

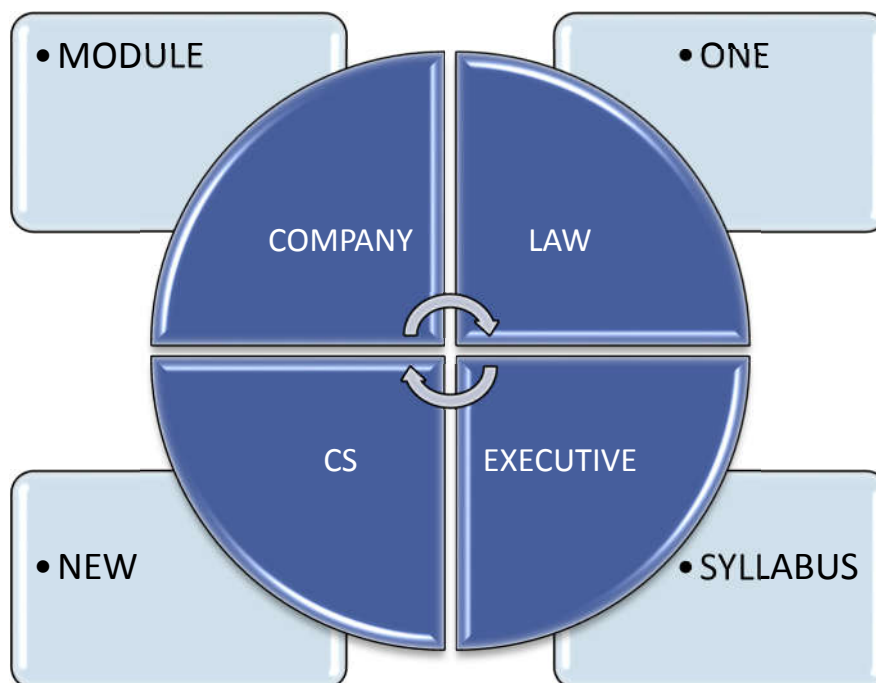
Note -*This notes are just a lucid presentation of study material covering almost all relevant topics and provisions amended up-to date*



COMPANY LAW

CS – EXECUTIVE

(NEW SYLLABUS)



RAJNISH PANDEY

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CHAPTER – 1

INTRODUCTION TO COMPANY LAW

The concept of 'Company' or 'Corporation' in business is not new, but was dealt with, in 4th century BC itself during 'Arthashastra' days. Its' shape got revamped over a period of time according to the needs of business dynamics.

It has evolved over time according to the needs of society and business dynamics. The word Company is made of two Latin words "Com" meaning "coming together" and "panis" meaning "bread". Company originally referred to group of people who took their meal together. It is important for the students as future Company Secretaries to understand the concept and legal provisions of Company Law very well as this forms as major part of working in future whether in practice or employment.

This chapter introduces the reader with the background and evolution of corporate legislation in India, the distinct features of Company, other forms of business, concepts under new law etc.

Meaning of a Company

The word 'company' is derived from the Latin word (Com=with or together; panis =bread), and it originally referred to an association of persons who took their meals together. In the leisurely past, merchants took advantage of festive gatherings, to discuss business matters. Nowadays, the business matters have become more complicated and cannot be discussed at festive gatherings. Therefore, the company form of organization has assumed greater importance. It denotes a joint stock enterprise in which the capital is contributed by several people. Thus, in popular parlance, a company denotes an association of likeminded persons formed for the purpose of carrying on some business or undertaking. A company is a corporate body and a legal person having status and personality distinct and separate from the members constituting it.

