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# UNIT 1 NATURE AND TYPES OF COMPANIES

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## 1.0 OBJECTIVES

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After studying this Unit, you should be able to:

- define a company;
- distinguish between company and body corporate;
- describe the characteristic features of a company;

- explain the concept of corporate veil;
- distinguish between company and partnership;
- distinguish between company and limited liability partnership;
- describe the various types of companies;
- understand associations not for profit; and
- describe an illegal association.

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## 1.1 INTRODUCTION

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The Companies Act, 2013 received the assent of the President on 29<sup>th</sup> August and was notified on 30<sup>th</sup> August, 2013. It has 470 sections and VII schedules, whereas the Companies Act 1956 had 658 sections and XV schedules. This Act provides detailed rules regarding formation, management and administration and winding up of companies by Tribunals. It has made changes in provisions relating to memorandum, definition of prospectus, appointment of auditors, and accounting standards and financial statements and investigations etc. This Act has been amended by Companies amendment Act 2015, 2017 and 2019. In this introductory unit you will study the meaning and definition of a company, the main features of a company form of business organization, its distinction from partnership as well as limited liability partnership and the various types of companies that can be formed in India.

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## 1.2 MEANING AND DEFINITION OF A COMPANY

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The term ‘company’ may be described to imply an association of persons formed for some common object or objects. The purposes for which people may associate themselves are multifarious and include economic as well as non-economic objectives. However, the term ‘company’ is normally reserved for those associated for economic purpose, i.e, to carry on a business for gain. **This should, however, not give you an impression that a company under the companies Act cannot be created for non-economic or charitable purposes. In fact, Section 8 of the Companies Act, 2013 allows formation of non-profit associations as companies.**

Partnerships often describe themselves as ‘A, B, C & Company’. But, this does not make the firm a company in the legal sense of the word; it only suggests that there are other persons also in the association.

In legal terminology, a company means a company incorporated or registered under the Companies Act, 2013 or under any of the earlier Companies Acts. Section 2(20) of the Companies Act, 2013 defines a company to mean a company incorporated under this Act or under any previous company law. This definition, however, is not exhaustive because it does not reveal the meaning and characteristics of a company. Thus we have to see definition of a company as given by famous Jurists.

*Lord Justice Lindley* defines a Company as follows:

“A company is an association of many persons who contribute money or money worth to a common stock and employ it in some trade or business, and who share the profit and loss (as the case may be) 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 called members. The

proportion of capital to which each member is entitled is his share. Shares are always transferable although the right to transfer them is often more or less restricted.”

Another definition as given by *Chief Justice Marshall* reads as follows:

“A company is a person, artificial, invisible, intangible and existing only in the eyes of law. Being a mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence.”

According to **Lord Haney**, “A company is an incorporated association which is an artificial person created by law, having a separate entity, with a perpetual succession and a common seal.”

From the above definitions, it is clear that a company has a corporate and legal personality. It is an artificial person and exists only in the eyes of law. It has an independent legal entity, a common seal and perpetual succession.

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### 1.3 COMPANY VS. BODY CORPORATE

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Body corporate means an association of persons which has been incorporated under some statute having perpetual succession, a common seal and having a legal entity different from the members constituting it. Section 2 (11) of the Companies Act, 2013 defines the expression ‘body corporate’ as follows:

“Body corporate” or “Corporation” includes a company incorporated outside India, but **does not include**—

- i) a co-operative society registered under any law relating to co-operative societies; and
- ii) any other body corporate (not being a company as defined in this Act), which the Central Government may, by notification, specify in this behalf”.

A body corporate may be-

- a) corporation sole, or
- b) corporation aggregate.

A ‘**corporation sole**’ is a body corporate constituted in a single person who, in right of some office or function, has corporate status. Examples of ‘corporation sole’ are to be found in perpetual offices such as the President, Governors, Crown, Ministers, and a public trustee. A corporation sole is not a ‘body corporate’ for the purposes of the Companies Act, 2013. It is still a legal person and as such person it can be a member of a company- **Star Tile Works Ltd. v. N. Govindan (1956)**.

A ‘**corporation aggregate**’ consists of a group of persons together associated so that they form a single person, e.g., a limited company, a trade union.

It may be of interest to note at this stage that because of inclusion of a company incorporated outside India within the definition of body corporate, a number of provisions of the Companies Act, 2013 apply to such companies; for example, Section 380 requires foreign companies carrying on business in India to deliver certain documents to the Registrar of Companies.

The expression ‘corporation’ or ‘body corporate’ is, thus, wider than the word ‘company’. A company, as noted above, is a corporation aggregate.

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## 1.4 IS COMPANY A CITIZEN?

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Although a company is regarded as a legal person (though artificial), it is not a citizen either under the Constitution of India or the Citizenship Act, 1955- **Heavy Engineering Mazdoor Union v. State of Bihar (1969)**. The Supreme Court of India in **State Trading Corporation Ltd. v. CTO (1963)** held that a corporation including a company cannot have the status of a citizen under the Constitution of India. Thus, under the Constitution, a company has no fundamental rights which are expressly available to citizens only. It can, however, claim the protection of those fundamental rights which are available to all persons, whether citizens or not, for example, the right to own property.

In **Narasaraopeta Electric Corporation Ltd. v. State of Madras (1951)**, the High Court observed that a company incorporated under the Indian Companies Act does not satisfy the requirements of the definition of 'citizen' in Article 5 of the Constitution and therefore is not a citizen.

A company is also not allowed to lay claim to fundamental rights on the basis of its being an aggregate of citizens. Once a company or a corporation is formed, the business of the company or the corporation is not the business of the citizens but that of the company or corporation formed as an incorporated body and the rights of the incorporated body must be judged on that footing and cannot be judged on the assumption that they are the rights attributable to the business of individual citizens-Supreme Court in **Telco Ltd. v. State of Bihar (1964)**.

Although a company cannot be a citizen, yet it has a nationality, domicile and residence. A company is said to be resident and national of the place and country where is incorporated.

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## 1.5 MAIN FEATURES OF A COMPANY

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On analyzing the various legal and juristic definitions of the term company, you will observe that a company formed and registered under the Companies Act has certain special features which distinguish it from the other forms of organisations. The main characteristic features of a company are as follows:

- 1) **Creation of Law:** A company is an association of persons (except in case of 'One Person Company') registered under the Companies Act. It comes into existence only when it is so registered. Minimum number required for the purpose is 2, in case of a private company and 7, in case of a public company. Only one person can form a 'one person company' (*Section 3*).
- 2) **Artificial Person:** A company is created with the sanction of law and is not itself a human being. It is, therefore, called artificial; and since it is clothed with certain rights and obligations, it is called a person. A company is accordingly an artificial person.
- 3) **Separate Legal Entity:** Unlike partnership, company is distinct from the persons who constitute it. Section 9 says that on registration, the association of persons becomes a body corporate by the name contained in the memorandum.

The legal status of a company has been aptly described by the Supreme Court of India in **Tata Engineering & Locomotive Co. Ltd. v. State of Bihar** as follows:

“The corporation in law is equal to a natural person and has a legal entity of its own. The entity of the corporation is entirely separate from that of its shareholders; it bears its own name and has a seal of its own; its assets are separate and distinct from those of its members; it can sue and be sued exclusively for its own purpose”.

Even though the company lacks physical existence, for purposes of law it is regarded as an independent legal person who has personality of its own and is different from the members constituting the company. Therefore, a company can enter into a contract with any of its members. A person can own its shares and also be its creditor. A shareholder of a company cannot be held liable for its acts and debts even though he virtually holds the entire share capital. No member can either individually or jointly claim any ownership rights in the assets of the company during its existence or on its winding up. Similarly, creditors of the company are the creditors of the company alone and they cannot take action against the members of the company.

Even where a single shareholder virtually holds the entire share capital, a company is to be differentiated from such a shareholder. In the well known case of **Salomon v. Salomon & Co. Ltd. (1895-99)**, Salomon was running a shoe business in England. He formed a company known as ‘Salomon & Co. Ltd.’. It consisted of Salomon himself, his wife, his four sons and a daughter. The shoe business of Mr. Salomon was sold to the company for £30,000. Mr. Salomon received from the company purchase price in the form of £20,000 fully paid shares of £1 each and £10,000 in debentures which carried a floating charge over the assets of the company and the balance in cash. One share of £1 each was subscribed for in cash by each member of Salomon’s family. Salomon was appointed the managing director of the company. During the course of business, the company became liable for some unsecured loan. The company in less than one year ran into financial difficulties and the liquidation proceedings started. On winding up, the assets realized £6,000. The company owed £10,000 to Mr. Salomon and £7,000 to unsecured creditors. Thus, after paying off the debenture holder (Mr. Salomon), nothing was left for unsecured creditors. The creditors claimed priority over the debentures contending that Mr. Salomon and Salomon & Co. Ltd. was one and the same person. The company was only a façade to defraud the innocent creditors. Mr. Salomon should not be treated as a secured creditor, outside creditors should be paid first. The House of Lords held that the company had been validly constituted, and it is independent of its members. So Salomon is entitled to get his money first as he is a secured creditor. The business belonged to company and not to Salomon. Salomon was its agent; the company was not the agent of Salomon.

