

# **Corporate Law**

**Subject: Commerce**

**Lesson: Corporate Law**

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# Corporate Law

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# Corporate Law

## Introduction

There are several forms of ownership of a business organization: it can be a sole proprietorship form of organization, where a single individual is the owner of the firm, it can be a partnership form of business organization, where two or more partners are the owners of the firm, it can be an LLP (limited liability partnership) which is a hybrid of both a partnership firm and a company and lastly it can be a company form of business organization. This lesson discusses in detail the company form of business organization. It gives a brief historical



**Figure 1.1 Forms of Business Organization**

background of how the company form of business organization came into existence in India. It defines and explains the characteristics of a company in detail. It also gives a distinction between a company and a partnership firm. Further, it explains terms like illegal association and lifting of corporate veil in a simplified manner

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## 1.1 History of Company Law in India

The earliest business associations in England were the 'Merchant Guilds'. Some of the merchant guilds were called regulated companies. A Royal Charter established the East India Company in the year 1600. In England the Joint Stock Companies Act was passed for the first time in 1844. Under this act, a provision was made for the registration of companies.

In the year 1850, taking the English Joint Stock Companies Act 1844 as a base, a provision was made for registration of joint stock companies in India. After this the Joint Stock Companies Act was passed in India in the year 1857. Under this Act the concept of limited liability<sup>1</sup> was introduced for the first time in India. Thereafter the Companies Act was passed in the year 1866. The Act consolidated and amended the law relating to incorporation, regulation and winding-up of trading companies and other associations.



Figure 1.2 History of Company Law in India

The Act was later replaced by The Indian Companies Act 1913. The Indian companies Act was based on the English Acts, therefore in cases pertaining to Company Law, the Indian Courts closely followed the decisions of the English courts.

However, after independence, the Government appointed a Committee under the chairmanship of Shri H.C. Bhaba in the year 1950 to revise the Indian Companies Act of 1913. The committee submitted its report in the year 1952. Based on the recommendation of the committee and the provisions of the English Companies Act 1948, the Companies Act 1956 was introduced in the parliament.

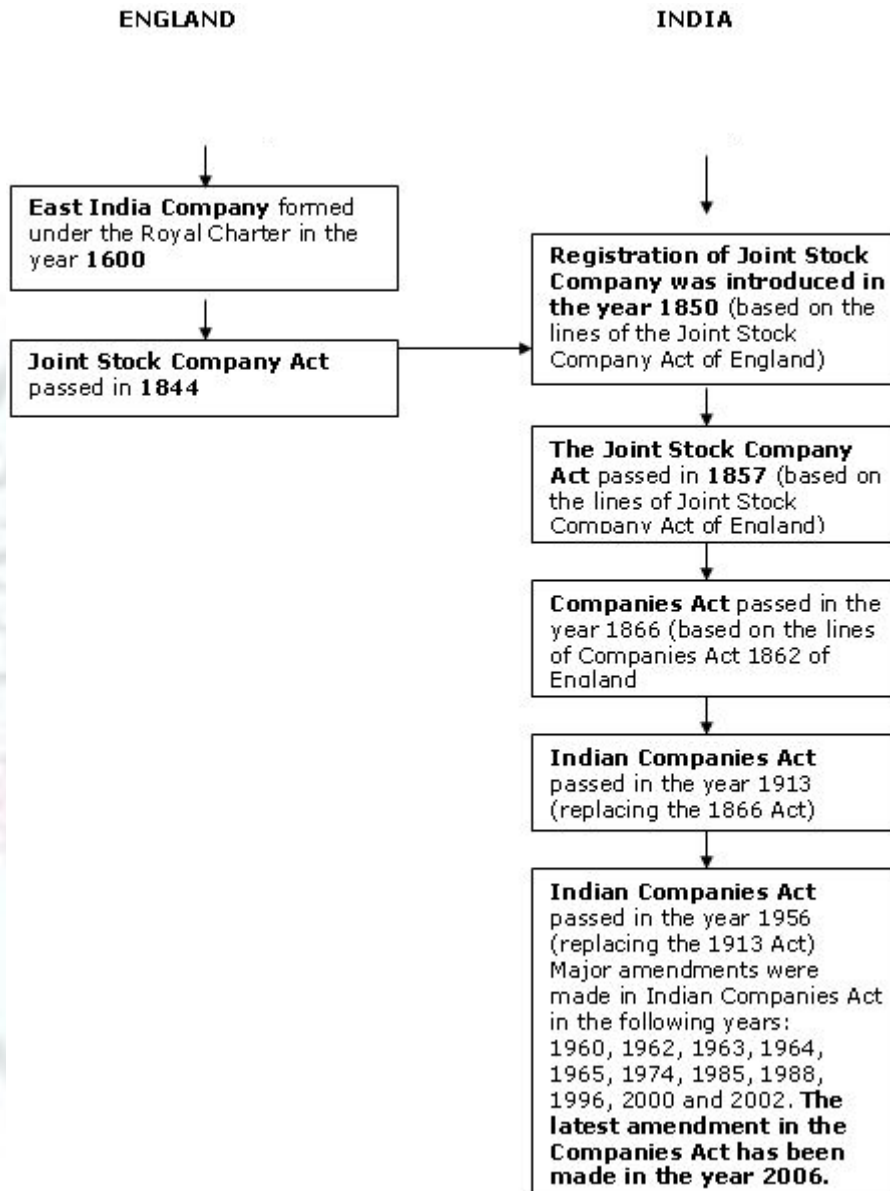
The Companies Act 1956 came into force on 1<sup>st</sup> April, 1956. The Companies Act has been amended from time to time. The latest amendments were made in 2006. To overhaul the Company Law in a comprehensive way, the Companies Act (Amendment) Bill 2009 was introduced in the parliament in August 2009. Some of the major amendments made in the Companies Act in the year 2002 are given below:

