

3

FORMATION OF A COMPANY

3.1 Stages in the formation of a company

3.1.1 Promotion

3.1.2 Incorporation of a company

3.1.3 Commencement of business

INTRODUCTION :

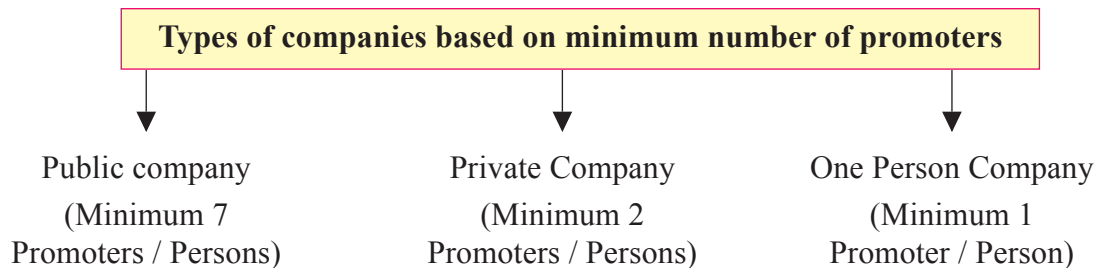
A company is an artificial legal person i.e. it is a creation of law. It comes into existence when it is registered by following the procedures laid down by the Companies Act, 2013.

Formation of a Company means registering or incorporating a company with the Registrar of companies in the state where the company's Registered office is to be located.

Registrar of companies (ROC) It is the authority as per the Companies Act which can incorporate companies.

□ Based on minimum number of promoters:

Promoters are the persons who undertake the process of formation of a company. As per the Companies Act, 2013 (Section 3), depending upon the number of promoters intending to form a company and other aspects, 3 types of companies can be formed as follows:



□ Based on the capital structure, a company may be registered as {section 3(2)} :

a) Company Limited by Shares :

In this company, capital is collected by issuing shares and the liability of the members is limited to the extent of unpaid part of face value of shares bought by them.

b) Company Limited by Guarantee :

In this company, its members have guaranteed to contribute a certain amount of money either to the assets of the company at the time of winding up or towards the cost of winding up of the company.

c) **Unlimited Liability Company :**

In this company, the liability of its members is unlimited i.e. the members are liable to the whole amount of company's debts and liabilities.

3.1 **STAGES IN THE FORMATION OF A COMPANY**

Following are the stages in formation of a company:

- A) Promotion
- B) Incorporation of a company
- C) Commencement of Business

The Companies Act, 2013; Section 3(1) has stated the following conditions for formation of a company :

- i) A Company shall be formed for any lawful purpose.
- ii) Minimum 7 promoters needed for a public company, minimum 2 promoters for private company and 1 promoter for One Person Company
- iii) All the promoters must subscribe their names to the Memorandum of Association.
- iv) The promoters must comply with all the provisions of Companies Act, 2013 with respect to incorporation of a company.

Memorandum of Association. It is a document which states the aims and objectives of the company.

Let us learn about the different stages in the formation of a company.

3.1.1 **PROMOTION**

Promotion of a company means taking all the necessary steps to incorporate a company as per the provisions of the Companies Act, 2013.

Meaning of Promoters :

The Persons who undertake the process of promotion of a company are called as 'Promoters'. A promoter can be an individual, a partner, a company, an association or a syndicate.

***Syndicate :** A group of individuals or organizations who have come together to promote a common interest.*

Section 2(69) of the Companies Act, 2013 defines the term Promoter as a person :

1. Who has been named as such in a prospectus or is identified by the company in the Annual Return or

***Prospectus :** It is a document issued by a public Company to invite the public to subscribe (buy) its shares at the time of public offer.*

***Annual Return :** It is a yearly statement prepared by the company which gives information about a company ownership, activities and financial position and is filed with ROC.*

2. Who has control over the affairs of the company, directly or indirectly whether as a shareholder, Director or otherwise or
3. In accordance with whose advice, directions or instructions, the Board of Directors is accustomed to act.

However, a person who is assisting the promoter in a professional capacity (e.g. A lawyer, accountant etc.) cannot be called as Promoter.

