



Business Laws

The Companies Act, 2013



CHAPTER-5

COMPANIES ACT, 2013

INTRODUCTION

- The Companies Act, 2013 was enacted to consolidate and amend the law relating to the companies.
- The Companies Act, 2013 contains 470 sections and seven schedules. The entire Act has been divided into 29 chapters.
- A substantial part of this Act is in the form of Companies Rules.
- The Companies Act, 2013 aims to improve corporate governance, simplify regulations, strengthen the interests of minority investors and for the first time legislates the role of whistle-blowers.

THEORY QUESTIONS :

Q-1 Describe Meaning and characteristics of company.

Ans.

- **Meaning:** In terms of the Companies Act, 2013 **Section 2(20)** : A “company” means a company incorporated under this Act or under any previous company law.
- **NATURE AND CHARACTERISTICS OF A COMPANY:**
 1. **Corporate personality:** It is a different ‘person’ from the members who compose it. A shareholder cannot be held liable for the acts of the company even if he holds virtually the entire share capital. **A member does not even have an insurable interest in the property of the company. The leading case on this point is of *Macaura v. Northern Assurance Co. Limited (1925)***
 2. **Perpetual Succession:** Members may die or change, but the company goes on. Death, Unsoundness and Insolvency of all the members do not affect the existence of company.
 3. **Limited Liability:** The liability of members will be limited
 - In case of company limited by shares: Liability will be limited till the unpaid face value of shares
 - In case of company limited by guarantee: Liability will be limited till the amount of guarantee amount
 - In case of unlimited liability company: In unlimited liability company liability will be unlimited but only towards company not towards third party
 4. **Artificial Legal Person:** A company is an artificial person created by the process other than natural birth. It legal or judicial as it is created by law.
 5. **Common Seal:** Common seal is the official signature of company but by amendment of 2015 now there is no compulsion on company to have common seal.

Q-2 What is corporate veil and state the circumstances when this veil will be lifted.

Ans.

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

Case-law: The case of *Salomon v. Salomon and Co. Ltd.*

- ➞ Once a company has been validly constituted under the Companies Act, it becomes a legal person distinct from its members and for this purpose it is immaterial whether any member holds a large or small proportion of the shares, and whether he holds those shares as beneficially or as a mere
- ➞ **Lifting of Corporate Veil:**
 1. **To determine the character of the company i.e. to find out whether co-enemy or friend:** Daimler co. Ltd v/s Continental tyre & Rubber co. Ltd.: It was held that a company will be regarded as having enemy character if the persons having de facto control of company are residents of enemy country or wherever they may be they are acting on instructions of enemy.
 2. **To protect revenue/tax:** Re. Dinshaw Manekjee Petit : The assessee was receiving Huge dividend and interest income and he created three companies to reinvest the income for reducing the tax burden, the companies were having no business other than receiving investment and giving back to assessee as a pretended loan. It was held that company was not more than the assessee himself and the assessee was held liable to pay the tax.
 3. **To avoid a legal obligation:** Where it was found that the sole purpose for the formation of the company was to use it as a device to reduce the amount to be paid by way of bonus to workmen, the Supreme Court upheld the piercing of the veil to look at the real transaction (***The Workmen Employed in Associated Rubber Industries Limited, Bhavnagar vs. The Associated Rubber Industries Ltd., Bhavnagar and another.***).
 4. **Formation of subsidiaries to act as agents:** A company may sometimes be regarded as an agent or trustee of its members, or of another company, and may therefore be deemed to have lost its individuality in favour of its principal. Here the principal will be held liable for the acts of that company.
 5. **Company formed for fraud/improper conduct or to defeat law:** Where the device of incorporation is adopted for some illegal or improper purpose, e.g., to defeat or circumvent law, to defraud creditors or to avoid legal obligations.

Q-3 Describe about Private company and public company.

Ans.

