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HISTORY AND ADMINISTRATION OF COMPANY LAW IN INDIA

BRIEF HISTORY UPTO 1956

THE company legislation in India has tended to follow to a very large measure the company legislation in England. The Companies Acts passed from time to time in India and their amendments have been modelled on the English Companies Acts. The first company legislation in India was passed in 1850 and it provided for registration of joint stock companies. This was passed on the lines of the English Companies Act of 1844. This Act of 1850 recognised the concept of separate legal entity for a company, but it did not confer the privilege of limited liability of members. Following the English Companies Act of 1855, another Act was passed in India in 1857. In this Act, the privilege of limited liability was introduced for the first time in India. However, this benefit of limited liability was not extended to banking and insurance companies. It was done only in 1860.

Then came the Companies Act of 1866 which was based on the English Companies Act of 1862 and was repealed by the Act of 1882. The latter remained in force till 1913. During the period 1882-1913, the following amendments were passed in India:

(*i*) Companies (Amendment) Act, 1887.
(*ii*) Companies (Memorandum of Association) Act, 1895.
(*iii*) Companies (Branch Registers) Act, 1900.
(*iv*) Companies (Amendment) Act, 1910.

In 1913, the Indian Companies Act of 1913 was passed. This was based on the English Companies (Consolidation) Act, 1908, with certain additional provisions to satisfy the peculiar business conditions in this country. The most outstanding feature of the Act of 1913 was that it introduced the institution of private companies in the corporate sector in India. Some minor amendments were made in 1914, 1915, 1920, 1926 and 1932. This Act of 1913, however, did not provide for certain peculiarities

of the Indian commercial world such as managing agency system and was, therefore, found to be highly unsatisfactory in several respects in the course of its working.

In order to remove these deficiencies and to control the evils of the managing agency system, the Indian Companies (Amendment) Act was passed in 1936 and it became operative from 15 January 1937. For the first time, the term "managing agent" was defined and provisions were made to regulate their activities. Holding and subsidiary companies were also identified by the Amendment Act of 1936 and suitable provisions were introduced to control their working. Other major amendments concerned the accounts of the company, meetings of shareholders and winding up of the company. Voluntary winding up was divided into two parts: (*a*) members' voluntary winding up; and (*b*) creditors' voluntary winding up.

A special chapter (Part X–A) was incorporated for banking companies. The special chapter was later repealed by the Banking Companies Act, 1949. Similarly, a special chapter was introduced for insurance companies which has been repealed by the Insurance Companies (Amendment) Act, 1950.

From 1937 to 1951, there have been minor amendments in the Act almost every year. The Indian Companies (Amendment) Act, 1951, empowered the Central Government to intervene directly in the affairs of a company. Powers of the court were extended so as to enable it to take suitable action when the affairs of a company were being conducted in a manner either prejudicial to its interests or oppressive to some of its members.

At the end of Second World War, the need was felt for making amendments in existing company law, as a sudden increase in industrial production in response to the growing tempo of war demands had brought with it several malpractices in the formation and management of companies. Moreover, the Cohen Committee in England had made its report suggesting several important changes in the English Companies Act, 1929. On 25 October 1950, the Government of India appointed a committee of twelve members representing various interests under the chairmanship of Mr H.C. Bhabha, to consider and report on the required amendments in the Indian Companies Act, 1913 with due regard to conditions necessary for the healthy growth of joint stock companies and the need for safeguarding and protecting the interests of investors and the public.

THE COMPANIES ACT, 1956

The Companies Act, 1956 constitutes the law relating to companies in India. It came into force with effect from 1 April 1956 and repeals all earlier Acts and subsequent amendments. The Companies Act, 1956 is based on the recommendations of the Bhabha Committee which submitted its report in 1952, recommending wholesale amendments in the Indian Companies Act, 1913 and it also incorporates most of the changes introduced in English Company Law by the English Companies Act of 1948. It contains 658 sections and 14 schedules and marks a distinct improvement on the Act of 1913.

The main objectives underlying the Companies Act, 1956 were:

(*i*) the maintenance of a minimum standard of good behaviour and business honesty in company promotion and management;

(*ii*) due recognition of the legitimate interests of shareholders and creditors and of the duty of managements not to prejudice those interests;

(*iii*) a full and fair disclosure of the affairs of companies in their published annual accounts;

(*iv*) recognition of the rights of shareholders to receive reasonable information and facilities for exercising an intellegent judgement with reference to the management;

(*v*) provisions for investigations in the affairs of any company managed in a manner prejudicial to the interests of minority shareholders, the company or the general public;

(*vi*) enforcement of the performance of duties by those engaged in the management of the companies; and

(*vii*) the establishment of an appropriate authority for administration of the Act in addition to enforcing the provisions of the Companies Act.

Mr. C.D. Deshmukh, the then Minister of Finance, pointed out that the Companies Act, 1956, was reflection of the Government's economic policy of introducing a socialistic pattern of society. The Act aimed at discouraging the concentration of economic wealth in a few hands and securing its more equitable distribution.

The Companies Act, 1956, made far-reaching changes in connection with:

(*i*) promotion and formation of companies;

(*ii*) capital structure of companies;

(*iii*) issue of prospectus by companies;

(*iv*) powers and responsibilities of directors and managing agents;

(*v*) company meetings;

(*vi*) maintenance and audit of company accounts;
(*vii*) powers of inspection and investigation of the affairs of the companies; and
(*viii*) administration of company law.

Scope of the Act

The Companies Act of 1956 extends to the whole of India subject to the following exceptions:

(*a*) In regard to the State of Nagaland, the Act provides that it shall apply only subject to such modifications, if any, as the Central Government may specify by the notification in the Official Gazette. [Sec. 1(3)]

(*b*) In respect of companies in the State of Goa and Union Territory of Daman and Diu, the Central Government may direct that the provisions mentioned in the notification shall not apply or will apply with modifications to any existing company or a company registered after 26 January 1963. (Sec. 620-B).

(*c*) In its application to Jammu and Kashmir, the Central Government may direct that the provisions mentioned in the notification will not apply or will apply with modifications to companies. The provisions of the Companies Act, 1956 were made applicable to Jammu and Kashmir by the Central Laws (Extension to Jammu and Kashmir) Act, 1968. (Sec. 620-C)

AMENDMENTS TO THE COMPANIES ACT, 1956

The Companies Act, 1956 has been amended from time to time to protect investors, to ensure efficient and honest management of the affairs of companies, to prevent undesirable persons from managing the affairs of companies, to discourage the concentration of economic power and wealth and to help in achieving the objectives of a socialistic pattern of society.

The Companies (Amendment) Act, 1960

In 1957, the Central Government appointed a committee known as the Sastri Committee to review the Companies Act, 1956. On the basis of recommendations by the Sastri Committee, the Companies Act, 1956, was amended for the first time by the Companies (Amendment) Act, 1960. The Amendment Act not only amended the provisions of the main Act but also introduced various new provisions mainly in the interests of fair and honest company management and the investing public. It also provided certain provisions to overcome the practical difficulties encountered in the working of the Act of 1956.

The Companies (Amendment) Act, 1962

The objective of this amendment was to empower the board of directors to contribute as much as it thinks fit to the National Defence Fund or any other fund approved by the Central Government for the purpose of national defence by insertion of Section 293-B. It also provided for disclosure in the profit and loss account of the company of the total amount or amounts contributed by it to the said fund.

The Companies (Amendment) Act, 1963

This provided for the establishment of a Companies Tribunal. However, the Companies Tribunal (Abolition) Act, 1967, abolished the Companies Tribunal. The main function of this Tribunal was to detect cases of fraud and misfeasance in the management of companies. The 1963 amendment also constituted a Board of Company Law Administration under Section 10 E. It also defined its powers and functions.

The Companies (Amentment) Act, 1964

This intended to provide temporary protection to employees of companies during investigations by an inspector or pendency of proceedings before the court, in certain cases under Section 635B.

The Companies (Amendment) Act, 1965

This introduced to provide the following changes:

(*i*) The Advisory Commission was replaced by an Advisory Committee. (Sec 410)

(*ii*) No new business could be started by a company without the approval of the shareholders by special resolution. [Sec. 149(2)]

(*iii*) Restrictions on the currency of blank transfers were imposed. [Sec. 108 (1A)]

(*iv*) The objects clause was to be divided into two parts: (*a*) main objects and objects incidental or ancillary to main objects; and (*b*) other objects. (Sec. 13)

(*v*) Companies engaged in mining, manufacturing, processing or production were to have accounts relating to utilization of materials, labour and other items of cost as may be prescribed. [Sec. 209 (4)]

(*vi*) A cost audit of companies engaged in mining or manufacturing on the directions of the Central Government. [Sec. 233(B)]

The Companies (Amendment) Act, 1966

Changes were introduced in respect of the production of documents

and evidence under Section 240, and loans to companies under the same management under Section 370.

The Companies (Second Amendment) Act, 1966

It amended Section 108 so as to exempt production of a proper instrument of transfer where shares are deposited by way of security for payment of loans and advances, or for the performance of any obligation subject to certain conditions.

The Companies Tribunal (Abolition) Act, 1967

It abolished the Companies Tribunal constituted under Section 10A. Its powers and functions were transferred back to the Central Government.

The Companies (Amendment) Act, 1969

This made two very important changes. One was to prohibit companies from contributing any money to any political party or for any political purpose to any individual or body by Section 293A. The second amendment was to abolish the institution of managing agents and secretaries and treasures with effect from 3 April 1970.

The Companies (Amendment) Act, 1974

This introduced major amendments in company law in India. It came into force w.e.f. 1 February 1975. Its basic intention has been to protect public interest and help the Government in achieving the objectives of a socialistic pattern of society. Important changes are:

1. The definition of prospectus has been enlarged and henceforth any document inviting deposits from the public shall be treated as a prospectus and all provisions of this Act in respect of prospectus shall be applicable to such advertisement. [Secs. 2(36) and 58(B)]

2. The strength of the Company Law Board has been increased from five members to nine. [Sec 10E (2)]

3. The power of the court in respect of confirmation of alternations of object clause or registered office clause (for shifting the registered office from one State to another) has been transferred to the Company Law Board. (Secs. 17 to 19)

4. The scope of section 43-A has been extended by inserting two sub-sections 43A (1A) and 43A(1B). These two sub-sections lay down certain conditions (*viz.,* those with average annual turnover of rupee one crore or more for three consecutive years or those holding not less than twenty five per cent of the paid share capital of a public company), and private companies satisfying these conditions shall be deemed to be public

companies.

5. Section 58A empowers the Central Government to regulate all public deposits. The Central Government has the power to prescribe the limits up to which, manner in which, and the conditions subject to which deposits may be invited and accepted by the companies either from the public or from members.

6. Provisions of Section 73 in respect of allotment of shares and debentures to be dealt in on stock exchanges have been substantially changed so as to provide greater protection to investors and underwriters.

7. The power of the court to sanction issue of shares at a discount has been transferred to the Company Law Board. (Sec 79)

8. A number of restrictions have been laid down on acquistion and transfer of shares in bodies corporate and in foreign companies to regulate the cases of 'take-over bids' by groups or combines (Secs. 108A to 108H)

9. The power of the court to order rectification of register of charges has been vested in the Company Law Board. (Sec. 141)

10. The power of the court to call an extraordinary general meeting has been vested in the Company Law Board. (Sec. 186)

11. With a view to controlling benami-holding of shares, all benami-holdings are required to be declared by benami-holders and beneficial owners. The Amendment Act also empowers the Central Government to appoint one or more inspectors to investigate and report as to whether the above provision has been complied with. (Secs. 187C and 187D).

12. Section 204A imposes certain restrictions on the appointment of former managing agents, secretaries and treasures to any office in the company. Such appointments can be made only with the previous approval of the company in a general meeting and of the Central Government. This restriction shall last for a period of five years from the date of the commencement of the Amendment Act of 1974. It intends to restrain former managing agents, secretaries and treasurers from controlling the companies in one way or another.

13. A company cannot declare dividend out of its distributable profits for any financial year arrived at after providing for depreciation, except after the transfer to the reserves of the company of such percentage of its profits for that year, but not exceeding ten per cent, as may be prescribed. [Sec. 205 (2A)]

14. The Amendment Act, 1974, has also inserted new provisions in respect of unpaid dividends under Section 205A.

15. The report of board of directors shall include a statement showing the name of every employee getting a remuneration of not less than Rs

36,000 per annum, his relationship, if any, with any of the directors or manager of the company, the name of such director or such other particulars as may be prescribed. (Sec. 217)

16. Two new sub-sections (IB) and (IC) have been added to Section 224. These sub-sections restrict the number of companies in which an individual or a firm can be appointed as auditor. Section 224A which has been inserted by the 1974 amendment lays down certain cases where a special resolution is required for appointment of auditors.

17. The provisions in respect of audit of cost accounts in certain cases have been substantially improved. (Sec. 233B)

18. For appointment and subsequent reappointment of a person as a managing or whole-time director, the Central Government's approval is required. While according its approval, the Central Government may accord approval to the appointment for a period less than the period for which the person is proposed to be appointed by the company. This is not applicable to an independent private company. (Sec. 269)

19. The Central Government is also empowered to prohibit the appointment of a sole selling agent where demand for goods of any category to be specified by the Government is substantially in excess of production or supply of such goods, and that the services of a sole selling agent will not be necessary to create a market for such goods. Moreover, in certain other cases appointment of a sole selling agent will be made only with the approval of the Central Government. (Sec. 294AA)

20. Where the paid-up share capital is not less than one crore and the directors desire to enter into any contact for the sale, purchase or supply of any goods, materials or services with the company, the prior approval of the Central Government will be required in addition to the sanction of the board of directors. (Sec. 297)

21. Section 388A, inserted by the Amendment Act, 1974, provides that every company having a paid-up share capital of rupees twenty-five lakhs or more shall have a whole-time qualified secretary. A firm or body corporate cannot be appointed as secretary.

