

# Company Law

By: Nirman Kaur

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# COMPANY LAW

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## BLOCK: I COMPANY AND ITS FORMATION

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### Nature and Types of Companies

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#### **INTRODUCTION**

Company Act has been passed from time-to-time in India with certain modifications to suit Indian conditions. After the end of World War II, many changes had taken place in the organization and management of joint stock companies in order to protect the interest of investors and ensuring efficient management of the affairs of the companies. The Companies Act, 1956 came into existence on April 1 1956. This Act is a comprehensive piece of legislation covering the entire field of the company organization and management. Latest amendment was made in the Companies Act in the year 2006. The Companies Act, 2013 came into existence on 30th August, 2013. It has 470 sections and VII schedules whereas the Companies Act, 1956 had 658 sections and XV schedules. In this chapter we will learn about a company and its characteristics, how it differs from body corporate, what is a concept of corporate veil, difference between company and partnership, various types of companies and what is an illegal association.

#### **CHAPTER AT A GLANCE**

##### **MEANING AND DEFINITION OF A COMPANY**

A company means a group of people associated together for the attainment of common objectives, social or economic. A company can be defined as an “artificial person”, invisible, intangible, created by or under law, with a discrete legal personality, perpetual succession, and a common seal. It is not affected by the death, insanity, or insolvency of an individual member. A company is a third legal business structure and has entirely a different organizational structure from the sole proprietorship or partnership. Its formation is due to firstly, the sole proprietorship and partnership cannot meet the increased capital demand of industry and commerce. Secondly, the company ensures the protection of limited liability to the shareholders and investors. Company is a legal entity for carrying on a commercial or industrial enterprise. Company members

share a common purpose, and unite in order to focus their various talents and organize their collectively available skills or resources to achieve specific, declared goals. Companies take various forms, such as voluntary associations, which may include nonprofit organizations, business entities with an aim of gaining a profit, financial entities and banks. A company or association of persons can be created at law as a legal person so that the company in itself can accept limited liability for civil responsibility and taxation incurred as members perform (or fail to discharge) their duty within the publicly declared “birth certificate” or published policy. Companies as legal persons may associate and register themselves collectively as other companies—often known as a corporate group. When a company closes, it may need a “death certificate” to avoid further legal obligations. The business should always be done 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. Section 8 of the Companies Act, 2013 allows formation of non-profit associations of companies.

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.

According to Prof. L.H. Haney, “Company is an artificial person created by law having separated entity with a perpetual succession and common seal”. According to Justice Lindley a company means association of persons who contribute in shape of money or money’s worth to a common stock and employ it for some specific purpose.

##### **COMPANY Vs. BODY CORPORATE**

Company is defined under Companies Act, 2013 means a company registered under Companies Act, 2013 or any of the previous company law. Whereas a body corporate broadly means a corporate entity which has a legal existence. The term body corporate is defined in Section 2(11) of the Companies Act, 2013. This includes a private company, public company, small company, one personal company, foreign company etc. Body corporate also includes a company incorporated

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outside India. However, body corporate doesn't include:

- A cooperative society registered under any law relating to cooperative societies, and
- Any other body corporate which the central Government may, by notification specify in this behalf.

A body corporate may be a corporation sole and corporation aggregate. A corporation sole is a legal entity consisting of a single ("sole") incorporated office, occupied by a single natural person. A corporation sole is one of two types of corporation, the other being a corporation aggregate. A corporation aggregate is a group of co-existing persons. "It is a collection of individuals united into one body under a special denomination, having perpetual succession under an artificial form, and vested by the policy of the law with the capacity of acting in several respects as an individual, particularly of taking and granting property, of contracting obligations and of suing and being sued, of enjoying privileges and immunities in common, and of expressing a variety of political rights, more or less extensive, according to the design of its institution, or the powers conferred upon it, either at the time of its creation or at any subsequent period of its existence." A joint stock company, a municipal corporation, a railway corporation, a chartered university, etc., are examples of a corporation aggregate.

#### IS COMPANY A CITIZEN

As per the Citizenship Act 1955 only natural persons can be "citizen" and not any juristic persons like corporation and therefore a company is an artificial person or as above said a juristic person and not a natural person, it cannot get the status of citizenship of the country. A company is a legal person in the eyes of law and can hold property, sue and be sued in its own name. But like a natural person it cannot be a citizen. It does not enjoy the fundamental rights which are enjoyed by a citizen as was decided in the case of State Trading Corporation of India *Vs.* Commercial Tax Officer. Even if all the members who form the company are citizens of India, the company doesn't become a citizen of India.