- The Company Law Board (CLB) has been abolished. Instead a Tribunal is formed which is called 'National Company Law Tribunal (NCLT)'. The matters pending with the CLB can be transferred to the NCLT and the orders already passed by CLB would be valid and can be enforced through court.<sup>2</sup>
- The rehabilitation of sick companies will be undertaken by the Tribunal and not by the Board for Industrial & Financial Reconstruction (BIFR). Earlier the BIFR<sup>3</sup> was entrusted with the rehabilitation of sick companies as the matter came under the jurisdiction of the Sick Industrial Companies Act 1985 (SICA)<sup>4</sup>, but now the Sick Industrial Companies Repeal Act 2003 has replaced SICA and the work of revival and rehabilitation has been entrusted to NCLT.

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The series of Acts which were passed are given chronologically in figure 1

Figure 1.1





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## 1.2 Definition of a Company

According to Section 3(1) (i) and (ii) of the Companies 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 former Companies Act".

Lord Justice Lindley <sup>5</sup> has defined a company as "an association of many persons who contribute money or money's worth to a common stock and employ it in some trade or business, and who share the profit and loss (as the case may be) arising there from. The common stock so contributed is denoted in money and is the capital of the company. The persons who contribute it, or to whom it belongs, are members. The proportion of capital to which each member is entitled is his share. Shares are always transferable although the right to transfer them is often more or less restricted."  
[http://en.wikipedia.org/wiki/Lord\\_Justice\\_Lindley](http://en.wikipedia.org/wiki/Lord_Justice_Lindley)



Figure 1.3 Definition of a Company

Prof. L.H. Haney<sup>6</sup> has defined a company as " An artificial person created by law, having a separate entity, with a perpetual succession and a common seal."

Thus a company may be defined as an association of persons registered under the Companies Act 1956 or under any former Companies Act. It is an artificial person created by law, having a common stock (capital) comprising of transferable shares, a separate legal entity, a perpetual succession and a common seal, and limited liability.

The company is discussed in detail under the heading characteristics of a company, which will help to have a better understanding of what exactly is meant by a company.

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## 1.3 Characteristics of a Company

**Artificial Person:** Unlike a human being a company is created by law and dissolved only by law. It is intangible and does not have the physical attributes of a natural person. However, it exercises the same rights, as are exercised by human beings and may be fined for the contravention of the provisions of the Companies Act. Thus like a natural person a company can exercise all the rights and duties, which are legally in force in the country where it is incorporated, but it cannot do certain things like marrying, eating, running and driving, which a natural person can.

### **Illustration:**

A group of childhood friends Rukku, Kukku, Majnu and Pankhu come together to run a travel agency. They name their travel agency RKMP and also get it registered. Rukku gets married and incurs a total expense of Rs. 30 Lakh on the marriage. He makes all the payment from the company's account and shows Rs 30 lakh as marriage expense in the account books of the company. The company is an artificial person and cannot get married, therefore it is impossible for the company to bear marriage expenses and so it should not be shown in the account books as an expense incurred by the company. The company has a right to sue Rukku and recover Rs. 30 lakh from him.