Private Company:

- ➞ **Meaning:** Private company is a company which may by its articles restrict the following:
 - Restrict the right to transfer shares.
 - Limits the number of members to 200 (which excludes Employees/Ex- employees and treating Joint holders as single member)
 - Prohibits invitation to public to subscribe for any securities

Other Criteria:

- It should have minimum paid up capital as may be prescribed
- It should have Minimum 2 members and maximum 200 (other than OPC)

- It should have minimum 2 directors.

Public Company:

Meaning:

- Company which is not private company is considered as Public Company.
- A subsidiary of Public company is also a public company.

Other Criteria:

- It should have minimum paid up capital as may be prescribed
- It should have minimum 7 members and there is no maximum limit.
- It should have minimum 3 directors

Q-4 Give Meaning of Holding and Subsidiary company.

Ans.

- ⇒ If one company is holding
- ⇒ Either more than:
 - 50% directors(Management control)
e.g. If B Ltd is having 6 directors and out of that more than 50% i.e. 4 or more directors can be appointed or removed by the direction of A Ltd then A Ltd will be considered as holding company and B Ltd will be considered as subsidiary.
 - 50% voting power(Ownership control)
e.g if B Ltd is having Rs.10 lacs as Paid up capital and A Ltd. is holding more than 50% of paid up capital than A Ltd will be considered as holding company and B Ltd will be considered as subsidiary company.
 - Indirect holding
e.g If A Ltd is holding company of B Ltd and B Ltd is holding company of C Ltd then A Ltd will by default become holding company of C Ltd
 - In other company
 - Then it is said to be the holding company of another company
 - **Related Provision (Associate Company):** "Associate company", in relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company. Explanation provides that "significant influence" means control of at least twenty per cent. of total share capital, or of business decisions under an agreement.

Q-5 Give meaning of Government Company.

Ans.

- Where Minimum 51% shares are held by:
 - State government
 - Central Government
 - State and Central Government combined
 - It is known as Government Company.
 - Audit of such company will be done by Comptroller & Auditor General of India.

Q-6 What is meant by a Guarantee Company? State the similarities and dissimilarities between a Guarantee Company and a Company having Share Capital.

Ans.

Meaning: The company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake by the memorandum to contribute to the assets of the company in the event of its being wound up.

Thus, the liability of the member of a guarantee company is limited upto a stipulated sum mentioned in the memorandum. Members cannot be called upon to contribute beyond that stipulated sum.

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

Similarity: The common features between a 'guarantee company' and 'share company' are legal personality and limited liability.

Difference: In the guarantee company the members may be called upon to discharge their liability only after commencement of the winding up and only subject to certain conditions; but in the company limited by shares, they may be called upon to do so at any time, either during the company's life-time or during its winding up.

Q-7 Describe about Section 8 company.

Ans.

Meaning: When a person or an AOP wants to be registered as a limited company and it

- Has in its objects the promotion of Commerce, Arts, Sports, Education, Research, Social welfare, Religion, Charity, Protection of Environment or any such other object.
- Intends to apply its profit or other income on promoting its objectives
- Intends to prohibit the payment of any dividend to its members.

Characteristics, advantages and disadvantages:

- The Central Government may permit such registration as a limited company under this section.(Section.8)without addition of words "Limited" and "Private Limited".
- A firm can be a member of such company.
- The MOA and AOA of this company cannot be altered without government's prior approval.
- Central Government can also revoke the license so granted after giving an opportunity of being heard to the company.
- Government can also pass order of winding up of such company.
- Government can also pass order for amalgamation of such company.

Q-8 Describe about OPC.

Ans.

Meaning: "One person company means a company which has only one person as a member."

Provisions:

- Person incorporating an OPC must be a natural person, an Indian Citizen and Resident in India.
- MOA of this company should also include the name of a nominee who, in case of incompetence of original member become the member of such company.
- The nominee must also be the Indian Citizen as well as Resident and must give a written consent to be the nominee for such OPC.