**In T.R. Pratt (Bombay) Ltd. vs. E.D. Sasoan and Co. Ltd.**, it was observed that under the law, an incorporated company is a distinct entity, and although all the shares may be practically controlled by one person, in law a company is a distinct entity. Similarly, in **Abdul Haq vs. Das Mal**, an employee sued a director of the company for the recovery of the amount of salary due to him. It was held that he could not succeed because the remedy lied against the company and not against the directors or members of the company.

As a consequence of separate legal entity, the company may enter into contracts with its members and vice-versa. Thus, a shareholder can be the creditor of the company.

4) **Limited Liability:** A major advantage enjoyed by a company is that the liability of its members is limited. The company being a separate person, its

members are not as such liable for its debts. You will later study that on the basis of liability, companies may be classified as (i) Companies limited by shares, (ii) Companies limited by guarantee, (iii) Companies limited by guarantee but having share capital, and (iv) Unlimited liability companies.

In case of a *company limited by shares*, the liability of members is limited to the nominal value of shares held by them. Thus, if the shares are fully paid up, their liability will be nil. In case of a *company limited by guarantee*, the liability of the members is limited up to the amount guaranteed by a member. But, in case of a *guarantee company having share capital*, the liability shall be limited to the aggregate of the amount remaining unpaid on the shares held by a member and the amount guaranteed by him.

You may note that, the Companies Act, 2013 allows companies to be formed with liability of members as unlimited. In case of an unlimited liability company, the liability of members shall not be limited to the nominal or face value of the shares held by them; they shall continue to be liable till each paisa of company's debts and liabilities has been paid off. However, the company being a separate legal entity, no suit can be filed by the creditors directly against the members.

- 5) **Separate Property:** Shareholders are not, in the eyes of the law, part owners of the undertaking. In India, this principle of separate property was best laid down by the Supreme Court in **Bacha F. Guzdar v. Commissioner of Income Tax, Bombay (supra)**. The Supreme Court held that a shareholder is not the part owner of the company or its property, he is given only certain rights by law, e.g., to vote or attend meetings, to receive dividends.

In **Macaura v. Northern Assurance Co. Ltd. (1925)**, it was held that a member does not even have an insurable interest in the property of the company. In this case, Macaura held all except one share of a timber company. He insured the company's timber in his own name. On timber being destroyed by fire, his claim was rejected because he had no insurable interest in that timber. The Court observed: "No shareholder has any right to any item of property of the company for he has no legal or equitable interest therein".

- 6) **Perpetual Succession:** The term perpetual succession means the continued existence. The existence of the company is not affected by reasons such as the insolvency, death, unsoundness of mind of its members. The company has a perpetual succession. Members may come and members may go but the company goes on. It continues even if all its human members are dead. Even where during the war, all the members of a private company, while in general meeting were killed by a bomb, the company survived. Not even a hydrogen bomb could have destroyed it. In the aforesaid eventuality, the legal successors of the deceased shareholders will become the members. But this does not mean that a company can never come to an end. You learnt that a company is creation of law, it can also be brought to an end by the process of law.
- 7) **Transferability of Shares:** One particular reason for the popularity of joint stock companies has been that their shares are capable of being easily transferred. The shares of a public company are freely transferable. A shareholder can transfer his shares to any person without the consent of other members. Articles of association, even of a public company can put certain restrictions on the transfer of shares but it cannot altogether stop it. A shareholder of a public company possessing fully paid up shares is at liberty to transfer his shares to anyone he likes in accordance with the

manner provided for in the articles of association of the company. **The Companies Act, 2013, vide Section 58(2) provides that without prejudice to sub-section (1), the securities or other interest of any member in a public company shall be freely transferable Provided that any contract or arrangement between two or more persons in respect of transfer of securities shall be enforceable as a contract. Thus, the present Act upholds shareholders' agreements providing for 'Right of first offer' and 'Right of first refusal' as valid even in case of a public company.**

However, a private company is required to put certain restrictions on transferability of its shares but the right to transfer is not taken away absolutely even in case of a private company.

- 8) **Common Seal:** A company being an artificial person is not bestowed with body of natural being. Therefore, it has to work through its directors, officers and other employees. But, it can be held bound by only those documents which bear its signatures. Common seal is the official signature of a company. A metallic seal should be used. A company may have a common seal with its name engraved on the same.

As per Section 22, a company may, under its common seal, through general or special power of attorney empower any person to execute deeds on its behalf in any place either in or outside India. It further provides that a deed signed by such an attorney on behalf of the company and under his seal where sealing is required, shall bind the company and have the effect as if it were under its common seal as per Companies (Amendment) Act, 2015, common seal is optional. In case a company doesn't have a common seal, the authorization shall be made by two directors or by a director and the company secretary, wherever the company has appointed a company secretary. Again, except where so provided in the Act, a document or proceeding requiring authentication by a company may be signed by any key managerial personnel or an officer or employee duly authorised by the Board in this behalf and need not be under its common seal [Section 21].

- 9) **Company may sue and be sued in its own name:** As juristic person, company can sue and be sued in its own name. This is so because a company has a separate legal existence. A company may enter into contracts and can enforce the contractual rights against others and it can be sued by others if it commits a breach of contract.

**Check Your Progress A**

- 1) Define a company.  
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- 2) Enumerate the three main features of a company.  
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- 3) State, whether the following statements are true or false:
- i) A company is the creation of law.
  - ii) A company is an artificial person.
  - iii) Since company is an artificial person, it can commit no wrong nor can it be sued in its own name.
  - iv) Like a partnership, a company comes to an end when any shareholder of the company dies.
  - v) A company although is a corporate person yet it is not a citizen.
  - vi) The liability of a member is limited to the face value of the shares held by him.

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## 1.6 LIFTING THE CORPORATE VEIL

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Under Para 1.5, you learnt that a company has a separate legal entity independent and different from its members. This principle of separate legal entity was well established in the famous case of **Salomon v. Salomon and Company Ltd.** On incorporation a line of demarcation or a veil is drawn between the company and its members. In fact, a company is an association of persons and such persons are the real beneficial owners of all the corporate property. Real persons behind the company are disregarded once they have formed a company and given the status of a legal entity.

As a consequence of this separate legal entity, the company enjoys several advantages which you have studied in foregoing Para. But, the advantages of incorporation are allowed to be enjoyed only by those who want to make an honest use of the 'company'. In case of a dishonest and fraudulent use of the facility of incorporation, the law lifts the corporate veil and identifies the persons who are behind the scene and are responsible for the fraud. The corporate veil is said to be lifted when the court ignores the company and concerns itself directly with the officers or members of the company. Prof. Gower has observed, "When the law disregards the corporate entity and pays regard instead to the individual members behind the legal façade, it is known as lifting the veil of corporate personality".

You should, however, note that the power of the court to lift the corporate veil is purely discretionary. The court will lift the corporate veil when it is in the public interest to do so. In **Cotton Corporation of India Ltd. v. G.C. Odusumathd (1999)**, the Karnataka High Court observed that lifting of the corporate veil of a company, as a rule is, not permissible in law unless otherwise provided by clear words of the statute or by very compelling reasons such as where fraud is intended to be prevented or trading with enemy company is sought to be defeated.

The circumstances under which the courts may lift the corporate veil may broadly be grouped under the following two heads:

- A) Under express statutory provisions
- B) Under judicial interpretations

Let us now discuss them in detail.

### 1.6.1 Under Express Statutory Provisions

The Companies Act, 2013 provides for certain circumstances in which the directors or members of the company may be held personally liable. In such cases, while



the separate entity of the company is maintained, the directors or members are held personally liable along with the company. These circumstances are as follows:

- 1) **Mis-statements in prospectus [Sections 34 & 35]** - In case of misrepresentation in a prospectus, the company and every director, promoter, expert and every other person, who authorised such issue of prospectus shall be liable to compensate the loss or damage to every person who subscribed for shares on the faith of untrue statement (Sec. 35).

Besides, these persons may be punished with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud (**Section 34 and Section 447 read together**). **However, a person may escape the aforesaid conviction if he proves that such statement or omission was immaterial or that he had reasonable grounds to believe, and did up to the time of issue of the prospectus believe, that the statement was true or the inclusion or omission was necessary.**

- 2) **Failure to return application money [Sec. 39]** - In case of issue of securities by a company to the public, if minimum subscription, as stated in the prospectus has not been received within 30 days of the issue of prospectus or such other period as may be specified by the SEBI, then as per Rule 11 of Companies (Prospectus and Allotment of Securities) Rules, 2014, the application money shall be repaid within a period of fifteen days from the closure of the issue and if any such money is not so repaid within such period, the directors of the company who are officers in default shall jointly and severally be liable to repay that money with interest at the rate of fifteen percent per annum.

In case of default, the company and its officer who is in default shall be liable to a penalty of one thousand rupees for each day during which such default continues or one lakh rupees, whichever is less.

