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# ORIGIN OF COMPANY LAW IN INDIA

The Companies Act, 1956 needed a substantial revamp due to significant changes which the corporate sector has undergone over the years. Therefore, the Companies Bill, 2011 was considered and approved by the Parliament and became the Companies Act, 2013 after it received the President's assent on August 29, 2013, repealing the earlier Companies Act, 1956.

## Early History

The first legislative enactment known as the Joint Stock Companies Act, 1850 was passed in India in 1850 which was based on the English Companies Act of 1844. It was amended in 1857 when the principle of limited liability was for the first time recognised in the Joint Stock Companies. This was followed by the Joint Stock Companies Act, 1860 whereby the principle of limited liability was extended to companies engaged in banking and insurance business. The Companies Act, 1866, however, repealed all the earlier Acts. This was followed by the Companies Consolidation Act, 1882, which, in turn, repealed the Act of 1866. The Companies Act, 1882, was supplemented by the Companies Memorandum of Association Act, 1895 and the Companies Branch Register Act, 1900. The Act was further amended by the Companies Amendment Act, 1910.

In the meantime the English Companies Consolidation Act was passed in 1908 in order to meet the peculiar business conditions in British India. Since the Companies enactments hitherto passed in India were mainly based on the English Companies Act, it was considered expedient to bring out a comprehensive Indian Companies Act, 1913 so as to consolidate and amend the law relating to trading Companies and other associations in British India. Therefore, an Act called the Indian Companies Act, 1913 was enacted which remained in force until the passing of the Companies Act, 1956.

The operation of the Companies Act, 1913, however, showed that it was highly unsatisfactory in many respects and therefore needed radical changes. Accordingly, the Indian Companies (Amendment) Act, 1936,[1] was passed which came into force on 15th January, 1937. It contained many new provisions specially those relating to managing agency which was peculiar to the Indian Commerce. During World War II (1939-45), the management and organisation of Joint Stock Companies witnessed a remarkable change which altered the character of trade and industry. About the same time, as a result of the Cohen Committee Report (1945) in England, the U.K. Companies Act, 1948 was enacted repealing the earlier Act. This necessitated review of the Indian Companies Act as well in the light of the changed political and administrative conditions in India due to partition of India and the end of British rule in this country.

The Government of India appointed a Committee under the Chairmanship of C.H. Bhabha in October, 1950 which submitted its Report in March, 1952. In the meantime,

1. Act XXII of 1936.

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the Indian Companies (Amendment) Act, 1951 was passed as an interim measure which conferred powers upon the Government to intervene directly in regulating the affairs of companies in India. It was on the recommendations of the Bhabha Committee that the Companies Act, 1956,[1] was enacted which came into force on 1st April, 1956.

## The Companies Act, 1956

It is significant to note that the Companies Act, 1956 was the largest of all the legislative enactments passed by the Indian Parliament so far. It consists of 658 Sections and fourteen Schedules. The Act was enacted with the object of amending and consolidating the law relating to Companies and certain other associations by repealing the Companies Act, 1913 following the recommendations of the Bhabha Committee. It was realised that the Company Law must respond favourably to changing corporate practices and address itself to modern development and economic transformation. The main object of the Act was to provide protection to investors, creditors and public at large while at the same time, leaving management free to utilize its resources and energies for the optimum output.

The working of the Companies Act, 1956 for a period of about three years, brought to light several lacunae and defects in its provisions. Therefore, the Act was amended by the Companies (Amendment) Act, 1960,[2] which consisted of as many as 218 Sections. The Act, besides amending certain existing provisions also introduced several new provisions which were not incorporated in the principal Act.

Despite extensive changes introduced by the Companies (Amendment) Act, 1960, the principal Act still suffered from certain serious defects, particularly with regard to contributions by companies to political parties and powers of Board of Directors of Companies to contribute to the National Defence Fund. This was necessitated in view of the Proclamation of Emergency on 26th October, 1962 consequent to Chinese invasion. As a result of this, a new Section 293-B was inserted in the principal Act which empowered companies to contribute freely to the National Defence Fund for the purpose of national security.[3]

The Companies Act was again amended in 1963 so as to provide for the appointment of a Companies Tribunal and constitution of the Board of Company Law Administration by the Central Government and for elaborating their powers and functions. Soon after, the Act was further amended by an Ordinance,[4] promulgated by the President which inserted a new Section 635-B to the principal Act, providing temporary protection to employees of companies whose affairs were being investigated under the Act. This provision was later replaced by the amending Act of 1964.

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# MEANING AND NATURE OF COMPANY

The word 'company' is derived from the combination of two Latin words, namely, *com* and *panis*. The word 'com' means 'together' and 'panis' means 'bread'. Thus initially the word 'company' referred to an association of persons who took their meals together. The merchants in the leisurely past, took advantage of these festive gatherings to discuss their business matters.[1] Initially the word 'company' did not have strictly any technical or legal meaning.[2]

## Meaning of 'Company'

Broadly speaking, the word company connotes two ideas in a legal sense : (1) the members of the association are so numerous that it cannot aptly be described as a firm or a partnership ; and (2) a member may transfer his interest in the association without the consent of other members. Such an association may be incorporated according to law whereupon it becomes a body corporate or what is usually called a corporation with perpetual succession and a common seal. It is then regarded as a legal person separate and distinct from its members.[3]

