



# **Business Environment & Law**

Law Relating to Corporate Business Entities



## **Law Relating to Corporate Business Entities**

### **Block**

# **5**

## **THE SOCIO-POLITICAL ENVIRONMENT OF BUSINESS**

### **UNIT 14**

**Insolvency and Bankruptcy Code, 2016**

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**1-36**

### **UNIT 15**

**A Brief Note on Companies Act, 2013**

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**37-100**

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## **BLOCK V: THE SOCIO-POLITICAL ENVIRONMENT OF BUSINESS**

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*The block* deals with the fundamental concepts relevant to Insolvency and Bankruptcy code 2016 and Companies Act 2013 and consists of two units 14 and 15. The unit no 14 provides an introduction to Insolvency and Bankruptcy code 2016 unit no 15 discusses the various aspects of Companies Act 2013

*Unit 14 Insolvency and Bankruptcy Code, 2016* discusses the dimensions and components of New Institutional Framework proposed under the Code, relationship between Insolvency, Bankruptcy, and Liquidation, legal dimensions of Insolvency and Bankruptcy Code, 2016 as an economic reform, Overview of erstwhile insolvency laws, Corporate insolvency resolution process, drafting resolution plan, liquidation process of the Corporate Debtor, Fast Track Insolvency Resolution Process, Voluntary Liquidation Process, insolvency resolution and bankruptcy for individuals and firms bankruptcy

*Unit 15 A Brief Note on Companies Act, 2013* deals with the Salient features of a company, types of companies, incorporation of a Company prospectus and allotment of Securities, Issue of shares and debentures, Company management and administration declaration and payment of dividend, accounts of companies, meetings of board and its powers, appointment and remuneration of managerial personnel, company meetings, resolutions, inspection, inquiry, and investigation.



## Unit 14

### Insolvency and Bankruptcy Code, 2016

#### Structure

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- 14.1 Introduction
- 14.2 Objectives
- 14.3 New Institutional Framework proposed under the Code
- 14.4 The Relationship between Insolvency, Bankruptcy, and Liquidation
- 14.5 Legal Dimensions of Insolvency and Bankruptcy Code, 2016 as an Economic Reform
- 14.6 Overview of Erstwhile Insolvency Laws
- 14.7 Corporate Insolvency Resolution Process
- 14.8 Drafting Resolution Plan
- 14.9 The Liquidation Process of the Corporate Debtor
- 14.10 Fast Track Insolvency Resolution Process
- 14.11 Voluntary Liquidation Process
- 14.12 Insolvency Resolution and Bankruptcy for Individuals and Firms
- 14.13 Bankruptcy
- 14.14 Summary
- 14.15 Glossary
- 14.16 Suggested Reading / Reference Material
- 14.17 Answers to Check Your Progress Questions

#### 14.1. Introduction

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In the previous unit we discussed about the special contracts. The concept agency is an important aspect in the business. We also discussed on the commercial agreements and various clauses incorporated in commercial agreements to

Commercial agreements represent the conditions agreed by the parties and which contain certain clauses that form the basis of the rights and liabilities of the parties involved. We have also discussed contracts related to employment. This unit discusses an important economic and financial reforms brought in bankruptcy laws . A Bankruptcy Law Reforms Committee (BLRC) was constituted in 2014 by the Government of India with a mandate to explore a legal bankruptcy framework for India for improving the global rating of ‘ease of doing business’. It was also envisioned that the new law should facilitate a better and faster debt recovery mechanism in the country. The draft legislation, along with report, was submitted in November 2015 by a panel headed by former law secretary Mr.

## **Block 5: Business Environment and Law**

T.K. Viswanathan. The draft bill has gone through various changes, including changes recommended by the Joint Parliamentary Committee in April 2016. After the Insolvency and Bankruptcy Code, 2016 was cleared by Parliament, on 28.05.2016, the Code was assented by President of India and notified as an Act.

The new law aims to consolidate the existing laws relating to insolvency of companies and limited liability entities (including limited liability partnerships and other entities with limited liability), unlimited liability partnerships and individuals, spread over a number of legislations into a single legislation. The Code draws distinction between insolvency and bankruptcy and provides genuine business failures a second chance to get rehabilitated. If no such possibility exists, the creditors are allowed final say in closing the business and selling the assets to recover their dues under time bound insolvency resolution process. Resolution is adjudicated only by a single tribunal-NCLT (National Company Law Tribunal) for Corporates and LLPs and DRT (Debt Recovery Tribunal) for individuals and others. Comprehensive legal and institutional mechanisms have been carefully crafted to expedite the process. Code introduces shift of decision making on initiating insolvency proceedings -from shareholders and promoters to creditors. In this direction the Code provides an institutional set-up comprising five entities, i.e., Insolvency Professionals Agency, Insolvency Professionals, Information Utilities, Insolvency and Bankruptcy Board of India and Adjudicating Authority.

In addition to financial creditors, the Code empowers the operational creditors and workmen also to initiate the insolvency resolution process upon non-payment of dues. Thus, the Code envisages to promote entrepreneurship, availability of credit to genuine borrowers from banking system and attempts to balance the interests of all stakeholders. The Code thus serves the purpose of a uniform, comprehensive insolvency legislation encompassing all companies, partnerships, and individuals (other than financial service providers).

### **14.2. Objectives**

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By the end of this unit, you should be able to:

- Explain Relationship between Insolvency, Bankruptcy, and Liquidation.
- Define Corporate Insolvency Resolution Process
- Discuss Insolvency Resolution and Bankruptcy for Individuals and Firm.

### **14.3. New Institutional Framework Proposed under the Code**

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The code suggested the following institutional framework to implement the IBC.

- a) **Insolvency Professionals:** These professionals will conduct the insolvency resolution process, takeover the management of a company, assist creditors in the collection of relevant information and manage the liquidation process.



The Code bestows such powers and duties upon the insolvency professional as required to efficiently drive the insolvency and liquidation process.

- b) **Insolvency Professional Agency:** It will accept registration, examine, and certify the insolvency professionals. Such agencies are to be registered with and certified by the Insolvency and Bankruptcy Board of India.
- c) **Insolvency and Bankruptcy Board of India:** The Board shall consist of a Chairperson, three members from the Central Government not below the rank of Joint Secretary or equivalent – one each to represent the Ministry of Finance, the Ministry of Corporate Affairs and Ministry of Law, ex-officio; one member to be nominated by the Reserve Bank of India, ex officio; five other members to be nominated by the Central Government. The Chairperson and the other members shall be persons of ability, integrity and standing, who have shown capacity in dealing with problems relating to insolvency or bankruptcy and have special knowledge and experience in the field of law, finance, economics, accountancy, or administration. This body will have regulatory over-sight over the Insolvency Professional, Insolvency Professional Agencies and Information Utilities. Under the Board's supervision, these agencies will develop professional standards, codes of ethics and exercise a disciplinary role over errant members leading to the development of a competitive industry for insolvency professionals. The Board is responsible for making guidelines and regulation on matters of insolvency and bankruptcy.
- d) **Insolvency Information Utilities:** The Code provides for information utilities which would collect, collate, authenticate, and disseminate financial information from listed companies and financial and operational creditors of companies. An individual insolvency database is also proposed to be set up with the goal of providing information on insolvency status of individuals.

#### **14.4. The Relationship between Insolvency, Bankruptcy and Liquidation**

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Insolvency, Bankruptcy and Liquidation – the words do not mean the same, but they have a relationship. The following paras provide details on the important relationship between these words:

##### **Insolvency and Bankruptcy defined**

Insolvency is when an individual or organization is unable to meet its outstanding financial debt towards its lender as it becomes due. Insolvency can be resolved by way of changing the repayment plan of the loans or writing off a part thereof. If it cannot be resolved, then a legal action may lie against the insolvent and its assets will be sold to pay off the outstanding debts. Generally, an official

## **Block 5: Business Environment and Law**

assignee/liquidator appointed by the Government of India, realizes the assets, and allocates it among the creditors of the insolvent.

Bankruptcy is a concept slightly different from insolvency, which is rather amicable. A bankruptcy is when a person voluntarily declares himself as an insolvent and goes to the court. On declaring him as 'bankrupt', the court is responsible to liquidate the personal property of the insolvent and hand it out to its creditors. It provides a fresh lease of life to the insolvent.

Insolvency is a financial position that arises due to the inability to pay off the outstanding dues to the creditors as the assets of entity are not enough to meet the liabilities. The continuous state of insolvency would lead to bankruptcy. If individual / company is not able to meet its financial obligations due to excess of liabilities over assets, it is insolvency.

Insolvency is technically of two types-

- The company is unable to pay its debts as they fall due (the "cash-flow test") and
- The value of a company's assets is less than the amount of its liabilities, considering its contingent and prospective liabilities (the "balance-sheet test").

In this context Code attempts to bring a shift from balance sheet to cash flow test and uses a cash flow test for solvency rather than the balance sheet test. Continued insolvency will lead to bankruptcy for non-corporates and liquidation of corporates.

While insolvency is a financial situation which arises due to inability to pay off the debts due to inadequate assets, bankruptcy is a legal situation wherein application is made to an adjudicating authority for declarations as bankrupt. This will continue until discharge that concludes the incompetence of debtor. All the debtor's assets are put to valuation and the sale of these assets may be used to repay a part of outstanding debt.

A bankrupt would be a legally confirmed insolvent whereas all insolvencies might not lead to be declared as bankruptcies. Thus, insolvency approach has two options – resolution and recovery or closing the business and sale. Bankruptcy is a legal process by which an insolvent debtor seeks relief from legal suits from different types of creditors. On declaring the person as bankrupt, the adjudicating authority takes over the responsibility to sell the property of the insolvent and distribute the property amongst the creditors of the insolvent debtors.

“Liquidation” is the winding up of a corporation or incorporated entity under Company Law. There are many eligible persons/ entities that can apply for Liquidation, those being: (a) The Regulatory Bodies; (b) The Directors of a Company; (c) The Shareholders of a Company; and (d) An Unpaid Creditor of a

Company and others included in Company Law. Liquidation is dissolving of a company. An insolvent company also can decide to liquidate itself voluntarily. Code offers simpler process for voluntary Liquidation.

#### **14.5. Legal dimensions of Insolvency and Bankruptcy Code, 2016 as an Economic Reform**

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As per Preamble to the Code this is an Act to consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals. This should be in a time bound manner for maximisation of value of assets of such persons, to promote entrepreneurship, viability of credit and balance the interests of all the stakeholders. This includes alteration in the order of priority of payment of Government dues, to establish an Insolvency and Bankruptcy Board of India and for matters connected therewith or incidental thereto.

The following Acts were modified / amended in sync with Insolvency and Bankruptcy Code.

- Amendments to Companies Act, 2013
- Amendments to Indian Partnership Act, 1932
- Amendments to the Central Excise Act, 1944
- Amendments to the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI)
- Amendments to the Sick Industrial Companies (Special Provisions) Repeal Act, 2003
- Amendments to the Income Tax Act, 1961
- Amendments to the Customs Act, 1962
- Amendments to the Recovery of Debts Due to Banks and Financial Institutions Act, 1993
- Amendments to the Payment and Settlement Systems Act, 2007
- Amendments to the Limited Liability Partnership Act, 2008
- Amendments to the Finance Act, 1994
- The Presidency–Towns Insolvency Act, 1909
- The Provincial Insolvency Act, 1920

Code will have overriding effect on all other existing laws.

This code is a Special Act and its provisions have overriding effect over other laws. There is only one adjudicating authority under the Code. It prohibits the Civil Courts to interfere with the application pending before the adjudicating authority.

## **Block 5: Business Environment and Law**

### **Institutional Framework Proposed under the Code**

The Code suggested establishment of empowered statutory authorities to facilitate speedier adjudication.

The Central Government has constituted National Company Law Tribunal (NCLT) under section 408 of the Companies Act, 2013 (18 of 2013) w.e.f. 1<sup>st</sup> June 2016. National Company Law Tribunal (NCLT) will be the Adjudicating Authority for Corporates, companies, limited liability partnerships and other body corporates; whereas Debt Recovery Tribunal (DRT) is the Authority for individuals and partnership firms.

### **Time bound Execution**

Time bound execution of the law through timelines is mandated by Code. The details are as follows:

- Resolution process to complete within 180 (+ 90) days - failing which company liquidates compulsorily. The process is easy for investors to exit failed ventures. It also proposes fast track resolution for corporate insolvency within 90 days with simple debt structures.
- The resolution process will have to be completed within a maximum period of 180 days from the date of registration of the case. This period may be extended by 90 days if 75% of the financial creditors agree.
- The process will involve negotiations between the debtor and creditors to draft a resolution plan .In case of insolvency resolution, negotiations between the debtor and creditors will be supervised by insolvency professional. In the event of a positive outcome of a repayment plan, agreed upon by a majority of the creditors, it will be submitted to the adjudicator. Otherwise the matter will precede to bankruptcy resolution.

The Code has been drafted to provide single window clearance to the applicant whereby the appropriate relief is obtained from the same authority to whom the application is made.

In view of paradigm shift of asset possession from debtors to the creditors, the code proposes that the creditors committee can decide either to revive a distressed company or liquidate its assets to pay off outstanding dues.

The Code provides a Fresh Start Process under which an individual will be eligible for a debt waiver of up to ` 35,000 subject to eligibility.

The code widens the categories of eligible applicants to initiate resolution process by including:

- a) Any company incorporated under the companies act, 2013 or under any previous company law;
- b) Any other company governed by any special Act;

- c) Any Limited Liability Partnership incorporated under Limited Liability Partnership Act, 2008;
- d) Such other body incorporated under any law for the time being in force, as the Central Government may specify;
- e) Partnership firms and individuals. In relation to their insolvency, liquidation, voluntary liquidation, or bankruptcy as the case may be.

### **Exemptions available in IBC**

Part III of the code pertaining to insolvency of individuals and firms does not apply to State of Jammu & Kashmir.

The code is also not applicable to financial service providers like Banks, Financial Institutions, and Insurance companies. (As per subsection 7 of section 3 read with subsection 17).

### **Allowing application on Default**

The code brings in an important shift in approach by allowing application on default.

Any financial or operational creditor(s) can apply for insolvency on default of debt or interest payment. Banks & Asset Reconstruction Companies are to be immensely benefitted in this context.

Classification of creditors is broadened into – Financial creditors (persons to whom financial debt is due) and Operational creditors (Trade creditors, employees etc.).

The Code empowers the operational creditors (workmen, suppliers etc.) also to initiate the insolvency resolution process upon non-payment of dues.

Code does not make any distinction between international and domestic creditors or between classes of financial institutions.

The code proposes shift from treating a defaulting concern as “gone concern” to “going concern” by giving a greater chance that the corporate entity can be saved as a going concern and the productive resources of the economy (labour and capital) are better utilized. In case of insolvency resolution, negotiations between the debtor and creditors will be supervised by insolvency professional. If negotiations succeed, a repayment plan, agreed upon by a majority of the creditors, will be submitted to the adjudicator. If they fail, the matter will proceed to bankruptcy resolution.

Equitable treatment for the interests of all the stakeholders can be brought by making changes in the order of priority of payment of debts. It is remarkable that financial debts owed to unsecured creditors have been kept above the Government’s dues in the list of priorities.

## **Block 5: Business Environment and Law**

**Strict punishment for misuse and malicious violations of law**-The Bill provides that for most offences committed by a debtor under corporate insolvency (like concealing property, defrauding creditors, etc.), the penalty will be imprisonment of up to five years, or with a fine of up to one crore rupees, or with both.

For offences committed by an individual (like providing false information), the imprisonment will vary based on the offence. For most of these offences, the fine will not exceed five lakh rupees.

Avoidance of transactions to be treated as void and will be reversed.

The look back period for 'Preferential transactions' (put creditor in beneficial position as compared to liquidation value) – is two years for related parties and one year for non-related party.

The look back period for 'Undervalued transactions' (gift/ transfer at significantly lesser value) is two years for related parties and one year for non-related parties.

The look back period for 'Extortionate transactions' (result in financial/ operational debt for corporate debtor) is two years preceding the commencement of insolvency.

'Transactions defrauding creditors' (gift/ transfer at significantly lesser value) do not have any look back period.

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### **Check Your Progress-1**

Indicate your choice of the correct answer from the options given by circling it.

1. Identify the code which is not suggested in the New Institutional Framework for IBC.
  - a. Insolvency Professionals
  - b. Insolvency Professional Agency
  - c. Insolvency and Bankruptcy Board of India
  - d. Insolvency Information Utilities
  - e. Insolvency Insurance Board of India
2. A bankruptcy is when a person is declared insolvent by the court (True/ False).
3. Liquidation is the winding up of a corporation or incorporated entity under \_\_\_\_\_ Law
  - a. Negotiable Instrument Act
  - b. Company Law
  - c. Civil Law
  - d. Labor Law
  - e. Criminal Law
4. Identify from the following an Acts which was not modified / amended in sync with Insolvency and Bankruptcy Code.

- a. Amendments to Companies Act, 2013
  - b. Amendments to Indian Partnership Act, 1932
  - c. Amendments to the Central Excise Act, 1944
  - d. Partnership Act 1932
  - e. Amendments to the Income Tax Act, 1961
5. Identify the maximum period by which the resolution for execution before proceeding for liquidation process.
- a. Resolution process to complete within 90 (+ 90) days
  - b. Resolution process to complete within 180 (+ 45) days
  - c. Resolution process to complete within 180 (+ 60) days
  - d. Resolution process to complete within 180 (+ 90) days
  - e. Resolution process to complete within 90 (+ 90) days

Self-Assessment Questions – 1	
1.	What is the institutional framework for implementation of IBC? ..... .....
2.	Define Insolvency and Bankruptcy. ..... .....
3.	Discuss the punishment for corporate and individuals who have committed offences under IBC. ..... .....

#### 14.6. Overview of Erstwhile Insolvency Laws

The need for an insolvency law in India was first contemplated for the three Presidency towns of Calcutta, Bombay and Madras. The earliest issues of insolvency legislation were incorporated in sections 23 and 24 of the Government of India Act, 1800, which conferred insolvency jurisdiction on the Supreme Court at Fort William and Madras and the Recorder's Court at Bombay. These Courts were empowered to make rules and order for granting reliefs to insolvent debtors. Subsequently the Companies Act dealt with the corporate insolvency law, and the individual insolvency laws which were a century old two Acts, i.e., The Provincial Towns Insolvency Act and the Presidency Towns Insolvency Act. There were multiple overlapping laws and adjudicating forums dealing with financial failure and insolvency of companies and individuals in India. Such provisions relating to insolvency and bankruptcy for companies found their place in the Sick Industrial Companies (Special Provisions) Act, 1985, the Recovery of Debt Due to Banks and Financial Institutions Act, 1993, the Securitization and

## **Block 5: Business Environment and Law**

Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 and recently enacted Companies Act, 2013.

The following sections used to address the insolvency in the financial transactions:

- Chapter XIX & Chapter XX of Companies Act, 2013
- Part VIA, Part VII & Section 391 of Companies Act, 1956
- RDBFI Act, 1993 SARFAESI Act, 2002
- SICA Act, 1985
- The Presidency Towns Insolvency Act, 1909
- The Provincial Insolvency Act, 1920
- Chapter XIII of the LLP Act, 2008

### **Major Amendments for easier adoption of Insolvency Laws**

Except special insolvency legislation for the Presidency-towns, there was no insolvency law in the rural areas. Some rules were incorporated in Chapter 20 of the Code of Civil Procedure, 1877, which conferred jurisdiction on the district Courts.

Prolonged proceedings of the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA) and the winding up provisions of the Companies Act, 1956 have not helped the creditors in speedy recovery and adversely affected the development of the credit markets in India.

SICA is basically remedial and empowered the quasi-judicial body BIFR to make appropriate measures for revival and rehabilitation of potentially viable sick industrial companies and for liquidation of non-viable companies. Where the BIFR concludes that it is not possible to revive the company and that it is just and equitable that the company should be wound up, it shall record and forward its opinion to the concerned High Court and the Court, may order winding up of the company.

SICA provided automatic stay of all legal proceedings and this led to enormous delays in resolution process. Willful defaulters have misused SICA to seek protection and moratorium from recovery proceedings. Unscrupulous promoters took advantage of the process of rehabilitation by manipulating sickness interpretations and defaulters gained time arising out of delay in decision making by BIFR.

Keeping in view the above shortcomings Code has brought important amendments in SICA to serve the objectives of reform.

**Sick Industrial Companies (Special Provisions) Repeal Act:** The provisions of the SICA have been totally wiped off by inserting Sec. 4(b) which inter alia stipulates that 'on the notified date, any appeal preferred to the Appellate Authority or any reference made or inquiry pending to or before the Board or any proceeding of



whatever nature pending under SICA 1985 shall stand abetted'. Option is available to such company to make reference to National Company Law Tribunal within 180 days from the commencement of Insolvency and Bankruptcy Code 2016 in accordance with the provisions of the Code. No fees will be payable for such reference.

Companies Act under the 11th Schedule to the Act almost 36 amendments have been introduced.

The prominent among them are the following:

- Section 2(23) – relating to Company Liquidator Section 2(94) – relating to winding up. Section 8(9) – the rehabilitation and insolvency fund. Section 66(8) – unable to pay the amount of debt or claim.
- Section 224 – wound up under Companies Act. Section 230 – Liquidator.
- Section 272 – Petition for winding up. Section 275(2) – Provisional Liquidator.
- Section 280- Jurisdiction.
- Section 326 – Overriding preferential payments.
- Section 434 – Transfer of pending proceedings.
- Section 468 – Relating to proceedings have been amended. One of the important provisions is under the Section 271 which lays down that 'if a company has acted against the interest of sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality then company can be subjected to winding up'.

Limited Liability Partnership Act 2008: Section 64(c) provided that a limited liability partnership may be wound up by the Tribunal 'if the limited liability partnership is unable to pay its debts.' This clause has been omitted.

#### **Important Amendments in Other Statutes:**

Income Tax Act - Section 178: Section 178 of the Income Tax Act as it stands now requires the liquidator of any company or receiver of assets of the company to give notice to the Assessing Officer and without leave of the Commissioner, Income Tax, he cannot part with any of the assets of the company or the properties until notified. Payment to secured creditors entitled under law to priority is not affected by this provision.

### **14.7. Corporate Insolvency Resolution Process**

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Corporate Insolvency Resolution is a process that enables financial creditors to assess whether the debtor's business is viable and options, if any, for its revival. The Insolvency Resolution Process provides a collective mechanism of decision making to lenders. If the insolvency resolution process fails financial creditors

## **Block 5: Business Environment and Law**

decide that the business of debtor cannot be profitably sustained, and it should be wound up, the debtor will undergo liquidation process.

Let us get familiarized with the terminology used in the insolvency resolution process:

### **Application on default**

Any financial or operational creditor(s) can apply for insolvency on default of debt or interest payment.

### **Appointment of Insolvency Professional (IP)**

IP to be appointed by the regulator and shall be approved by the creditor committee. IP will take over the running of the Company. From date of appointment of IP, power of board of directors will be suspended and vested in the IP. IP shall have immunity from criminal prosecution and any other liability for anything done in good faith.

### **Moratorium period**

Adjudication authority will declare moratorium period during which no action can be taken against the company or the assets of the company. Key focus will be on running the Company on going concern basis. A Resolution plan would have to be prepared and approved by the Committee of creditors.

### **Credit committee**

A credit committee of creditors will be constituted. Related party to be excluded from committee. Each creditor shall vote in accordance to voting share assigned if 75% of creditor approves the resolution plan, same needs to be implemented.

### **Initiation**

Failure to approve resolution plan within specified days will cause initiation of Liquidation. Debtor can also opt for voluntary liquidation by a special resolution in a General Meeting.

### **Liquidator**

The IP may act as the liquidator, and exercise all powers of the BoD. The liquidator shall form an estate of the assets, and consolidate, verify, admit, and determine value of creditors' claims.

### **Important Terminology of IBC**

Some of the important terms frequently used in Insolvency and Bankruptcy Code:

**Corporate Person** means (a) a company as defined under section 2(20) of the Companies Act, 2013; (b) a Limited Liability Partnership as defined in 2(1)(n) of Limited Liability Act, 2008; or, (c) any other person incorporated with limited liability under any law but shall not include any financial service provider.

**A creditor** means any person to whom a debt is owed and includes a financial creditor, an operational creditor, a secured creditor, an unsecured creditor, and a decree-holder.

**Default:** The process of insolvency can be switched on occurrence of default (when the amount of the default is one lakh rupees or more). Under Section 3(12) of the Code says that, default means non-payment of debt when whole or any part or installment of the amount of debt has become due and payable and is not repaid by the debtor or the corporate debtor. However, the Central Government may, by notification, specify the minimum amount of default of higher value which shall not be more than one crore rupees (Section 4).