**Separate Legal Entity:** A company has an entity separate from its members. It has the right to own property and transfer the title to the property to anyone it likes. None of its members owns the assets of the company. The company can sue and be sued in its own name by its members and the outsiders. The creditors of the company cannot sue individual members of the company for non-payment of dues. For non-payment they can sue only the company.

### **Illustration:**

A group of childhood friends Rukku, Kukku, Majnu and Pankhu come together to run a travel agency. Soon they purchase a van, a bus, five computers, ten air conditioners and other assets for running the business. Pankhu takes his family from Delhi to Agra in the company van. He is not allowed to use the company van for his personal use. Hence the company has a right to recover from Pankhu the rent for using the van or any other cost which is taken from a usual customer who hires the company van for personal use.

### **Illustration:**

A group of childhood friends Rukku, Kukku, Majnu and Pankhu come together to run a travel agency. One day a tour from Delhi to Shimla is organized by the Company and Kukku and Majnu plan to take the trip. Just at the time of departure it starts raining very heavily and Kukku and Majnu decide to cancel the trip. However they do not reimburse the travel fare to the passengers. The passengers sue the company for the refund of the travel fare and the company is held liable to pay. Although the decision to cancel the trip was that of Kukku and Majnu, it is the company that is liable to the third party.

### **Case Law 1**

**Salomon Vs. Salomon & Co. Ltd. (1895-99 ALL ER 33 (HL))<sup>8</sup>**  
Salomon was a leather merchant.

He converted his business into a limited company- Salomon & Co. Ltd. The company consisted of Salomon, his wife and five of his children. In all there were seven members in the company. The company purchased the business of Salomon for 39000 pounds. The purchase consideration was paid in terms of 10,000 pounds debenture confer ring a

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charge over the company's assets, 20,000 pounds fully paid 1 pound share each and the balance in cash. The company in less than one year ran into difficulties and liquidation proceedings commenced.



**Figure 1.5 House of Lords**

The assets of the company were not even sufficient to discharge the debentures held by Salomon himself. However nothing was left for the unsecured creditors. The unsecured creditors claimed priority over the debenture holder (Mr Salomon) on the ground that a person cannot owe to himself and that Salomon and the company were one and the same person. The House of Lords unanimously held that the company had been validly constituted, since the act only required seven members holding at least one share each. Salomon was the agent of the company and the company was not the agent of the company therefore the company's assets must be applied in payment of the debentures first in priority

**Common Seal:** A Company has an existence separate from its members, however it does not have a hand. Therefore unlike a natural person, it cannot sign on legal contracts and documents on its own. For this reason the law has provided a seal, with the name of the company engraved on it, for the purpose of signature. Any document bearing the company's seal and witnessed by at least two directors of the company is binding on the company.



**Figure 1.6 Common Seal**



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## Illustration:

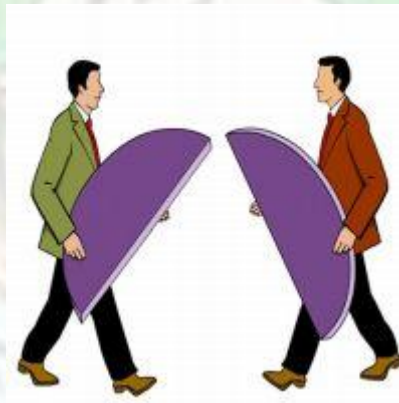
A group of childhood friends Rukku, Kukku, Majnu and Pankhu come together to run a travel agency. They name their company 'RKMP Travel Agency' and also get their company registered. Rukku purchases buses and vans for the company, Kukku purchases computers, tables and chairs for the company and Majnu and Pankhu buy land for the company. Different members enter into different agreements with different vendors, but there is one thing common in all the agreements, and that is the company seal. An agreement having the seal of the company implies that the members have entered into contracts on behalf of the company.

**Limited Liability:** The liability of a member of a company is limited, that is, the liability of the member for the debts of the company is limited to the amount unpaid on his/ her shares.