Though a company cannot be a citizen, yet it has a nationality domicile and residence. The nationality of the company is decided by the place of its incorporation. Similarly, the domicile of the company is the place of its registration. A company can have only one nationality and one domicile, but it may have several residences. Residence is important from the taxation view of point.

#### MAIN FEATURES OF A COMPANY

A Company is a voluntary association of persons formed for the purpose of doing business, having distinct legal identity, a name and limited liabilities. A company as an entity has many distinct features which together make it a unique organization. The essential characteristics of a company are as follows:

1. **Creation of Law:** A company is an incorporated association which is an artificial person created by law. It comes into existence when it gets registered under the Company Act. Minimum two persons are required to form a private company and minimum seven persons are required for a public company.
2. **Artificial Person:** A company is an artificial entity, it is created with the sanction of law. Since a company is having certain rights and obligations, it is called a person.
3. **Separate Legal Entity:** Under Incorporation law, a company becomes a separate legal entity as compared to its members. The company is distinct and different from its members in law. It has its own seal and its own name, its assets and liabilities are separate and distinct from those of its members. It is capable of owning property, incurring debt, and borrowing money, employing people, having a bank account, entering into contracts and suing and being sued separately.
4. **Limited Liability:** The liability of the members of the company is limited to contribution to the assets of the company upto the face value of shares held by him. A member is liable to pay only the uncalled money due on shares held by him. If the assets of the firm are not sufficient to pay the liabilities of the firm, the creditors can force the partners to make good the deficit from their personal assets. This cannot be done in the case of a company once the members have paid all their dues towards the shares held by them in the company.
5. **Perpetual Succession:** A company does not cease to exist unless it is specifically wound up or the task for which it was formed has been completed. Membership of a company may keep on changing from time-to-time but that does not affect life of the company. Insolvency or Death of member does not affect the existence of the company.
6. **Separate Property:** A company is a distinct legal entity. The company's property is its own. A member cannot claim to be owner of the company's property during the existence of the company.
7. **Transferability of shares:** Shares in a company are freely transferable, subject to certain conditions, such that no share holder is permanently or necessarily wedded to a company. When a member transfers his shares to another person, the transferee steps into the shoes of the transferor and acquires all the rights of the transferor in respect of those shares.  
The Companies Act, 2013, According to Section 58(2) 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.

**8. Common Seal:** A company is an artificial person and does not have a physical presence. Thus, it acts through its Board of Directors for carrying out its activities and entering into various agreements. Such contracts must be under the seal of the company. The common seal is the official signature of the company. The name of the company must be engraved on the common seal. Any document not bearing the seal of the company may not be accepted as authentic and may not have any legal force.

**9. Capacity to Sue and being Sued:** A company can sue or be sued in its own name as distinct from its members.

#### LIFTING THE CORPORATE VEIL

We have already discussed that a company has separate legal entity and it is independent from its members. In *Salomon Vs. Salomon & Company*, the House of Lords effected these enactments and cemented into English law the twin concepts of corporate entity and limited liability. In that case, the apex court simply laid down that a company is a distinct legal person entirely different from the members of that company. However, the courts have not always applied the principal laid down in *Salomon Vs. Salomon & Co.*

In a number of circumstances, the court will pierce the corporate veil or will ignore the corporate veil to reach the person behind the veil or reveal the true form and character of the concerned company. The rationale behind this is probably that the law will not allow the corporate form to be misused or for the purposes which is set out in the statutes. In those circumstances in which the court feels that the corporate form is being misused, it will rip through the corporate veil and expose its true character and nature disregarding the Solomon principal as laid down by the House of Lords. On incorporation, a line, veil is drawn between the company and its member. Forming a veil, company enjoys several benefits which we have already discussed.

In case when a company uses the corporate veil for some improper conduct, to protect fraudulent activities or misleading or misrepresentation of facts, the law discards the corporate veil and take legal step against the company and person behind the company treating both of them as same entity. Corporate veil is said to be lifted when the court ignores the company and relate it directly to the members associated with

the company. According to Prof. Gower, "When the law disregards the corporate entity and pays regard instead to the individual member behind the legal facade, it is known as lifting the veil of corporate personality."

