

## **“Promotion and Formation of Company - Advantages and Disadvantages of Incorporation of a Company”**

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### **ABSTRACT**

This research paper tells about INCORPORATION OF COMPANY. Incorporation generally mean FORMATIONS. IT TELLS stages how the company is formed and become separate legal entity ie different from the members. This research paper also focuses on advantages and disadvantages after incorporation of company..

### **Let, us first discuss what is COMPANY?**

A company, in common, means a group of persons associated together for the attainment of a common end, social or economic. It has “no strictly technical or legal meaning.”

According to sec. 3 (1) (ii) of the Companies Act, 1956 a company means, a company formed and registered under the Companies Act, 1956 or any of the preceding Acts. Thus, a Company comes into existence only by registration under the Act, which can be termed as incorporation.

Now, let us discuss stages of formation of a company.

### **STAGES OF FORMATION OF A COMPANY:**

#### **STAGE 1:**

**Promotion of a company**

#### **STAGE 2:**

**Registration and incorporation of a company**

#### **STAGE 3:**

**Raising of capital**

#### **STAGE 4:**

**Commencement of business**

### **PROMOTION OF A COMPANY:**

Promotion is the first stage in the formation of a company. Certain persons who wish to carry on some business come together to form a company.

These persons are known as promoters.

- Promotion means the preliminary steps undertaken by the promoters to bring a Company into existence.
- It refers to all those steps which are taken from the time of having an idea of starting a company to the time of actual starting of a company.

## **A PROMOTER**

R [Section 2(69)]

### **MEANING OF PROMOTER**

- Promoter means a person who thinks of forming a Company and actually brings it into existence.
- He takes all the effective steps to incorporate it.
- A person, who was not associated with the initial formation of the Company but subsequently helps in floating its capital, will also be regarded as promoter.
- Persons assisting the promoters by acting in a professional capacity are not promoters. However, if he goes further than this, like, introducing his clients to a person who may be interested in purchasing the shares in the proposed Company would be regarded as promoter.

### **Legal Position of Promoters**

They are neither the agents nor the trustees of the proposed Company. The promoters stand in fiduciary relation to the Company they promote and to those persons, whom they induce to become shareholders in it.

### **CASE LAW D.R. Patil v. A.S. Dimilov**

It was held that a promoter is personally liable to third parties upon all contracts made on behalf of the intended company, until with their consent, the company takes over this liability.

If the promoter commits a breach of duties, the company can either rescind the contract or can compel him to account for any secret profits that he has made. Companies (Incorporation) Fifth Amendment Rules, 2016.

Date of enforcement 1st day of January, 2017.

**STEPS OF INCORPORATION OF A COMPANY.**

It is the second stage in the formation of a company. A company is registered by filing an application along with requisite fees and documents, with the ROC of the area in which the registered office of the company is proposed to be situated.

**Documents to be filed:****1) Memorandum of Association (MOA)**

It describes the scope of company's activities. It must be signed by the required number persons, which are necessary for the formation of the company.

**2) Articles of Association (AOA)**

It defines the rules and regulations of the company. It must also be signed by the persons who signed the Memorandum.

**3) Declaration**

A declaration that all the requirements of this Act and the rules, in respect of registration and related matters have been complied with in the prescribed form by

- i. An advocate/ a chartered accountant/ cost accountant/ company secretary in practice, who is engaged in the formation of the company, and
- ii. By a person named in the articles as a director/manager/secretary of the company.

**4) Declaration Affidavit by Subscribers & First Directors**

An declaration affidavit from each of the subscribers to the memorandum and from persons named as the 1st directors, if any, in the articles that

- i. He is not convicted of any offence in connection with the promotion, formation or management of any company, or
- ii. That he has not been found guilty of any fraud or misfeasance or of any breach of duty to any company under this Act or any previous company law during the preceding 5 years and
- iii. That all the documents filed with the Registrar for registration of the company contain information that is correct and complete and true to the best of his knowledge and belief.

**5) Address for Correspondence**

The address for correspondence till its registered office is established.

**6) Particulars of every subscriber to the Memorandum****ISSUE CERTIFICATE OF INCORPORATION**

The Registrar on the basis of documents and information filed shall register all the documents in his register and issue a certificate of incorporation in INC 11.

**Case Law Patinson v. Bindhya Debi AIR, 1933**

Two companies which are incorporated with the same set of shareholders are nevertheless distinct and separate entities.