22. Previously the Central Government could appoint two directors to prevent oppression or mismanagement. Now the 1974 amendment empowers the Central Government to appoint such number of persons as directors as it may consider necessary or appropriate to safeguard the interests of the company or its shareholders or public interest. The Central Government may also require the persons appointed as directors to report to the Central Government from time to time with regard to the affairs of the company. (Sec. 408)

23. A foreign company in which not less than fifty per cent of the paid-up capital is held by one or more citizens of India or one or more body

corporates incorporated in India, whether singly or in the aggregate, such company shall comply with such provisions of this Act as may be prescribed with regard to the business carried by it in India, as if it were a company incorporated in India. (Sec. 591)

24. Provisions of Sections 159 (relating to annual return), 209 and 209A (relating to books of account and their inspection), 233A and 233B (relating to special audit and cost audit) and 234 to 246 (relating to inspection and investigation) shall be applicable to foreign companies having as established place of business in India. (Sec. 600)

25. The 1974 amendment has also empowered the Central Government to restrict the remuneration payable to managerial personnel within the limits specified in this Act. (Sec. 637AA)

The Companies (Amendment) Act, 1977

It came into force w.e.f. 24 December 1977. This amending Act introduced the following changes:

1. The Amendment Act has empowered the Central Government to grant partial relaxation like extention of time to any company or class of companies for the repayment of deposits or exemption from one or more of the provisions of Section 58A in deserving cases. Section 58A empowers the Central Government to make rules for regulating the acceptance of deposits by companies from its members or the public.

2. Section 220 has also been amended and now it provides that even where the annual general meeting of the company for any year has not been held on account of any reasons, three copies of the balance sheet and the profit and loss account should be filed with the Register within thirty days from the latest date on or before which that meeting should have been held in accordance with the provisions of the Act. This is to enable the shareholders and other persons to find out, from inspection of the said documents in the Registrar's office, the affairs of the company and its financial condition.

3. The ceiling for donation to charitable and other funds (not directly relating to the business of the company or the welfare of its employees) has been raised from Rs 25,000 to Rs 50,000 [Sec. 293(1)(e)]

4. Section 620 of the Companies Act, 1956, empowers the Central Government to modify, by notification, any of the provisions of the Act in its application to a particular Government company or to Government companies in general. According to amended provisions, every notifications proposing to make such modifications is required to be placed before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions. Before this amendment, the period of thirty days was

required to be completed in one session which posed difficulties to the Government. This amendment shall be deemed to come into force w.e.f. 1 February 1975.

5. The Company Law Board has been given the power of an execution court by Section 634A, inserted by the Amendment (Act) of 1977. This section authorises the Company Law Board to execute or enforce its orders under Sections 17, 18, 19, 79, 141 and 186 in the same manner as it were a decree issued by a court.

The Companies (Amendment) Act, 1985

It come into force w.e.f. 24 May 1985. This amending Act introduced the following changes:

1. By substituting a new Section for Section 293A, the Companies (Amendment) Act of 1985 has lifted the blanket ban on political contributions by companies. The amended provisions permit non-government companies which have been in existence for not less than three financial years, to contributed money, directly or indirectly, to any political party or to an political person for political purposes. The amount contributed in any financial year shall not exceed five per cent of the average net profits of three immediately preceeding financial years. Contribution should be authorised by a resolution passed at a meeting of a board of directors of the company.

Such contributions are required to be disclosed by every company in its profit and loss account, giving details of the total amount contributed and the name of the party or person to which or to whom such amount has been contributed.

2. Section 396 has been amended and now it provides that any person aggrieved by an assessment of compensation made by the prescribed authority under an order of amalgamation, is entitled to prefer an appeal to the Company Law Board and thereupon the assessment of the compensation shall be made by the Company Law Board.

3. Section 529 and 530 have been amended and a new section 529A has been inserted. According to the amended provisions, the dues of the workmen have been equated with those of secured creditors by providing that the security of every secured creditor shall be deemed to be subject to a *pari passu* charge in favour of workmen. Section 529A provides that the workmen's dues as equated with those of secured creditors shall have priority over all other debts including preferential payments listed in Section 530.

The Companies (Amendment) Act, 1988

The Companies (Amendment) Act, 1988 has been brought out in the

light of the recommendations made by the Expert Committee (Sachar Committee) and in the light of the experience gained by the Central Government in the administration of the Companies Act, 1956 over the last few years. It seeks to plug loopholes in the law and remove some lacunae which had come to surface in the working of the Act. It is also proposed to streamline some of the existing provisions for better working and administration of the Act.

The Companies (Amendment) Act, 1988 was notified in the Official Gazette dated 27th May, 1988. Besides amending various sections of the Companies Act, 1956, the Amendment Act of 1988 has introduced two new Schedules XIII and XIV. Schedule XIII relating to depreciation rates has been made applicable retrospectively from 2nd April, 1987, while most of the provisions of the Companies (Amendment) Act. 1988 have been brought into force with effect from 15th June, 1988. Brief details of the Amendment Act of 1988 are given below.

1. Secretary. The definition of secretary has been brought in line with the definition of company secretary as contained in the Company Secretaries Act, 1980 and includes an individual possessing the prescribed qualification. [Sec. 2(45)]

The concept of secretary in whole-time practice has been introduced by the newly inserted Section 2 (45A). A secretary in whole-time practice means a company secretary in practice as defined in the Company Secretaries Act and who is not in full-time employment. A secretary in wholetime practice can be engaged for certifying compliance with certain requirements of the Act.

2. Independent Company Law Board. Section 10E has been amended to provide for establishing an independent Company Law Board. Prior to this amendment, the Company Law Board was subject to the control of the Central Government. Many of the powers presently being exercised by the court or the Central Government have been transferred to the Company Law Board. In the exercise of its powers and the discharge of its functions, the Company Law Board shall have the power to regulate its own procedure and it shall be guided by the principles of natural justice. The Central Government is empowered to appoint chairman and members of the Company Law Board and to prescribe qualifications and experience of the members.

The decisions of the Company Law Board will be final on matters of facts. However, the orders of the Company Law Board will be applicable to the High Court on question of law within 60 days from the date of the communication of the order.

3. Deemed to be public companies. Under the amended Section 43A, the limit of average annual turnover of Rs 1 crore or more during three

preceding years as the criterion for deeming a private company as public company has been raised to Rs 5 crores or more. The newly inserted sub-section (1C) to Section 43A provides that a private company which invites deposits from the public through an advertisement, shall also become a public company.

4. Abridged prospectus. With a view of reducing the cost of public issue of capital, the form of application for shares/debentures will now be accompained by a memorandum containing such salient features of the prospectus as may be prescribed, instead of a full prospectus. However, copy of full prospectus will be made available only if requested by an investor.

5. Repayment of deposits. As a measure of protecting the interest of depositors, Section 58A has been amended to provide for compulsory repayment of deposits on maturity unless renewed in accordance with the prescribed rules. It also empowers the Company Law Board to take cognizance of any case of non-repayment of deposits on maturity, either on its own motion or on the application of any depositor.

6. Compulsory listing of all public issues. Section 73 has been amended to provide for compulsory listing of all public issues with at least one recognised stock exchange.

7. Preference shares. No company can now issue irredeemable preference shares or preference shares which are redeemable after the period of ten years from the date of issue. [Sec. 80 (5A)]

8. Extension of the validity period of transfer deed. Validity period of instrument of transfer in the case of listed shares has been extended from two months to twelve months. (Sec. 108)

9. Appeal against refusal to register transfer of shares. Companies are now required to give reasons for not accepting a transfer of shares. Prior to the amendment, the Central Government had the power to hear appeals against the decision of a company refusing to register a transfer of shares. This power has now been transferred to the Company Law Board. In addition, the power to order rectification of register of members, which was earlier vested in the High Court, has also been transferred to the Company Law Board.

10. Delivery of share certificates. It is now obligatory on the part of companies to deliver the certificates of shares and debentures within 3 months of allotment or with 2 months after the application for registration of transfer is made. (Sec. 113)

11. Delayed filing of particulars of charges. The Registrar of Companies has been empowered to accept delayed filing of particulars of charges within a period of 30 days beyond the prescribed period on payment of additional fee as against 7 days prior to the amendment. (Sec.

125)

12. Annual return. Annual returns containing full particulars as to the past and present members shall now be filed once in every six years as against once in every three years as at present. (Sec. 159)

13. Demand for poll. Poll can now be demanded by members having not less than one-tenth of the total voting power or having shares on which an aggregate sum of not less than Rs 50,000 has been paid up. (Sec. 179)

14. Managerial remuneration in cases of losses or inadequate profits. Where a company has losses or its profits are inadequate, the approval of the Central Government is required for payment of minimum remuneration to a managerial personnel. However, the approval of the Central Government shall not be required for payment of minimum remuneration to a managerial personnel so long as the appointment and remuneration are in accordance with Section 269. [Sec. 198(4)]

15. Depreciation. Depreciation shall now be calculated in accordance with the rates specified in Schedule XIV of the Companies Act, 1956, thereby delinking the rates of depreciation under the Companies Act from those under the Income Tax Act. (Sec. 205)

16. Unpaid or unclaimed dividends. All dividends remaining unpaid or unclaimed within 42 days from the date of declaration, must be deposited in Unpaid Dividend Account. (Sec 205A)

17. Mercantile system of accounting. Section 209 has been amended to make it obligatory on all companies to maintain accounts on mercantile system only.

18. Disclosures in board's report. Companies are now required to disclose the prescribed particulars regarding conservation of energy, technology absorption, foreign exchange earnings and outgo in the report of board of directors. The report shall also disclose the particulars of employees whose remuneration is not less than Rs 72,000 per annum or Rs 6,000 per month as against Rs 36,000 per annum or Rs 3,000 per month prior to amendment. (Sec. 217)

19. Abridged annual accounts to members. With a view to reducing the cost of servicing the shareholders, listed companies are now required to send only abridged form of annual accounts to every member and every trustee of debenture holders. (Sec. 219)

20. Filing of annual accounts. Section 220 has been amended so that a company not adopting the balance sheet at its annual general meeting or adjourning the meeting without adopting the balance sheet, is required to send a statement to that effect and of the reasons thereof alongwith the balance sheet to the Registrar.

21. Ceiling on number of audits. Now in case of firm of auditors, a

partner in full-time employment elsewhere will be excluded for calculating the specified number of companies for which the firm can be appointed as auditors. (Sec. 224)

22. Election of directors. Now a candidate seeking election for directorship shall deposit Rs 500 with the company. This amount shall be refunded to him if he gets elected, otherwise the same will be forfeited. (Section 257)

23. Appointment of managing or whole-time directors. Section 269 has been amended to provide that every public company or a private company subsidiary of a public company having a paid-up share capital of Rs 1 or more shall compulsorily appoint a managing or whole-time director or a manager. Approval of the Central Government for such an appointment is not necessary if the appointment conforms to the conditions laid down Schedule XIII.

24. Increase in remuneration. Remuneration of directors can be increased within the limits specified in Schedule XIII without the approval of the Central Government. Monetary ceiling of Rs 250 in respect of sitting fee for attending a meeting of the board of directors has been replaced by differential scales of sitting fee (ranging from Rs 250 per meeting to Rs 1,000 per meeting) depending upon the paid-up share capital of the company. (Sec. 310)

25. Appointment to office or place of profit. Monetary ceilings prescribed by Section 314 for the appointment of directors and their associates to an office or place of profit have been replaced by such ceilings which may be prescribed by the Central Government.

26. Inter-corporate loans and investments. Old ceilings of inter-corporate loans and investments have been replaced by such ceilings in terms of percentages as may be prescribed by the Central Government from time to time. (Secs. 370 and 372)

The Companies (Amendment) Act, 1996

It came into force w.e.f. 1st March, 1997. This amending Act has dispensed with the requirement of seeking confirmation of Company Law Board for alteration of the objects clause of the memorandum of association (Sec. 17). It has further increased the period of redemption of redeemable preference shares to a maximum of 20 years from 10 years as at present. (Sec. 80)

The Companies (Amendment) Act, 1999

It is deemed to have come into force on the 31st day of October, 1998. This amending Act introduced the following changes:

1. Nomination facilities for shareholders, debentureholders and depositors in companies. (Secs. 58-A, 109-A and 109-B)

2. Buy-back of their own shares by companies subject to certain safeguards. (Sec. 77-A)

3. Issue of sweat equity shares by companies to their directors or employees. (Sec. 79-A)

4. Establishment of Investor Education and Protection Fund. (Sec. 205-C)

5. Constitution of National Advisory Committee on Accounting Standards. (Sec. 210-A)

6. Inter-corporate loans and investments subject to fulfilment of certain conditions without prior approval of the Central Government. (Sec. 372-A)

ADMINISTRATION OF COMPANY LAW

The Central Government is charged with the overall responsibility for administration of the Companies Act, 1956. The administration, at present, is done through the Department of Company Affairs under the Ministry of Industry and Company Affairs. Till 1985, the Department of Company Affairs formed part of the Ministry of Law. Justice and Company Affairs. The Companies Act confers various powers on the Central Government and most of the powers and functions vested in the Central Government have been delegated to one or other of the agencies created under the Act. The various administrative authorities are discussed below:

1. Company Law Board. The Amendment Act of 1963 abolished the Company Law Department and empowered the Central Government to constitute a Board to be called the Company Law Board. In order to ensure better and convenient administration of the Companies Act, the Company Law Board was set up by the Central Government in 1964. The Company Law Board started functioning from 1 February 1964 with its headquarters in New Delhi. The Company Law Board is the principal agency concerned with the administration of the Companies Act.

The administrative set-up of the Company Law Board consists of (a) the Central Office situated in New Delhi; (b) four Regional Offices headed by Regional Directors; and (c) Registrar of Companies in each State.