Before the inception of company as a device for business enterprise, two modes of carrying out business activities were commonly prevalent, namely, (1) Monopoly, and (2) Partnership. With the advance of time and impact of industrial revolution during 18th Century, the business activities expanded tremendously bringing about a radical change in the pattern of commercial activities. The monopolistic device involved great risk as it required investment of capital by a single person who in the event of loss, had to bear the entire burden himself. Partnership, on the other hand, was a suitable device for small scale enterprises which could be financed and managed by a limited number of persons called the partners who take mutual interest and there is also mutual trust and confidence among them.[4] But both these devices were unsuited to large scale business organisations which involved greater mobilisation of capital resources. Therefore, a new device in the form of company has now become the most dominant mode of carrying out business activities. It provides the structural framework for the modern industrial society.[5]

## Definition of Company

A company has been defined in the Companies Act, 1956 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".[6]

Lord Justice Lindley defined company as "an association of many persons[7] who contribute money or money's worth to a common stock and employ it for a common

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purpose. 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".[1]

This definition gives an idea of the incorporated company and has been popularly accepted.

In Halsbury's Laws of England, the term 'company' has been defined as "a collection of many individuals united into one body under a special domination, having perpetual succession under an artificial form, and vested by the policy of law with the capacity of acting in several respects as an individual, particularly of taking and granting property, of contracting obligations, and of suing and being sued, of enjoying privileges and immunities in common, and of exercising a variety of political rights, more or less extensive, according to the designs of its institution, or the power upon it, either at the time of its creation or at any subsequent period of its existence".[2]

In common law, a company is a "legal person or 'legal entity', separate from, and capable of surviving beyond the lives of its members".[3]

According to Justice James, a company means, "an association of persons united for a common object. Such association may be in the form of an ordinary firm or a Hindu Joint Family business or a society registered under the Societies Registration Act or Provident Fund Society, or a Trade Union or company incorporated by Royal Charter or by an Act of Parliament or by some Indian Law or it may be a company incorporated under an Act relating to companies".

Chief Justice Marshall of the Supreme Court of U.S.A. in *Dormouth Cottege* v. *Woodward*,[4] defined a Joint Stock Company as, "an artificial person—invisible, intangible and existing only in the eyes of law. Being a mere creation of law, it possesses only those properties which the charter of its creation confers upon it either expressly or as incidental to its very existence, among the most important are immortality and if the expression may be allowed, individuality, properties by which a perpetual succession of many persons is considered as the same and may act as a single individual".

Heney has defined a joint stock company as "a voluntary organisation formed with the object of earning profit, whose capital is divisible into transferable shares and membership is necessary for its ownership".

A company may further be defined as an association of individuals formed generally for the purpose of some business or undertaking carried on in the name of the association, each member having the right of assigning his share to any other person, subject to the regulation of the company.

The definition of a Joint Stock Company as contained in Section 566 of the Companies Act, 1956, was as follows :

> "............a joint stock company means a company having a permanent paid up or nominal share-capital of fixed amount divided into shares, also of fixed amount, or held and transferable as stock, or divided and held partly in one way and partly in the other, and formed on the principle of having for its members the holders of those shares or that stock and no other persons.[5]

> Such a company when registered with limited liability under this Act, shall be deemed to be a company limited by shares."

In modern times the functioning of companies has assumed a new role in society. Commenting on this aspect of Company's role Hon'ble Justice P.N. Bhagwati, former Chief Justice of the Supreme Court of India in *National Textile Worker's Union* v. *P.R. Ramkrishnan*,[1] *inter-alia* observed :

> "It is now accepted on all hands, even in predominantly capitalist countries that a company is not a property. The traditional view that the company is the property of its shareholders is now an exploded myth. A company, according to the new socio-economic thinking, is a social institution having duties and responsibilities towards the community in which it functions......................it is now acknowledged even in highly developed countries like the United States and England that maximisation of social welfare should be the legitimate goal of a company and shareholders should be regarded not as proprietors of the company, but merely as suppliers of capital entitled to no more than reasonable return and the company should be responsible not only to shareholders, but also to workers, consumers and the other members of the community and should be guided by considerations of national economy and progress."

It must be stated that environmental degradation resulting from industrial pollution in recent years has become a positive danger to social security. Legal provisions are therefore incorporated in the Indian Penal Code,[2] to punish industrial and business organisations which create danger to public life by polluting water,[3] and District Magistrate can initiate proceedings against them under Section 133 of the Code of Criminal Procedure, 1973.

## Distinction between company and other associations

A company as defined in the Companies Act, 1956 must have been formed and registered under the present Act or any of the former Companies Act.[4] Such a company is also called an incorporated company. However, there are many other forms of associations such as partnerships, chartered companies, unincorporated companies, Insurance companies, co-operative societies, etc. in the business world. Therefore, it would be pertinent to distinguish a public company from such associations.

## Company and Partnership Distinguished

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

1. A company is a distinct person,[5] but a partnership firm is not distinct from the persons who form it.

2. In a partnership, the property of the firm is the property of the individual members who are collectively entitled to it. In case of a company the property belongs to the company and not the members.[6]

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3. The 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. But the creditors of a company can proceed only against the company and not against its members.[1]

4. Partners are the agents of the firm, but members of a company are not its agents. Therefore, a partner can dispose of the property and incur liabilities so long as he acts in the course of firm's business. A member of a company has no such power.[2]

5. A partner cannot contract with his firm of which he is a partner, whereas a member of a company can contract with a company of which he is a shareholder.[3]

6. A partner cannot transfer his share and make the transferee a member of the firm without the consent of other partners, whereas the shares of a company can ordinarily be transferred without the consent of other shareholders.

