



Incorporation

Company Law (Karnataka State Law University)



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Introduction

The word 'Company' has a strict legal meaning according to the provisions of the Companies Act of 2013, a company refers to a company formed and registered under the Companies Act. In common law, a company is a "legal person" or a "legal entity" which is separate and capable of surviving beyond the lives of its members.

Incorporation of a company refers to the setting up of a company according to the provisions laid out in the Companies Act of 2013. This article deals with the process of incorporation of a Company, the advantages that an incorporated company would have over the Non-Incorporated Companies and also the disadvantages of Incorporation of a Company.

Advantages of Incorporation of a Company

The advantages mentioned below are only enjoyed by the companies which are incorporated according to the provisions laid out in the Companies Act of 2013. Non incorporated companies do not enjoy these benefits.

Separate Legal Identity

Once a business is incorporated, it becomes a separate legal identity. An incorporated company, unlike a partnership firm which has no identity of its own, has a separate legal identity of its own which is independent of its shareholders and its members. The companies can thus own properties in their name, become signatories to contracts etc.

According to [Section 34\(2\) of the Companies Act, 2013](#), upon the issue of the certificate of incorporation (which will be talked about later in the article), the

subscribers to the memorandum and other persons, who may from time to time be the members of the company, shall be a body corporate capable of exercising all the functions of an incorporated company having perpetual succession. Thus the company becomes a body corporate which is capable of immediately functioning as an incorporated individual.

Perpetual Succession

The term perpetual succession means that the longevity of the company does not depend on its members or their financial status. Even if all the members of the company go bankrupt or all of them die, the company will not dissolve on its own unless it is made to dissolve on grounds which are laid out in the act.

Transferable Shares

According to [Section 82 of the Companies Act of 2013](#), the shares of a company are deemed to be movable and transferrable in the manner provided by the articles of the company. This enables the member to sell his shares in the open market and to get back his investment without having to withdraw money from the company. This provides liquidity to the investor and the stability of the company. In a partnership, on the other hand, a partner cannot transfer his share in the capital of the firm except with the unanimous consent of all the partners.

Capacity to Sue

An incorporated company is also vested with the power of suing individuals and other companies in its name.

Flexibility

Every company has complete independence to form policies suited to their organisation provided they do not violate general principles of law and equity.

Limited Liability

The company being a separate entity, leading its own existence, its members are not liable for its debts. The liability of the members is limited to his or her share in the company and the liability ends there. No one is bound to pay more than what he has put in.

Disadvantages of Incorporation of a Company

Lifting the Corporate Veil

Under this concept, the court disregards the status of a company as a separate legal entity if the members of the company try to take advantage of this status. The intentions of the persons behind the veil are completely exposed. They are made personally liable for using the company as a vehicle for undesirable purposes. This can be done where the only purpose of incorporation of a company was to evade taxes, where the company was brought forth for fraudulent purposes etc.

The corporate veil can also be lifted when the members of the company go against the statutory provisions. For example, in cases where a business is carried on beyond six months after the knowledge that the membership of the company has gone below the statutory requirement, the members of the company will be held liable.

Paperwork and Expenses

Incorporation of a company is both, an expensive affair in monetary terms and a cumbersome process because of the paperwork that it requires.

Company is not Citizen

A company, though a legal person, is not a citizen. It can have the benefit of only such fundamental rights as are guaranteed to every "person" whether a citizen or not. A company, however, does have a nationality, domicile and residence. A company incorporated in a particular country possesses the nationality of that particular country, but unlike a particular person, it cannot change its nationality.

Registration and Incorporation of Company

A company can get incorporated as various types of businesses which generally depends on the need and the capital of the business owner. These various types include one person companies, public limited companies, private limited companies, limited liability partnerships, foreign companies etc. Barring a few minor differences, all these various forms are incorporated in more or less the same way.

According to [Section 33 of the Companies Act, 2013](#), the registration of a company is obtained by filing an application with the Registrar of Companies. Other than the application, the following documents should also be submitted. These include the Memorandum of Associations and the Articles of Association (if necessary).