Lord Justice Lindley 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 arising therefrom. The common stock so contributed is denoted in money and is the capital of the company. The persons who contributed in it or form it, or to whom it belongs, are members. The proportion of capital to which each member is entitled is his "share". The shares are always transferable although the right to transfer them may be restricted."*

Companies Bill, 2012

The Government considered the recommendations of Irani Committee and also had detailed discussions and deliberations with various stakeholders viz Industry Chambers, Professional Institutes, Government Departments, Legal Experts and Professionals etc. Thereafter, the

Companies Bill, 2009 was introduced in the Lok Sabha on 3rd August, 2009, The Bill laid greater emphasis on self-regulation and minimization of regulatory approvals in managing the affairs of the company. The Bill promised greater shareholder democracy, vesting the shareholders with greater powers, containing stricter corporate governance norms and requiring greater disclosures. The Companies Bill, 2009 after introduction in Parliament was referred to the Parliamentary Standing Committee on Finance for examination which submitted its report to Parliament on 31st August, 2010. Certain amendments were introduced in the Bill in the light of the report of the Committee and a revised Companies Bill, 2011 was introduced. This version was also referred to the Hon'ble Committee, which suggested certain further amendments. The amended Bill was passed by the Lok Sabha on 18th December, 2012 and by the Rajya Sabha on 8th August, 2013. The Bill was retitled as Companies Bill, 2012

Evolution of the companies act 2013

The Companies Act, 1956 was enacted with the object to amend and consolidate the law relating to companies. This Act provided the legal framework for corporate entities in India and was a mammoth legislation. As the corporate sector grew in numbers and size of operations, the need for streamlining this Act was felt and as many as 24 amendments had taken place since then. Major amendments were made through the Companies (Amendment) Act, 1988 after considering the recommendations of the Sachar Committee, and then again in 1998, 2000 and in 2002 through the Companies (Second Amendment) Act.

The response to the concept paper on Company Law was tremendous. The Government, therefore, felt it appropriate that the proposals contained in the Concept Paper and suggestions received thereon be put to merited evaluation by an independent Expert Committee. A Committee was constituted on 2nd December, 2004 under the Chairmanship of Dr. J JIrani, Director, Tata Sons, with the task of advising the Government on the proposed revisions to the Companies Act, 1956 with the objective to have a simplified compact law that will be able to address the changes taking place in the national and international scenario, enable the adoption of internationally accepted best practices as well as provide adequate flexibility for timely evolution of new arrangements in response to the requirements of ever-changing business models. The Committee submitted its report to the Government on 31st May 2005.

Companies Act 2013

Passed in Loksabha	December 18, 2012
Passed in RajyaSabha	August 08, 2013
President's assent	August 29, 2013
Total number of section	470
Total number of chapters	29
Total number of schedules	7

THE NEW CONCEPTS INTRODUCED

The Companies Act 2013 has introduced new concepts supporting enhanced disclosure, accountability, better board governance, better facilitation of business and so on. It includes the following aspects:-

1. Associate company
2. One person company
3. Small company
4. Dormant company
5. Independent director
6. Women director
7. Resident director
8. Special court
9. Secretarial standards
10. Secretarial audit
11. Class action
12. Registered valuer etc.

MEANING AND DEFINITION OF COMPANY –

As per **section 2(20)** of companies act, “A company may be formed or registered under this act or any existing company formed or registered under any other previous company law.

CHARACTERISTICS / FEATURES OF A COMPANY

1. Corporate personality –

A company incorporated under the Act is vested with a corporate personality so it bears its own name, acts under name, has a seal of its own and its assets are separate and distinct from those of its members. It is a different ‘person’ from the members who compose it. Therefore it is capable of owning property, incurring debts, borrowing money, having a bank account, employing people, entering into contracts and suing or being sued in the same manner as an individual. Its members are its owners however they

can be its creditors simultaneously. A shareholder cannot be held liable for the acts of the company even if he holds virtually the entire share capital.

Case law-

1. A juristic person is in law also conferred with rights and obligations and is dealt in accordance with law. In other words, the entity acts like a natural person but only through a designated person, whose acts are processed within the ambit of law [*Shiromani Gurdwara Prabandhak Committee v. Shri Sam Nath Dass* AIR 2000 SCW 139].