7. Restrictions on the powers of a particular partner contained in the partnership agreement shall not avail against outsiders, but those contained in the articles of association of a company are effective against the public because articles of association of a company being a public document, one can find out what is contained in them.[4]

8. A partner's liability is always unlimited whereas the liability of a shareholder of a company is limited either by share or by guarantee.

9. A company, being a creature of law, can only be dissolved as laid down by law, but a partnership firm is the result of an agreement between the partners and therefore it can be dissolved any time by agreement.

10. A company has a perpetual succession *i.e.* the death or insolvency of a shareholder or all of them does not affect the life of the company. On the other hand, a partnership is dissolved on death or insolvency of a partner unless otherwise provided.

11. A partnership firm cannot be formed, with more than ten members in the case of banking business and twenty members in case of any other business, whereas in a public company there must not be less than seven members and in case of a private company the minimum number is two. There is no restriction as to maximum number of members of a company except in case of a private company which cannot have more than fifty members, excluding past and present employees.

12. In the absence of any agreement to the contrary, every partner has an equal right in the conduct of the firm's business. But in case of a company, the right of management vests in few members called the Directors, and the rest of the members do not take any active part in the management of the company, nor do they necessarily know each other.

13. A company is legally bound to have its accounts audited annually by a Chartered Accountant whereas the accounts of a partnership firm are audited at the discretion of partners.

## Distinction between a Company and Joint Hindu Family Business

A company differs from a Joint Hindu Family business in the following aspects :—

1. A company consists of hetrogenous members whereas a Hindu undivided family business consists of homogenous members since it comprises members of the joint family itself.

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2. A person becomes a member of Joint Hindu Family business by virtue of birth but it is not so in case of a company.

3. Registration of a company is compulsory but no registration is necessary for a Joint Hindu Family for carrying on business for gain even if the number of its members exceeds twenty.[1]

4. In a Hindu Joint Family Business, the *'KARTA'* has the sole authority to contract debts etc. for the business and the coparceners have no right to do so but no such provision exists in case of a company.

## Corporation or Body Corporate

An association of persons incorporated according to the relevant law and clothed with legal personality, separate and distinct from the persons constituting it, is known as a corporation. A corporation or a body corporate has been defined in Section 2(11) of the Companies Act, 2013 as follows :—

"A 'Body Corporate' or 'Corporation' includes a company incorporated outside India, but does not include :—

(*i*) a co-operative society registered under any law relating to co-operative societies ; and

(*ii*) any other body corporate (not being a company as defined in this Act), which the Central Government may, by notification, specify in this behalf."

Thus it may be seen that the expression "Corporation", or "Body Corporate" is far wider than the word "Company".

A corporation sole is a single person (*i.e.* human individual) who is the holder for the time being of a perpetual office, or official position *e.g.* the King or Crown of England or a Bishop are the examples of a corporation-sole. A corporation sole continues to exist even though the human beings go on changing. The manifestation of this concept is to be seen in the maxim, "the King is dead, long live the King" which refers to the individual who has died and to the corporation which survives.[2] It is, however, significant to note that though a corporation sole is excluded from the definition of the 'Body Corporate' for the purposes of the Companies Act, 1956, it continues to be a legal person capable of holding property and becoming a member of a company.

A corporation or a body corporate includes within it a 'corporation-aggregate', a term so commonly used in legal parlance. A corporation aggregate is a collection of many individuals united in one body, under a special denomination, having perpetual succession under an artificial form, and vested, by law, with a capacity of acting in several respects, as an individual, particularly of taking and granting property, of contracting obligations, and of suing and being sued ; of enjoying privileges and immunities in common, and of exercising a variety of rights or powers conferred upon it, either at the time of its creation or at any subsequent period of its existence.[3]

## Modes of Incorporation of Companies

Corporations formed for purposes of trade and commerce are usually called 'companies'. In India, a company may be incorporated either by special statute or by registration under the Companies Act for the time being in force. In United Kingdom, a

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property of the company, came before the English Court of Appeal, Criminal Division, in the form of Attorney General's reference.[1] The Court held that a company is a legal entity separate from its shareholders. Therefore, it cannot be said that shareholders and directors are the sole owners of all company's property.

A company being a body corporate can sue and be sued in its own name. This is so, because it has a legal personality of its own.

## 2. Limited Liability

One of the principal advantages of an incorporated company is the privilege of limited liability. It is the main feature of registered companies which provides a special attraction to investors. The principle of limited liability implies that the liability of a member in the event of the company's winding up, in respect of the shares held by him is limited to the extent of the unpaid value on such shares. Thus the liability does not fluctuate but remains limited to the amount which, for the time being remains unpaid, whether from the original shareholder or the transferee of such shares as the case may be. Thus, if a shareholder has 100 shares of Rs.10/- each at par, and has already paid Rs.5/- on each share, he has paid Rs.500/- and therefore his liability extends to remaining Rs.500/- *i.e.* unpaid value of the shares held by him and nothing more than that. Even if he has transferred these partly paid shares, the transferee's liability shall be limited to the extent of unpaid value of shares only.