- 3) **Non-disclosure /Misdescription of Name [Sec. 12] - As per Section 12, a company shall have its name printed on hundies, promissory notes, bills of exchange and such other documents as may be prescribed.** Thus, where an officer of a company signs on behalf of the company any contract, bill of exchange, hundi, promissory note, cheque or order for money, such person shall be personally liable to the holder if the name of the company is either not mentioned, or is not properly mentioned. Accordingly, where on a cheque, the name of a company was stated as 'LR agencies limited' whereas the real name of the company was 'L&R Agencies Ltd.' the signatory directors were held personally liable [**Hendon v. Adelman (1973)**]. Besides, the company and its officer who is in default shall be liable to a penalty of one thousand rupees for each day during which such default continues or one lakh rupees, whichever is less.
- 4) **For facilitating the task of an inspector appointed under Section 210 or 212 or 213 to investigate the affairs of the company [Sec. 219]** - Section 219 provides that if an inspector appointed under Section 210 or 212 or 213 to investigate the affairs of the company considers it necessary for the purposes of investigation, he may investigate into the affairs of another related company in the same management or group as well as into the affairs of any person who is or has at any relevant time been the company's managing director or manager or employee.

- 5) **For investigation of ownership of company [Sec. 216]** - Under Section 216, where it appears to the Central Government that there is a reason so to do, it may appoint one or more inspectors to investigate and report on matters relating to the company, and its membership for the purpose of determining the true persons—
- a) **who are or have been financially interested in the success or failure, whether real or apparent, of the company; or**
  - b) **who are or have been able to control or to materially influence the policy of the company.**
- 6) **Liability for *ultra vires* acts** - Directors and other officers of a company will be personally liable for all those acts which they have done on behalf of a company if the same are *ultra vires*, i.e, beyond the powers of the company.

7) **Fraudulent Conduct of business (Section 339)**

Under Section 339 of the Act if in the course of the winding up of a company, it appears that any business of the company has been carried on with the intention to defraud its creditors or any other persons, in such a case the persons who were knowingly party to such acts may be held personally liable for any debts and other liabilities of the company. In such a situation, the Tribunal may disregard the legal entity of a company and make the fraudulent persons personally liable for the debts of the company.

- 8) **Liability under other statutes** - Besides the Act, directors and other officers of the company may be held personally liable under the provisions of other statutes. *For example*, under the *Income-tax Act*, where any private company is wound-up and if tax arrears of the company in respect of any income of any previous year cannot be recovered, every person who was director of that company at any time during the relevant previous year shall be jointly and severally liable for payment of tax. Similarly, under *Foreign Exchange Management Act, 1999*, the directors and other officers may be proceeded individually or jointly for violations of the Act.

### 1.6.2 Under Judicial Interpretations

It is difficult to deal with all the cases in which courts have lifted or might lift the corporate veil. Some of the cases where the veil of incorporation was lifted by judicial decisions may be discussed to form an idea as to the kind of circumstances under which the facade of corporate personality will be removed or the persons behind the corporate entity identified and penalised, if necessary.

- 1) **Protection of revenue** - In *Sir Dinshaw Maneckjee Petit, Re (1927)*, the assessee was a millionaire earning huge income by way of dividend and interest. He formed four private companies and transferred his investments to each of these companies in exchange of their shares. The dividends and interest income received by the company was handed back to Sir Dinshaw as a pretended loan. It was held that the company was formed by the assessee purely and simply as a means of avoiding tax and company was nothing more than assessee himself. It did no business, but was created simply as a legal entity to ostensibly receive the dividends and interest and to hand them over to the assessee as pretended loans.
- 2) **Prevention of Fraud or improper conduct** - Where the medium of a company has been used for committing fraud or improper conduct, courts

have lifted the veil and looked at the realities of the situation. In *Gilford Motor Company v. Horne* [1933], 'Horne' had been employed by the company under an agreement that he shall not so solicit the customers of the company or compete with it for a certain period of time after leaving its employment. After ceasing to be employed by the plaintiff, Horne formed a Company which carried on a competing business and caused the whole of its shares to be allotted to his wife and an employee of the company, who were appointed to be its directors. It was held that since the defendant (Horne) in fact controlled the company, its formation was a mere 'cloak or sham' to enable him to break his agreement with the plaintiff. Accordingly, an injunction was issued against him and against the company he had formed restraining them from soliciting the plaintiff's customers.

Similarly, in *Jones v. Lipman* [1962], seller of a piece of land sought to evade specific performance of a contract for the sale of the land by conveying the land to a company which he formed for the purpose. It was held that specific performance of the contract cannot be resisted by the vendor by conveyance of the land to the company which was a mere 'facade' for avoidance of the contract of sale and specific performance of the contract was therefore ordered against the vendor and the company.

- 3) **Determination of the enemy character of a company** - Company being an artificial person cannot be an enemy or friend. However, during war, it may become necessary to lift the corporate veil and see the persons behind as to whether they are enemies or friends. It is because, though a company enjoys a distinct entity, its affairs are essentially run by individuals. In *Daimler Company Ltd. v. Continental Tyre & Rubber Co. (Great Britain) Ltd.* [1916], a company was incorporated in London for the purpose of selling tyres manufactured in Germany by a German company. Its majority shareholders and all the directors were Germans. On declaration of war between England and Germany in 1914, it was held that since both the decision-making bodies, the Board of directors and the general body of shareholders were controlled by Germans, the company was a German company and hence an enemy company. Accordingly, the suit filed by the company to recover a trade debt was dismissed on the ground that such payment would amount to trading with enemy and thus against public policy.
- 4) **Formation of subsidiaries to act as an agent** - In *Merchandise Transport Limited v. British Transport Commission* [1982], a transport company wanted to obtain licences for its vehicles, but it could not do so if it made the application in its own name. It, therefore, formed a subsidiary company and the application for licences was made in the name of the subsidiary. The vehicles were to be transferred to the subsidiary. Held, the parent and the subsidiary company were one commercial unit and the application for licences was rejected.

In the *State of U.P. v. Renusagar Power Co.* [1991], the Govt. of U.P. announced certain subsidies to companies which produced power for their captive (own) use. Renusagar Power Supply Company was a 100% subsidiary of Hindalco and supplied its entire power output to Hindalco and none else. The Supreme Court held that where the holding company holds 100% shares in a subsidiary company and the latter is created only for the purpose of the holding company, corporate veil can be lifted. Thus, Hindalco was held entitled to the subsidies. 'Hindalco' and 'Renusagar Power Supply Company'

were considered as one entity. *You may note here that, in this case corporate veil was lifted for the benefit of the company and not to punish the company, its officers or directors.*

Again, in *J.B. Exports Ltd. v. BSES Rajdhani Power Ltd.* [2007], appellant No. 1 company acquired entire share capital of appellant No. 2 company, which was a registered consumer of electricity connection granted at its factory premises and on finding that electricity was being consumed by appellant No. 1, Electricity Board passed impugned order demanding sub-letting charges from appellant No. 2, Court *held that* by applying principle of piercing of corporate veil, both companies appeared to be same entity and, therefore, there was no question of sub-letting.

- 5) **Where a company acts as an agent for its members/shareholders** - If there is an arrangement between the shareholders and a company to the effect that the company will act as the shareholders' agent for the purpose of carrying on the business, the business is essentially that of the shareholders. Thus, where an arrangement, as aforesaid, prevails, the individual shareholders may be identified for fixing their liability. In *R.G Films Ltd's case*, an American company financed and produced a film 'Monsoon' in India. But technically, the film was made in the name of a company incorporated in England. This British company had only a capital of £ 100 divided into 100 shares of £ 1 each. Of this, 90 shares were held by the President of the American company. The Board of Trade declined to register the film as a British film. The view of the Board of Trade was upheld by the Court. The Court held that the British company acted only as an agent of the American company which was the true maker of the film.
- 6) **In case of economic offences** - In *Santanu Ray v. Union of India* [1989], it was held that in case of economic offences a court is entitled to lift the veil of corporate entity and pay regard to the economic realities behind the legal facade. In this case, it was alleged that the company had violated section 11(a) of the Central Excises & Salt Act, 1944. The Court held that the veil of the corporate entity could be lifted by adjudicating authorities so as to determine as to which of the directors was concerned with the evasion of the excise duty by reason of fraud, concealment or willful misstatement or suppression of facts or contravention of the provisions of the Act and the rules made thereunder.
- 7) **Where company is used to avoid welfare legislation** - Where it was found that the sole purpose for the formation of the new company was to use it as a device to reduce the amount to be paid by way of bonus to workmen, the Supreme Court upheld the piercing of the veil to look at the real transaction — *Workmen of Associated Rubber Industry Ltd. v. Associated Rubber Industry Ltd.* [1986]. In this case, a new company was formed with no assets of its own except those transferred to it by the principal company. Further, the new company had no business of its own; it only received dividends on shares transferred to it by the principal company. Thus, the principal company was able to reduce its gross profits and consequently the amount of bonus to workmen was also reduced. The Supreme Court rejected the independent status of the new company and directed that the amount paid to the new company as dividend should also be taken into account determining the gross profit of the principal company.

