

Quadrant II – Notes

Paper Code: COLO511

Module Name: Advantages and Disadvantages of the Company

Module No: 02

Advantages of Incorporation of the Company

1) Legal Personality

The law divides person into two kinds viz.,

- i. natural persons, and
- ii. legal persons.

Natural persons are human persons such as men, women, children etc. The natural persons are the creations of nature.

Legal persons or artificial persons, on the other hand, are created and devised by human laws i.e. created by a legal process and not through natural birth. An artificial person, though abstract, invisible and intangible, can do everything like a natural person except a few acts, which only natural persons can do.

A company is a distinct legal person, existing independent of its members. The independent corporate existence is the outstanding feature of a company.

2) Limited Liability

The principle of limited liability is a feature as well as a privilege of the corporate form of enterprise. In other words, the liability of the members is limited. It means that the shareholders enjoy immunity from liability beyond a certain limit. A shareholder cannot be called upon to pay anything more than the unpaid value of the share that he has undertaken to pay under a contract between himself and the company.

3) Perpetual Succession

As a juristic person, a company enjoys perpetual succession. In other words, a company never dies, nor its life depends on the life of its members. Even if all the members die, it shall not affect the privileges, immunities, estates and possessions of the company.

4) Right to Property

A company, being a legal person has a right to acquire, possess and dispose of property in its own name. Its property is not that of the shareholders. Although the members contribute the capital and assets of company, the property of the company will not be considered as the joint property of the members constituting the company.

5) Common Seal

The common seal is considered as the Official Signature of the company. Its common seal must authenticate all the acts. When common seal is affixed on a document, it is considered as the authoritative document of the company. The secretary of the company should keep the seal under lock and key. He should make use of it only according to the directions of the Board of Directors.

6) Transferability of Shares

The capital of a company is divided into several small parts known as shares. The primary objective of joint stock companies is that it should be able to transfer shares easily. The law also considers the share of a company as movable property and hence like any other movable asset, the shareholder can transfer his title over his share to some other person.

7) Capacity to Sue and be Sued

A company being a legal person, can sue other persons in its corporate name. Similarly, others can also sue the company in their own name. It can also be fined for contravening any law but it cannot be imprisoned for a criminal offense.

Disadvantages of the Company

- 1) Lifting of corporate veil
- 2) Expensive and troublesome
- 3) Company is not a citizen

Misuse of the Corporate Veil

After incorporation, the veil of incorporation exists between the company and its members and the company is made distinct from its members.

In order to protect themselves from liabilities of the company, its members may take shelter of the corporate veil and may misuse the veil for their selfish ends.

1. Lifting or Piercing the Corporate Veil

Although the general rule is that a company has a separate legal identity from its members, there are exceptions to this rule when a court will not treat a company as a separate entity. This is often referred to as "lifting the veil of incorporation". This is to prevent abuse of the principle of separate identity. The corporate veil will be lifted by the courts and legislatures in the interest of justice, equity and good conscience.

Instances of Lifting the Corporate Veil

- a) To prevent fraud or improper conduct
- b) When the company is cloak or sham
- c) Evasion of Tax or avoiding welfare legislation
- d) Under the authority of statute

a) Fraud and Improper Conduct

When the corporate personality is used as an instrument of fraud. The doctrine of piercing the corporate veil may be applied in the interest of the justice.

P.N.B.Finance Ltd. V Shital Prasad Jain(AIR 1991 Delhi 13)

b) When the company is a mere cloak or sham

The corporate veil may be lifted by the courts, where corporate personality is being used as a cloak or sham for doing an unlawful act. **Gilford Motors Co. Ltd. V. Horne (1933 Ch 935)**

c) Evasion of Tax or Avoiding Welfare Legislation

Corporate veil is lifted by courts by ignoring the corporate entity/ personality, where corporate personality is misused for evasion of tax or avoiding welfare legislation. **Dinshaw Maneckjee Petit, Re Case (AIR 1927 Bom 371), Bacha F. Guzdar v C.I.T. Bombay (AIR 1955 SC 74)**

d) Statutory Authority

Corporate veil is lifted by the courts if it is necessary or permissible under the statute. **L.I.C of India v Escorts Ltd. (AIR 1986 SC 1370)**

2) Expensive and Troublesome

Incorporation of a company involves lot of formalities and also expensive. Hence the promoter who is engaged in the task of incorporation will face many troubles.

3) Not a Citizen

Although a company is a legal person, it is not a citizen under the Indian Constitution. It can act only through natural persons.