26 CHAPTER

COMPANIES ACT 2013

சிறப்பீனும் செல்வம் பெறினும் பிறர்க்குஇன்னா
செய்யாமை மாசற்றார் கோள்.

-- குறள் 311

COUPLET

It is the determination of the spotless not to cause sorrow to others, although they could (by so causing) obtain the wealth which confers greatness.

Learning Objectives

To enable the students to understand the

- Developments in company law and the logic of the company law.
- Elementary ideas on the Formation of Company
- Role of Promoters
- Meaning of Shares and Debentures.
- Basic idea on Share Certificate and Share warrants

Chapter Synopsis

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. Company form of business has certain distinct advantages over other forms of businesses like Sole Proprietorship, Partnership etc. It includes features such as Limited Liability, Perpetual Succession etc.

26.01 Evolution & History of Company Law in India

The earliest business associations in England were the "Merchant Guilds". Some of the merchant Associations or guilds who have regulated the companies.

(i) A Royal Charter established the East India Company in the year 1600.

(ii) In England the Joint Stock Companies Act was passed for the first time in 1844.

(iii) In the year 1850, taking the English Joint Stock Companies Act 1844 as a base, a provision was made for registration of joint stock companies in India.

(iv) The Joint Stock Companies Act was passed in India by introducing the concept of limited liability in the year 1857.

(v) In 1913, the Indian Companies Act of 1913 was passed. The Act introduce the institution of private companies in the corporate sector in India. After Independence. Based on the recommendation of the Shri.H.C.Baba committee in 1950 and the provisions of the English Companies Act 1948, the Companies Act 1956 was introduced in the parliament.

The Companies Act 1956 came into force on 1st April, 1956. The main objectives of the Company Law 1956 are:

(i) To sustain trust and faith of Shareholders

(ii) To protect and preserve the rights of Share holders

(iii) To have drastic control over all the activities of company

(iv) To make regulation of an effective Annual Meeting,

(v) The investment of general public should be used for the development of society or social welfare activities.

The Companies Act 1956 has been amended from time to time. From 2006 to 2009 some important Changes was made.

(i) The Company Law Board (CLB) has been abolished and National Company Law Tribunal (NCLT) is formed.

(ii) The rehabilitation of sick companies will be undertaken by the NCLT and not by the Board for Industrial & Financial Reconstruction (BIFR).

(iii) Earlier the BIFR was entrusted with the rehabilitation of sick companies as the matter came under the jurisdiction of the Sick Industrial Companies Act 1985 (SICA) but now the Sick Industrial Companies Repeal Act 2003 has replaced SICA and the work of revival and rehabilitation has been entrusted to NCLT.

Again the Companies Act has been amended in the year 2013 and has introduced several new concepts and definitions.

26.02 The Companies Act 2013

The New 2013 Companies Act got the ascent of President on 29th August, 2013 but it was passed in the Lok sabha on 18th December, 2012 and in Rajya Sabha on 8th August, 2013. The Act 2013 consists of 29 Chapters 470 Sections and 7 Schedules as against 13 chapters 658 Sections and 15 Schedules in 1956 Act. Separate Chapters for Registered Valuers, Government Companies, Furnish information or Statistics, Nidhis, National Company Law Tribunal & Appellate Tribunal and Special Courts are introduced in Companies Act 2013.

Some Important Basic changes made in the new Companies Act 2013 are as follows:

