



## PRIVATE COMPANIES – PRIVILEGES AND EXEMPTIONS

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### ABSTRACT

In today's world, the word 'COMPANY' is no more new to us, as most of the organisations are in themselves corporates. Having limited liability towards the act of the company has become one of the key features why a number of companies are coming up these days, apart from the revolutions taking place in the technological industry that led to industrialization.

In this paper, we will come across the basic concept of company and look into why a private company is preferred over other forms of business associations. We will also go through the comparative differences between the both, and also discuss the drawbacks of a private limited company before concluding.

### RESEARCH METHODOLOGY

The methodology to be used to meet the objectives of this research would be preliminarily doctrinal and will be based on various articles and books written speaking about the working of a private company by the academicians.

### RESEARCH QUESTIONS

- What is a company? What are its features?
- What is a Private Limited Company?
- What are the Privileges that a Private Company enjoys over others?
- Does a private company have benefits over other forms of business?

- What is the scope for success of a private limited company in India today?
- Are there any drawbacks for a private company?

### OBJECTIVES

- To have a basic understand about companies in legal format.
- To understand the concept of a Private Company and its privileges.
- To distinguish between private, sole-proprietorship, partnership and public company form of businesses.
- To understand the scope for growth of private limited company in India.
- To know the drawbacks of a private company.

### CHAPTER I INTRODUCTION 1.1 COMPANY

In today's world, as a result of industrial revolution that took place few decades back, the word 'COMPANY' is no more new to us. Now- a - days, it is difficult to run an enterprise or a business under a single leadership keeping the legal problems in view, that we mostly find a business is run not merely by an individual but by a group of individuals having common interest in the activity of the organisation.

The word 'COMPANY' has been defined under Companies Act, 1956 as 'an association formed and registered under this



act or any existing company.’<sup>1</sup> Justice Marshall defined a company as:

*“A company is a person, artificial, invisible, intangible, and existing only in the contemplation of the law. Being a mere creature of law, it possesses only those properties which the character of its creation or its creation confers upon it either expressly or as incidental to its very existence”.*<sup>2</sup>

### 1.2 FEATURES OF A COMPANY

- It is an artificial person in the view of law, once it is incorporated as per the law.
- It has perpetual existence and so is not affected by change of ownership, even by the death of the owners.
- It is a separate legal entity and so can conduct business, sue etc. on its own name.
- A key feature of a company is that it offers limited liability to its share- holder’s and so they are not personally liable for the acts of the company, unless the court decides to lift off the corporate veil.
- The shares of a company can be freely transferred in an open stock market.
- The company is primarily run, not by the owners, but by a Board of Directors.

Because of the above mentioned benefits, a company form of organisation is preferred over sole-proprietorship or partnership.

### 1.3 LIFTING UP OF THE CORPORATE VEIL

One of the main added feature as to why a company is preferred over other forms of business is because it provides only for a limited liability of its members (to the extent of their holding in the company). But the

same advantage is being mis- used now- a-days and the companies through its members act against the interest of the law.

Hence, in recent times a number of statutory as well as judicial reasoning’s have come up where the corporate veil that a company is a separate entity and so is different from its members, is being lifted off so as to hold the actual intender liable for his acts.

Some of them are as follows:

#### STATUTORY PROVISIONS

- A mis- statement of prospectus would result in the personal liability of the promoters of the company.
- A mis- description in the name of the company in any instrument will also lead to the piercing of the corporate veil.
- Any fraudulent conduct of the company would make its members personally liable.

#### JUDICIAL INTERPRETATIONS

- In case, a company fails to pay tax as per statutory requirements, then, the members are held personally liable.
- In case, the company acts in favour/ support of an enemy character.
- If the company forms subsidiaries in order to defeat the provisions of law.
- In cases of economic offences.

The above mentioned are few situations where in the corporate veil is lifted off, thereby makes the members personally liable for the act of the company.

### 1.4 CLASSIFICATION OF COMPANIES

Depending upon the basis of classification, companies can be of various kinds and types.

<sup>1</sup>

[http://www.mca.gov.in/Ministry/pdf/Companies\\_Act\\_1956](http://www.mca.gov.in/Ministry/pdf/Companies_Act_1956)

<sup>2</sup> <http://www.ddegjust.ac.in/studymaterial>



In this paper, we shall see the classification on basis of the holding in a company.