Role of Promoters :

- i) Promoters are the ones who come up with the idea of starting a business.
- ii) They decide the objects of the business, amount of capital needed, scale of business operation etc.
- iii) They prepare the various documents needed for incorporation of a company like Memorandum and Articles of Association.
- iv) Approach investors for collecting capital for the company.
- v) Promoters often nominate themselves as first directors of the company and are first subscribers to Memorandum and Articles of Association.
- vi) The promoters can enter into contracts with third parties on behalf of the proposed company. These contracts are called as 'Pre-incorporation contracts' or 'Preliminary Contracts'. For e.g.. Contracts for preparing and printing Memorandum and Articles of Association, hiring office premises, etc.
- vii) Promoters have fiduciary duties towards the company they are setting up. They are supposed to act in such a manner so as to protect and promote the interest of the proposed company . They cannot make any secret profits while promoting a company.

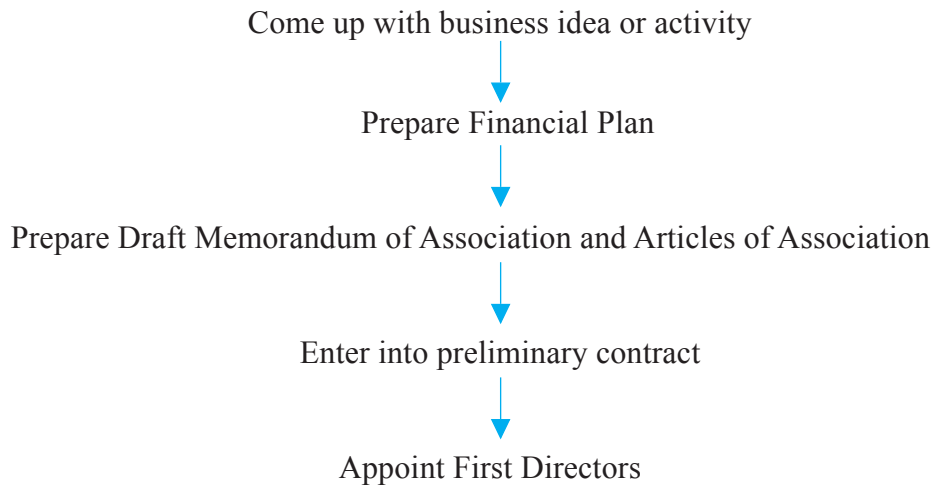
Fiduciary Duty : Means a person has to act in good faith and trust put upon him by another person.

They have to disclose any personal interest they have in a transaction they have entered on behalf of the proposed company.

After incorporation, the company compensates the promoters by reimbursing them the expenses incurred by them in promotion of a company known as preliminary expenses. Immediately after incorporation of a company, the Board of Directors takes charge of the management of the company.

Steps in Promotion of a company

Promotion involves following steps :



1. **Come up with an idea or suggest a business activity:**

The promoters come up with a business activity that they wish to undertake. They choose a business activity after studying various factors like scope of business, competition in the market, availability of factors of production, applicable laws etc. Based on this they prepare a business plan.

2. **Prepare Financial Plan :**

The promoters decide the scale of operation and accordingly prepare the Financial Plan. The Financial plan gives details of the amount of capital needed and from where to raise it.

3. **Prepare draft of Memorandum of Association and Articles of Association:**

Promoters prepare the draft of two most important documents viz. the Memorandum of Association and the Articles of Association which is to be submitted along with the application for incorporation of a company to Registrar of Companies.

4. **Enter into Preliminary Contracts :**

On behalf of the proposed company the promoters may enter into preliminary contracts with third parties. They enter into such contracts so that the company can start its business activity immediately after its incorporation.