**Debt** means a liability or obligation in respect of a claim which is due from any person and includes a financial debt and operational debt.

**Claim:** As per Section 3(6) of the Code, *Claim* means a right to payment or right to remedy for breach of contract if such breach gives rise to a right to payment whether or not such right is reduced to judgment, fixed, matured, un matured, disputed, undisputed, legal, equitable, secured or unsecured.

**Financial Debt:** As per Section 5(8) of the Code, *Financial Debt* means a debt along with interest, if any, which is disbursed against the consideration for the time value of money.

**Security Interest** means right, title or interest or a claim to property, created in favour of, or provided for a secured creditor by a transaction which secures payment or performance of an obligation and includes mortgage, charge, hypothecation, assignment and encumbrance or any other agreement.

**A transaction** includes an agreement or arrangement in writing for transfer of assets, or funds, goods, or services, from or to the corporate debtor.

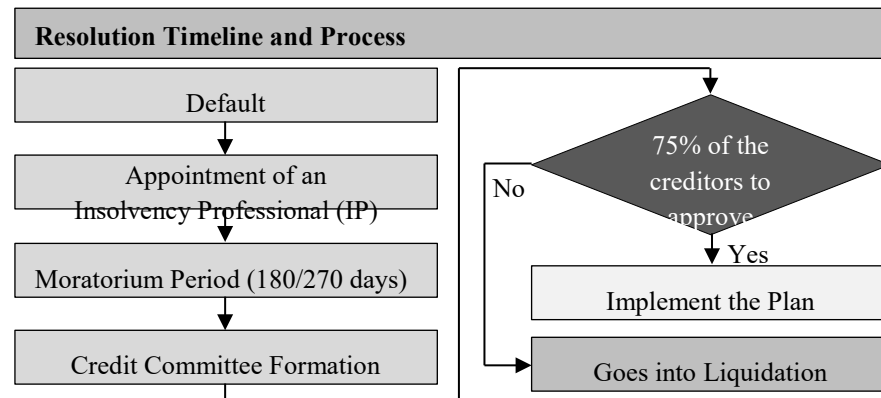
**Transfer** includes sale, purchase, exchange, mortgage, pledge, gift, loan or any other form of transfer of right, title, possession or lien. In case of property-transfer of property means transfer of any property and includes a transfer of any interest in the property and creation of any charge upon such property.

**Operational Debt:** As per Section 5(21) of the Code, *Operational Debt* means a claim in respect of (a) Provision of goods or (b) Provision of services including employment (c) Or a debt in respect of the repayment of dues arising under any law for the time being in force and payable to the Central Government, any State Government or any local authority.

Now let us move to the corporate insolvency resolution process. The following Figure 14.1 covers the resolution process:

## Block 5: Business Environment and Law

**Figure 14.1: Corporate Insolvency Resolution Process**

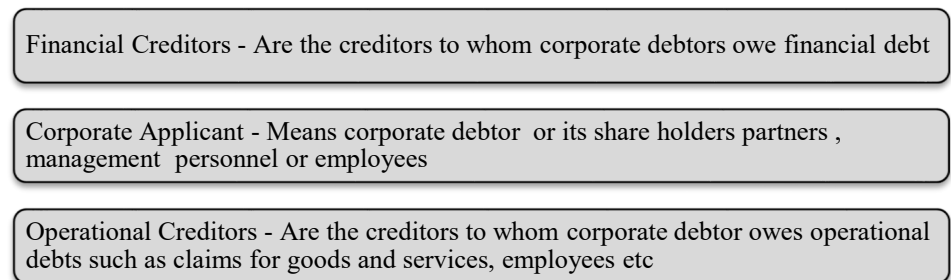


Source: *The Insolvency and Bankruptcy Code, 2016: An Overview 2016 Ernst & Young LLP, published in India.*

### Persons who can file application to Adjudicating Authority

Now let us see (Figure 14.2), who can file application to Adjudicating Authority:

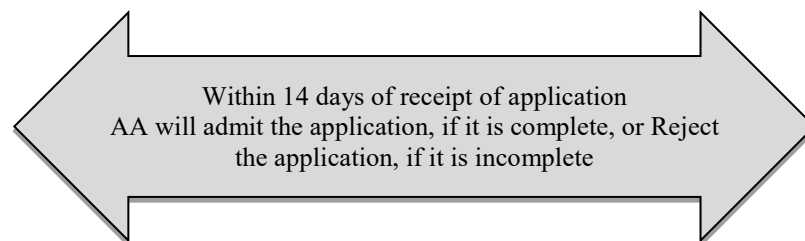
**Figure 14.2: Persons who can File Application to Adjudicating Authority**



Source: *ICFAI Research Center*

Adjudication Authority has a time frame (Figure 14.3) to accept or reject the application.

**Figure 14.3: Time frame for acting upon the application**



Source: *ICFAI Research Center*

### Persons not entitled to make application (Section 11)

The following persons shall not be entitled to make an application to initiate corporate insolvency resolution process (a) a corporate debtor undergoing a

corporate insolvency resolution process; or (b) a corporate debtor having completed corporate insolvency resolution process twelve months preceding the date of making of the application; or (c) a corporate debtor or a financial creditor who has violated any of the terms of resolution plan which was approved twelve months before the date of making of an application or (d) a corporate debtor in respect of whom a liquidation order has been made.

### **Order of priority for distribution of assets**

What is the order of priority for distribution of the assets of the applicant once the issue is settled? The Code suggested the following order for distribution of the assets.

- Insolvency related costs
- Secured creditors and workmen dues upto 24 months
- Other employee's salaries/dues up to 12 months
- Financial debts (unsecured creditors)
- Government dues (up to 2 years)
- Any remaining debts and dues
- Equity

Now let us go through the actual process of adopting IBC when different persons who files application against the principle Debtor-

### **Filing of application before adjudicating authority by a financial creditor**

We are aware that a financial creditor either by itself or jointly with other financial creditors may file an application for initiating corporate insolvency resolution process against a corporate debtor before the Adjudicating Authority when a default has occurred.

*Furnishing of information:* The creditor shall, along with the application furnish — (i) record of the default recorded with the information utility or such other record or evidence of default as may be specified; (ii) the name of the resolution professional proposed to act as an interim resolution professional; and (iii) any other information as may be specified by the Board.

*Determination of default:* The Adjudicating Authority shall, within fourteen days of the receipt of the application, ascertain the existence of a default from the records of information utility or based on other evidence furnished by the financial creditor.

*Order to admit application:* Where the Adjudicating Authority is satisfied that (i) a default has occurred, and the application is complete and there is no disciplinary proceeding pending against the proposed resolution professional, it may, by order, admit such application. The Adjudicating Authority shall communicate the order to the financial creditor and the corporate debtor;

## **Block 5: Business Environment and Law**

Adjudicating Authority shall, before rejecting the application, give a notice to the applicant to rectify the defect in his application within seven days.

*Commencement of corporate insolvency resolution process:* The corporate insolvency resolution process shall commence from the date of admission of the application.

### **Insolvency resolution by operational creditor**

(Section 8) (a) Deals with Serving of demand Notice. On the occurrence of default, an operational creditor shall first send a demand notice and a copy of invoice to the corporate debtor. On receipt of demand notice by corporate debtor corporate debtor shall, within a period of ten days of the receipt of the demand notice or copy of the invoice, bring to the notice of the operational creditor about (i) Existence of dispute, if any, and record of the pendency of the suit or arbitration proceedings filed before the receipt of such notice or invoice in relation to such dispute; (ii) Repayment of unpaid operational debt is evidenced by an attested copy of the record of electronic transfer of the unpaid amount from the bank account of the corporate debtor; and by an attested copy of record that the operational creditor has encashed a cheque issued by the corporate debtor.

*Application for initiation of corporate insolvency resolution process by operational creditor* (Section 9) Filing of application by operational creditor: After the expiry of the period of ten days from the date of delivery of the notice or invoice demanding payment, if the operational creditor does not receive payment from the corporate debtor or notice of the dispute, the operational creditor may file an application before the Adjudicating Authority for initiating corporate insolvency resolution process.

### **How to submit the application by an operational creditor and what happens subsequently?**

The operational creditor shall, along with the application furnish the following documents:

- (i) A copy of the invoice demanding payment or demand notice delivered by the operational creditor to the corporate debtor;
- (ii) An affidavit to the effect that there is no notice given by the corporate debtor relating to a dispute of the unpaid operational debt;
- (iii) A copy of the certificate from the financial institutions maintaining accounts of the operational creditor confirming that there is no payment of an unpaid operational debt by the corporate debtor; and
- (iv) Such other information as may be specified.

An operational creditor can propose for an interim resolution professional during resolution process order of an adjudicating authority. The Adjudicating Authority

shall, within fourteen days of the receipt of the application, by an order admit the application and communicate such decision to the operational creditor if the application made is complete and all the eligibility criteria are satisfied.

Adjudicating authority shall reject the application and communicate such decision to the operational creditor and the corporate debtor if eligibility conditions are not satisfied provided that Adjudicating Authority, shall before rejecting an application which is incomplete, gives a notice to the applicant to rectify the defect in his application within seven days of the date of receipt of such notice.

As per Rule 8 of Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016, application for insolvency process may be withdrawn any time before admission of application, with the permission of Adjudicating Authority.

#### **Time-limit extension for completion of insolvency resolution process**

The resolution professional shall file an application to the Adjudicating Authority to extend the period of the corporate insolvency resolution process beyond one hundred and eighty days, if instructed to do so by a resolution passed at a meeting of the committee of creditors by a vote of seventy-five per cent of the voting shares.

On receipt of an application, if the Adjudicating Authority is satisfied that the subject matter of the case is such that corporate insolvency resolution process cannot be completed *within one hundred and eighty days*, it may by order extend the duration of such process beyond one hundred and eighty days by such further period as it thinks fit, but not exceeding *ninety days* provided that any extension of the period of corporate insolvency resolution process under this section shall not be granted more than once.

#### **Declaration of moratorium and public announcement (Section 13)**

The Adjudicating Authority, after admission of the application, shall, by an order —(a) declare a moratorium, (b) cause a public announcement of the initiation of corporate insolvency resolution process and call for the submission of claims, and (c) appoint an interim resolution professional in the manner as laid down in section. The public announcement is made immediately after the appointment of the interim resolution professional.

Let us discuss some of the issues related to moratorium.

*Moratorium* (Section 14) After the commencement of corporate insolvency resolution, a *status quo* period for 180 days is declared, during which all suits and legal proceedings etc. against the Corporate Debtor are kept in abeyance.

## **Block 5: Business Environment and Law**

According to the section 14 of the Code, on the insolvency commencement date, the Adjudicating Authority shall by order, declare moratorium prohibiting all the following acts:

- (i) The institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgment, decree, or order in any court of law, tribunal, arbitration panel or other authority;
- (ii) Transferring, encumbering, alienating, or disposing of by the corporate debtor any of its assets or any legal right or beneficial interest therein;
- (iii) Any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of its property including any action under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;
- (iv) (a) The recovery of any property by an owner or lessor where such property is occupied by or in the possession of the corporate debtor. (b) The supply of essential goods or services to the corporate debtor as may be specified shall not be terminated or suspended or interrupted during moratorium period.

### **Public Announcement of Corporate Insolvency Resolution Process (Section 15)**

Interim Resolution Professional shall make the Public Announcement immediately after his appointment. “Immediately” refers to not more than three days from the date of appointment of the Interim Resolution Professional. As per Section 15 of the Code, public announcement shall include the following:

- (a) Name & Address of Corporate Debtor under the Corporate Insolvency Resolution Process.
- (b) Name of the authority with which the corporate debtor is incorporated or registered.
- (c) Details of interim resolution Professional who shall be vested with the management of the Corporate Debtor and be responsible for receiving claims.
- (d) Penalties for false or misleading Claims.
- (e) The last date for the submission of the claims.

### **Exemption from Prohibited Acts**

Acts prohibited during Moratorium period, shall not apply to such transactions as may be notified by the Central Government in consultation with any financial sector regulator.



Effect of the order of moratorium: The order of moratorium shall have effect from the date of such order till the completion of the corporate insolvency resolution process:

If the Adjudicating Authority approves the resolution plan or passes an order for liquidation of corporate debtor, the moratorium shall cease to have effect from the date of such approval or liquidation order, as the case may be.

**Appointment, tenure, and Power of interim resolution professional (Section 16)**

The Adjudicating Authority shall appoint an interim resolution professional within fourteen days from the insolvency commencement date. Where the application for corporate insolvency resolution process is made by a financial creditor or the corporate debtor, as the case may be, the resolution professional, as proposed in the application shall be appointed as the interim resolution professional, if no disciplinary proceedings are pending against him.

Where the application for corporate insolvency resolution process is made by creditor and no proposal for an interim resolution professional is made, the Adjudicating Authority shall make a reference to the Board for the recommendation of an insolvency professional who may act as an interim resolution professional. The Board shall, within ten days of the receipt of a reference from the Adjudicating Authority, recommend the name of an insolvency professional to the Adjudicating Authority. The initial term of the interim resolution professional shall not exceed thirty days from the date of his appointment.

**Eligibility for appointment as a resolution professional**

As per Regulation 3 of the Insolvency and Bankruptcy (Insolvency Resolution) Regulation, 2016, an insolvency professional shall be eligible for appointment as a resolution professional for a corporate insolvency resolution process if he and all partners and directors of the insolvency professional entity of which he is partner or director are independent of the corporate debtor i.e.,

- a) He is eligible to be appointed as an independent director on the board of the corporate debtor u/s 149 of the Companies Act, 2013, where the corporate debtor is a company.
- b) He is not a related party of the corporate debtor.
- c) He is not an employee or proprietor or a partner of a firm of auditors or company secretaries in practice or cost auditors of the corporate debtor in the last three financial years.
- d) He is not an employee or proprietor or a partner of a legal or consulting firm that has or had any transaction with the corporate debtor amounting to ten per cent or more of the gross turnover of such firm in the last three financial years.

## Block 5: Business Environment and Law

Resolution professionals are accredited on the basis of qualifications and pass in an eligibility test specified by Board.

### Roles of an Interim Resolution Professional

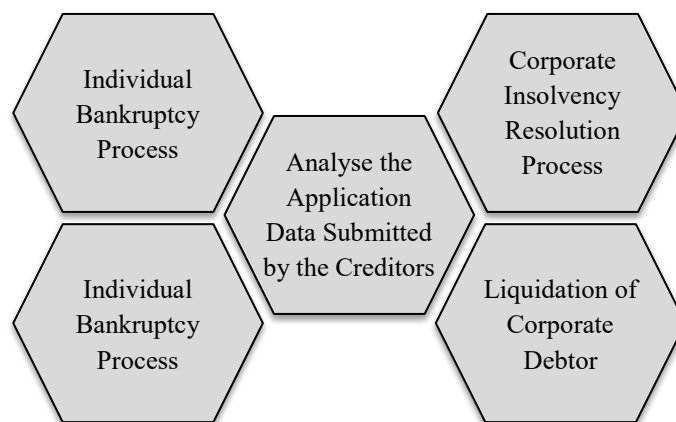
The Resolution Professional's key role is to take over the management of the corporate borrower and guide its business as a going concern –other major functions are:

- Management of affairs of the corporate debtor from the date of his appointment by exercising of Powers of Board/ partners.
- Ensuring reporting and supervision of officers/managers of enterprise under insolvency. Monitoring of financial position by following up all bank accounts.

As per Section 28 of the Code, the resolution professional shall require prior approval of the Committee of Creditors by a vote of seventy-five per cent for critical financial decisions that are likely to enhance liability such as raising any interim finance, to create any security interest over the assets of the corporate debtor or to change the capital structure of the corporate debtor etc.

The Figure 14.4 depicts the functions of an insolvency professional.

**Figure 14.4: Functions of Insolvency Professional**



*Source: ICFAI Research Center*

Every Insolvency Professional shall abide by the following code of conduct:

- To take reasonable care and diligence while performing his duties.
- To comply with all requirements and terms and conditions specified in the bye-laws of the insolvency professional agency of which he is a member.
- To allow the insolvency professional agency to inspect his records.

- To submit a copy of the records of every proceeding before the Adjudicating Authority to the Board as well as to the insolvency professional agency of which he is a member.
- To perform his function in such manner and subject to such conditions as may be specified.

#### **Constituting Committee of creditors (Section 21)**

- (a) The interim resolution professional shall after collection of all claims received against the corporate debtor and determination of the financial position of the corporate debtor, constitute a committee of creditors comprising of all financial creditors of the corporate debtor (Provided that a related party to whom a corporate debtor owes a financial debt shall not have any right of representation, participation or voting in a meeting of the committee of creditors).
- (b) Where the corporate debtor owes financial debts to two or more financial creditors as part of a consortium or agreement, each such financial creditor shall be part of the committee of creditors and their voting share shall be determined on the basis of the financial debts owed to them.
- (c) Where any person is a financial creditor as well as an operational creditor, such person shall be a financial creditor to the extent of the financial debt owed by the corporate debtor, and shall be included in the committee of creditors, with voting share.

#### **Quorum Issues**

Requisite quorum – Members of the committee of creditors representing at least thirty three percent of the voting rights are present either in person or by video/audio means, as per Regulation 22 of the Insolvency and Bankruptcy (Insolvency Resolution) Regulations, 2016 a member of committee of creditors may attend the meeting by video conferencing or other audio and visual means.

If the requisite quorum for committee of creditors is not fulfilled the meeting cannot be held and the meeting shall automatically stand adjourned at the same time and place on the next day. The adjourned meeting shall proceed with the members of the committee attending the meeting.

#### **Non-Existence of Financial Creditors**

As per Regulation 16 of the Insolvency and Bankruptcy (Insolvency Resolution) Regulations, 2016, where the corporate debtor has no financial debt or where all financial creditors are related parties of the corporate debtor, the committee shall be formed comprising of following members: (a) 18 largest operational creditors by value (b) 1 representative elected by all workmen (c) 1 representative elected by all employees. Where the number of operational creditors is less than 18, the committee shall include all such operational creditors.

### **14.8. Drafting Resolution Plan**

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A resolution plan is a proposal prepared with the mutual consent of Debtors and Creditors to resolve the situation of insolvency within a time frame. The resolution plan shall be approved by the Committee of Creditors by a vote of not less than seventy five percent of voting share of the financial creditors.

As per Section 30, the Insolvency Resolution Professional (IRP) within the prescribed time i.e. 180 days or in case of extension 270 days, where Fast Track Resolution within 90 days or in case of extension 135 days, is required to submit the Resolution Plan to Adjudicating Authority (i.e., NCLT) shall be prepared by resolution applicant based on the information memorandum. Insolvency Resolution Process Costs have priority over others in case of winding up. National Company Law Tribunal (NCLT) has powers to reject Resolution plans proposed by the Committee of Creditors.

The Resolution Plan contains: (i) payment of insolvency resolution costs; (ii) repayment of the debts to operational creditors; and (iii) management of affairs of the corporate debtor.

NCLT may also pass orders for the liquidation of the corporate debtor if the Resolution Plan is not filed within 180 days of the Commencement date or such other extended period.

### **14.9. The Liquidation Process of the Corporate Debtor**

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As per Section 33 of the Code, the Adjudicating Authority may order for the liquidation of the Corporate Debtor in the following cases:

- a) Where before the expiry of the Insolvency Resolution Process or within 180 days of the initiation Insolvency Resolution, the Adjudicating Authority does not receive the Resolution Plan.
- b) If the Committee of Creditors before the expiry of the resolution process intimates the Adjudicating Authority, of the decision of the Committee of Creditors that they have passed an order for the liquidation.
- c) Where the Resolution Plan is in contravention with the interest of any person.

#### **Contents of order of liquidation**

The order of liquidator shall contain the following:- (a) An order requiring the corporate debtor to be liquidated in the manner as laid down in Chapter III Part II of the Code. (b) An order for issuing a Public Announcement stating that the corporate debtor is in liquidation. (c) It shall also require such order to be sent to the authority with which the corporate debtor is registered.

As per Section 33 of the Code, the following shall be the effect of passing of an order of liquidation by the Adjudicating Authority:-

- a) No suit or other legal proceeding shall be instituted by or against the corporate debtor. However, the liquidator may institute a suit or other legal proceeding on behalf of the corporate debtor with the prior approval of the Adjudicating Authority.
- b) The legal proceedings in relation to such transactions as may be notified by the Central Government in consultation with any financial sector regulator shall not be affected.
- c) The order for liquidation shall be deemed to be a notice of discharge to the officers, employees, and workmen of the corporate debtor, except in the case where the business of the corporate debtor is continued during the liquidation process by the liquidator.

### **Appointment of Liquidator and the role of liquidator**

The regulation lays down the eligibility criteria to appoint a liquidator. The person should be an insolvency professional not related to any stakeholder entity. Such a professional will not be eligible to be the liquidator if he is representing any of the stakeholders. The regulation has a provision for his remuneration and it also vests a few powers in him.

### **Powers of a Liquidator**

The liquidator has the following powers:

- He has the power to report and retain such a report in an electronic and paper form.
- He has powers to hold complete registers and books of account.
- The Liquidator can appoint professionals for his assistance.
- The Liquidator can consult the stakeholders in all matters relating to liquidation.
- The Liquidator can make public announcements for things listed in the regulations.
- The Liquidator can dispose of claims by checking the authenticity. The liquidator also has the power to ask such claimants for other proof to substantiate the claims. The liquidator shall receive or collect the claims of creditors within a period of thirty days from the date of the commencement of the liquidation process which shall form an estate of all assets of corporate debtor called the liquidation estate.
- The Liquidator can distribute the assets in the manner of priorities of debts laid in the Code.

### **Dealing with the Preferential Transactions by the Liquidator**

Corporate debtor shall be deemed to have given a preference in the following circumstances:

## **Block 5: Business Environment and Law**

- a) If there is a transfer of property or an interest thereof of the corporate debtor for the benefit of a creditor or a surety or a guarantor for or on account of an antecedent financial debt or operational debt or other liabilities owed by the corporate debtor.
- b) If the transfer under clause (a) has the effect of putting such creditor or a surety or a guarantor in a beneficial position than it would have been in the event of a distribution of assets being made in accordance with Section 53 of the Code.

Where the liquidator is of the opinion that the corporate debtor has at a relevant time given a preference in transactions to any of the following persons:-

- a) A related party (other than by reason only of being an employee), during the period of two years preceding the insolvency commencement date.
- b) A person other than a related party during the period of one year preceding the insolvency commencement date.

The liquidator shall apply to Adjudicating Authority for avoidance of such preferential transactions.

As per Section 43(3) of the Code, following transfers shall not be referred to as preference transactions:

- a) The transfer made in the ordinary course of the business
- b) Any transfer creating a security interest in property acquired by the corporate debtor to the extent that (i) such security interest secures new asset and was used by corporate debtor; and (ii) such transfer was registered with an information utility on or before thirty days after the corporate debtor receives possession of such property.

### **Dealing with Undervalued Transactions by the Liquidator**

As per Section 45 of the Code, a transaction shall be considered undervalued where the corporate debtor:

- (a) makes a gift to a person; or (b) enters into a transaction with a person which involves the transfer of one or more of the assets for a consideration which is significantly less than the value of the consideration provided by the corporate debtor and such transaction has not taken place in the ordinary course of business.

*Relevant Period for Avoiding Any Undervalued Transaction:* As per Section 46 of the Code, if in an application, the liquidator or resolution professional demonstrates (a) that the transaction was entered within the period of one year preceding the insolvency commencement date; or (b) that the transaction was made with a related party within a period of two years preceding the insolvency commencement date.

### **Dealing with Credit Transactions in Case of a Corporate Debtor**

As per Section 51 of the Code, if an Adjudicating Authority after examining the application is satisfied that the terms of a credit transaction required exorbitant payments to be made by the corporate debtor, it shall, by an order:- (a) Restore the position as it existed prior to such transaction; (b) Set aside the whole or part of the debt created on account of the extortionate credit transaction; (c) Modify the terms of the transaction; (d) Require any person who is, or was, a party to the transaction to repay any amount received by such person; or (e) Require any security interest that was created as part of the extortionate credit transaction to be relinquished in favour of the liquidator or the resolution professional, as the case may be.

### **Creditor Discretion**

A creditor, within fourteen days of the receipt of decision wherein his claim has been rejected may appeal to the Adjudicating Authority against the decision of the liquidator. As per Section 47 of the Code, where an undervalued transaction has taken place and the liquidator or the resolution professional has not reported it to the Adjudicating Authority, a creditor, member or a partner of a corporate debtor may make an application to the Adjudicating Authority to declare such transactions void and reverse their effect.