Articles of Association are deemed necessary only for unlimited companies. A copy of the agreement which the company proposes to enter into with any individual for his or her appointment as a director or a manager also needs to be given if at all someone has been appointed. Lastly, a declaration that all the requirements of the Act have been complied with also needs to be given.

The preparation of a document known as Memorandum of Association is the first step in the formation of a company. This document contains the constitution of the company. According to Section 12 & 13 of the Companies Act of 2013, the document is divided into five clauses:

Name Clause

The first clause of the memorandum states the name of the proposed company. According to [Sec 20, Companies Act, 2013](#), the name should not be undesirable. Generally, a name is said to be undesirable when it is too close to the name of another company. The name should not mislead as to the nature of the business carried on by the company. If the company is with "limited liability", the last word of the name should be "limited" and in the case of a private company "private limited".

This informs the person contracting with the company what the liability of the members of the company is. The Central Government may, however, permit the company to drop the "limited" from its name in special cases like if the company is formed for the promotion of commerce, art, religion or science or any other useful object. The name of the company is also required to be painted outside of every place where the company carries on the business and printed on every business document and official letter. According to [Section 147 of the Companies Act, 2013](#), misdescription of name entails personal liability.

Registered Office Clause

The second clause of the memorandum states the State in which the registered office of the company shall be situated. After incorporation, the exact address of the registered office should be sent to the Registrar.

Objects Clause

The third clause of the memorandum states the objects of the proposed company. The company carries on business with other people's money and therefore the investors must be informed of the objects in which their money is going to be used. The objects clause has to be divided into two sub-clauses, the first subclause talks about the main objects. This subclause states the main objects to be pursued by the company on its incorporation and the objects incidental or ancillary to the main objects are covered under the subclause called other objects. This subclause may state any other objects which are not included in the first subclause.

Liability Clause

The fourth clause has to state the nature of the liability of the members of the business. The clause will state whether the liability of the members shall be limited, and, if so, whether limited by shares or by guarantee, or unlimited.

Capital Clause

The last clause states the amount of capital with which the company is proposed to be registered and the kinds, number and value of shares into which the capital is to be divided.

Articles of Association

Articles of Association is the second important document, which in the case of some companies, has to be registered with the memorandum. Articles are internal regulations and bye-laws needed to define how the company will actually operate. Companies which must have the articles of association are:

1. Unlimited Companies
2. Companies limited by guarantee; and
3. Private companies limited by shares.

Articles of association may prescribe such regulations for the company as the subscribers to the memorandum deem convenient. The Act gives the subscribers a free hand. Any stipulations as to the relations between the company and its members, and between the members inter se may be interested in the articles. It must also be noted that the document must not be in violation of the provisions laid out in the act.

Upon the satisfaction of the Registrar, he registers the company, enters its name in the Register of Companies and issues a certificate called the Certificate of Incorporation which is talked about in [Section 34 of the Companies Act, 2013](#).

Certificate of Incorporation

The significance of the Certificate of Incorporation lies in the fact that this certificate brings the company into existence as a legal person. The certificate is proof that all the requirements of the Act with respect to the aforementioned matters have been complied with and that the association is a company authorised to be registered under this act.

Effects of Pre-incorporation Contracts

A lot of times what happens is that contracts are made on behalf of companies which are not even incorporated. This subsection will discuss the effects and the legality of these Pre-incorporation Contracts. Firstly, the company, when it comes into existence, is not bound by any contract made on its behalf before its incorporation. A solicitor, who on the request of promoters, prepared a company's documents and spent time and money in getting it registered, could not recover his charges from the company.

Secondly, the other party to the contract is also not bound. The company cannot ratify a pre-incorporation contract and hold the other party liable. Thirdly, the agents who contract for a proposed company may sometimes incur personal liability.