## Illustration:

A group of childhood friends Rukku, Kukku, Majnu and Pankhu come together to run a travel agency. They name their company 'RKMP Travel Agency' and also get their company registered. Each member invests Rs 1,00,000 each in the form of 1000 shares of Rs 100 each. The company makes losses for a couple of years and is declared insolvent. Because of the feature of limited liability, the loss of each member comes to Rs.1,00,000 only. One of the members, Majnu, had paid only Rs 90, 000. There is still a balance of Rs 10,000, that is, 10 shares of Rs 1000 each, which is unpaid by him. Thus Majnu is liable to pay Rs. 10,000 more at the time of the dissolution of the company.

**Transferability of shares:** The shares are freely transferable in a public limited company<sup>9</sup> whereas in a private company there are some restrictions on the transferability of shares.



**Figure 1.7 Transferability of Shares**

## Illustration:

A group of four childhood friends Rukku, Kukku, Majnu and Pankhu come together to run a travel agency. They name their company 'RKMP Travel Agency' and also get their company registered. Each member invests Rs 1,00,000 each in the form of 1000 shares of Rs 100 each. Kukku a holder of 1000 fully paid up shares sells 100 of his shares to Ramneek. With the transfer of 100 shares to Ramneek the total membership of the company increases to five.

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## 1.4 Differences between a Company and a Partnership firm

There are various forms of business organizations such as Sole Proprietorship, Partnership, Limited Liability Partnership (LLP) and Company. In a sole proprietorship form of business organization there is a single person who owns and controls the business enterprise. His/her liabilities are unlimited and his/her death, retirement or insolvency brings an end to the business enterprise as well.

In a partnership, two or more persons called partners form a business enterprise. There must be at least two partners and a maximum of ten partners in a banking firm, and a maximum of twenty partners in a non-banking firm. The liability of partners is unlimited.

In a limited liability partnership (LLP), two or more persons called partners form a LLP, which has some of the features of a partnership firm and some of a company.

The company form of business organization has already been discussed above. Given below in Table 1 are the differences between a company and a partnership firm.

TABLE 1.1

Basis of difference	Company	Partnership firm
<b>Act applicable</b>	A company is governed by the companies Act 1956.	A partnership firm is governed by the Partnership Act 1932.
<b>Registration</b>	It is mandatory for a company to be registered.	A partnership firm may or may not be registered.
<b>Minimum number of members</b>	There must be a minimum of 2 members in a private company and a minimum of 7 members in a public company.	There must be a minimum of two partners in a partnership firm.
<b>Maximum number of members</b>	There cannot be more than 50 members in a private company, but there is no limit on membership for a public company.	In a banking firm, there cannot be more than 10 partners, and in a non-banking firm there cannot be more than 20 partners.
<b>Liability</b>	The liability of the members is limited to the amount unpaid on their shares.	The liability is unlimited, therefore each partner is personally liable for the debts of the firm.
<b>Management</b>	Not all the members have a right to take part in the management of the company. It is only the board of directors who can manage the company.	All partners have a right to take part in the management of the firm.
<b>Transfer of interest</b>	In case of a private company a member can transfer his/her interest (shares) only with the prior permission of the board of directors, whereas in case of a public company, a member can transfer his / her interest	A partner cannot transfer his/her interest to a third party without the consent of all the partners.

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	(shares) freely without any restriction.	
<b>Dissolution</b>	A company has a perpetual existence, therefore the death, retirement or insolvency of a member cannot lead to the dissolution of a company.	If all but one partner dies, retires or becomes insolvent, the firm gets dissolved.

## 1.5 Illegal Association and Consequences of Non-registration

1.5.1 Consequences of Non-Registration As discussed above, an association of persons which falls within the terms of Section 11 and is not registered is treated as an illegal association. The effects of non-registration are as follows:

**No legal existence:** An illegal association cannot enter into a contract. In other words any agreement entered into by it cannot bind it. Neither the association nor its members can sue any outsider nor can they sue each other. The outsider as well as the members cannot sue the association for any matter connected with the association.



Figure 1.9 No Contract

### **Illustration:**

A family comprising of seven members forms a company but does not get it registered. The company is formed to run a restaurant. One day the restaurant gets an order from a customer Mr Vinayak, to make dinner arrangements for 100 guests. The restaurant makes the arrangement and the dinner is served to 100 guests. Mr Vinayak has already paid Rs 1000 in advance and the dinner bill amounts to Rs. 15,000. Mr Vinayak refuses to pay the balance amount. As the restaurant is not a registered company, it cannot sue Mr Vinayak for the payment.