It must, however, be noted that limited liability of members extends only for company's debt in the event of its winding up. The company itself, being a *legal persona*, is always fully liable and therefore its liability is unlimited. In other words, it is liable to pay the debts so long as assets are available. The order of priority for payment of debt shall, however, depend on the class of creditors as laid down in the Companies Act.

The English Joint Stock Companies Act, 1844 which for the first time allowed associations of persons to obtain registration under the Act, did not initially provide for the privilege of limited liability. As such this privilege had to be obtained only by a specific Royal Charter or Act of Parliament. It was after a considerable deliberation in the British Parliament that the privilege of limited liability was extended to registered companies by the Limited Liability Act, 1855.

In India, the Companies (Amendment) Act, 1857 allowed companies to be registered with limited liability but this privilege did not extend to companies which were formed for the purpose of banking and insurance business. The restriction on banking and insurance companies was later removed by the Amendment Act of 1860.

Section 9 of the Companies Act, 2013 provides that in the event of the company being wound up, the members shall have liability to contribute to the assets of the company in accordance with the Act. In the case of limited companies, no member is bound to contribute anything more than the nominal value of shares held by him. The privilege of limiting the liability is one of the main advantages of carrying on business under a corporate organisation.

Commenting on the advantages of limited liability Buckley, J. *In Re London & Globe Finance Corporation*,[2] observed :—

> "The statutes relating to limited liability have probably done more than any legislation of the last fifty years to further the

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commercial prosperity of the country. They have, to the advantage as well of the investor 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."

The contribution of the principle of limited liability to the corporate world is further emphasised by an eminent American scholar who expressed a view, "limited liability corporation is the greatest single discovery of modern times. Even steam and electricity are less important than the limited liability company".[1]

Undoubtedly, the working of business organisations in the corporate sector over the years has established beyond doubt the utility of the limited liability clause, the main reason being that persons who form or invest in such companies as shareholders, know beforehand, the exact quantum of risk involved in the investment and the maximum extent of their liability.

Despite the advantages of limited liability, some critics of this doctrine have refuted to accept it as a sound principle. Thus, to quote an example, Lawton, L.J. in *Rolled Steel Products (Holdings) Ltd.* v. *British Steel Corporation*,[2] *inter alia* observed :

> "The fact that limited liability has all too often enabled many to enrich themselves at the expense of those who have given credit to the companies they control, is the price the business world has to pay for the potentiality for growth and convenience which goes with limited liability."

### 3. Perpetual Succession [Section 9]

As stated in Section 9 of the Companies Act, 2013, an incorporated company has perpetual succession, that is notwithstanding any change in its members, the company shall retain the same entity with the same privileges and immunities, estate and possessions.[3] In other words, the death or insolvency of individual member does not in any way, affect its corporate existence and the company shall continue its existence as usual until it is wound up in accordance with the provisions of the Companies Act. The perpetual existence of an incorporated company is well illustrated by proverbial saying, "members may come and members may go, but the company can go on for ever".

Professor Gower has cited an interesting illustration to explain the perpetual existence of a company. He says, "during the war all the members of a private company were killed by a bomb while they were in general meeting, but the company still survived and not even a hydrogen bomb could have destroyed it".[4]

The High Court of Calcutta in *Gopalpur Tea Co. Ltd.* v. *Penhok Tea Co. Ltd.*,[5] applying the doctrine of company's perpetual succession observed that though the whole undertaking of a company was taken over under an Act which purported to extinguish all rights of action against the company, neither the company was thereby extinguished nor any body's claim against it.

### 4. Transferability of shares

Section 56 of the Companies Act, 2013, specifically provides that the shares or other interest of any member in a company shall be movable property, transferable in the

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manner provided by the articles of association of the company. Thus the member of an incorporated company can dispose of his share by selling them in the open market and get back the amount so invested. The transferability of shares has two main advantages, namely it provides liquidity to investors and at the same time ensures stability of the company.[1] The transfer of shares of a company does not in any way affect its existence or management and the shareholder can conveniently get relieved of his liability by transferring his shares to some other person.

### 5. Corporate Finances

The shares of an incorporated company being transferable, it can raise maximum capital in minimum possible time. That apart, an incorporated company has the privilege of raising its capital by public subscriptions either by way of shares or debentures. The public financial institutions willingly lend loan to companies as it is generally secured by floating charge which is an exclusive privilege of a registered company.

In *R.T. Perumal* v. *John Deavin*,[2] it has been observed that a company is a real person in which all its property is vested, and by which it is controlled, managed and disposed of. Their Lordships further observed that "no member can claim himself to be the owner of the company's property during its existence or in its winding up".

### 6. Separate Property

Incorporation helps the property of the company to be clearly distinguished from that of its members.[3] The property is vested in the company as a corporate body and no changes of individual membership affect the title. The property remains vested in the company whereas the shareholders may come and go but the company may convey, assign, mortgage or otherwise deal with it.[4] In other words, the property of the company is not the property of shareholder, it is the property of the company.[5]

### 7. Centralised Management

As stated earlier, shareholders have no direct concern with the management of the company. They exercise only a formative control. Thus the management of the company is altogether different from its ownership. Independent functioning of managerial personnel attracts talented professional persons to work for the company in an atmosphere of independence thus enabling them to achieve highest targets of production and management leading to company's overall prosperity.

The management of the company generally vests in the directors who decide the policy matters in the meetings of the Board of Directors. The tenure of director's office is five years so as to ensure flexibility in management and eliminate the possibility of Board misusing its powers. With skilled professional managers supported by financial resources, companies are able to develop and carry on their business efficiently. In short, professional form of management of business disassociates the 'ownership' from control of business and thus helps to promote efficiency. Besides, it provides flexibility and autonomy to business undertakings within the framework of company law.

