

NATURE OF COMPANY

(UNIT 1)

A. Definition

B. Characteristics of a Company

C. Distinction

D. Lifting of Corporate Veil

E. Others

A. DEFINITIONS

Chief Justice Marshall

A Company is an artificial being, invisible, intangible and existing only in the contemplation of law.

Haney

A Company is an incorporated association which is an artificial person created by law having a separate entity with perpetual succession and a common seal.

Lord Justice Lindley

A Company is an association of persons who contribute money or money's worth to a common stock and employ it in some trade or business and who share the profit or loss arising therefrom. The common stock is denoted in money and is the capital of the Company. The persons who contribute it or to whom it belongs are the members. The proportion of capital to which each member is entitled is his share.

Indian Companies Act 1956

Section 2(10) – A Company means a Company

Cases Referred

- Salomon Vs. Salomon & Co Ltd.
- Lee Vs. Lee's Air Farming Ltd
- Kandoli Tea Co. Ltd
- Macaure Vs Northern Assurance Co. Ltd.
- Daimler Co. Ltd. Vs Continental Tyre and Rubber Co. Ltd.
- Bacha F. Guzdar Vs C.I.T. Bombay
- Jones Vs Lipman
- Gilford Motor Co Ltd Vs Horne
- F.G. Films Ltd. Case
- Connors Bros Vs Connors
- Hendon Vs Adelman & others

as defined in Section 3.

Section 3(1)(i) – Company means a Company formed and registered under this Act or an existing Company.

Section 3(1)(ii) – Existing Company means a Company formed and registered under any of the previous Companies Laws.

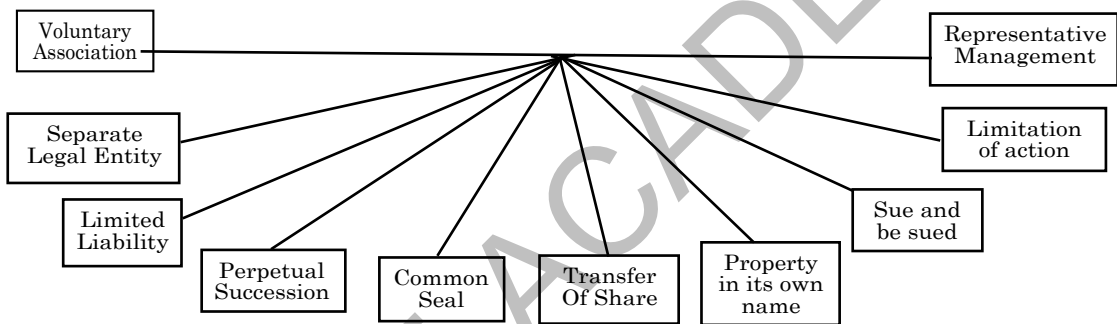
Com + Panis = Company

With (or) + Bread Together

The word “Company” is derived from the Latin words COM meaning ‘With’ or ‘Together’ and PANIS meaning ‘Bread’

B. CHARACTERISTICS OF A COMPANY

CHARACTERISTICS OF A COMPANY



1. **Voluntary Association** : It is a voluntary association of persons.
2. **Separate Legal Entity** : A Company is, in law regarded as an entity separate from its members, ie., it has an independent corporate existence.

a. **Salomon Vs. Salomon & Co. Ltd.**

Facts

There was a sale by 'S' of a shoe business to a newly formed Company. The consideration was 38,782 pounds of which 'S' took 20,000 shares of 1 pound each, debentures worth 10,000 pounds and the balance in cash. His wife, daughter and 4 sons took up one share each. Subsequently, the Company was wound up on which date the assets were worth 6,000 pounds and liabilities were 17,000 pounds (including 10,000 pounds secured debentures held by 'S'). Payment was first made to 'S' as he was a secured creditor.

Contention

The unsecured creditors contended that 'S' could not be treated as a secured creditor as he was the Managing Director of the one man Company which was no different from 'S' and the

cloak of the Company was a mere sham and fraud.