The case of *Salomon v. Salomon and Co. Ltd.*, (1897) A.C. 22

The above case has clearly established the principle that once a company has been validly constituted under the Companies Act, it becomes a legal person distinct from its members and for this purpose it is immaterial whether any member holds a large or small proportion of the shares, and whether he holds those shares as beneficially or as a mere trustee.

In the case, Salomon had, for some years, carried on a prosperous business as a leather merchant and boot manufacturer. He formed a limited company consisting of himself, his wife, his daughter and his four sons as the shareholders, all of whom subscribed to 1 share each so that the actual cash paid as capital was £7. Salomon sold his business (which was perfectly solvent at that time), to the Company formed by him for the sum of £38,782. The company's nominal capital was £40,000 in £1 shares. In part payment of the purchase money for the business sold to the company, debentures of the amount of £10,000 secured by a floating charge on the company's assets were issued to Salomon, who also applied for and received an allotment of 20,000 £ 1 fully paid shares. The remaining amount of £8,782 was paid to Salomon in cash. Salomon was the managing director and two of his sons were other directors. The company soon ran into difficulties and the debentureholders appointed a receiver and the company went into liquidation. The total assets of the company amounted to £6050, its liabilities were £10,000 secured by debentures, £8,000 owing to unsecured trade creditors, who claimed the whole of the company's assets, viz., £6,050, on the ground that, as the company was a mere 'alias' or agent for Salomon, they were entitled to payment of their debts in priority to debentures. They further pleaded that Salomon, as a principal beneficiary, was ultimately responsible for the debts incurred by his agent or trustee on his behalf.

Their Lordships of the House of Lords observed:

"...the company is a different person altogether from the subscribers of the memorandum; and though it may be that after incorporation the business is precisely the same as before, the same persons are managers, and the same hands receive the profits, the company is not, in law, their agent or trustee. The statute enacts nothing as to the extent or degree of interest, which may, be held by each of the seven or as to the proportion of interest, or influence possessed by one or majority of the shareholders over others. There is nothing in the Act requiring that the subscribers to the memorandum should be independent or unconnected, or that they or any of them should take a substantial interest in the undertakings, or that they should have a mind or will of their own, or that there should be anything like a balance of power in the constitution of company."

The case of *Lee v. Lee's Air Farming Ltd.* (1961) A.C. 12 (P.C.)

The above case illustrates the application of the principles established in Salomon's case (supra). In this case, a company was formed for the purpose of aerial top-dressing. Lee, a qualified pilot, held all but one of the shares in the company. He voted himself the managing director and got himself appointed by the articles as chief pilot at a salary. He was killed in an air crash while working for the company. His widow claimed compensation for the death of her husband in the course of his employment. The company opposed the claim on the ground that Lee was not a worker as the same person could not be the employer and the employee. The Privy Council held that Lee and his company were distinct legal persons which had entered into contractual relationships under which he became the chief pilot, a servant of the company. In his capacity of managing director he could, on behalf of the company, give himself orders in his other capacity of pilot, and the relationship between himself, as pilot and the company, was that of servant and master. Lee was a separate person from the company he formed and his widow was held entitled to get the compensation. In effect the magic of corporate personality enabled him (Lee) to be the master and servant at the same time and enjoy the advantages of both.

Other important case – law –

- *Re. Kondoli Tea Co. Ltd., (1886) ILR 13 Cal. 43*
- *New Horizons Ltd. v. Union of India, (AIR 1994, Delhi 126)*

2. Company as an artificial person

A Company is an artificial person created by law. It is not a human being but it acts through human beings. It is considered as a legal person which can enter into contracts, possess properties in its own name, sue and can be sued by others etc. It is called an artificial person since it is invisible, intangible, existing only in the contemplation of law. It is capable of enjoying rights and being subject to duties.