- 8) **Where company is used for some illegal or improper purpose** - Courts have shown themselves willing to lift the veil where device of incorporation is used for some illegal or improper purpose - *PNB Finance Limited v. Shital Prasad Jain [1983]*. Again, in *SEBI v. Libra Plantation Ltd. [1999]*, Bombay High Court allowed the property acquired under fraudulent schemes to be chased even in the hands of third persons.
- 9) **To punish for contempt of court** - Company being an artificial person cannot disobey the orders of the court. Therefore, the persons at fault should be identified [*Jyoti Limited v. Kanwaljit Kaur Bhasin (1987)*].
- 10) **For determination of technical competence of the company** - The Supreme Court in *New Horizons Ltd. v. Union of India [1995]* held that the experience of the promoters could well be considered as the experience of the company in determining its technical competence. *Once again, you may note that the veil in this case was lifted for the benefit of the company.*
- 11) **Where company is a mere sham or cloak** - In *Delhi Development Authority v. Skipper Construction Company (P.) Ltd. [1996]*, the Supreme Court held that the fact that the director and members of his family had created several corporate bodies did not prevent the court from treating all of them as one entity belonging to and controlled by the director and his family if it was found that these corporate bodies were mere cloaks and that the device of incorporation was really a ploy adopted for committing illegalities and/or to defraud people.

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## 1.7 DISTINCTION BETWEEN COMPANY AND PARTNERSHIP

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You learnt that a company is an artificial person created by law, with limited liability and perpetual succession as its main features. Let us now study the difference between a company and another popular association of persons formed to run business in India, namely, Partnership.

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

1. **Mode of creation** - A company comes into existence only when it is registered under the Companies Act.  
  
A partnership, on the other hand, is created by mutual agreement between partners. Registration of partnership firm is not compulsory under the Partnership Act, 1932. An unregistered partnership, therefore, is not an illegal association.
2. **Membership**
  - a) **Minimum** - The minimum number of members in a partnership is two whereas the minimum number of members in a private company is two and in case of public company, seven.
  - b) **Maximum** - In partnership, the maximum number of partners is 50. The maximum number of members in private company is 200 (excluding employee and ex-employee members and joint shareholders counted as a single member) but in a public company there is no limit on the maximum number of members.

## Company and Its Formation

3. **Legal status** - A company has a separate legal personality of its own whereas a partnership is not a distinct person. A partnership, commonly called a firm, has no legal existence apart from its members. Firm is only a convenient way of addressing the partners collectively. A company being a juristic person is quite distinct from its members.
4. **Liability of members** - The liability of every shareholder of a limited liability company is limited up to the nominal value of shares held by him or up to the amount of guarantee given by him. The creditors of a company can proceed only against the company and not against any member or members. Even in case of unlimited liability company, the company being an entity distinct from the members, the creditors are not allowed to proceed against members individually or even jointly; they can only proceed against the company. But in partnership the liability of partners is unlimited and partners are severally and jointly liable for the debts of the firm. Creditors of the firm are the creditors of all the partners and they can proceed against the partners individually as well as collectively.
5. **Transfer of shares** - Shares in a public company are freely transferable. A private company does place restrictions on free transferability of shares without denying transferability. In partnership, no partner can transfer or sell his share in the firm without the consent of all the other partners.
6. **Perpetual succession** - A company enjoys perpetual succession. The existence of the company is not affected by the death, insolvency, insanity or separation of a member. But, it is not so in case of partnership. Unless otherwise agreed, death, insolvency, etc. of a partner dissolves the firm.
7. **Management** - The affairs of a company are managed by a Board of directors. Directors on the Board are elected, appointed or reappointed by shareholders in a general meeting. Members of a company have no role in managing the affairs of the company. Every partner, on the other hand, unless otherwise provided in the partnership deed/agreement, can participate in management of the firm.
8. **Agency relationship** - A shareholder is not an agent of the company and thus has no power to bind the company by his acts. In partnership, every partner is an agent of the firm and that of other partners. A partner is bound by all the acts of other partners done within the scope of his apparent or ostensible authority.
9. **Property** - In the case of a company, the property of the company is in the name of the company and is owned by it. It does not belong to the individual shareholders of the company. During the lifetime of the company, no shareholder has any legal or equitable interest in any property of the company. But, in the case of partnership, the partners are the joint owners of the property of the firm.
10. **Statutory requirements** - A company is required to comply with various statutory formalities, such as maintaining statutory books, getting the accounts audited by chartered accountants, whereas a partnership firm is not required to perform any such statutory obligations.
11. **Powers** - The powers of the company are contained in the object clause of the memorandum of association. A change can be effected by following the rigid procedure as laid down in the Act. In partnership, the partners can do

anything which they agree to do. Changes in partnership deed can be effected by mutual consent.

12. **Dissolution** - A company's existence will come to an end only according to the provisions laid down in the Companies Act, 2013. A partnership firm can be dissolved at any time by an agreement between the partners or in case of partnership at will, by the withdrawal of even one partner.
13. **Governing legislation** - A company is governed by the Companies Act, 2013, SEBI Regulations, Listing Requirements of Stock Exchanges. A partnership, on the other hand is governed by the Partnership Act, 1932.

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## 1.8 DISTINCTION BETWEEN COMPANY AND LIMITED LIABILITY PARTNERSHIP

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Limited Liability Partnership (LLP) Act, 2008, is a new piece of legislation. This Act enables formation of partnerships with liability of partners being kept limited like that of share holders as in case of companies. Thus, the public has been given a choice to form a partnership either under the partnership law, i.e, Partnership Act, 1932 or under Limited Liability Partnership Act, 2008. Although, in case of a Limited Liability Partnership, the liability of partners is limited but it differs from a company in many respects. The main points of distinction between a 'limited liability partnership' and 'limited liability company' are as follows:

1. **Regulating Act:** A Limited Liability Partnership is regulated by the Limited Liability Partnership Act, 2008, whereas a company is governed by the Companies Act, 2013.

The name of a company must end with words 'Limited or Private Limited' whereas of Limited Liability Partnership with words 'LLP' or 'Limited liability partnership'.

2. **Minimum and Maximum Number of Members:** In case of Limited Liability Partnership, minimum numbers of partners required are 2 whereas in case of public company minimum number of members required are 7. There is no limit to maximum number of partners in case of Limited Liability Partnership but in case of a private company number of members cannot exceed 200.
3. **Governance Structure:** A basic difference between a Limited Liability Partnership and a joint stock company lies in that the governance structure of a company is regulated by statute (i.e., Companies Act, 2013) through memorandum and articles of association whereas for a Limited Liability Partnership it would be by contractual agreement between partners.
4. **Management:** In the case of a Limited Liability Partnership, management rests with those partners (including designated partners) who are authorized by Limited Liability Partnership agreement. But in the case of a company the right to control and manage the business is vested in the Board of Directors elected by the shareholders. Thus, the management ownership divide inherent in a company is not there in a limited liability partnership.
5. **Transfer of Interest:** In the case of a limited liability partnership, a partner's economic rights (i.e. right to a share of the profits and losses and to receive contribution at the time of winding up) shall be transferable (Section 42). However, such transfer shall not by itself cause the disassociation of the partner and a dissolution and winding-up of the Limited Liability Partnership.

**Company and Its Formation**

Further, such transfer would not make the transferee a ‘partner’ of the Limited Liability Partnership entitled to participate in its management (Section 42). For becoming a partner of Limited Liability Partnership, unless otherwise provided in the Limited Liability Partnership agreement, consent of all the existing partners is required (Schedule I appended to Limited Liability Partnership Act). But in the case of a public company a shareholder can transfer his shares freely without restriction and the transferee succeeds to all the rights of membership.

- 6. **Audit:** The audit of the accounts of a company is a legal necessity but it is not so in the case of a Limited Liability Partnership. If the capital contribution does not exceed Rs.25 lakhs or if the annual turnover does not exceed Rs. 40 lakhs [Rule 24(8) of the Limited Liability Partnership Rules, 2009] audit is not compulsory.
- 7. **Meeting:** Annual General meeting of shareholders of a company is compulsory by law but in Limited Liability Partnership, the annual meeting of partners is not mandatory.

**Check Your Progress B**

- 1) What is meant by corporate veil?  
.....  
.....  
.....
- 2) List any four circumstances when the corporate veil can be pierced.  
.....  
.....  
.....  
.....
- 3) Enumerate three main points of difference between a company and a partnership.  
.....  
.....  
.....  
.....
- 4) What are the main points of difference between a company and a limited liability partnership (LLP).  
.....  
.....  
.....  
.....
- 5) Fill in the blanks:
  - a) The effect of incorporation is that the company is regarded as a ..... person.



- b) If an officer of a company, while entering into contract on behalf of the company, fails to disclose his ..... capacity, he becomes personally liable on such contract.
  - c) When two nations are at war, the corporate veil of the company can be lifted to ascertain the ..... of the company.
  - d) The corporate veil can be lifted due to Court's intervention and under .....
  - e) The liability of each member of Limited Liability Partnership is .....
- 6) State, whether the following statements are true or false:
- i) A company comes into existence when the company is registered.
  - ii) Registration of a company, though desirable, is not compulsory.
  - iii) After registration, a company ceases to be an association of persons and acquires a juristic status.
  - iv) For the recovery of his debts, a creditor of a company can proceed against private properties of a member.
  - v) In case of a company, except a private company, any member may freely transfer his shares to any person.
  - vi) A shareholder is not an agent of the company.
  - vii) A person can be a member and a creditor of a company at the same time.