**Unlimited liability:** A member of an illegal association will be personally liable to the outsider for any liability incurred in the business.

### **Illustration:**

A family comprising of seven members form a company but do not get it registered. The company is formed to run a restaurant. One day a few people come to the restaurant and order a meal. Soon after eating, they become sick and are taken to a hospital. The doctor diagnoses food poisoning and they have to be admitted for medical treatment. The expense incurred on the medical treatment amount to Rs. 20,000. They sue the company for the reimbursement of the hospital expenses. In this case as the company is not registered, the family is personally liable to reimburse the expenses.

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**Fine:** According to Sub-Section (5) of Section 11, members of an illegal association are punishable with fine, which may extend to Rs 10,000. However the member can claim the refund of his/her amount of subscription provided the association has not used it.



**Figure 1.10 Fine**

### **Illustration:**

Twenty-five friends start a partnership firm with a total capital of Rs. 2,50,000. Each partner contributes Rs. 10,000. As the firm has more than 20 members, it is an illegal association. The partners can be fined for running such an association. During the running of the business Rs. 2,00,000 has been used and only Rs. 50,000 is left. The partners are entitled to claim the unused money each getting a refund of Rs. 2000.

**Tax liability:** The association is liable to pay the taxes on profits earned by it.

### **Illustration:**

A family comprising of seven members form a company but do not get it registered. The company is formed to run a restaurant. At the end of the financial year it is found that the association so formed has a profit of Rs. 5, 00,000. Even if the company is not registered it is liable to pay the taxes to the government.

**Illegality:** If the association reduces its number of members to 20 or below 20 (non-banking partnership) or to 10 or below 10 (banking partnership) it will still be illegal until it gets itself registered. However, subsequent registration will not alter the position with regard to past acts.

### **Illustration:**

A group of 20 people form a partnership firm to carry a construction work. As it is not compulsory for a partnership form of business to register itself, their business is legal. On 1st January 2009 one more person joins them as a partner, making the total number 21. Thereafter the partnership becomes an illegal association. During the same period a worker loses his life while working on the construction site. Due to the illegality of the association, the partners are held personally liable for the accident and are to be punished. After the incident the partners get the partnership firm registered but this does not change their position or their liability with regard to the past acts.



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## 1.6 Advantages and Disadvantages of Incorporation

### 1.6.1 Advantages of Incorporation

There are certain advantages a company enjoys after getting itself incorporated under the Companies Act 1956, which a sole proprietorship and a partnership firm do not enjoy. The advantages or benefits, which a company enjoys, are as follows: **Perpetual Succession:** Due to death, insolvency or retirement of any or all of its members the existence of a company is not affected. The company continues to exist.

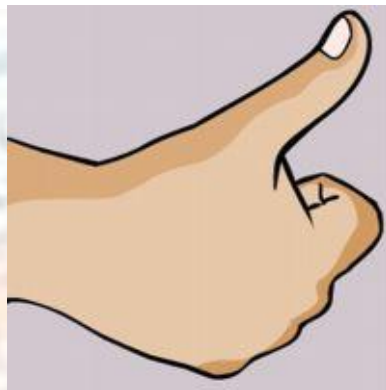


Figure 1.11 Advantages of Incorporation

**Limited Liability:** In a company the liability of its member is limited to the face value of shares held by them.

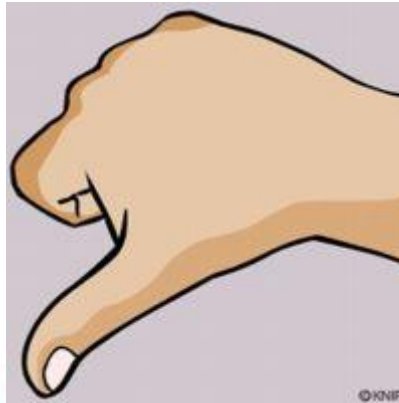
**Separate legal entity:** The company is independent of its members. The outsiders deal directly with the company and the company is liable to the outsiders for any breach of contract.