Union Bank of India v. Khader International Construction and Other [(2001) 42 CLA 296 SC]

In this case, the question which arose before the Court was whether a company is entitled to sue as an indigent (poor) person under Order 33, Rule 1 of the Civil Procedure Code, 1908. The aforesaid Order permits persons to file suits under the Code as pauper/indigent persons if they are unable to bear the cost of litigation. The appellant in this case had objected to the contention of the company which had sought permission to sue as an indigent person. The point of contention was that, the appellant being a public limited company, it was not a 'person' within the purview of Order 33, Rule 1 of the Code and the 'person' referred to only a natural person and not to other juristic persons. The Supreme Court held that the word 'person' mentioned in Order 33, Rule 1 of the Civil Procedure Code, 1908, included any company as association or body of individuals, whether incorporated or not. The Court observed that the word 'person' had to be given its meaning in the context in which it was used and being a benevolent provision, it was to be given an extended meaning. Thus a company may also file a suit as an indigent person.

3. Company is not a citizen

The company, though a legal person, is not a citizen under the Citizenship Act, 1955 or the Constitution of India.

In State Trading Corporation of India Ltd. v. C.T.O., A.I.R. 1963 S.C. 1811, the Supreme Court held that the State Trading Corporation though a legal person, was not a citizen and can act only through natural persons. Nevertheless, it is to be noted that certain fundamental rights enshrined in the Constitution for protection of “person”, e.g., right to equality (Article 14) etc. are also available to company. Section 2(f) of Citizenship Act, 1955 expressly excludes a company or association or body of individuals from citizenship.

Bennet Coleman Co. v. Union of India, AIR 1973 SC 106

In this case, the Supreme Court stated that:

“It is now clear that the Fundamental Rights of shareholders as citizens are not lost when they associate to form a company. When their Fundamental Rights as shareholders are impaired by State action, their rights as shareholders are protected. The reason is that the shareholders’ rights are equally and necessarily affected if the rights of the company are affected.”

4. Company has Nationality and Residence

Though it is established through judicial decisions that a company cannot be a citizen, yet it has nationality, domicile and residence. ***In Gasque v. Inland Revenue Commissioners, (1940) 2 K.B. 88, Macnaghten. J.*** held that a limited company is capable of having a domicile and its domicile is the place of its registration and that domicile clings to it throughout its existence.

In Tulika v. Parry and Co., (1903) I.L.R. 27 Mad. 315, Kelly C.B. observed:

“A joint stock company resides where its place of incorporation is, where the meetings of the whole company or those who represent it are held and where its governing body meets in bodily presence for the purposes of the company and exercises the powers conferred upon it by statute and by the Articles of Association.”

5. Limited Liability

“The privilege of limited liability for business debts is one of the principal advantages of doing business under the corporate form of organisation.” The company, being a separate person, is the owner of its assets and bound by its liabilities. The liability of a member as shareholder, extends to the contribution to the capital of the company up to the nominal value of the shares held and not paid by him. Members, even as a whole, are neither the owners of the company’s undertakings, nor liable for its debts. In other words, a shareholder is liable to pay the balance, if any, due on the shares held by him, when called upon to pay and nothing more, even if the liabilities of the company far exceed its assets. This means that the liability of a member is limited.

Buckley, J. in ***Re. London and Globe Finance Corporation, (1903) 1 Ch.D. 728 at 731,*** has observed: “The statutes relating to limited liability have probably done more than any legislation of the last fifty years to further the commercial prosperity of the country. They have, to the advantage of the investor as well as of the public, allowed and encouraged aggregation of small sums into large capitals which have been employed in undertakings of

“great public utility largely increasing the wealth of the country”.