Prior to the Companies (Amendment) Act of 1988, the Company Law Board was subject to the control of the Central Government in the exercise of its powers and the discharge of its functions. This posed a serious limitation to the independence and judicial character of the Company Law Board. The Amendment Act of 1988 has made significant changes in Section 10E for establishing an independent Company Law Board to exercise such judicial and quasi-judicial functions, as are presently being exercised either by the court or the Central Government. The Company Law Board is now not subject to the control of the Central Government. The provisions of Section 10E, as amended by the Companies (Amendment) Act of 1988, are given below:

(*i*) **Constitution of the Company Law Board.** The Central Government shall constitute a Board to be called the Board of Company Law Administration by a notification in the Official Gazette. [(Sec 10E(1)]

(*ii*) **Powers and functions of the Company Law Board.** The Company Law Board shall exercise and discharge such powers and functions as may be conferred on it by or under the Companies Act or any other law. It shall also exercise and discharge such powers and functions of the Central Government under this Act or any other law as may be conferred on it by the Central Government, by notification in the Official Gazette. [Sec. 10E(1A)]

(*iii*) **Members and chairman of the Board.** The Company Law Board shall consist of such number of members, not exceeding nine, as the Central Government deems fit. Members are to be appointed by the Central Government and they shall possess such qualifications and experience as may be prescribed. One of the members shall be appointed by the Central Government to be the chairman of the Company Law Board. [Sec. 10E(2), (2A) and (3)]

(*iv*) **Validity of the acts of the Board.** No act of the Company Law Board shall be called in question on the ground only of any defect in the constitution of the Board. [Sec. 10E(4)]

(*v*) **Formation of Benches.** In order to expedite the disposal of matters, the Company Law Board is empowered to form one or more Benches from among its members and authorise each such Bench to exercise and discharge such of the Board's powers and functions as it may think fit. Any act of a Bench is deemed to be the act of the Board.

While trying a suit, every Bench of the Board shall have the powers of the court under the Civil Procedure Code with respect to the following matters:

(*a*) discovery and inspection of documents or other material objects producible as evidence;

(*b*) enforcing the attendance of witnesses and requiring the deposit of their expenses;

(*c*) compelling the production of documents or other material objects producible as evidence and compounding the same;

(*d*) examining witnesses on oath;

(*e*) granting of adjournment; and

(*f*) reception of evidence of affidavits. [SEC. 10E(4B), (4C)]

(*vi*) **Principles of natural justice.** In the exercise of its powers and the discharge of its functions, the Company Law Board shall be

guided by the principles of natural justice and shall act in its discretion [Sec. 10E(5)]

(*vii*) **Procedures.** The Company Law Board shall also have the power to regulate its own procedure. [Sec. 10E(6)]

(*viii*) **Appeals against the orders of the Board.** The newly inserted Section 10F provides that the orders of the Company Law Board will be appealable to the High Court on the question of law alone within 60 days from the date of communication of the order. However, decisions of the Company Law Board will be final on matters of facts. The limitation period of 60 days can be extended by another 60 days, if the appellant could satisfy the High Court that the appeal could not be filed for sufficient cause in the said period.

Enforcement of orders of the Board. Section 634 A, inserted by the Companies (Amendment) Act of 1977 and amended by the Amendment Act of 1988, authorises the Company Law Board to enforce its orders in the same manner as if it were a decree issued by a court. In the case of its inability to execute its order, it shall be lawful for the Board to send the order to the court within the local limits of whose jurisdiction the registrered office of the company falls or the individual against whom the order is issued resides or works.

2. Regional Directors. The Company Law Board has set-up four regional offices with headquaters at Bombay, Calcutta, Kanpur and Madras. This has been done to avoid administrative difficulties and unnecessary delays. Each regional office is under the charge of a Regional Director who is assisted by a Solicitor and a qualified Accounts Officer. The Regional Director is responsible for administration of company law in his region and acts as the local representative of the Central Government. The Regional Directors also coordinate and supervise the work of the Registrars in their respective regions. In discharge of their functions and responsibilities, the Regional Directors are subject to the control of the Company Law Board.

3. Registrar of Companies. The Central Government has appointed a full-time officer in each State to be known as Registrar of Companies and he is assisted by the qualified staff. He generally functions at the capital of each State and is responsible for the administration of company law in his State. He works partly under the control of the High Court and partly under the Company Law Board. The Companies Act has conferred important powers and imposed many responsibilities on him in connection with the administration of the Companies Act. One of the essential features of joint stock companies is that they must be registered under

the Companies Act and various documents and returns connected with the working of such companies should also be registered in accordance with the provisions of the law. The functionary appointed for this is the Registrar of Companies in each State. Persons desirous of forming a company have to file important documents with the Registrar of Companies for getting the company registered. The Registrar issues the certificate of incorporation and commencement of business to enable a company to commence its business. The Registrar must see to it that each company registered in his State, files in the proper form and within the prescribed time, various documents and returns required to be filed by a company. He also maintains a Register of Companies. It is his duty to see that the returns filed by the companies comply with the provisions of law. The Registrar's office provides central facilities for the inspection of such documents. Section 610 states that any person may inspect any documents filed with the Registrar or obtain certified copies of any documents or extracts therefrom. Section 439 also entitles the Registrar to present a petition to the court for winding up of a company under certain circumstances. Section 235 states that the Central Government may appoint one or more competent persons as inspectors to investigate the affairs of any company on a report by the Registrar under Section 234.

4. Public Trustee. The Amendment Act of 1963 empowered the Central Government to appoint a person as a public trustee. The public trustee is to exercise the voting rights attached to shares held in trusts in a company under certain circumstances. The intention is that the holding of securities by trusts should not be used by a group of persons for the purpose of augmenting their own voting rights. (Sec. 153A)

5. Official Liquidators. The Official Liquidators are attached to the High Court in each State. They conduct the proceedings in the winding up of a company ordered by the court and perform such other duties as the court may impose. In a voluntary winding up, the liquidator shall send a copy of the accounts to the Official Liquidator who shall make a scrutiny of the books and papers of the company and the company will be dissolved only when the Official Liquidator, on such a scrutiny, makes a report to the court that the affairs of the company have been conducted in a manner prejudicial to the interests of its members or to the public interest.

6. Advisory Committee. The Amendment Act of 1965 abolished the Advisory Commission and replaced it by the Advisory Committee. The function of this Committee is to advise the Central Government and the Company Law Board on such matters arising out of the administration of the Companies Act, as may be referred to it by the Central Government or the Company Law Board. Section 410 empowers the Central Govern-

ment to constitute an Advisory Committee consisting of not more than five persons with suitable qualifications. It shall be noted here that this section does not make it obligatory on the part of the Central Government or the Company Law Board to refer any specific matters to the Committee for its advice.

7. The Court. According to Section 10, the court having jurisdiction under this Act shall be the High Court having jurisdiction in relation to the place at which the registered office of the company is situated. The Central Government may, however, by notification in the Official Gazette and subject to such restrictions, limitations and conditions as it thinks fit, empower any District Court to exercise all or any of jurisdiction conferred by this Act upon the High Court. In such a case the District Court alone will deal with the matters falling within its jurisdiction in respect of companies having their registered office in the district. But the Central Government cannot confer jurisdiction on District Courts regarding all companies in respect of matters covered by Sections 237, 391, 394 and 395. This also applies to companies with a paid-up capital of Rs one lakh and over in respect of all matters covered by Sections 425 to 560 and other provisions relating to winding up. (Sec. 10)

QUESTIONS

1. Trace briefly the history of company-legislation in India. Also explain the special features of the Companies Act of 1956.
2. Give a brief note on the Companies (Amendment) Act of 1988.
3. (*a*) Write a note on socio-economic objectives of the Companies Act, 1956.
   (*b*) Explain the scheme of administration of Company Law in our country.
4. Write a note on administration of Company Law.

2

DEFINITION AND NATURE OF A COMPANY

MEANING OF A COMPANY

IN simple words, a company can be defined as a group of persons associated together for the purpose of carrying on a business, with a view to earn profits. However, one must remember that companies may also be formed for the promotion of commerce, art, science, religion or charity or any other useful object under the Companies Act.

Section 3(1)(i) of the Act provides that, "a company means a company formed and registered under this Act or an existing company." Section 3(1)(ii) lays down that, "an existing company means a company formed and registered under any of the previous companies laws." These definitions, however, do not clearly point out the concept of a company; the following definitions are more helpful:

Lord Justice Lindley defines it as follows: "A company is in association of many persons who contribute money or money's worth to a common stock and employ it in some trade or business and who share the profit and loss arising therefrom. The common stock so contributed is denoted in money and is the capital of the company. The persons who contribute it or to whom it belongs are members. The proportion of capital to which each member is entitled is his share. The shares are always transferable although the right to transfer is often more or less restricted."

According to Chief Justice Marshall, "a corporation is an artificial being, invisible, intangible, existing only in contemplation of the law. Being a mere creation of law, it possesses only the properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence."

Still another definition is given by Haney who observes that, "a company is an incorporated association, which is an artificial person created by law, having separate entity, with a perpetual succession and a common seal."

These definitions clearly bring out the characteristics of a company. A company is created by law. It comes into existence only when it is registered under the Act. It has a personality of its own which is distinct from the personality of its shareholders. The capital of the company is divided into transferable shares and liability of the members is limited to the nominal value of shares held. The persons who hold shares in the company are known as shareholders and they elect the directors who control and manage the affairs of the company. It has a perpetual succession and a common seal. It continues to exist until it is wound up in accordance with the provisions of the Act.

CHARACTERISTICS OF A COMPANY

The most distinguishing characteristics of a company are:

1. **Incorporated association.** A company is created when it is registered under the Companies Act. It comes into being from the data mentioned in the certificate of incorporation. It may be noted in this connection that Section 11 provides that an association of more than ten persons carrying on business in banking or an association of more than twenty persons carrying on any other type of business must be registered under the Companies Act and is deemed to be an illegal association, if it is not so registered.

For forming a public company at least seven persons and for forming a private company at least two persons are required. These persons will subscribe their names to the memorandum of association and also comply with other legal requirements of the Act in respect of registration to form and incorporate a company, with or without limited liability. [Sec. 12(1)]

2. **Artificial legal person.** A company is an artificial person. Negatively speaking, it is not a natural person. It exists in the eyes of the law and cannot act on its own. It has to act through a board of directors elected by the shareholders. It was rightly pointed out in *Bates v. Standard Land Co.*[1] that: "The board of directors are the brains and the only brains of the company, which is the body and the company can and does act only through them."

But for many purposes a company is a legal person like a natural person. It has the right to acquire and dispose of the property, to enter into contract with third parties in its own name, and can sue and be sued in its own name.

3. **Separate legal entity.** This means that a company has a legal entity

[1]1910 2 Ch. 408 at p. 416.

distinct from and independent of its members.[2] The creditors of the company can recover their money only from the company and the property of the company. They cannot sue individual members. Similarly, the company is not in any way liable for the individual debts of its members. The property of the company is to be used for the benefit of the company and not for the personal benefit of the shareholders. On the same grounds a member cannot claim any ownership rights in the assets of the company either individually or jointly during the existence of the company or in its winding up.[3] At the same time the members of the company can enter into contracts with the company in the same manner as any other individual can. Separate legal entity of the company is also recognised by the Income Tax Act, where a company is required to pay Income-tax on its profits and when these profits are distributed to shareholders in the form of dividend, the shareholders have to pay income-tax on their dividend income. This proves that a company and its shareholders are two separate entities.

The principle of separate legal entity was explained and emphasised in the famous case of *Salomon v. Salomon & Co. Ltd.*[4]

In this case Salomon had for many years carried on a prosperous business as a leather merchant. In 1892, he decided to convert it into a limited company. In the newly formed company, his wife, one daughter and four sons took up one share each of £1 to fulfil the statutory requirement of at least seven members. Salomon, with his two sons, constituted the board of directors. The purchase consideration was paid by the company by the allotment of 20,000 shares of £1 each and £10,000 debentures which gave Salomon charge over all the assets of the company, and the balance was paid in cash to Salomon.

The company almost immediately ran into difficulties and only a year later the then holder of the debentures appointed a receiver and the company went into liquidation. The position on liquidation was as follows: debentures issued to Salomon—£10,000; unsecured creditors—£7,000; and assets—£6,000. Thus it was found that after paying the debenture holders, nothing was left for unsecured creditors.

The unsecured creditors contended that Salomon, and Salomon and Co. Ltd., are one and the same; Salomon could not owe money to himself. The company was a mere sham and an agent or nominee for Salomon who remained the real proprietor of the business. As such Salomon was bound to pay the unsecured creditors of the company out of his

[2]*Kathiawar Industries Ltd. v. C.G. of Evacuee Property,* A.I.R. (1967) Punj. 337.
[3]*Baccha F. Guzdar v. Comm. of Income Tax, Bomb.,* A.I.R. (1955) S.C. 74.
[4](1897) A.C. 22.

pocket in spite of the fact that his shares had already been fully paid-up. But it was held that once the company was incorporated under the Act, it had separate legal entity independent of its members. Salomon who was holding substantially the whole share capital could also be a creditor of the company. In this case where Salomon was a secured creditor, he was entitled to be repaid in priority over the unsecured creditors. It was observed:

> "...When the memorandum is duly signed and registered though there be only seven shares taken, the subscribers are a body corporate capable forthwith of exercising all the functions of an incorporated company. It is difficult to understand how a body corporate thus created by statue can loose its individuality by issuing the bulk of its capital to one person. The company is at law a different person altogether from the subscribers of the memorandum; and though it may be that after incorporation the business is precisely the same as before, the same persons are managers, and the same hands receive the profits, the company is not in law their agent or trutee. The status enacts nothing as to the extent or degree of interest which may be held by each of the seven or as to the proportion of interest, or influence possessed by one or majority of the shareholders over others. There is nothing in the Act requiring that the subscribers to the memorandum should be independent or unconnected, or that they or any of them should have a mind or will of their own, or that there should be any thing like a balance of power in the constitution of the company."

Similarly in *Lee v. Lee's Air Farming Ltd.*,[5] *Lee* incorporated a company. He had himself appointed the Managing Director and Chief Pilot of the company. He was killed in an air crash, while working for the company and his widow claimed compensation. It was held that *Lee* and *Lee's Air Farming Ltd.* were separate and, as such, a claim for compensation was valid. "In effect the magic of corporate personality enabled him to be the master and servant at the same time."