**Transferability of shares:** The shares of a public company are freely transferable that is a member has the freedom to sell his/her shares on the stock exchange

### 1.6.2 Disadvantages of Incorporation

Being a company form of business organization has its own disadvantages, which are as follows: **Legal formalities:** A company form of business organization has to go through many legal formalities, which are quite cumbersome and time consuming. The process of incorporation itself needs preparation and filing of a number of documents like memorandum of association and articles of association to the Registrar of Companies. Once the company is incorporated.

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**Figure 1.12 Advantages of Incorporation**

it has to work under the legal provisions of the Companies Act 1956. The accounts of a public company have to be properly maintained and have to be audited at the end of every financial year.

**Inefficiency:** There is no limit to the number of members in a joint stock company therefore a company has many members. It is not possible for all the members to take active part in the management of the company so they elect few representatives called directors who take part in the management. Sometimes the directors so elected may not be efficient in their work or may lack personal motivation to work sincerely for the progress of the company.

**Lack of control:** Ownership and management are separate in a public company. All members are owners but it is only a few elected representatives of the members (directors) who manage the company affairs. Thus unlike sole proprietorship and partnership where every member exercise control over the management of the firm the majority of the owners in a public company lack such control.

**Loss of privacy:** All public companies have to prepare public documents (such as memorandum of association, article of association and prospectus) and file them with the Registrar of companies. Similarly they also have to maintain books of accounts in a prescribed manner and present them before its members at the annual general meeting at the end of every financial year. This prevents the company from maintaining privacy as no document can be kept in secret.

Advantages of Incorporation	Disadvantages of Incorporation
<ul style="list-style-type: none"><li>➤ Perpetual Succession</li><li>➤ Limited Liability</li><li>➤ Separate Legal Entity</li><li>➤ Transferability of Shares</li><li>➤ No restriction on number of members</li></ul>	<ul style="list-style-type: none"><li>➤ Legal Formalities</li><li>➤ Inefficiency</li><li>➤ Lack of Control</li><li>➤ Loss of Privacy</li></ul>

# Corporate Law

## 1.7 Lifting of the Corporate Veil

A company has an existence separate from its members. Veil is a covering, which is given to the members of a company. Due to the 'veil of corporate personality' the identity of the members cannot be perceived. However company is an artificial person therefore the members of the company are the real beneficiaries of the company's assets. Sometimes members use the corporate personality to commit frauds and illegal activities. In such circumstances the corporate veil is lifted and the guilty members are identified. The phenomenon of identifying the guilty members is called lifting of corporate veil.

Given below are circumstances where the corporate veil is lifted or pierced and the identity of the members is revealed. These circumstances are also called exceptions to the doctrine of corporate veil. They can be studied under the following two heads:

- Under statutory positions and
- Under judicial interpretation

### 1.7.1 Under Statutory Provisions

Under statutory provisions, the corporate veil may be lifted as per the provisions of the Companies Act 1956. This can happen in the following circumstances:

**1. Reduction of the number of members below statutory minimum:** In case the number of members fall below 7 in a public company and below 2 in a private company and the company carries on business for more than six months then every continuing member of the company who is aware of the fact, can be individually liable for the payment of the whole debts of the company contracted during that time, and may be severally sued.



Figure 1.13 Minimum 7 members for Public Company

#### **Illustration:**

A public company has 7 members on 1st January 2009. On 1st March 2009 one of the members Ragini sells all her shares to her sister Sangita who is already a shareholder of the company. The total membership of the company comes down to 6. These 6 members though fully aware of the fact continue to run the business for more than 6 months from the date of reduction of membership. During the same period the company incurs debts. As the members continue running the business for more than 6 months after the reduction in number of members, each person becomes personally liable for the payment of debts.



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2. Establishing the relationship of holding and subsidiary company: When one company controls the management of another company the former is called the holding company and the latter is called the subsidiary company. In this case the law can lift the corporate veil in order to determine whether there exists a relationship of holding and subsidiary between the two companies.

### Illustration:

Aksar company has its office in Delhi and Rupak Company has its office in Mumbai. The staff of Aksar company are paid their salary by Rupak company. Similarly Rupak company makes all the purchases of raw material required and used by Aksar Company. This may be happening because Aksar company may be a subsidiary of Rupak company. Hence the law can intervene and lift the corporate veil in order to determine whether there exists a relationship of holding and subsidiary between the two companies.

3. Facilitating the task of an inspector appointed under section 235 or 237 to investigate the affairs of a company: According to Section 239 of the Companies Act 1956 if it is necessary for the satisfactory completion of the task of an inspector appointed to investigate the affairs of a company for any mismanagement, fraud or wrong policies towards its members, he/she has can lift the corporate veil of another related company having the same management to investigate the affairs of the company.