Exceptions to the principle of limited liability

- ☞ When the company is incorporated as an Unlimited Company under Section 3(2)(c) of the Act.
- ☞ Where a company has been got incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact or information.
- ☞ Further under section 339(1), where in the course of winding up it appears that any business of the company has been carried on with an intent to defraud creditors of the company or any other persons or for any fraudulent purpose.
- ☞ Under Section 35(3), where it is proved that a prospectus has been issued with intent to defraud the applicants for the securities of a company or any other person or for any fraudulent purpose.
- ☞ Where a company fails to repay the deposit or part thereof or any interest thereon and it is proved that the deposits had been accepted with intent to defraud the depositors or for any fraudulent purpose, every officer of the company who was responsible for the acceptance of such deposit shall, without prejudice to other liabilities, also be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by the depositors.
- ☞ where the report made by an inspector states that fraud has taken place in a company and due to such fraud any director, key managerial personnel, other officer of the company or any other person or entity, has taken undue advantage or benefit, whether in the form of any asset, property or cash or in any other manner, the Central Government may file an application before the Tribunal for appropriate orders with regard to disgorgement of such asset, property, or cash, and also for holding such director, key managerial personnel, officer or other person liable personally without any limitation of liability.

6. Perpetual Succession

An incorporated company never dies, except when it is wound up as per law. A company, being a separate legal person is unaffected by death or departure of any member and it remains the same entity, despite total change in the membership. Perpetual succession, means that the membership of a company may keep changing from time to time, but that shall not affect its continuity. The membership of an incorporated company may change either because one shareholder has sold/transferred his shares to another or his shares devolve on his legal representatives on his death or he ceases to be a member under some other provisions of the Companies Act. Thus, perpetual succession denotes the ability of a company to maintain its existence by the succession of new individuals who step into the shoes of those who cease to be members of the company. Professor L.C.B. Gower rightly mentions, “Members may come and go, but the company can go on forever. During the war all the members of one private company, while in general meeting, were

killed by a bomb, but the company survived — not even a hydrogen bomb could have destroyed it”.

7. Separate property –

A company has own personality, so it can own property or attach property in its own name and no members can claim on its property.

Mrs. Bacha F. Guzdar v. The Commissioner of Income Tax, Bombay, A.I.R. 1955 S.C. 74

The Supreme Court in this case held that, though the income of a tea company is entitled to be exempted from Income-tax up to 60% being partly agricultural, the same income when received by a shareholder in the form of dividend cannot be regarded as agricultural income for the assessment of income-tax. It was also observed by the Supreme Court that a shareholder does not, as is erroneously believed by some people, become the part owner of the company or its property; he is only given certain rights by law, e.g., to receive notice of or to attend or vote at the meetings of the shareholders. The court refused to identify the shareholders with the company and reiterated the distinct personality of the company.

8. Capacity to sue and be sued –

A company being a body corporate, can sue and be sued in its own name. To sue, means to institute legal proceedings against (a person) or to bring a suit in a court of law. All legal proceedings against the company are to be instituted in its name. Similarly, the company may bring an action against anyone in its own name. A company's right to sue arises when some loss is caused to the company, i.e. to the property or the personality of the company. Hence, the company is entitled to sue for damages in libel or slander as the case may be [**Floating Services Ltd. v. MV San Fransceco Dipalooa (2004) 52 SCL 762 (Guj)**]. A company, as a person distinct from its members, may even sue one of its own members.

9. Transferability of Shares

The capital of a company is divided into parts, called shares. The shares are said to be movable property and, subject to certain conditions, freely transferable, so that no shareholder is permanently or necessarily wedded to a company. When the joint stock companies were established, the object was that their shares should be capable of being easily transferred.

10. Contractual Rights

A company, being a legal entity different from its members, can enter into contracts for the conduct of the business in its own name. A shareholder cannot enforce a contract made by his company; he is neither a party to the contract, nor be entitled to the benefit derived from it, as a company is not a trustee for its shareholders. Likewise, a shareholder cannot be sued on contracts made by his company. The distinction between a company and its members is not confined to the rules of privity but permeates the whole law of contract.

Thus, if a director fails to disclose a breach of his duties towards his company, and in consequence a shareholder is induced to enter into a contract with the director on behalf of the company which he would not have entered into had there been disclosure, the shareholder cannot rescind the contract.