### **Procedure for enforcement of security interest by secured creditor**

As per Section 52(4) of the Code, the secured creditor may enforce, realize, settle, compromise or deal with the secured assets after completion of verification by liquidator in accordance with such law as applicable to the security interest and apply the proceeds to recover the debts due to it. The secured creditor may apply to Adjudicating Authority under Section 52(5) of the Code to facilitate the secured creditor to realize such security interest.

### **Ineligible Assets for Recovery in Liquidation**

The following assets shall not be used for recovery in the liquidation:- Any assets owned by a third party, which are in possession of a corporate debtor and which include– (a) Assets held in trust for any third party; (b) Bailment contracts; (c) All sums due to any workman or employee from the provident fund, the pension fund and the gratuity fund; (d) Other contractual arrangements which do not stipulate transfer of title but only use of the assets; (e) Such other assets as may be notified by the Central Government in consultation with any financial sector regulator; (f) Assets in security collateral held by financial services providers and are subject to netting and set-off in multilateral trading or clearing transactions; (g) Personal assets of any shareholder or partner of a corporate debtor as the case may be provided such assets are not held on account of avoidance transactions that may be avoided under this Chapter; (h) Assets of any Indian or foreign subsidiary of the corporate debtor; or (i) Any other assets as may be specified by

## **Block 5: Business Environment and Law**

the Board, including assets which could be subject to set-off on account of mutual dealings between the corporate debtor and any creditor.

### **Waterfall Mechanism of the sale of the liquidated assets**

“Waterfall Mechanism” is the order of priority in which the proceeds from the sale of liquidation assets are distributed.

As per Section 53 of the Code, any insolvency resolution process costs, and the liquidation costs to be paid in full.

According to this section, debts shall rank equally between and among the following:

- Any workmen dues outstanding for a period of twenty-four months preceding the liquidation commencement date.
- Debts which are owed to a secured creditor where such secured creditor has relinquished security. Wages and any unpaid dues owed to employees other than the workmen for a period of twelve months preceding the liquidation commencement date.
- Financial debts owed to unsecured creditors.

Also the following dues shall rank equally between and among the following:- (i) Any amount which is due to the Central Government and the State Government including any amount to be received on account of the Consolidated Fund of India and the Consolidated Fund of a State, if any, in respect of the whole or any part of the period of two years preceding the liquidation commencement date. (ii) All debts owed to a secured creditor for any amount unpaid following the enforcement of security interest.

Any remaining debts and dues to persons like preference shareholders; equity shareholders or partners; any contractual arrangements if disrupting the order of priority under that sub-section shall be disregarded by the liquidator.

### **Dissolution of the Company by the Liquidator**

After the affairs of the corporate person have been completely wound up and its assets are completely liquidated, the liquidator shall make an application to the Adjudicating Authority for the dissolution of the company.

### **When can the borrower contest against NCLT order?**

An appeal can be filed against the order of the National Company Law Tribunal, as per Section 61 of the Code, to National Company Law Appellate Tribunal within thirty (30) days from the date of order of the National Company Law Tribunal (NCLT).

As per Section 62 of the Code, any person aggrieved by the order of National Company Law Appellate Tribunal may file an appeal to the Supreme Court within



45 days from the date of receipt of the order. However, appeal shall lie only on the Question of law arising out of this Code.

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**Check Your Progress-2**

6. Insolvency Profession to be appointed by the Government and shall be approved by the creditor committee. (True/ False)
7. Identify one of the following which is placed incorrect in the order of priority for distribution of the assets of the applicant once the issue is settled as per the code?
  - a. Insolvency related costs
  - b. Secured creditors and workmen dues up to 24 months
  - c. Other employee's salaries/dues up to 12 months
  - d. Equity
  - e. Financial debts (unsecured creditors)
8. The Adjudicating Authority shall appoint an interim resolution professional within \_\_\_\_\_ days from the insolvency commencement date
  - a. 30 Days
  - b. 20 days
  - c. 7 days
  - d. 14 days
  - e. 60 days
9. Which of the following is the key role for the Resolution Professional's?
  - a. To take over the management of the corporate borrower and guide its business as a going concern.
  - b. To arrange for liquidation of assets immediately
  - c. To remove the existing management professional from the board.
  - d. To Identify Banks who can support the company to start functioning
  - e. To seize the assets and prevent the management to operate.
10. What should be the minimum number Members of the committee of creditors of the voting rights should be present either in person or by video/audio means, as per Regulation 22 of the Insolvency and Bankruptcy (Insolvency Resolution) Regulations, 2016?
  - a. 50 %
  - b. 66 %
  - c. 100 %
  - d. 33 %
  - e. 75 %

<b>Self-Assessment Questions – 2</b>	
1.	Discuss corporate insolvency resolution process. ..... .....
2.	List out the entities who can file application to Adjudicating authorities. ..... .....
3.	List out the order of priority for distribution of the assets of the applicant once the issue is settled as per the IBC. ..... .....

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#### **14.10. Fast Track Insolvency Resolution Process**

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A fast track insolvency resolution, as the name suggests, is a process wherein the insolvency resolution process shall be completed within 90(ninety) days from the insolvency commencement date.

An application under this category can be made by

- a) A corporate debtor with assets and income below a level as may be notified by the Central Government; or
- b) A corporate debtor with such class of creditors or such amount of debt as may be notified by the Central Government; or
- c) Such other category of corporate persons as may be notified by the Central Government.

The aggrieved may make an application to the Adjudicating Authority and if it is satisfied that the fast track corporate insolvency resolution process cannot be completed within a period of ninety days, it may, by order; extend the duration of such process to a further period which shall not be exceeding forty-five days.

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#### **14.11. Voluntary Liquidation Process**

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Section 59 of the Code empowers a corporate person intending to liquidate itself voluntarily if it has not committed any default. Any corporate person registered as a company shall meet the following conditions to initiate a voluntary liquidation process:-

A declaration from majority of the directors of the company verified by an affidavit stating:

- That they have made a full inquiry into the affairs of the company and have formed an opinion that either the company has no debts or that it will be able

to pay its debts in full, from the proceeds of assets to be sold in the voluntary liquidation; and

- That the company is not being liquidated to defraud any person.

The declaration shall be accompanied with the following documents, namely:

- i. Audited financial statements and a record of business operations of the company for the previous two years or for the period since its incorporation, whichever is later;
- ii. A report of the valuation of the assets of the company, if any, prepared by a registered valuer.

Within four weeks of making such declaration, the corporate debtor shall comply with the following course of action.

- i. Pass a special resolution at a general meeting stating that the company should be liquidated voluntarily and an insolvency professional to act as the liquidator may be appointed.
- ii. Pass a resolution at a general meeting stating that the company be liquidated voluntarily as a result of expiry of the period of its duration (fixed by its articles or on the occurrence of any event in respect of which the articles provide that the company shall be dissolved, if any) and appointing an insolvency professional to act as the liquidator.

As per the proviso to Section 53(3) of the Code, if the company owes any debt to any person, then creditors representing two-thirds in value of the debt to the company shall approve the resolution to be passed at the general meeting, within seven days of such resolution.

According to Section 65 of the Code, any person who fraudulently or with malicious intent initiates the insolvency resolution process or liquidation process/voluntary liquidation shall be punishable with a minimum penalty of one lakh rupees which may extend to one crore rupees.

#### **14.12 Insolvency Resolution and Bankruptcy for Individuals and Firms**

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Insolvency and Bankruptcy Code 2016 provides better mechanism for creditors who want to recover their dues from individuals, proprietorship concerns or partnership firms. Individual cases handled under the Presidency Towns Insolvency Act, 1909 and Provincial Insolvency Act, 1920 are now replaced by the aforesaid code.

Code facilitates the creditors who want to recover their dues even if the debtor has closed his proprietorship or partnership firm. In case liquidation process is initiated against the debtor, he is bound to disclose his assets.

## **Block 5: Business Environment and Law**

If the default is above ₹ 1,000 (may be increased up to ₹ 1 lakh by the Government, by notification as and when need arise), then the Code applies to such individuals and partnerships.

### **Distinct Processes**

The following actions are to be initiated under specific circumstances.

#### **Fresh Start Process**

Under the automatic fresh start process, eligible debtors can apply to the Debt Recovery Tribunal (DRT) for discharge from certain debts not exceeding a specified threshold, allowing them to start afresh. The fresh start process is only available to individual insolvency (under Part III, Chapter II, of the Code) and not available for corporate persons.

An individual will be eligible for a debt waiver of up to ₹ 35,000. For an individual to be eligible for this process, he should have:

- Annual income of less than ₹ 60,000,
- Assets under ₹ 20,000,
- No ownership of a house and he is not an un-discharged bankrupt.

#### **Insolvency Resolution Process**

A debtor (majority of partners if applying for a firm), creditor (himself or jointly with other creditors), individually or through resolution professional may apply to DRT.

DRT shall appoint resolution professional upon confirmation received from the Board. Resolution professional may be replaced at any time, with a majority voting of the creditors and through an application to DRT. Board shall confirm, and the DRT shall appoint the creditors' nominated person or Board's recommended person as resolution professional.

The resolution professional shall examine insolvency application and submit his report to DRT with his recommendation to admit or reject it. A resolution professional receives claims from creditors, accepts or rejects the application and submits a report with reasons to the DRT. Based on the said report, the DRT accepts or rejects the application. DRT shall issue public notice inviting claims from all creditors within 21 days of such notice. Creditors shall register claims with resolution professional. Resolution professional shall prepare a list of creditors. The resolution professional shall determine the voting share to be assigned to each creditor.

DRT shall within 14 days admit or reject the application. Upon admission, DRT may on the request of resolution professional, issue directions for conducting negotiations between debtor and creditors for arriving at a repayment plan.

The insolvency resolution process consists of preparation of a repayment plan by the debtor, for approval of creditors. If approved, the DRT passes an order binding the debtor and creditors to the repayment plan.

The debtor shall prepare a repayment plan containing a proposal to the creditors for restructuring his debts. The resolution professional shall submit the repayment plan along with his report on the resolution plan to DRT within 21 days of last day of submission of claims.

The resolution professional shall summon a meeting of creditors to approve, modify or reject the repayment plan by a majority of more than 75% votes. Debtor's consent to every modification shall be taken.

Secured creditor is entitled to participate and vote in creditor's meeting if he forfeits the right to enforce the security. If the secured creditor does not forfeit his right to enforce security, then his right to vote is only in respect of the unsecured part of his debt. Secured and unsecured parts of the debt are treated as separate debts.

The resolution professional prepares a report of the meeting and submits to DRT. DRT may approve or reject the repayment plan based on the report. Approved repayment plan shall be binding on creditors and debtor. If the DRT rejects the repayment plan, then bankruptcy proceeding can be initiated.

### **Moratorium**

Moratorium has been explained in Section 14 of the Code,

An automatic interim moratorium operates when an application for fresh start process by debtor, or an application for insolvency resolution of partnership firm or individual, or application for bankruptcy is made. Interim moratorium ceases to have effect upon admission of such application by the adjudicating authority.

The Adjudicating Authority shall declare moratorium for prohibiting any legal action against debtor by way of the institution of suits, continuation of pending suits or proceedings including execution of judgement, decree, or order in any court of law, tribunal, arbitration panel or other authority transferring, encumbering, alienating or disposing debtor's assets.

During the moratorium period the following acts shall be prohibited:

(a) The institution of suits or continuation of any pending suits or proceedings against the corporate debtor including execution of any judgment, decree or order in any court of law, tribunal, arbitration panel or other authority; (b) Transferring, encumbering, alienating or disposing of by the corporate debtor any of its assets or any legal right or beneficial interest therein; (c) Any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of its property including any action under the SARFAESI Act, 2002; (d) The recovery of any property by an owner or lessor where such property is occupied by or in the possession of the corporate debtor.

## **Block 5: Business Environment and Law**

The supply of essential goods or services to the debtor shall not be interrupted during moratorium period.

### **14.13 Bankruptcy**

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The process is similar to liquidation of a corporate person.

When application for insolvency is rejected by the DRT or the repayment plan is not submitted in time or the repayment plan fails, the debtor himself may apply to DRT for bankruptcy of the debtor. The application cannot be withdrawn except with the leave of the tribunal. The DRT will pass an order, thereby indicating commencement of bankruptcy proceeding (date of such order is the bankruptcy commencement date).

The following restrictions shall be imposed on a Bankrupt:

- a) He shall not act as a director of any company, or directly or indirectly take part in or be concerned in the promotion, formation, or management of a company.
- b) He shall be prohibited from creating any charge on his estate or taking any further debt, except with the previous sanction of the Bankruptcy Trustee.
- c) He shall be required to inform his business partners that he is undergoing a bankruptcy process.
- d) He shall inform all the parties involved in transaction with him that he is undergoing a bankruptcy process.
- e) He shall be incompetent to maintain any legal action or proceedings in relation to the bankruptcy debts, except with the previous sanction of the Adjudicating Authority.
- f) He shall not be permitted to travel overseas without the permission of the Adjudicating Authority.

A secured part of the creditor's debt may at his discretion be made part of bankruptcy trust. He may choose to make an application for bankruptcy only in terms of unsecured part of his debt. A bankruptcy order does not affect his right to realize his security interest. However, he may do so only within 30 days from bankruptcy commencement date.

A bankruptcy trustee is appointed by the DRT based on Board's confirmation of nominated person by applicant or Board's recommendation of another person. A bankruptcy trustee may be replaced by 75% voting of committee of creditors or he may resign himself.

As per Section 151 of the Code, the Bankruptcy Trustee has right to hold property, make contracts, sue, and be sued, enter into engagements in respect of the estate of the bankrupt and do any other act which is necessary or expedient for the purposes of or in connection with the exercise of his rights.

The bankruptcy trustee shall divide Estate of bankrupt among creditors. The estate of the bankrupt shall not include-

- a) Excluded assets
- b) Property held by the bankrupt on trust for any other person.
- c) All sums due to any workman or employee from the provident fund, the pension fund and the gratuity fund.

The DRT shall send notice to creditors of commencement of bankruptcy proceeding and shall issue a public notice calling for claims from creditors.

The claims of creditors shall be registered with the bankruptcy trustee. The trustee shall prepare a list of creditors and summon a meeting of creditors. A committee of creditors shall be formed in the meeting. Creditors are entitled to a vote in accordance with the voting share assigned to them by the resolution professional.

Creditors shall submit proof of debt within 14 days of preparing list of creditors. The creditor shall give full particulars (along with proof) of claim and/or security interest. If a creditor does not file a proof of security within 30 days of notice to that effect sent by the trustee, then with DRT's leave the bankruptcy trustee may sell or dispose of any property that was subject to a security charge, free of that security charge.

### **Discharge of Bankrupt**

Once the distribution is complete or on expiry of one year from date of bankruptcy commencement, the bankrupt may be discharged by an order of the DRT.

The Bankruptcy Trustee shall apply to the Adjudicating Authority for passing of a Discharge Order on the expiry of one year from the bankruptcy commencement date or within seven (7) days of the approval of the Committee of Creditors of the completion of administration of the estates of the bankrupt.

The Discharge Order shall release the bankrupt from all the bankruptcy debt. However, it shall not affect the following:-

- a) It shall not affect the functions of the Bankruptcy Trustee.
- b) It shall not affect the operation of the provisions of IBC Chapters IV and V of Part III.
- c) It shall not release the bankrupt from any debt incurred by means of fraud or breach of trust to which he was a party.
- d) It shall not discharge the bankrupt from any excluded debt.

The DRT may recall its bankruptcy order or modify it on an application from creditor/s or *suo moto*, whether or not the bankrupt is discharged, if satisfied that there exists an error apparent on face of order or bankruptcy debts are paid for or secured to the authority's satisfaction.

The Code provides for a list of priority of debts regarding distribution of proceeds following bankruptcy of the partnership firm or individual.

## **Block 5: Business Environment and Law**

The Bankruptcy trustee shall realize the estate and distribute the proceeds or the assets itself to the creditors in installments or in totality as per the list of priority of debts and availability of funds.

### **Order of priority of payment of debts**

The Code provides for priority regarding distribution of proceeds following liquidation of the company or bankruptcy of individual or partnership as below:

- Insolvency resolution cost and liquidation cost
- Workmen's dues (for 24 months before commencement) and debts to secured creditor (who have relinquished their security interest)
- Wages and unpaid dues to employees (other than workmen) (for 12 months before commencement)
- Financial debts to unsecured creditors and workmen's dues for earlier period
- Crown debts and debts to secured creditor following enforcement of security interest
- Remaining debts
- Preference shareholders
- Equity Shareholders or partners

Any surplus remaining after payment of debts shall be applied in payment of interest accrued since commencement date. Bankruptcy proceedings shall continue even if the bankrupt dies. Claims of legal representatives shall be entertained.

### **Appeals**

Under Part III, Chapter VI of the Code, Debt Recovery Tribunal (DRT) would be the adjudicating authority for insolvency resolution and bankruptcy of individuals, unlimited partnerships, and partner/s thereof. Jurisdiction would be based on place of residence or works for gain or carries on business.

Appeal can be made to Debt Recovery Appellate Tribunal (DRAT) within 30 days (15 days' extension if there is sufficient ground). Further appeal from DRAT would be within 45 days before the Supreme Court only on question of law.

### **Claims by Workmen/Employees**

Workman or employee of the corporate debtor shall submit proof of claim to the interim resolution professional in person or by post or by electronic means in Form D of the Schedule. The workmen or employees may prove the existence of dues against the corporate debtor on the basis of:

- Records available with an information utility
- Proof of employment such as contract of employment for the period for which the dues are claimed. Evidence of notice demanding payment of unpaid dues and any documentary or other proof that payment has not been made



- An order of Court or Tribunal that has adjudicated upon nonpayment of dues (Exhibit 14.1).

**Exhibit 14.1: The Insolvency and Bankruptcy Code (IBC) Amendment Ordinance 3 of 2021 Issued on 04.04.2021**

No industry across the world escaped the Covid-19 pandemic. The pandemic has affected the businesses, financial markets and economies across the world, including and its negative effects were more on micro, small and medium enterprises leading to financial distress;

The Government has taken several measures to support the Industries, markets and made suitable modification in IBC through the ordinance 2021 as well to mitigate the distress.

- a. Increasing the minimum amount of default for initiation of corporate insolvency resolution process to one crore rupees,
- b. Extension of suspension for filing of applications for initiation of corporate insolvency resolution process for defaults arising during the period which ended on 24th March 2021 further.
- c. To urgently address the requirements of micro, small and medium enterprises relating to the resolution of their insolvency.
- d. To provide an efficient alternative insolvency resolution process for corporate persons classified as micro, small and medium enterprises under the Insolvency and Bankruptcy Code, 2016,
- e. Ensuring quicker, cost-effective and value maximizing outcomes for all the stakeholders
- f. Introducing a pre-packaged insolvency resolution process for corporate persons classified as micro, small and medium enterprises.

A pre-pack is the resolution of the debt repayment through an agreement between the lenders and investors instead of a public bidding process. It also helps the MSME to restructure their dues and start afresh and the MSME will still be in control of the assets.

The President assent to an ordinance amending the Insolvency and Bankruptcy Code (IBC) is not applicable for errant promoters of defaulting companies from regaining control of their assets being sold under the bankruptcy process

Source: [https://www.mca.gov.in/Ministry/pdf/IBCAmedOrdinanceBill\\_06042021.pdf](https://www.mca.gov.in/Ministry/pdf/IBCAmedOrdinanceBill_06042021.pdf)  
dated 4<sup>th</sup> April 2021

#### 14.14 Summary

- The Insolvency and Bankruptcy Code aims to consolidate the existing laws relating to insolvency of companies and limited liability entities (including limited liability partnerships and other entities with limited liability),

## Block 5: Business Environment and Law

unlimited liability partnerships and individuals, spread over a number of legislations into a single legislation.

- The Code succeeded in presenting a comprehensive legal framework to deal with insolvency resolution in India by not only repealing 2 statutes, but also amending 11 other statutes such as Companies Act, SICA, and SARFAESI Act etc. Insolvency is technically tested in two types-the "cash-flow test") and the "balance-sheet test".
- A bankrupt would be a legally confirmed insolvent whereas all insolvencies might not lead to be declared as bankruptcies
- "Liquidation" is the winding up of a corporation or incorporated entity under Company Law. Code offers simpler process for voluntary Liquidation.
- Insolvency Resolution and Bankruptcy for Individuals and Firms were discussed in detail
- Moratorium has been explained in Section 14 of the Code.

### 14.15 Glossary

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**Insolvency** - Is a situation when an individual or organization is unable to meet its outstanding financial debt towards its lender as it becomes due.

**Bankruptcy** - Is a situation when a person voluntarily declares himself as an insolvent and goes to the court for declaring him bankrupt.

**Liquidation** - Is the process of winding up of a corporation or incorporated entity under Company Law.

**Adjudicating authority** - Any authority, appointed or authorised to pass any order or decision under this Act.

**Creditor** - a person or firm to whom money is due.

**Shareholders** - A person, company, or organization that holds *stock(s)* in a given company.

**Tribunal** - Is an administrative body established for the purpose of discharging quasi-judicial duties.

**Distressed company** - Are companies that are unable to meet, or have difficulties in, paying-off their liabilities.

**Limited Liability Partnership** - Is an alternative corporate business form that gives the benefits of limited liability of a company and the flexibility of a partnership.

**Going concern** - Is a business entity that is expected to meet its financial obligations when they fall due without the threat of liquidation.

**Moratorium period** - Is a legally authorized period that delays the payment of money due on account of specific loan instalments.

Self-Assessment Questions – 3	
1. What is the concept of fast track insolvency resolution process and the entities who can file application under the fast track process?	..... .....
2. Discuss the insolvency resolution and bankruptcy for individuals , sole proprietors and partnership firms who have closed the business.	..... .....

#### **14.16 Suggested Reading / Reference Material**

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2. RCEP’s Birth Is Oversold As The World’s Largest New Free-Trade Area, Forbes, Harry Broadman- Forbes team, <https://www.forbes.com/sites/harrybroadman/2020/11/30/rceps-birth-is-oversoldas-the-worlds-largest-new-free-trade-area/?sh=570f05bf2a53>, 30th November 2020

## Block 5: Business Environment and Law

3. Cyber security, Emerging challenges and solutions for the boards of F S companies, Mc Kinsey team, [https://www.mckinsey.com/business-unctions / risk/ ourinsights/ cybersecurity-emerging-challenges-and-solutions-for-the-boards-offinancial-services-companies](https://www.mckinsey.com/business-unctions/risk/ourinsights/cybersecurity-emerging-challenges-and-solutions-for-the-boards-offinancial-services-companies), 2nd October 2020
4. How Artificial Intelligence (AI) will empower tax functions, EY Global, [https://www.ey.com/en\\_gl/tax/how-artificial-intelligence-will-empower-the-taxfunction](https://www.ey.com/en_gl/tax/how-artificial-intelligence-will-empower-the-taxfunction), 17th November 2020

### 14.17 Answers to Check Your Progress Questions

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Following are the answers to the Check Your Progress questions given in the Unit.

1. (e) Insolvency Insurance Board of India
2. **False**- A bankruptcy is when a person voluntarily declares himself as an insolvent and goes to the court
3. (b) Company Law
4. (d) Partnership Act 1932
5. (d) Resolution process to complete within 180 (+ 90) days
6. **False** IP to be appointed by the regulator and shall be approved by the creditor committee.
7. (d) Equity- This is last in the list of priority
8. (d) 14 days
9. (a) The Resolution Professional's key role is to take over the management of the corporate borrower and guide its business as a going concern
10. (d) 33%

### Suggested Answers

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#### Self-Assessment Questions – 1

1. The code suggested the following institutional framework to implement the IBC.
  - a. Insolvency Professionals: These professionals will conduct the insolvency resolution process, takeover the management of a company, assist creditors in the collection of relevant information and manage the liquidation process
  - b. Insolvency Professional Agency: It will accept registration, examine, and certify the insolvency professionals. Such agencies are to be registered with and certified by the Insolvency and Bankruptcy Board of India.
  - c. Insolvency and Bankruptcy Board of India: The Board shall consist of a Chairperson, three members from the Central Government not below the rank of Joint Secretary or equivalent
  - d. Insolvency Information Utilities: The Code provides for information utilities which would collect, collate, authenticate, and disseminate financial information from listed companies and financial and operational creditors of companies

2. Insolvency is when an individual or organization is unable to meet its outstanding financial debt towards its lender as it becomes due. Insolvency can be resolved by way of changing the repayment plan of the loans or writing off a part thereof. A bankruptcy is when a person voluntarily declares himself as an insolvent and goes to the court. On declaring him as 'bankrupt', the court is responsible to liquidate the personal property of the insolvent and hand it out to its creditors.
3. The Bill provides that for most offences committed by a debtor under corporate insolvency (like concealing property, defrauding creditors, etc.), the penalty will be imprisonment of up to five years, or with a fine of up to one crore rupees, or with both. For offences committed by an individual (like providing false information), the imprisonment will vary based on the offence. For most of these offences, the fine will not exceed five lakh rupees.