Figure 1.14 Facilitating an Investigator

### Illustration:

Aksar company is a subsidiary of Rupak Company. A case of fraud is filed against the management of Aksar company. In order to do justice the law allows investigators to look into the affairs of Rupak company.

**4 Investigation of ownership of Company:** According to Section 247 of the Companies Act the central government may order to lift the corporate veil by appointing 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 and influence its policy.

### Illustration:

For three consecutive years the ABD Co Ltd. has not declared dividend for its shareholders. In the fourth year too it does not declare dividend. This calls for investigation in order to determine whether the people in the management are making secret profits by not declaring dividends. During investigation the inspector who conducts the investigation has the right to determine the true identity of the persons who have financial interests in the company and who control and influence its policy.



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## 1.7.2 Under Judicial Interpretation

**The cases where the court can lift the corporate veil are as follows:**

1. Evasion of taxes: If it is found that the company has been formed with the sole purpose of making money and the members are using unfair practices such as evasion of tax to amass wealth then the court has the power to lift the corporate veil to enquire about the real members of the company who are making financial gain through such unfair means.

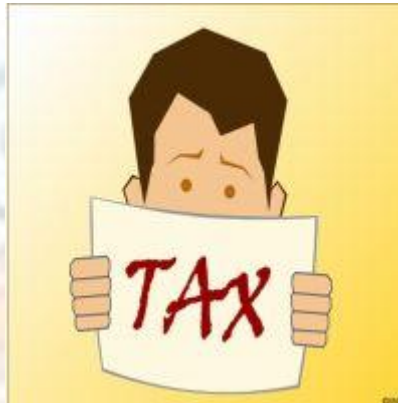


Figure 1.15 Evasion of Tax

### **Case Law 2**

#### **Juggilal Kamalapat Vs. Commissioner of Income tax U.P.** <sup>10</sup>

In this case the Supreme Court held that the Court is entitled to lift the mask of corporate entity if the concept is used for tax evasion or to circumvent tax obligations or to perpetrate fraud.

**2. Fraud and unethical conduct:** The court has the power to lift the corporate veil if it finds that its members for defrauding its creditors and for avoiding contractual obligations are using the company and making personal gains.

### **Case Law 3**

#### **Jones Vs. Lipman** <sup>11</sup>

In this case Mr Lipman contracted with Jones to sell his land. Later he changed his mind and requested Mr. Jones to be released from the contract. Mr. Jones did not agree to this. With an object to avoid specific performance of the contract Mr. Lipman sold the land to a company, which was formed especially for the purpose. Lipman and a clerk of his solicitor were the only two shareholders or members of the company. Jones brought an action for the specific performance against Lipman and the company. The court ordered specific performance against Mr. Lipman and the company both on the ground that company was a mere cloak for Lipman. The company formed and controlled by Lipman was denied to have juristic personality distinct from its members and thereby the corporate veil was lifted to frustrate the attempt of Mr. Lipman to avoid his contract.

**3. Enemy character of the company:** If there are reasons to believe that the company is being controlled and run by members who are alien enemies (citizens of countries with whom our country is at war) then the court can lift the corporate veil to identify those members.

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## Case Law 4

### Daimler Co. Ltd. Vs. Continental Tyre and Rubber Co. (Great Britain) Ltd.<sup>12</sup>

In this case a company was incorporated in England for the purpose of selling the tyres manufactured in Germany by a German Company. Its majority shareholders and all the directors were Germans, resident in Germany. On declaration of war between England and Germany in 1914, the persons in de facto control of its affairs became alien enemies, and accordingly the company was declared to be an enemy company. During the war period the company filed a suit to recover a trade debt. The court dismissed the suit and observed that such payment would be a trading with the enemy company and to allow alien enemies to trade under the corporate façade will be against public policy.