Commencement of Business

According to [Section 149 of the Companies Act, 2013](#), a private company can commence its business right from the date of its incorporation but in case of a public company, a further certificate for the commencement of business has to be obtained. This becomes necessary where a company has issued a prospectus inviting the public to subscribe for its shares. It will be entitled to the certificate subject to the following conditions according to Section 149(1):

1. Shares payable in cash must have been allotted up to the amount of the minimum subscription;
2. Directors must have paid in cash the application and allotment money in respect of the shares contracted to be taken by them for cash;
3. No money is liable to become refundable to the applicants by reason of failure to apply for or to obtain permission for shares or debentures to be dealt in on any recognised stock exchange.

No public company can commence any business or exercise any borrowing power unless this certificate is obtained. Any contract made before the date at which the company is entitled to commence business. The certificate is conclusive evidence that the company is so entitled.

Conclusion

Incorporation of a company thus has its own pros and cons. Incorporation greatly depends on the needs of the business, if the members perceive the business as scalable then the high incorporation costs are completely justified.

A company being an artificial entity comes into existence only after its registration with the Registrar of Companies. A number of formalities have to be completed before a request is made to the Registrar for its registration. A legal process has to be completed before a company obtains a separate legal entity. After ensuring that all necessary documents are filed, the Registrar of companies issues a Certificate of Incorporation. With this Certificate, the company becomes a separate legal entity.

Steps for Incorporating a Company:

Before getting a company registered, a number of steps have to be taken up:

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1. Application for approval of name:

The first step in getting a company incorporated is of obtaining the approval of name from Registrar of Companies. A company may adopt any name which is not prohibited under the Emblems and Names (Prevention of Improper Use) Act, 1950 and which is not identical with or does not closely resemble the name of a company already registered.

The applicant should give a panel of three names in order to avoid delay. The application for the approval of name should be sent the Registrar of Companies of the state, in which, the Company is to be situated. The Registrar is expected to approve the name within 14 days of the receipt of application. The proposed name must be registered within 3 months from the date of intimation by the Registrar, failing which, the promoter will have to apply again to the Registrar for the revalidation of the approval.

2. Preparation of Memorandum of Association:

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The preparation of Memorandum of Association is the next step in the incorporation of a company. It is the constitution of the company, which describes its objects and scope and the relation with outside world. The memorandum is to be signed by at-least seven persons if it is a public limited company and at least two persons in case of a private limited company. The memorandum should also be properly stamped.

3. Preparation of Articles of Association:

Besides memorandum, the promoters will also prepare Articles of Association. It is a document which contains rules and regulations relating to the internal management of the company. A public limited company may not file its own Articles of Association, it may adopt model clauses prescribed in Table A, Schedule 1 of the Act. A private limited company is also required to submit its Articles duly signed by the signatories.

4. Preparation of other documents:

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The promoters are also expected to prepare the following documents at the time of incorporating the company:

(i) The consent of directors is acquired first and filed with the Registrar of Companies.

(ii) The promoters should execute a Power of Attorney in favour of one of them or an advocate who is to carry out the formalities required for registration.

(iii) Copies of preliminary agreements, memorandum and Articles of Association must also be prepared and filed at the time of registration.

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(iv) The company is required to have a registered office and its information is filed with the Registrar within 30 days of its registration or from the date of commencement of business, whichever is earlier.

(v) Where the company names first directors in its Articles, their particulars are to be submitted with the Registrar within 30 days of its registration or appointment of such directors.

(vi) A statutory declaration that all legal requirements for registration have been complied with is also filed with the Registrar at the time of registration. The declaration must be signed by an advocate of Supreme Court or High Court, or an attorney or pleader of High Court or a practising Chartered Accountant.

5. Payment of fees:

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At the time of registration, prescribed registration fees and filing fee for each document filed for registration are to be paid at the Registrar's office. The fee to be paid, varies with the amount of nominal Capital in case of companies with share capital or according to the number of members in case of companies without share capital.

