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Academic Scripts

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## **INTRODUCTION**

Hello friends! Today we will be talking about Companies Act, 1956. The word company means an association formed by a number of persons for some common object. When such an association of persons is registered under the companies act, it becomes an artificial person with perpetual succession and common seal. This session deals with its meaning of company, the characteristics, and various types of companies, its incorporation and details.

## **COMPANY**

**According to sec. 3(1) (i) of the Company Act, 1956:** A company is defined as, 'a company formed and registered under this act or an existing company.' An existing company means 'a company formed and registered under any of the previous company laws.'

The definition given by the Companies' Act does not define the company clearly as to its features. Chief Justice Marshall of U.S.A. has defined the term company, as 'a company is a person, artificial, invisible, intangible and existing only in the contemplation of the law. Being a mere creature of law, it possess only those properties which the charter of its creation confers upon it either expressly or as incidental to its very existence.'

## **Characteristics of the company**

The following are the characteristics of the company:

- 1. Incorporated Association:** Under the Companies Act, a company must be registered or incorporated. The minimum numbers of persons required for incorporation are seven in case of public company and two in case of private company.
- 2. Artificial person:** It is an artificial legal person enjoying same rights and owing same obligations as a nature person.
- 3. Separate Legal Entity:** A company is a separate and distinct from the persons who constitute it.
- 4. Limited Liability:** the liability of its members is limited to the unpaid value of the shares held by them or guarantee given by them.
- 5. Separate Property:** Company is entitled to owe and hold property as distinct from its members.
- 6. Transferability of Shares:** Shares of the company are freely transferable which makes the life of the company independent of the lives of its members.
- 7. Perpetual Existence:** A company being an artificial judicial person, it is not affected by the death, insolvency or retirement of the members. Members may come and members may go but the company can go on forever.
- 8. Common seal:** Common seal is the official signature of the company because a company cannot sign like a natural person.
- 9. Company may sue and be sued in its own name:** One of the consequences of separate legal entity is that a company may sue and be sued in its own name.

### **Corporate veil**

A company is a legal person and is distinct from its members. This principle is regarded as a curtain or a veil between the company and its members protecting the later from the liabilities of the former. This veil is the corporate veil and is impassable as an iron curtain.

### **Lifting of the Corporate Veil.**

As per the judicial point of view, a company is a separate legal entity different from its members (saloman Vs. Saloman & co. Ltd.). When there are cases of dishonesty and fraudulence in incorporation, the law lifts this veil. This veil is a fictional veil and not a wall between the company and its members. Lifting the corporate veil may be defined as looking behind the company as a legal person and identifying the persons who are behind the scene and are responsible for the preparation of fraud.

The circumstances under which the court may lift the corporate veil may be broadly divided into following two heads:-

1. Judicial Interpretation
2. Statutory Provision

**1. Judicial Interpretation:** following are the cases under which the court has lifted the corporate veil:-

**a. Avoidance of welfare legislation:** Where the device of incorporation is used for reducing the amount to be paid by way of bonus to the workmen, the Supreme Court can be upheld the lifting of the veil to look at the real transactions: [workmen of Associated Rubber Industry Vs. Associated Rubber Co.]

**b. Protection of Revenue:** Where the medium of the company has been used for tax evasion or to circumvent tax obligation, courts have lifted the veil and looked at the realities of situation

**c. Where company is a sham:** When the court finds that company is a mere cloak or sham and is used for some illegal or improper purpose, it may lift veil. The leading case on this was P.N.B. Finance V. Shital Prasad, where a person borrowed money from a company and invested it into three different companies, the lending company was advised to bring together the assets of all the three companies, as they were created to do fraud with the lending company.

**d. Where the company is acting as the agent of the shareholders:** Where a company is devised to act as an agent of its shareholders or of another company it will be responsible for its acts. However, it will be a question of fact every case whether the company is acting as agent for its shareholders.

**e. Determination of character:** Test of control is adopted in the cases when the trade is conducted with enemy country. In such cases the court will lift the veil at the times of war to see whether a company is controlled by enemy aliens. Consequently, a company registered in England may be alien enemy if its agents or the persons in default controls of its affair are alien.

**f. Provision of fraud or improper conduct:** The court will disregard the separate existence of the company, where it is shown the company is formed for evading contractual and statutory obligations [Gilford Motor Co. Ltd. V. Horne]

**2. Statutory Provision:** cases are as follows: -

**a. Number of member below statutory minimum [sec. 45]**

When at any time the number of members of a company is reduced below two in case of a private company or below seven in case of a public company and then too it continues its business for more than six months, then every member who knows the fact will become liable to an unlimited extend for the payment of the whole debt of the company done during that time. The reason behind this is to withdraw the advantage of incorporation when the conditions are not fulfilled.

**b. Company not mentioned on the bills of exchange [sec. 147]:** When the bills of exchange, promissory note, cheque or order for money or goods are signed by officer of the company or any other person on behalf of the company, and the name of company is not fully or properly mentioned. Then the person who signed the instrument will be personally liable, unless the amount is paid by the company.