S. No	CHANGES		CHANGES MADE
1	**Incorporation of Company**	Types of Companies	Public company Private company One Person company (OPC)
		Maximum no of members for private companies	A private company can have maximum of 200 members
		One person Company	New Concept Introduced
		Commencement of business	Now applicable to all companies having share capital
2	**Memorandum of Association (MOA)**	Object Clause	MOA to contain the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof
3	**Key Managerial Person (KMP)**	Section 2 (51)	KMP Includes: • CEO or MD or Manager; • Company Secretary; • WTD; • CFO; and Such other officers as may be prescribed
4	**APPOINTMENT OF WHOLE TIME KMP**	Section 203	States that Every Company belonging to class or classes of companies as may be prescribed shall have KMPs • MD or CEO or Manager and in absence of a WTD • Company Secretary • Chief Financial Officer
5	**Regarding Issue of Share Capital**	Issue of Shares at a discount	Shares, other than sweat equity shares, cannot be issued at a discount
		Issue of preference shares for more than 20 years	Preference shares have to be redeemed within 20 years of issue except for the shares issued for prescribed infrastructure projects, provided a certain percentage of shares are redeemed annually at the option of shareholders
		Notice of alteration of share capital	Company shall file a notice in the prescribed form with the Registrar within a period of thirty days of redemption of redeemable preference shares.
		Consolidation and division of shares	Consolidation and division which results in changes in the voting percentage of shareholders shall require approval of the Tribunal to be effective.

26.03 Meaning and Definition of a Company

The word 'company' is derived from the Latin word (Com=with or together; pains =bread), and it originally referred to an association of persons who took their meals together. A company is a corporate body and a legal person having status and personality distinct and separate from the members constituting it.

It is called a body corporate because, the persons composing it are made into one body by incorporating it according to the law and clothing it with legal personality. The word 'corporation' is derived from the Latin term 'corpus' which means 'body'.

Accordingly, 'corporation' is a legal person created by a process other than natural birth. It is, for this reason, sometimes called artificial legal person. As a legal person, a corporate is capable of enjoying many of the rights and incurring many of the liabilities of a natural person.

An incorporated company owes its existence either to a special Act of Parliament or to company law. Public corporations like LIC, RBI, SBI etc., have been brought into existence through special Acts of Parliament, whereas companies like Tata Steel Ltd., Reliance Industries Limited have been formed under the Company law i.e. Companies Act, 1956 which is being replaced by the Companies Act, 2013

In the **legal sense**, a company is an association of both natural and artificial persons and is incorporated under the existing law of a country.

In terms of the Companies Act, 2013 [Section 2(20)] "company" means a company incorporated under this Act or under any previous company law.

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 there from.

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 "share". The shares are always transferable although the right to transfer them may be restricted."

From the above definition, it can be concluded that a company is registered association, having its own corporate and legal personality distinct which is separate from its members with a perpetual succession, a common seal for its signatures, a common capital comprised of transferable shares and carrying limited liability. (These aspects are discussed in 11thstd)

Body Corporate

Body corporate means a corporate entity which has a legal existence. According to section 2(11) "body corporate" or "corporation" includes a private company, public company, one personal company, small company, Limited Liability Partnerships, foreign company incorporated outside India, but does not include

1. a co-operative society registered under any law relating to co-operative societies; and
2. any other body corporate (not being a company as defined in this Act),

26.04 Formation/Incorporation of a Company

Section 3(1) of the Act states that a company may be formed for any lawful purpose by-

(a) seven or more persons, where the company to be formed is to be a public company;

(b) two or more persons, where the company to be formed is to be a private company; or

(c) 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:

The process of formation of company consists of different stages, which starts when a person envisage an idea to form a company and ends when a company gets a certificate from the Registrar of Companies after complying with the various provisions relating to the formation of a company. 'Formation of a Company' has been divided into four stages:

1. Promotion
2. Registration
3. Capital Subscription and
4. Commencement of Business.

Out of the four stages, the first two stages 'Promotion and Registration' are necessary for both public and private companies. A private company can start operating its business immediately after registration, but a public company has to pass through two more stages- capital subscription and commencement of business.

A public company can raise funds from the public by issuing shares. After following all the legal provisions of public issue, which are specified in The Company's Act, a public company can start operating of its business.

26.05 Share and Share Capital

The term "Capital" is viewed by a layman as the money, which a business persons invest in the business and in case of company raise the capital by issue of shares. They uses this money to meet its requirements by way of acquiring business premises and stock-in-trade, which are called the fixed capital and the circulating capital respectively. The phrase "loan or borrowed capital" is sometimes used to mean money borrowed by the company and secured by issuing debentures. This, however, is not the proper use of the word "capital".

