge** is registered in the name of the acquiring company.

Section 79(b) – Modification of Charge:

- Any **change in terms, conditions, extent, or operation** of a registered charge must be **registered under Section 77**.
- **Modification** includes:
 - Change in **rate of interest** (by mutual agreement or by operation of law).
 - **Variation** in extent or operation of the charge.
 - **Assignment** of charge-holder's rights to a third party.

Examples of Modification of Charge:

1. Change in **terms and conditions** through a new agreement.
2. **Increase or decrease** in credit limits.
3. **Ceding pari passu** charge to another lender.
4. Change in **rate of interest** (other than bank rate).
5. Change in **repayment schedule** of loan (except demand working loans).
6. **Partial release** of charge on specific asset/property.

Issue of Certificate of Modification:

- When modification of charge is registered under **Section 79**, Registrar issues a **Certificate of Modification** in **Form CHG-3**.
- Such certificate is **conclusive evidence** of compliance with **Chapter VI** of the Act and related Rules.

**POWER OF REGISTRAR TO RECORD SATISFACTION/RELEASE WITHOUT INTIMATION
[SECTION 83 & RULE 8]**

1. When **property under charge is sold** to a third party and **no intimation** is given by company or charge-holder.
2. **Registrar's Authority:** If **evidence** shown to the satisfaction of Registrar that debt is **wholly/partly paid or satisfied** or **property released**, Registrar may record **memorandum of satisfaction** in register of charges.
3. Registrar may note that:
 - Debt is **satisfied in whole/part**, or
 - **Part of property/undertaking released** or **ceased** to belong to company.
4. **Information to Parties:** Registrar shall **inform affected parties** within **30 days** of making such entry
5. **Independent Power:** Registrar may act **even without company's intimation**.
6. Registrar shall issue **Form CHG-5** as **certificate of registration of satisfaction of charge**.

Question: 4

Whether **Ranjit (a third-party purchaser)** who acquired property from **ABC Ltd.**, earlier **mortgaged to OK Bank**, and **fully discharged the loan** (also recorded by the **Sub-Registrar**), can seek relief when **neither ABC Ltd. nor OK Bank** has filed **satisfaction of charge with ROC**, and what **statutory powers** the Registrar has in absence of company intimation. [MTP Sep 2024 – Series II - 5 Marks]

Answer:

Under **Section 83 read with Section 82(4)** of the Companies Act, 2013, the **Registrar has suo motu power** to enter **satisfaction or release of a registered charge** on being satisfied with evidence of repayment or release of property,

even without any filing by the company or bank; the Registrar must inform affected parties within 30 days and, in case of full satisfaction, issue Form CHG-5 (Rule 8(2)), hence Ranjit can directly approach the Registrar with proof for appropriate relief.

CHAPTER 7 - MANAGEMENT & ADMINISTRATION

Question: 1

[MTP Sep 2024 – Series II – 5 Marks] [Nov 18 – 4 Marks]

Whether **quorum was present** at the **AGM of KMN Ltd. (900 members)** held on **11 March 2018 at 11:00 A.M.**, considering presence of **3 individual shareholders (P1–P3)**, **2 authorised corporate representatives (P4–ABC Ltd., P5–DEF Ltd.)**, and **2 proxies (P6–P7)** by **11:30 A.M.**, What if P4 representing ABC Ltd., reached in the meeting after 11:30 A.M.? and the **legal consequences of absence of quorum**, including **adjournment rules and quorum at adjourned meeting**.

Answer:

- Under **Section 103**, quorum for a public company with up to 1000 members is **5 members personally present**;
- **3 individual shareholders (P1–P3)** are counted as members,
- **corporate representatives (P4, P5)** are counted as members,
- while **proxies (P6, P7)** are excluded—
- hence quorum **was present**
- but **not present** if P4 arrived after 11:30 A.M., causing **adjournment to next week same day/time/place** (or as decided by Board) with **minimum 3 days' notice**;
- if quorum is absent even at the **adjourned meeting**, **members present constitute quorum**.

Question: 2

[RTP May 20]

Whether **valid quorum** was present at the **EGM of Ajad Ltd. having 965 members**, where the **Articles require 7 members personally present**. Attendance included:

- **A as representative of the Governor of Uttar Pradesh**,
- **B and C, preference shareholders**,
- **D, authorised representative of two corporate members (Y Ltd. and Z Ltd.)**, and
- **E, F, G and H attending as proxies**,
- and the meeting agenda was **appointment of Managing Director**.