The Indian courts have also recognised the principle of separate legal entity of a company. For instance, in *Abdul Haq v. Das Mal*[6], an employee of a company had not been paid salary for several months. He sued a director of the company for the recovery of the amount due to him. It was held that he could not succeed because "the remedy lies against the company and not against the directors or members of the company." This

[5](1960) 3 All E.R. 420.
[6](1910) 19 IC 595.

means that a company incorporated under the Companies Act has an independent corporate personality, seperate and distinct, not only from the entities of its members but also from the entities of its directors and other managerial personnel.

The same principle of separate legal entity was applied in other cases such as *Dhulia-Amalner Motor Transport Ltd. v. Roychand Rupsi Dharamsi*[7], *Flitcroft's Case*[8], *T.R. Pratt (Bombay) Ltd. v. E.D. Sasoon and Co. Ltd.*[9], *Macaura v. Northern Assurance Co. Ltd.*[10]

Not a citizen. Although a company is a legal person distinct from its members, it is not a citizen.[11] This means that a company does not acquire citizenship rights either under the Constitution of India or under the Citizenship Act. A company cannot claim the protection of such fundamental rights as are expressly guaranteed to citizens, such as the right of franchise. However, a company being a person can enforce those fundamental rights which are guaranteed to all persons whether citizens or not.

4. **Perpetual succession.** A company has perpetual succession and is independent of the life of its members. Its existence is not affected in any way by the death, insolvency or exit of any shareholder. "During the war all the members of one private company, while in general meeting, were killed by a bomb. But the company survived; not even a hydrogen bomb could have destroyed it."[12] A company can be compared with a river which retains its identity though the parts which compose it are constantly changing. Perpetual succession thus means that in spite of a change in the membership of the company, its continuity is not affected. Since a company is created by law, it can be wound up by resorting to the legal provisions of the Companies Act. Perpetual succession lends stability and long life to a company as compared to other forms of business organisation.

5. **Limited liability.** One of the important advantages of company is that the liability of its members is limited. In the case of a company limited by shares, the liability of members is limited to the extent of the nominal value of shares held by them. If a shareholder has paid the full nominal value of shares held by him, his liability is nil. This means that a shareholder remains liable to pay the unpaid value of shares, if any. In

[7]A.I.R. (1952) Bomb. 337.

[8](1882) 21 Ch. D. 530

[9]A.I.R. (1936) Bomb. 62.

[10](1925) A.C. 619.

[11]*State Trading Corporation of India v. C.T.O.*, A.I.R. (1963) S.C. 1811.

[12]L.C.B. Gower, *Principles of Modern Company Law*, London, Stevens and Sons (3rd edn.) 1969, footnote, p. 76.

the case of a company limited by guarantee, the liability of each member is to contribute a specified amount to the assets of the company in the event of its being wound up while he is a member or within one year of his ceasing to be a member. In effect, we find that a member is not directly liable to a company's creditors but he is a limited guarantor of the company's debt in both cases. However, the Act does not prevent the companies from making the liability of its members unlimited. But such companies are very rare.

6. **Transferable shares.** In a public company, the shares are freely transferable. The right to transfer shares is a statutory right and it cannot be taken away by a provision in the articles. However, the articles shall prescribe the manner in which such transfer of shares will be made and it may also contain *bond fide* and reasonable restrictions on the rights of members to transfer their shares. But absolute restrictions on the rights of members to transfer their shares shall be *ultra vires.* However, in the case of a private company, the articles shall restrict the rights of members to transfer their shares in compliance with its statutory definition.

In order to make the right to transfer shares more effective, the shareholder can apply to the Central Government in case of refusal by the company to register a transfer of shares.

7. **Common seal.** A company in an artificial person. It cannot act on its own. It acts through natural persons who are known as directors. All contracts entered into by the directors must be under the common seal of the company. The common seal, with the name of the company engraved on it, is used as a substitute for its signature. No document issued by the company shall be binding on it unless it bears the common seal which is duly witnessed by at least two directors of the company.

8. **Separate property.** A company, being a legal person, is capable of owning, enjoying and disposing of property in its own name. The property of the company is to be used for the company's business and not for the personal benefit of its shareholders. A member does not have insurable interest in the property of the company.[13] Members have no direct proprietory rights to the company's property, merely due to their shares. It is also important to note the claim of the company's creditors will merely be against the company's property and not that of shareholders.

9. **Capacity to sue and being sued.** The company is a legal person and it can enforce its legal rights. Similarly it can be sued for breach of its legal duties.

[13]*Macaura v. Nothern Assurance Co. Ltd.,* (1925) A.C. 619.

LIFTING THE CORPORATE VEIL

The principle of separate legal entity was established in the famous case of *Salomon v. Salomon & Co. Ltd.* as explained earlier. This precedent has been followed in a number of cases and it has come to be regarded as a fundamental principle of company law. When a company has been formed and registered under the Act, all dealings with the company will be in the name of the company, and the persons behind the company will be disregarded however important they may be. This shows that once the company is registered under the Act, there is a veil drawn between the company and its members. This veil is partition or curtain between the company and its members. Following this principle the courts in most cases have refused to go behind the curtain and see who are the real persons composing the company.

But sometimes the necessity of the situation may compel the authorities to disregard the corporate legal entity and look to individual members who are in fact the real beneficial owners of all corporate property, and this in fact is what is known as, "Lifting or Piercing the Corporate Veil." Thus the doctrine of lifting the corporate veil may be understood as the identification of a company with its members and when the corporate veil is lifted the individual members may be held liable for its acts or entitled to its property.

The courts will lift the corporate veil where it is essential to secure justice, where it is in the public interest to do so or where it is for the benefit of revenue. But it must be kept in mind that a separate legal entity is still the general rule. The corporate entity will be disregarded only in exceptional cases. These case may be divided in two:

(1) Under express statutory provisions.

(2) Under judicial interpretation.

The following instances may be included under (1):

1(*i*) **Reduction of membership below the statutory minimum.** When the company carries on business for more than six months after its number of members is reduced below seven in the case of a public company and below two in the case of a private company, every person who is cognisant of the fact and is a member during the time the company so carries on business after these six months, is severally liable for all the debts of the company contracted during that time. However, the member or members will enjoy the privilege of limited liability for the six months (Sec. 45). We find that this section enables creditors to look beyond the company to its members for satisfaction of their amounts.

1(*ii*) **Fraudulent trading.** Sometimes in the course of the winding up of a company, it may appear that any business of the company has been

carried on with an intent to defraud creditors of the company or any other persons or for any fraudulent purpose. In such a case, the court may declare that those who were knowingly partly to such conduct of business shall be personally liable for all or any of the debts of the company without any limitation of liability. The Official Liquidator, the liquidator, any creditor or contributory of the company can make an application to the court in this connection. (Sec. 542)

1 *(iii)* **Misdescription of the company.** Section 147 requires that the name of the company must be fully and properly mentioned on all documents issued by it. Where the name of the company is not properly indicated as required by Section 147, persons who have committed the act or made the contract shall be personally liable for it. Thus, where a bill of exchange is accepted by an officer of the company and the name of the company is not properly indicated as required by Section 147, the officer shall be personally liable to the holder of the bill if the company fails to pay it.

1 *(iv)* **For establishing the relationship of a holding and subsidiary company.** When one company controls the composition of the board of directors of another company or holds majority of its shares, the former is called the holding company and the latter is known as the subsidiary company. The separate corporate entitles of both the companies shall exist in the eyes of law. It has been held that even a hundred per cent subsidiary is a separate legal entity and its holding or parent company is not liable for its acts.[14] Similarly, a holding company cannot sue to enforce rights which belong to its subsidiary.[15]

But for establishing the relationship of a holding and subsidiary company, the court may lift the corporate veil and look behind to the persons who control the companies. Section 212 also provides for group accounts. It provides that there shall be attached to the balance sheet of a holding company, a copy of the balance sheet, profit and loss account, directors' report and auditors' report of each subsidiary and a statement of the holding company's interest in each subsidairy.

Again, the court may, on the facts of a case, refuse to grant a subsidiary company an independent status and treat the subsidiary company as only a branch of holding company. "Circumstances such as the profits of the subsidiary company being treated as those of the parent company; the control and conduct of the business of the subsidiary company resting completely in the nominees of holding company; and the brain behind

[14]*Ebbew Value Urban Area Distt. Council v. South Wales Traffic Area Licensing Authority* (1951) 2 K.B. 356.

[15]*Bell v. Lever Brothers Ltd.* (1932) 2 A.C. 161.

the trade of the subsidiary company being really the holding company, may indicate that in fact the subsidiary company is only a branch of the holding company.[16]

1 (*v*) **In case of an investigation of the affairs of the company.** Section 239 provides that where an inspector is appointed to investigate the affairs of a company, he shall also have the power to investigate the affairs of any other body corporate in the same management or group. The object of this section is to provide for investigation into the affairs of some companies which may be so related that it is necessary to bring the affairs of those companies also under investigation.

1 (*vi*) **In case of an investigation of the ownership of a company.** Where it appears to the Central Government that there is good reason to do so, it may appoint one or more inspectors to investigate and report on the membership of any company and other matters relating to the company for the purpose of determining the true persons (*a*) who are or have been financially interested in the success or failure of the company; or (*b*) who are or have been able to control or materially influence the policy of the company.

This will be done by lifting the corporate veil so as to ascertain the real persons controlling it. (Sec. 247)

Under (2), the following may be included:

2 (*i*) **For determining the character of the company.** "A company may assume an enemy character when persons in de facto control of its affairs are residents in an enemy country or wherever residents are acting under the control of enemies.[17] Thus whenever it is suspected that the company is owned or controlled by enemies, the court may lift the corporate veil and examine the characters of the persons constituting it. It becomes necessary to do so because the company can neither be loyal nor disloyal, it can neither be a friend nor an enemy as it is an artificial person. It is the persons behind the corporate fiction who determine its loyalty or disloyalty, or its character.

In *Daimler Co. Ltd. v. Continental Tyre & Rubber Co.*[18], a company was incorporated in England. It had the object of selling tyres manufactured by a German company situated in Germany. In the English company the bulk of shares was held by the German company and the directors of the English company were Germans resident in Germany. In brief, the English company was controlled by Germans. During First World War the English company filed a suit to recover a trade debt. It was held that

[16]*Freewheel (India) Ltd. v. Veda Mitra,* A.I.R. (1969) Delhi 258.
[17]*Daimler Co. Ltd. v. Continental Tyre & Rubber Co.* (1916) 2 A.C. 307.
[18](1916) 2 A.C. 307.

the company had become an enemy company as it was controlled by residents in an enemy country and, as such, the suit filed by the English company was dismissed. It would be against policy to allow alien enemies to trade under the corporate facade.

But a company registered in England and carrying on business in an enemy country is not necessarily an alien enemy.[19]

2 (*ii*) **In case of fraud of misconduct.** The court shall also lift the corporate veil where it finds that the company has been formed to defraud creditors or to defeat the provisions of any law or to avoid any legal obligations. In short, the corporate veil will be pierced where the company has been formed for any fraudulent or unlawful purpose. This is well illustrated by the case of *Gilford Motor C. v. Horne.*[20]

In this case *Horne* was appointed Managing Director of *Gilford Motor Co.* The appointment was made on the condition that he would not solicit or entice away the customers of the company while in office. He, in the course of time, formed a company to carry on his own business and this company solicited the customers of *Gilford Motor Co.* It was held "that the company was a mere cloak or sham for the purpose of enabling the defendant to commit a breach of his covenant against solicitation. Evidence as to the formation of the company and as to the position of its shareholders and directors leads to that inference. The defendant company was a mere channel used by the defendant *Horne* for the purpose of enabling him, for his own benefit, to obtain the advantage of the customers of the plaintiff company, and that the defendant company ought to be restrained as well as the defendant *Horne.*"

Similarly in *Jones v. Lipman,*[21] *Lipman* agreed to sell land to *Jones.* Subsequently, in order to avoid an order of specific performance, he fromed a company and sold the land to it. *Lipman* and a clerk of his solicitor were the only shareholders and directors of the newly formed company. *Jones* applied to the court for an order to specific performance against *Lipman* and the company. The court looked into the reality of the situation, ignored the original transfer to the company and ordered specific performance against *Lipman* and the company both on the ground that the company was nothing but mere cloak for *Lipman* who could compel the company to transfer the land to *Jones.*

2. (*iii*) **For the benefit of revenue.** The court may also lift the corporate veil in the interests of revenue. The court will not hesitate to look behind the corporate facade where it is found that the company has been formed

[19]*Re Hilckes* (1917) I.K.B. 48.
[20](1933) 1 Ch. 935.
[21](1962) 1 W.L.R. 832.

for evasion of taxes. In such cases individual shareholders may be held liable to pay income-tax. A clear illustration is provided by the case of *Re Sir Dinshaw Maneckjee Petit.*[22]

In this case the assessee was enjoying a huge dividend and interest income from investments held by him. Four private companies were formed by him and each private company would take over a part of his investments. He was to be allotted shares in each company, in lieu of which he would transfer a part of his investments to them. However, the actual transfer was to take place only when the company called upon him to do so, something that was never done. It may also be noted that the entire issued capital of the company was held by him and his nominees, while he also held investments as a trustee of the company.

Later, as soon as the interest and dividends were received, the amount was credited to the company, and on the same day was withdrawn as a loan from the company to the assessee. This loan was never paid back by him. In this way the income of the assessee was reduced. But the court held that the company was, in fact, not carrying on any business. It was being used as a tool to reduce *Petit's* tax liability. Company and assessee were held to be one and the same.

However, the court may refuse to identify the shareholders with the company if this results in loss of revenue of the Government or if it is not beneficial for the revenues of the State. In *Bacha E. Guzdar v. The Commissioner of Income-tax, Bombay,*[23] G was a member of a tea company. She received certain amount as dividend in respect of shares held by her in the company. Under the Income-tax Act, then in force, sixty per cent of the income of a tea company was exempt as agricultural income and only forty per cent of the income was taxed as income from manufacture and sale of tea. G also claimed that her dividend income should be regarded as agricultural income up to sixty per cent as in the case of a tea company. But it was held that although the income in the hands of the company was partly agricultural, the same income when received by G as dividend could not be regarded as income from agriculture.