On basis of number of members holding shares in the company, it can be classified as two types.

1. Private Company
2. Public Company

Let us look into different aspects of these types through this paper.

## CHAPTER II

### 2.1 PRIVATE COMPANY

A private company as defined by the Companies Act, 1956 under Sec.3(iii)<sup>3</sup> is a company which has a minimum paid up capital of One Lakh Rupees and by its articles of association has limitations as to

- The right to transfer the shares
- The number of members
- Prohibiting invitation of Public offerings

The recent Companies Act, 2013 has lifted the limitation as to the number of members in a private company to 200 members.

### 2.2 FEATURES OF A PRIVATE COMPANY

In a private company, the right of the shareholders to sell/ dispose of their shares is restricted. They are under an obligation to first offer their holding to any existing member of the company, and in case no member is ready to buy the shares, then only the shares can be offered to an outsider of the company, but in no case to general public.

The number of members that a private company needs to be formed is two, while the maximum allowed is 200. This is to limit the differences in decision making and so as to

ensure a better and fast decision making process.

A private company can in no case raise its capital from public unless converted into a public limited company by amending its Articles of Association. Hence, the capital funding required in investing and running the business has to be arranged by members themselves in proportion to their holding in the company.

### 2.3 INCORPORATION OF A PRIVATE COMPANY<sup>4</sup>

The procedure under Companies Act, 2013 involves the following formalities to be done for a private company to be recognized under law.

The minimum number of people required to come together to form a private limited company are two. The association of people need to first have a clear idea of the business that they would want to carry on upon the incorporation of the company.

A name for the company need to be identified and registered as to identify and distinguish the company in the market. The company needs to be named and the wording 'private ltd.' has to be included in the name of the company as to clarify its identity to all. The said name has to be registered with the registrar of the state by paying a nominal fee, which within three months will see that the patent over the name is given to the promoters of the company in absence of any other litigation/ claims.

<sup>3</sup> *Supra note 1.*

<sup>4</sup> <https://www.legalwiz.in/blog/procedure-incorporation-private-company>



The promoters of the company need to make a Memorandum of Association where in the rules of the company and the details of the business, the objectives, and the information regarding registration, liability and the capital share of the company is provided and is available at the registrar of the companies for public reference.

Further Articles of Association should also be prepared which speaks about the internal rules and procedures of the company. This mentions about the liabilities, duties and rights of the members of the company. This is also available with the registrar of the companies for public reference.

Any act not mentioned under Objectives in these documents cannot be performed by the company, unless the same is amended to include the same. These documents need to be attested duly by the subscribers of the company in presence of the witness for it to be valid in law.

A statutory declaration has to be submitted by the directors undertaking that all the provisions of the Companies Act, 2013 have been followed and any liability thereof from the same lies on them. Further on payment of the fees (depends on the share capital), the process of registration comes to end from the side of the promoters.

After assuring themselves, the ministry and registrar of the companies provides a Certificate of Incorporation to the company, and from here, the company is recognized as a separate legal entity under law and can start with its business.

#### 2.4 PRIVILEGES OF A PRIVATE COMPANY<sup>56</sup>

There are a notable number of privileges that a private company enjoys, which are not available for a public limited company as they have the interest of common man vested in them, which is absent in case of the private companies.

A private company can sometimes be a subsidiary of a public company, but still continues to hold certain general privileges like:

- A private company can be incorporated with only two members.
- It is not required to issue a prospectus for the public, hence limiting the legal necessities and liabilities to a greater extent.
- A private company can commence its business from the date of incorporation, a certificate.
- The director need not require the permission from the registrar. Also, the provisions of qualification and pay grade do not apply to the directors of private companies.
- It need not submit any statutory report with the Registrar of companies, which is a mandate for public limited companies.
- Restriction as to voting rights under Sec. 43 and 47, Companies Act, 2013 do not apply to members of private companies.<sup>7</sup>
- Private Companies are exempted from passing a special resolution to dispose of the interest of the company from its assets as per Sec. 180.
- Sec. 185 which explains that the company cannot offer loan to its director, is relaxed towards Private Companies.