Answer:

- Under **Section 103** of the Companies Act, 2013, quorum is the **higher of statutory quorum (5) or AOA requirement (7)**;
- only **members personally present and entitled to vote** are counted—
- thus, **A counts as one, D counts as two (for Y Ltd. and Z Ltd.)**,
- **B and C are excluded** (preference shareholders with no voting rights on MD appointment), and
- **proxies are excluded**, resulting in **only 3 members present**,
- hence **quorum is not met and the meeting is invalid**.

Question: 3

Whether **valid quorum** existed at the **general meeting of QL Ltd.**, a **public company with 1,200 members**, held on **10.12.2023**, where **14 members were present in person** and **Mr. Mohan acted as authorised representative of two**

body corporates, and whether the **Chairman could adjourn the meeting** merely due to the **absence of an important member (Mr. Shyam)** despite opposition from members present.

Answer:

- Under **Section 103 of the Companies Act, 2013**, quorum for a public company having **more than 1,000 and up to 5,000 members** is **15 members personally present**;
- as per **SS-2**, an authorised representative of multiple body corporates is **counted separately for each member**,
- hence **14 persons + Mr. Mohan representing two members = 15**, meaning **quorum was present**,
- **Assumption: It is assumed that these 14 persons are inclusive of Mr. Mohan.**
- and therefore, **the Chairman had no authority to adjourn the meeting** solely on the ground of Mr. Shyam's absence.

Question: 4

[May 24 – 5 Marks] [RTP Sep 25]

The question tests **quorum requirements and consequences of absence of quorum** under **Section 103** for **LKJ Ltd.**, a company with **paid-up share capital of ₹12.50 crores and 3,500 members**, covering three situations:
(i) effect of **only 2 members present at an adjourned meeting** held on **13.05.2023** after original meeting on **06.05.2023** lacked quorum;
(ii) effect where **16 members were present initially (valid quorum)** but the meeting was **adjourned due to unruly behaviour**, and only **3 members** attended the adjourned meeting; and
(iii) consequence where the meeting was **called by requisitionists under Section 100** and quorum was absent.

Answer:

- Under **Section 103**, quorum for a company having **more than 1,000 and up to 5,000 members** is **15 members personally present**;
- if quorum is absent, the meeting (other than requisitionists' meeting) stands **adjourned to next week with minimum 3 days' notice**,
- and **at the adjourned meeting, members present constitute quorum**, hence **2 members are sufficient in case (i)**; however, where the original meeting had quorum and was adjourned **for reasons other than lack of quorum**, the adjourned meeting **must again satisfy full quorum**, so **3 members are insufficient in case (ii)**; and where a meeting is **called by requisitionists**, **absence of quorum results in cancellation** under **Section 103(2)(b)**.

Question: 5

[MTP May 23]

Whether an **AGM of Abbey Lights and Sounds Ltd.** having **2,300 members**, held on **23 August 2022 at 10:30 a.m.**, was **valid throughout its proceedings** when **18 members were present by 11:00 a.m.** (meeting commenced validly), but **4 members left at 3:00 p.m.**, reducing attendance while **Agenda 4 and 5 (special business)** were taken up and resolutions passed.

Answer:

As per **Section 103 of the Companies Act, 2013** read with **Secretarial Standard-2 (SS-2)**, **quorum must be present not only at the commencement but also during the transaction of business**; since quorum ceased to exist when Agenda 4 and 5 were discussed, the resolutions passed on those items are **invalid and a nullity**, though proceedings till Agenda 3 remain valid.

Question: 6

[Jan 2025 – 5 Marks]

The question examines **AGM-related compliances of a Section 8 company—Top Spinners Foundation**, incorporated in **2016**, having **1,200 members**, regarding:

- (i) whether the **Board is bound to act on members' suggestion to shift AGM venue** from the club-cum-registered office at **Jaipur** to a nearby hotel;
- (ii) validity of giving **15 days' notice** for AGM instead of 21 days; and
- (iii) legality of providing **only physical voting and not e-voting**, despite having **1,200 members**.