A similar illustration is found in the facts of *Commissioner of Income-tax, Calcutta v. Associated Clothiers Limited.*[24] In this case, the assesses, *Associated Clothiers,* formed a company holding all its shares. They sold certain properties to the new company. The difference between the selling price and the cost of the property in the hands of the assessees was assessed as their income. On behalf of the assessees, it was contended

[22]A.I.R. (1927) Bomb. 371.
[23]A.I.R. (1955) S.C. (74).
[24]A.I.R. 1963 Cal. 629.

that it was not a commercial sale yielding any profit which was liable to taxation. Their contention was that the transfers was from self to self as all the shareholders and all the directors of these two companies were the same at the relevant time and their objects in the memorandum were for all practical purposes identical. But the court rejected this and held that it was a sale from one entity to another and not a transfer from self to self.

DIFFERENCES BETWEEN A COMPANY AND A PARTNERSHIP

We have already seen that a company is an artificial entity created by law, with limited liability, perpetual succession and a common seal, and that its capital is divided into transferable shares.

Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all. The persons who have entered into partnership with one another are called, individually, "partners" and collectively, a "firm", and the name under which their business is carried on is the firm's name.

The principal points of difference between a company and a partnership are as follows:

(1) A company comes into existence only when it is registered under the provisions of the Companies Act. However, a partnership is created by an agreement betweeen partners. Registration of a partnership firm under the Partnership Act is optional.

(2) A private company must be constituted by at least two persons, and by at least seven in case of a public company. A partnership can be created by two persons.

(3) In a public company, there is no limit on the maximum number members while in a private company, the number of members shall be resticted to fifty excluding its present and past employees. In the case of a partnership carrying on banking business, the maximum number of partners can be ten, and in the case of any other business twenty.

(4) A company has a separate legal entity distinct from the members who constitute it. A partnership, commonly called a firm, has no legal existence apart from its members. This means that partners and firm are one and the same.

5. In the case of a company, property belongs to the company and not to its individual members, whereas the property of a partnership firm belongs to individual partners comprising the firm.

[25] *Re Geogre Newman & Co.* (1895) 1 Ch. 674, 685; *Chiranjilal v. The Union of India* (1950) S.C.R. 869, 964.

(6) A shareholder may enter into a contract with a company, whereas a partner cannot enter into a contract with a firm. However, a partner can enter into a contract with other partners.

(7) Creditors of the company are not the creditors of individual shareholders. They can proceed against the company alone. Creditors cannot hold the shareholders directly liable for their amounts. The creditors of a partnership firm are the creditors of individual partners and a decree obtained against a firm can be enforced against them.[26]

(9) A shareholder is not an agent of the company whereas a partner is an agent of his firm in connection with partnership business.

(10) The liability of partners is unlimited. The liability of shareholders is usually limited. However, the law does not prevent a company from rendering the liability of members unlimited.

(11) Shares of a company are freely transferable. However, in the case of a private company the articles restrict the rights of members to transfer their shares. In a partnership, a partner cannot transfer his share without the consent of his co-partners.

(12) In a company, restrictions in the articles are effective as there is constructive notice of the memorandum and articles to every person who deals with the company. But in the case of a partnership, restrictions on a member's authority contained in the partnership deed are of no avail against outsiders.[27]

(13) A company has perpetual succession. Death, insolvency or the exit of any shareholder does not affect the existence of the company. It comes to an end only when it is liquidated according to the provisions of the Act. Unless otherwise provided, a partnership comes to an end when a partner dies or becomes insolvent.

(14) In a company, the shareholders do not interfere in affairs of the company directly. It is managed by a board of directors, who are elected by the shareholders. But a partnership is managed by all partners or any of them acting for all.

(15) Each partner is the agent of every other partner in all matters connected with the business of the partnership. Every partner has the authority to act on behalf of all and can, by his actions, bind all the partners of the firm. In a company, no shareholder is an agent of another shareholder. Neither a shareholder can bind other shareholders by his actions nor he is bound by the actions of other shareholders.

(16) A company's powers are defined by the memorandum. The articles contain rules and regulations for internal management, and any

[26] *Flitcroft's Case* (1882) 21 Ch. D. 533.
[27] *Earnest v. Nicholls* (1857) 6 H.L. Cas. 418, 419.

change in these documents can be made only by following the legal procedure laid down in the Companies Act. In the case of a partnership, rules regarding management of the business of the firm and the powers of the firm are spelt out in the partnership deed which can be easily altered with the consent of all the partners.

(17) A company is also subject to strict control by the Companies Act with regard to various matters such as maintenance of books of account, share capital, distribution of profit, etc. There are no such statutory obligations in a partnership.

QUESTIONS

1. Define a company. Explain its characteristics.

(Delhi, B. Com., 1990)

2. "A company is an artificial person created by law with a pepetual succession and a common seal." Explain this statement and point out the basic features of a company.

3. What do you understand by the concept of corporate personality? Under what circumstances is lifting of corporate veil possible?

[Delhi, B. Com., (Hons.), 1972]

4. "A company is a legal person and it has identity separate, from members comprising it." Bring out the truth of this statement.

(Bombay, Inter, Oct., 1970)

5. "An incorporated company is a totally different person or thing or entity from its members--the individuals comprising it." Explain and illustrate.

[Delhi, B. Com. (Hons.), 1974, 85]

6. Elaborate the doctrine of lifting the corporate veil. How far does it ensure protection to third parties?

(Delhi, M. Com., 1975)

7. "A company enjoys separate personality from its shareholders." Critically examine this statement with special reference to the principle of lifting the corporate veil.

(Delhi, M. Com., 1977)

8. "Though the principle that the company is a separate legal entity lies at the root of the legal idea of a corporate body, modern practice, in deference to the reality of the economic facts, has frequently admitted exaceptions to it." Discuss the above with reference to case law.

[Company Secretary (Final), April 1963]

9. "A company is a legal entity quite district from its members." Explain.

[Delhi, B. Com. (Hons.), 1986]

10. Contrast an ordinary partnership from a limited company.

11. "The doctrine of lifting of the veil of the corporate personality is an accepted principle." Discuss.

[Delhi, B. Com. (Hons.), 1988]

PRACTICAL PROBLEMS

1. A husband and wife who were the only two members of a private company died in an accident. Does the company also come to an end?

[*Delhi, B. Com. (Hons.), 1973*]

2. *A, B* and five others are the only shareholders of the fully paid-up shares of a public company. *A's* shares are sold in a court auction and *B* purchases them. Assuming that this fact is known to other shareholders, what are the consequence if the company continues to carry its business thereafter?

(*I.C.W.A., June 1976*)

3. A public limited company has eight shareholders. All shares are fully paid up. All the shares of the two of the shareholders were sold in a court auction and were purchased by another shareholder of the same company to the knowledge of all the other shareholders. The company continued to carry on business thereafter. What would be the legal consequences of such continuance? Explain the reasons for your answer.

[*C.A. (Inter), Nov. 1978*]

4. Ram, a trader, carries on business under the name of "Ram & Co. Ltd.," without being registered as a company with limited liability under the Companies Act. Discuss the consequence of Ram's acts.

5. *M* is the holder of nearly all the shares, except one, of a timber company. He is also a substantial creditor of the company. He insured the company's timber in his own name. The timber having been destroyed by fire, he claimed the loss from the insurance company. Is the company liable to *M*?

6. Some persons owned a tea estate. They formed a company, became its shareholders and transferred their tea estate to the company. They claimed exemption from *ad valorem* duty on the ground that they themselves were the shareholders in the company and, therefore, it was nothing but a transfer from them to themselves under another name. Is their contention valid?

7. A shareholder of a tea company received certain amount as dividend in respect of shares held by him in the company. Under the Income Tax Act, then in force, sixty per cent of the income of a tea company was exempt from income tax as it was deemed to be agricultural income and only forty per cent of its income was taxable as income from manufacture and sale of tea. The shareholder also claimed that his dividend income should be regarded as agricultural income upto sixty per cent as in the case of a tea company. The Income tax Officer refused to grant the exemption and taxed the whole of his income without any exemption. Is he right?

8. *X* and *Y* sold a certain business to *Z* and agreed not to compete with him for a given number of years. Shortly afterwards, in violation of the contract term, they formed a private company for doing similar business and they became the principal shareholders and directors of the company. Explain the rights of *Z* against the company.

3

KINDS OF COMPANIES

CLASSIFICATION OF COMPANIES BY MODE OF INCORPORATION

DEPENDING on the mode of incorporation, there are three classes of joint stock companies:

(1) **Chartered companies.** These are incorporated under a special charter by a monarch. The East India Company and The Bank of England are examples of chartered companies incorporated in England. The powers and nature of business of a chartered company are defined by the charter which incorporates it. A chartered company has wide powers. It can deal with its property and bind itself to any contracts that any ordinary person can. In case the company deviates from its business as prescribed by the charter, the Sovereign can annul the latter and close the company. Such companies do not exist in India.

(2) **Statutory companies.** These companies are incorporated by a Special Act passed by the Central or State legislature. Reserve Bank of India, State Bank of India, Industrial Finance Corporation, Unit Trust of India, State Trading Corporation and Life Insurance Corporation are examples of statutory companies. Such companies do not have any memorandum or articles of association. They derive their powers from the Acts constituting them and enjoy certain powers that companies incorporated under the Companies Act have. Alterations in the powers of such companies can be brought about by legislative amendments.

The provisions of the Companies Act shall apply to these companies also except in so far as provisions of the Act are inconsistent with those of such Special Acts. [Sec. 616 (d)]

These companies are generally formed to meet social needs and not for the purpose of earning profits.

(3) **Registered or incorporated companies.** These are formed under the Companies Act, 1956 or under the Companies Act passed earlier to this. Such companies come into existence only when they are registered under the Act and a certificate of incorporation has been issued by the

Registrar. Such companies derive their powers from the Companies Act from the memorandum of association (every company registered under the Act has to prepare a memorandum). Rules and regulations for internal management are contained in the articles. This is the most popular mode of incorporating a company. Registered companies may further be divided into three categories, as Section 12(2) provides that a company incorporated under the Act may be either (*a*) a company limited by shares, or (*b*) a company limited by guarantee, or (*c*) an unlimited company.

CLASSIFICATION OF COMPANIES BY LIABILITY OF MEMBERS

(1) **Companies limited by shares.** A company that has the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them is termed a company limited by shares. The main attraction of these companies is that the liability of their members is limited to the nominal value of shares held by each member. If the shareholder had paid the full nominal value of shares held by him, his liability is nil. The liability of the shareholder to pay the unpaid amount can be enforced during the existence of the company as also during its winding up. Companies limited by shares are by far the most common and may be either public or private.

(2) **Companies limited by guarantee.** A company that has 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, is known as a company limited by guarantee [Sec. 12(2b)]. It may further be noted that the guarantee amount is required to be paid only when the company is wound up.

Generally, non-trading companies are formed with a guarantee capital. Such companies are not intended for purpose of making profits and distributing these among their members. Rather, they are formed for the promotion of art, science, culture and sports, etc. Such companies may be registered with or without a share capital.

In the case of a company limited by guarantee, the articles shall state the number of members with which the company is to be registered [Sec. 27(2)]. Section 13(3) provides that the memorandum of a company limited by guarantee should also state that each member undertakes to contribute to the assets in the event of its being wound up while he is a member or within one year after he ceases to be a member, for (*i*) payment of liabilities of the company or of such debts and liabilities of the company as may have been contracted before he ceases to be a

member, as the case may be, (*ii*) payment of costs, charges and expenses of winding up, and (*iii*) for adjusting the rights of the contributories among themselves, such amount as may be required, not exceeding a specified amount.

(3) Unlimited companies. A company that has no limit on the liability of its members is termed an unlimited company [Sec. 12(2C)]. The members are liable for the company's debts in proportion to their respective interests in the company, and their liability is unlimited. Such companies may not have share capital.

In an unlimited company, the articles shall state the number of members with which the company is to be registered, and, if the company has a share capital, the amount of share capital with which the company is to be registered [Sec. 27(1)]. This may be either a public company or a private company though these days, such companies are rare.

PRIVATE AND PUBLIC COMPANIES

On the basis of the number of members, companies can be divided in two: (*i*) private companies, (*ii*) public companies.

A *private company* is a company which, by its articles, (*a*) restricts the right to transfer its shares, if any; (*b*) limits the number of its members to fifty, excluding members who are or were in the employment of the company; and (*c*) prohibits any inviation to the public to subscribe for any shares in, or debentures of, the company.

Where two or more persons hold one or more shares jointly in the company, they shall be treated as a single member for the purpose of this definition. [Sec. 3(1)(*iii*)]

In a private company without share capital, the articles need not contain the provisions for restricting the right of members to transfer shares. [Sec. 27(3)]

The minimum number required to form a private company is two. A private company shall add the words "Private Limited" at the end of its name, and it may commence its business immediately after obtaining a certificate of incorporation. But it should be noted here that a public company, after obtaining the certificate of incorporation, has to company with certain formalities to obtain a certificate of commencement of business, after which only it is entitled to do so. Private companies are usually family concerns, since shares are generally held by members of the family. The basic point of a private company is that shareholders have the advantage of limited liability and its affairs remain secret to a considerable extent.

A *public company* is that which is not a private company [Sec. 3

(1)(iv)]. This means that it may invite the general public to subscribe for any shares in, or debentures of, the company. However, this is not binding on the company. Similarly, the limit of a maximum of fifty members as applicable to a private company does not apply to a public company. However, the minimum number of members required to form a public company is seven. At the same time the articles need not contain a clause for restricting the right of members to transfer their shares. These are freely transferable. It should be noted that a public company must add the word "Limited" at the end of its name.

Differences between Private and Public Company

(1) *Number of members.* The number of members in a private company is two while public company must have at least seven.

The maximum number of members in a private company cannot exceed fifty, excluding its present or past employees. In the case of a public company, there is no maximum limit on members.

(2) *Name of the company.* In a private company, the words "Private Limited" shall be added at the end of its name. In a public company, the word "Limited" only shall be added at the end of its name.