### 8. Permanence of capital and stability of the company

The provision contained in Section 67(1) of the Companies Act, 2013 prohibits a company with limited liability from purchasing its own shares subject to certain

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exceptions. This ensures permanence of capital raised by the company which in turn provides its stability and at the same time protection to the creditors of the company to certain extent.

## 9. Protection to Investors against loss

One of the advantages of incorporated company is that it affords an opportunity to even a common man with meagre resources to invest a part of his income in the company's capital through purchase of shares or debentures without being exposed to substantial loss in the event of failure of company's business. The company too, on its part, can borrow money and raise its capital on debentures, which an ordinary trader cannot do. Any member of a company acting in good faith, is as much entitled to take and hold company's debentures as any outside creditor. Thus, incorporation of companies seeks to fulfil the desire of common men who do not intend to directly participate in the business because of the risk involved therein, but wish to invest a part of their income in business ventures to earn profit.

## Disadvantages of Incorporation

Despite the advantages of incorporation as stated above, there are certain disadvantages which deserve attention. Some of these disadvantages are :—

## 1. Lifting or Piercing the Corporal Veil

An incorporated company is clothed with a distinct personality by fiction of law. But in reality it is an association of persons who, in a way, are the beneficial owners of the property of the body corporate.[1] A company being an artificial person, cannot act on its own, it can only act through natural persons.

Undoubtedly, the theory of corporate entity of a company is still the basic principle on which the whole law of corporations is based. But the separate personality of the company, being a statutory privilege, it must always be used for legitimate business purposes only. Where the legal entity of a corporate body is misused for fraudulent and dishonest purposes, the individuals concerned will not be allowed to take shelter behind the corporate personality. Ir such cases, the Court will break through the corporate shell and apply the principle of what is known as "lifting or piercing the corporate veil". That is, the Court will look behind the corporate entity.

Professor Gower has analysed the principle of lifting the corporal veil and according to him, "there are cases where the Court has looked behind the facade of the company and its place of registration in order to determine its residence and for this purpose the test laid down is the place of central management and control.[2] Similarly the Court has looked at the corporators, in order to determine the true character of the corporation as an enemy alien or as a British resident". According to him, this does not involve breach of the principle laid down in *Salomon's* case.[3]

The Supreme Court adopted a similar approach and in some cases it has seen through the corporate veil. Thus in *Central Inland Water Transport Corporation Ltd.* v. *Brojo Nath Ganguly,*[4] the Apex Court while considering the question whether the appellant company was an agency or instrumentality of the State for the purpose of Article 12 of the Constitution of India, *inter-alia* observed :

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"Generally and broadly speaking, we may say that the corporate veil may be lifted where a statute itself contemplates lifting the veil, or fraud or improper conduct is intended to be prevented, or a taxing statute or beneficient statute is sought to be evaded or where associated companies are inextricably connected as to be, in reality, part of one concern. It is neither necessary nor desirable to enumerate the classes of cases where lifting the veil is permissible, since that must necessarily depend on the relevant statutory or other provisions, the object sought to be achieved, the impugned conduct, the involvement of the element of public interest, the effect on parties who may be affected etc."

(b) *To prevent evasion of taxation*

The Courts have made inroads on the principle of separate legal personality in order to prevent evasion of taxes. At times, a company is incorporated and formed by certain persons in order to evade their personal tax liability taking shelter of corporate nature of the company. This is well illustrated by the facts of the case of *Bacha F. Guzdar* v. *Commissioner of Income Tax, Bombay.*[1]

At the time in question, the agricultural income was exempt from tax under the Income Tax Act. The income of a Tea company was exempt to the extent of 60 per cent as agricultural income and 40 per cent was taxed as income from manufacture and sale of tea. The plaintiff, a member of the tea company received certain amount as dividend in respect of shares held by her in the company. She claimed that sixty per cent of her dividend income should be exempt from the Income Tax being an agricultural income. The Supreme Court rejected the argument of the plaintiff and held that although the income in the hands of the company was partly agricultural, yet the same income when received by the shareholders as dividend could not be regarded as agricultural income.

Another case where the Supreme Court upheld the piercing of the corporate veil to determine whether it has been used for evasion of taxes and duties is that of *In Re Sir Dinshaw Maneckjee Petit.*[2]

In the instant case, the assessee was a wealthy man enjoying huge income from dividends and interests. He formed four private companies and agreed with each to hold a block of investment as an agent for it. He credited the income received by him in the accounts of the companies and took it back in the form of a pretended loan. The whole idea was to split his income into four parts with a view to evade taxes. Dismissing the petition, the Supreme Court, *inter alia*, observed :

The company was formed by the assessee purely and simply as a means of avoiding super-tax 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 loan."[3]

The Supreme Court, in *C.I.T.* v. *Meenakshi Mills Ltd.*,[4] reiterated its earlier stand and held that in cases where it was found that the sole purpose of incorporation was to

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evade taxes the Court would ignore the concept of separate entity and lift the corporate veil to look into the real transaction.

In *Mc Dowell & Co. Ltd.* v. *Commercial Tax Officer,*[1] the Supreme Court has pointed out that "it is upto the Court to take stock to determine the nature of new and sophisticated legal devices for what they really are and to refuse to give judicial benedictions".