Answer:

- **Venue of AGM:** Under the **second proviso to Section 96(2)** read with **MCA Notification G.S.R. 466(E) dated 5 June 2015**, the Board must decide AGM time/place **having regard to directions (if any)** given by members; however, a **mere suggestion is not binding**, unless it amounts to a formal direction.
- **Notice period:** As per **G.S.R. 466(E)**, a **Section 8 company may give minimum 14 days' notice**; hence **15 days' notice is valid**.
- **E-voting:** Under **Section 108** read with **Rule 20 of the Companies (Management and Administration) Rules, 2014**, a **Section 8 company with 1,000 or more members must provide e-voting**; therefore, offering **only physical voting is not valid** in this case.

Question: 7

The questions collectively test **service of notice of general meetings and validity of shorter notice**, covering three situations:

- Whether a company is **liable for non-service of AGM notice** when notice was **sent by e-mail** but allegedly **not received by the member (Mr. Abhinav)**.
- Whether an **EGM can be validly called on shorter notice** when **only 60% members holding 80% of paid-up capital (₹40 lakh out of ₹50 lakh)** consent.
- Whether, for an **AGM held on shorter notice**, **larger shareholding gives greater influence**, or whether **number of members** is decisive.

Answer:

- **Service of notice by e-mail:** As per **Rule 18(3)(v) & (vi) of the Companies (Management & Administration) Rules, 2014**, once the company **transmits the notice by e-mail**, its obligation is fulfilled; it is **not liable for transmission failure beyond its control** or if the member **failed to update his e-mail ID**—hence **no contravention of Section 101** by Elixir Logistics Ltd.
- **EGM on shorter notice:** Under **Section 101(1)**, shorter notice for an EGM requires consent of **members majority in numbers holding not less than 95% of paid-up share capital carrying voting rights**; since consent was only **80% (₹40 lakh out of ₹50 lakh)**, the EGM **cannot be validly called**.
- **AGM on shorter notice:** As per **Section 101**, an AGM may be held on shorter notice **only with consent of at least 95% of members entitled to vote, irrespective of their shareholding size**; therefore, **larger shareholders do not have greater influence**, and **number of consenting members is decisive**, not the quantum of shares held.

Question: 8

Whether **Rijwan Ltd.**, a **listed company** having its **registered office at Bhiwadi, Rajasthan**, can validly hold its **6th AGM on 22 August 2019 at 3:00 PM at Ansal Plaza, Bhiwadi**, despite members' objections; and whether the legal position would **change if the company were unlisted** and proposed to hold the AGM at **Jaipur**.

Answer:

Under **Section 96(2)** of the Companies Act, 2013, an AGM must be held **during business hours (9 a.m. to 6 p.m.)** and **within the city, town or village where the registered office is situated**; hence, for a **listed company**, holding the AGM at **Ansal Plaza, Bhiwadi** is **valid**, and members' objections are not sustainable. However, in case of an **unlisted company**, the AGM **may be held at any place in India**, including **Jaipur**, **only if all members give prior consent in writing or by electronic mode**; otherwise, such AGM would be invalid.

Question: 9

[MTP Sep 2024 – Series II – 5 Marks] [RTP Sep 24] [Nov 19 – 4 Marks]

Whether a **notice of general meeting issued by Om Ltd.** is **valid under Section 102** when it proposes:
(i) **increase in authorised share capital** (without specifying the amount of increase), and
(ii) **appointment and fixation of remuneration of Mr. Prateek as auditor** (without stating the remuneration), and whether omission of such details affects the validity of the notice.

Answer:

- Under **Section 102(1) read with Section 102(2)(b)** of the Companies Act, 2013, **all special business must be accompanied by an explanatory statement disclosing all material facts**, including **amounts involved**; since **increase in authorised share capital** is a **special business**, non-disclosure of the proposed amount renders the **notice invalid**.
- Though **appointment of auditor is an ordinary business** (no explanatory statement required), the **combined notice becomes invalid** due to non-disclosure of material particulars, and hence **the shareholder's objection is valid**.

Question: 10

[Jan 2025 – 5 Marks]

Whether **members of Srinivas Iron and Steel Ltd.**, a **public sector listed company**, can issue a **valid Special Notice** for **appointment of an auditor other than the existing statutory auditor (M/s CVB & Associates)** at the AGM scheduled on **28.09.2024**, considering that **Mr. H, Mr. J and Mr. K** together hold **paid-up share capital of ₹5,00,000 (₹1,50,000 + ₹1,00,000 + ₹2,50,000)**; also the **time limit for issuing such notice** and the **company's obligation to circulate it to members**.