6. Incorporation Certificate:

When all the required documents are filed with the Registrar along with the requisite fees, a scrutiny is made. When all documents are found in order, the Registrar will enter the name of the company in the Register of Companies and issues a Certificate of Incorporation. The date mentioned in the certificate is the date of incorporation of the company.

Effect of Certificate of Incorporation:

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After the incorporation, the company becomes a separate legal entity with perpetual succession. The certificate of incorporation is a conclusive proof of the existence of the company. Once a certificate of incorporation is issued, the company comes into existence from the date mentioned on it. Any deficiency or infirmity found in the incorporation of the company later on will not influence the existence of the company and the incorporation, will remain valid.

Capital Subscription:

After going through the incorporation formalities, the next stage will be to raise funds. A private company and a public company without share capital can start business immediately. A public company cannot commence business unless minimum subscription as stated in the prospectus has been subscribed. The amount stated for allotment should be duly received in cash and allotment has been made properly.

Following steps are required to raise funds from the public:

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(i) SEBI approval:

SEBI (Securities Exchange Board of India) is a regulatory body to control capital markets in India. A public company is required to submit relevant information with the SEBI before issuing securities in the capital market. The companies are required to give information according to 'guidelines for disclosure and investor protection 2000'. So, prior permission of SEBI is required before raising funds from the public.

(ii) Filing of prospectus:

A prospectus or a 'statement in lieu of prospectus' has to be filed with the registrar of companies. A prospectus is a document inviting general public to subscribe to the shares or debentures of the company. The investor's make-up their mind about investments on the basis of information contained in the prospectus.

(iii) Appointment of bankers, brokers, underwriters:

The Bankers are appointed to receive application money from the public. The application money goes to the bank account of the company. The brokers encourage public to subscribe to the shares offered by the company. If the company is not sure of selling the whole lot of shares, it may appoint underwriters. The brokers purchase unsold shares themselves and charge commission for this service.

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(iv) Minimum subscription:

In order to prevent companies to start business with inadequate funds, a minimum subscription is fixed. A company must sell a minimum number of shares before starting the next process. This minimum number is called 'minimum subscription'. As per the rules of SEBI, a company must receive 90 per cent of the issued amount within a period of 120 days from the issue of prospectus. In case the company does not receive the minimum subscription, then it must return the application money within the next 10 days.

(v) Application to Stock Exchange:

A company must get itself listed in a stock exchange before selling the securities to general public. The company must make application to at-least one stock exchange for a permission to deal in its stocks. The stock exchange authorities verify the financial soundness and other aspects of the company.

After satisfying from the information of the company, the name of the company is listed in the exchange. If the company fails to get permission from the stock exchange within ten weeks from the date of closure of subscription list then the allotment will become void and money received on applications must be returned within eight days. ,

(vi) Allotment of shares:

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After getting the shares listed, the company makes allotment of shares. A list is prepared giving details about names and addresses of all the shareholders, and the number of shares allotted etc. The

company has to submit a return of allotment with the registrar giving details of shares allotted to each shareholder.

Commencement of Business:

A private company is not required to get a Certificate of Commencement. It can straight way start work after getting Certificate of Incorporation. A public company has to complete certain formalities before it can get the Certificate of Commencement.

The company will file the following documents with the Registrar:

1. A declaration that a prospectus or a statement in lieu of prospectus has been filed with the Registrar of Companies.
2. A declaration that shares payable in cash equivalent to minimum subscription have been allotted.

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3. A declaration that directors have taken up their qualification shares and have paid application and allotment money in the same proportion as others.
4. A statement that no money is liable to become refundable to the applicants by reason of failure to apply for or to obtain permission for shares or debentures to be dealt in on any recognised stock exchange.

5. The secretary of the company or a director files a statutory declaration that the requirements relating to the commencement of business have been duly complied with.

The Registrar will satisfy himself that all documents are in order and all the legal formalities have been completed. He will issue a Certificate of Commencement c business entitling the company to start its business from the date mentioned in the certificate. The process of company formation comes to an end with the issue of this certificate.