### **Self-Assessment Questions – 2**

1. Corporate Insolvency Resolution is a process that enables financial creditors to assess whether the debtor's business is viable and options, if any, for its revival. The Insolvency Resolution Process provides a collective mechanism of decision making to lenders. If the insolvency resolution process fails financial creditors decide that the business of debtor cannot be profitably sustained, and it should be wound up, the debtor will undergo liquidation process.
2. Three types of entities can file application to Adjudicating authorities:
  - a. Financial Creditors - Are the creditors to whom corporate debtors owe financial debt
  - b. Corporate Applicant - Means corporate debtor or its shareholders partners, management personnel or employees
  - c. Operational Creditors - Are the creditors to whom corporate debtor owes operational debts such as claims for goods and services, employees etc.
3. The Code suggested the following order for distribution of the assets.
  - (i) Insolvency related costs
  - (ii) Secured creditors and workmen dues upto 24 months
  - (iii) Other employee's salaries/dues up to 12 months
  - (iv) Financial debts (unsecured creditors)
  - (v) Government dues (up to 2 years)
  - (vi) Any remaining debts and dues
  - (vii) Equity

### **Self-Assessment Questions – 3**

1. A fast track insolvency resolution, as the name suggests, is a process wherein the insolvency resolution process shall be completed within 90(ninety) days from the insolvency commencement date as against 180 days in the normal process. An application under this category can be made by

## **Block 5: Business Environment and Law**

- a) A corporate debtor with assets and income below a level as may be notified by the Central Government; or
  - b) A corporate debtor with such class of creditors or such amount of debt as may be notified by the Central Government; or
  - c) Such other category of corporate persons as may be notified by the Central Government
2. IBC facilitates the creditors who want to recover their dues even if the debtor has closed his proprietorship or partnership firm if the default is above a threshold level for such individuals and partnerships. As decided by the government. Presently it is Rs 1.00 lakh.

## Unit 15

### A Brief Note on Companies Act, 2013

#### Structure

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- 15.1 Background
- 15.2 Objectives
- 15.3 Salient Features of a Company
- 15.4 Types of Companies
- 15.5 Incorporation of a Company
- 15.6 Prospectus and Allotment of Securities
- 15.7 Issue of Shares and Debentures
- 15.8 Company Management and Administration
- 15.9 Declaration and Payment of Dividend
- 15.10 Accounts of Companies
- 15.11 Meetings of Board and its Powers
- 15.12 Appointment and Remuneration of Managerial Personnel
- 15.13 Company Meetings and Resolutions
- 15.14 Inspection, Inquiry, and Investigation
- 15.15 Compromises, Arrangements, and Amalgamations
- 15.16 Companies Incorporated Outside India
- 15.17 Other Areas of Companies Act, 2013
- 15.18 Summary
- 15.19 Glossary
- 15.20 Self-Assessment Questions
- 15.21 Suggested Reading / Reference Material
- 15.22 Answers to Check Your Progress Questions

#### 15.1. Background

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In the previous unit we have discussed the new law - The Insolvency and Bankruptcy Code relating to insolvency of companies and limited liability entities (including limited liability partnerships and other entities with limited liability), unlimited liability partnerships and individuals, spread over a number of legislations into a single legislation. Various operational issues in Insolvency and Bankruptcy Code were discussed.

This unit briefly discusses on the amended Companies Act 2013.

## Block 5: Business Environment and Law

The Companies Act, 2013 came into existence after receiving consent from the President of India on 29<sup>th</sup> August 2013 in place of sixty years old Companies Act, 1956. The objective behind this new Act is to bring Indian Company Law at par with the best global practices.

The Companies Act, 2013 has 7 schedules, 29 chapters and 470 sections.

This new Act introduced ideas like Corporate Social Responsibility (CSR), Class Action Suits and Fixed Term Independent Directors, tightening the provisions for raising money from the public and prohibiting insider trading by company directors or key managerial personnel by treating such activities as a criminal offence etc.

Section 2(20) of the Companies Act, 2013 defines a company to mean a company incorporated under this Act or any previous company law. A company to which the Companies Act applies comes into existence only when it is registered under the Act. On registration, a company becomes a body corporate i.e., it acquires a legal personality of its own, separate, and distinct from its members. A registered company is therefore, created by law and law alone can regulate, modify, or dissolve it.

In case of a public company minimum number of persons required is seven. In case of a private company it is two. Section 3 of the Companies Act, 2013 allows formation of 'One Person Company'.

Memorandum of Association (MOA) is the charter of the company and defines the scope of its activities. Articles of Association (AOA) of the company is a document which regulates the internal management of the company. As per Section 2(56) of the Companies Act, 2013 "**Memorandum**" means the Memorandum of Association of a company as originally framed or as altered from time to time in pursuance of any previous company law or of this Act. Section 4 of the Companies Act, 2013 deals with Memorandum of Association.

The Memorandum of a company shall contain name clause, (in the case of a public limited company, or the last words "Private Limited" in the case of a private limited company), situation clause (the State in which the registered office of the company is to be situated), object clause, liability clause (in the case of a company limited by shares– liability of its members is limited to the amount unpaid, if any, on the shares held by them; and in the case of a company limited by guarantee-the amount up to which each member undertakes to contribute), capital clause.

One important feature to be followed is name of the company. The restrictions in citing the name are given under identical/undesirable names.

The name stated in the memorandum shall not (a) be identical with or resemble too nearly to the name of an existing company registered under this Act or any previous company law; or (b) be such that its use by the company (i) will



constitute an offence under any law for the time being in force; or (ii) is undesirable in the opinion of the Central Government.

A company shall not be registered with a name which contains (a) any word or expression which is likely to give the impression that the company is in any way connected with, or having the patronage of, the Central Government, any State Government, or any local authority, corporation or body constituted by the Central Government or any State Government under any law for the time being in force; or (b) such word or expression, as prescribed in the Companies (Incorporation) Rules, 2014 unless the previous approval of the Central Government has been obtained for the use of any such word or expression.

Another important document for a company is Articles of Association. Section 5 of the Companies Act, 2013 deals with Articles of Association.

The Articles of Association (AoA) is a subsidiary to the memorandum of association of the company. The AoA defines the rights, duties, powers of the management of a company as between themselves and the company at large. They particularly provide for matters such as the making of calls, forfeiture of shares, and directors qualifications. The procedure for transfer and transmission of shares and debentures, powers, duties, and appointment of auditors is also discussed in the AoA. The AoA also prescribes the mode and form in which changes in the internal regulation of a company may be made from time to time. The articles of association of a company must always be in consonance with the memorandum of that company and being subordinate to the memorandum; they cannot extend the objects of a company as specified in the memorandum of the company.

### **15.2. Objectives**

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By the end of this unit, you should be able to:

- Explain Types of companies and procedure for incorporation of a company.
- Discuss the prospectus and allotment of securities
- Analyse company management and administration
- Outline board meetings and powers of the board.

### **15.3. Salient Features of a Company**

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The word ‘company’ has no strictly technical or legal meaning. A company is a voluntary association of persons formed for the purpose of doing business, having a distinct name and limited liability. It is a juristic person having a separate legal entity distinct from the members who constitute it, capable of rights and duties of its own and endowed with the potential of perpetual succession.

## Block 5: Business Environment and Law

Companies are those business entities that are incorporated under separate enactments. They have a distinct legal personality, separate from the persons constituting it. The word ‘corporation’ or the word ‘body corporate’ is defined in Clause (11) of Section 2 of the Companies Act, 2013:

“Body corporate” or “Corporation” includes a company incorporated outside India but does not include –

- A co-operative society registered under any law relating to co-operative societies; and
- Any other body corporate not being a company which the Central Government may, by notification in the Official Gazette, specify in this behalf.

A company under the Company Law is a company incorporated under this Act or under any previous company law [Section 2(20)]. A company is allowed to incorporate only for a lawful purpose. A company can either be a public company, private company or a one person company. One person company is a form of private company.

To form a company, a requisite number of persons decide the type of company to be incorporated. To incorporate a public company, seven or more persons is a requisite number. For a private company, two or more persons and for one Person Company, one person is the requisite number. The said persons shall subscribe their names or name to a memorandum of the company and fulfill all the requirements of incorporation stated in the Companies Act, 2013. [Section 3(1)].

The following are the characteristic features of a company:

- a. Independent Corporate Entity:** One of the important features of a company is its separate legal entity, once it is incorporated or registered under the Companies Act. The case of *Salomon vs. Salomon & Co. Ltd.*, is noteworthy in this context. Salomon was a prosperous leather merchant who converted his sole proprietorship firm into a limited company named as Salomon & Co. Ltd. The company so formed consisted of Salomon, his wife and five of his children as members. The company purchased the business of Salomon for £39,000 and the purchase consideration was paid in terms of debentures worth £10,000 conferring a charge over the company’s assets and 20,000 shares of £1 each fully paid-up. The balance was contributed in cash. The company in less than one year ran into difficulties and liquidation proceedings commenced. During liquidation, other shareholders and creditors raised arguments that they get preference over the other shareholders as other shareholders belong to one group who incorporated the company to protect their interests. It was held by the House of Lords that the business belonged to the company and not to Salomon.

- b. Limited Liability:** No member can be called upon to pay anything more than the unpaid value of the shares held by him/her or the amount guaranteed by him/her. But, in the case of companies formed with unlimited liability of members, the liability of the members in such cases is not limited only to the extent of the face value of their shares and the premium, if any, unpaid thereon but members will also be required to contribute further to meet the debts of the company in the event of winding up.
- c. Separate Property:** The wealth of the shareholders and the wealth of the company are separate. A member does not even have an insurable interest in the property of the company. An incorporated company's wealth is clearly distinguished from that of its members
- d. Perpetual Succession:** A company once incorporated will never die and continues to exist till it is dissolved. Being an artificial person, it cannot be incapacitated by illness and it does not have an allotted span of life. Also, as the company is distinct from its members, the death, insolvency or retirement of its members leaves the company unaffected and will continue to be the same entity with the same privileges and immunities, estates, and possessions.
- e. Transferability of Interest:** The Companies Act provides that the shares or other interests of any member in a company shall be movable property, transferable in the manner provided by the articles of the company. A member may sell his share in the market without having to withdraw the capital from the company.
- f. Can Sue and be Sued:** Once the company is incorporated or registered under the Companies Act, it exists as an independent legal person and has its own entity distinct from the persons who constitute it. The company enjoys rights and liabilities, which are not the same as that of its members. Being a distinct legal entity, the company has the capacity to sue and be sued.

#### **Corporate Veil and Limitations:**

As it can be seen from the case of *Salomon vs. Salomon & Co Ltd.*, a company is given a distinct legal entity in comparison to the individuals who are managing the affairs of the company. This provides a 'veil' for the persons who run the incorporated company as its 'arms' and 'heads'. The courts generally consider themselves bound by the principle of separate legal entity and adopt a cautious approach while piercing a corporate veil.

However, there have been instances where the courts lift the corporate veil of an incorporated company either to expose the dishonest persons behind the company or to find out the real purpose of incorporating it. The corporate veil is said to be lifted or pierced when the court ignores the company and concerns itself directly with the members or management.

## **Block 5: Business Environment and Law**

The circumstances under which the court may lift the corporate veil can be broadly grouped under two heads: Statutory provisions and judicial interpretations.

### **Statutory Provisions:**

The Companies Act, 2013 expressly provides for the following provisions pertaining to the lifting of the corporate veil:

- Failure to Refund Application Money
- Mis-description of Company Name
- Fraudulent Conduct
- Violation of provisions of Holding and Subsidiary Companies

### **Judicial Interpretations:**

The decisions of the courts have always been intended to provide opportunities for an incorporated company to retain its identity. However, certain circumstances compel the courts to divert from the Salomon principle only to restrict any unjust result. While exercising discretion, the courts rely on the underlying social, economic and moral factors associated with the corporation. Some of the cases where the veil has been lifted are discussed below, throwing light on the interpretation of this particular clause by the courts:

- i. Protection of Revenue
- ii. Prevention of Fraud or Improper Conduct
- iii. Determination of the Character of the Company
- iv. Where a Company is used to Avoid Welfare Legislation
- v. For Determination of the Technical Competence of the Company

## **15.4. Types of Companies**

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As per Companies Act, 2013 a variety of companies may be promoted and registered. The common types of companies which can be registered under the Act are:

- (a) Private companies such as (i) One Person Company (ii) Small Company.
- (b) Public companies may be incorporated either as companies with limited liability or unlimited liability.

Companies may also be classified as:

- (i) Statutory Companies (ii) Registered companies (iii) Existing Companies (iv) Associations not for Profit (v) Government Companies (vi) Foreign Companies (vii) Holding and Subsidiary Companies.

### **Private Company**

Under Section 2(68) of the Companies (Amendment) Act, 2015 Private Company means a company having a minimum of paid up share capital as prescribed by its

articles. As per the revised definition, the Pvt. Co. can now be floated with any amount of paid up capital. There is no minimum amount prescribed.

It restricts the right to transfer its shares if issued; limits the number of its members to 200 excluding persons who are in employment of the company. It prohibits invitation to public to subscribe for its securities if any. As per Section 3 of the Companies Act, 2013, two or more persons are required to subscribe their names to Memorandum of Association. A private company enjoys certain privileges and exemptions from certain provisions of the Companies Act. It loses these privileges if it fails to abide by the restrictive clauses of Section 2(68) of the Companies Act, 2013. Given below are the privileges and exemptions enjoyed by a private company:

- As per Section 3 of the Companies Act, 2013, a minimum of 2 persons as against 7 in case of a Public company may form a company.
- As per Section 149 of the Companies Act, 2013, a Private company shall have minimum of 2 directors as against 3 in case of a Public company.
- As per Section 103 of the Companies Act, 2013, unless otherwise stated in articles, quorum for general meetings in case of a Private company, is 2 members personally present. In case of a Public company 5, 15 or 30 members personally present depending upon the total members as on date of meeting 1,000, 5,000 or more than 5,000 respectively.
- A Private Company is exempted from Section 197 of the Companies Act, 2013 which fixes the overall limit to the managerial remuneration at 11% of the net profits.
- As per Section 152 of the Companies Act, 2013, all directors of a private company can be non-rotational directors.
- Section 161 of the Companies Act, 2013 regarding the manner of filling of casual vacancies among directors and the duration of the period of office of those so appointed, do not apply to a private company.
- A private company may, by its Articles of Association, provide special disqualifications for appointment of directors in addition to those contained in Section 164(1&2).
- As per Section 165 of the Companies Act, 2013, no person can be a director in more than 10 public companies whereas he can become a director in maximum 20 private companies provided none of those companies is a holding or subsidiary of a public company.
- A Private Company is exempted from the requirement of appointment of independent director/s as per Section 149 of the Companies Act, 2013.
- As per Section 177 of the Companies Act, 2013, a Private company is not required to constitute Audit Committee of the Board.

## **Block 5: Business Environment and Law**

- As per Ministry of Company Affairs notification dated 5-6-2015 under Section 43, a Private company may issue shares other than equity or preference shares, if so provided in its Memorandum or Articles of association.
- As per Ministry of Company Affairs notification dated 5-6-2015 a Private company need not keep its rights issue open for minimum period of 15 days under Section 62 of the Companies Act, 2013.
- As per Ministry of Company Affairs notification dated 5-6-2015, for issue of shares to its employees under Employee Stock Options an ordinary resolution is enough for a Private company.
- A Private company can provide loans for purchase of its own shares if the following conditions are fulfilled:
  - No other body corporate should have invested any money.
  - Borrowings from banks, FIIs or bodies corporate less than ` 50 crores or double of its paid up capital, whichever is lower.
  - Company not defaulted in repayment of existing borrowings.
- A Private company is exempted from filing Board resolutions of the Board of directors with the Registrar of Companies.
- A Private company may give a loan or provide guarantee or offer a security to director's loan if:
  - No other body corporate should have invested any money in the lending company.
  - Borrowings from banks, financial institutions or bodies corporates is less than twice its paid up share capital or `50 crores, whichever is lower.
  - Lending company should not have defaulted repayments of borrowings.
- According to Section 141(3) (g) a person cannot be an auditor for more than 20 Companies at a time. The ceiling of 20 audits under Section 141 of the Companies Act, 2013 excludes private companies having paid-up share capital less than ` 100 crores.
- In case of a Private Company Section 184(2) of the Companies Act, 2013 shall apply; with the exception that the interested director may participate in such meeting after disclosure of his interest as per Notification dated 5th June, 2015.
- Provisions under Section 160, 162 and 180 of the Companies Act, 2013 relating to appointment and restrictions on the powers of directors do not apply to Private companies.

## Unit 15: A Brief Note on Companies Act, 2013

- Provisions under Section 101 to 107 and 109 of the Companies Act, 2013 relating to General Body Meeting shall not apply to a Private company unless Articles of the company provide otherwise.
- Under Section 73 of the Companies Act, 2013, Private companies are allowed to accept deposits from members up to 100% of the paid up capital and free reserves provided ROC is informed in the prescribed manner.
- In case of a Private company not defaulted in filing financial statements under Section 137 of the Companies Act, 2013 or annual return with the Registrar under Section 92 of the Companies Act, 2013, the following exemption is available:

With respect to the acceptance of deposits from the members of a company under Section 72, the conditions applicable to a Public company as contained in clauses (a) to (e) of Section 73(2) are not applicable to a Private company. Details of monies accepted under the following need to be filed with the Registrar of the Companies in the specified manner.

- From members not exceeding 100% of the aggregate of the paid-up share capital, free reserves and securities premium account, or
  - which is a startup for five years from the date of its incorporation, or
  - which fulfills all of the conditions namely- not an associate or a subsidiary of any other company, borrowing of such company from banks or financial institutions or anybody corporate is less than twice of its paid-up share capital or ₹ 50 crores whichever is lower and such company not defaulted in the repayment of such borrowings subsisting at the time of accepting deposits under this Section.
- In case of a Private company which is a startup, annual return shall be signed by the director of the company if the company does not have a company secretary provided it did not default under sections 137 and 92 of the Companies Act, 2013.
  - A Private company which is a startup may hold only one meeting of the Board in each half of the calendar year provided gap between two meetings should not be less than 90 days provided it did not default under sections 137 and 92 of the Companies Act, 2013.
  - An interested director of a Private company shall be counted towards the quorum provided it did not default under sections 137 and 92 of the Companies Act, 2013.

### One Person Company

Under Section 3(1) (c) of the Companies Act, 2013, it is a one shareholder corporate entity which may be formed for any lawful purpose by one person

## Block 5: Business Environment and Law

subscribing his name to a Memorandum and complying with the requirements of registration.

One Person Company **cannot** be formed with the objective of charitable purpose (under Section 8) of the Companies Act, 2013. One Person Company can be registered as 'limited by shares' or limited by guarantee (in the case of a company limited by guarantee-the amount up to which the member undertakes to contribute).

Legal and financial liability is limited to the company only. A private company other than registered under the Companies Act, 2013 (nonprofit association) which has a share capital of up to ₹50 lakhs and average annual turnover up to ₹2 crores can convert into a One-Person Company by passing a special resolution in the general meeting. Rule 3(5) of the Companies (Incorporation) Rules 2014 categorically provides that One Person Company cannot be incorporated or converted into a company under Section 8 of the Companies Act, 2013. As per Rule No. 7A if a One-Person Company or any officer of such company contravenes any of the provisions, then they shall be punishable with a fine of up to ₹5,000 and if offence continues a fine of ₹500 per day.

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### **Check Your Progress- 1**

1. One of the important features of a company is its separate legal entity, once it is incorporated or registered under the Companies Act. This concept is based on the legal case of \_\_\_\_\_
2. Identify one of the following which is incorrect as regards to characteristics of a company?
  - a. Unlimited Liability
  - b. Separate Property
  - c. Perpetual Succession
  - d. Transferability of Interest
  - e. Can Sue and be Sued
3. Which one of the following provisions pertaining to the lifting of the corporate veil is not as per Companies Act 2013?
  - a. Failure to Refund Application Money
  - b. Mis-description of Company Name
  - c. Fraudulent Conduct
  - d. Not meeting the financial commitments to the Bank
  - e. Violation of provisions of Holding and Subsidiary Companies
4. A Private company can provide loans for purchase of its own shares subject to fulfillment of certain conditions. However one of the following condition is incorrect. Identify?



- a. No other body corporate should have invested any money.
  - b. Borrowings from banks, FIIs or bodies corporate less than ` 50 crores
  - c. The borrowings from the banks, FIIs or body corporate is double of its paid up capital
  - d. Company not defaulted in repayment of existing borrowings.
  - e. Borrowings from banks, FIIs or bodies corporate less than ` 50 crores or double of its paid up capital, whichever is higher?
5. One Person Company cannot be formed with the objective of \_\_\_\_\_ (under Section 8) of the Companies Act, 2013
- a. Making profit
  - b. Pursuing business activities
  - c. Charitable purpose
  - d. Business expansion
  - e. To export goods

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### **Small Company**

As per Section 2(85) of the Companies Act, 2013 a Small Company is a company other than a public company. The paid-up share capital should not exceed Rs 200 lakhs. Higher amount may be prescribed by the Central Government, not in excess of ` 20 crores. Turnover as per last profit and loss account should not exceed ` 2 crores. Higher amount may be prescribed by the Central Government, not in excess of ` Rs 100 crores. Small company excludes a holding company or a subsidiary company, company registered under Section 8 of the Companies Act, 2013 (non-profit association) and a body corporate governed by any Special Act. A Small Company cannot be formed for non-economic objectives.

### **Public Company**

As per Section 2(71) of the Companies Act, 2013 which was amended under Companies Amendment Act, 2015 a Public Company means a company which is not a private company and has a minimum paid up share capital as may be prescribed. A company which is a subsidiary of a company, not being a private company shall be deemed to be public company even if the subsidiary company continues to be a private company in its articles.

### **Statutory Company**

Life Insurance Corporation of India, Reserve Bank of India etc., are Statutory Companies. Each Statutory Company is governed by the provisions of its special Act. As per Section 1(4) of the Companies Act, 2013, Companies Act 2013 is applicable to these companies insofar as the same are not inconsistent with the Special Acts under which these companies are formed.

## **Block 5: Business Environment and Law**

### **Registered Company**

Any company registered under the Companies Act is known as a registered company. It can be incorporated as a Limited Liability Company or as unlimited liability company. Further it may be incorporated as a Public company or as a Private company.

**Limited liability companies:** They may be divided under 3 heads:

- (1) **Companies limited by shares:** As per Section 4(1)(d)(i) of the Companies Act, 2013 a company having the liability of its members limited by the Memorandum, to the amount, if any, unpaid on the shares respectively held by them is termed as a company limited by shares. It is also known as 'Limited Liability Company' although the liability of the company is never limited.
- (2) **Companies limited by Guarantee:** A company limited by guarantee is a company having liability of its members limited by the Memorandum to such amount as the members may respectively undertake to contribute such as the costs, charges and expenses of winding up and for adjustment of the rights of the contributories among themselves as per Section 4(1)(d)(ii) of the Companies Act, 2013.
- (3) **Companies Limited by Guarantee having share capital:** As per Section 285 of the Companies Act, 2013 the liability of a member of the company having share capital not merely limited to the amount just as a company limited by guarantee, shareholder may be called upon also to contribute to the extent of any sums remaining unpaid on the shares.

### **Unlimited Liability Company**

Section 3(2) of the Companies Act, 2013, allows a company to be formed as an unlimited company. In case of an unlimited liability company, the liability of each member extends to the whole amount of the company's debts and liabilities.

**Association not for profit:** It is generally formed not for making profit but for the promotion of commerce, art, science, sports, protection of environment etc. Such association may or may not be registered as a company under the Companies Act. If registered as a company with a limited liability, license may be given by the Central Government as a company with limited liability without addition to its name of the word 'limited' or 'Private limited' under Section 8 of the Companies Act, 2013. Notification dated 5-6-15 of Ministry of Company Affairs extends the following exemptions for Section 8 Companies:

- Appointment of qualified Company Secretary not mandatory.
- Can hold AGM before or after business hours or on a national holiday at a place other than its registered office as decided by the Board beforehand.