In the English case of *Apthorpe* v. *Peter Schoenhofen Brewing Co.,*[2] the law did not permit the foreigners to hold land in New York. Despite this restriction, a British Company established its business in New York and acquired considerable assets. However, it retained the ownership of the premises of its Company in the name of the American Company so that there was no violation of the restriction as to holding of land in New York by a foreigner. In fact, the whole business and financial management of the said American Company was controlled by the British Company. The Court therefore, lifted the corporate veil of the Company and observed that the American Company was operating as an agent of the British Company, hence the entire profit amount earned by the Company was taxable as the income of the British Company and the Company cannot be allowed to evade its tax liability.

(c) *Avoidance of welfare Legislation*

In cases where it is found that the sole purpose for the formation of a new company was to use it as a device to avoid liability under any welfare legislation, the Court may lift the corporate veil to look at the real transaction and purpose behind it. The Supreme Court decision in *Workmen of Associated Rubber Industry Ltd.* v. *The Associated Rubber Industry Ltd., Bhavnagar,*[3] is an illustration on the point.

The facts of the case were that a new company was created wholly owned 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 and serving no purpose whatsoever except to reduce the gross profit of the principal company.

The Supreme Court found that the creation of new company was intended as a device to reduce the amount of bonus payable to workmen of the principal company and therefore the separate existence of the two companies had to be ignored while computing the bonus. The Court further observed :

> "It is the duty of the Court, in every case where ingenuity is expected to avoid taxing and welfare legislations, to go behind the smoke-screen and discover the true state of affairs. The Court is not to be satisfied with *form* and leave well alone the *substance* of a transaction."

(d) *Prevention of Fraud or improper conduct*

Where the corporate entity has been used for fraud or improper conduct or to defeat or circumvent the law, Courts may pierce the corporate veil to look into the realities of the situation. This is well illustrated by the case of *Gilford Motor Co.* v. *Horne.*[4]

In this case, one Mr. Horne was appointed as a managing director of the plaintiff company on the condition that he shall not at any time while he shall hold office of a managing director or afterwards, solicit or entice the customers of the company. Horne's

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1. (1985) 3 SCC 230.

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However, Mr. Justice Krishna Iyer took a contrary view in *Som Prakash Rekhi* v. *Union of India*,[1] wherein the assets and business of Burmah Shell was acquired and vested in the Central Government. The aggrieved employee, who had certain rights as to Provident Fund etc. against the former company, claimed them against the Government by means of a writ. His claim was resisted on the plea that the undertaking had been vested to a company which was registered under the Companies Act and therefore the question of writ against a private company could not arise. But rejecting this contention Mr. Justice Krishna Iyer held that since whole undertaking had been vested in the Central Government, it had become a State undertaking. The learned Judge emphasised that law should not go by the fact whether the company is registered under the Companies Act or otherwise, but by the nature of the functions which the undertaking was performing. To quote his own words, Justice Krishna Iyer observed :

> "........What we wish to emphasise is that merely because a company or other legal person has functional and jural individuality for certain purposes, it does not necessarily follow that for the effective enforcement of fundamental rights, we should not scan the real character of that entity ; and if it is found to be a mere agent or surrogate of the State, in fact owned by the State, in truth controlled by the State and in effect an incarnation of the State, constitutional lawyers must not blink at these facts and frustrate enforcement of fundamental rights.........."[2]

The Supreme Court has ruled that Life Insurance Corporation cannot be treated as an instrumentality of the State when it is exercising its ordinary right as a majority shareholder in a company for removing the existing management and reconstituting the Board of Directors of that company.[3]

*(f) To punish the real persons in Quasi-Criminal cases against the Company*

The Courts have sometimes applied the doctrine of lifting the corporate veil in quasi-criminal cases relating to companies in order to look behind the legal person and punish the real persons who have violated the law.

The Delhi High Court was called upon to decide upon the applicability of the doctrine in *New Horizons* v. *Union of India*,[4] wherein none of the situations referred to above seemed to cover the case. In this case the doctrine was sought to be put forth by a public limited company in support of its contention that the government had failed to award it the contract for printing *Yellow Pages Telephone Directory*, even though its offer of royalty was higher than that of the concern whose tender had been accepted. The petitioner's offer had been rejected on the ground that it did not have experience of printing *Yellow Pages*. The petitioner's counter contention on this point was that, (i) one of its shareholders, a Singapore company, had such experience; (ii) the concerned authorities should have conducted an inquiry into the experience of its shareholders; and (iii) such experience should have been taken into consideration in the public interest.

These contentions of the petitioner did not find favour with the Division Bench of the Delhi High Court since the case was a novel one not falling in any of the recognised

of a public company and two in the case of a private company, and the company carries on business for more than six months while the number is so reduced, every person who is a member of that company during the time the company so carries on business after those six months and is aware of that fact, shall be severally liable for the payment of company's debts contracted during that time. Thus, in such cases, the privilege of limited liability is denied to the shareholders.

(b) *Agreement for sale—Enforceability of Contracts against private company*

Where in compliance with provisions of Section 46 of the Companies Act, all the directors have executed agreement for sale in the name of a private company, the contract would not be held invalid or illegal in the absence of resolution under Section 48. Thus the Supreme Court in *Pancharan Dharma* v. *Monmatha Nath Maity*,[1] held that all the five directors of the private company who executed agreement for sale in the name of the company the execution of the sale agreement could not be held to be invalid on the ground that no resolution in regard had been passed under Section 48 of the Companies Act. The Company was, therefore, held liable having regard to nature of the transaction and authority of those who had executed it.