**ALLOTMENT OF CORPORATE IDENTITY NUMBER (CIN)**

Registrar shall allot to the company a Corporate Identity Number (CIN), which shall be a distinct identity for the company and which shall also be included in the certificate.

**ALL DOCUMENTS FILED WITH REGISTRAR TO BE PRESERVED**

The company shall maintain and preserve at its registered office copies of all documents and information as originally filed till its dissolution under this Act.

**FOREIGN COMPANY REGISTRATION NUMBER**

- Every Foreign Company has been allotted a Foreign Company Registration Number (FCRN).
- Corporate Identity Number (CIN) works as a unique identifier of an Indian company. Foreign
- Company Registration Number (FCRN) is a unique identifier in the case of a Foreign Company.

**Director Identification Number (DIN) Number**

Director Identification Number (DIN) is a unique Identification number for an existing director or a person intending to become the director of a company. Any individual who is a director or intends to be a director of a company should apply for DIN. In the scenario of e - filing, DIN will be a pre-requisite for filing of certain company related documents.

**EFFECT OF CERTIFICATE OF INCORPORATION**

1. From the date of incorporation mentioned in the certificate of incorporation, such subscribers to the memorandum and all other persons, as may, from time to time, become members of the company.

2. It shall be a body corporate.
3. It shall exercise all the functions of an incorporated company.
4. Upon incorporation, the Company becomes a legal person separate from its members.
5. It acquires perpetual succession and common seal.
6. It shall have power to acquire, hold and dispose of property, both movable and immovable, tangible and intangible.
7. It shall have power to contract and to sue and be sued, by the said name.

### **MEANING OF CERTIFICATE OF INCORPORATION**

- A certificate which certifies that the company is registered is called, „Certificate of Incorporation“. It is issued by the ROC.
- It contains the name of the company, the date of its issue and the signature of Registrar with his seal.
- The Company comes into existence from the date of the certificate of incorporation.
- After scrutinizing the documents filed with the ROC, and after being satisfied that all the requirements have been fulfilled, the Registrar will enter the name of the company in the Register of companies and shall certify under his hand that the company is incorporated.

### **CERTIFICATE OF INCORPORATION IS A CONCLUSIVE EVIDENCE**

- Company's life commences from the date of incorporation and the date appearing on it is conclusive, even if it is wrong.
- Certificate of Incorporation given by the Registrar in respect of any Company shall be conclusive evidence of registration of the company.
- In other words, no one can question the validity of certificate of incorporation once it is issued.

Thus, the certificate is conclusive evidence on the following points:

- All the requirements under the Act have been complied with in respect of registration of Company and matters precedent and incidental thereto, and
- The association is a Company, authorized to be registered and duly registered under this Act.

Thus, if Memorandum of Association is:

- Materially altered after signature but before registration, or

- Signed by only 1 person for all 7 subscribers, or
- If signatories are all minors, or
- If all or some of the signatures on the Memorandum and Articles are forged,
- Contains illegal objects,
- The certificate would be conclusive and would not affect the status and existence of the Company as legal person although such irregularities might give rise to claims between the subscribers.

#### **“TV KRISHNA VS ANDHRA PRABHA”**

If the Company has been incorporated with illegal objects, illegal objects would not become legal by issue of Certificate of Incorporation.

- If a Company with illegal objects happens to be registered, the existence of certificate means that the corporate status of the Company cannot be questioned.
- But the Company is forbidden to carry on its illegal objects. D

#### **“JUBILIE COTTON MILLS VS LEWIS”**

Documents for registration of the Company were filed with the ROC on 6th January.

- ROC issued Certificate of Incorporation on 8th January but dated it 6th January.
- On 6th January, the Company made an allotment of shares to Lewis.
- It was contended that the allotment is void on the ground that it was made before the company come into existence.
- However, the Court held that the Certificate of Incorporation is conclusive evidence of incorporation of Company on 6th January and hence the allotment was valid.