In case of company limited by shares, the word "capital" means the share capital i.e., the capital in terms of rupees divided into specified number of shares each having fixed rupee value. For e.g. share capital of a company is Rs.10,00,000 which can be divided into 10,000 shares of Rs.100 each or 1,00,000 shares of Rs.10 each, whichever is reasonable to the company.

Share

The term Share is viewed by a layman as a fraction or portion of total capital of the company which have equal denomination. In simple, the total capital of the company is shared by many person and each share is having equal value.

According to Section 2(84) of the Companies Act, 2013, share means share in the "Share Capital of a company and includes stock except where a distinction between stock and share is expressed or implied"

Kinds of Share Capital

According to Section 43 of the Act, a company which is limited by shares can issue two classes of shares they are:

(i) Equity Share Capital:

  a) With Voting rights or

  b) With differential rights as to dividend, voting or otherwise in accordance with such rules as may be prescribed.

(ii) Preference Share Capital

Meaning of Equity Share

Those shares which are not called as preference share are known as Equity share or the share of a company which do not have any preferential rights with regard to dividend and repayment of share capital at the time of liquidation of a company.

Meaning of Preference Share

Section 42 of the Companies Act, 2013 the term 'preference shares' mean that part of the share capital the holders of which have a preferential right over payment of dividend (fixed amount or rate) and repayment of share capital in the event of winding up of the company.

Kinds of Preference shares

There are eight types of preference shares. In case of dissolution of the company, any of the eight types would be paid out before other types of equity.

Cumulative Preference shares: As the word indicates, all dividends are carried forward until specified, and paid out only at the end of the specified period.

Non-cumulative Preference shares: The opposite of cumulative, obviously. Dividends are paid out of profits for every year. There are no arrears carried over a time period to be paid at the end of the term

Redeemable Preference shares: Such preference shares can be claimed after a fixed period or after giving due notice.

Non-Redeemable Preference shares: Such shares cannot be redeemed during the lifetime of the company, but can only be obtained at the time of winding up (liquidation) of assets.

Convertible Preference shares: The shares can be converted into equity shares after a time period or as per the conditions laid down in the terms.

Non-convertible Preference shares: Non-convertible preference shares cannot be, at any time, converted into equity shares.

Participating Preference shares: Such shares have the right to participate in any additional profits, after paying the equity shareholders. The surplus of profit is apart from the fixed dividend paid up for preference shares.

Non-Participating Preference shares: Non-participating preference shares do not possess any right to participate in surplus profits or any surplus gained at the time of liquidation of the company.

Tenure of Preference Shares

Tenure of Preference Shares continued as 20 years except for "Infrastructural Projects" Companies having "infrastructural projects" can issue Preference Shares for more than 20 years but up to 30 years subject to minimum 10% redemption of such preference shares from 21st year onward or earlier.

26.06 Issue of shares, Bonus shares and Right shares

There are various ways by which shares can be issued.

Issue of shares at Par

Normally shares are issued at their face value or par value i.e at a price mentioned on the face of share certificate concerned. There is no legal restrictions on issuing shares at par / face value.

Issue of Shares at Premium

When shares are issued at a price above the face or nominal value, they are said to be issued at a premium. For example, a share having the face value of Rs.10 is issued at Rs.12. Here, Rs.2 is the premium. The amount of share premium has to be transferred to an account called the 'Securities Premium Account'. This account is capital in nature and can only be utilized for the purposes specified by the Act under Section 78 viz; Issue of fully paid bonus shares to members of the company.

(i) To write off preliminary expenses.

(ii) To write off the expenses of issue, or commission paid, or discount allowed, on issue of shares or debentures of the company.

(iii) To provide for the payment of premium on the redemption of any redeemable preference shares or debentures of the company.