11. Limitation of Action

A company cannot go beyond the power stated in its Memorandum of Association. The Memorandum of Association of the company regulates the powers and fixes the objects of the company and provides the edifice upon which the entire structure of the company rests. The actions and objects of the company are limited within the scope of its Memorandum of Association. In order to enable it to carry out its actions without such restrictions and limitations in most cases, sufficient powers are granted in the Memorandum of Association. But once the powers have been laid down, it cannot go beyond such powers unless the Memorandum of Association, itself altered prior to doing so.

12. Separate Management

As already noted, the members may derive profits without being burdened with the management of the company. They do not have effective and intimate control over its working and they elect their representatives as Directors on the Board of Directors of the company to conduct corporate functions through managerial personnel employed by them. In other words, the company is administered and managed by its managerial personnel.

- 13. A company is a voluntary association for profit. It is formed for the accomplishment of some stated goals and whatsoever profit is gained is divided among its shareholders or saved for the future expansion of the company. Only a Section 8 company can be formed with no profit motive.
- 14. A company, being an artificial juridical person, does not die a natural death. It is created by law, carries on its affairs according to law throughout its life and ultimately is effaced by law. Generally, the existence of a company is terminated by means of winding up. However, to avoid winding up, sometimes companies adopt strategies like reorganisation, reconstruction and amalgamation.

Distinction Between Company and Partnership

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

- ❖ A company is a distinct legal person. A partnership firm is not distinct from the several persons who form the partnership.
- ❖ In a partnership, the property of the firm is the property of the individuals comprising it. In a company, it belongs to the company and not to the individuals who are its members.

- ❖ Creditors of a partnership firm are creditors of individual partners and a decree against the firm can be executed against the partners jointly and severally. The creditors of a company can proceed only against the company and not against its members.
- ❖ Partners are the agents of the firm, but members of a company are not its agents. A partner can dispose of the property and incur liabilities as long as he acts in the course of the firm's business. A member of a company has no such power.
- ❖ A partner cannot contract with his firm, whereas a member of a company can.
- ❖ A partner cannot transfer his share and make the transferee a member of the firm without the consent of the other partners, whereas a company's share can ordinarily be transferred.

Distinction Between Company and HUF Business

- ❖ A company consists of heterogeneous (varied or diverse) members, whereas a Hindu Undivided Family Business consists of homogenous (unvarying) members since it consists of members of the joint family itself.
- ❖ In a Hindu Undivided Family business the Karta (manager) has the sole authority to contract debts for the purpose of the business, other coparceners cannot do so. There is no such system in a company.
- ❖ A person becomes a member of a Hindu Undivided Family business by virtue of birth. There is no provision to that effect in the company.
- ❖ No registration is compulsory for carrying on business for gain by a Hindu Undivided Family even if the number of members exceeds twenty [*Shyam Lal Roy v. Madhusudan Roy*, AIR 1959 Cal. 380 (385)]. Registration of a company is compulsory.

Distinction Between Limited Liability Partnership (LLP) and a Company

LLP is an alternative corporate business form that gives the benefits of limited liability of a company and the flexibility of a partnership. LLP can continue its existence irrespective of changes in partners. It is capable of entering into contracts and holding property in its own name. LLP is a separate legal entity, is liable to the full extent of its assets but liability of the partners is limited to their agreed contribution in the LLP. Further, no partner is liable on account of the independent or un-authorized actions of other partners, thus individual partners are shielded from joint liability created by another partner's wrongful business decisions or misconduct. Mutual rights and duties of the partners within a LLP are governed by an agreement between the partners or between the partners and the LLP as the case may be. The LLP, however, is not relieved of the liability for its other obligations as a separate entity. A basic difference between an LLP and a company lies in that the internal governance structure of a company is regulated by statute (i.e. Companies Act) whereas for an LLP it would be by a contractual agreement between partners. Since LLP contains elements of both 'a corporate structure' as well as 'a partnership firm structure' LLP is called a hybrid between a company and a partnership.