## **Unit 15: A Brief Note on Companies Act, 2013**

- 14 days' notice of General Meeting of the company is enough instead of 21 days.
- Provision of Section 118 with regards to recording of minutes not applicable, minutes may be recorded within 30 days of conclusion of every meeting if Articles of Association requires confirmation of minutes.
- Section 149 of the Companies Act, 2013 relating to appointment of minimum and maximum directors to the Board does not apply.
- Sections 149 and 150 of the Companies Act, 2013 relating to appointment of Independent Directors does not apply.
- Consent to act in the capacity of a director which is to be filed within 30 days with ROC under Section 152(5) of the Companies Act, 2013 does not apply.
- As per Section 8 of the Companies Act, 2013 company needs to hold at least 2 meetings of the board, one in every six months instead of 4 meetings.
- Quorum for Board Meetings shall be either 8 members or 25% of its total strength whichever is less but not less than 2 as against 1/3 of total strength or 2 directors whichever is higher.
- Power of the Board with regards to borrow or invest funds or grant loan or give guarantee or provide security in respect of loans may be exercised by circulation instead of in duly held meeting.

### **Government Companies**

As per Section 2(45) of the Companies Act, 2013 a Government company is one where capital not less than 51% is held by the Central Government or any state Government or Governments or partly by the Central Government and partly by one or more State governments. A subsidiary of a Government company is also treated as a Government company. Difference between a Statutory Company and a Government Company is that a Statutory Company is one formed under special statute whereas a government company is one which is defined under Section 2(45) of the Companies Act, 2013. A statutory corporation formed under a state of the Legislature like LIC of India is not a company under Companies Act, 2013 or under any previous company law and as such is not a Government Company. MCA vide its notification dated 5-6-2015 announced the following exemptions to a Government company:

- Not required to use 'Limited' or 'Private Limited' at the end of its name for example Andhra Bank.
- For transfer of bonds issued by the Government company there exists no need for duly stamped instrument of transfer. Enough to deliver to the company by transferee the intimation specifying his name, address, and occupation along with certificate/letter of allotment relating to the bond.

## **Block 5: Business Environment and Law**

- Provisions of Section 89 and 90 of the Companies Act, 2013 with respect to declaration of beneficial interest that does not apply to shares in a Government company.
- AGM at registered office or at place approved by the Central Government as per Section 96 of the Companies Act, 2013.
- Under Section 123(4) of the Companies Act, 2013 if entire shares capital is held by the Central Government or State Government then there exists no need to deposit dividend in a scheduled bank.
- No need for Nomination and Remuneration committee (Boards report regarding policy on directors' appointment and remuneration) to a Government company.
- Under Section 149(6)(a) in case of a Government company a person is considered as an Independent Director if in the opinion of the Ministry or Department of the Central Government the concerned Director is a person of integrity and possess relevant expertise and experience.
- Provisions of Section 197 of the Companies Act 2013 relating to managerial remuneration do not apply.
- Provisions of the Companies Act, 2013 under Sections 160, 162, 163, 170, 171, 185 and 186 are not applicable.
- For a company which is not listed provisions relating to rotation of directors and filling of vacancy arising due to retirement of directors shall not apply under Section 152(6) and (7).
- Provisions relating to Mergers and Amalgamations under Sections 230-232, power vests with the Central Government instead of NCLT.

### **Foreign Company**

As per Section 2(42) of the Companies Act, 2013 a Foreign Company is a company or body corporate incorporated outside India which has a place of business in India physically/through electronic mode and conducts any business activity in India. Share transfer office or share registration office constitute a place of business for example British Burma Petroleum Company Ltd. A foreign company has to furnish the following to the ROC as per Section 380 of the Companies Act, 2013 within 30 days of the establishment of business in India.

- A certified copy of the charter, statute or Memorandum and Articles of the company or other instrument
- Full address of the registered or principal office of the company
- Particulars as prescribed regarding list of the directors and secretary
- Name and address of one or more persons resident in India authorized to accept notices or documents on behalf of the company

- Full address of the company in India which is deemed to be the principal place of business in India
- Particulars of opening and closing place of business in India on earlier occasion or occasions
- Declaration that none of the directors of the company or authorized representative has ever been convicted or debarred from formation of companies and management in India

Under Section 381 of the Companies Act, 2013 every foreign company shall in every calendar year make out a Balance Sheet and Profit and Loss account in such form prescribed and submit to the registrar.

### **Holding and Subsidiary Companies**

As per Section 2(87) of the Companies Act, 2013 a subsidiary company in relation to any other company means a company in which the holding company controls the composition of the directors or exercises or controls more than one half of the total share capital either at its own or together with one or more of its subsidiary companies. Example for Holding company and Subsidiary company, Tata Sons is the holding company TCS, Tata Motors and Tata Steel are its subsidiary companies.

**Associate Company:** As per Section 2(6) of the Companies Act, 2013 ‘Associate company’ in relation to another company means a company in which that other company has control of at least 25% of share capital or of business decisions under an agreement. Example for Associate Companies of ITC Ltd., are Gujarat Hotels Limited, International Travel House Limited.

### **Public Financial Institutions**

As per Section 2(72) of the Companies Act, 2013 the following financial institutions are regarded as public financial institutions.

LIC of India, IDFC, UTI Trustee Company, UTI Asset Management Company, institutions notified by the Central Government under sub-section (2) of Section 4A of the Companies Act, 1956 and such other institutions as may be notified by the central government in consultation with the RBI.

### **Unregistered Companies**

As per Section 375 of the Companies Act, 2013 an unregistered company to include any partnership firm, LLP or a Cooperative Society, AOP consisting of more than 7 members. As per Section 464 of the Companies Act, 2013 read along with Rule 10 of the Companies (Miscellaneous Rules, 2014) it cannot have more than 50 members.

### **Dormant Company and other Types**

As per Section 455 of the Companies Act, 2013 a dormant company means a company formed and registered for a future project or to hold an asset or

## Block 5: Business Environment and Law

intellectual property, has no significant accounting transactions and has not filed financial statements or annual returns for 2 financial years consecutively.

**Inactive company:** As per Section 455 of the Companies Act, 2013 an inactive company means a company which has not been carrying on any business or operation or has not made any significant accounting transaction during the last two financial years or has not filed financial statements and annual returns during the last 2 financial years.

<sup>1</sup>**Producer Companies:** Formation as per Sections 581A to 581ZT of the Companies Act, 1956. As per Section 581C of the Companies Act, 1956 any 10 or more producers who are individuals or any 2 or more producer institutions or a combination form and incorporate a company as a producer company. As per Section 581B of the Companies Act, 1956 objectives of Producer Company shall relate to all or any of the following:

- Production, harvesting, procurement, grading, pooling, handling, marketing, selling, export of primary produce of the members or import of goods or services for their benefit
- Processing including preserving, drying, distilling, brewing, venting, canning, and packaging of produce of its members
- Manufacture, sale or supply of machinery, equipment, or consumables mainly to its members
- Providing education on the mutual assistance principles
- Rendering technical service, consultancy etc., to its members
- Generation transmission and distribution of power revitalization of land
- Insurance of producers or their primary produce
- Promoting techniques of mutuality and mutual assistance
- Welfare measures for the benefit of members etc.

Exhibit 15.1 details about the amendments to the Companies Act, 2013.

### Exhibit 15.1: Amendments to Companies Act 2013

There has been substantial amendments to the original Act of 2013 and these were introduced in 2015, 2017, 2019, 2020. The amendments in 2015 are:

- Making Common Seal has been made optional instead of being mandatory
- Company cannot pay dividend without setting the accumulated losses of earlier years which includes depreciations against profits

*Contd. ....*

<sup>1</sup> Section 465 of the Companies Act 2013:-

465. Repeal of certain enactments and savings.— (1) The Companies Act, 1956 (1 of 1956) and the Registration of Companies (Sikkim) Act, 1961 (Sikkim Act 8 of 1961) (hereafter in this section referred to as the repealed enactments) shall stand repealed: Provided that the provisions of Part IX A of the Companies Act, 1956 (1 of 1956) shall be applicable mutatis mutandis to a Producer Company in a manner as if the Companies Act, 1956 has not been repealed until a special Act is enacted for Producer Companies:

- Fraud amount above Rs 1 cr to be reported to Central Government by the Auditor

**The amendments in 2017:**

- Key Managerial Person should be a wholetime employee and should include officer one level below the directors designated by the board.
- For defining an associate, Holding, Subsidiary company, total voting power will be the criteria
- New Section 3A which relates to liability of continuing members in case of reduction in number of members below statutory minimum is included
- Identified person will be the term used in the place of Private Placement
- The concept of Significant Beneficial Owner is introduced
- E voting replaces the term postal ballot
- CSR Committee to have two or more directors for those companies which need not have an independent director.

**The amendments in 2019:**

- New section 10A introduced wherein the Company having a share capital has to make certain declarations;
- Conversion of Public Company into Private, changing financial year of a company will be accorded by the Central Government
- The term fine is replaced by liable to penalty Registrar of Companies (RoC) and Regional Director (RD) can impose penalties
- Penalty will be imposed in case of defaults where no fraud is detected and do not involve large public interest, instead of imprisonment.
- Certain class of companies are excluded from the definition of Listed Company by introducing a provision to Sec. 2(52).
- Suitable provision has been made to enable public companies to list their securities in foreign jurisdiction.
- Lesser penalty for start-up company, small company, producer company for failure to comply with provisions of the Companies Act, 2013.

Source: <https://www.taxmann.com/post/blog/6181/the-journey-of-companies-act-from-1956-to-2021/#journey-of-the-companies-act-so-far-dated-31st-August-2021>

### 15.5. Incorporation of a Company

At this juncture, it is appropriate to discuss Memorandum of Association and Articles of Association in detail:

**Memorandum of Association:**

The Memorandum of Association is a document of greater importance in relation to a company. As per Section 2(56) of the Act, Memorandum means 'Memorandum of Association' of a company as originally framed or altered from time to time, in pursuance of any provisions of any previous company law or of this Act. It is often described as the charter of the company defining as well as confining the powers of the company. Any act done beyond the scope of the memorandum is *ultra vires* the company and hence null and void.

Section 4(1) of the Act prescribes that the memorandum of association of a limited company should essentially have the following clauses:

## **Block 5: Business Environment and Law**

### **Name Clause**

The memorandum of association should contain the name of a company, whether it is a private or public company under section 4(1)(a). Companies covered by Section 8 are exempted from the use of word(s) Ltd./Private Ltd. Section 8 of the Act speaks about the formation of companies with charitable objects, etc.

No company shall be registered by a name, which in the opinion of the Central Government is undesirable.

### **Registered Office Clause**

Section 4(1)(b) and 12 speaks about the registered office of the company. The prescribed form underneath is eForm INC-22.

Accordingly, a company shall have the registered office of the company on and from 15th date of its incorporation and at all times thereafter. A notice of the exact place of the registered office, in eForm INC-22, must be given to the Registrar within 30 days from the date of incorporation.

However, as and when necessity demands, the company is at privilege to shift its registered office from one place to another. However, this shift is subject to the compliance of certain provisions of the Companies Act, 2013. The same is explained below:

#### **Shifting of registered office from one to another within the same city, town or village.**

A company can shift its registered office from one place to another within the same city, town or village by a board resolution. Notice of such change should be intimated to the registrar in eForm INC-22 within 15 days of such change.

Shifting of registered office from one city to (another place) same city (within) the same state.

If it is proposed to shift the registered office from one city to another city (within) the same state, a special resolution to that effect has to be passed and the registrar informed about the change within 15 days of passing the special resolution.

Shifting of registered office from one State to another State.

In addition to passing the aforesaid special resolution, the approval of the central government also needs to be obtained.

### **Objects Clause**

Section 4(1)(c) of the Act speaks about the objects clause in the Memorandum of Association.

The objects clause defines the objects of the company and it indicates the sphere of activities:

- The objects with which the company is proposed to be incorporated.



- Objects incidental or ancillary to the attainment of main objects.

The construction of the objects should be such that a concentrated line of activity exists and it confines the corporate action within fixed limits.

It is to be noted that the function of the memorandum is to delimit and identify the objects in an unambiguous manner so as to enable a layman identify the field of industry within which the corporate activities are to be confined. A company intending to change its objects clause can do so by passing a special resolution.

In case of change/alteration of objects clause of memorandum, the Companies Act, 2013, laid certain restrictions to be complied with by the company. This restriction is applicable for a company where it had raised money for public for one or more objects specified in the prospectus but lands with unutilized money in its pockets.

### **Liability Clause**

Section 4(1)(d) states that the liability, whether limited or unlimited, shall be stated in this clause of Memorandum of Association of the company.

In the case of an unlimited company, the members' liability is unlimited to the extent of debts the company owes. In simple words, company's liability is members' liability, unless otherwise stated. This is irrespective of the unlimited company by shares or by guarantee.

In the case of a limited company, two concepts are to be considered-

In the case of a company limited by shares, the liability of members gets restricted to the amount unpaid on the shares held by them.

In the case of a company limited by guarantee, the liability of the members gets restricted to the amount upto which each member undertakes to contribute at the time of becoming a member of the company. The contribution shall be in respect of -

- ✓ Assets of the company in the event of winding up. This holds good while he/she is a member or within one year after he/she ceases to be a member.
- ✓ Payment of debt and liabilities of the company or for all such debts and liabilities of the company that are incurred before he/she ceases to be a member.
- ✓ Costs, charges and expenses of winding up, and
- ✓ Adjustment of the rights of the contributories among themselves

### **Capital Clause**

In the case of a company having share capital, the following aspects need to be discussed-

## **Block 5: Business Environment and Law**

- The authorized share capital of the company.
- Face value of each share.
- Number of shares into which such capital is divided.

### **Subscription Clause**

Number of shares that subscribers to memorandum agreed to undertake. The subscription shall not be less than one share.

Such shares shall be indicated opposite his/her name.

**In case of One Person Company**, the only subscriber of the company shall disclose the name of the person who can take his/her place as a subscriber in the event of his/her death or incapacity to contract. Disclosure can be made only with the prior written consent of such person. Such consent is required to be filed with the concerned Registrar of Companies at the time of its incorporation along with its memorandum and articles. However, such person is qualified enough to withdraw his/her consent but subject to the procedure prescribed in this regard.

Similarly, the member of OPC is also entitled to replace such person by giving due notice to him/her in the prescribed manner. The member intimates the change of person to the Company either by indicating in the memorandum or in any other manner as prescribed underneath. The Company intimates the same in the manner and within the time prescribed. Such change of person shall not amount to the alteration of Memorandum of Association of such company.

In case of death of the subscriber to the memorandum of OPC, then the name specified shall be the subscriber and thereby member of such OPC.

### **Articles of Association**

Section 2(5) of the Act defines Articles of Association of a company as originally framed or as altered from time to time in pursuance of any previous company law or of this Act. In terms of Section 5 of the Act, the Articles of Association of a company are its byelaws or rules that govern the management of its internal affairs and the conduct of its business. It defines the powers of its officers and also establishes a contract between the company and the members and between the members *inter se*.

The articles play a subsidiary part to the Memorandum of Association. The memorandum and articles are contemporaneous documents which must be read together. Any ambiguity and uncertainty in one of them may be removed by reference to the other.

**Contents:** The articles usually contain the provisions relating to the following matters:

Share capital including sub-division thereof, rights of various shareholders, the relationship of these rights, payment of commission, share certificates.

- Lien on shares

- Calls on shares
- Transfer of shares
- Transmission of shares
- Forfeiture of shares
- Surrender of shares
- Conversion of shares into stock
- Share warrants
- Alteration of share capital
- General meetings and proceedings
- Voting rights of members

Directors, including first directors or directors for life, their appointment, remuneration, qualification, powers and proceedings of board of directors' meetings

- Dividends and reserves
- Accounts and audit
- Borrowing powers
- Winding up
- Adoption of preliminary contracts

Incorporation of a company means registration of a company. For incorporation the process prescribed under the Companies Act 2013 needs compliance as discussed below:

- The Memorandum of Association shall only state the mandatory objects. The Company cannot provide for other object clause as per Section 4 of the Companies Act, 2013.
- After reservation of name for the proposed company, if it is found that the name was applied by furnishing wrong or incorrect information then,
  - If the Company is not incorporated, then reserved name is cancelled and a penalty not exceeding ` 1 lakh shall be levied
  - If the Company is incorporated- name to be changed or to make a petition for winding up then Section 4(4) and 4(5) of the Companies Act, 2013 need to be followed.
- Articles of Association may contain provisions with respect to entrenchment whereby the specified provisions of the article can be altered only if the more restrictive conditions or procedures as compared to those applicable in case of special resolution have been met with as per Section 5 of the Companies Act, 2013.

## **Block 5: Business Environment and Law**

- A declaration, in the prescribed form, required to be filed with the Registrar of Companies at the time of registration of a company that all the requirements of the Act in respect of registration and matters precedent or incidental thereto have been complied with, will be required to be signed by both - a person named in the articles as a director, manager or secretary of the company as well as by an advocate, a chartered accountant, cost accountant or company secretary in practice, who is engaged in the formation of the company as per Section 7 of the Companies Act, 2013.
- As per companies Act, 2013 if a Company has raised money from the public through prospectus and if there is any unutilized amount out of the money so raised, it shall not change its objects unless a special resolution is passed and other requirements of advertisement and exit opportunity to dissenting shareholders is complied with.

The 2013 Act mandates inclusion of declaration to the effect that all provisions of the 1956 Act have been complied with, which is in line with the existing requirement of 1956 Act. Additionally, an affidavit from the subscribers to the memorandum and from the first directors has to be filed with the ROC, to the effect that they are not convicted of any offence in connection with promoting, forming or managing a company or have not been found guilty of any fraud or misfeasance, etc., under the 2013 Act during the last five years along with the complete details of name, address of the company, particulars of every subscriber and the persons named as first directors. The 2013 Act further prescribes that if a person furnishes false information, he or she, along with the company will be subject to penal provisions as applicable in respect of fraud i.e. section 447 of 2013 Act [section 7(4) of 2013 Act].

According to Ministry of Company Affairs, (MoCA) the registration of company is easy, and the following procedure is to be followed.

Incorporating a company through ‘Simplified Proforma for Incorporating Company electronically (SPICe)’ is the required application form to be filed electronically with MoCA. It is the default option and most companies are required to be incorporated through SPICe only.

Under SPICe, Stakeholders can avail of 5 different services (Name Reservation, Allotment of Director Identification number (DIN), Incorporation of New Company, Allotment of PAN and Allotment of TAN) in one form by applying for Incorporation of a new company through SPICe form (INC-32) –

Simplified Proforma for Incorporating Company electronically (SPICe) - with eMoA. The users are required to attach the pdf attachments of MoA and AoA.

After scrutinizing the documents filed and on being satisfied that they are in order, that the requisite fee has been paid and that all other legal requirements have been

duly complied with, the registrar of the Central Registration Center will enter the name of the company in the Registrar of Companies and shall certify under his/her hand that the company is incorporated and that the company is limited by shares/limited by guarantee/unlimited company as the case may be. He/she would then issue a certificate in the prescribed Form No. INC-11 under his/her signature, certifying that the company is incorporated. The certificate contains the name of the company, the date of issue and the signature of the Registrar of Central Registration Centre with his/her seal. The certificate of incorporation shall mention permanent account number of the company where it has been issued by Income. Tax department. Certificate of incorporation constitutes the company's birth certificate and the company becomes a body corporate with perpetual succession and common seal. The company comes into existence on the date given on the certificate of Incorporation. As per Section 7(3) of the Companies Act, 2013, on and from the date mentioned in the Certificate of Incorporation, the Registrar shall allot to the company a corporate identity number (CIN) which provides a distinct identity to the company.

### **Doctrine of Ultra Vires**

A purported activity beyond the powers of the company will be ineffective even if ratified by all the members. This rule is commonly known as 'doctrine of *ultra vires*'.

The rule of *ultra vires* was devised for the protection of the company's interest and it is not capable of being used against the company's interest. Therefore, others cannot sue the company on the ground of *ultra vires*.

### **Doctrine of Indoor Management**

This doctrine lays down that the persons dealing with the company should first satisfy themselves that the proposed transaction is not inconsistent with the memorandum and articles. Then they are not bound to inquire into the regularity of the internal proceedings. That is, while the persons contracting with a company are presumed to know them, they are entitled to assume that the provisions have been observed by the officers of the company. An outsider is not bound to see that the company carries out its own internal processes. This rule has been found to be of less rigor as compared to Doctrine of Constructive Notice.

The Doctrine of Constructive Notice says that every person who contemplates to enter into a contract with a company has the means of ascertaining the propriety of the contract being entered into, as the Memorandum and Articles of Association are public documents.

The doctrine of indoor management has its genesis in the case of *Royal British Bank vs. Turquand*. The directors of a company borrowed a sum of money from the plaintiff. The company's articles provided that the directors might borrow on bonds from time to time to be authorized by a resolution passed at a general body

## **Block 5: Business Environment and Law**

meeting of the company. The directors gave a bond to Turquand without the authority of any such resolution. It was held that Turquand could sue the company on the strength of the bond, as he was entitled to assume that the necessary resolution had been passed.

### **Exceptions to the Doctrine of Indoor Management**

The following are the exceptions where an outsider cannot claim relief on the grounds of 'indoor management':

- Knowledge of irregularity
- No knowledge of articles
- Negligence
- Forgery
- Non-existent authority of the company

## **15.6. Prospectus and Allotment of Securities**

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The 2013 Act has introduced a new section [section 23] to explicitly provide the ways in which a public company or private company may issue securities. This section explains that a public company may issue securities in any of the following manners:

- To public through prospectus
- Through private placement
- Through rights issue or a bonus issue.

For private companies, this section provides that it may issue securities through private placement, by way of rights issue or bonus issue.

The 2013 Act also introduces certain changes with respect to prospectus and public offers aimed at enhancing disclosure requirements as well as streamlining the process of issuance of securities.

*Issue of prospectus:* In the 2013 Act, the information to be included in the prospectus is specified in section 26 of 2013 Act. The 2013 Act mandates certain additional disclosures related to any litigation or legal action pending or taken by a government department or a statutory body during the last five years immediately preceding the year of the issue of prospectus against the promoter of the company.

*Sources of promoter's contribution:* The 2013 Act has also relaxed the disclosure requirements in some areas. Examples of certain disclosures not included in the 2013 Act are as follows:

- Particulars regarding the company and other listed companies under the same management, which made any capital issues during the last three years
- Export possibilities and export obligations
- Details regarding collaboration

A Private company may issue securities only through private placement by complying with the provisions of Part II of Chapter III.

As per Section 27 of the Companies Act, 2013, if the company has varied the terms of contract and has not utilized any amount raised by it, the dissenting shareholders have an exit option.

Section 28 of the Companies Act, 2013, provides provisions for offer of sale by existing shareholders to public.

As per Section 31 of the Companies Act, 2013, any class of companies or companies as the SEBI may provide by regulations may file shelf prospectus.

Section 35 of the Companies Act, 2013 deals with Civil liability and where it is proved that a prospectus has been issued with intent to defraud, then every person (like directors, promoters, experts etc.,) shall be personally liable without any limit.

As per Section 37 of the Companies Act, 2013, any person including group or association who is affected by any misleading statement or inclusion or omission of any matter in the prospectus can file any suit or take any action under Section 35 or 36 providing for civil liability for misstatement in prospectus and Punishment for fraudulently inducing persons to invest money.

As per Companies Act, 2013, Section 38 a person shall be liable for impersonation, in case he makes multiple applications in different name or in different combination of surnames for acquiring or subscribing the securities of the company.

As per Section 39(4) of the Companies Act, 2013 every Company has to file the Return of allotment with the ROC.

Companies can issue GDRs (Global Depository Receipts) by passing the special resolution and subject to such conditions as may be prescribed under Section 41 of the Companies Act, 2013.

### **15.7. Issue of Shares and Debentures**

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According to Section 2(84) of the Companies Act, 2013, a share means share in the share capital of a company, and includes stock. Having a 'share' in a company also means a right to participate in the profits made by a company, while it is growing, and in the assets of the company when it is wound up.

Under the Companies Act, shares may be issued by the company to shareholders in return for cash or other value equal to or greater than its nominal value. Shares in the authorized share capital are available to be issued. The issued share capital refers to shares which have been allotted, issued and held by shareholders. Not all of the authorized share capital needs to be issued. When shares are issued, the person subscribing must pay cash or equivalent value of at least the nominal

## **Block 5: Business Environment and Law**

amount. Where the share is worth more than its nominal amount, a premium may also be paid.

