

# UNIT 3

## **The Companies Act 2013: Meaning and types**

### **Meaning of a Company**

A company, derived from the Latin word "companis," refers to an organized group of individuals with shared objectives conducting business or other activities. Legally, it is recognized as a distinct entity, separate from its members. A company is a "body corporate," meaning it exists independently of its owners. This legal separation grants the company rights and responsibilities similar to an individual and offers advantages, such as limited liability for shareholders.

### **Characteristics of a Company**

The nature of a company under the Companies Act, 2013 includes:

- **Separate Legal Entity:** Once incorporated, a company operates as its own entity, capable of owning property, incurring debt, and entering contracts, independent of its shareholders.
- **Incorporated Association:** A company must be incorporated or registered under the Companies Act. Minimum no. of people is 7 for public company, 2 for private and one for one-person company
- **Limited Liability:** Shareholders are only liable to the extent of their shares or guarantees.
- **Perpetual Succession:** A company's existence is not affected by changes in membership.
- **Transferability of Shares:** Ownership in the form of shares can be transferred freely, particularly in public companies.
- **Capacity to Sue and Be Sued:** A company can initiate or face lawsuits in its own name.

### **Types of Companies :**

**Public Company:** Section 2(71) states that a public company means a company which:

- a. is not a private company

b. has a minimum paid-up share capital of 5 lakh rupees or such higher paid-up capital as may be prescribed. It may be formed by 7 or more persons. The securities of a public company may quote on stock exchange. The provisions contained in the law for the free transferability of shares in a public company is found on the principle that members of the public must have the freedom to purchase and every shareholder the freedom to transfer.

### **Private Company:**

Section 2(68): "Private Company means a company having a minimum paid up share capital of one-lakh rupees or such higher paid up share capital as may be prescribed. The words private limited must be added at the end of its name by a private limited company."

### **One-Person Company:**

A single person can constitute a company under the OPC concept. Central Govt. provides a simpler compliance regime for small companies. OPC is a one shareholder corporate entity, where legal and financial liability is limited to the company only. An OPC shall have a minimum of one director, and may be formed as a company limited by shares or limited by guarantee, or an unlimited liability company. Only a natural person who is an Indian citizen and resident in India is eligible to incorporate an OPC and shall be a nominee for the sole member of the company.

### **Small Company:**

As per section 2(85): "A small company means a company other than a public company" whose paid up capital ranges from 60 lakh to 5 crore and turnover ranges from 2 crores to 20 crores.

### **On-Basis of Incorporation:**

-Statutory Company – Constituted by special act of Parliament or State Legislature. (RBI, CIC)

-Registered Company – Companies registered under the Companies Act 2013 or under any previous law

### **On-Basis of Liability:**

-Unlimited Liability Company-The members of such companies are liable for the company's debts in proportion to their respective interests in the company and their liability is unlimited

-Companies limited by guarantee – The members of a guarantee company are in effect placed in the position of guarantors of the company's debts up to the agreed amount.

-Companies limited by shares – A company that has the liability of its members limited by the memorandum of association, to the amount if any, unpaid on the shares respectively held by them is termed as a company limited by shares.

### **Other forms of Companies :**

-Associations not for profit, having license under Section 8 of Companies Act, 2013.

-Government Companies

-Foreign Companies

-Holding & Subsidiary Companies

-Associate Companies

-Investment Companies

-Producer Companies

-Dormant Companies

### **Incorporation :**

The incorporation of a company is a significant legal step, granting it a distinct corporate entity status. Under Section 3(1) of the Companies Act, 2013, a company can be formed for any lawful purpose by:

1. **Seven or more individuals** if it is to be a public company.
2. **Two or more individuals** if it is to be a private company.
3. **One individual** for a One Person Company (a private company).

## **Preliminary Steps for Incorporation**

Promoters must complete specific preliminary steps before applying for the company's incorporation:

1. **Name Selection:** Under Section 4(2), the proposed name must not be undesirable or too similar to an existing company name. Promoters may apply using Form 1 A, submitting up to six name choices.
2. **Digital Signature:** The applicant's digital signature must accompany the form, and a Rs. 500 fee is applicable. If the proposed name is unavailable, a new application with a different name must be submitted.
3. **Name Reservation:** Upon approval, the name is reserved for 20 days, during which promoters must submit required incorporation documents (Forms 1, 18, and 32).
4. **Professional Assistance:** Promoters should hire chartered accountants, attorneys, and other professionals to prepare the necessary documents.
5. **Drafting Memorandum and Articles of Association:** These documents must be drafted, approved, and printed. The Memorandum of Association (MoA) defines the company's scope and authority.
6. **Signing of Documents:** At least seven subscribers (or two for a private company) must sign the Memorandum and Articles of Association, specifying their subscribed share quantity and type.