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## 1.9 KINDS OF COMPANIES

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Companies can be classified according to various bases. These are:

- 1) On the basis of incorporation
- 2) On the basis of liability
- 3) On the basis of control

See figure 1.1 to have an overall view of the different types of companies:

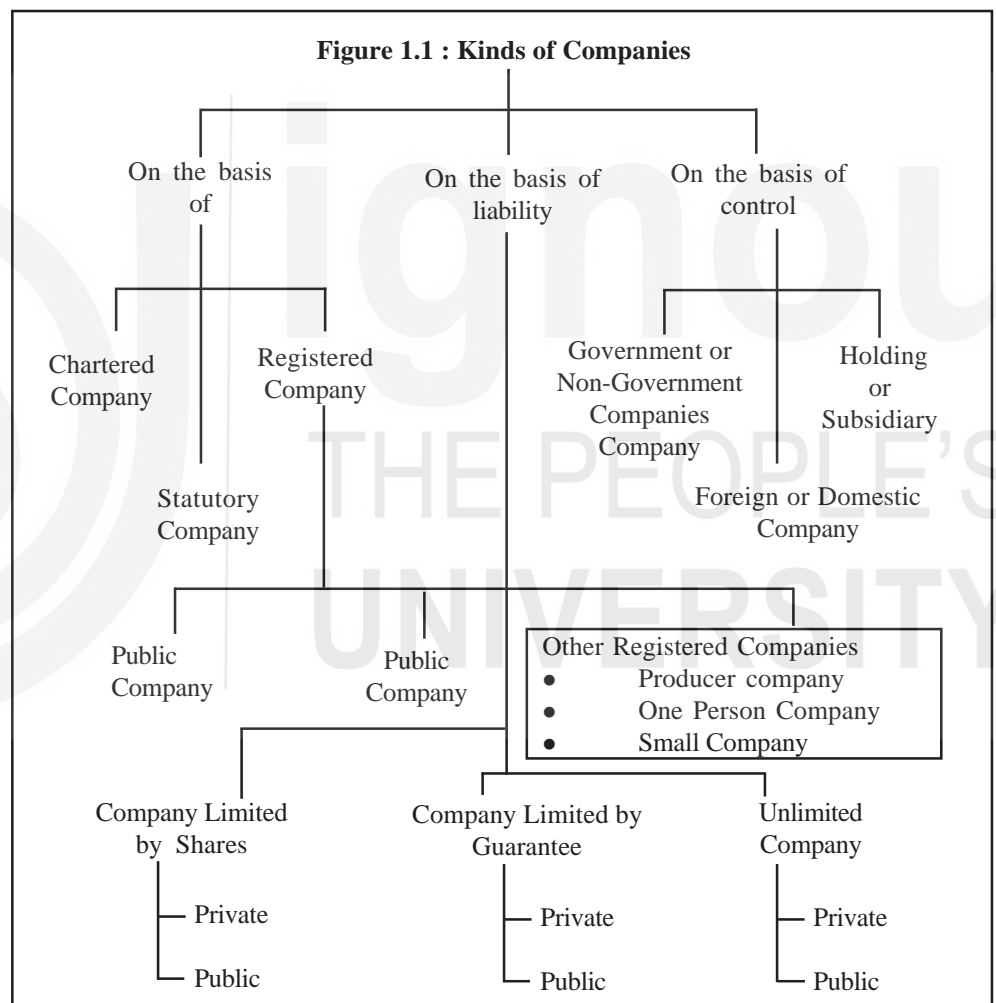
### 1.9.1 On the Basis of Incorporation

Depending upon the mode of incorporation, joint stock companies may be divided into the following three categories:

- i) **Chartered Company:** A company incorporated under a special charter granted by the King or Queen of England is called 'chartered company'. A chartered company is regulated by its charter and the Companies Act does not apply to it. The charter also prescribes the nature of business and the powers of the company. The familiar examples of chartered companies are the East India Company and the Bank of England. *This type of company cannot now be formed in India.*
- ii) **Statutory Company:** A statutory company is one which is created by a special Act of Parliament or a State Legislature. Such companies are usually formed for achieving a purpose related with public utilities. The nature and powers of such companies are laid down in the Special Act under which they are created. However, the provisions of the Companies Act are also applicable

to them in so far as they are consistent with the provisions of the Special Act. A statutory company also has a separate legal entity and it is not required to use the word 'limited' after its name. The audit of such companies is conducted by the Controller and Auditor General of India (C&AG) and the annual report of working is required to be placed before the Parliament or State Legislature, as the case may be. Familiar examples of such companies are Reserve Bank of India, The Life Insurance Corporation of India, The Food Corporation of India, State Bank of India, etc.

- iii) **Registered or Incorporated Company:** A registered company is one which is registered in accordance with the provisions of the Companies Act 2013 and also includes companies formed and registered under any of the previous Acts. A registered company comes into existence only when it receives the certificate of incorporation. Registered Companies are governed by the provisions of the Companies Act, 2013.



**A registered company may either be a private company or a public company.** A *private company* is one which by its articles of association (a) restricts the right of transfer of shares; (b) except in case of a one person company limits the number of its members to two hundred (not including members who are the present or past employees); (c) prohibits any invitation to the public to subscribe for any securities of the company [Section 2(68)].

*On the other hand, a public company* is one which is not a private company but subsidiary of a public company even where such subsidiary company continues to be a private company in its articles [Section 2 (71)].

The minimum number of members required to form a private company is two, while for the public company the minimum number is seven.

### 1.9.2 On the Basis of Liability

On the basis of liability, an incorporated company may either be (i) a company limited by shares, or (ii) a company limited by guarantee; or (iii) an unlimited company.

- 1) **Company Limited by Shares:** A company having the liability of its members limited by the memorandum, to the amount, if any, unpaid on the shares respectively held by them is termed “a company limited by shares” [Section 2 (22)]. Such a company is commonly called Limited Liability Company although the liability of the company is never limited; it is the liability of its members which is limited. The liability of members can be enforced at any time during the existence and also during the winding-up of the company. Such a company must have share capital as the extent of liability is determined by the face value of shares. However, there is no liability to pay any balance amount due on the shares, except in pursuance of calls duly made in accordance with law and the articles, while the company is a going concern or of calls made in the event of winding of the company.
- 2) **Company Limited by Guarantee:** A company limited by guarantee may be defined as a company having 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 [Section 2 (21)].

Such a company may or may not have share capital. If a company limited by a guarantee is formed without any share capital, then the members would be liable to pay only the guaranteed amount and that too when the company goes into liquidation. But if the company limited by guarantee is formed with share capital, then the members are also liable to pay the unpaid amount on their shares. But the guaranteed amount can be called up only at the time of winding-up of the company.

- 3) **Unlimited Company:** A company having no limit on the liability of its members is an unlimited company [Section 2(92)]. Thus, in the case of an unlimited liability company, the liability of each member extends to the whole amount of the company’s debts and liabilities. It may be seen that the liability of members of an unlimited company is similar to that of the partners but unlike the liability of partners, the members of the company cannot be directly proceeded against. Company being a separate legal entity, the claims can be enforced only against the company. Thus, creditors shall have to institute proceedings for winding-up of the company for their claims. But the official liquidator may call upon the members to discharge the debts and liabilities without limit.

An unlimited company may or may not have share capital.

Under Section 18, a company registered as an unlimited company may subsequently convert itself into a limited liability company. Any debt, liabilities, applications or contracts in regard to or entered into, by or on behalf of the unlimited liability company before such conversion shall not be affected by such conversion.

### 1.9.3 On the Basis of Control

Let us study the classification of companies on the basis of control, i.e., who

## Company and Its Formation

effectively controls the affairs of the company. On this basis, the companies may be grouped as follows:

- i) Holding and Subsidiary Companies
- ii) Government Company
- iii) Foreign Company

### i) **Holding and Subsidiary Companies**

Generally speaking, if one company controls another company, the controlling company may be termed as the 'Holding company' and the company so controlled as a 'Subsidiary'.

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

- i) controls the composition of the Board of Directors; or
- ii) exercises or controls more than one-half of the total share capital<sup>1</sup> either at its own or together with one or more of its subsidiary companies:

A company (let's call it Company 'S') shall be deemed to be the subsidiary of another company (let's call it Company 'H') only in the following cases:

- a) When the company (Company 'H') controls the composition of Board of directors of other company (Company 'S')
- b) When the Company 'H' holds more than half of the total share capital of Company 'S'. Again, where Company 'H' together with Company 'S' holds more than half of the total share capital of company 'Z', then company 'Z' will be subsidiary of Company 'H'.
- c) When Company 'S' is a subsidiary of a Company 'T' which itself is a subsidiary of Company 'H'.

*Only in any of the above cases, would the Company 'S' be deemed a subsidiary of Company 'H'.*

As you have just learnt from the above discussion, a holding company is usually a very major shareholder of its subsidiary but both continue to enjoy separate legal entities in the eyes of the law. Unless there is a specific contract between the two companies, one cannot be said to be the agent of another. A subsidiary company also cannot be said to be a part of the holding company.