(3) *Transfer of shares.* In a private company, the articles restrict the right of members to transfer their shares whereas in a public company, the shares are freely transferable.

(4) *Public subscription.* A private company cannot invite the public to purchase its shares or debentures. A public company may do so.

(5) *Issue of deferred shares.* A private company can issue deferred shares carrying disproportionate voting rights. But a public company cannot issue such shares.

(6) *Issue of prospectus.* Unlike a public company, a private company is not expected to issue a prospectus or file a statement in lieu of prospectus with the Registrar before allotting shares.

(7) *Minimum number of directors.* A private company shall have at least two directors, and a public company, at least three.

(8) *Restrictions on appointment of directors.* In a public company, the directors must file with the Registrar, their consent to act as such in writing. Similarly, they must sign the memorandum or enter into a contract for their qualification shares. At least two-thirds of the directors of a public company must retire by rotation. They cannot vote on a contract in which they are personally interested. These restrictions, however, do not apply to the directors of a private company.

(9) *Managerial remuneration.* In a public company the overall limit of managerial remmuneration is 11 percent of net profits. However, this restriction does not apply to private company.

(10) *Issue of share warrants.* A private company cannot issue share warrants while a public company can.

(11) *Holding of statutory meeting.* A private company is not required to hold a statutory meeting whereas a public company must do so after one month, but before six months of obtaining the certificate of commencement of business.

(12) *Commencement of business.* A private company may commence its business immediately after obtaining a certificate of incorporation. A public company cannot commence its business until it is granted a "certificate of commencement of business."

(13) *Allotment of shares.* A private company can proceed to allot shares even before the minimum subscription is subcribed or paid. But a public company can not allot shares without raising minimum subscription.

(14) *Issue of right shares.* While making further issue of capital, a public company is required to first offer such further shares to its existing shareholders on a pro-rata basis. But a private company is not required to do so.

In addition to the above, a private company enjoys certain special privileges which are not granted to a public company. These are described below in detail.

Special Privileges of Private Companies

Though public as well as private companies are governed by the Companies Act, yet private companies are exempted from certain of its provisions. These exemptions are the special privileges of a private company. The idea underlying this sort of differentiation is that a public company raises money from the general public and therefore in order to protect the interests of investors, a strict control on public companies is required. In the case of private companies, the money is invested by private individuals, generally members of the same family, and as the number of members is comparatively small, the Act can affort to exempt such companies from some of its provisions. These privileges can be studied as follows:

(*a*) **Special privileges of all private companies.** The following privileges are available to every private company, including a private company which is subsidiary of a public company or deemed to be a public company:

(1) A private company may be formed with only two persons as members. [Sec. 12(1)]

(2) It may commence allotment of shares even before the minimum subscription is subscribed for or paid (Sec. 69)

(3) It is not required to either issue a prospectus to the public or file a statement in lieu of a prospectus. [Sec. 70(3)]

(4) Restrictions imposed on public companies regarding further issue of capital do not apply on private companies. [Sec. 81(3)]

(5) Provisions of Sections 114 and 115 relating to share warrants shall not apply to it. (Sec. 114)

(6) It need not keep an index of members. (Sec. 115)

(7) It can commence its business after obtaining a certificate of incorporation. A certificate of commencement of business is not required. [Sec. 149(7)]

(8) It need not hold statutory meeting or file a statutory report. [Sec. 165(10)]

(9) Unless the articles provide for a larger number, only to persons personally present shall form the quorum in case of a private company, while at least five members personally present form the quorum in case of a public company. (Sec. 174)

(10) In case of a private company, poll can be demanded by one member if not more than seven members are present, and by two members if more than seven members are present. In case of a public company, poll can be demanded by persons having not less than one-tenth of the total voting power in respect of the resolution or holding shares on which an aggregate sum of not less than fifty thousand rupees has been paid-up. (Sec. 179)

(11) It need not have more than two directors, while a public company must have at least three directors. (Sec. 252)

(12) A director is not required to file his consent to act as such with the Registrar. Similarly, the provisions of the Act regarding undertaking to take up qualification shares and pay for them are not applicable to directors of a private company. [Sec. 266(5)(b)]

(13) Provisions in Section 284 regarding removal of directors by the company in general meeting shall not apply to a life director appointed by a private company on or before 1st April 1952. [Sec. 284(1)]

(*b*) **Additional special privileges of independent private companies.** In addition to the privileges specified above, the independent private companies enjoy the following additional privileges:

(1) An independent private company is not prohibited from giving financial assistance directly or indirectly for purchase or subscription of its own shares. [Sec. 77(2)]

(2) It may issue any kind of shares and allow disproportionate voting rights. [Sec. 90(2)]

(3) A transferor or transferee of shares shall have no right of appeal to the Company Law Board against a refusal by the company to register

a transfer of shares except as regards transmission by court sale or sale by other public authority. (Sec 111)

(4) Provisions of the Act in respect of matters specified in Sections 171 to 186, namely, general meetings, notice, quorum, chairman, proxies, voting, poll, etc., shall not be applicable to a private company to the extent to which it makes its own regulations by its articles. [Sec. 170(1)]

(5) An independent private company is exempted from many provisions of the Act relating to directors, managing director or manager. These exemptions are given below:

(*a*) Restrictions contained in Section 198 regarding overall maximum managerial remuneration shall not apply to an independent private company. Section 198 fixes overall maximum managerial remuneration at eleven percent of net profits.

(*b*) All its directors can be permanent life directors and the provisions relating to retirement of directors by rotation (one-third every year) shall not apply to it. (Secs. 255 and 256)

(*c*) Two or more directors may be appointed by a single resolution. But in a public company, each director shall be appointed by a seperate resolution put to vote separately. (Sec. 263)

(*d*) The directors may vote on resolutions in which they are interested. (Sec. 300)

(*e*) There are not restrictions on the board of directors to sell the whole or part of the undertaking. (Sec. 293)

(*f*) There are no restrictions on a private company to make loans to its directors or to provide guarantees or securities for moneys borrowed or lent by them. (Sec. 295)

(*g*) Provision requiring sanction of the Central Government for increasing the number of directors beyond the limit fixed by the articles shall not apply to an independent private company. (Sec. 259)

(*h*) Restrictions as to number of companies which can be managed by a director (twenty companies) or by a managing director (two companies) or by a manager (two companies) shall not apply to independent private companies. (Secs. 278, 316 and 386)

(*i*) Provision prohibiting appointment of managing director or manager for more than five years at a time shall not apply to it. (Sec. 317)

(*j*) No government approval is required for appointment or reappointment of managing or whole-time director or manager. Similarly no Government approval is required to amendment of provisions relating to managing or whole-time director or manager. (Secs. 268 and 269)

(*k*) Provisions of Section 270 specifying the time within which the share qualification is to be obtained by a director (within two months after his appointment as a director), and the maximum amount in respect

of share qualification (five thousand rupees or the nominal value of one share where it exceeds five thousand rupees) shall not apply to an independent private company. (Sec. 273)

The above provisions and restrictions are applicable to public companies, while private companies are not required to comply with them.

(6) No person other than a member of the private company is entitled to inspect or obtain copies of the profit and loss account and the balance sheet filed with the Registrar. [Sec. 220(1)]

(7) Restrictions on making loans to other companies under the same management shall not apply to it. (Sec. 370)

(8) Provisions regarding prohibition of purchase by company of shares, etc., of other companies shall not apply to an independent private company. (Sec. 372)

(9) Provisions regarding the power of the Company Law Board to prevent change in the board of directors likely to affect the company prejudicially shall not apply to an independent private company (Sec. 409)

(10) Contracts entered into by an agent of a private company, which is not the subsidiary of a public company, if entered into by him on behalf of the company as undisclosed principal, need not be recorded by a memorandum in writing. (Sec. 416)

CONVERSION OF A PRIVATE COMPANY INTO A PUBLIC COMPANY

(1) **Conversion by default.** Where the articles of a company include the provisions relating to a private company, but default is made in complying with any of these provisions, the company shall cease to be entitled to the privileges and exemptions conferred on private companies under the Act, and the Act shall apply to the company as if it were not a private company.

The Company Law Board may relieve the company of the consequences of non compliance with the aforesaid restrictions, if it is of the opinion that the non-compliance was accidental or inadvertent. The Company Law Board shall grant relief on such terms and conditions as it may think just and expedient. (Sec. 43)

(2) **Conversion under Section 43 A (Deemed to be public companies).** The Companies (Amendment) Act, 1960 introduced Section 43A. Private companies, as mentioned earlier, have certain privileges and exemptions compared to public companies because they do not use public money. But it was found that certain companies, registered as private companies, were using public money to a considerable extent as a large number of

shares in them were held by public companies. In this way these private companies were availing of privileges and exemptions granted to a private company, but at the same time using public money for conducting their business. It was to check this tendency that Section 43A was added to the Act. A private company shall be deemed to be a public company in the following cases:

(a) Where not less than twenty-five per cent of the paid up share capital of a private company is held by one or more public companies or private companies which had become public companies by virtue of this section, i.e., Section 43A, the private company will be deemed to be a public company from the date on which the aforesaid percentage is so held.

However, in computing the above percentage, the shares held by a banking company on trust or as executors or administrators of the decreased shareholder shall not be taken into account. [Sec. 43A (1)]

(b) Where the average annual turnover of a private company is rupees twenty-five crores or more during the relevant period, the private company will become a public company after the expiry of three months from the last date of the relevant period. [Sec. 43A (1A)]

Prior to this, the limit of average annual turnover was rupees ten crores or more. The term "relevant period" means a period of three consecutive financial years. The term "turnover" means the aggregate value of realisations made from the sale or supply or distribution of goods or on account of services rendered or both.

(c) Where a private company holds not less than twenty-five per cent of the paid-up share capital of a public company, it will become a public company from the date it holds such shares. [Sec. 43A (IB)]

(d) Where a private company accepts, after an invitation is made by an advertisement, or renews, deposits from the public, other than its members, directors or their relatives, it shall become a public company on and from the date on which acceptance or renewal of deposits from the public is first made. [Sec. 43A (1C)]

Effect. A private company, which has become a public company by virtue of Section 43A, loses all the advantages of a private company except that its articles of association may continue to include those provisions (such as restrictions on transfer of shares, limitation of the number of members to fifty and prohibition of invitation to the public to buy shares or debentures), that make it a private company. Such a company may continue to have two directors and less than seven members.

Information to Registrar. Information must be given to the Registrar within three months of the company being deemed to be a public company who will make the necessary changes including alteration in the certificate of

incorporation issued to the company and its memorandum of association. [Sec. 43A(2)]

A private company which has become a public company by virtue of the above provisions shall continue to be a public company until it becomes a private company again with the approval of the Central Government [Sec. 43A(4)]

Submission of certificates. A private company having a share capital will have to file with the Registrar alongwith its annual return a certificate to the effect that no company or companies has or have held twenty-five per cent or more of its paid-up share capital. The certificate shall also state that its average annual turnover was less than rupees twenty five crores during the relevant period and that it did not accept or renew deposits from the public. [Sec. 43A(8)]

A private company shall also file another certificate along with the annual return. This certificate shall be signed by both the signatories to the return stating that since the date of the annual general meeting with reference to which the last return was submitted, the private company did not hold twenty five per cent or more of the paid-up share capital of one or more public companies. [Sec. 43A(9)]

(3) Conversion by alteration of articles of association. Section 44 lays down the method by which a private company may be converted into public company. The procedure is as follows:

(i) It shall pass a special resolution to alter its articles so as to eliminate the provisions relating to a private company. (The provisions relating to a private company are, limitation of the number of members to fifty, restrictions on transfer of shares, and prohibition of an invitation to the public to purchase it shares and debentures).

(ii) Within thirty days, a prospectus or a statement in lieu of a prospectus together with a copy of special resolution and a copy of altered articles should be filed with the Registrar.

(iii) It shall increase the number of members to at least seven if it is less than seven. It must also increase the number of directors to at least three.

(iv) It shall delete the word 'Private' from its name. If the change of name involves anything more than removing the word 'Private', written approval of the Central Government must be obtained.

The company shall cease to be a private company from the date of the alteration.

The conversion of a private company into public and the consequent change of name would not affect the identity of the company.[1]

[1] *All India Reporter Ltd. v. Ramchandra Datar,* A.I.R. (1962) Bom. 292

CONVERSION OF A PUBLIC COMPANY INTO A PRIVATE COMPANY

In order to convert a public company into a private company, the following steps are essential:

(i) A public company shall pass a special resolution to alter its articles so as to include in it the provisions relating to a private company, such as limiting the number of members to fifty, restricting the transfer of shares and prohibiting invitation to the public to purchase its shares and debentures.

(ii) The sanction of the Central Government must be obtained.

(iii) A copy of the special resolution and a printed copy of the articles as altered shall be filed with the Registrar within one month of the date of receipt of order of approval of the Central Government. (Sec. 31)

ASSOCIATION NOT FOR PROFIT

Licence to drop the word 'Limited'. The memorandum of every company shall state the name of the company. The word "Limited" will be added at the end of the name of a public company, and the words "Private Limited" will be added at the end of the name of a private company. However, under Section 25, the Central Government may, by licence, direct that the association be registered as a company with limited liability, without the addition to its name of words "Limited" or "Private Limited."

Conditions for granting licence. The Central Government shall grant a licence only when it is satisfied that (a) the association is about to be formed as a limited company to promote commerce, art, science, religion, charity, or any other useful object; and that (b) it intends to apply its profits, if any, or other income to promote its objects and to prohibit the payment of any dividend to its members.

On registration, it shall enjoy all the privileges and be subject to all the obligations of limited companies.