Answer:

- Under **Section 115 read with Rule 23 of the Companies (Management & Administration) Rules, 2014**, members holding **not less than 1% voting power or paid-up shares of at least ₹5,00,000** may issue a **Special Notice**; since the members collectively hold **₹5,00,000**, the notice is **valid** for proposing appointment of an auditor other than the retiring auditor under **Section 140(4)**.
- As per **Rule 3**, the Special Notice must be sent **not earlier than 3 months and at least 14 days before the AGM**, making **13.09.2024** the **last date**, and upon receipt, the company must **circulate the notice to all members at least 7 days before the meeting** in the same manner as general meeting notices.

Question: 11

[May 24 – 3 Marks]

The question tests the **procedure for voting by joint shareholders** under the Companies Act, 2013, where **Mr. M and Mr. P, joint holders of 500 equity shares in Primal Private Limited**, hold **conflicting views on a special business** (proposed amendment of the **Articles of Association**) at an EGM.

Answer:

In case of **joint shareholding**, voting must be exercised **in accordance with the order of seniority** unless the Articles provide otherwise; as per **Regulation 52 of Table F**, the **vote of the joint holder whose name appears first in the Register of Members prevails**, and accordingly, the resolution shall be **treated as approved or rejected based on that senior holder's vote**, irrespective of the dissent of the other joint holder.

Question: 12

[Jan 21 – 5 Marks] [MTP Sep 25 – Series II – 5 Marks]

The question examines the **procedure for signing minutes of an AGM** under the Companies Act, 2013 when **Veena Ltd. held its AGM on 15 September 2018**, presided over by **Mr. Mohan Rao (Chairman)**, who **left India on 17 September 2018 without signing the minutes**, resulting in his **inability to sign within the statutory period**.

Answer:

As per **Section 118** of the Companies Act, 2013 read with **Rule 25 of the Companies (Management and Administration) Rules, 2014**, minutes of a general meeting must be **signed within 30 days**; where the Chairman of the meeting is **unable to sign within that period**, the **last page of the minutes shall be dated and signed by a director duly authorised by the Board**, and each page shall be initialled—accordingly, in this case, the minutes may be validly signed by a **Board-authorised director** in the absence of Mr. Mohan Rao.

Question: 13

[Nov 23 – 5 Marks]

The question tests **multiple compliance issues under the Companies Act, 2013** in respect of **Majboot Cement Ltd. (MCL)**, incorporated in **July 2000**, having **authorised capital ₹1,000 crore**, **paid-up capital ₹600 crore**, and **free reserves ₹650 crore** as on **31.03.2023**. The issues examined are:

- whether MCL can **maintain its Register of Members at its Faridabad branch** when **15% members reside there** though the **registered office is in New Delhi**;
- the **nature of charge** created on **18.06.2023** for **₹325 crore (₹200 crore term loan + ₹125 crore working capital loan)** Charge was created on all the assets of company on that day for above loan of Rs. 325 crore, and whether **registration on 18.08.2023** complies with **Section 77**; and
- whether the **AGM convened on 10.09.2023** with notice given on **22.08.2023** is valid when **only 78% members consented to shorter notice**.

Answer:

- **Register of Members:** Under **Sections 88 and 94(1)**, the Register of Members must ordinarily be kept at the registered office but **may be kept at another place in India** where **more than one-tenth of members reside**, if **approved by a Special Resolution**; hence MCL can **keep the register at Faridabad** subject to passing a special resolution.
- **Charge registration:** The charge created on **all assets** on **18.06.2023** constitutes a **floating charge**; as per **Section 77**, registration is allowed within **30 days**, extendable by **another 30 days**, and further by **60 days on payment of ad-valorem fees**—since MCL filed on **18.08.2023**, it **missed the first 60-day window** but may still be **regularised within the further 60 days (up to 17.10.2023)** subject to prescribed fees.

- **Shorter notice AGM:** As per **Section 101(1)**, an AGM on shorter notice requires **consent of not less than 95% of members entitled to vote**; since only **78% consented**, the **AGM notice is not in compliance** with the Act.

Question: 14

[May 19 RTP]

Whether **Primal Limited**, a company incorporated in **India**, having **two foreign subsidiaries—Privy Ltd. (75% holding)** and **Malvy Ltd. (wholly owned)**—can validly hold its **Extraordinary General Meeting (EGM)** inside India or outside India (**Netherlands**) on an urgent basis.