Thus, the Securities Premium Account cannot be treated as a revenue reserve for distributing dividends. It can only be used for the above mentioned purposes and also for buying back of securities (section 77A). It must be noted that Security premium is not available for distribution of dividend.

Issue of Securities at Discount

When the shares are issued at a price below the face value they are said to be issued at a discount. For example, a share having the face value of Rs 10 is issued at Rs 8. The companies act 2013, prohibits the issue of shares at discount (Section 53), except sweat Equity share.

Sweat Equity Shares

Under section 54 of the Companies Act 2013, Sweat Equity Shares can be issued at Discount. Sweat Equity Shares means issue of shares to employees or directors at a lower price for cash or other than Cash, in lieu of providing know-how or making available rights in the nature of intellectual property rights or any value additions.

Bonus Shares

A company may, if its Articles provide, capitalize its profits by issuing fully-paid bonus shares. The issue of bonus shares by a company is a common feature. In simple, Bonus share means to utilize the company's reserves and surpluses, issue of shares to existing shareholders without taking any consideration is known as Bonus Shares. It can be issued by:

(i) Making partly paid up shares as fully paid

(ii) Issuing new shares

Right Shares

Right shares are the shares which are issued by the company, with the aim of increasing the subscribed share capital of the company by further issue, if it is authorized by its Articles. The right shares are primarily issued to the existing equity shareholders through a letter of an issue, on pro rata basis.

26.07 Share Certificate and Share Warrant

A share certificate is an instrument in writing, that is a legal proof of the ownership of the number of shares stated in it. Every company, limited by shares, whether it is public or private must issue the share certificate to its shareholders except in case, where shares are held in dematerialization system.

According to Section 45 of the Companies Act, 2013 each share of the share capital of the company shall be distinguished with a distinct number for its individual identification. However, such distinction shall not be required, if the shares are held by a person whose name is entered as holder of beneficial interest as per the records of a company.

The share certificate contains the following details in it, they are:

(i) Company name

(ii) Date of issue

(iii) Details of the member

(iv) Shares held

(v) Nominal value

(vi) Paid up value

(vii) Definite number

The share certificate is issued by the company within three months of the allotment of shares to the applicants, which is issued under the common seal of the company. Normally, the holder of the share certificate is regarded as the member of the company.

Share Warrant

A share warrant is a negotiable instrument, issued by the public limited company only against fully paid up shares. It is also termed as a document of title because the holder of the share warrant is entitled to the number of shares mentioned in it. There is no compulsion of the issue of share warrants by the company. Although if the public company wants to issue share warrants, then prior approval of the Central Government (CG) is required. Further the issue of a share warrant must be authorized in the articles of association of the company.

The holder of the share warrant can take a share certificate only if holder surrenders the share warrant and pays the required fee for the issue of share certificate. Thereafter, the company will cancel the warrant and issue a new share certificate to him as well as the company will enter his name as the member of the company in the register of members, after which he will become a member of the company.

Generally, the holder of the share warrant is not the member of the company, but if the articles of association of the company provide it, then the bearer is deemed to be the member of the company.

26.08 Share and Stock

The definition of the term 'Share' under the Companies Act, 1956 (Section 2(46)) includes 'Stock'. A company can convert its shares into stock and vice versa by following the provisions of Table A (Articles 36-39). Stock is created from fully paid shares by passing an ordinary resolution in the general meeting. The Articles of Association of the company must permit this conversion.

26.09 Debentures

Adequate amount of capital is necessary to run a business effectively/successfully. In some cases capital arranged through internal resources i.e. by way of issuing equity share capital or using accumulated profit is not adequate and the organisation is resorted to external resources of arranging capital i.e. External Commercial borrowing (ECB), Debentures, Bank Loan, Public Fixed Deposits etc.

When a company needs funds for extension and development purpose without increasing its share capital, it can borrow from the general public by issuing certificates for a fixed period of time and at a fixed rate of interest. Such a loan certificate is called a debenture.

Debentures are offered to the public for subscription in the same way as for issue of equity shares. Debenture is issued under the common seal of the company acknowledging the receipt of money.