The principle of limited liability generally takes the form of a guarantee company in the case of such association. [Sec. 25(1),(2)]

A licence may be granted by the Central Government on such conditions and subject to such regulations as it thinks fit. These conditions and regulations are binding on the company to which a licence is granted. These conditions and regulations shall be included in the memorandum or the articles of association, if the Central Government so directs. [Sec. 25(5)]

A body in respect of which a licence under this section is in force shall not alter its memorandum with respect to its objects, except with the

approval of the Central Government signified in writing. [Sec. 25 (8)(a)]

Partnership firms as members. Though a partnership firm is not a legal person like a body corporate, still it may be a member in a licensed company in its own name and it is on the dissolution of the firm that its membership shall cease. [Sec. 25(4)]

Revocation of licence. The licence may at any time be revoked by the Central Government and, upon revocation, the Registrar shall enter the word "Limited" or the words "Private Limited" at the end of the name upon the register of the body to which the licence was granted, and the body shall cease to enjoy the exemptions granted by this section.

Before a licence is so revoked, the Central Government shall give notice in writing of its intention to the body and shall afford it an opportunity of being heard in opposition to the revocation. [Sec. 25(7)]

Upon revocation of a licence granted under this section to a body, the name of which contains the words, "Chamber of Commerce," that body shall, within a period of three months from the date of revocation or such longer period as the Central Government may think fit to allow, change its name to a name which does not contain these words. [Sec. 25(9)]

ONE-MAN COMPANIES

In these companies, one man holds practically the entire share capital of the company. He takes a few other members who are no more than dummies or nominees of the former. This is done to fulfil the statutory requirement of at least seven members in the case of public company, and at least two members in the case of a private company. These other members usually subscribe the memorandum for one share each. In this way the person who holds the entire bulk of the share capital, except a few shares held by his nominees, enjoys full control over the company and is thereby enabled to do his business with limited liability.

Such a company is perfectly valid in the eyes of the law. It has its own entity which is separate from the entity of its members.

In *Salomon v. Salomon & Co. Ltd.*,[2] Salomon was holding substantially the entire share capital in his name, and to fulfil the statutory requirement of at least seven members, his wife, a daughter and four sons joined him to form the company. These other members took only one share of £1 each.

It was held that the company is perfectly in order. It enjoys a separate entity of its own. *Salomon & Co. Ltd.* and *Saloman* were treated separate even when *Saloman* was holding practically the entire share capital of the

[2](1897) A.C. 22.

company. It was pointed out that the Act requires at least seven persons, each of whom should hold at least one share. Once this conditions is fulfilled, it does not matter whether the members are independent or dummies.

The principle established in *Saloman v. Saloman & Co. Ltd.* has been followed in a number of cases. In fact it has become the basic principle of the company form of organisation.

FOREIGN COMPANIES

Ordinarily, a foreign company is understood as a company incorporated outside India but for the purpose of Section 591 a foreign company means a company which is incorporated outside India but has an established place of business in India.

Rules as to Foreign Companies

(1) **Registration of documents.** A foreign company which establishes a place of business in India is required to deliver the following documents to the Registrar for registration within thirty days of the establishement of such place of business:

(i) A certified copy of the constitution of the company. If it is not in English, a certified translation in English there of.

(ii) The full address of the registered or principal office of the company in foreign country.

(iii) A list of the directors and secretary of the company giving name in full, residental address, nationality of origin, his business occupation and any other directorship or directorships held by him.

(iv) The names and addresses of one or more persons resident in India who are authorised to accept service of notice and other documents on behalf of the company.

(v) The full address of the office of the company in India which is deemed its principal place of business in India. (Sec. 592)

(2) **Alterations.** Alterations in any of the documents of particulars mentioned above must be notified to the Registrar within the prescribed time. (Sec. 593)

(3) **Accounts.** Every foreign company shall, in every calendar year, make out a balance sheet and profit and loss account under the provisions of this Act as if it is an Indian company. It shall also file with the Registrar three copies of the balance sheet and profit and loss account and other documents required under the Act. The Central Government may modify or cancel the application of this rule for any foreign company. (Sec. 594)

(4) **Name.** Every foreign company shall (i) state the name of the country of its incorporation in every prospectus inviting subscriptions in India for its shares or debentures; (ii) conspicuously exhibit on the outside of every office or place where it carries on business in India the name of the company and the country in which it is incorporated, in English and in one of the local languages: (iii) cause the name of the company and the country in which it is incorporated to be stated in English on all business letters, bill heads and letter paper and in all notices and other official publications of the company; and (iv) if liability of the members of the company is limited, cause notice of this fact to be stated in English and one of the local languages, on the outside of every office or place where it carries on business in Indian and on its letter paper, bill heads etc. (Sec. 595)

(5) **Service.** Any process, notice or document required to be served on a foreign company shall be deemed to be sufficiently served, if addressed to any authorised person of the company and either left at his address or sent to the address by post. (Sec. 596)

(6) **Delivery of documents.** Any document which any foreign company is required to deliver to the Registrar shall be delivered to the Registrar having jurisdiction over New Delhi, in addition to delivery of such documents to the Registrar of the State in which the principal place of business of the company is situated. (Sec. 597)

(7) **Failure to company with the above provisions.** If the company fails to comply with any of the provisions, (a) the company and every officer or agent of the company who is in default shall be punishable with a fine which may extend to one thousand rupees, and in case of continuing default, with an additional fine which may extentd to one hundered rupees for every day during whice the default continues. (Sec. 598): (b) it shall not affect the validity of any contract, dealing or transaction entered into by the company or its liability to be sued in respect thereof. But the company shall not be entitled to bring any suit, claim any set-off, make any counter-claim or institute any legal proceeding in respect of any such contract, dealing or transaction until it has complied with the above provisions. (Sec. 599)

(8) **Application of other provisions of the Companies Act.** The provisions relating to registration of charges (Secs. 124 to 145) will apply to a foreign company in respect of charges on property created in India. The provisions of Section 118 relating to the rights of members and debenture holders to obtain and inspect a copy of the trust deed for securing any issue of debentures of the company shall apply to foreign companies. Similarly the provisions of Section 209 shall apply to a foreign company to the extent of requiring it to keep at its principal place

of business in India the books of account with respects to moneys received and expended, sales and purchases made and asset and liabilities in relation to its business in India.

On and from the commencement of the Companies (Amendment) Act, 1974, the following provisions of the Act shall be applicable to foreign companies:

(a) The provisions of Section 159 relating to the annual return to be made by a company having a share capital, subject to such modifications of adaptations as may be made therein by the rules made under this Act.

(b) The provisions of Section 209(A) relating to inspection of books of account by the Registrar or officer of the government.

(c) The provisions of Section 233 (A) relating to the powers of the Central Government to direct special audit of the company's accounts.

(d) The provisions of Section 233(B) relating to audit of cost accounts in certain cases.

(e) The provisions of section 234 to 246 (both inclusive) relating to the powers of the Registrar to call for information or explanations a investigation of the affiars of company by the appointment of inspecto (Sec. 600)

Under Section 591(2), the Central Government may notify that the provisions of the Act as may be specified by it shall apply to a foreign company in which Indian citizens and bodies corporate incorporated in India hold not less than fifty per cent of the paid-up share capital of the company.

It may be noted here that the above provisions apply to a foreign company only in respect of its Indian business.

(9) **Fees for registration of documents.** There shall be paid to the Registrar for registering any document, such fees as may be prescribed. (Sec. 601)

(10) **Prospectus.** A prospectus inviting subscriptions for shares or debentures issued by a foreign company must be dated and it shall state the following particulars:

(i) name of the company;

(ii) name of the country in which it is incorporated and the date of incorporation;

(iii) the instrument constituting or defining the constitution of the company;

(iv) the enactments under which the incorporation was affected;

(v) the address in India where the said instrument, enactments or copies thereof can be inspected;

(vi) whether the company has established a place of business in India, and if so, the address of its principal office in India; and

(vii) matters specified in Part I of Schedule II and reports specified in Part II of that Schedule, subject always to the provisions contained in Part III of the Schedule. (Sec. 603)

The prospectus shall also state whether the liability of members is limited. [Sec. 595 (d)]

Where the prospectus includes a statement purporting to be made by an expert, the prospectus shall contain a statement that the expert has given and has not withdrawn his consent to the statement. [Sec. 604 (1)]

Section 605 provides that no prospectus shall be issued unless a copy of the prospectus certified by the chairman and two other directors of the company as having been approved by resolution of the managing body has been delivered for registration to the Registrar and the prospectus states on the face of it that a copy has been so delivered.

The liability for misstatement in the prospectus is the same as that for a prospectus issued by an Indian company. (Sec. 607)

(11) **Winding up.** Where a body corporate incorporated outside India that has been carrying on business in India ceases to do so, it may be wound up as an unregistered company. It may be wound up even if it has been dissolved or ceased to exist according to its own law of incorporation. (Sec. 584)

GOVERNMENT COMPANIES

There was a time when the State was concerned only with problems relating to the maintenance of law and order. But now the relationship between the State and economy has undergone a considerable change. There has been a growing participation of the State in the industrial development of the country. Considering this tendency, the Companies Act also includes provisions for government companies. The basic feature of these provisions is to enable the Government to undertake business ventures and to combine the operating flexibility of privately organised companies with the advantages of State regulation and control in the public interest.

Definition. A government company is one in which not less than fifty-one per cent of the paid-up share capital is held by the Central Government, or by any State Government, or Governments, or partly by the Central Government and party by one or more State Governments. The subsidiary of such a company is also a government company. (Sec. 617)

It is worth noting that a government company is not an agent of the Government unless it performs, in substance, governmental functions.[3]

[3]*Heavy Engineering Mazdoor Union v. State of Bihar* (1969) Comp. Cases 905 S.C.

On the same grounds it was held in *Ranjit Kumar v. Union of India* [4] that employees of a government company are not holders of civil posts under the State. In matter of industrial adjudication, the principles applicable to private companies will govern government companies.[5]

Special Provisions Relating to Government Companies

Appointment of auditors. The auditor of a government company shall be appointed or reappointed by the Central Government on the advice of the Comptroller and Auditor General of India. [Sec. 619 (2)]

Conduct of audit. The Comptroller and Auditor General of India shall have the power to direct the manner in which the company's accounts shall be audited by the auditor and to give such an auditor instructions in regard to any matter relating to the performance of his functions as such. He also has the power to conduct a supplementary or test audit of the company's accounts by such person or persons as he may authorise in this behalf. [Sec. 619 (3)]

Audit report to be submitted to the Comptroller and Auditor General of India. The auditor shall submit a copy of his audit report to the Comptroller and Auditor General of India who shall have the right to comment upon or supplement the audit report in such manner as he may think fit. [Sec. 619(4)]

Audit report to be placed before the annual general meeting. Any such comments upon, or supplement to, the audit report shall be placed before the annual general meeting of the company at the same time and in the same manner as the audit report. [Sec. 619(5)]

Annual reports to be placed before Parliament. Where the Central Government is a member of a government company, the Central Government shall prepare the annual report on the working and affairs of the company within three months of it annual general meeting before which the audit report is placed. The annual report is to be laid before both Houses of Parliament together with a copy of the audit report and the comments or supplementary report of the Comptroller and Auditor General of India. [Sec. 619(A)(1)]

Where in addition to the Central Government, a State Government is also a member of a government company, that State Government shall cause a copy of the annual report to be laid before the State Legislature together with a copy of the audit report and the comments or supplementary report of the Comptroller and Auditor General of India. [Sec. 619(A)(2)]

[4] A.I.R. (1969) Cal. 95.

[5] *Hindustan Antibiotics v. The Workmen*, A.I.R. 1967, S.C. 948.

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Where the Central Government is not a member of a government company, every State Government which is a member of that company or where only one State Government is a member of the company, the State Government shall cause an annual report on the working and affairs of the company to be prepared within three months of its annual general meeting before which the audit report is placed. The annual report is to be laid before the State Legislature together with a copy of the audit report and comments or suplementary report of the Comptroller and Auditor General of India. [Sec. 619(A)(3)]

The Amendment Act of 1988 makes it obligatory for laying of an annual report on a government company before both the Houses of Parliament or the State Legislature even in the case of government company in liquidation. [Sec. 619(A)(4)]

Provisions of Section 619 to apply to certain companies. Section 619(B) empowers the Central Government to appoint auditors on the advice of the Comptroller and Auditor General of India for the purpose of the audit of accounts of companies in which not less than fifty-one per cent of the paid-up share capital is held by Government, government companies and public financial corporations. The Comptroller and Auditor General of India shall have powers to direct the manner in which the company's accounts shall be audited.

Power of the Central Government to modify Act in relation to government companies. The Central Government may direct that the provisions of the Act specified in the notification (other than Sections 619 and 619 A) shall not apply to any government company. In a similar way it may direct that specified provisions of that Act will apply with modifications as mentioned in the notification. [Sec. 620(1)]

A copy of every such notification proposed to be issued shall be laid before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions. If the Parliament disapproves of the issue of the notification, it shall not be issued. The Parliament may approve it with modifications. In such a case the modified notification may be issued. [Sec. 620(2)]

A government company shall comply with all the provisions of the Act unless it is specifically exempted, as mentioned above. Like other companies, it can aiso be wound up under the provisions of the Companies Act.

HOLDING AND SUBSIDIARY COMPANIES

When a company has control over another company, it is known as a

holding company. The company which is so controlled is known as a subsidiary company.

Section 4(4) provides that a company shall be deemed to be the holding company of another, if, but only if, that other is its subsidiary.