DOCTRINE OF LIFTING OF OR PIERCING THE CORPORATE VEIL

The separate personality of a company is a statutory privilege and it must be used for legitimate business purposes only. Where a fraudulent and dishonest use is made of the legal entity, the individuals concerned will not be allowed to take shelter behind the corporate personality. The Court will break through the corporate shell and apply the principle/doctrine of what is called as “lifting of or piercing the corporate veil”. The Court will look behind the corporate entity and take action as though no entity separate from the members existed and make the members or the controlling persons liable for debts and obligations of the company.

The Companies Act, 2013 itself contains some provisions [Sections 7(7), 251(1) and 339] which lift the corporate veil to reach the real forces of action. Section 7(7) deals with punishment for incorporation of company by furnishing false information; Section 251(1) deals with liability for making fraudulent application for removal of name of company from the register of companies and Section 339 deals with liability for fraudulent conduct of business during the course of winding up.

The corporate veil is lifted when in defence proceedings, such as for the evasion of tax, an entity relies on its corporate personality as a shield to cover its wrong doings. [BSN (UK) Ltd. v. Janardan Mohandas Rajan Pillai [1996] 86 Com Cases 371 (Bom).]

There are 2 ways for lifting out of corporate veil –

- ✚ Lifting of corporate veil under statutory interpretation.
- ✚ Lifting of corporate veil under judicial interpretation.

A. Lifting of Corporate Veil under Judicial Interpretation

In this case the power to lift out the corporate veil is given to the court as in the following situations –

1. Where the corporate veil has been used for commission of fraud or improper conduct. In such a situation, Courts have lifted the veil and looked at the realities of the situation.

In Jones v. Lipman, (1962) 1 W.L.R. 832

A agreed to sell certain land to B. Pending completion of formalities of the said deal, A sold and transferred the land to a company which he had incorporated with a nominal capital of £100 and of which he and a clerk were the only shareholders and directors. This was done in order to escape a decree for specific performance in a suit brought by B. The Court held that the company was the creature of A and a mask to avoid recognition and that in the eyes of equity A must complete the contract, since he had the full control of the limited company in which the property was vested, and was in a position to cause the contract in question to be fulfilled.

2. Where a corporate facade is really only an agency instrumentality.

In Re. R.G. Films Ltd. (1953) 1 All E.R. 615

An American company produced a film in India technically in the name of a British Company, 90% of whose capital was held by the President of the American company which financed the production of the film. Board of Trade refused to register the film as a British film which stated that English company acted merely as the nominee of the American corporation.

3. Where the conduct conflicts with public policy, courts lifted the corporate veil for protecting the public policy.

In Connors Bros. v. Connors (1940) 4 All E.R. 179

The principle was applied against the managing director who made use of his position contrary to public policy. In this case the House of Lords determined the character of the company as "enemy" company, since the persons who were *de facto* in control of its affairs, were residents of Germany, which was at war with England at that time. The alien company was not allowed to proceed with the action, as that would have meant giving money to the enemy, which was considered as monstrous and against "public policy".

4. Further, In ***Daimler Co. Ltd. v. Continental Tyre & Rubber Co., (1916) 2 A.C. 307***, it was held that a company will be regarded as having enemy character, if the persons having *de facto* control of its affairs are resident in an enemy country or, wherever they may be, are acting under instructions from or on behalf of the enemy.
5. Where it was found that the sole purpose for which the company was formed was to evade taxes the Court will ignore the concept of separate entity and make the individuals concerned liable to pay the taxes which they would have paid but for the formation of the company.

Re. Sir Dinshaw Maneckjee Petit, A.I.R. 1927 Bombay 371

The facts of the case are that the assessee was a wealthy man enjoying large dividend and interest income. He formed four private companies and agreed with each to hold a block of investment as an agent for it. Income received was credited in the accounts of the company but the company handed back the amount to him as a pretended loan. This way he divided his income in four parts in a bid to reduce his tax liability. But it was held "the company was formed by the assessee purely and simply as a means of avoiding supertax and the company was nothing more than the assessee himself. It did no business, but was created simply as a legal entity to ostensibly receive the dividends and interests and to hand them over to the assessee as pretended loans". The Court decided to disregard the corporate entity as it was being used for tax evasion.