A private independent company has further more privileges like:

<sup>5</sup> <https://www.owlgen.com/question/what-is-a-private-company-what-are-the-privileges-enjoyed-by-such-a-company>

<sup>6</sup> <https://www.taxmanagementindia.com>

<sup>7</sup> *Exemptions to Private Companies*, Rameshwar Sai.



- Financial assistance to subscribe for the share of the company can be given by the company itself.
- Rules as to right of the shareholders, issue of shares etc. do not apply to an independent private company.
- Any transaction regarding transfer of shares cannot be questioned in court of law.
- Restrictions as to the term of director and his appointment, rotation etc. do not apply in this case.
- It need not constitute a separate audit committee.
- It can continue with minimum two directors.
- It is not required to maintain an index of its registered members.
- Condition as to minimum subscription do not apply, all it requires is a minimum paid up capital of One Lakh Rupees and two members to constitute a company.
- In order to issue shares to employees, a private company need not pass a special resolution which is essential in case of public limited companies.

### CHAPTER III PRIVATE COMPANY VERSUS OTHER FORMS OF BUSINESS IN INDIA

Let us now look into different forms of business associations that exist other than a company and then compare them with the working of a private company.

#### 3.1 SOLE-PROPRIETORSHIP<sup>8</sup>

Sole- proprietorship is a business run by a single person who is the investor, decision-maker as well as risk- bearer of the business. Here the business is not incorporated under law and so does not have a separate identity form the owner i.e., the natural person.

Though the decision- making process is simple, it is difficult to raise the capital if one is aiming at a large business base, as only the owner is the manager here, who is competent enough to take all the decisions as he is the sole person liable wholly and personally for any act. Also, the business cannot sue as it does not have a legal identity and capacity.

Unlike in Sole- proprietorship, a company is legally recognized and can sue under its own name. A company has a huge capital base even in private, as it includes a number of people while a sole- proprietor has a limited investment in the business. The members of the company are only liable to the extent of their holding in the company and so are better than the unlimited liability of the sole- proprietor.

Also, it has been evident that collective decisions prove to be more efficient, and collective management is more effective to lead the business on success path which is possible in case of companies than in sole- proprietorship where in only one person is responsible to manage all of these responsibilities and hence, a huge burden rests on him, which might not lead to an effective management and accordingly, a successful business enterprise.

#### 3.2 PARTNERSHIP

In this form of business association, two or more persons collectively contribute skills, money and all other required resources and operate the business so as to share the profits,

<sup>8</sup> <https://smallbusiness.chron.com/differences-between-sole-proprietorship-partnership-corporation>



losses and bear risks together collectively as per their agreement.<sup>9</sup>

Partnership firm unlike a company is not a separate legal entity from its members and so does not have right to sue under its own name. It can either be registered or not, so the legal issues are subject to the agreement of the partners of the association who can be up to 20 members.

The partners here have an unlimited and personal liability unlike in the company where in it is a limited liability. The partnership does not have a perpetual succession and hence all the formalities of forming a partnership should be followed on exit or entry of even one partner even if it is due to death of a partner.

The share of a partnership cannot be transferred as easily as it can be in a company, as here all the terms of the contract of partnership will be affected due to change in the shareholding in the partnership firm. As similar to sole- proprietorship, even in partnership the capital investment is limited to that in a company because here the members are less in number and so has to bear all the expenditure personally.

### 3.3 PUBLIC LIMITED COMPANIES

These companies are where the common public contributes for raising the share capital for investment of the company. The promoters own a very meagre value of shares while the rest is to be subscribed by the public. The incorporation of a public limited company is in itself a major step as the public should raise the capital as required by the

organisation within the timeline for the association to go ahead with its business after getting incorporated.

The major setback is that though a large capital can be raised, the legal measures in case of a public company are more than that of a private company as it involves interest of the general public directly in its business.

The rules and procedures for establishing and running a public company are strict than in any other form of business. The directors of the company here have only a limited liability so as to their holding in the company and the rest is to be borne by the shareholders of the company. The company can sell its shares in an open market by getting listed in one of the stock exchanges.