Lifting of Corporate Veil	
Under Statutory Provisions	Under Judicial Interpretation
<ul style="list-style-type: none"><li>&gt; Reduction of the number of members below statutory minimum</li><li>&gt; Establishing the relationship of holding and subsidiary company</li><li>&gt; Facilitating the task of an inspector appointed under section 235 or 237 to investigate the affairs of a company</li><li>&gt; Investigation of ownership of Company</li></ul>	<ul style="list-style-type: none"><li>&gt; Evasion of taxes</li><li>&gt; Fraud and unethical conduct</li><li>&gt; Enemy character of the company</li></ul>

## Section

Important Section	
Section	Description
3(1) (i) and (ii)	Definition of a Company
11	Illegal Association

# Corporate Law

## Summary

### Characteristics of a Company

- Incorporated Association
- Artificial Person
- Separate Legal Entity
- Perpetual Existence
- Common Seal
- Limited Liability
- Transferability of Shares

### Basis of difference between a Company and Partnership firm

- Applicability
- Registration
- Minimum number of members
- Maximum number of members
- Liability
- Management
- Transfer of interest
- Dissolution

### Illegal Association

- A company or partnership association of more than 20 persons in case of non-banking business and 10 in case of banking business be formed to carry on any business for gain unless it is registered under the Companies Act or any other Indian law.

### Consequences of Non-Registration

- No legal existence
- Unlimited liability
- Fine
- Tax liability
- Illegality

### Advantages of Incorporation

- Perpetual Succession
- Limited Liability
- Separate Legal Entity
- Transferability of Shares
- No restriction on number of members

### Disadvantages of Incorporation

- Legal Formalities
- Inefficiency
- Lack of Control
- Loss of Privacy

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## Lifting of Corporate Veil Under Statutory Provisions

- Reduction of the number of members below statutory minimum
- Establishing the relationship of holding and subsidiary company
- Facilitating the task of an inspector appointed under section 235 or 237 to investigate the affairs of a company
- Investigation of ownership of Company

## Under Judicial Interpretation

- Evasion of taxes
- Fraud and unethical conduct
- Enemy character of the company





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## Exercise

### Question 1

Discuss the advantages and disadvantages of incorporation of a company.

### Question 2

What are the various characteristics of a company?

### Question 3

How is a company different from a partnership firm?

### Question 4

What are the consequences of non-registration of a firm?

### Question 5

What are the exceptions to the doctrine of corporate veil?

1) A public company had 7 members on 1st January 2009. On 1st March 2009 one of the members Ashok sold all his shares to Rashmi who was already a shareholder of the company. Hence the total membership of the company came to 6. The remaining 6 members in spite of knowing the fact continue to run the business for more than 6 months from the date of reduction of membership. During this period the company incurs debts. Are the members liable?

**Answer** – Yes, as the members continued to run the business for more than 6 months therefore they all personally liable for the debts accrued.

2) Ram carries on business under the name Ram Ltd. Company without getting the company registered. Can he do business?

**Answer** – No, his company is an illegal association because according to section 11 companies which are run without registering are illegal. Hence Ram is not allowed to do business.

3) Sumeet and his friend Hari started a partnership firm where they manufactured readymade garments. They ran business for 5 years. In the sixth year their debtor Mr Modi refused to pay the debt. Can Sumeet and Hari sue Mr Modi as partners of the firm?

**Answer** – No, since the partnership firm is not registered therefore it has no existence in the eyes of law hence Sumeet and Hari as partners of the firm cannot sue Mr Modi (debtor of the firm).

4) All the members of a private limited company are killed in an earthquake. Does the company cease to exist?

**Answer** – No, the company has perpetual existence therefore even if all the members are dead the company still continues to exist. The legal heirs of the deceased members will become members by transmission of shares.

5) Seeta and Geeta were two members in a private company. Each held Rs. 1 lakh share each. The company took a loan of rupees 5 crores from a bank which it had to repay in 7 years. 7 years elapsed the company was unable to pay the loan. Are Seeta and Geeta liable to pay the loan amount?

**Answer** – As it is a private company therefore Seeta and Geeta have a limited liability which is restricted to the amount of share capital held by them which is Rs 1 lakh each.

# Corporate Law

## Glossary

Words	Description
Company	A company formed and registered under Companies act 1956 or an existing company. An existing company means a company formed and registered under any of the former Companies Act.
Partnership	Two or more persons called partners form a business enterprise.
Illegal Association	No company or partnership association consisting of more than 20 persons in case of non-banking business and 10 in case of banking business may be formed to carry on any business for gain unless it is registered under the companies act or any other Indian Law. ;
Lifting of Corporate Veil	The Corporate veil is lifted and the guilty members are identified. This phenomenon of identifying the guilty member is called lifting of corporate veil.