Answer:

- Under **Section 100 of the Companies Act, 2013 (proviso)**, while the **Board** may call an EGM whenever it deems fit, an **EGM of a company incorporated in India must be held within India**,
- except in the case of a company which is **wholly owned subsidiary of a company incorporated outside India**;
- hence, **Primal Limited can validly hold its EGM in India but cannot hold it in the Netherlands**, irrespective of its foreign subsidiaries.

Question: 15

[MTP Jan 2025 – Series 1 – 5 Marks] [MTP March 18 – 8 Marks]

The question tests the **validity of the Chairman's decisions regarding demand and withdrawal of poll** at an **AGM of a company having share capital**, where:

- **80 members**, present **in person or by proxy**, holding **more than one-tenth of the total voting power**, demanded a **poll**, which the Chairman rejected on the ground that **only members present in person** can demand a poll; and
- During the **poll process**, the members who demanded the poll sought to **withdraw the demand**, which the Chairman again rejected, stating that **once a poll has started, it cannot be withdrawn**.

Answer:

Under **Section 109 of the Companies Act, 2013**, a poll may be demanded **by members present in person or by proxy** (where allowed) holding **not less than one-tenth of the total voting power or shares with paid-up value of at least ₹5 lakh**, and the **demand for poll may be withdrawn at any time by the persons who made it**; therefore, the **Chairman was incorrect in both cases—he could not reject the valid demand for poll, nor refuse withdrawal of the poll once demanded**.

CHAPTER 8 - DECLARATION AND PAYMENT OF DIVIDEND

Question: 1

Lalchand Ltd, proposes to declare dividend in the current year and provides you the following information:

Equity share capital (paid-up)	5 Crore
10% Preference share capital (paid-up)	2 Crore
General Reserves (Free Reserves)	1.50 Crore
Securities Premium	5 Crore
Surplus as per Profit & Loss Account	10 Lakh

Dividend declared in the past years 2019-2020, 2020-2021, 2021-2022 is 10%, 12% and 14% respectively.

Calculate the amount available to be drawn out of reserves and the maximum rate of dividend that can be declared by the company citing the relevant provisions of the Companies Act, 2013. Assume that no adequate profit was available in the current year for distribution of dividend. **[5 Marks]**

Answer:

Declaration of dividend out of reserve [Proviso to Section 123(1)]: If due to inadequacy or absence of profits in any financial year, any company proposes to declare dividend out of the accumulated profits earned by it in previous years and transferred by the company to the free reserves.

No dividend shall be declared or paid by a company from its reserves other than free reserves.

As per Rule 3 of the Companies (Declaration & Payment of Dividend) Rules, 2014, in the event of inadequacy or absence of profits in any year, a company may declare dividend out of free reserves subject to the fulfilment of the following conditions:

(1) The rate of dividend declared shall not exceed the average of the rates at which dividend was declared by it in the 3 years immediately preceding that year. However, this rule shall not apply to a company, which has not declared any dividend in each of the 3 preceding financial year.

Average rate of dividend = $10 + 12 + 14 / 3 = 12\%$

Amount required for dividend at 12% = $5,00,00,000 \times 12\% = 60,00,000$

(2) The total amount to be drawn from such accumulated profits shall not exceed 1/10th of the sum of its paid-up share capital and free reserves as appearing in the latest audited financial statement.

Paid-up share capital = $5,00,00,000 + 2,00,00,000 = 7,00,00,000$

Free Reserves = $1,50,00,000 + 10,00,000 = 1,60,00,000$

(Paid-up capital + Free Reserve) $\times 1/10$

$(7,00,00,000 + 1,60,00,000) \times 1/10 = 86,00,000$.

(3) The amount so drawn shall first be utilized to set off the losses incurred in the financial year in which dividend is declared before any dividend in respect of equity shares is declared.

Total amount to be drawn from accumulated profits [Amount calculated as per Rule (1) or (2), whichever is less]	60,00,000
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(-) Losses incurred

Amount that can be drawn from accumulated profits	60,00,000
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(4) The balance of reserves after such withdrawal shall not fall below 15% of its paid-up share capital as appearing in the latest audited financial statement.