**c. Failure to refund application money [sec. 69]:** In case of issue of shares by a company to the public, if the company is unable to receive minimum subscription within 120 days from the first issue of the prospectus than all money received from application shall have to be refunded. If the amount is not refunded within 10 days, the directors shall be liable to repay the money with interest at the rate of 6% per annum.

**d. Fraudulent trading [sec. 542];** On the winding up procedure of the company, if it is found that any business of the company has been carried on to defraud creditors, the court shall declare those persons personally liable for the debts and other liabilities of the company.

**e. Group accounts [sec. 212]:** Where the company has subsidiaries and group accounts, then the principle of separate legal entity may be disregarded. Along with the own profit and loss account and balance sheet, subsidiaries and group accounts have also to be laid down.

Thus, these are the circumstances where the veil can be lifted.

## **TYPES OF COMPANIES**

There are 5 types of classification of companies. They are :

- A. On the basis of incorporation
- B. On the basis of liability
- C. On the basis of members
- D. On the basis of domicile
- E. Miscellaneous or Other

### **(A) On the basis of incorporation:**

**On the basis of incorporation, companies can be classified as:**

- (i) Chartered companies
- (ii) Statutory companies
- (iii) Registered companies

#### **(i) Chartered companies:**

The crown in exercise of the royal prerogative has power to create a corporation by the grant of a charter to persons assenting to be incorporated. Such companies or corporations are known as chartered companies. Examples of this type of companies are Bank of England (1694), East India Company (1600). The powers and the nature of business of a chartered company are defined by the charter which incorporates it. After the country attained independence, these types of companies do not exist in India.

#### **(ii) Statutory companies:**

A company may be incorporated by means of a special Act of the Parliament or any state legislature. Such companies are called statutory companies, Instances of statutory companies in India are Reserve Bank of India, the Life Insurance Corporation of India, the Food Corporation of India etc. The provisions of the Companies Act 1956 apply to statutory companies except where the said provisions are inconsistent with the provisions of the Act creating them. Statutory companies are mostly invested with compulsory powers.

#### **(iii) Registered companies:**

Companies registered under the Companies Act 1956, or earlier Companies Acts are called registered companies. Such companies come into existence when they are registered under the Companies Act and a certificate of incorporation is granted to them by the Registrar.

**(B) On the basis of liability:**

**On the basis of liability, the company can be classified into:**

- (i) Companies limited by shares
- (ii) Companies limited by guarantee
- (iii) Unlimited companies.

**(i) Companies limited by shares:**

When the liability of the members of a company is limited to the amount if any unpaid on the shares, such a company is known as a company limited by shares. In a company limited by shares the liability of the members is limited to the amount if any unpaid on the shares respectively held by them. The liability can be enforced during existence of the company as well as during the winding up. Where the shares are fully paid up, no further liability rests on them.

**(ii) Companies limited by guarantee:**

It is a registered company in which the liability of members is limited to such amounts as they may respectively undertake by the memorandum to contribute to the assets of the company in the event of its being wound up. In the case of such companies the liability of its members is limited to the amount of guarantee undertaken by them. Clubs, trade associations, research associations and societies for promoting various objects are various examples of guarantee companies.

**(iii) Unlimited companies:**

A company not having a limit on the liability of its members is termed as unlimited company. In case of such a company every member is liable for the debts of the company as in an ordinary partnership in proportion to his interest in the company. Such companies are not popular in India.

**(C) On the basis of number of members:**

**(i) Private company:**

**A private company means a company which by its Articles of Association:**

- (i) Restricts the right to transfer its shares
- (ii) Limits the number of its members to fifty (excluding members who are or were in the employment of the company) and
- (iii) Prohibits any invitation to the public to subscribe for any shares or debentures of the company.

(iv) Where two or more persons hold one or more shares in a company jointly, they are treated as a single member. There should be at least two persons to form a private company and the maximum number of members in a private company cannot exceed 50. A private limited company is required to add the words "Private Ltd" at the end of its name.

**(ii) Public company:**

A public company means a company which is not a private company. There must be at least seven persons to form a public company. It is of the essence of a public company that its articles do not contain provisions restricting the number of its members or excluding generally the transfer of its shares to the public or prohibiting any invitation to the public to subscribe for its shares or debentures. Only the shares of a public company are capable of being dealt in on a stock exchange.

**(D) According to Domicile:**

**(i) Foreign company:**

It means a company incorporated outside India and having a place of business in India.

**According to Section 591 a foreign company is one incorporated outside India:**

(a) Which established a place of business within India after the commencement of this Act or (b) Which had a place of business within India before the commencement of this Act and continues to have the same at the commencement of this Act.

**(ii) Indian Companies:**

A company formed and registered in India is known as an Indian Company.

**(E) Miscellaneous Category:**

**(i) Government Company:**

It means any company in which not less than 51 percent of the paid up share capital is held by the Central Government, and/or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments. The subsidiary of a Government company is also a Government company.