### ii) **Government Company**

Section 2 (45) of the Companies Act, 2013 defines a Government company to mean any company (registered under the Companies Act) in which not less than 51% of the paid-up share capital is held by:-

- i) the Central Government; or
- ii) any State Government or Governments; or
- iii) partly by the Central Government and partly by one or more State Governments.

*A subsidiary of a Government company shall also be treated as a Government company.*

Engineers India Ltd. (EIL), BHEL, and Hindustan Aeronautics Ltd. (HAL), are examples of Government companies. A statutory corporation formed under special

Act of Parliament of State Legislature, like Life Insurance Corporation of India, is not a 'company' under the Companies Act, and as such is not a Government company. These are corporations as distinguished from Government companies and are incorporated as well as governed by respective separate Acts.

A government company registered under this Act is not an agent of the government. It enjoys, like any other company registered under the Companies Act, an entity distinct from its members. Employees of such a company cannot be said to be the employees of the Government. Again, like any other company, it may be registered as a private company or a public company. Further, like any other company, it is governed by the provisions of the Companies Act 2013.

### iii) **Foreign Company**

As per Section 2 (42) "foreign company" means any company or body corporate incorporated outside India which—

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

However, *as per Section 386(C), having a share transfer office or share registration office will constitute a place of business.*

Section 380 requires the following documents to be filed with the Registrar of Companies within thirty days of the establishment of place of business in India by a Foreign Company:

- a) a certified copy of the charter, statutes or memorandum and articles, of the company or other instrument constituting or defining the constitution of the company and, if the instrument is not in the English language, a certified translation thereof in the English language;
- b) the full address of the registered or principal office of the company;
- c) a list of the directors and secretary of the company containing such particulars as may be prescribed;
- d) the name and address or the names and addresses of one or more persons resident in India authorised to accept on behalf of the company any notices or other documents required to be served on the company;
- e) the full address of the office of the company in India which is deemed to be its principal place of business in India;
- f) particulars of opening and closing of a place of business in India on earlier occasion or occasions;
- g) declaration that none of the directors of the company or the authorised representative in India has ever been convicted or debarred from formation of companies and management in India or abroad; and
- h) any other information as may be prescribed.

Where any alteration is made or occurs in the documents delivered to the Registrar under this section, the foreign company shall, within thirty days of such alteration, deliver to the Registrar for registration, a return containing the particulars of the alteration in the prescribed form.

Again, as per Section 382, a foreign company is obliged to conspicuously exhibit on the outside of every office or place, where it carries on business in India as well as in every prospectus issued by it:

## Company and Its Formation

- i) the name of the company,
- ii) the country in which it is incorporated,
- iii) the fact that liability of its members is limited.

The aforesaid should also be stated on all business letters, bill heads, letter paper, all notices and other official publications of the company in legible English and also in a language in general use in the locality in which the office or place is situated.

Section 381 requires that every foreign company, except a foreign company or such class of foreign companies which have been exempted by the Central Government, shall, in every calendar year:

- a) make out a balance sheet and profit and loss account in such form, containing such particulars and including or having annexed or attached thereto such documents as may be prescribed; and
- b) deliver a copy of those documents to the Registrar.

Provisions of Section 92 of the Act relating to the filing of the annual return with the Registrar of Companies are also applicable to a foreign company.

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## 1.10 OTHER KINDS OF REGISTERED COMPANIES

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Other kinds of registered companies include:

- i) Producer Company
- ii) One Person Company
- iii) Small Company

### 1.10.1 Producer Company\*

Based on the recommendations of Dr. Alagh Committee, the following is the summary of important provisions relating to Producer Companies:

1. **Meaning of Producer Company:** A producer company means a body corporate engaged in any activity connected with or related to any primary produce. 'Primary produce' means (i) produce of farmers, arising from agriculture (including animal husbandry, bee farming, etc.); OR (ii) from any other primary activity which promotes the interest of farmers or consumers; OR (iii) produce of persons engaged in handloom, handicraft and other cottage industries; OR (iv) by-products or ancillary of the aforesaid activities.
2. **Minimum and Maximum Number of Members:** Any ten or more producers\*\* who are individuals or any two or more producer institutions\*\*\* or a combination of ten or more individuals and producer institutions may form and incorporate a company as a Producer Company. However, no person, who has any business interest which is in conflict with business of the Producer Company, shall become a member of that Company.

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\* It may be noted that vide Section 465 of the Companies Act, 2013, producer companies shall continue to be governed by the existing provisions of the Companies Act, 1956 until a special Act is enacted.

\*\* **Producer'** means any person engaged in any activity connected with any primary produce. [Section 581A(k).

\*\*\* **Producer Institution** means a producer company or any other institution having only producer(s)/producer company(ies) as its members whether incorporated or not having any of the objects referred to in Section 581B and which agrees to make use of the services of the producer company(ies) as provided in its articles.

*There is no ceiling on maximum membership.*

3. **Share Capital:** The share capital of a producer company shall consist of equity shares only.
4. **Transferability and Transmission of Shares:** Shares of a member of a producer company shall not be transferable except to an active member with the previous approval of the Board. Shares, if allowed to be transferred, shall be at par value only.

*However, in the event of death of a member, shares will be registered in the name of his nominee who must be a producer.*

5. **Liability of Members:** Liability of members of a Producer Company shall be limited to the amount, if any, unpaid on the shares held by them.
6. **Promoters' Remuneration:** The Producer Company may, with the approval of its members at its first general meeting, reimburse to its promoters all direct costs associated with the promotion and registration of the company including registration, legal fees, printing of a memorandum and articles.
7. **Status of a Private Company:** On registration, the Producer Company shall become a body corporate as if it is a private limited company without, however, any limit to the number of members thereof and without use of the word private as part of its name. As per Section 581F, name of a producer company shall end with the words 'Producer Company Limited'.
8. **Voting Rights of Members:**
  - a) Where the membership consists (i) solely of individual members; or (ii) of individuals and producer institutions, the voting rights shall be based on a single vote for every Member, irrespective of his shareholding or patronage of the Producer Company.
  - b) In a case the membership consists of Producer institutions only, the voting rights of such Producer institutions shall be determined on the basis of their participation in the business of the Producer Company in the previous year, as may be specified by Articles. However, during the first year of registration of a Producer Company, the voting rights shall be determined on the basis of the shareholding by such Producer institutions.

9. **Cessation of Membership:**

Whereas, no person, who has any business interest which is in conflict with business of the Producer Company, shall become a member of that Company, a member, who acquires any business interest which is in conflict with the business of the Producer Company, shall, cease to be a member of that Company and be removed as a member in accordance with articles. Again, a person will cease to be a member, where he ceases to be a primary producer. He will, however, be paid par value of his shares or any other value that may be determined by the Board.

10. **Benefits to Members:**

- a) Members shall not receive full value of the produce pooled or supplied. 'Withheld price' shall be paid later in cash or equity shares, as per the decision of the Board.
- b) Every member shall receive a limited return on the capital contributed by the members.

- c) Members may be allotted bonus shares.
- d) Surplus, if any, after making (i) provision for limited return and reserves (as required under Section 581(ZI) (ii) providing for the development of the business of the Producer Company; (iii) providing for common facilities; may be distributed to members as bonus in proportion to their respective participation in business. This may be given in cash or by way of equity shares.

#### 11. General Meetings:

- i) **First AGM:** The first annual general meeting (AGM) of a producer company shall be held within 90 days of incorporation to discuss appointment of directors, and adoption of articles of association. *No extension of time is permissible.*
- ii) **Subsequent AGMs:** Gap between two AGMs must not be more than 15 months. Registrar of Companies may extend this period for a maximum period of 3 months.
- iii) **Time and Place of AGM:** Provisions in this regard are same as applicable to other companies. Thus, AGMs should be held at the registered office, on a day which is not a public holiday and during business hours.
- iv) **EGM (Extraordinary general Meeting):** An EGM shall be called by the directors on a requisition duly signed by 1/3<sup>rd</sup> or more of the members who are entitled to vote thereat. *No requirement for quorum has been prescribed for EGM.*
- v) **Notice:** Notice of every general meeting shall be sent to : (a) every member; and (b) the auditor.
- vi) **Quorum:** Quorum for AGM shall be 1/4<sup>th</sup> of total number of members. Articles may however fix higher quorum.

#### 1.10.2 One Person Company (OPC)

Section 2 (62) of the Companies Act, 2013 defines 'One Person Company' to mean a company with only one person as its member. Section 3 (1) (c) provides that a company may be formed for any lawful purpose by one person, where the company to be formed is to be One Person Company, that is to say, a private company by subscribing his name to a memorandum and complying with the requirements of the Act in respect of registration.

**An One Person Company may be registered as 'limited by shares' or 'limited by guarantee'.**

However, the memorandum of One Person Company shall indicate the name of the other person, with his prior written consent in the prescribed form (Form No. INC.3), who shall, in the event of the subscriber's death or his incapacity to contract become the member of the company and the written consent of such person shall also be filed with the Registrar at the time of incorporation of the One Person Company along with its memorandum and articles.

Such other person may withdraw his consent in such manner as may be prescribed.

*On the death of the promoter member of an OPC, the person nominated by*



such promoter member shall be the person recognised by the company as having title to all the shares of the member and shall be entitled to the same dividend and other rights and liabilities to which such sole promoter member of the company was entitled or liable.