Free Reserves	1,60,00,000
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Arjun Chhabra
(CS LLB LLM)

Amount that can be drawn from accumulated profits [Bal. Fig.]	(55,00,000)
Balance of free reserve [7,00,00,000 × 15%]	1,05,00,000
Amount calculated as per Rule (3) Rs. 60,00,000 or Rule (4) Rs. 55,00,000, whichever is less i.e. Rs. 55,00,000 will be the maximum dividend that can be paid out of free reserve of the company.	
Total amount that can be paid as dividend	55,00,000
(-) Preference dividend	(20,00,000)
Amount that can be used for paying equity dividend	35,00,000
Thus, maximum rate of equity dividend as per Rule 3 of the Companies (Declaration & Payment of Dividend) Rules, 2014 is 7%.	
Rate of dividend = $35,00,000 / 5,00,00,000 \times 100 = 7\%$	

Question: 2

- **Company:** Long Boots Ltd., a **listed company** engaged in manufacturing shoes and accessories.
- The company is in recovery mode after **8 years of inadequate profits**.
- No dividend was declared during these 8 years.
- **Proposal:**
 - The Board has **recommended dividend of ₹50 lakhs**.
 - Dividend is proposed to be paid:
 - **₹16 lakhs** from **current year profits**, and
 - **₹34 lakhs** from **accumulated profits** of past years.
- **Financial data:**
 - Accumulated profits of past 8 years: **₹170 lakhs**.
 - These accumulated profits represent **25% of total paid-up share capital**.
- **Requirement:**
 - To decide **whether dividend can be validly declared in case of inadequate profits**,
 - By examining **Section 123 of the Companies Act, 2013** read with **Rule 3 of the Companies (Declaration and Payment of Dividend) Rules, 2014**,
 - And to support the answer with **necessary calculations**.

Answer:

- **Rule 3**, Companies (Declaration and Payment of Dividend) Rules, 2014
(Declaration of dividend out of accumulated profits when current profits are inadequate)

Condition-wise compliance under Rule 3

Condition I – Rate of dividend

- Dividend rate must not exceed the **average of last 3 years' dividend rates**.
- **Exception applies** here because **no dividend was declared in each of the preceding three financial years**.
- **Condition not applicable**

Condition II – Maximum withdrawal limit

- Amount drawn from accumulated profits shall not exceed **10% of (Paid-up share capital + Free reserves)**

Calculation:

- Paid-up share capital = ₹680 lakhs (**₹170 ÷ 25%**)
- Free reserves (accumulated profits) = ₹170 lakhs
- Total = ₹850 lakhs
- 10% of ₹850 lakhs = **₹85 lakhs**
- Amount proposed to be withdrawn = **₹34 lakhs**
- ₹34 lakhs less than ₹85 lakhs → **Condition satisfied**

Condition III – Set-off of current year losses

- Withdrawn amount must first be used to **set off current year losses**, if any.
- The company has **current year profits of ₹16 lakhs**, not losses.
- **Condition satisfied**

Condition IV – Minimum reserve balance

- Balance of free reserves **after withdrawal** must not fall below **15% of paid-up share capital**.

Calculation:

- Free reserves before withdrawal = ₹170 lakhs
- Withdrawal = ₹34 lakhs
- Balance reserves = ₹136 lakhs
- 15% of paid-up share capital (₹680 lakhs) = **₹102 lakhs**
- ₹136 lakhs is more than ₹102 lakhs → **Condition satisfied**

Final Conclusion

- Since **all applicable conditions under Rule 3 are complied with**,
- **Long Boots Ltd. can validly declare dividend of ₹50 lakhs**, partly out of **current year profits** and partly out of **accumulated profits**,
- In accordance with **Section 123 of the Companies Act, 2013 read with Rule 3 of the Companies (Declaration and Payment of Dividend) Rules, 2014**.
- **Dividend declaration is legally valid.**

Question: 3

- **Company position:**
 - Accumulated **Free Reserves = ₹75 lakhs** (earned over last 5 years).
 - **No dividend declared** during these last **5 years**.
- **Current year performance:**
 - **Profit earned = ₹12 lakhs**, which is **inadequate** to meet proposed dividend.
- **Dividend proposal:**
 - Board proposes **dividend of ₹30 lakhs**, i.e. **30% on paid-up share capital**.
 - Hence, **paid-up share capital = ₹100 lakhs**.
- **Source of dividend:**
 - Partly from **current year profits** and
 - Largely from **accumulated free reserves**.
- **Issue to be examined:**
 - Whether declaration of **₹30 lakhs dividend** is valid?