6. Avoidance of welfare legislation is as common as avoidance of taxation and the approach in considering problems arising out of such avoidance has necessarily to be the same and, therefore, 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.

The Workmen Employed in Associated Rubber Industries Limited, Bhavnagar v. The Associated Rubber Industries Ltd., Bhavnagar and another, A.I.R. 1986 SC 1.

The facts of the case were that a new company was created wholly by the principal company with no assets of its own except those transferred to it by the principal company, with no business or income of its own except receiving dividends from shares transferred to it by the principal company i.e. only for the

purpose of splitting the profits into two hands and thereby reducing the obligation to pay bonus. The Supreme Court of India held that the new company was formed as a device to reduce the gross profits of the principal company and thereby reduce the amount to be paid by way of bonus to workmen. The amount of dividends received by the new company should, therefore, be taken into account in assessing the gross profit of the principal company.

7. Another instance of corporate veil arrived at by the Court arose in *Kapila Hingorani v. State of Bihar*.

Kapila Hingorani v. State of Bihar, 2003(4) Scale 712

In this case, the petitioner had alleged that the State of Bihar had not paid salaries to its employees in PSUs etc. for long periods resulting in starvation deaths. But the respondent took the stand that most of the undertakings were incorporated under the provisions of the Companies Act, 1956, hence the rights etc. of the shareholders should be governed by the provisions of the Companies Act and the liabilities of the PSUs should not be passed on to the State Government by resorting to the doctrine of lifting the corporate veil. The Court observed that the State may not be liable in relation to the day-to-day functioning of the PSUs but its liability would arise on its failure to perform the constitutional duties and the functions of these undertakings. It is so because, “life means something more than mere ordinal existence. The inhibition against deprivation of life extends to all those limits and faculties by which life is enjoyed”.

8. Where it is found that a company has abused its corporate personality for an unjust and inequitable purpose, the court would not hesitate to lift the corporate veil. Further, the corporate veil could be lifted when acts of a corporation are allegedly opposed to justice, convenience and interests of revenue or workmen or are against public interest.

9. **Lifting the Corporate Veil of Small Scale Industry**

Where small scale industries were given certain exemptions and the company owning an industry was controlled by some group of persons or companies, it was held that it was permissible to lift the veil of the company to see whether it was the subsidiary of another company and, therefore, not entitled to the proposed exemptions. [*Inalsa Ltd. v. Union of India, (1996) 87 Com Cases 599 (Delhi).*]

Use of Corporate Veil for Hiding Criminal Activities

Where the defendant used the corporate structure as a device or facade to conceal his criminal activities (evasion of customs and excise duties payable by the company), the Court could lift the corporate veil and treat the assets of the company as the realisable property of the shareholder.

FORMATION AND INCORPORATION OF COMPANIES

Section 3(1) states that a company may be formed for any lawful purpose by—

1. seven or more persons, where the company to be formed is to be a public company;

2. two or more persons, where the company to be formed is to be a private company; or
3. one person, where the company to be formed is to be One Person Company that is to say, a private company by subscribing their names or his name to a memorandum and complying with the requirements of this Act in respect of registration.

A company formed under Section 3(1) may be either—

- (a) a company limited by shares; or
- (b) a company limited by guarantee; or
- (c) an unlimited company.

Section 7(1) of the Act provides for the detailed procedure for incorporation of company.

(Note: For details on Types of Companies and Formation of Companies - you may refer Paper 3 of Module 1 i.e. “Setting up of Business Entities and Closure”)

Bennet Coleman Co. v. Union of India, AIR 1973 SC 106

In this case, the Supreme Court stated that:

“It is now clear that the Fundamental Rights of shareholders as citizens are not lost when they associate to form a company. When their Fundamental Rights as shareholders are impaired by State action, their rights as shareholders are protected. The reason is that the shareholders’ rights are equally and necessarily affected if the rights of the company are affected.”