Decision

It was held that a Company is distinct from the members who form it and their liability is restricted to the extent of unpaid value of shares, if any.

b. Lee V Lee's Air Farming Ltd.

Facts

'L' held 2,999 shares out of 3,000 shares in an Airline Company. He was the Managing Director and chief pilot on a salary. He was killed in an air crash while working for the Company. His wife claimed compensation since her husband died during the course of employment.

Contention

The Insurers challenged that 'L' and the Company were the same person.

Decision

It was held that 'L' was a separate person distinct from the Company he formed and hence compensation was due to the widow.

c. Kandoli Tea Company Ltd.

Facts

Certain persons transferred their estates, on which advalorem duty was payable, in the name of the Company. They claimed exemption from such advalorem duty on the ground that the transfer was from them individually, to themselves in another name.

Decision

It was held that the Company was separate from the shareholders and transfer was as much as conveyance. Hence transfer of shares was deemed to be taxable.

- 3. Limited Liability** : A Company may be limited either by shares or by guarantee. If it is a Company limited by shares, then the liability of the members is limited to the extent of money remaining unpaid on shares held by them. For example, if face value of a share is Rs. 10/- and a member has already paid Rs. 6/-, then he cannot be called upon to pay during the lifetime of the Company, more than Rs. 4/- per share.

If it is a Company limited by guarantee, then the liability of the members is limited to such an amount as the members may undertake to contribute, in the event of its winding up.

- 4. Perpetual Succession** : A Company is a juristic person and its life does not depend on the life of its members. The membership of a Company may keep changing from time to time, but that does not affect the Company's continuity. The death or insolvency of an individual member does not in any way affect the

corporate existence of the Company. As Gover puts it “Members may come and members may go, but the Company goes on for ever”. As has been held in Meat Supplies Guildford Ltd., even a hydrogen bomb could not destroy a Company. An incorporated body never dies.

- 5. Common Seal** : It is the official signature of the Company. As the Company has no physical existence it has to act through its agents and all contracts entered into by its agents must be under the seal of the Company. Normally the seal of the Company is affixed to the documents in accordance with the prescription of the Company’s Articles.
- 6. Transferability of Shares** : This provides liquidity to the investor and stability to the Company. Shares or interest of the member in a Company is freely transferable except to the extent of restrictions prescribed in the Articles of a Private Company.
- 7. Own & Hold property in its own name** : A Company is a legal person. It is capable of owning, enjoying and disposing of the property in its own name. No member can claim himself to be the owner of the Company’s property during its lifetime or even on its winding up. A shareholder does not have even an insurable interest in the property of the Company. The property of the Company is not the property of its shareholders.
Eg : Macaure held all except one share of a timber Company. He was also a substantial creditor of the Company. He insured the Company’s timber in his own name. The timber was destroyed by fire. His claim was rejected by the insurance Company for want of insurable interest. Held, the insurance Company was not liable to him. (Macaure Vs. Northern Assurance Co. Ltd.)
- 8. Capacity to sue & be sued** : A Company being a body corporate can sue and be sued in its own name.
- 9. Limitation of action** : The creditors can make their claims (limitation) only against Company and cannot proceed against shareholders. Their action stops with the Company. It is only the Company which can call for any unpaid capital from its shareholders.
- 10. Representative Management** : The Company is managed by elected representatives of the shareholders viz., Directors, collectively referred to as the ‘Board’.

C. DIFFERENCE BETWEEN A COMPANY AND A PARTNERSHIP FIRM

BASIS OF DIFFERENCE	COMPANY	PARTNERSHIP FIRM
Mode of Creation	Only when registered under Companies Act	By mutual agreement between partners. Registration is optional
Separate Legal Entity	Yes	No
Own Property	Yes	No

Agents	Members are not agents of the Company.	Partners are agents of the Firm
Transfer of Shares	Shares can be transferred	Cannot be transferred
Enter into contracts with Company / Firm	Member can enter into a contract with the Company.	Partner cannot enter into a contract with the Firm.
Liability	Limited	Unlimited
Perpetual Succession	Yes	No
Minimum No. of Persons	Two for Private Companies and Seven for Public Companies.	Two
Maximum No. of Persons	Fifty - Private Companies Unlimited - Public Companies	10 for Banking and 20 for any other Business
Audit	Compulsory	Optional
Minimum paid-up capital	Applicable - Rs.1 Lakh for Private Co. Rs.5 Lakhs for Public Co.	Not applicable