- No person shall be eligible to incorporate more than one OPC or be a nominee of such company.
- Nominee's name with the written consent should be filled with ROC .
- Nominee may withdraw his consent at anytime by giving notice to sole member of the company. In such a case, the sole member shall give another nomination in the same manner within 30 days of withdrawal.
- When the sole member dies or becomes incapacitated from contracting then the nominee is sole member, he has to nominate another natural person.
- **Prohibition on Voluntary Conversion:** OPC cannot get itself converted into any other company until 2 years of Incorporation
- **Mandatory Conversion:** OPC should convert itself to private or public co. in the following situations:
 - Where paid up capital exceeds Rs.50 lakhs; or
 - Where the average annual turnover for the past 3 F.Y. exceeds Rs.2 Crores; or
 - Within 30 days , the OPC shall give notice of its conversion to the ROC.

Q-9 Describe about Doctrine of Ultravires

Ans.

Meaning: The meaning of the term ultra vires is simply "beyond (their) powers".

- It is a fundamental rule of Company Law that the objects of a company as stated in its memorandum can be departed from only to the extent permitted by the Act - thus far and no further **[Ashbury Railway Company Ltd. vs. Riche]**. In consequence, any act done or a contract made by the company which travels beyond the powers not only of the directors but also of the company is wholly void and inoperative in law and is therefore not binding on the company.
- The impact of the doctrine of ultra vires is that a company can neither be sued on an ultra vires transaction, nor can it sue on it. Since the memorandum is a "public document", it is open to public inspection. Therefore, when one deals with a company one is deemed to know about the powers of the company. If in spite of this you enter into a transaction which is ultra vires the company, you cannot enforce it against the company.
- **The whole position regarding the doctrine of ultra vires can be summed up as:**
- When an act is performed, which though legal in itself, is not authorized by the object clause of the memorandum, or by the statute, it is said to be ultravires the company, and hence null and void.
- An act which is ultravires, the company cannot be ratified even by the unanimous consent of all the shareholders.
- An act which is ultravires the directors, but intravires the company can be ratified by the members of the company through a resolution passed at a general meeting.
- If an act is ultravires the Articles, it can be ratified by altering the Articles by a Special Resolution at a general meeting.

Q-10 Describe about Doctrine of Constructive notice and indoor management.

Ans.

Doctrine of Constructive Notice:

- This doctrine is in favour of a company i.e., it creates a presumption in favour of a company.
- **Effect Of this doctrine:**
 - Once registered MOA and AOA becomes the public documents. Therefore, any person dealing

with company is presumed to have read the Memorandum and Articles correctly.

- The doctrine prevents any person dealing with a company alleging that he did not read the provisions contained in MOA and AOA.

Case Law: (Kotla Venakataswamy v/s C Rammurthi)

- The Articles of a company required that all the documents and deeds of the company shall be signed by MD, the secretary and a working director of a company.
- A mortgage deed was signed by secretary and a working director only.
- It was held that the mortgage deed was invalid even though the plaintiff had acted in good faith and money was utilised for benefit of the company.

Doctrine of Indoor Management

- This Doctrine operates in favour of the outsiders.

Meaning:

As per this doctrine, outsiders dealing with the company are not required to enquire into the internal management of the company.

Outsiders dealing with the company are entitled to assume that as far as internal proceedings of the company are concerned, everything has been done regularly.

- **Effect:** If a contract is entered into on behalf of company by any director or officer of company, It is enforceable against the company if provisions contained in the MOA and AOA are fulfilled, even though while entering into a contract some irregularity had arisen of which the outsider was unaware.

Case law : (Royal British Bank v/s Turquand)

- The articles of a company stated that the directors could borrow money on behalf of a company, if they are authorized by a resolution passed by the shareholders in GM.
- The directors borrowed money from T without being authorized by shareholders.
- T lent money assuming that shareholders had authorized the directors.
- It was held that borrowing of money without any authorization was internal irregularity and since T had no knowledge of such irregularity he was not bound.

Conclusion: The benefit can be availed:

- If the person has knowledge of the MOA and AOA
- He has no knowledge of internal irregularity.

Q-11 Describe the concept of shares and share capital.

Ans.

Meaning: A share represents such proportion of the interest of the shareholders as the amount paid up thereon bears to the total capital payable to the company. It is a measure of the interest in the company's assets to which a person holding a share is entitled.