The member of One Person Company may at any time change the name of such other person by giving notice and shall intimate the Registrar any such change within such time and in such manner as may be prescribed.

The words “One Person Company” shall be mentioned in brackets below the name of such company, wherever its name is printed, affixed or engraved.

### **Relaxations available to One Person Company**

Relaxations given to an OPC include:

1. There is no need to prepare a cash-flow statement [Section 2(40)].
2. The annual return can be signed by the Director and not necessarily a Company Secretary (Section 92).
3. There is no necessity for an Annual General Meeting (AGM) to be held (Section 96).
4. Specific provisions related to general meetings and extraordinary general meetings would not apply (Sections 100 to 111).
5. Compliance can be said to have been done if the resolutions are entered in the minutes’ book of the company (Section 122).
6. It would suffice if one director signs the audited financial statements (Section 134).
7. Financial statements can be filed within six months from the close of the financial year as against 30 days (Section 137).
8. An OPC need to hold only one meeting of the Board of Directors in each half of a calendar year and the gap between the two meetings should not be less than ninety days (Section 173).

### **Special Provisions applicable to One Person Companies**

Where the OPC limited by shares or by guarantee enters into a contract with the sole member of the company who is also the director of the company, the company shall, unless the contract is in writing, ensure that the terms of the contract or offer are contained in a memorandum or are recorded in the minutes of the first meeting of the Board of Directors of the company held next after entering into contract (Section 193). This will not apply to contracts entered into by Company in the ordinary course of its business.

#### ***As per the Rules framed by the Central Government:***

1. Only a natural person who is an Indian citizen and resident in India shall be eligible to incorporate a One Person Company or be appointed as a nominee for the sole member of a One Person Company. The term “resident in India” means a person who has stayed in India for a period of not less than 182 days during the immediately preceding financial year (**Rule No. 3.1**).
2. No person shall be eligible to incorporate more than a One Person Company or become nominee in more than one such company (Rule No. 3.2).
3. No minor shall become member or nominee of the One Person Company or can hold share with beneficial interest (Rule No 3. 4).

4. Such Company cannot be incorporated or converted into a company under section 8 of the Act (Rule No 3.5) or carry out Non-Banking Financial Investment activities including investment in securities of any body corporate (Rule No 3.6).
5. Where the paid up share capital of a One Person Company exceeds 50 lakh rupees and its average annual turnover during the relevant period exceeds 2 crore rupees, it shall cease to be entitled to continue as a One Person Company. **(Rule No 3.7). It may convert itself into a private or public company within a period of 6 months from the date its paid up capital exceeds Rs. 50 lakh and turnover exceeds Rs. 2 crore (Rule No. 6).**
6. **Conversion of One Person Company into a private company or a public company:** *One Person company can get itself converted into a Private or Public company after increasing the minimum number of members and directors to 2 or minimum of 7 members and 3 directors as the case may be, and by maintaining the minimum paid-up capital as per requirements of the Act for such class of company and by making due compliance of section 18 of the Act for conversion i.e. Conversion of companies already registered (Rule No 6). However, such a company cannot convert voluntarily into any kind of company unless two years is expired from the date of its incorporation (Rule No. 3. 7).*

### 1.10.3 Small Company

The concept of Small Company has also been introduced for the first time in the Companies Act, 2013. According to Section 2 (85) of the Companies Act, 2013 as amended by the (Amendment) 2017 “small company” means a company, other than a public company —

- i) paid-up share capital of which does not exceed fifty lakh rupees or such higher amount as may be prescribed which shall not be more than ten crore rupees; and
- ii) turnover of which as per its last profit and loss account for the immediately preceding financial year does not exceed two crore rupees or such higher amount as may be prescribed which shall not be more than one hundred crore rupees:

However, the expression ‘small company’ shall not include:

- a) a holding company or a subsidiary company;
- b) non-profit association (i.e, companies registered under Section 8 of the Companies Act, 2013);
- c) a company or body corporate governed by any special Act.

In such company there is no need to prepare cash flow statement, annual return can be signed by the Director or Secretary and to hold only one meeting in one half of calendar year and gap between two meetings should not be more than 90 days.

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## 1.11 ASSOCIATIONS NOT FOR PROFIT (SECTION 8)

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An “Association not for profit” (companies with charitable objects) is an association which is formed not for making profits but for the promotion of commerce, art,

science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object. Such an association may or may not be registered as a company under the Companies Act. When such an association is registered as a company with limited liability, it may be given a licence by the Central Government.

The Central Government may grant such a licence if it is proved to the satisfaction of the Central Government that a person\* or an association of persons proposed to be registered under this Act as a limited company:

- i) has in its objects the promotion of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object;
- ii) intends to apply its profits, if any, or other income in promoting its objects; and
- iii) intends to prohibit payment of any dividend to its members.

When the above conditions are fulfilled, the Central Government may, by licence, direct that the person or association may be registered as a company with limited liability without the addition to its name of the word “Limited” or the words “Private Limited”.

*Examples of such companies registered under Section 8 include Mohan Bagan Club, Gymkhana Club, Delhi District Cricket Association (D.D.C.A.) etc.*

- **Alteration of Memorandum and Articles of Association**

Such an association shall not alter the provisions of its memorandum or articles except with the previous approval of the Central Government.

- **Partnership Firm may become Member**

It may be noted that a partnership firm may become a member of such a company. However, on dissolution of the firm, its membership will come to an end [Section 8(3)]. Moreover, one person company can not be formed or converted into a company under Section 8 [Rule 3 (5)] Companies (Incorporation) Rules, 2014.

- **Conversion of a company formed under Section 8 into any other kind**

A company registered under section 8 which intends to convert itself into a company of any other kind may do so by passing a special resolution at a general meeting for approving such conversion and also complying with the prescribed procedure (Rule 21 of the Companies (Incorporation) Rules, 2014).

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## 1.12 ILLEGAL ASSOCIATIONS

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### 1.12.1 Meaning

Section 464 of the Companies Act, 2013 read along with Rule 10 of the Companies (Miscellaneous) Rules, 2014 provides that no association or partnership consisting of more than 50 persons shall be formed for the purpose of carrying on any business that has for its object the acquisition of gain by the association or

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\* You may note that under Section 8, the use of the word ‘person’ appears to allow even a single person to form a company for the objects specified.

partnership or by the individual members thereof, unless it is registered as a company under this Act or is formed under any other law for the time being in force. Thus, if such an association is formed and not registered under either the Companies Act or any other law, it will be regarded as an 'Illegal Association' although none of the objects for which it may have been formed is illegal.

### 1.12.2 Exceptions

- a) **A Hindu undivided family (HUF) carrying on any business**, that is, a joint Hindu family may carry on any business, even for earning profits and with any number of members without being registered or formed in pursuance of any Indian Laws as required by Section 464 of the Act, and yet it will not be illegal association. But, where two joint Hindu families join hands to carry on business, the provisions of Section 464 become applicable. However, in such a case, in reckoning the number of members of such an association, the minor members shall be excluded. As regards adult members, both male and female members shall be taken into account.
- b) **An association or partnership, if it is formed by professionals who are governed by special Acts.**

### 1.12.3 Consequences

Following are the effects of an association being illegal:

1. Every member of such an association or partnership carrying on business shall be punishable with fine which may extend to one lakh rupees.
2. Every member is personally liable for all liabilities incurred in the business.
3. Such an association cannot enter into any contract.
4. Such an association cannot sue any of its members or any outsider, not even if the association is subsequently registered as a company.
5. It cannot be sued by a member or an outsider for any debts due to him because it cannot contract any debt.
6. It cannot be wound-up even under the provisions relating to winding-up of unregistered companies.
7. *Can a member sue for partition or dissolution or accounts of an illegal association?* The question was brought before the High Court of Allahabad in **Mewa Ram v. Ram Gopal (1926)**. It was held that where an association was illegal and the business had been carried for some years, none of its members could sue for partition because partition would involve realisation of the assets of the company and payment of its debts, the very things which would be done in a suit for dissolution of partnership or winding-up of a company.

It should be noted that while an unregistered firm can be dissolved, an illegal association cannot be dissolved because law does not recognise its very existence.

8. The illegality of an illegal association cannot be cured by subsequent reduction in the number of its members (**Kumar Swami Chettiar v. M.S.M. Chinnathambi Chettiar**).
9. The profits made by an illegal association are, however, liable to assessment to income-tax (**Gopalji Co. v. CITA**).

Check Your Progress C

1) What is a statutory company?

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2) What is meant by a registered company?

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3) What is meant by a company limited by guarantee?

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4) What is a Government Company?

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5) What do you mean by 'Illegal Association'?

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6) Fill in the blanks:

- a) An incorporated company can come into existence as a chartered company, as a statutory company and as ..... company.
- b) In a company limited by guarantee, a member is required to pay the guaranteed sum only if the company is .....
- c) A government company is one in which not less than ..... per cent of the paid up share capital is held by the Central Government.
- d) An auditor for a government company is appointed by the .....