(c) *Misdescription of name*

Where an officer of a company signs on behalf of the company any contract, Bill of exchange, hundi, promissory note, cheque or an order for money goods, such person shall be personally liable to the holder if the name of the company is not fully or properly mentioned in the instrument.

Thus, in *Hendon* v. *Adelman*,[2] the directors were held personally liable for a cheque signed by them in the name of a company stating the company as 'L.R. Agencies Ltd.' whereas the real name of the company was "L&R Agencies Ltd."

(d) *Subsidiary company*

A holding company has to disclose to its members, the accounts of its subsidiaries. Though in the eyes of law a subsidiary company is a separate legal entity under certain circumstances, the Court may not treat the subsidiary company as an independent entity in a particular situation. Thus in *Freewheel (India) Ltd.* v. *Dr. Veda Mitra*,[3] where the holding company prayed for an injunction against its subsidiary restraining the latter from going ahead with the proposed issue of capital as it would deprive the holding company of its controlling interest and also depreciate its shares. Mr. Justice Kapur of the Delhi High Court refused to issue the injunction on the ground that the holding company held only nominal majority *i.e.* 52% share capital of the subsidiary company, therefore, it could not be said that the subsidiary company has lost its identity as a separate legal person. In this case, Justice Kapur further remarked :

> "It may not be possible to put in a strait jacket of judicial definition as to when the agent, subsidiary company can really be treated as a branch, or an agent, or a trustee of the holding company. Circumstances such as the profits of the subsidiary company being treated as those of the parent company, the control and conduct of the business of subsidiary company vesting completely in the nominee of the holding company----- may indicate that in fact the subsidiary company is only a branch of the holding company."

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There may be two situations when a subsidiary company may lose its independent identity to a certain extent, namely, (1) the law may brush aside the legal forms and require companies in a group to present a joint picture in order to give better information of the financial position of the group as a whole to the public, creditors and shareholders ; and (2) where the control and conduct of business of a subsidiary company rests solely in the nominees of the holding company, it may be inferred that the subsidiary company is merely a branch of holding company and has no separate identity of its own.[1]

(e) *Fraudulent conduct of business (Section 339)*

Where in the course of winding up of a company it appears that any business of the company has been carried on with intent to defraud creditors of the company or any other person, or for any fraudulent purpose, in such a case, those who were knowingly parties to such conduct of business may, at the discretion of the Court, be made personally liable without any limitation as to liability for all or any of the debts of the company.[2]

(f) *Failure to Return Application Money (Section 39)*

The provision contained in clause (5) of Section 69 of the Companies Act, 1956 makes the director of a public company personally liable to pay the money with interest if the application money is not repaid within 130 days in the event of minimum subscription not having been received or company not having obtained certificate of commencement of business by the company.

(g) *Civil Liability for Misrepresentation in Prospectus (Section 35)*

In case of misrepresentation in the prospectus of a company, every director, promoter, and every other person who authorises issue of such prospectus, incurs liability towards those who subscribe for shares on the faith of untrue statement.

(h) *Ultra vires acts*

The directors of a company shall be personally liable for all those acts done by them on behalf of the company if they are *ultra vires* the company.

(i) *Non-payment of Tax*

In the event of winding up of a private company, if any tax assessed on the company whether before or in course of liquidation in respect of any income of any previous year cannot be recovered, every person who was director of that company at any time during the relevant previous year, shall be jointly and severally liable for payment of such tax.

### 3. Expenses and formalism

Incorporation of a company is an expensive affair. Besides, it involves completion of a number of formalities. Moreover, the administration of a company has to be carried on strictly in accordance with the provisions of the company law and activities are limited by its memorandum which at times creates problems in its progress. On the other hand, a partnership firm does not involve these complexities and as such, it is comparatively a simple affair. The very fact that there are more than 200 offences under the Companies Act, 1956, amply suggests the magnitude of formalities involved in the

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incorporated company. There are as many as 50 items in respect of which returns have to be filed by incorporated companies.[1]

The critics of incorporated limited companies have pointed out that "incorporation of a business as a limited company involves considerable expense, capital duty and stamp duty, printing etc. and recurring expenditure on company registration fees and audit fees and also considerable expenditure of time in complying with the provisions of the Companies Act. It also involves disclosure of the company's accounts to the public and various other matters."[2] It is therefore suggested that small companies should be formed with simplified procedure and less expenditure than the present one.

## 4. Company is not a citizen

Last but not the least, though a company is a legal person, it is not a citizen under the constitutional law of India or the Citizenship Act, 1955. The reason as to why a company cannot be treated as a citizen is that citizenship is available to individuals or natural persons only and not to juristic persons.

The question whether a corporation is a citizen was decided by the Supreme Court in *State Trading Corporation of India* v. *Commercial Tax Officer*,[3] wherein it was contended on behalf of the petitioners that the corporation was incorporated under the Companies Act and all the shares were held by the President of India and two Secretaries in their official capacities and since all these three persons were citizens of India, the corporation should also be treated as a citizen. Rejecting the plea putforth by the petitioners the Supreme Court refused to recognise the corporation as a citizen. The Court observed :

> "...............if all of them (*i.e.* members) are citizens of India,
> the company does not become a citizen of India any more than,
> if all are married, the company would be a married person."