Section 44 states that the share or other interest of any member in a company shall be movable property, transferable in the manner provided by the articles of the company. A share is not a negotiable instrument. The purchaser of shares cannot be denied registration of the shares purchased by him/her on any ground other than those stated in the articles. Also, a share certificate is not a share in itself – it is only a prima facie evidence of the title of the share.

### **Share Certificate**

Share certificate is a document issued by the company and is evidence that the person named therein is the holder of specified number of shares (as indicated in the document) of the company. It can be issued only in pursuance of a board resolution and on surrender of the letter of allotment if issued.

### **Types of Shares**

A company may have many different types of shares that come with different conditions and rights. There are four main types of shares:

Ordinary/Equity shares are standard shares with no special rights or restrictions. They have the potential to give the highest financial gains, but also have the highest risk. Ordinary shareholders are the last to be paid if the company is wound up.

Preference shares typically carry a right that gives the holder preferential treatment when annual dividends are distributed to shareholders.

### **Equity or Ordinary Shares**

Equity share capital means all the share capital which is not preference share capital. That is, equity shares are those shares which do not enjoy any preferential right in the matter of payment of dividend or repayment of capital. The equity shareholders are entitled to dividend after the payment of dividend to the preferential shareholders (if any).

The equity shareholders are entitled to vote in proportion to the paid-up equity capital subject to the provisions of Section 106.

### **Preference Shares**

Explanation to Section 43 of the Act describes a preference share as preference share capital, with reference to any company limited by shares, means that part of the issued share capital of the company which carries or would carry a preferential right with respect to —

- (a) Payment of dividend, either as a fixed amount or an amount calculated at a fixed rate, which may either be free of or subject to income-tax; and
- (b) Repayment, in the case of a winding up or repayment of capital, of the amount of the share capital paid-up or deemed to have been paid-up. This is



irrespective of whether or not, there is a preferential right to the payment of any fixed premium or premium on any fixed scale, specified in the memorandum or articles of the company.

### **Types of Preference Shares**

There are three main types of preference shares, namely:

Participating, Cumulative and Non-cumulative Preference Shares.

Cumulative preference shares give holders the right that, if a dividend cannot be paid in one year, it will be carried forward to successive years. Otherwise, they are categorized as non-cumulative preference shares.

- **Redeemable and Irredeemable Preference Shares**

Redeemable preference shares come with an agreement that the company can buy them back at a future date. A company cannot issue only redeemable shares. It issues non-redeemable preference shares as well

No company limited by shares shall, after the commencement of the Companies (Amendment) Act, 1996, issue any preference share which is irredeemable or is redeemable after the expiry of a period of 20 years from the date of its issue. In the light of provisions of Companies Act, 2013, this limitation is not applicable to the preference shares issued for infrastructure projects. Infrastructure projects are the projects that are defined under Schedule VI of the Act, 2013. These shares are redeemable at such percentage prescribed annually and at the option of such class of shareholders.

In case, the company at any time is not in a position to pay the redemption amount or dividend amount on the due date, then with the consent of the preference shareholders holding three fourth of the preference share capital and with the approval of the Tribunal, can issue further redeemable preference shares equal to the amount due to them. The amount due includes the dividend amount payable to such shareholders. It may be noted that these are issued against redeemable preferences not redeemed on the due date, and the issue of these redeemable shares exhibits that the unredeemed shares are deemed to have been redeemed.

### **Shares at a Premium**

Although the Company Law does not place any restriction on the issue of shares at a premium, it has laid down guidelines for utilization of such share premium.

Share premium is in the nature of capital reserve and can be used for:

- Issue of fully paid-up bonus shares;
- Writing off preliminary expenses and any commission or discount allowed on issue of shares or debentures;
- Providing for premium payable on redemption of preference shares or debentures of the company; and

## **Block 5: Business Environment and Law**

- Purchase of its own shares or other securities under Section 68

The share premium raised is not available for payment of dividend as it is not profit. If a company distributes the amount lying in the account for purposes other than those stated above, it shall amount to reduction in capital and provisions of Section 66 shall apply. The law also requires that a company should transfer the amount of share premium (whether received in cash or in kind) to a separate account called the 'Securities Premium Account'.

### **Issue of Sweat Equity Shares**

In terms of Section 2(88) of the Companies Act, 2013, Sweat Equity Shares are the shares that are issued by a company to its directors or employees in lieu of their service to the company. The service may be with regard to providing their know-how, making available rights in the nature of intellectual property rights or value additions. The issue may be either at a discounted price or for consideration other than cash.

The procedural aspects for issue of such shares are dealt under Section 54 of the Companies Act, 2013. Accordingly, a company can issue sweat equity shares in respect of class of shares already issued.

### **Bonus Shares**

Section 63 deals with the issue of bonus shares by a company. Bonus shares are called 'Capitalization Shares'. A company is allowed to capitalize profits by issuing fully paid-up shares to the members thereby transferring the sums capitalized from the profit and loss account or securities premium account or capital redemption reserve account to the share capital. Such shares are issued to the existing members of the company free of charge. The company shall not issue bonus shares from the capital reserves created out of revaluation of assets. The issue shall be made by following the provisions laid down under this Section of the Companies Act, 2013.

### **Further Issue of Share Capital**

Section 62 provides that any company having share capital can make a further issue of share capital to the persons specified and in the manner prescribed in it. This can be done any time during the life time of the company. The company can either be a public company or a private company. Such capital can be raised within the limits of the authorized share capital of the company. The company can offer such issue to:

- Existing shareholders
- Employees under the Employee Stock Option Scheme, or
- Any other person.

### **Global Depositary Receipts (GDRs)**

Section 41 of the Companies Act, 2013 is the relevant section for issue of Global Depositary Receipts (GDRs). The GDRs are issued to any foreign country subject

to the provisions of this section. This is the recently introduced mode of raising capital for the company.

As per the Companies Act, 2013 under Section 43 a company can issue two kinds of shares- Equity share capital with voting rights and or with differential rights regarding dividend and or voting otherwise and Preference shares.

As per Section 46 of the Companies Act, 2013 if a company with intent to defraud, issues a duplicate certificate of shares, the company shall be punishable with fine which shall not be less than five times the face value of the shares involved in the issue of the duplicate certificate, but which may extend to ten times the face value of such shares or rupees ten crore, whichever is higher and every officer of the company who is in default shall be liable for action under Section 447.

As per Section 47 of the Companies Act, 2013 Preference shareholders can exercise voting rights only on such resolutions which directly affect the rights attached to the preference shares, when dividends payable in respect of preference shares are in arrears for a period of 2 years or more the preference shareholders shall also get voting right on every resolution placed before the company.

If the variation of one class of shareholders affects the rights of any other class of shareholders the consent of  $\frac{3}{4}$  of that class should also be obtained as per Section 48 of the Companies Act, 2013.

Such class of companies as may be prescribed and whose financial statements comply with the accounting standards can utilize securities premium for, in writing off the preliminary expenses, for providing the premium payable on the redemption of preference shares or of any debentures of the company as per Section 52 of the Companies Act, 2013.

A Company cannot issue shares at discount other than as sweat equity (**Sweat equity shares** are such **equity shares**, which are issued by a Company to its directors or employees at a discount or for consideration, other than cash, for providing their know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called) that too subject to compliance of the specified conditions as per Section 54 of the Companies Act, 2013.

As per Section 55 of the Companies Act, 2013, a company may issue Preference shares redeemable after 20 years but not exceeding 30 years for such infrastructure projects as may be specified subject to redemption of specified % of preference shares on annual basis at the option of the preference shareholder. The term infrastructure projects have been defined for this section as the infrastructure projects specified in Schedule VI.

A Company can issue bonus shares under Section 63 of the Companies Act, 2013 if authorized by its articles of association recommended by its Board and authorized by general meeting of the company and if there are no defaults in

## **Block 5: Business Environment and Law**

respect of statutory dues such as PF, gratuity, and bonus. It can issue bonus shares out of – Free reserves, Securities Premium, Capital Redemption Reserve but not in lieu of Dividend.

Besides existing shareholders, if the company, having share capital at any time, proposes to increase its subscribed capital by the issue of further shares, such shares may also be offered to employees by way of ESOP subject to approval of shareholders by way of special resolution as per Section 62 of the Companies Act, 2013.

As per Section 66 of the Companies Act, 2013 reduction of Share Capital requires confirmation by Tribunal, but diminution needs no confirmation by the Tribunal as per Section 61. No reduction of capital shall be allowed if the company is in arrears for payment of deposits, accepted either before or after the commencement of Companies Act, 2013. The Tribunal on receiving an application for reduction of share capital shall give notice to the Central Government, Registrar and to the SEBI and consider the representations received in this behalf. Reduction of share capital without the sanction of the tribunal is in the following cases:

- Buy back of shares by a company under Section 68: Notwithstanding anything contained in this Act, but subject to the provisions of sub-section (2), a company may purchase its own shares or other specified securities (hereinafter referred to as buy-back) out of— (a) its free reserves; (b) the securities premium account; or (c) the proceeds of the issue of any shares or other specified securities provided that no buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.
- Forfeiture of shares: A company may, in pursuance of its articles forfeit shares for non-payment of calls.
- Surrender of shares: It is a shortcut to forfeiture. It may be accepted by the company under circumstances where its forfeiture is justified. It has the effect of releasing the shareholder whose surrender is accepted from liability on shares.
- Diminution of capital: As per Section 61(2) of the Companies Act, 2013 the cancellation of shares shall not be deemed to be reduction of share capital.
- Redemption of redeemable preference shares: As per Section 55 of the Companies Act, 2013 a company limited by shares may, if so authorized by its articles, issue preference shares which are liable to be redeemed within a period not exceeding twenty years from the date of their issue subject to such conditions.

- Purchase of shares of member by the company under Section 242: The tribunal may order the purchase of shares of any member by the company under certain circumstances.
- Transmission of shares takes place (i) when the registered shareholder dies or (ii) when he is adjudicated as insolvent or (iii) where the shareholder is a company, it goes into liquidation. Section 56(2) provides that the company shall have the power to register, on receipt of an intimation of transmission of any right to securities by operation of law from any person to whom such right has been transmitted. Sub Section (4) further requires that the company shall unless prohibited by any provision of law or any order of Court, tribunal or other authority, deliver the certificate duly transmitted within a period of one month from the date of receipt by the company about the intimation of transmission. The transfer of any security or other interest of a deceased person in a company made by his legal representative shall, even if the legal representative is not a holder thereof, be valid as if he had been the holder at the time of the execution of the instrument of transfer as per sub-section 5.

Section 2(30) of the Companies Act, 2013 define inclusively debenture as "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. The power to issue debentures can be exercised on behalf of the Company at a meeting of the Board under the provisions of Section 179(3) of the Companies Act, 2013. Further Section 71 of the Companies Act, 2013 deals with the provisions relating to the issuance of debentures along with the penalties for noncompliance of the provisions which can be summarized as follows:

- A company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption. The issue of debentures with an option to convert such debentures into shares shall be approved by a special resolution passed by the shareholders in a duly convened general meeting of the company.
- Company can issue secured and unsecured debentures. Secured debentures may be issued by a company subject to such terms and conditions as may be prescribed.
- Company cannot issue any kind of debentures carrying any voting rights.
- Company shall create a debenture redemption reserve account out of the profits of the company available for payment of dividend and the amount credited to such account shall not be utilized by the company except for the redemption of debentures.
- Company cannot issue a prospectus or make an offer or invitation to the public or to its members exceeding five hundred for the subscription of its

## **Block 5: Business Environment and Law**

debentures, unless it has, before such issue or offer, appointed one or more debenture trustees.

- A debenture trustee shall take steps to protect the interests of the debenture holders and redress their grievances in accordance with such rules as may be prescribed.
- Any provision contained in a trust deed for securing the issue of debentures, or in any contract with the debenture-holders secured by a trust deed, shall be void in so far as it would have the effect of exempting a trustee thereof from, or indemnifying him against, any liability for breach of trust, where he fails to show the degree of care and due diligence required of him as a trustee, having regard to the provisions of the trust deed conferring on him any power, authority or discretion; provided that the liability of the debenture trustee shall be subject to such exemptions as may be agreed upon by a majority of debenture-holders holding not less than three fourths in value of the total debentures at a meeting held for the purpose.
- A company shall pay interest and redeem the debentures in accordance with the terms and conditions of their issue.
- Where at any time the debenture trustee comes to a conclusion that the assets of the company are insufficient or are likely to become insufficient to discharge the principal amount as and when it becomes due, the debenture trustee may file a petition before the Tribunal and the Tribunal may, after hearing the company and any other person interested in the matter, by order, impose such restrictions on the incurring of any further liabilities by the company as the Tribunal may consider necessary in the interests of the debenture-holders.
- Where a company fails to redeem the debentures on the date of their maturity or fails to pay interest on the debentures when it is due, the Tribunal may, on the application of any or all of the debenture-holders, or debenture trustee and, after hearing the parties concerned, direct, by order, the company to redeem the debentures forthwith on payment of principal and interest due thereon.
- If any default is made in complying with the order of the Tribunal under this section, every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than two lakh rupees, but which may extend to five lakh rupees, or with both.
- A contract with the company to take up and pay for any debentures of the company may be enforced by a decree for specific performance.

- The Central Government may prescribe the procedure, for securing the issue of debentures, the form of debenture trust deed, the procedure for the debenture-holders to inspect the trust deed and to obtain copies thereof, quantum of debenture redemption reserve required to be created and such other matters.

Further Rule 18 of the Companies (Share Capital and Debentures) Rules, 2014 ('2014 Rules') which prescribes certain conditions to be fulfilled by a company in order to issue secured debentures provides that:

- An issue of secured debentures may be made, provided the date of its redemption shall not exceed ten years from the date of issue. Provided that a company engaged in the setting up of infrastructure projects may issue secured debentures for a period exceeding ten years but not exceeding thirty years;
- Such an issue of debentures shall be secured by the creation of a charge, on the properties or assets of the company, having a value which is sufficient for the due repayment of the amount of debentures and interest thereon; the company shall appoint a debenture trustee before the issue of prospectus or letter of offer for subscription of its debentures and not later than sixty days after the allotment of the debentures, execute a debenture trust deed to protect the interest of the debenture holders; and the security for the debentures by way of a charge or mortgage shall be created in favour of the debenture trustee on-
  - any specific movable property of the company (not being in the nature of pledge); or
  - any specific immovable property wherever situated, or any interest therein.
- As per Section 71 of the Companies Act, 2013, no company shall issue a prospectus or make an offer or invitation to the public or to its members exceeding five hundred for the subscription of its debentures, unless the company has, before such issue or offer, appointed one or more debenture trustees and the conditions governing the appointment of such trustees shall be such as may be prescribed.
- As per Section 77 of the Companies Act, 2013 all types of charges created would be required to be registered with ROC.

### **15.8. Company Management and Administration**

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The Companies Act 2013 facilitated improvement of corporate governance by requiring disclosure of nature of concern or interest of every director, manager, any other key managerial personnel and relatives of such a director, manager or any other key managerial personnel. The threshold of disclosure of shareholding interest in the company to which the business relates of every key managerial personnel has been reduced from 20% to 2% as per Section 102(2) of 2013 Act.

## **Block 5: Business Environment and Law**

The term 'key managerial personnel' was also defined in the 2013 Act. They are the chief executive officer, managing director, manager, company secretary, whole-time director, chief financial officer and any such other officer as may be prescribed. The following points provide some key information.

- As per Section 92 of the Companies Act, 2013 new particulars to be included in the Annual return under clause (e) to (k).
- As per Section 93 of the Companies Act, 2013 every listed company shall file a return in the prescribed form with the Registrar with respect to change in the number of shares held by promoters and top ten shareholders of such company, within 15 days of such change.
- First Annual General Meeting of the Company shall be held within the period of 9 months from closure of its first financial year instead of 18 months from the date of the Incorporation. AGM can be called on a public holiday as per Section 96 of the Companies Act, 2013.
- The Central Government may prescribe the class or classes of companies and manner in which a member may exercise his right to vote by the electronic means as per Section 108 of the Companies Act, 2013.
- The resolution requiring special notice has to be moved by such number of members holding not less than 1% of total voting power or holding shares on which an aggregate sum of not less than five lakh rupees has been paid-up as per Section 115 of the Companies Act, 2013.
- Penalty is now prescribed for tampering with the minutes as per Section 118 of the Companies Act, 2013.
- Every Listed Public Company is required to prepare a report in the manner as may be prescribed on each AGM including the confirmation that meeting was convened, held, and conducted as per the Act and the rules made thereunder as per Section 121 of the Companies Act, 2013.

### **15.9. Declaration and Payment of Dividend**

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A company may before the declaration of dividend transfer part of its profits for that financial year to reserves as it may consider appropriate as per Section 123 of the Companies Act, 2013. No dividend shall be paid by a company from its reserves other than free reserves.

The Board of Directors of a company may declare interim dividend during any financial year out of the surplus in the Statement of Profit and Loss and out of profits of the financial year in which such interim dividend is sought to be declared. A company cannot declare interim dividend at a rate higher than the average dividends declared by the company during the immediately preceding three financial years, where it has incurred loss during the current financial year



up to the end of the quarter immediately preceding the date of declaration of interim dividend as per Section 123(3) of the Companies Act, 2013.

All shares for which unpaid or unclaimed dividend has been transferred to Investor Education Protection Fund shall also be transferred by the company in the name of Fund along with a statement containing such details as may be prescribed as per Section 124(6) of the Companies Act, 2013.

### **15.10. Accounts of Companies**

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The 2013 Act has introduced significant amendments in this chapter. Several additional requirements such as preparation of consolidated financial statements, additional reporting requirements for the directors in their report related to the development and implementation of the risk management policy, disclosures in respect of voting rights not exercised directly by the employees in respect of shares to which the scheme relates, etc. were introduced. Let us run through some of the important aspects.

As per Section 2(41) of the Companies Act, 2013 financial Year of any Company can be only from April-March.

The term Balance Sheet & Profit & Loss Account, has been defined collectively as financial statement under the Act and cash flow statement also forms part of the same as per Section 2(40) of the Companies Act, 2013.

As per Section 120 of the Companies Act, 2013 any document, record, register, minutes, etc., required to be kept by a company or allowed to be inspected or copies to be given to any person by a company under the Act, may be kept or inspected or copies given, as the case may be, in electronic form, in such form and manner as may be prescribed.

Every company shall prepare and keep at its registered office books of account and other relevant books and papers and financial statement for every financial year which give a true and fair view of the state of the affairs of the company, including that of its branch office or offices, if any, and explain the transactions effected both at the registered office and its branches and such books shall be kept on accrual basis and according to the double entry system of accounting. In case of default, the Managing Director, the whole-time director in charge of finance, the CFO and any other person charged by the Board with the duty of complying with the provisions of this Section, they shall be punishable, even if the default was not done willfully as per Section 128 of the Companies Act, 2013.

The requirement of attaching the balance sheet, profit & loss account, report of board of directors, auditor report, statement of the holding company's interest in the subsidiary and others reports as was required by Section 212 of the Companies Act 1956 has been dispensed with.

The benefit given to Private Companies to file their balance sheet & profit and loss account separately has been withdrawn.

## **Block 5: Business Environment and Law**

Along with the financial statement, consolidated financial statement of all subsidiaries shall be prepared and shall also be laid before the AGM. Subsidiary shall for the purpose of this requirement include associate company and joint venture as per Section 129 of the Companies Act, 2013.

As per Section 130 of the Companies Act, 2013, no re-opening or re-casting of book of accounts of the Company is allowed except under Court's or Tribunal's orders.

Voluntary revision of financial statements or Board's Report can also be made with Tribunal's consent as per Section 131 of the Companies Act, 2013.

### ***National Financial Reporting Authority (NFRA)***

Central Government under Section 132(1) of the Companies Act, 2013 is empowered to constitute a National Financial Reporting Authority (NFRA) for matters relating to accounting and auditing standards. The accounting standards as recommended by the Institute of Chartered Accountants of India are prescribed by the Central Government after considering the recommendations of NFRA under Section 133 of the Companies Act, 2013.

Powers of NFRA include:

- Monitor and enforce the compliance with accounting and auditing standards
- Oversee the quality of service of the professions associated with ensuring compliance with such standards
- Have the power to investigate into the matters of professional or other misconduct committed by any member or firm of chartered accountants and impose penalties of not less than ` 1 lakh in case of individuals which may extend to five times of the fees received and ` 10 lakhs in case of firms which may extend to ten times the fees and debar members/ firms for a period of 6 months to 10 years. Any person aggrieved by any order of the NFRA shall have the right to appeal before the appellate authority.

As per Section 134 of the Companies Act, 2013, the Director's report for every company except for One Person Company, shall provide various types of additional information like number of meetings of the Board, Company's policy on directors' appointment and remuneration; explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made by the Company Secretary in his secretarial audit report, particulars of loans, guarantees or investments etc.

The Directors responsibility statement in case of listed company shall also include additional statement related to internal finance control and compliance of all applicable laws.

### **Corporate Social Responsibility**

- As per Section 135 of the Companies Act, 2013, Corporate Social Responsibility Committee consisting of three or more directors, out of which at least one director shall be an independent director for companies.
- It is applicable to: Companies having net worth of ` 500 crores or more or turnover of ` 1,000 crores or more or net profit of ` 5 crores or more during any financial year.
- The committee shall recommend the CSR policy to the Board. The Board to ensure at least 2% of average net profits during 3 immediately preceding years spent every year on CSR.
- As per Section 138 of the Companies Act, 2013 Certain Class of companies are required to appoint an internal auditor to conduct internal audit of the books of company. Internal Auditor shall be a Chartered Accountant or Cost Accountant or such other professional as may be decided by Board.

### **Audit and Auditors**

The 2013 Act introduced many changes with reference to appointment of auditors and audit activity to enhance audit effectiveness and accountability of the auditors. Along with introducing new concepts related to rotation of audit firms and class action suits, the 2013 Act also increases the auditor's liability substantially.

According to the Companies Act 2013, the auditor can be appointed for a period of five years, with a requirement to ratify such an appointment at each annual general meeting [section 139(1) of the 2013 Act]. The 2013 Act also provides that in respect of appointment of a firm as the auditor of a company, the firm shall include a limited liability partnership incorporated under the Limited Liability Partnership Act, 2008 [Explanation to section 139(4) of the 2013 Act]. Also, the 2013 Act specifies that where a firm, including a limited liability partnership is appointed as an auditor of a company, only those partners who are chartered accountants shall be authorized to act and sign on behalf of the firm [section 141 of the 2013 Act].

The further details are provided hereunder:

- Every company shall, at the first annual general meeting, appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting.
- Provisions for compulsory rotation of individual auditors in every five years and of audit firm every 10 years in the listed company & certain other class of companies, as may be prescribed.

## **Block 5: Business Environment and Law**

- A transition period of 3 years from the commencement of this Act has been prescribed for the Company existing on or before the commencement of this Act to comply with the provision of the rotation of auditor.
- Guidelines are issued under Section 139(2) of the Companies Act, 2013 regarding number of years for which an individual auditor can function as auditor in the same company.
- Where a company constitutes an Audit Committee, all appointments including the filling of a casual vacancy of an auditor shall be made after taking into account the recommendations of Audit Committee.
- Appointment is done once for 5 years.
- Mandatory retirement after 5 years in case of individual and 10 years in case of firms.
- No auditor/audit firm/ audit firms having common partners shall take audit for a consecutive term of 5 years after 5 years have been completed.

Provision applicable to all listed companies and companies of such class as may be prescribed.

- A person at the time of appointment or reappointment holding appointment as auditor of more than twenty companies shall not be eligible for appointment as per Section 141(3)(g) of the Companies Act, 2013.
- In case, LLP is appointed as auditor only chartered Accountants are allowed to act and sign on behalf of the firm as per Section 141(2) of the Companies Act, 2013.
- Multidisciplinary partnership is allowed to be appointed as auditors under Provision to Section 141(1) of the Companies Act, 2013.
- Fraud reporting- A duty has been casted on the auditor, to immediately report to the central government, any offence involving fraud which is being or has been committed against the company by officers or employees of the company, which he believes to be committed during the course of performance of his duties as an auditor if the fraud amount is more than 1 crore as per Section 143(2) of the Companies Act, 2013.
- The Auditor shall also comply with auditing standards. The Central Government will prescribe the standards of auditing or any addendum thereto, as recommended by the ICAI, in consultation with and after examination of the recommendations made by the NFRA as per Section 143 of the Companies Act, 2013.
- As per Section 144 of the Companies Act, 2013 Auditor of the company shall not provide directly or indirectly the specified services to the company, its holding and subsidiary company.