**(ii) Holding and subsidiary companies:**

A company is known as the holding company of another company if it has control over another company. A company is known as subsidiary of another company when control is exercised by the latter over the former called a subsidiary company. A company is to be deemed to be subsidiary company of another

**(a) If the other:**

(a) Controls the composition of its Board of directors or

(b) Exercises or controls more than half of its total voting power where it is an existing company in respect where of the holders of preference shares issued before the commencement of the Act have the same voting rights as the holders of equity shares or

(c) In case of any other company holds more than half in nominal value of its equity share capital or

**(b)** If it is a subsidiary of a third company which is subsidiary of the controlling company.

**(iii) One-man Company:**

This is a company in which one man holds practically the whole of the share capital of the company and in order to meet the statutory requirement of minimum number of members, some dummy members hold one or two shares each. The dummy members are usually nominees of principal shareholder. The principal shareholder is in a position to enjoy the profits of the business with limited liability. Such type of companies are perfectly valid and not illegal.

**REGISTRATION/INCORPORATION OF A COMPANY.**

**Procedure for registration/Incorporation of a company.**

A company comes into existence when the number of persons come together with a view to exploit some business opportunity.

According to section 12, for a private company any two persons or more and for a public company any seven persons or more may incorporate a company, by subscribing their names to the Memorandum of Association and complying with other requirements, in respect of registration.

The memorandum for registration of a company should be presented to the registrar of the state in which the business office of the company is to be situated.

**Documents to be filed with the registrar: -**

1. Application for availability of name
2. Memorandum of Association
3. Articles of Association
4. Copy of proposed agreement
5. Statement of nominal capital
6. Address of the registered office
7. List of directors and their consent
8. Undertaking to take up qualification shares

## 9. Statutory declaration

When the Registrar of Companies is satisfied by the filed documents, he registers the company and places its name on the register of companies. If there are small defects in the documents, the registrar can get it rectified and then get the company registered. But, if there is a material defect, he may refuse for registration.

### **Restrictive conditions on the basis of which a company may be incorporated as a private company:**

The conditions of restriction with which a private company is incorporated under the Companies Act, 1956 are as follows: -

1. Every private company should have paid up capital of Rs. 1 Lakh or such higher as may be prescribed.
2. The right to transfer share is restricted
3. The number of members is limited to 50 excluding the past and present employees who are the members of the company.
4. Prohibition on inviting public to subscribe to any shares or debentures of the company.
5. Prohibition on invitation or acceptance of deposit from person other than its members, directors or their relatives [section 3 (i) (iii) of Companies Act, 1956].

### **Certificate of Incorporation**

On registration of the company when the documents required for registration of a proposed company is filed by the company along with the necessary fees, the registrar of Companies issues a Certificate that the company is incorporated. This certificate is called Certificate of Incorporation. In case of a limited company the fact that the company is limited is mentioned in the certificate [section 34]

A certificate of incorporation is conclusive as to all administrative acts relating to incorporation and as to date of incorporation.

The following are the effects of incorporation: -

1. It becomes a body corporate distinct from its members
2. It has a perpetual succession and a common seal
3. A company can sue and be sued in its own name
4. The debts of company are the liabilities of the company only
5. The property of the company belongs to the company and not to its members.

Therefore, the certificate of incorporation is conclusive evidence.

### **Commencement of business by a company**

A private company can begin its business immediately after getting the certificate of incorporation. Whereas, a public company cannot start its business after incorporation unless it has obtained this certificate. The company may comply with the provision of section 149 of the Companies Act. The method for obtaining the certificate varies with the fact whether the company has issued a prospectus or not.

**If the company has share capital and the prospectus is issued the company cannot commence its business until: -**

1. Shares up to the amount of minimum subscription have been allotted by the company.
2. Every director has paid up the application and allotment money on the shares taken
3. No money is to be repaid to the application for failure to apply or obtain permission for the shares to be dealt in any recognized stock exchange
4. A statutory declaration duly verified by one of the directors has been complied with [section 149(1)]

**Where the company has not issued a prospectus:**

If the company has a share capital but has not issued a prospectus to the public, it shall not commence the business unless: -

1. Statement in lieu of prospectus has been filed with the registrar.
2. Every director has paid in cash the application and allotment money on the shares taken by him
3. A statutory declaration duly verified by one of the directors or the secretary or where the company has not appointed a secretary in whole time practice in the prescribed form, been filed with the registrar [section 149(2)]

When the company has complied with the aforesaid conditions, the registrar of Companies will issue a certificate to commencement of business.

## **SUMMARY**

In today's session we covered the fundamentals of the Company's Act 1956. This exhaustive act covers every minute details in regards to a company which is very useful to all those who are running it and wishing to open up a new one. Today we learnt the legal meaning of the term company along with its characteristics, got acquainted with various types of companies and lastly talked about its incorporation. I hope this would have given a fair idea about the Act to you. Thank you.