- e) A foreign company which establishes a place of business in India after the commencement of the Companies Act, 2013, shall deliver to the Registrar of Companies, necessary documents for registration within ..... days of establishing the place of business in India.
  - f) Under Section ..... of the Act, any association created not for profit may be exempted by the Central Government and be registered with limited liability without using the word 'limited' as its last word.
- 7) State, whether the following statements are true or false:
- i) Once a company has been registered as an unlimited company, it cannot be converted into a limited company without dissolving the company.
  - ii) A Government company is not governed by the provisions of the Companies Act, 2013.
  - iii) In a Government company, company's paid up share capital can be held partly by the Central Government and partly by one or more State Governments.
  - iv) A foreign company may carry on business in India even without establishing place of business in India.
  - v) A foreign company is a company registered in India and carries on its business in a foreign company.
  - vi) In case of a holding company and a subsidiary company both companies continue to enjoy separate legal status.
  - vii) A private company which is a subsidiary of a public company is a public company.
  - viii) A partnership firm can be a member of an association not for profit.
  - ix) An illegal association has no independent personality.
- 8) State which of the following alternative is correct:
- a) A private company
    - i) must have at least 7 members, ii) cannot have more than 50 members, iii) must prohibit any invitation to public to subscribe for its shares, iv) must file a statement in lieu of prospectus
  - b) An illegal association is
    - i) a partnership formed for illegal activities, ii) a partnership with more than 100 partners, iii) a partnership dissolved by a court of law, iv) a HUF with more than 100 members

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### **1.13 LET US SUM UP**

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A Company implies an association of persons for some common object or objects. A 'company' under the Act is defined to mean a "company formed and registered under the Companies Act, 2013 or under any of the previous Company laws.

A company is characterised by the following features: (1) It is an incorporated association registered under the Act. (2) On registration, it becomes a body corporate and thus acquires an entity distinct from the members constituting it. (3)

Although, a company is recognised as a person enjoying the rights and obligations thereof, it is an artificial person and exists only in contemplation of law. (4) The liability of members of a limited liability company is limited to the extent of the amount unpaid on the shares held by him or the amount guaranteed by him. (5) A company being a distinct entity, the property of the company is also separate. Shareholders are not the part owners of the undertakings. A member does not even have an insurable interest in the property of the company. (6) The shares of a company are movable property, transferable in the manner provided by the articles of the company. (7) A company being an artificial person cannot be incapacitated by illness or otherwise. Members may come and go but the company can go on forever. (8) A company has to work through the agency of human beings. It may have a common seal.

A company is an entity distinct from the members but is an artificial person. The persons who are engaged to manage its affairs may commit certain illegal acts or frauds in its name. It may, therefore, become necessary to identify and hold these individuals personally liable for their deeds. In other words, the veil of corporate personality may be pierced or lifted. The circumstances under which the corporate veil can be lifted as follows:

- a) Under Express Statutory Provisions
- b) Under judiciary interpretation

Under express statutory provisions corporate veil is lifted in the following circumstances:

(1) Misrepresentations in prospectus; (2) Failure to return application money; (3) Mis-description of name; (4) For investigating the affairs of the company; (5) For investigation of ownership of company; (6) Where the business of the company is found to have been carried for fraudulent purpose; (7) For ultra vires acts; (8) For violations of the provisions of other statutes;

Under judiciary interpretations the corporate veil is lifted in the following cases:

(a) Where the medium of body corporate is used to evade taxes; (b) Where body corporate is used to commit fraud or improper conduct; (c) For determination of the enemy character of the company; (d) Where subsidiaries are formed to act as mere agents of the holding company; (e) Where a company acts as an agent for its shareholders; (f) Where company is used to avoid welfare legislation; (g) Where company is used for some illegal or improper purpose; (h) Punishment for contempt of Court ; (i) For determination of technical competence of the company; (j) Where company is a mere sham or cloak.

A 'company' should, however, be distinguished from a 'body corporate'. The expression body corporate is a wider expression than company. Body corporate includes, besides a company, a company incorporated outside India, public financial institutions, nationalised banks and any other association of persons declared as a body corporate by the Central Government.

A company is a person in the eyes of law. It also has a domicile and nationality. The courts have held that company is not a citizen and therefore cannot be said to have the fundamental rights expressly conferred upon citizens, only. However, those fundamental rights which are available to all persons, whether citizens or not, like the right to own property are available to the company.

A 'company' differs from a 'partnership' on the following grounds viz., mode of creation, number of minimum and maximum member, legal status, liability of

members, transfer of shares, agency of members, management, perpetual succession, powers, dissolution and legal obligations.

Companies may be classified into the following categories (i) Chartered companies; (ii) Statutory companies; and (iii) Registered Companies. A registered company may be either a company limited by shares or a company limited by guarantee or an unlimited company. Such company may, either be a private company or a public company. Foreign companies are those which are incorporated outside India, but have a place of business in India.

A company is deemed to be the holding company of another, if that other is its subsidiary. A company is deemed to be a subsidiary of another company only if:

- i) the other company controls the composition of its board of directors;
- ii) the other company holds more than half of the nominal value of its equity share capital; or
- iii) it is subsidiary of any other company which, in turn, is the subsidiary of holding company.

Producer companies have been added to Companies Act 1956 by the Companies (Amendment) Act 2002. These are companies in which any ten or more producers who are individuals or any two or more producer institutions may form and incorporate a company as a Producer Company.

One-person Company is a one shareholder corporate entity, where legal and financial liability is limited to the company only.

“Small Company” means a company, other than a public company (i) paid-up share capital of which does not exceed fifty lakh rupees; and (ii) turnover of which as per its last profit and loss account does not exceed two crore rupees

An association or partnership which is formed with more than fifty persons according to Section 464, Companies Act 2013 must be regarded as an illegal association. However, a joint Hindu family carrying on a business, a stock exchange and associations not for profit-making are not illegal associations. Every member of an illegal association shall be personally liable for all liabilities incurred in such business.

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### 1.14 KEY WORDS

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**Company:** An association of persons registered under the Companies Act. It is an artificial person created by law, with a distinctive name, a common seal and perpetual succession of its members.

**Chartered Company:** A company which is incorporated under a special Royal Charter granted by the King or Queen of England.

**Statutory Company:** A company which is created by a special Act of Parliament or State Legislature.

**Company limited by shares:** A company having the liability of its members limited to the value of shares held by them.

**Company limited by guarantee :** A company having the liability of its members limited to such an amount as the members may respectively undertake to contribute to the assets of the company in the event of its being wound-up.

**Government Company:** A company in which not less than 51 per cent of the paid up capital is held by the Government.



**Private Company:** A private company is one which by its articles of association (a) restricts the right of transfer of shares; (b) limits the number of its members to 200 (not including the present or past employee members); (c) prohibits any invitation to the public to subscribe for any shares or debentures of the company and (d) prohibits any invitation or acceptance of deposits from persons other than its members, directors or their relatives. The minimum number of members required to form a private company is 2.

**Public Company:** A public company is one which is not a private company is a private company but subsidiary of a public company. The minimum number of members required to form a public company is seven.

**Unlimited company:** A company in which the liability of the members is unlimited.

**Perpetual Succession:** Continued existence irrespective of the life or sanity of its members.

**Foreign Company:** A company incorporated outside India but having a place of business in India.

**Corporate Veil:** A line of demarcation or a veil is drawn between the company and its members.

**Producer Company:** A company formed by any ten or more individuals, each of them being a producer or any two or more producer institutions or a combination of ten or more individuals and producer institutions.

**One person Company:** One-person Company is a one shareholder corporate entity, where legal and financial liability is limited to the company only.

**Small Company:** "Small Company" means a company, other than a public company:

- i) paid-up share capital of which does not exceed fifty lakh rupees; and
- ii) turnover of which as per its last profit and loss account does not exceed two crore rupees.

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### 1.15 ANSWERS TO CHECK YOUR PROGRESS

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- A 3) i) True; ii) True; iii) False; iv) False;  
v) True; vi) True
- B 5) a) separate legal  
b) representative  
c) enemy character  
d) express statutory provisions  
e) unlimited  
6) i) True; ii) False; iii) False; iv) False;  
v) True; vi) True; vii) True
- C 6) a) registered  
b) wound up  
c) fifty one

- d) Comptroller and Auditor General of India
  - e) Thirty
  - f) 8
- 7) i) False; ii) False; iii) True; iv) True; v) False; vi) True; vii) True; viii) True; ix) True
- 8) a) (iii); b) (ii)

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### 1.16 TERMINAL QUESTIONS

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- 1) Company is an artificial person by law with a perpetual succession and is different from the members constituting it. Comment.
- 2) Describe the main characteristics of a company.
- 3) Discuss the concept of corporate veil. Under what circumstances can this veil be lifted?
- 4) Distinguish between a company and a partnership.
- 5) Distinguish between 'company' and 'body corporate'.
- 6) Write a note on government company
- 7) Briefly discuss different types of companies.
- 8) What is a foreign company? Describe special provisions relating to a foreign company.
- 9) Define a holding company and a subsidiary company. When can a company be called a subsidiary of another company? Explain.
- 10) What do you mean by an illegal association? What are the consequences of forming such an association?
- 11) Briefly discuss 'One Person Company' and 'Small Company'.

**Note:** These questions will help you to understand the unit better. Try to write answers for them but do not submit your answers to the University. These are for your practice only.