### **NOW LET US DISCUSS WHAT ARE THE ADVANTAGES AND DISADVANTAGES OF INCORPORATION OF A COMPANY**

#### **Advantages of incorporation:**

Incorporation offers certain advantages to a company as compared with all other kinds of business organizations. They are:

1. **Independent corporate existence:** The outstanding feature of a company is its independent corporate existence. By registration under the Companies Act, a company becomes vested with corporate personality, which is independent of, and distinct from its members. A company is a legal person. The decision of the House of Lords in *Salomon v. Salomon & Co. Ltd.* (1897 AC 22) is an

authority on this principle: One S incorporated a company to take over his personal business of manufacturing shoes and boots. The seven subscribers to the memorandum were all his family members, each taking only one share. The Board of Directors composed of S as managing director and his four sons. The business was transferred to the company at 40,000 pounds. S took 20,000 shares of 1 pound each in debentures worth 10,000 pounds. Within a year the company came to be wound up and the state of affairs was like this: Assets- 6,000 pounds; Liabilities- Debenture creditors-10,000 pounds, Unsecured creditors- 7,000 pounds. It was argued on behalf of the unsecured creditors that, though the co was incorporated, it never had an independent existence. It was S himself trading under another name, but the House of Lords held Salomon & Co. Ltd. must be regarded as a separate person from S.

2. **Limited liability:** limitation of liability is another major advantage of incorporation. The company, being a separate entity, leading its own business life, the members are not liable for its debts. The liability of members is limited by shares; each member is bound to pay the nominal value of shares held by them and his liability ends there.
3. **Perpetual succession:** An incorporated company never dies. Members may come and go, but the company will go on forever. During the war all the members of a private company, while in general meeting, were killed by a bomb. But the company survived, not even a hydrogen bomb could have destroyed it (K/9 Meat Supplies (Guildford) Ltd., Re, 1966 (3) All E.R. 320).
4. **Common seal:** Since a company has no physical existence, it must act through its agents and all such contracts entered into by such agents must be under the seal of the company. The common seal acts as the official seal of the company.
5. **Transferable shares:** when joint stock companies were established the great object was that the shares should be capable of being easily transferred. Sec 82 gives expression to this principle by providing that “the shares or other interest of any member shall be movable property, transferable in the manner provided by the articles of the company.”
6. **Separate property:** The property of an incorporated company is vested in the corporate body. The company is capable of holding and enjoying property in its own name. No members, not even all the members, can claim ownership of any asset of company’s assets.
7. **Capacity for suits:** A company can sue and be sued in its own name. The names of managerial members need not be impleaded.
8. **Professional management:** A company is capable of attracting professional managers. It is due to the fact that being attached to the management of the company gives them the status of business or executive class.

**Disadvantages of incorporation:**

1. Lifting of corporate veil- though for all purposes of law a company is regarded as a separate entity it is sometimes necessary to look at the persons behind the corporate veil.
2. Determination of character- The House of Lords in Daimler Co Ltd. v. Continental Tyre and Rubber Co., held that a company though registered in England would assume an enemy character if the persons in de facto control of the company are residents of an enemy country.
3. For benefit of revenue- The separate existence of a company may be disregarded when the only purpose for which it appears to have been formed is the evasion of taxes. – Sir Dinshaw Maneckjee, Re / Commissioner of Income Tax v. Meenakshi Mills Ltd.
4. Fraud or improper conduct- In Gilford Motor Co v. Horne, a company was restrained from acting when its principal shareholder was bound by a restraint covenant and had incorporated a company only to escape the restraint.
5. Agency or Trust or Government company- The separate existence of a company may be ignored when it is being used as an agent or trustee. In State of UP v. Renusagar Power Co, it was held that a power generating unit created by a company for its exclusive supply was not regarded as a separate entity for the purpose of excise.
6. Under statutory provisions- The Act sometimes imposes personal liability on persons behind the veil in some instances like, where business is carried on beyond six months after the knowledge that the membership of company has gone below statutory minimum(sec 45), when contract is made by misdescribing the name of the company(sec 147), when business is carried on only to defraud.

**CONCLUSION**

This research paper tells about incorporation of company. Incorporation generally means formations. It tells stages how the company is formed and become separate legal entity i.e. different from the members. This research paper also focuses on advantages and disadvantages after incorporation of company.

**REFERENCE**

1. Lords in Salomon v. Salomon & Co. Ltd.
2. JUBILIE COTTON MILLS VS LEWIS”
3. TV KRISHNA VS ANDHRA PRABHA
4. Patinson v. Bindhya Debi AIR, 1933
5. D.R. Patilv. A.S. Dimilov
6. MOOSAGOOLAM ARIF VS IBRAHIMGOOLAMARIF etc...