Conditions of holding and subsidiary relationship. A company shall be deemed to be a subsidiary company of another only if any or more of the following conditions are satisfied:

(1) *Where the composition of its board of directors is controlled by the other company* [Sec. 4(1)(a)]. The composition of a company's board of directors shall be deemed to be controlled by another company if other company, by exercise of some power exercisable by it at its discretion without the consent or concurrence of any other person, can appoint or remove the holders of all or a majority of directorships. [Sec. 4(1)(a)]

A company shall be deemed to have power to appoint to a directorship in each of the following three cases: (a) if a person cannot be appointed to a directorship without the exercise in his favour by that other company of such a power as aforesaid; (b) if a person's appointment to a directorship follows necessarily from his appointment as a director or manager or to an other office of employment in that other company; (c) if the directorship is held by an individual nominated by that other company or subsidiary threof. [Sec. 4(2)]

(2) *Where the other company holds more than half in nominal value of its equity share capital;* or where the other company, holds more than half of the total voting power of such company, if such company has preference shareholders who had, before the commencement of the Act of 1956 and therefore, still have, the same voting rights in all respects as the holders of equity shares. [Sec. 4(1)(b)]

In determining whether one company is a subsidiary of another, shares held or power exercisable in the following cases shall not be taken into account; (a) any shares held or power exercisable by that other company in a *fiduciary* capacity; (b) where the shares are held or power is exercisable by any person by virtue of the provisions of any debentures or of a trust deed for securing any issue of such debentures; and (c) where shares are held or power is exercisable by a lending company by way of security only for the purpose of a transaction entered into in the ordinary course of that business. [Sec. 4(3)]

(3) *Where one company is a subsidiary of any company that is another's subsidiary, e.g.* company B is a subsidiary of company A, and company C is a subsidiary of company B. Accordingly, company C becomes a subsidiary of company A. If company D is a subsidiary of company C, company D will become a subsidiary of company B and consequently also of company A. [Sec. 4(1)(c)]

Case of a foregin Company. In the case of a body corporate which is incorporated in a country outside India, a subsidiary or holding company of the body corporate under the law of such a country shall be deemed to be a subsidiary or holding company of the body corporate within the meaning and for the purposes of this Act also, whether the requirements of this section are fulfilled or not. [Sec. 4(6)]

Case of a private company. It may further be noted that a private company which becomes a subsidiary of a public company shall lose some of the privileges and exemptions conferred on an independent private company.

A private company, being a subsidiary of a body corporate incorporated outside India, which if incorporated in India, would be a public company within the meaning of this Act, shall be deemed for the purposes of this Act to be a subsidiary of a public company unless the entire share capital in that private company is held by that body corporate whether alone or together with one or more other bodies corporate incorporated outside India. [Sec. 4(7)]

Membership of holding company. Section 42 provides that a company cannot be a member of its holding company and any allotment or transfer of shares in a company to its subsidiary or nominee for its subsidiary will be void. This section shall not apply where the subsidiary is concerned as the legal representative of a deceased member of the holding company or where the subsidiary is trustee for some other shareholder and the holding company or its subsidiary is not beneficially interested except as lender of money in the ordinary course of a business. Where at the commencement of the Act a subsidiary was a member of the holding company, it may continue its membership but without any voting rights except in the two cases mentioned above.

Section 77 provides that no public company or no subsidiary private company shall in any way provide money to any person to enable him to buy any share in the company or in its holding company.

Balance sheet of holding company. Under section 212(1), there shall be attached to the balance sheet of a holding company the following documents in respect of each subsidiary; (a) a copy of the balance sheet of the subsidiary; (b) a copy of the profit and loss account; (c) a copy of the report of its board of directors; (d) a copy of the report of its auditors; and (e) a copy of the holding company's interest in the subsidiary at the end of the financial year; (f) if for any reason, the board of directors of the holding company is unable to obtain information on any of the above matters, a report in writing to that effect must be attached to the balance sheet of the holding company; (g) where the financial year of the subsidiary company does not coincide with the financial year of the

holding company, a statement indicating the change in the holding company's interest in the subsidiary between the gap of the two companies' financial years must be attached.

Rights of holding company's representatives and members. A holding company may, by resolution, authorise its representatives to inspect the account books of its subsidiary companies and the books of account of any such subsidiary shall be open to inspection by those representatives at any time during business hours. [Sec. 214(1)}

Although the corporate veil may be lifted for determining whether the relationship of a holding and subsidiary company does exist between two companies yet each company has its own separate legal entry.[6]

ILLEGAL ASSOCIATION

An association is a group of persons associated together for some common object. The maximum number of members who can carry on business for gain without registration as an association is ten in the case of banking business, and twenty in the case of any other type of business. Section 11 provides that no company, association or partnership consisting of more than twenty persons (ten in the case of banking business) shall be formed for the purpose of carrying on any business with a view to gain, unless it is registered as a company under the Companies Act or is formed in pursuance of some other Indian law. If it is not so registered, it is deemed to be an illegal association, although none of the objects for which it may have been formed is illegal.

Conditions of an illegal association. An association will be deemed an illegal association in the following conditions:

(1) the association must consist of more than ten persons in the case of banking business, and twenty in the case of any other business;

(2) the association must have been formed for the purpose of carrying on business;

(3) the object of the association must be the acquisition of the gain for itself or for its members; and

(4) the association must not have been registered as a company under the Companies Act or must not have been formed in pursuance of some other Indian law.

Single Joint Hindu Family exempted. Section 11 shall not apply to Joint Hindu Family carrying on a business as such. Such a family can carry on family business with more than twenty members without getting

[6]*Turner Morrison & Co. Ltd., v. Hungerford Investment Trust Ltd.*, A.I.R. 1969, Cal. 238.

itself registered as a company under the Companies Act or any other Indian law.

Rules for counting number of members. Section 11 does not apply to a Joint Hindu Family carrying on a business. But where a business is conducted by two or more joint families, Section 11 applies and in computing the number of persons for this section, minor members of such families shall be excluded any only adults of both joint families shall be counted. [Sec. 11 (3)]

But if the "karta" of a family enters into partnership in his representative capacity on behalf of his family, he shall be treated as an individual.[7]

A sub-partner in a firm does not affect the number of partners in a firm for the purpose of Section 11. [8]

A partnership has no separate legal entity of its own and if it is a member of an association, it will not be counted as one person. Rather each partner will be counted as separate member of the association.[9]

Conducting business for gain. For the application of Section 11, there must be a business for the acquisition of gain. Where an association is formed and members contribute sums to be applied for the medical relief of members and the balance is distributed at the end of every year amongst the members, it is held not to be a business.[10] It was held in *Smith* v. *Anderson*,[11] that association formed for mutual indemnity and trusts for hazardous securities formed for the purpose of investment and saving of loss do not constitute a business and as such need not be registered.

Similarly, where more than twenty members carrying on a similar business entered into a "pooling agreement to eliminate competition and the members gained out of this pooling agreement," it was not considered to be an association formed for the purpose of carrying on business under Section 11. It was considered a trade association formed with the object of protecting its members from unnecessary competition.[12]

It may further be noted that an association conducting a business whose object is not acquistion of gain, need not be registered under the Act. "Gain" refers to acquiring or obtaining something. It is not limited to pecuniary gain or commercial profit.[13] Accordingly an association

[7] *Mewa Ram v. Ram Gopal*, A.I.R. (1926) 48 Alld. 735.
[8] *Chandu Lal v. Keshav Lal* 38 Bomb. L.R. 486.
[9] *Senaji v. Pannaji* 32 Bomb. L.R. 1607. (P.C.).
[10] *Re One and All Sickness Etc., Association* (1909) 25 T.L.R. 674.
[11] (1880) 15 Ch. D. 247.
[12] *New Mofussil Co. Ltd. v. Rustomji* 38 Bomb. L.R. 408.
[13] *Tan Waing v. Bo Hein* 10 Rang. 490.

formed for the purpose of promoting art, science and religion or for charitable purposes need not be registered.

The profits made by an illegal association are liable to assessment to income-tax.[14]

Consequences of Illegal Association

An illegal association has serious consequences and limitations:

(i) It is not recognised by law and hence it has no legal existence. It was pointed out that the consequence of illegality of a partnership is that its members have no remedy against each other for contribution or apportionment in respect of partnership dealings and transactions.[15]

(ii) In cannot enter into a contract.[16]

(iii) It cannot sue any member or any outsider if the illegality becomes apparent.[17]

(iv) It cannot be sued by a member or an outsider for it does not have contractual capacity.[18]

(v) It cannot enforce a contract.[19]

(vi) It cannot be dissolved through the court.[20]

(vii) It cannot be wound up under the Act at the instance of a creditor, member or the association itself.[21]

Members, however, can ask for a refund of money paid by them provided the money has not already been used for conducting the business of the illegal association. The court may, under general jurisdiction, administer trusts, without reference to this Act, wind up an unregistered society and make the manager account for and distribute assets.[22]

It may be noted here that the illegality of unregistered association cannot be remedied by a subsequent reduction of members to below twenty.[23] Similarly a contract made by an illegal association before registration cannot be made valid and be sued upon even if the company is subsequently registered.[24]

[14]*Sri Gopalji Co. v. C.I.T.,* A.I.R. 1931 Lahore 376.

[15]*Kamaraswami Chettiar v. Chinnathambi Chettiar* (1950) 2 M.L.J. 453.

[16]*Jennings v. Hammond* 9 Q.B.D. 225.

[17]*N.C. Shaha v. L.M. Shaha* (1938) 2 Cal. 368.

[18]*Maneckji v. C.N. Cama* 3 Bomb. H.C.R. 159 (O.C.).

[19]*Shaw v. Benson* (1883) 11 Q.B.D. 563.

[20]*Mewa Ram v. Ramgopal*, A.I.R. 1926 48 Alld. 735.

[21]*Re Ilfracombe Permanent Mutual Benefit Bldg. Society Ltd.* (1901) 1 Ch. 102.

[22]*Greenberg v. Cooperstein* (1929) 1 Ch. 657.

[23]*Madan Lal v. Janki Prasad* 49 Alld. 319.

[24]*The Gujarat Trading Co. Ltd. v. Tricumji* 3 Bomb. H.C.R. (O.C.) 45.

(viii) Further, every member of the illegal association shall be personally liable for all liabilities incurred in business. [Sec. 11(4)]

(ix) Moreover every member of such an association shall be punishable with fine which may extend to one thousand rupees. (Sec. 11(5)

QUESTIONS

1. What are the different types of companies which may be incorporated under the Companies Act? Explain their features.

2. What is a private company? What are the privileges and exemptions enjoyed by it under the Companies Act? *[Delhi B. Com. (Hons.), 1987]*

3. "The law not only recognises a private company but also bestows its benedictions on the same." Comment. *[Delhi B.Com. (Hons.), 1980]*

4. Differentiate between a private and a public company. When does a private company become a public company? *[Delhi, B.Com. (Hons.), 1976]*

5. What are main characteristics of a private limited company? Under what circumstances does a private limited company become a public company by virtue of provisions of Sec. 43 A of the Companies Act? *[C.A. (Final), May 1976]*

6. (a) Describe the main privileges of a private limited company.

(b) How can a private company be converted into a public limited company. *[Delhi, B.Com., 1989]*

7. (a) Define a private company. How does it differ from a public company?

(b) Describe the restrictions on a private company. *[Poona B.Com. (Part I), 1970]*

8. What are Government Companies? What are the special provisions of the Companies Act pertaining to this class of companies?

[Delhi, B. Com. (Hons.), 1970; Company Secretary (Final), Oct. 1970]

9. What is a Government Company? What are its special features? How far, if at all, it is governed by the Companies Act, 1956? *(I.C.W.A. July 1967)*

10. Can a public company be converted into a private company and if so, how?

11. Define a foreign company. What are the provisions of the Companies Act relating to foreign companes?

12. (a) State the nature of the documents to be filed with the Retgistrar of Companies by foreign companies carrying on business in India.

(b) Under what circumstances will a foreign company carrying on business in India be treated as if it were incorporated in India? *[C.A. (Final), May 1976]*

13. Briefly explain the meaning of: (i) Holding Company, (ii) Subsidiary Company and distinguish between them. *[C.A. (Final), May 1976]*

14. What do you understand by a holding company and a subsidiary company? Under what circumstances a company shall be deemed to be the subsidiary of another company? Also, state the rights of the members of a holding company in respect of its subsidiary company.

15. Write a short note on holding company. *[Delhi, B. Com. (Hons), 1986]*

16. What is the position and status of a company consisting of more than 20 members but not registered under the Companies Act? What are the disabilities

that the said company and those who deal with it suffer from?

17. What is an illegal association? What are its consequences?,

[Delhi B. Com. (Hons), 1986]

18. Write short notes on the following.

(a) One-man Companies

(b) Association not for Profits.

19. "A limited company can be formed without the word 'Limited' as the last word of its name." *[Delhi B.Com.(Hons), 1974]*

PRACTICAL PROBLEMS

1. Forty-nine per cent of the paid-up capital of *A*, a private company is held by *B*, a non-banking public company incorporated in India. Does *A* become a public company? Give reasons for your answer. *[Delhi B.Com (Hons), 1969]*

2. Thirty-five per cent of the paid-up share capital of *A*, a private company, is held by *C*, a non-banking public company incorporated in India. Does *A* become a public company? Give reasons for your answer. *(I.C.W.A. Dec. 1974)*

3. Forty per cent of the paid-up share capital of Company *A* is held by the Central Government and eleven per cent by public institutions like the Life Insurance Corporation of India and the Unit Trust of India. Is *A* a government company? *[Delhi, B. Com. (Hons.), 1970]*

4. An association of 12 persons starts a banking business without being registered. Four members retire and thereafter a suit is instituted by one of continuing members for the partition of the assets of the business. Is the suit competent. *(Delhi, M. Com. 1962)*

5. A Company *X*, its Managing Director and another Director hold respectively one-third of the number of shares in another Company *Y* and thus together they hold all shares of the Company *Y*. Is *Y* a subsidiary of Company *X*?

[Company Secretary (Final), April 1976]

6. A Joint Hindu Family consisting of a father and five major sons, and another family, consisting of a father, five major sons and one minor son, carried on banking business, as owners thereof. Discuss if the organisation requires registration under the Companies Act. *(C.A., May 1964)*

7. Two Joint Hindu families carry on a business as joint-owners. The first family consists of 3 brothers and their respective sons, being 12 in number. The second family consists of the father, 4 major sons and 2 minor sons. Is the association illegal? *(I.C.W.A., Dec. 1977)*

8. The Karta of a joint Hindu family *A* consisting of 12 adult members and the Karta of another joint Hindu family *B* consisting of 13 adult members enter into partnership in their representative capacities on behalf of their families without getting registered under the Companies Act. Is the association illegal?

9. In a private limited company, it is discovered that there are, in fact 54 members. On an enquiry, it is ascertained that 6 of such members have been employees of the company in the recent past, and that they acquired their shares while they were still employees of the company. Is it necessary to convert the company into a public limited company? *(I.C.W.A., June 1976)*