According to Section 2(30) of Companies Act 2013 "debenture" includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not; It is evident from the definition that the term debentures covers both secured and unsecured debentures.

Features of Debentures

The important features of debentures are as follows:

1. It is issued by the Company in the form of a certificate under the common seal.
2. Debenture holders are the creditors of the company
3. Debentures carry a fixed rate of interest.
4. Debenture is redeemed after a fixed period of time.
5. Debentures may be either secured or unsecured.
6. Interest payable on a debenture is a charge against profit and hence it is a tax deductible expenditure.
7. Debenture holders do not enjoy any voting right.
8. Interest on debenture is payable even if there is a loss.

Kinds of Debentures

Debentures are generally classified into different categories on the basis of:

(1) Convertibility of the Instrument

(2) Security of the Instrument

(3) Redemption ability

(4) Registration of Instrument

1. On the basis of convertibility, Debentures may be classified into following categories:

(i) Non Convertible Debentures (NCD): These instruments retain the debt character and cannot be converted into equity shares.

(ii) Partly Convertible Debentures (PCD): A part of these instruments are converted into Equity shares in the future at notice of the issuer. The issuer decides the ratio for conversion. This is normally decided at the time of subscription.

(iii) Fully convertible Debentures (FCD): These are fully convertible into Equity shares at the issuer's notice. The ratio of conversion is decided by the issuer. Upon conversion the investors enjoy the same status as ordinary shareholders of the company.

(iv) Optionally Convertible Debentures (OCD): The investor has the option to either convert these debentures into shares at a price decided by the issuer/agreed upon at the time of issue.

2. On the basis of Security, debentures are classified into:

(A) Secured Debentures: These instruments are secured by a charge on the fixed assets of the issuer company. So if the issuer fails on payment of either the principal or interest amount, such fixed assets can be sold to repay the liability to the investors.

(B) Unsecured Debentures: These instrument are unsecured in the sense that if the issuer defaults on payment of the interest or principal amount, the investor has to be included as unsecured creditors of the company.

3. On the basis of Redeemability, debentures are classified into:

(A) Redeemable Debentures: It refers to the debentures which are issued with a condition that the debentures will be redeemed at a fixed date or upon demand, or after notice, or under a system of periodical drawings. Debentures are generally redeemable and on redemption these can be reissued or cancelled.

(B) Perpetual or Irredeemable Debentures: A Debenture, in which no specific time is specified by the companies to pay back the money, is called an irredeemable debenture. The debenture holder cannot demand repayment as long as the company is a going concern. Issuing company has to pay interest periodically. But all debentures, whether redeemable or irredeemable become payable on the company going into liquidation. However, after the commencement of the Companies Act, 2013, now a company cannot issue perpetual or irredeemable debentures.

4. On the basis of Registration, debentures may be classified as

(A) A Registered Debentures: Registered debentures are issued in the name of a particular person, whose name appears on the debenture certificate and who is registered by the company as holder on the Register of debenture holders.

(B) Bearer debentures: Bearer debentures on the other hand, are issued to bearer, and are negotiable instruments, and so transferable by mere delivery like share warrants.

26.10 Distinction Between Debentures and Shares

S. No	DEBENTURES	SHARES
1.	Debentures constitute a loan.	Shares are part of the capital of a company.
2.	Middle and Lower Level	Top level
3.	Debenture holder gets fixed rate of Interest which carries a priorities over dividend.	Shareholders gets dividends with a varying rate.
4.	Debentures generally have a charge on the assets of the company.	Shares do not carry any such charge.
5.	Debentures can be issued at a discount without restrictions.	Shares cannot be issued at a discount.
6.	The rate of interest is fixed in the case of debentures	Whereas on equity shares, the dividend varies from year to year depending upon the profit of the company and the Board of directors decision to declare dividends or not.
7.	Debenture holders do not have any voting right	Shareholders enjoy voting right.
8.	Interest on debenture is payable even if there are no profits i.e. even out of capital.	Dividend can be paid to shareholders only out of the profits of the company and not otherwise.
9.	Interest paid on debenture is a business expenditure and allowable deduction from profits.	Dividend is not allowable deduction as business expenditure.
10.	Return of allotment is not required for allotment of debentures.	Return of allotment in e-Form No. 2 is to be filed for allotment of shares.