- **Equity share capital —**

Meaning: 'Equity share capital', with reference to any company limited by shares, means all share capital which is not preference share capital;

Types:

- (1) with voting rights; or

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

Q-12 Describe about the consequences where company was registered by providing false information.

Ans.

- **Furnishing of false or incorrect information or suppression of material fact at the time of incorporation (i.e. at the time of Incorporation):** If any person furnishes any false or incorrect particulars of any information or suppresses any material information, of which he is aware in any of the documents led with the Registrar in relation to the registration of a company, he shall be liable for action for fraud under section 447.
- **Company already incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact (i.e. post Incorporation):** Where, at any time after the incorporation of a company, it is proved that the company has been got incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporating such company, or by any fraudulent action, the promoters, the persons named as the first directors of the company and the persons making declaration under this section shall each be liable for action for fraud under section 447.
- **Order of the Tribunal :**
- Where a company has been got incorporated by furnishing false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration led or made for incorporating such company or by any fraudulent action, the Tribunal may, on an application made to it, on being satisfied that the situation so warrants,—
 - o pass such orders, as it may think fit, for regulation of the management of the company including changes, if any, in its memorandum and articles, in public interest or in the interest of the company and its members and creditors; or
 - o direct that liability of the members shall be unlimited; or
 - o direct removal of the name of the company from the register of companies; or
 - o pass an order for the winding up of the company; or
 - o pass such other orders as it may deem fit:
 - o Provided that before making any order,—
 - o the company shall be given a reasonable opportunity of being heard in the matter; and
 - o Tribunal shall take into consideration the transactions entered into by the company, including the obligations, if any, contracted or payment of any liability.

CLASS WORK

MULTIPLE CHOICE QUESTIONS

1. Maximum number of members under a private company as provided under the Companies Act, 2013.
(a) 50 (b) 150 (c) 200 (d) No limit
2. Document that regulates the management of internal affairs of a company are-
(a) Memorandum of Association (b) Prospectus
(c) Article of Association (d) Certificate of incorporation
3. Under the Companies Act, 2013, "Significant influence" constitutes how much % of total share capital or of business decisions under an agreement?
(a) At least 2% (b) At least 2.5% (c) At least 10% (d) At least 20%
4. A Private Company which is subsidiary of a Public Company is treated as-
(a) Public Company (b) Private Company (c) Holding Company (d) Family Company
5. Which one of the following is not the content of the Memorandum of Association?
(a) Name clause (b) Registered office clause
(c) Objects clause (d) Board of Directors clause.
6. An Act is said to be ultra vires a company when it is beyond the powers.
(a) Of the Company
(b) Of the Directors
(c) Of the Directors but not the company
(d) Conferred on the company by the Articles of Association.
7. Turquand Rule is related to:
(a) Doctrine of ultra vires (b) Doctrine of constructive notice
(c) Doctrine of indoor management (d) Doctrine of subrogation
8. The minimum number of members in a private company and public company are
(a) Three and Seven respectively (b) Two and seven respectively
(c) Two and nine respectively (d) None of the above

PRACTICAL PROBLEMS

1. Four persons are the only members of a private company. All of them go for a pleasure trip in a car and due to an accident all the four die. Does the private company exist?
2. Radhika was having a huge dividend income and that income was exempt from tax if it is invested in other companies so she formed three companies and invested the income from dividend and interest into the companies which in return gave that amount as a pretended loan to Radhika. Discuss what should be done in this case.

HOME WORK

Case Studies :

- (a) Four persons are the only members of a private company. All of them go for a pleasure trip in a car and due to an accident all the four die. Does the private company exist?

(Hint: Characteristics of company)

- (b) Radhika was having a huge dividend income and that income was exempt from tax if it is invested in other companies so she formed three companies and invested the income from dividend and interest into the companies which in return gave that amount as a pretended loan to Radhika. Discuss what should be done in this case.

(Hint: Lifting of corporate veil)

- (c) Describe about Incorporation Process of company.

- (d) Can a member take insurance on assets of company explain with relevant case.

(Hint: Corporate personality)