## **Memorandum of association :**

The **Memorandum of Association (MoA)** is a crucial document in the incorporation process of a company. It outlines the essential details that define the company's identity and legal boundaries, functioning as a charter that regulates the company's external affairs and limits its scope of operations. Under the Companies Act, 2013, the MoA includes specific clauses that must be included when establishing any new company.

## Key Clauses in the Memorandum of Association

### 1. Name Clause

- The MoA must include the name of the company. The name signifies the legal existence of the company and differentiates it from other entities.
- Public companies are required to include "Limited" (Ltd.) and private companies "Private Limited" (Pvt. Ltd.) after their names.

### 2. Registered Office Clause

- This clause specifies the state where the company's registered office is located. The exact address must be provided within 30 days of incorporation.

### 3. Object Clause

- The Object Clause is critical because it defines the scope of activities the company can undertake. It is divided into three parts:
  - **Primary Objects:** The main activities of the company.
  - **Other Objects:** Additional objectives outside the primary ones.
  - **Geographical Scope:** Non-trading companies must specify the Indian states in which they intend to operate.
- The company cannot engage in activities outside its stated objects without an amendment to the MoA.

### 4. Liability Clause

- This clause specifies the extent of liability of the company's members. It states whether members' liabilities are limited by shares or by a guarantee.

### 5. Capital Clause

- It specifies the total number of shares and their par (face) value. This clause helps potential investors understand the maximum equity the company can issue.

## 6. Subscription Clause

- The Subscription Clause includes a declaration by each subscriber to the memorandum, stating the number of shares they agree to take.

### **Articles of association:**

The Articles of Association (AoA) is a key document that governs the internal management and operational rules of a company. Unlike the Memorandum of Association (MoA), which defines the company's external objectives and scope, the AoA provides a framework for managing the company's day-to-day operations. It contains the regulations related to the rights, duties, and powers of the company's members, directors, and officers.

#### **1. Share Capital and Rights of Shareholders:**

- The AoA defines rules on issuing, transferring, and allotting shares, detailing shareholder rights attached to various shares (like equity or preference) and dividend distribution procedures.

#### **2. Directors' Appointment, Powers, and Duties:**

- This section outlines the criteria for director appointments, their roles, powers, and responsibilities, including the structure and procedures for board meetings, voting, and removal.

#### **3. Meetings and Voting Procedures:**

- It details procedures for holding general meetings (AGM, EGM), quorum requirements, notice periods, voting rights, proxies, and rules for passing resolutions.

#### **4. Transfer and Transmission of Shares:**

- AoA sets rules on transferring shares, with specific restrictions for private companies, and guidelines for transmitting shares in cases of a shareholder's death or incapacity.

#### **5. Dividend and Reserve Policy:**

- This outlines how dividends are declared and distributed, specifies the process for payments, and includes policies for creating reserves or funds for future use.

**6. Accounts and Audit:**

- It describes how financial records are prepared, audited, and accessed, outlining the appointment and duties of auditors and shareholders' inspection rights.

**7. Borrowing Powers:**

- This section defines the board's borrowing powers, including limits, types of securities that can be issued, and necessary shareholder approvals.

**8. Winding Up:**

- AoA includes procedures for winding up or liquidating the company, detailing roles and responsibilities for managing assets and liabilities during dissolution.

**9. Indemnity and Liability:**

- It may provide indemnity for directors and officers against certain liabilities and define the extent of members' financial liability

**Distinction b/w MOA & AOA**

1. MOA is the charter of the company and defines the fundamental conditions and objects for which the company is granted incorporation. AOA are the rules and regulations framed to govern the internal management of the company.

2. Clauses of MOA cannot be easily altered. They can be altered in accordance with the mode prescribed by the Act or by the permission of Central Govt. or the court. In the case of AOA, members have a right to alter the articles by a special regulation.

3. MOA cannot include any clause contrary to the provisions of the Companies act. The AOA is subsidiary both to the Companies Act & the MOA.

4. The MOA generally defines the relation between the company and outsiders, while the AOA regulate the relationship between the company and its members and between the members inter se.

## Prospectus

A prospectus is an invitation issued to the public to offer purchase/subscribe any securities of the company. Section 2(70): “Any document described or issued as a prospectus and includes a red herring prospectus referred to in Section 32, or shelf prospectus referred to in Section 31 or any notice, circular, advertisement or any other document inviting offers from the public for the subscription or purchase of any securities of a body corporate.