Answer:

- **Section 123 (Second proviso)** – Dividend in case of inadequate profits
- **Rule 3 of the Companies (Declaration and Payment of Dividend) Rules, 2014**

Condition-wise analysis under Rule 3

Condition 1 – Rate of dividend

- Dividend rate must not exceed average rate of preceding **3 financial years**.
- **Exception:** Condition does **not apply** if **no dividend declared in all of preceding 3 years**.
- **Fact:** No dividend declared in **last 5 years**.
- **Condition 1 not applicable**

Condition 2 – Maximum withdrawal limit

- Withdrawal from accumulated profits shall not exceed **10% of (Paid-up share capital + Free Reserves)**.

Calculation:

- Paid-up share capital = ₹100 lakhs
- Free reserves = ₹75 lakhs
- Total = ₹175 lakhs
- 10% of ₹175 lakhs = **₹17.5 lakhs**
- Proposed dividend = **₹30 lakhs**
- **Violation** - Maximum permissible dividend from reserves = **₹17.5 lakhs only**

Condition 3 – Minimum reserve balance

- Balance of free reserves after withdrawal shall not fall below **15% of paid-up share capital**.

Calculation:

- Free reserves = ₹75 lakhs
- Permissible withdrawal = ₹17.5 lakhs
- Balance reserves = ₹57.5 lakhs
- 15% of paid-up capital (₹100 lakhs) = **₹15 lakhs**
- **Condition satisfied**

Final Conclusion

- Though **Condition 1** is not applicable and **Condition 3** is satisfied,
- **Condition 2 is violated** because proposed dividend of **₹30 lakhs exceeds the permissible limit of ₹17.5 lakhs**.
- Therefore:
 - The company **can declare dividend only up to ₹17.5 lakhs (17.5%)**, and
 - **Proposal to declare ₹30 lakhs (30%) dividend is invalid**.
- **Dividend proposal is invalid under Section 123 read with Rule 3 of the Companies (Declaration and Payment of Dividend) Rules, 2014.**

Question: 4

- **Company:** ESPN Heavy Engineering Ltd., a **listed company** providing engineering solutions.
- **Past performance:**
 - Consistent growth in earlier years.
 - **Dividend rates in immediately preceding 3 financial years:**
 - Year 1: **15%**
 - Year 2: **20%**
 - Year 3: **25%**
- **Current year (FY 2021–22):**
 - Company incurred **losses** due to obsolescence of machinery.
- **Interim dividend:**
 - Declared **10% interim dividend** during FY 2021–22.
- **Final dividend proposal:**
 - Board approved financial results and **recommended final dividend @15%** in its meeting held on **5 August 2022**.
 - **General Meeting held on 31 August 2022**.
- **Shareholders' demand:**
 - Since **10% interim dividend** was already declared, shareholders demanded that **final dividend should not be less than 20%**.
- **Company Secretary's stand:**
 - Final dividend **cannot be increased** beyond what is recommended by the Board.
- **Issues raised:**

- (i) Whether the company can declare **interim dividend despite current year losses**, and what should be the **correct rate**?
- (ii) Whether the **Company Secretary is correct** regarding final dividend, and what should be the **correct rate of final dividend**?

Answer:

(i) Interim Dividend

Section 123(3), Companies Act, 2013

Rule:

- Interim dividend may be declared out of:
 - Surplus in Profit & Loss Account, or
 - Profits of the financial year.
- **Proviso:**
If the company has **incurred losses during the current financial year up to the end of the quarter immediately preceding declaration**,
- Interim dividend **shall not exceed the average rate of dividend declared in the immediately preceding three financial years**.

Calculation:

- Dividend rates of preceding three years = 15%, 20%, 25%
- Average = $(15 + 20 + 25) \div 3 = 20\%$

Conclusion on Interim Dividend:

- ✓ Company **can declare interim dividend even though it incurred losses**.
- ✓ Maximum permissible rate = **20%**.
- ✓ Declared interim dividend @ **10%** is **valid and within limit**.

(ii) Final Dividend

- **Section 123(1), Companies Act, 2013**
- **Clause 80 of Table F, Schedule I**

Rule:

- Dividend is declared by the company in **general meeting**,
- **But it cannot exceed the amount or rate recommended by the Board of Directors**.
- Board recommended **final dividend @15%** on 5 August 2022.
- Shareholders demanded final dividend of **at least 20%** (10% interim + higher final dividend).

Conclusion on Final Dividend:

- Shareholders **cannot increase** the rate of final dividend beyond **15%** recommended by the Board.
- Company Secretary's view that **final dividend cannot be increased** is **legally correct**.