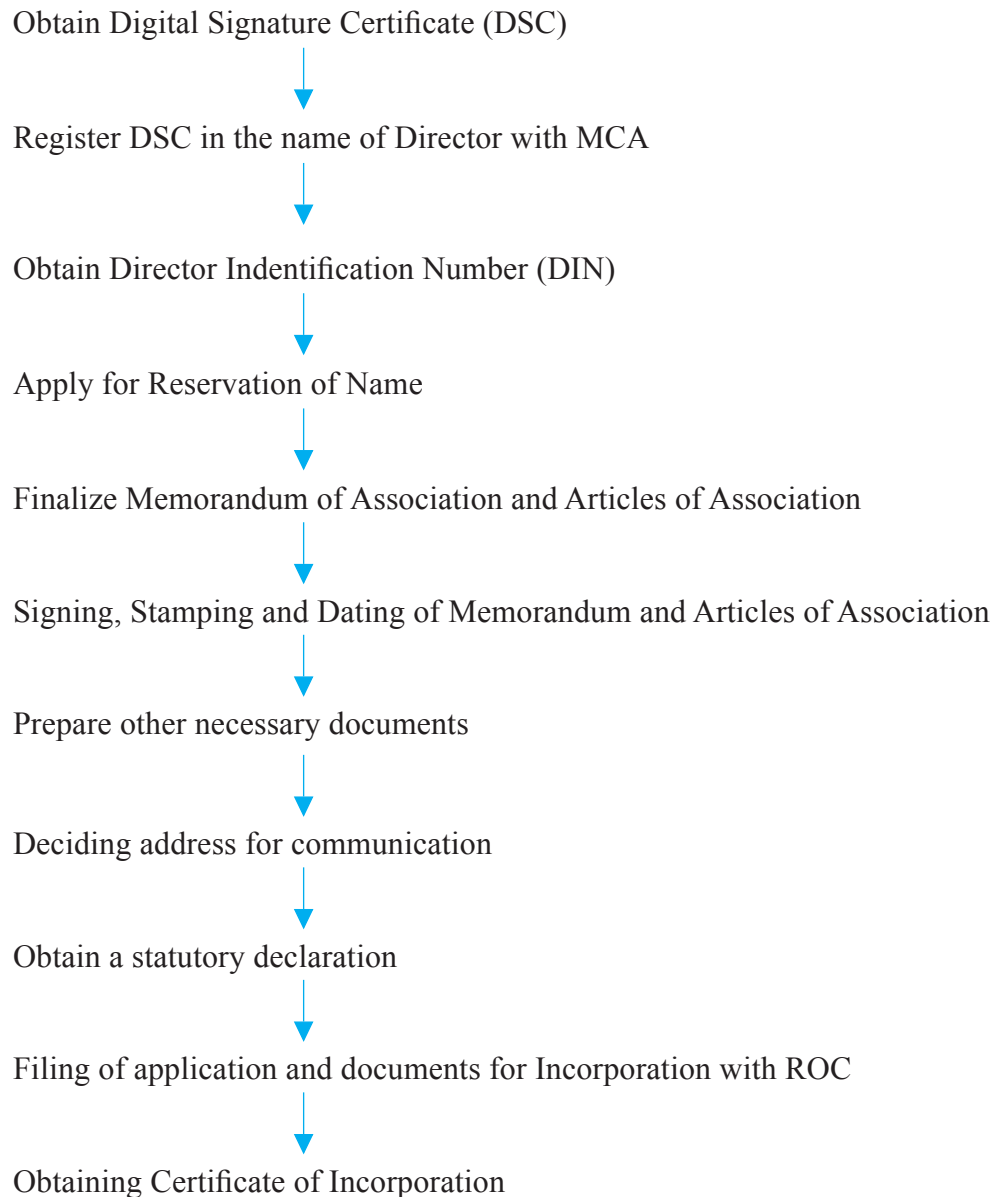
5. **Appoint First Directors :**

Promoters have to appoint first directors who will take charge of management of the company immediately after incorporation. Promoters often nominate themselves as first directors of company.

3.1.2 INCORPORATION OF A COMPANY

Depending upon the objects of the company, scale of operation, amount of capital needed, etc. the promoters decide whether to form a public company or a private company.

Following steps are undertaken to incorporate a company :



1. Obtain Digital Signature Certificate (DSC):

A Digital Signature Certificate is needed for persons authorized to sign documents for e-filing. So Promoters and the proposed first directors need to obtain a DSC by applying to the Certified Authority .

Digital Signature Certificate (DSC) : Is a signature of a person in digital (electronic) form. It is used to sign on e-documents.