### Types:

i. **Red Herring Prospectus:** When a company decides to attract investors to invest in their company, they use red herring prospectus. The price and quantum are not mentioned or disclosed.

ii. **Abridged Prospectus:** It contains all the salient features of a prospectus (which might be too large), it gives them a basic idea of the company and contain all the important and materialistic information.

iii. **Shelf Prospectus:** Only selected companies bring this prospectus as all companies are not eligible for the same. (Normally finance companies are eligible) It has a validity of one year. Every time a company wishes to raise funds, they must file their prospectus to the regulators for approval (Stock Exchange & ROC). If a company submits their Shelf Prospectus, they don't have to file the prospectus again and again while raising funds for that particular year.

iv. **Deemed Prospectus:** When a company agrees to allot shares to an issuing house (which is a different company) which they will later sell to the public, then the document by which the offer is made is deemed to be a prospectus.

(The issuing house should issue the share to the public 6 months after the agreement with the company whose shares are to be issued)

### Role of Directors

1. Act in accordance with the articles of the company.
2. Act in good faith in order to promote the objects of the company, for the benefit of its members as a whole, and in the best interest of the company, its employees, the shareholders, the community and for the protection of environment.



3. Exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgement.
4. Not involve in a situation in which he may have a direct or indirect interest that conflicts, or possibly may conflict with the interest of the company.
5. Not achieve or attempt to achieve any undue gain or advantage either to himself or his relatives, partners or associates.
6. Not assign his office and any assignment so made shall be void.

### **Shares and Types of Shares**

A share is a unit of ownership in a company's share capital, as defined under Section 2(84) of the Companies Act, and generally represents a portion of the company's stock unless a distinction is explicitly made. Per Section 45, companies with share capital must have identifiable members, although this doesn't apply to shares recorded in a depository under beneficial ownership.

**Types of Shares** include:

1. **Equity Shares:** These shares represent ownership and usually come with voting rights but may not have fixed dividends, making them subject to company performance. They are common shares issued to general investors.
2. **Preference Shares:** These shares provide dividends at a fixed rate before equity shareholders receive theirs and are often non-voting. They are prioritized during liquidation.
3. **Sweat Equity Shares:** Issued at a discount or for non-cash consideration, these shares reward directors or employees for contributing intellectual property or valuable expertise. Under Section 2(88), the issuance must be backed by a special resolution and is capped at 15% of the company's paid-up capital or ₹5 crore in value, whichever is higher.
4. **Bonus Shares:** When a company has excess distributable profits, it can issue bonus shares to existing shareholders without requiring payment, effectively converting profits into capital shares.
5. **Rights Issue:** This is an offer made to existing shareholders to purchase additional shares in proportion to their holdings, typically at a favorable price. It is optional and can be transferred by the shareholder.

## **Company Meetings**

These meetings are general meetings as they are attended by all the members, the management of the company is undertaken through meetings of the company's shareholders where major decisions are to be taken. Types of general meetings are:

1. **Statutory meeting:** The first meeting of the members of the company after it commences the business. It is held once in the lifetime of the company.
2. **Annual General meeting:** AGM is a required meeting under the ordinance. It is an annual meeting through which the shareholders control the affairs of the company. They may raise questions about the affairs of the company including its accounts. It is therefore, the annual general meeting of the company that protects the interest of the shareholders and must be held every year.
3. **Extraordinary General Meeting:** All general meetings other than AGM & Statutory meetings of the company are called <sup>^</sup>. Such meetings are called to deal with some urgent special business that cannot be postponed till AGM. The notice of such meeting shall be sent to the members at least 21 days before the date of meeting

## **The Limited Liability Partnership Act 2008**

### **Meaning & Nature of Limited Partnership**

Section 2(1) of the LLP Act define LLP as "Limited Liability partnership means a partnership formed and registered under this Act." A limited liability partnership is a body corporate, which is an artificial person, having a separate legal entity, with a perpetual succession, a common seal and carrying limited liability.

### **Characteristics of LLP**

- 1) **Body Corporate** – A body corporate is generally taken to be a legal entity distinct and separate from its constituents and having perpetual existence and a common seal with capacity to hold property, sue and be sued in its own name.

2) **Artificial Legal Person** – A LLP is artificial legal person in the sense that it is created by a process other than natural birth and is clothed with many of the rights of a natural person. As a rule, LLP may enter into contract through the agency of natural persons.