D. LIFTING OF CORPORATE VEIL

A Company is a person created by law, having a separate legal entity. The principle of separate and distinct entity has been well established in the case of *Salomon Vs. Salomon & Co. Ltd.* In the words of Lord MacNaghten “The company is at law different altogether from the subscribers to the memorandum, and though it may be that after incorporation the business is precisely the same as it was before and the same persons are managers and the same hands receive the profits, the company is not in law the agent of subscribers or trustees for them. Nor are the subscribers, as members, liable in any shape or form, except to the extent and in the manner provided by the Act.”

When a Company has been formed and registered under the Act, all dealings with the Company will be in the name of the Company and the persons behind the Company will be disregarded, however important they may be. This principle is referred to as the Veil of Incorporation. The Courts in general consider themselves bound by this principle. The effect of this principle is that there is a fictional veil (i.e., a curtain and not a wall) in between the Company and its members.

However, the advantages of corporate personality are allowed to be enjoyed only by those who make use of it for honest purposes. In case of a dishonest and fraudulent use of the facility of incorporation, the law will lift the corporate veil and identify the persons (members) who are behind the curtain and make them responsible for the fraud and improper conduct.

The corporate entity will be disregarded in the following circumstances –

1. Cases falling under judicial interpretation
2. Cases falling under statutory provisions

1. Cases falling under judicial interpretation

a) *Determination of the character; whether it is an enemy Company or not*

A Company may assume an enemy character when persons in defacto control of its affairs are residents in an enemy country. In such a case, the Court may, at its discretion, examine the character of the persons in real control of the Company, disregard the corporate fiction and declare the Company to be an enemy Company.

Daimler Co. Ltd. Vs. Continental Tyre and Rubber Co. Ltd.

A Company was incorporated in England by a German Company for the purpose of selling in England tyres which were manufactured in Germany. The German Company virtually held the entire share capital in the English Company. All the Directors were German residents. During the First World War, the English Company commenced an action for recovery of a trade debt from another English Company.

It was held that the Company was an alien Company and the payment of debt to it would amount to trading with the enemy and therefore the Company was not allowed to proceed with the action.

b) *Protection of Revenue*

The Courts may ignore the 'separate legal entity' status of a Company, where it is used for tax evasion or circumventing tax obligation.

Sir Dinshaw Maneckjee Petit

'D', an assessee, who was receiving huge dividend and interest income, transferred his investments to 4 private Companies formed for the purpose of reducing his tax liability. These Companies transferred their income to 'D' as a pretended loan. Held, these Companies were formed by 'D' purely and simply as a means of avoiding tax obligation and the Companies were nothing more than 'D' himself. They did no business but were created simply as legal entities to ostensibly receive the dividends and interest and hand them over to 'D' as pretended loans.

c) *Prevention of fraud or improper conduct*

The legal personality of a Company may also be disregarded in the interest of justice where the machinery of incorporation has been used for some fraudulent purpose.

Eg: Defrauding creditors or defeating or circumventing law or avoiding legal obligation.

Jones Vs Lipman

'L' agreed to sell a certain piece of land to 'J' for Pound 5,250. He subsequently changed his mind and to avoid specific performance of the contract, he sold it to a Company (with a capital of Pound 100), which was formed especially for this purpose. The Company had 'L' and a clerk of his solicitors as the only members. 'J' brought an action against 'L' and the Company for specific performance of the contract. The Court looked into the reality, ignored the transfer, and ordered the Company to convey the land to 'J'.

Gilford Motor Co. Ltd. Vs. Horne

'H', a former employee of 'G', was subject to a covenant not to solicit its customers. 'H' formed a Company to carry on a business which solicited the customers of 'G'. The Court gave an injunction both against 'H' and his Company to restrain them from carrying on the business further.