2. Register DSC in the name of the Director with MCA:

After obtaining the DSC in the name of the with Promoter / Director, the DSC has to be registered with the MCA. MCA maintains the details of every Director including their DIN, personal details, etc.

MCA : Ministry of Corporate Affairs. It administers the Companies Act, 2013.

3. Obtain Director Identification Number (DIN)

The proposed first directors of the proposed company who do not have DIN, have to apply for DIN in electronic form SPICe - 32 at the time of incorporation. A person to be appointed as a Director must have a DIN.

Director Identification Number (DIN) : *It is a unique 8 digit identification number allotted to a person to be appointed as a Director of a company.*

4. Apply for Reservation of Name :

The Promoters have to get the proposed name of the company approved by the Central Registration Centre (CRC) by filling form RUN (Reserve Unique Name) along with the prescribed fees through MCA Portal (www.mca.gov.in).

Central Registration Centre : *It is an authority which provides speedy incorporation related services especially in reservation of proposed name of a company including DSC.*

Promoters may suggest more than one name in the order of their preference. After verifying its database, CRC will give its approval for the proposed name and reserve the name for a period of 20 days from the date of application.

5. Finalize Memorandum of Association and Articles of Association :

Two important documents the Memorandum and Articles of Association have to be submitted along with the application for incorporation of a company. These documents contain legal and technical information related to objectives of company and regulations for operation of company pursuant to company Law. Hence, the promoters take the help of professionals like a company Secretary, legal experts, accountants, etc. to finalize the draft Memorandum and Articles of Association.

In case a proposed public company wants to list itself with one or more stock exchanges, Promoters should send a copy of the draft Memorandum of Association and Articles of Association to such stock exchanges for their review and suggestions.

6. Signing, Stamping and Dating of Memorandum and Articles of Association:

The Memorandum of Association and Articles of Association must be signed by each subscriber to the Memorandum and shall add his name, description address, occupation, etc. in the presence of at least one witness who shall attest the signatures and likewise sign and add his name, description, address, occupation, etc.

After signing, the Memorandum and Articles of Association needs to be stamped as per the Indian Stamp Act, 1899. The stamp duty depends on the authorized share capital of the company and varies from state to state. There should be date on M/A or A/A. It may be stamping date or any other date after stamping.

Due stamp duty is required to be paid at the time of Incorporation.

7. Preparing other necessary documents needed for incorporating a company.

i) Consent of Directors

A list of persons who have agreed to be the first directors along with their written consent should be prepared. Their personal details, DIN, Proof of identity, interest in other firms or companies, etc. should be included in the list. The required written consent should be in prescribed format as per Companies Act, 2013.

ii) Details of Manager, Secretary, etc.

If the Articles of Association names a person who will be the manager, Secretary, etc; particulars of such persons should also be prepared for filing purposes.

iii) Declaration by subscribers to the Memorandum and First Directors

A declaration should be taken from each subscriber to the Memorandum of Association and every person named as First Directors in the Articles of Association that he is not convicted of any offence in connection with promotion, formation or management of any company and he has not been found guilty of any fraud or dishonesty or breach of any duty to any company during the preceding 5 years. They also have to give an undertaking that all the documents filed with the Registrar of companies are correct, complete and true.

8. Address for communication and notice of Registered office address :

At the time of incorporation, if the proposed company has not decided its location of Registered office, the promoters have to give an address for communication. As per the Companies Act, 2013, a company is required to have a Registered office within 30 days of incorporation.

9. Obtain a statutory declaration from:

- i) An advocate, practicing company Secretary, a cost accountant or chartered accountant who is engaged in the formation of the company, and
- ii) A person named in the Articles of Association as a Director, Manager or Secretary stating that all requirements related to incorporation has been complied with.

10. Filing of application and documents for incorporation of a company:

After all the documents are prepared, the promoters have to submit an application to the Registrar of companies in the prescribed form along with all the necessary documents and the prescribed fees for incorporation.