DO YOU KNOW?

Navratnas Companies

1. Bharat Electronics Limited (BEL)
2. Container Corporation of India (CONCOR)
3. Engineers India Limited (EIL)
4. Hindustan Aeronautics Limited (HAL)
5. Hindustan Petroleum Corporation Limited (HPCL)
6. Mahanagar Telephone Nigam Limited (MTNL)
7. National Aluminium Company (NALCO)
8. National Buildings Construction Corporation (NBCC)
9. National Mineral Development Corporation (NMDC)
10. Neyveli Lignite Corporation Limited (NLCIL)
11. Oil India Limited (OIL)
12. Power Finance Corporation
13. Power Grid Corporation of India Limited
14. Rashtriya Ispat Nigam Limited
15. Rural Electrification Corporation
16. Shipping Corporation of India (SCI)

DO YOU KNOW?

Maharatnas Companies

1. National Thermal Power Corporation (NTPC)
2. Oil and Natural Gas Corporation (ONGC)
3. Steel Authority of India Limited (SAIL)
4. Bharat Heavy Electricals Limited (BHEL)
5. Indian Oil Corporation Limited (IOCL)
6. Coal India Limited (CIL)
7. Gas Authority of India Limited (GAIL)
8. Bharat Petroleum Corporation Limited (BPCL)

DO YOU KNOW?

How to propose the Name for a Company

1. Plural version of any of the words appearing in the name of an existing company is not allowed.
   Example: Suppose a company exists in the name of "Eswar equipment Private Limited Company", then the name of "Eswar equipments Private Limited Company" will not be proposed.
   Similarly, The following changes in existing company name is also not allowed
2. Changes in Type, Letter Case, Spacing or Punctuation marks
3. Joining words or separating words before or after the company name
4. Different tense or number of the same word
5. Different phonetic spellings or spelling variations
6. Intentionally misspelled words
7. Addition of internet related designation
8. Addition of common names or titles
9. Addition of name of place
10. Different combination of the same words
11. Translation of a word

Key Words

One Person company (OPC)	Promoter
Misrepresentation of facts	Incorporation
Share and Share Capital	Shares
Sweat Equity Shares	Bonus Shares
Right Shares	Share Certificate

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Exercise

I. Choose the Correct Answers:

1. **The Company will have to issue the notice of situation of Registered Office to the Registrar of Companies within _____ days from the date of incorporation.**

   (a) 14 days (b) 21 days
   (c) 30 Days (d) 60 Days

2. **How does a person who envisages the idea to form a company called?**

   (a) Director (b) Company Secretary
   (c) Registrar (d) Promoter

3. **Which of the following types of shares are issued by a company to raise capital from the existing shareholders?**

   (a) Equity Shares (b) Rights Shares
   (c) Preference Shares (d) Bonus Shares

4. **The shares which are offered to the existing shareholder at free of cost is known as ___________.**

   (a) Bonus Share (b) Equity Share
   (c) Right Share (d) Preference Share

5. **The shares which are offered first to the existing shareholder at reduced price is known as ______________.**

(a) Bonus Share (b) Equity Share

(c) Right Share (d) Preference Share

Answers:

1	c	2	d	3	b	4	a	5	c

II. Very Short Answer Questions:

1. What are the four stages of formation of a company?
2. What is Bonus Shares?
3. What is Right Shares?
4. What is Debentures?

III. Short Answer Questions:

1. What do you understand by Issue of Securities at Premium?
2. Explain different kinds of Preference shares. (any 3)

IV. Long Answer Questions:

1. Write the differences between Shares and Debentures. (any 5)
2. What are the various kinds of Debentures? (any 5)

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