The situation and cases in which corporate veil can be lifted are broadly classified as under:

1. Under express statutory provisions,
2. Under judicial interpretations.

**Under Statutory Provisions:** As per the Companies Act, 2013 there are certain circumstances according to which the members of the company or the directors may be held personally liable along with the company, however company is a separate entity. Such circumstances are as follows:

1. **Mis-statements in Prospectus:** Prospectus is the sole of any company. On the basis of the contents of the prospectus, the general public makes up their mind whether to invest in that company or not. Hence, the statements in the prospectus hold a great gravity of being absolutely true. But if there is any wrong information given in the prospectus shall be liable to compensate the loss or damage. According to section 62 of the Companies Act, 1956 makes certain person liable to pay compensation to every person who subscribes for any shares or debentures on the faith of the prospectus for any loss or damage he may have suffered due to any untrue statements made in the prospectus. According to Section 34 and Section 447 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 omission was necessary.
2. **Failure to return application money:** The directors of a company are jointly and severally liable to repay the application money with interest if the company fails to refund the application money of those applicants who have not been allotted shares within 130 days from the date of issue of the prospectus. However, this does not in any way affect the very existence of the company or indeed its subsequent independent personality and other features.
3. **Non-Disclosure:** 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. Section 147(4) provides that an officer of a company who signs any Bill of Exchange, Hundi,

Promissory note, cheque, wherein the name of the company is not mentioned in the prescribed manner, such officer shall be held personally liable to the holder of such Bill of exchange, hundi, promissory note or cheque as the case may be; unless it is duly paid by the company.

4. **For facilitating the task of an inspector to investigate the affairs of the company:** If it is necessary for the satisfactory completion of the task of an inspector appointed to investigate the affairs of a company for alleged mismanagement, or oppressive policy towards its members, he may investigate into the affairs of another related company in the same management or group.
5. **For investigation of ownership of Company (Sec. 216):** The Central Government may appoint one or more inspectors to investigate and report on the membership of any company for the purpose of determining the true persons who are financially interested in the company and who control its policy or materially influence it.
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 the company.
7. **Fraudulent conduct:** If in the course of winding up of a company, it appears that any business of the company has been carried on with the intent to defraud the creditors of the company or any other person or for any other fraudulent purpose, the persons who were knowingly parties to the carrying on of the business, in the manner aforesaid, shall be personally liable for all or any of the debts or other liabilities of the company, as the court may direct.
8. **Liability under other statutes:** A holding company is required to disclose to its members the accounts of the subsidiaries. Every holding company is supposed to attach to its balance sheet, copies of the balance sheet, profit and loss account, directors report and auditors' report, etc. in respect of each subsidiary company. It amounts to lifting of the corporate veil because in the eyes of law a subsidiary company is a separate legal entity and through this mechanism their identity is known.

#### Under Judicial Interpretations

Apart from the cases discussed above the courts have allowed to lift the veil of incorporation for ensuring proper administration of taxation, duties etc. these circumstances are as follows:

1. **Protection of Revenue:** If any company is

formulated for the purpose of evading the tax liability the court will allow the lifting of corporate veil. We can understand this by using this case: In *Sir Dinsaw Maneckjee Petit*, the assessee was a millionaire earning a huge income by way of dividend and interest. He formed four private companies and transferred his investments to each of these companies in exchange for their shares. The dividends and interest income received by the company was handed back to Sir Dinshaw as a pretend loan. It was held that the company was formed by the assessee purely as a means of avoiding tax and companies thus formed were nothing more than the assessee himself. It did no business and was created as a legal entity simply to extend pretend loans to Sir Dinshaw.

2. **Protection 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 reality of the situation. The two classic cases of the fraud exception are *Gilford Motor Company Ltd Vs. Horne and Jones Vs. Lipman*. In the first case, Mr. Horne was an ex-employee of The Gilford motor company and his employment contract provided that he could not solicit the customers of the company. In order to defeat this he incorporated a limited company in his wife's name and solicited the customers of the company. The company brought an action against him. The Court of appeal was of the view that "The company was formed as a device, a stratagem, in order to mask the effective carrying on of business of Mr. Horne. "In this case it was clear that the main purpose of incorporating the new company was to perpetrate fraud." Thus the court of appeal regarded it as a mere sham to cloak his wrongdoings. In the second case of *Jones Vs. Lipman* a man contracted to sell his land and thereafter changed his mind in order to avoid an order of specific performance he transferred his property to a company. Russel J specifically referred to the judgments in *Gilford Vs. Horne* and held that the company here was "a mask which (Mr. Lipman) holds before his face in an attempt to avoid recognition by the eye of equity" he awarded specific performance both against Mr. Lipman and the company.
3. **Determination of the enemy character of a company:** In times of war the court is prepared to lift the corporate veil and determine the nature of shareholding as it did in the *Daimler Co. Ltd. Vs. Continental Tyre and Rubber Co.,* where a company was incorporated in London for the purpose of selling German tyres