- As per Section 146 of the Companies Act, 2013 the Auditor unless otherwise exempted by the company shall attend any general meeting by himself or through his representative.
- As per Section 144 of the Companies Act, 2013, auditors not to provide non-audit services such as accounting and book keeping services; internal audit; design and implementation of any financial information system; actuarial services; investment advisory services; investment banking services; rendering of outsourced financial services; management services; and any other kind of services as may be prescribed not to the company, holding company, or subsidiary directly or indirectly. Indirectly includes through relative, connected, or associated person or other entity over which individual has significant influence or control, or whose name or trade mark or brand is used by the individual.

#### **Penalty on the auditor under Section 147 of the Companies Act, 2013**

Any contravention by the auditor of appointment (Section 139), power and duties (Section 143), prohibited services (Section 144) or signing of audit report (Section 145) shall be punishable with fine of rupees twenty five thousand to five lakhs under Section 147(2). If the auditor is found to have contravened such provisions knowingly or willingly with the intention to deceive the company or its shareholders or creditors or tax authorities, the fine shall not be less than 1 lakh that may extend to 25 lakhs and imprisonment which may extend to 1 year. The convicted auditor shall also be liable to refund the remuneration received from the company besides damages. In case of Audit firm partners concerned, the liability is joint and several.

#### **Cost Audit under Section 148 of the Companies Act, 2013**

In case of a company engaged in production, processing, manufacturing, or mining activities in specified goods or services, the central government may direct cost audit to be conducted in such class of companies which have the prescribed networth or turnover and who has been directed to include the particulars relating to the utilization of material or labour or to other items of cost as may be prescribed in their books of account. No approval is required of central government for the appointment of cost auditor to conduct the cost audit. Cost audit requirement under Section 148 is in addition to the audit conducted by an auditor under Section 143 of the Companies Act, 2013. The cost auditor in default shall be punishable in the manner provided in sub sections (2) to (4) of Section 147 of the Companies Act, 2013.

#### **Appointment and Qualifications of Directors**

The directors of a company shall be appointed complying the provisions of the Companies Act 2013 as discussed below:

## **Block 5: Business Environment and Law**

- As per Section 149 of the Companies Act, 2013 in prescribed class or classes of companies, there should be at least 1 woman director. This Section gives who can be appointed as a Director and who cannot be appointed.
- Section 154 of the Companies Act, 2013 requires that every individual intending to be appointed as director should have been allotted DIN (Director Identification Number).
- As per Section 152 of the Companies Act, 2013 the first directors are usually appointed by name in the articles in the manner provided therein.
- According to Section 152(2) every director shall be appointed by the company in general meeting except where the Act provides otherwise. Subsection (6) of the Section 152 provides that unless the articles provide for the retirement of all directors at every annual general meeting not less than two-thirds of the total number of directors of a public company shall (i) be persons whose period of office is liable to determination by retirement of directors by rotation (ii) be appointed by the company in general meeting except where otherwise expressly provided in this Act. The remaining directors in the case of such a company (i.e., public company) shall in default of and subject to any regulations in the articles of the company also be appointed by the company in general meeting. These provisions do not apply to Government Company and to a subsidiary of a Government company.
- Out of all the Directors, at least one director shall be a person who has stayed in India for a total period of not less than one hundred and eighty-two days in the previous calendar year as per Section 149(3) of the Companies Act, 2013.
- As per Section 149 (1) of the Companies Act, 2013, the maximum limit of directors in the Company has been increased to 15 with a power to add more directors upon passing of Special Resolution.
- A person cannot become a director in more than 20 companies and out of this 20, he cannot be a director of more than 10 public companies as per Section 165 of the Companies Act, 2013. A transitional period of 1 year is provided to persons acting as director to comply with the requirement of maximum number of directorship and they have to intimate their choice to each of company where they wish to continue as director and also to the Registrar.
- Independent Directors- Section 149(4) of the Companies Act, 2013 requires every listed company to have at least one third of the total number of directors as independent directors. The Central Government vide Rule 4 of Companies (Appointment and Qualification of Directors) has prescribed that the following class or classes of Companies shall have at least 2 independent directors-the public company having paid-up share capital of 10 crore rupees or more or the Public companies having turnover of 100 crore rupees or more or the public companies which have an aggregate outstanding loans, debentures and deposits more than 50 crore rupees.

## Unit 15: A Brief Note on Companies Act, 2013

- Section 149(6) of the Companies Act, 2013 defines independent director elaborately and who can be an independent director.
- Schedule IV of the Companies Act, 2013 has elaborately given the manner of appointment of independent directors, their reappointment, tenure, resignation, removal and separate meetings of the independent directors as well as their evaluation. As per Section 149(10) and (11), term upto 5 consecutive years prospectively but not for more than two consecutive terms, reappointment by special resolution. On holding for two consecutive terms, cooling-off period of 3 years is the prescribed eligibility to become an independent director again.
- Section 149(12) of the Companies Act, 2013 makes an independent director liable only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through board processes, and with his consent or connivance or where he had not acted diligently.
- Act provides provision for limiting the liability of Independent Director and non-executive director not being a promoter or key managerial personnel.
- As per Section 150 of the Companies Act, 2013 an independent director may be selected from a data bank containing names, addresses and qualifications of persons who are eligible and willing to act as independent Directors.
- As per Section 151 of the Companies Act, 2013 a listed company may have one director elected by such small shareholders (holding shares of nominal value not more than ` 20,000) in such a manner and with such terms and conditions as may be prescribed.
- The company and the independent directors shall abide by the provisions of (Code of Conduct) specified in Schedule IV of the Act.
- As per Section 163 of the Companies Act, 2013, a company may provide in its Articles for the appointment of not less than 2/3<sup>rd</sup> of the total directors through the system of proportional representation once in 3 years. Every listed public company shall have at least one-third of the total number of directors as independent directors.
- Section 167 of the Companies Act, 2013 provides for the office of the director becoming vacant on the happening of certain events which is given in subsection (1) of Section 167 such as director becoming disqualified under Section 164, abstains from board meetings for a period of 12 months without seeking leave of absence etc.
- As per Section 168 of the Companies Act, 2013 a director may resign from his office by giving a notice in writing to the company. On receipt of such notice, the board shall take note of the same and the company shall intimate the registrar in such manner within such time and in such form as may be prescribed. The director who submitted resignation is also required to forward

## **Block 5: Business Environment and Law**

a copy of his resignation along with the detailed reasons for his resignation within 30 days to the registrar of companies.

- Section 169 of the Companies Act, 2013 recognises the inherent right of shareholders to remove the directors appointed by them. It is not even necessary that there should be proof of mismanagement, breach of trust, misfeasance, or other misconduct on the part of the directors. Where the shareholders feel the policies pursued by the directors or any of them are not to their liking, they have the option to remove the directors by passing ordinary resolution. Directors who cannot be removed are – Directors appointed by the tribunal and directors appointed under the system of proportional representation.
- Where an application has been made to the Tribunal under Section 241 against oppression and mismanagement of Company's affairs, the tribunal may order for the termination or setting aside of an agreement which the company might have made with any of its directors.

### **Liabilities of Director:**

The directors who do not act diligently and honestly are subjected to the following liabilities:

**Unlimited Liability (Section 286):** In a limited company, the liability of all or any of the directors or managers may be made unlimited if it is provided under the Companies Act, 2013.

Section 286 speaks about the obligations of directors and managers. Accordingly the director's liability can be made unlimited at the time of commencement of winding up of the company.

**Liability for Breach of Fiduciary Duty:** An independent director, being in the fiduciary position of a trustee for the company, may incur liability for breach of his/her fiduciary duty to the company. (Schedule IV of the Companies Act, 2013).

### **Personal liability of a Director**

- For ultra vires acts
- For mala fide acts
- For negligence

### **Liability to the third parties**

Directors are criminally liable in pursuance of the different sections of the Companies Act, 2013:

Some of the important liabilities are:

**Section 40** – Failure to comply with respect to securities to be dealt with in stock exchanges



**Section 42** – Failure to comply with respect to offer or invitation for subscription of securities on private placement

**Section 74** – Failure to comply with respect to repayment of deposits, etc., accepted before the commencement of this Act, 2013

**Section 102(5)** – Failure to comply with respect to statements to be annexed to notice

**Section 127** – Punishment for failure to distribute dividends

**Section 129** – Failure to comply with respect to financial statements

**Section 137** – Failure to comply with regard to filing of financial statements with the concerned Registrar.

**Section 167** – Failure to comply with regard to vacation of office of director

**Section 182** – Prohibitions and restrictions regarding political contributions

**Section 185** – Failure to comply with regard to loans to directors, etc.

**Section 209A** – Failure to assist the Registrar or any officer so authorized by the Central Government in inspection of books of account, etc.

**Section 305** – False declaration of company's solvency in case of proposal to wind up voluntarily

**Section 447** – Punishment for Fraud

### **15.11. Meetings of Board and its Powers**

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The 2013 Act facilitated use of electronic mode for sending notice of meetings [Section 173(3) of 2013 Act], passing of resolution by circulation [Section 175 of 2013 Act] and other areas. Some of the other significant changes in relation to the board and its functioning are provided hereunder.

- As per Section 173(1) of the Companies Act, 2013 read along with SS-1 (Secretarial Standard) every company shall hold the first meeting of its board within 30 days of its incorporation. Atleast 4 meeting should be held every year and the gap between two Board meetings must not be more than 120 days.
- Section 173(2) of the Companies Act, 2013 provides that Directors can participate in the Board meeting through video conferencing or other audio-visual mode as may be prescribed.
- Section 173(3) of the Companies Act, 2013 says notice of not less than seven days in writing is required to call a board meeting and notice of meeting to all directors shall be given, whether he is in India or outside India by hand delivery or by post or by electronic means.

## **Block 5: Business Environment and Law**

- As per Section 174 the participation of director at Board meeting through video conferencing or by other electronic means shall be counted for the purpose of Quorum.
- As per Section 174(1) of the Companies Act, 2013 the quorum for meeting of Board of Directors shall be 1/3 of its total strength or two directors whichever is higher. This excludes vacancies and interest directors.
- It is not possible to organize and hold board's/committee of the board's meeting or an urgent decision may be required or to save on the expenses in holding Board's/Committee's meeting a resolution/s may be got passed by circulating the same among the directors/members of the committee, procedure to be followed is illustrated in the Section 175 of the Companies Act, 2013.
- Section 118 of the Companies Act, 2013 contains provisions with respect to minutes of every meeting of Board of the directors or of every committee of the Board.
- Every Listed Company and such other company as may be prescribed shall form Audit Committee comprised of minimum 3 directors with majority of the Independent Directors and majority of members of audit committee shall be person with ability to read and understand financial statement. Vigil mechanism to be established in the prescribed manner by every listed company or such class or classes of companies, as may be prescribed under Section 177 of the Companies Act, 2013.
- As per Section 178 of the Companies Act, 2013 every listed company and prescribed class or classes of companies, shall constitute the Nomination and Remuneration Committee consisting of three or more non-executive directors out of which not less than one half shall be independent directors. Every company which consists of more than one thousand shareholders, debenture-holders, deposit-holders, and any other security holders at any time during a financial year shall constitute a Stakeholders Relationship Committee consisting of a chairperson who shall be a non-executive director and such other members as may be decided by the Board.
- As per Section 179 of the Companies Act, 2013 board exercises powers subject to the provisions contained in that behalf in the Act, or in the memorandum or articles, or in any regulations not inconsistent therewith and regulations made by the company in general meeting: The Board of Directors of a company shall exercise the following powers on behalf of the company by means of resolutions passed at meetings of the Board:
  - (a) to make calls on shareholders in respect of money unpaid on their shares;
  - (b) to authorize buy-back of securities, (c) to issue securities, including debentures, whether in or outside India; (d) to borrow monies; (e) to invest

the funds of the company; (f) to grant loans or give guarantee or provide security in respect of loans; (g) to approve financial statement and the Board's report; (h) to diversify the business of the company; (i) to approve amalgamation, merger or reconstruction; (j) to take over a company or acquire a controlling or substantial stake in another company; (k) any other matter which may be prescribed: Provided that the Board may, by a resolution passed at a meeting, delegate to any committee of directors, the managing director, the manager or any other principal officer of the company or in the case of a branch office of the company, the principal officer of the branch office, the powers specified in clauses (d) to (f) on such conditions as it may specify.

- As per Section 182 of the companies Act, 2013 the limits for political contribution by company shall not exceed 7.5% of the average net profits of the Company during the three immediately preceding financial years.
- As per Section 184 of the Companies Act, 2013 disclosure of interest by every director has been made mandatory. The disclosure shall be made at the first meeting of the Board in which he participates as a director and thereafter at the first meeting of the Board in every financial year or whenever there is any change in the disclosures already made. In case of private company also, an interested director cannot vote or take part in the discussion relating to any matter in which he is interested.
- As per Section 185 of the Companies Act, 2013 no company shall, directly or indirectly advance any loan, including any loan represented by a book debt, to any of its directors or to any other person in whom the director is interested or give any guarantee or provide any security in connection with any loan taken by him or such other person it will not apply to giving of any loan to a managing or whole-time director— as a part of the conditions of service extended by the company to all its employees; or to any scheme approved by the members by a special resolution; or a company which in the ordinary course of its business provide loans or give guarantees or securities for the due repayment of any loan and in respect of such loans an interest is charged at a rate not less than the bank rate.
- As per Section 186 of the Companies Act, 2013 Inter corporate investments not to be made through more than 2 layers of investment companies.
- No approval of Central Government is required for entering into any related party transactions and for appointment of any director or any other person to any office or place of profit in the company or its subsidiary as per Section 188 of the Companies Act, 2013.
- A company shall not enter into any arrangement by which a director of the company or of its holding company or any person connected with him can

## **Block 5: Business Environment and Law**

acquire assets for the consideration other than cash from the company & vice versa without the approval of company in general meeting as per Section 192 of the Companies Act, 2013.

- As per Section 194 of the Companies Act, 2013 forward dealing in securities of company by director and key managerial personnel is prohibited. Penalty in case of contravention will be imprisonment for 2 years and fine from ` 1 lakhs to ` 5 lakhs.
- Insider trading of the securities in the company is prohibited as per Section 195 of the Companies Act, 2013.

### **15.12. Appointment and Remuneration of Managerial Personnel**

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The 2013 Act brought many changes to the existing guidelines related to appointment and remuneration of managerial personnel. The provisions for appointment of managing director, whole time director or manager are applicable to all companies. The overall ceiling in respect of payment of managerial remuneration by a public company remains at 11% of the profit for the financial year computed in the manner laid down in the 2013 Act.

- Independent director not entitled to stock option and may receive remuneration only by way of fees or commission.
- There is no specific provision in the Companies Act, 2013 suggesting that directors must be paid remuneration for their services. However, Section 197(5) and (6) lay down the manner of payment of remuneration to a director and the limits thereto. Section 197 deals with overall maximum managerial remuneration. Schedule V deals with payment of remuneration to managerial personnel obviating requirement of the approval of the Central Government.
- Where a company is required to re-state its financial statement due to fraud or non-compliance with any requirement under this Act and the rules made thereunder, the company shall recover from any past or present managing director or whole-time director or manager who, during the period for which the financial statements are required to be re-stated, the remuneration received (including stock option) arisen due to such statement or non-compliance in excess of what would have been paid to the managing director, whole-time director or manager under such re-stated financial statements as per Section 199 of the Companies Act, 2013.
- Every company belonging to such class or description of companies as may be prescribed shall have a Managing Director, or Chief Executive Officer or Manager and in their absence, a whole-time director, and Company Secretary. An individual shall not be appointed or reappointed as the chairperson of the company, in pursuance of the articles of the company, as well as the managing director or Chief Executive Officer of the company at the same

time after the date of commencement of this Act unless, — the articles of such a company provide otherwise; or the company does not carry multiple businesses as per Section 203 of the Companies Act, 2013.

- Secretarial Audit compliance report in case of certain class of companies to be annexed with the Board's report as per Section 204 of the Companies Act, 2013.

### **15.13. Company Meetings and Resolutions**

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Company meetings must be convened and held in perfect compliance with the applicable provisions of the Companies Act, 2013 and the Rules framed thereunder. Meeting to be properly convened means the meeting must have been convened by the proper authority. The proper authority to convene meeting is the Board of directors, shareholders or tribunal and proper and adequate notice must have been given to all those entitled to attend. Company meetings are classified as:

- Shareholder's meetings- Annual General Meeting (AGM), Extraordinary General Meeting (EGM) and Class meetings
- Board Meetings
- Meetings of the Committees of the Board
- Meetings of Debenture-holders
- Meetings of Creditors
- Meetings of contributories in winding up

Now, let us discuss in brief different types of meetings:

#### **Annual General Meeting (AGM)**

Section 96 of the Companies Act, 2013, is the dealing section for the Annual General Meetings (AGMs) of the Company. This section applies to all companies except to One Person Company.

In terms of this Section, every company shall hold its AGM every year. It should be conducted within a period of six months from the closure of financial year. Further, the period between one AGM and the other AGM shall not be more than 15 months. However, this 15months period can be extended for three more months by the concerned Registrar of Companies. This extension shall be given only on submission of special reasons by the company to the Registrar.

So far as a newly incorporated company is concerned, first AGM shall be conducted within a period of nine months from the date of closure of its first financial year. And, there is no requirement to conduct the first AGM in the year of its incorporation. Every company holding an annual general meeting shall prepare an 'Annual Return' in the prescribed form and shall file the same with the concerned Registrar of Companies within 60 days from the date on which the annual general meeting is held. In case, no annual general meeting is held, then

## **Block 5: Business Environment and Law**

within 60 days from the date on which the annual general meeting of the company is required to be held in terms of the Companies Act, 2013, a statement shall be annexed to the annual return specifying the reasons for not holding the Annual General Meeting along with an additional fee as prescribed. So far as listed companies are concerned, they are required to file a report with the concerned Registrar in the manner prescribed on each annual general meeting held. The report includes a confirmation that a meeting was convened, held and conducted in the manner prescribed under the Companies Act, 2013 and the relevant rules hereunder. (Section 121)

### **Extraordinary General Meetings (EGM)**

Section 100 of the Companies Act, 2013, is the dealing section for Extraordinary General Meetings (EGM). All the general meetings of the company with the exception of the Annual General Meeting are Extraordinary General Meetings (EGMs). The purpose of EGM is to transact special business defined in the previous meeting which arises in between two annual general meetings. The special business transacted at the EGM has to be urgent, which cannot be deferred to the next annual general meeting. For instance, a change in the objects or shift of registered office or alteration of capital or removal of a director/auditors require immediate attention which cannot be deferred till the next annual general meeting. An extraordinary general meeting may be called by:

The board of directors on its own or on the requisition of a specified number of members entitled to vote.

- By the requisitionists themselves in case of failure by the board to call for a meeting.
- By the National Company Law Tribunal (NCLT).

### **Class Meetings of Shareholders**

Class meetings are those meetings which are held by holders of a particular class of shares, for example, preference shares. Need for such meetings arise when it is proposed to vary the rights of a particular class of shares. It was held in *House of Fraser vs. ACGEE Investments Ltd.* (1987) that a cancellation of preference shares by repayment of the capital paid upon those shares and in accordance with rights attached to those shares does not involve any modification or variation of class rights so as to require a meeting of the preference shareholders.

### **Board Meetings**

The meetings of the Board of the Directors for the purpose of collectively taking decisions for smooth functioning of the company are referred as 'Board Meetings'. It has to be noted that the meeting does not require any agenda for the meeting of the directors. Any business whatsoever, thus can be transacted at a board meeting. Chapter XII of the Companies Act, 2013 deals with the 'Meetings

of Board and its Powers'. To formulate management policies, take decisions of importance pertaining to running of the company, review of progress made by the company and on any other important matters related to the company. The quorum for a Board Meeting shall be one third of its total number of directors or two whichever is higher. The director's participation in the meeting via video-conferencing or other audio visual means shall also be counted for the purpose of quorum. In a board meeting, at any time, the number of interested directors exceeds or is equal to the two third of its total number of directors, then the quorum for the board meeting shall be the non-interested directors present at the meeting and their number is not less than two. Where the meeting could not be held for want of quorum then, the same shall be adjourned to the same day at the same time and place in the next week and if that day is a national holiday then the next succeeding day which is not a public holiday and at the same time and place. In the absence of quorum for a board meeting, the continuing directors can carry out any activity only for the purpose of increasing the number towards compliance of quorum number or to convene a general meeting of the company. **Board Resolution** is the resolution passed in the Board of Directors meeting which is the replica of the directors' decision in the meeting.

**Powers of the Board of Directors:**

- Delegated Powers, and
- Restrictions on Powers of the Board.

**Delegated Powers:** The power delegated to the Board of Directors will have to be exercised at the properly convened board meeting unless the articles provide otherwise. Section 173 of the Companies Act, 2013 lays down that the following decisions have to be taken only at the meeting of the Board of Directors:

- Make calls on shareholders in respect of unpaid money on their shares;
- Authorize buy-back of securities under section 68;
- To issue securities, including debentures, whether in India or outside India;
- To borrow moneys otherwise than on debentures;
- To invest the funds of the company;
- To make loans or give guarantee or provide security for such loans granted;
- To approve financial statement and the Board's report;
- To diversify the business of the company;
- To approve amalgamation, merger or reconstruction;
- To take over a company or acquire a controlling or substantial stake in company;
- Any other matter as prescribed.

## **Block 5: Business Environment and Law**

The Board of Directors of a company by passing a resolution in its meeting can delegate some of its aforesaid powers to any of its committee of directors or managing director or manager or to any other principal officer of the company. In case of branch office of a company, then such power can be delegated to the principal officer of such branch office. These powers can be delegated subject to the conditions specified in the concerned resolution. Not all, only some of its powers can be delegated. They are:

- To borrow monies
- To invest the funds of the company and
- To grant loans or give guarantee or provide security in respect of loans.

However, the banking transactions that are in the ordinary course of business are not deemed to be the borrowings under this section. Further, the company, is empowered to restrict the aforesaid powers of the Board of Directors by passing a resolution in its general meeting in the manner prescribed.

**Restrictions on Powers of Board:** The Board of Directors shall exercise its power only with the consent of the company via passing a special resolution in its general meeting.

### **Meetings of Committee of Directors**

Underneath, we discuss the following Meetings of Committee of Board of Directors - Audit Committee (Section 177), Nomination and Remuneration Committee (Section 178) and Stakeholders Relationship Committee (Section 178).

The provisions relating to the meetings of a committee of directors and provisions relating to directors' meetings are by and large same as those of board meetings.

The minutes of the proceedings of a committee of directors meetings is not open for inspection to general public.

### **Minutes of Board/Committee of Directors' Meeting**

Every company shall enter the minutes of the proceedings of every Board of Directors meetings or of every committee of directors meetings. It shall be entered within 30 days from the date of conclusion of such meeting. It should be prepared, signed and consecutively numbered in the manner prescribed under the Act, 2013.

The minutes of the board meeting or a committee thereof shall comprise:

- Names of the Directors present at the meeting.
- In case of resolution passed at the meeting, the names of the directors who concurred and dissented such resolution.
- The minutes should project a fair and correct summary of the proceedings conducted at the board meeting.



### **Meeting of Debenture Holders**

As in the case of Class Meetings, if any, variation is proposed to be made in terms of security or to alter the rights of debenture holders in certain circumstances, then a Meeting of Debenture Holders is called. All the matters connected with the holding, conduct and proceedings of the meetings of the debenture holders are given in the Debenture Trust Deed. The decisions arrived at such meetings with the requisite majority, are valid and binding upon the minority.

### **Meeting of Creditors**

Meeting of creditors for certain arrangements with the company either in case of a running concern or in the event of winding-up is referred to as 'Meeting of Creditors'. These kinds of meetings are not company meetings in the real sense.

When a company goes into liquidation, a meeting of creditors and of contributors is held to ascertain the total amount due by the company to its creditors and also to appoint a liquidator to wind up the affairs of the company.

### **Conduct of General Meetings**

#### **Notice**

In terms of Section 101 of the Companies Act, 2013, a general meeting of the company has to be conducted by giving at least clear notice of 21 days to the shareholders. The notice can either be in writing or can be in electronic mode. It should be in the manner prescribed.

So far as Annual General Meeting is concerned, shorter notice is also permitted where the consent is obtained from at least 95 percent of the members entitled to vote at such general meeting. This is irrespective of whether the notice is in writing or in electronic mode.

Every notice of such general meeting shall contain the date, venue and time of the proposed meeting to be held. It should also contain a statement of business proposed to be transacted in such meeting.