3) **Separate Legal Entity** – A LLP is a legal person having the right to own and transfer property. No partner can either individually or jointly claim any ownership rights in the assets of LLP during its existence or in its winding up. It can sue and be sued in its own name by its partners and outsiders

4) **Perpetual Existence** – A LLP's life does not depend upon the death, insolvency,

retirement of any or all partners. The transferability of economic rights of a partner helps to preserve the perpetual existence of LLP.

5) **Common Seal** – It is optional for LLP to have a common seal. The name of LLP shall be engraved on the seal and shall be used as a substitute of its signature.

6) **Limited Liability** – Every partner of LLP for the purpose of business of LLP, would be an agent of LLP but not of other partners. Liability of partners shall be limited only to the extent of their investment except in case of unauthorized acts, frauds or negligence.

### **Nature of LLP (Section 3)**

1. An LLP is a body corporate formed and incorporated under the LLP Act and as such it is a legal entity separate from that of its partners.

2. An LLP shall have perpetual succession.

3. Any change in the partners of an LLP shall not affect the existence, right or liabilities of the LLP.

### **Formation**

Formation or Incorporation of LLP is described briefly below:

1) Before incorporation, find out the availability of proposed name from the ROC, the name chosen must have Limited Liability Partnership or LLP as last word of its name, and must not be undesirable in the opinion of Central Govt., or a name which is identical or too nearly resemble to that of any other partnership form, or LLP or body corporate.

- 2) The application for reservation of name is to be registered to ROC having jurisdiction where the registered office of LLP is to be situated.
- 3) Once the name is registered, two or more person associated for carrying lawful business will be required to subscribe their name to an Incorporation Document. It shall be filled in such manner with such fees as prescribed with ROC of state. A statement stating that all requirements of LLP act and rules have been complied with, shall be filled. (signed by a CA or cost accountant or Company Secretary)
- 4) Contents of Incorporation Document: Name, Proposed Business, Address, Name & Address of each of persons who are to be partners, Name & Address of designated partners, such other information concerning the proposed LLP as may be prescribed.
- 5) ROC will scrutinize the documents, and if they are in order, he will register LLP within a period of 14 days. On registration, ROC shall issue a Certificate of Incorporation which serves as a conclusive evidence of the fact that the LLP is duly registered.

#### **Partners & their relations :**

Any individual, An Indian company, any other LLP, a foreign LLP and a foreign Company can be partners in an LLP. Every LLP shall have at least 2 partners, with no upper limit on the number of partners. There should be at least 2 designated partners.

**Designated Partner's Identification Number (DPIN):** Every partner is required to obtain a DPIN which means an identification no. which the Central Government may allot to an individual intending to be appointed as designated partner. (Directors' Identification No. is issued to individual for becoming a director of a company under Companies Act)

**Liabilities of Designated Partner:** He is responsible for doing all acts, matters and things as are required to be done by the limited liability partnership in respect of compliance with provisions of the Act. He is liable to all penalties imposed on LLP for any contravention of any provision of Act

Schedule I (Contains provisions regarding matters relating to mutual rights & duties of partners)

1. All partners of LLP are entitled to share equally in capital, profits and losses of the LLP.

2. LLP shall indemnify each partner in respect of payments made and personal liabilities in the ordinary conduct of business.
3. Every partner shall indemnify the LLP for any loss caused to it by his fraud in conduct of business.
4. Every partner may take part in management of LLP.
5. No partner shall be entitled to remuneration for acting in the management of LLP.
6. No partner may be introduced as a partner without the consent of all the existing partners.
7. Any matter relating to LLP shall be decided by a resolution passed by majority of partners, with each partner having one vote.
8. Each partner shall render true accounts and full information of all things affecting the LLP to any partner.

#### **Extent & limitation of Liability :**

**Extent of LLP's Liability:** An obligation of the LLP, whether arising out of contract or otherwise, will solely be the obligation of LLP. The liabilities of LLP shall be met out of the property of LLP. This is the greatest advantage of LLP, conferring limited liability upon its partners as compared to the traditional partnership, where the partners are exposed to unlimited personal liability.

**Extent of Partner's Liability:** Partner is not personally liable, directly or indirectly for an obligation of the LLP, whether arising out of contract or otherwise, solely by reason of his being a partner of LLP. A partner of LLP would be personally liable for his wrongful act or omission done without its authority, but would not be liable for any other partner's wrongful act or omission.

**Unlimited Liability in case of Fraud:** Where an act by an LLP or a partner is done with intent to defraud creditors or any other person, the liability of partners who acted with intent to defraud shall be unlimited for all or any of the debts or other liabilities of LLP.