The concept of transparency is very vital in these organisations so as to secure the public for attracting more investments from them. Failure of getting subscribed as expected will lead to failure of the business ultimately as it would not be recognized as a public limited company by the registrar of the companies.

While private limited companies have an easy and quick decision making process along with sufficient funds in reserve, in a public limited company the same cannot be guaranteed, as risks can't be taken easily due to rules and interests involved alongside the share value of the company can go down any moment thus may lead to insufficiency of share capital to perform business.

## CHAPTER IV SCOPE OF GROWTH FOR PRIVATE COMPANY IN INDIA

In India, when we go through the evolution of the market and the economy, it is far better

<sup>9</sup>

<http://www.businessdictionary.com/definition/partnership.html>



today than it was few decades back. After independence, all the actions relating to public were under the control of government to protect the Indian manufacturers and customers, which in later course of period became a burden as it, is very cost cutting to finance all the projects in India, at the same time to ensure the development of the nation. All these burden and failure of the governments in the aspect of building our economy has listed in degradation on Indian economy, that in 1991 under Prime Minister P V Narsimha Rao, on the suggestions of the Narsimham Committee, the economy of India was opened up for the private players, so as to reduce the burden from the shoulders of the government and at the same time to ensure that the Indian players come across to build a global level products and services.

Under these circumstances was that the industrialization has took place at a massive rate, allowing many private corporations to come up with plans, technology which would also help the government in eliminating the unemployment issue in the country.

So far, in recent times, even RBI has de regularized many difficult laws so as to promote private investors who help in the increase of the GDP of India as well as lead to the development of the country as an overall.

In India, if we wish to have a business, a private company would be a favourable form to opt for, as in the finance as to the capital funding can be arranged via banks with deposit of security, by having enough members, who are qualified, we can assure the quality of work. Since the decision

making power lies within the members, decisions can be more effective as there is no intervention of the outsiders.

Also, it has been a proven fact, that a private company yields more favourable results as it attracts more accountability of its members since their interest is vested in it along with the absence of reason to be lenient towards its employees. Also the private players create a healthy competition between them leading to a perfect market.

Hence, the scope for growth of a private company is greater than that of a public company.

#### CHAPTER V DRAWBACKS OF A PRIVATE COMPANY<sup>10</sup>

Until now we have seen why a private limited company has more advantages and the privileges that it enjoys. But, as said that a coin has two sides, even private companies have certain limitations and drawbacks which play a major role in deciding whether to opt for this form of business or not. Some of the drawbacks are as follows:

- A private company has smaller resources in form of capital, than a public company due to bar on its number of members. This can often lead to lack of sufficient capital to conduct the business.
- The shares in a private company cannot be transferred easily. One, who intends to transfer it, should first approach the remaining members and then only an outsider. But in no case the public. Hence, the transfer of shares once the interest is lost by the member is difficult.

<sup>10</sup> <https://www.indiafilings.com/learn/disadvantages-private-limited-company/>



- Since, the shares of a private company are not listed in any stock- exchange markets; an investor does not know the actual market rate of his investment on a day to day basis.
- Borrowing of funds is a hectic task for a private company as the banks need sufficient security for the same. Unlike the public companies where the borrowing is easy.
- Public do not seem much attracted towards the company as they do not form a part of the internal system of the company and also due to secrecy as the company need not disclose its internal affairs as a public limited company.
- The legal control in case of a private company has become strict due to certain mis-uses of the privileges provided to them.

### CONCLUSION

So as to conclude to what all we have come across in this paper are that, a company is a better form of business than other forms such as sole- proprietorship, partnership, with a leading feature that a company involves only a limited liability of the members unlike other forms where a person can be made personally liable.

Also, over the comparisons, we found out that a public company involves more risk due to direct involvement of the general public's interest in its capital funding, which is not the case in the private companies.

Also, the government in India, is now encouraging private companies to raise with their plans and management maintaining sufficient capital and to lead the country to development by bringing in the changes in technological industry and by providing training to the public and ensuring that their skill set is improved in a professional world, so as to face the competitive global world.

A proof of such encouragement is that the Companies Act of 2013 and orders thereon have relaxed a number of legal requirements in favour of the private entities. With all the advantages having a brighter side, the private entities also suffer from certain material drawbacks, which put its members in a risk.

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