In case special business is to be transacted in the Annual General Meeting, then every notice calling such meeting shall disclose the nature of concern and interest in each item of such special business by every

- director,
- manager,
- any other key managerial personnel and
- relatives of such director, manager or key managerial personnel [Section 102(1)]

The notice of such meeting shall be given to:

- Every member of the company
- Legal representative of any deceased member of the company

## **Block 5: Business Environment and Law**

- Assignee of an insolvent member
- Auditor(s) of the company, and
- Every director of the company

In case, there is any accidental omission to give notice to, or non-receipt of such notice by the eligible person shall not invalidate the proceedings of meeting.

In a nutshell every company, whether Public or Private, having share capital or not, limited, or unlimited must hold this meeting. First AGM of a company shall be held within 9 months from the date of closing of its financial year. No extension of time can be allowed for holding the first AGM. The gap between two AGMs must not be more than 15 months. Other than the first AGM Registrar may for any special reason extend the time within which any AGM shall be held by a period not exceeding 3 months.

### **Resolutions**

With respect to the general body meetings, there are three kinds of resolutions- Ordinary resolution under Section 114(1) of the Companies Act, 2013, Special resolution (Section 114(2)) and Resolutions requiring Special notice under Section 115 of the Companies Act, 2013.

### **15.14. Inspection, Inquiry, and Investigation**

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Shareholders are the owners of the company in normal parlance and are given with various rights including the right to vote. As the shareholders are spread across many places widely on many occasions they do not take active participation in the affairs of the companies where they are the shareholders. This responsibility is to be taken by the Board of Directors of the Company. To protect the interest of the shareholders the Central Government assumed certain powers to investigate the affairs of the company in appropriate cases particularly where there was reason to believe that the business of the company was being conducted with the intent to defraud its creditors or members or for a fraudulent or unlawful purpose, or in any manner oppressive of any of its members. Chapter XIV contains Sections 206 to 229 of the Companies Act, 2013, deals with the provisions relating to Inspection, Inquiry, and Investigation of the affairs of a company.

Investigation within the meaning of the relevant provisions of the Act is a form of probe; a deeper probe; into the affairs of a company. The main object of investigation is to collect evidence and to see if any illegal acts or offences are disclosed and then decide the action to be taken. The said expression also includes investigation of all its business affairs—profits and losses, assets including goodwill, contracts and transactions, investments and other property interests and control of subsidiary companies too.

The following are some of the measures suggested in the Companies Act on these issues:

- As per Section 211 of the Companies Act, 2013 the Central Government will establish Serious Fraud Investigation Office (SFIO) for investigation of frauds relating to a company. Till the time SFIO is not established, SFIO set up by the Central Government in terms of the Government of India Resolution No.45011/16/2003-Adm-I, dated:02.07.2003 to be used for the purpose. Investigation report filed by SFIO with the court for framing of charges shall be treated as a Report filed by a Police Officer. SFIO shall have the power to arrest as per Section 212.
- As per Section 229 of the Companies Act, 2013, in the process of the Investigation, Inquiry or inspection if any person:
  - a) Destroys, mutilates, or falsifies or conceals or tamper or does unauthorized removal or is a party to that or any document relating to the property, assets or affairs of the company or body corporate, or
  - b) Makes or is a party to the making of any false entry in the document concerning the company or body corporate, or
  - c) Provides any false information which he knows to be false then he shall be liable to punishment for imprisonment for a term from 6 months to 10 years and shall also be liable to fine which shall not be less than the amount involved in fraud, but which may extend up to 3 times of the amount of fraud as per Section 447.

### **15.15. Compromises, Arrangements, and Amalgamations**

The 2013 Act provided some comprehensive provisions related to the areas of mergers and acquisitions. These provisions are aimed at ensuring higher accountability for the company and majority shareholders and increasing flexibility for corporates. The provisions suggested companies to consider the scale and extent of compliance requirements while formulating their restructuring plans. Some of the important aspects are given below.

- As per Section 230 of the Companies Act, 2013 no compromise or arrangement shall be sanctioned by the Tribunal unless a certificate by the company's auditor has been filed with the Tribunal to the effect that the accounting treatment, if any, proposed in the scheme of compromise or arrangement is in conformity with the accounting standards prescribed under Section 133.
- Separate provisions have been provided for the merger or amalgamation between two small companies or between a holding company and a wholly owned subsidiary company as per Section 233 of the Companies Act, 2013.
- Provision for cross border amalgamations between Indian Companies and companies incorporated in the jurisdictions of such countries as may be

## **Block 5: Business Environment and Law**

notified from time to time by the Central Government as per Section 234 of the Companies Act, 2013.

- There is a specific provision for purchase of minority shares under Section 236 of the Companies Act, 2013 in case an acquirer or person acting in concert with the acquirer become holder of 90% or more of the issued capital of the company, either directly or by virtue of any amalgamation, share exchange, conversion of securities or any other reason.

### **Prevention of Oppression and Mismanagement**

Section 245 (Class Action Suits) as per Companies Act 2013 provides for class action by specified number of Members or Depositors against the company except the banking company, which is prevalent in developed countries.

Penalty for failing to comply with an order passed by Tribunal is as under:

- Company – ` 5 lakhs to ` 25 lakhs,
- Officer – ` 25,000 to ` 1 lakh, Imprisonment which may extend to 3 years

### **Registered Valuers**

Where any valuation is required to be made of any property, stocks, shares, debentures, securities or goodwill or any other assets (herein referred to as the assets) or net worth of a company or its liabilities under the provision of this Act, it shall be valued by a person having such qualifications and experience and registered as a valuer in such manner, on such terms and conditions as may be prescribed and appointed by the audit committee or in its absence by the Board of Directors of that company as per Section 247(1) of the Companies Act, 2013.

### **Removal of Names of Companies from the Register of Companies**

As per Section 248 of the Companies Act, 2013, the Registrar has the power to remove the name of a company from its record under certain circumstances. In case of a company regulated under a Special Act, approval of the regulatory body constituted or established under that Act shall also be obtained.

### **Revival and Rehabilitation of Sick Companies**

Under Section 253 of the Companies Act, 2013 where on a demand by the secured creditors of a company representing fifty per cent or more of its outstanding amount of debt for repayment, and the company has failed to pay the debt within a period of thirty days of the service of the notice of demand or to secure or compound it to the reasonable satisfaction of the creditors, then any secured creditor may file an application to the Tribunal in the prescribed manner along with the relevant evidence for such default, non-repayment or failure to offer security or compound it, for a determination that the company be declared as a sick company.

### Winding Up

As per Section 270 of the Companies Act, 2013 with the passing of the Insolvency and Bankruptcy Code, 2016 a company can now be wound up under the Companies Act, 2013 only by the Tribunal. ***Concept of voluntary winding up has been removed.*** Winding up by the Tribunal may be ordered in cases mentioned in Section 271. Grounds for compulsory winding up by the Tribunal are:

- If the company resolves through special resolution for winding up
- If the company acted against sovereignty and integrity of India
- Application made by Registrar or any other person authorized by Central Government and tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner
- Company making default in filing financial statements/annual returns for the past 5 years with the Registrar
- Tribunal feels just and equitable to wind up the company

### Dissolution of a Company

Section 302 of the Companies Act, 2013 is the dealing section for 'Dissolution of a Company'.

Where the affairs of the company are wound up or where the National Company Law Tribunal (NCLT) is of the opinion that the liquidator cannot proceed with the winding up due to lack of funds and assets or for any other reason whatsoever and further where the NCLT feels it is just and equitable to do so, it may make an order that the company be dissolved from the date of the order and the company shall be dissolved accordingly.

The power of the NCLT will continue till the date of dissolution. It was held in *Official Liquidator, Gannon Dunkerley & Co. (Madras) Limited vs. Assistant Commissioner, Urban Land Tax* that a company in liquidation will continue to exist as a legal person and it will be liable to pay taxes in respect of the land in its name till the order of dissolution is made by the NCLT.

Once the dissolution order is made, the existence of the company comes to an end. Also the liquidator's duty towards creditors and contributories comes to an end on the dissolution of the company. Where a liquidator has committed a breach of his/her duty to any creditor in contravention of any of the provisions of the Companies Act, he/she will be held liable to pay damages.

According to Section 302(2), the order of dissolution should not only be communicated but also forwarded to the Registrar for registration within 30 days from the date of the order. The Registrar shall then make a minute of the dissolution of the company in his/her books.

## Block 5: Business Environment and Law

If the liquidator makes a default in forwarding a copy as aforesaid, he/she shall be punishable with fine which may extend to ` 5000 for every day during which the default continues.

### 15.16. Companies Incorporated Outside India

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Any process, notice, or other document required to be served on a foreign company shall be deemed to be sufficiently served, if addressed to any person whose name and address have been delivered to the Registrar under section 380 and left at, or sent by post to, the address which has been so delivered to the Registrar or by electronic mode (Section 383 of the Companies Act, 2013). As per Section 391 of the Companies Act 2013:

- (1) The provisions of sections 34 to 36 (both inclusive) shall apply to: (i) The issue of a prospectus by a company incorporated outside India under section 389 as they apply to the prospectus issued by an Indian company. (ii) The issue of Indian Depository Receipts by a foreign company.
- (2) The provisions of Chapter XX shall apply mutatis mutandis for closure of the place of business of a foreign company in India as if it were a company incorporated in India.

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### Check Your Progress-2

6. Small Company is a company other than a public company wherein the paid-up share capital should not exceed \_\_\_\_\_crore and higher amount may be prescribed by the Central Government, not in excess of \_\_\_\_\_crore
  - a. 2 .00 and 20.00
  - b. 0.50 and 2.00
  - c. 50.00 and 100.00
  - d. 20.00 and 200.00
  - e. 100.00 and 200.00
7. Identify from the following the correct section of the companies act where reduction of Share Capital is confirmed by Tribunal
  - a. Section 61
  - b. Section 66
  - c. Section 62
  - d. Section 55
  - e. Section 63

8. Which one of the following statement is correct as regards to issue of debenture by companies?
- a. Company can issue only secured debentures
  - b. Company can issue any kind of debentures carrying any voting rights
  - c. Company need not create a debenture redemption reserve account
  - d. A company may issue debentures with an option to convert such debentures into shares
  - e. Unlike mutual funds trustee, there is no such a person called debenture trustee.
9. Companies can reopen or re-casting the book of accounts after obtaining the approval of shareholders in AGB . (True/ False)
10. As per Section 135 of the Companies Act, 2013, Corporate Social Responsibility Committee has to be constituted for \_\_\_\_\_ companies
- a. Companies having net worth of 100 crores or more or turnover of 500 crores or more or net profit of 5 crores or more during any financial year.
  - b. Companies having net worth of 500 crores or more or turnover of 5,000 crores or more or net profit of 100 crores or more during any financial year.
  - c. Companies having net worth of 500 crores or more or turnover of 1,000 crores or more or net profit of 5 crores or more during any financial year.
  - d. Companies having net worth of 10 crores or more or turnover of 100 crores or more or net profit of 5 crores or more during any financial year.
  - e. Companies having net worth of 100 crores or more or turnover of 1,000 crores or more or net profit of 10 crores or more during any financial year.

### **15.17. Other Areas of Companies Act, 2013**

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As per Section 447 of the Companies Act, 2013, without prejudice to any liability including repayment of any debt under this Act or any other law for the time being in force, any person who is found to be guilty of fraud, shall be punishable with imprisonment for a term which shall not be less than 6 months but which may extend to 10 years and shall also be liable to fine which shall not be less than the amount involved in the fraud, it may extend to three times the amount involved in the fraud. If the fraud in question involves public interest, the term of imprisonment shall not be less than three years.

#### **Companies to Furnish Information or Statistics**

As per Section 405 of the Companies Act, 2013, the Central Government may, by order, require companies generally, or any class of companies, or any

## Block 5: Business Environment and Law

company, to furnish such information or statistics with regard to their or its constitution or working, and within such time, as may be specified in the order. If any company fails to comply with an order made under this Section, or knowingly furnishes any information or statistics which is incorrect or incomplete in any material respect, the company shall be punishable with fine which may extend to twenty-five thousand rupees and every officer of the company who is in default, shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to three lakh rupees, or with both.

### Special Courts

As per Section 435(1) of the Companies Act, the Central Government may, for the purpose of providing speedy trial of offences punishable under this Act with imprisonment of two years or more by notification, establish or designate as many Special Courts as may be necessary. Provided that all other offences shall be tried, as the case may be, by a Metropolitan Magistrate or a first class Judicial Magistrate having jurisdiction to try any offence under this Act or under any previous company law.

### Acceptance of Deposits

The 2013 Act strengthened the provisions related to acceptance of deposits by Companies. According to Companies Act 2013, only those public companies which meet the prescribed net worth or turnover criteria may accept deposits from persons other than its members. Other companies can accept deposits only from its members. The Companies will have to incur additional costs due to requirements related to credit rating, maintenance of additional liquid funds, deposit insurance, etc.

All companies will be required to comply with the prescribed conditions which includes issuance of a circular to its members, obtaining credit rating, providing deposit insurance, maintaining deposit repayment reserve account, etc. [Section 73(2) of the 2013 Act].

### Details of 7 Schedules of Companies Act 2013

Schedule I	Memorandum of Association and Articles of association Table A to J
Schedule II	Useful Lives to Compute Depreciation Part A to Part C
Schedule III	Division I: Financial Statements for a company whose financial Statements are required to comply with the Companies (Accounting Standards) Rules, 2006. General Instructions For <i>Contd. ....</i>



	Preparation of Balance Sheet And Statement of Profit And Loss of a Company  Division II: Financial Statements for a company whose financial statements are drawn up in compliance of the Companies (Indian Accounting Standards) Rules, 2015. General Instructions For Preparation Of Financial Statements Of A Company Required To Comply With the Indian Accounting Standards (Ind AS)
Schedule IV	Code for Independent Directors Section 149(8)
Schedule V	Section 196 and Section 197 Conditions to be fulfilled for the appointment of a Managing or Whole Time Director or a Manager without the approval of the Central Government
Schedule VI	Section 55 and 186 related to Infrastructure Projects or Infrastructure Facilities
Schedule VII	Activities which may be included by companies in their Corporate Social Responsibility Policies (Section 135)

**15.18 Summary**

- The Companies Act, 2013 came into existence in August 2013 in place of sixty years old Companies Act, 1956.
- The Companies Act, 2013 has 7 schedules, 29 chapters and 470 sections.
- This new Act introduced ideas like Corporate Social Responsibility (CSR), Class Action Suits and Fixed Term Independent Directors, tightening the provisions for raising money from the public and prohibiting insider trading by company directors or key managerial personnel by treating such activities as a criminal offence etc.
- The common types of companies which can be registered under the Act are: (a) Private companies such as (i) One Person Company (ii) Small Company. (b) Public companies may be incorporated either as companies with limited liability or unlimited liability.
- Companies may also be classified as: (i) Statutory Companies (ii) Registered companies (iii) Existing Companies (iv) Associations not for Profit (v) Government Companies (vi) Foreign Companies (vii) Holding and Subsidiary Companies.
- Section 2(5) of the Act defines Articles of Association of a company as originally framed or as altered from time to time in pursuance of any previous company law or of this Act.
- Memorandum of Association is described as the charter of the company defining as well as confining the powers of the company. It contains name clause, Registered Office Clause, Shifting of registered office from one to

## Block 5: Business Environment and Law

another within the same city, town or village, Objects Clause, Liability Clause, capital clause and subscription clause etc.

- Issues related Prospectus and Allotment of Securities, Issue of Shares and Debentures, Company Management and Administration, Declaration and Payment of Dividend, Board related issues, Company Meetings and Resolutions were discussed.

### 15.19. Glossary

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**Abridged Prospectus** is one where the salient points of prospectus accompany the application forms.

**Allotment** is the distribution of shares to applicants in a new issue.

**Articles of Association** means the byelaws of the company that is rules and regulations relating to the internal management of the company which is incorporated.

**Artificial Person** is a legal entity usually an organization such as a corporation or a government ultimately composed of natural persons.

**Associate Company** in relation to another company is a company where such another company has a significant influence, but not a subsidiary company of the latter. It includes Joint Venture Company.

**Blank Transfer** is where the seller gives a blank deed to the buyer by only filling his name and affixing his signature and he is said to have executed a blank transfer deed.

**Bonus Shares** are those which are issued to the existing shareholders without payment of any consideration, either in cash or kind.

**Certification of Incorporation** means a certificate issued by a state that shows acceptance of a corporation's articles of incorporation.

**Corporate Veil** is a judicial doctrine that allows enjoyment of advantages of corporate nature and which are otherwise not available.

**Defunct Company** means a company, which never commenced business or which is not carrying on business and has either no assets or has such assets as shall not be sufficient to meet the costs of liquidation.

**Equity Shares** are those shares which do not enjoy any preferential right in the matter of payment of dividend or repayment of capital.

**Foreign Company** means a company incorporated outside India but having its place of business in India.

**Global Depository Receipts** are depository receipts issued for issue of shares outside India.

**Government Company** means any company that has at least 51% of the paid-up share capital held either by the Central Government, or by any state government

or governments or partly by the Central Government and partly by one or more state governments.

**Investment Company** means a company whose principal business is the acquisition of shares, stock, debentures or other securities.

**Memorandum of Association** is an important document of a company that is essential for the incorporation. It contains company's name registered office, objectives etc.

**Official Liquidator** is an officer appointed by the court/Central Government under Section 448 of the Companies Act, 1956, to take control of the company that has been ordered to be wound up by the court.

**Perpetual Succession** the continuation of a corporation's existence despite the death of any owner (shareholder) or any transfer of stock.

**Preference Shares** are those shares in a company which give their holders an entitlement to a fixed dividend, but the holders do not usually carry voting rights.

**Premium** is the difference between the face value or par value of a security and its market price when the latter is greater.

**Promoter** is one who alone or in the company of others actively participates in the formation of a business or venture.

**Share Certificate** is a printed certificate issued by a company when a person is entered into the register of members as the holder of shares in the company and is the prima facie evidence of the registered person's title to the shares.

**Share Warrants** are securities which are issued by a company. These securities give their owners the right to purchase shares in the company at a specific price at a future date.

**Surrender** means to relinquish possession or control to another voluntarily. In other words, to give up completely or agree to forgo.

**Transmission of Shares** is called so when the right to any shares has passed to a person by operation of law, such as the death, insolvency, lunacy of the shareholder or by acquiring shares by purchase in a court sale.

### **15.20. Self-Assessment Questions – 1**

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1. List down the circumstances in which the court ignores the company and concerns itself directly with the members or the management.
2. Mr. A diverts his investments to three private companies to receive the dividends and interest. One of the companies was in the name of his spouse and two on his name. Preliminary investigation reveals that Mr. A's purpose was to circumvent tax obligations. Discuss the legality of above act with reference to case laws.

## **Block 5: Business Environment and Law**

3. A company was incorporated at Mumbai with a paid up capital of 5 crore. 25% of paid up capital held by the Maharashtra government and 30% of paid up capital held by the central government. Identify the type of company.

### **Self-Assessment Questions – 2**

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1. ABC Ltd., altered its Memorandum of Association for change of its registered office from Hyderabad to Vijayawada in Andhra Pradesh. The registrar had been informed of the change within 30 days of altering of the MOA. Can the change be registered by the Registrar?
2. AlfaTech Ltd., put up cable wires in a certain area. There was no power in the Memorandum of Association of the company to put up wires there. BetaTech Ltd., a business rival of AlfaTech Ltd., cut the cable wires down. AlfaTech Ltd., wants to sue BetaTech Ltd., for damages. Can AlfaTech Ltd. sue BetaTech Ltd., for damages?
3. The secretary of Alfa Leo Technologies Ltd., forged signatures of two director required under the articles on a share certificate and issued the certificate without the authority of the company to Rajiv. Sanjay purchased these shares from Rajiv without knowing the facts. The Alfa Leo Technologies Ltd., rejected to enter the name of Sanjay in its Register of Members. Sanjay sues the company. Is the company liable to Sanjay or Rajiv?

### **Self-Assessment Questions – 3**

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1. Can a newspaper advertisement stating that some shares were still available for sale according to the terms of the prospectus of the company which could be obtained on application be held as a Prospectus?
2. Zaheerudin held shares in a Public Ltd. Co. After his death, his son has applied for transfer of shares. What does this amount to?

### **Self-Assessment Questions – 1 - Answers**

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1. The Companies Act, 2013 expressly provides for the following provisions pertaining to the lifting of the corporate veil.
  - i. In case of reduction of membership.
  - ii. Failure to Refund Application Money.
  - iii. Mis-description of Company Name.
  - iv. Misrepresentation in the Prospectus.
  - v. Fraudulent Conduct.
  - vi. Holding and Subsidiary Companies.

2. Protection of Revenue can be ground on which courts have pierced the veil of corporate entity.
3. Section 2(45) defines a government company as any company which has at least 51% of the paid up share capital held either by the Central Government, or by any State Government or partly by both. In the given case too since 25% was held by State Government and 30% by Central Government, the company is a Government Company. Since the concept of Government Company has been introduced into the Companies Act, 2013, it would mean a Government Company will mean a company registered and incorporated under the Companies Act, 2013.

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**Self-Assessment Questions – 2 - Answers**

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1. If a company proposes to shift the registered office from one city to another within the same state, a special resolution to that effect has to be passed and the Registrar informed about the change within 30 days of passing the special resolution.
2. The AlfaTech Ltd can recover the damages from BetaTech Ltd., as the Doctrine of Ultravires cannot prevent the company from protecting its property. More specifically, the rule of Ultravires was devised for the protection of the company's interest and it is not capable of being used against the company's interest or to cause loss to company's property.
3. According to the Doctrine of indoor management, the persons dealing with the company having satisfied themselves that the proposed transaction is not in its nature inconsistent with the Memorandum and Articles of the company are not bound to enquire into the regularity of the internal proceeding. An outsider is not bound to see that the company carries out its own internal regulations.

In the given case also the company is not liable to either Sanjay or Rajiv as the signatures of the directory were forged by the secretary of the company.

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**Self-Assessment Questions – 3 - Answers**

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1. A prospectus is an invitation issued to the public to purchase/subscribe shares or debentures of the company. The provisions of the Act relating to prospectus apply only if it is issued to the general public. In *Pramatha Nath Sanyal vs. Kali Kumar Dutt*, a newspaper advertisement stating that some shares were still available for sale according to the terms of the prospectus of the company which could be obtained on application was held to be a prospectus.
2. The transfer of shares to deceased Zaheerudins's son is known as Transmission of shares by operation of law.

**15.21. Suggested Reading / Reference Material**

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### **15.22. Answers to Check Your Progress Questions**

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Following are the answers to the Check Your Progress questions given in the Unit.

1. (e) Salomon vs. Salomon & Co. Ltd.
2. (a) It is limited liability and not unlimited liability
3. (d) Not meeting the financial commitments to the Bank
4. (e) Borrowings from banks, FIIs or bodies corporate less than ₹ 50 crores or double of its paid up capital, whichever is lower
5. (c) Charitable purpose
6. (c) E2 and 20 crore
7. (b) As per Section 66 of the Companies Act, 2013 reduction of Share Capital requires confirmation by Tribunal
8. (d) A company may issue debentures with an option to convert such debentures into shares
9. **False**  
As per Section 130 of the Companies Act, 2013, no re-opening or re-casting of book of accounts of the Company is allowed except under Court's or Tribunal's orders.
10. (c) Companies having net worth of 500 crores or more or turnover of 1,000 crores or more or net profit of ₹ 5 crores or more during any financial year.

## **Business Environment and Law**

### **Course Components**

<b>BLOCK I</b>	<b>The Socio-Political Environment of Business</b>
Unit 1	Business Environment: An Introduction
Unit 2	Demographic and Social Environment
Unit 3	Cultural Environment
Unit 4	Political Environment
<b>BLOCK II</b>	<b>The Economic and Technological Environment of Business</b>
Unit 5	Economic Environment
Unit 6	Financial Environment
Unit 7	Trade Environment
Unit 8	Technological Environment
<b>BLOCK III</b>	<b>The Legal and Ethical Environment of Business</b>
Unit 9	Legal and Regulatory Environment
Unit 10	Tax Environment
Unit 11	Ethics in Business
<b>BLOCK IV</b>	<b>Business Contracts</b>
Unit 12	Law of Contracts
Unit 13	Special Contracts
<b>BLOCK V</b>	<b>Law Relating to Corporate Business Entities</b>
Unit 14	Insolvency and Bankruptcy Code, 2016
Unit 15	A Brief Note on Companies Act, 2013
<b>BLOCK VI</b>	<b>Tax Laws</b>
Unit 16	Direct Taxes
Unit 17	Goods and Services Tax: An Overview