Since a company is not treated as a citizen, it cannot claim protection of such fundamental rights as are expressly guaranteed to citizens,[4] only but it can certainly claim the protection of such fundamental rights as are guaranteed to all persons whether citizens or not.

In *Tata Engineering Company* v. *State of Bihar*,[5] it was held that since the legal personality of a company is altogether different from that of its members and shareholders, it cannot claim protection of fundamental rights although all its members are Indian citizens. However, the Court in *R. C. Cooper* v. *Union of India*,[6] made it clear that where any right of a Company is affected by an order passed by the executive or the Legislature or by a legislation and it also has adverse effect on the Shareholders of the Company, then protection under Article 19 cannot be denied to the Company on the ground that a Company not being a citizen, is not entitled for such protection. The reason being that a citizen who becomes a shareholder of a Company does not cease to enjoy his fundamental rights and the safeguards available against violation of such rights under Article 19 of the Constitution of India.

The Supreme Court, in *Benett Coleman & Co.* v. *Union of India*,[7] however, observed that if an act of the State impairs the right of the share-holders as well as the

1. C. Narayanswamy : Complexities, Cumbersomeness and Anomalies of the Company Law, (1966) 2

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company, the Court would not deny to itself jurisdiction to grant relief. Elaborating the point further, the Apex Court *inter alia* observed :

> "It is now clear that fundamental rights of citizens are not lost when they associate to form a company. When their fundamental rights as shareholders are impaired by State action, the rights of the company are protected. The reason is that the shareholder's rights are equally and necessarily affected if the rights of the company are affected."

It would thus be seen that the company acquires a standing by impleading a shareholder with itself in an action for enforcement of fundamental rights.[1]

Though a company is not a citizen, it does have a nationality, domicile and residence. As observed by Mac Naughten, J. in *Gasque* v. *Commissioners of Inland Revenue,*[2] :—

> "It is quite true that a body corporate cannot have a domicile in the same sense as an individual............but by analogy with a natural person the attributes of residence, domicile and nationality can be given to a body corporate."

Similar view had been expressed in an earlier decision in *Jenson* v. *Dryfountain Consolidated Mines Ltd,*[3] by House of Lords in 1902.

It has been well settled now that a company incorporated in a particular country shall have the nationality of that country though unlike a natural person, it cannot change its nationality.[4]

As regards the determination of the residence of a company, it has been held that for the purposes of income tax law, a company resides where its real business is carried on and the real business of a company shall be deemed to be carried on where its Central management and control is actually located.[5]

## A Body Corporate distinguished from an Incorporated Company

It has been stated earlier that the term 'company' has been defined in Section 2 (20) of the Companies Act, 2013 as a company formed and registered under the Companies Act and an existing company formed and registered under the earlier Companies Act, 1913.

The term 'body corporate' has been defined in clause (11) of Section 2 of the Companies Act which reads as under :—

"A body corporate or a corporation includes a company incorporated outside India but does not include—

(*a*) A corporation sole ;

(*b*) a co-operative society registered under any law relating to co-operative societies ; and

(*c*) any body corporate (not being a company as defined in the Companies Act) which the Central Government may, by notification in the Official Gazette specify in this behalf."

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Thus it is evident that a 'body corporate' being a wider term, includes an incorporated company and also other associations of persons. In other words, the expression 'body corporate' is the genus and incorporated company, its specie.

## Illegal Associations [Section 464]

In order to prevent mischief arising from large trading undertakings carrying on business in an unincorporated form, it was necessary to provide that every business association having a certain number of members must be registered as a company, failing which it shall be regarded as an illegal association. Thus an unincorporated company, association or partnership consisting of large number of persons has been declared illegal.

The relevant provision is contained in Section 464 of the Companies Act, 2013 which says that no company, association or partnership consisting of more than such number of persons as prescribed shall be formed for the purpose of carrying on any business for gain, unless it is registered as a company under the Companies Act, or is formed in pursuance of some other Indian Law, or is a joint Hindu family carrying on business,[1] for gain. The term 'gain' referred to in the section really means 'acquisition' and its meaning is not confined to pecuniary gain, much less to a commercial profit.[2]

Accordingly, where the number of individuals in an association formed for carrying on any business for gain exceeds more than prescribed in case of association formed for carrying on banking business exceeds ten, it must be necessarily registered under the Companies Act, failing which the association shall be treated as an 'illegal association' in law though none of the objects for which it has been formed may be illegal within the meaning of Section 23 of the Indian Contracts Act, 1872.

It is significant to note that provisions of Section 464 of the Companies Act, 2013 do not apply in case of a single Joint Hindu Family carrying on any business with whatever number. But where the business is carried on by two or more Joint Hindu Families together, the section shall *ipso facto* apply and if the number of persons exceeds the statutory limit, it will be treated as an illegal association. In computing the number of members for the purpose of Section 464 the minor members shall be excluded.[3]

It must, however, be noted out that a stock exchange is not included within the purview of Section 464 as it is not formed for the purpose of carrying on any business, much less for the purpose of gain.[4]

Since the law does not recognise an illegal association, such as association suffers from certain disabilities arising out of its illegality. They are :—

1. It cannot enter into a valid and enforceable contract.

2. It cannot sue any member or an outsider even after the company is subsequently registered, nor can a member or an outsider, sue an illegal association.

... explained by Privy Council in Goswami Shri Girdhariji ... a person might

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