SIMPLIFIED PROFORMA FOR INCORPORATING COMPANY ELECTRONICALLY (SPICE) :

Rule 38 of Companies (Incorporation) (Fourth Amendment) Rules has introduced, with effect from 2.10.2016, a simplified integrated process for incorporation of a company. Under this, only one form-Form INC-32 (SPICE), needs to be submitted at the time of incorporation of a company. SPICE is to be filed for applying for :

- i) Reservation of Name of Company
- ii) Incorporation of a new company
- iii) DIN for Directors
- iv) PAN and TAN for new company

PAN : *Permanent Account Number : is issued by Income Tax Department and is the proof of identify of a person who pays Tax. It consists of 10 digit alpha numeric code.*

TAN : *Tax Deduction and Collection Account Number is issued by Income Tax Department to all persons who are responsible for deducting or collecting Tax. It is a 10 digit alphanumeric code.*

Along with the SPICe form, e-Memorandum of Association, e-Articles of Association and the prescribed fees and other documents necessary for incorporation of a company are to be submitted electronically.

11. Obtaining Certificate of Incorporation

After verifying that all the documents and information submitted to it is proper, the Registrar of Companies will enter the name of the company in the Register of Companies and certifies under his hand that the company is incorporated. Registrar issues the Certificate of Incorporation in the prescribed form.

Contents of Certificate of Incorporation:

- i) the name of the company.
- ii) date of issue of Certificate of Incorporation.
- iii) CIN.
- iv) PAN and TAN of the company.
- v) Signature of Registrar with date and his seal.

Importance of Certificate of Incorporation:

- i) Certificate of Incorporation is like the Birth Certificate of the Company as the company comes into existence from the date mentioned in the certificate.
- ii) The Company now becomes a legal person distinct from its members.
- iii) Company becomes a body corporate having perpetual succession from the date of its incorporation
- iv) The company can sue and be sued upon others in its own name.

**GOVERNMENT OF INDIA
MINISTRY OF CORPORATE AFFAIRS**

Central Registration Centre

Certificate of Incorporation

{Pursuant to sub-section (2) of section 7 of the Companies Act, 2013
(18 of 2013) and rule 18 of the Companies (Incorporation) Rules, 2014}

I hereby certify that is incorporated on this Day of
Two thousand under the Companies Act, 2013 (18 of 2013) and that the company
is limited by shares.

The Corporate Identity Number of the Company is.....

The Permanent Account Number (PAN) of the company is

The Tax Deduction and Collection Account Number (TAN) of the company is.....

Given under my hand at..... this.....day of (month) Two thousand

Digital Signature Certificate

For and on behalf of the Jurisdictional Registrar of Companies

Registrar of Companies

Central Registration Centre

Disclaimer : This Certificate only evidences incorporation of the company on the basis of documents and declarations of the applicant (s). This Certificate is neither a license nor permission to conduct business or solicit deposits or funds from public. Permission of sector regulator is necessary wherever required. Registration status and other details of the company can be verified on www.mca.gov.in

Mailing address as per record available in Registrar of Companies office :

Allotment of Corporate Identity Number (CIN):

At the time of issuing Certificate of Incorporation the ROC also allots a CIN to the Company which is its unique identity number. CIN is a 21 digit alpha numeric code and is to be quoted in every form and correspondence that the company uses.

CIN : Corporate Identity Number – issued by ROC at the time of incorporation of a Company. It indicates whether a company is listed or unlisted, Industry code, state of its location, year of incorporation, ownership type and registration number.

E.g., CIN. of Air India Ltd. - U62100DL 1992GOI048581

Additional information:

How to read and understand CIN of a Company

Tata Steel Limited's CIN is - L27100MH1907PLC000260

L	27100	MH	1907	PLC	000260
↓	↓	↓	↓	↓	↓
Listed (L) or unlisted (U) company	Industry Code	State code of ROC	Year of Incorporation	Type of company i.e., Public(PLC), Private(PTC), OPC	ROC's Company Registration number



Activity:

From the following CIN, identify the type of companies:

- 1) U74999TN2014OPC098340
- 2) L28920MH1945PLC004520
- 3) U72900KA2003PTC033028

3.1.3 COMMENCEMENT OF BUSINESS

Public Companies and Private Companies not having a share capital can commence its business activities immediately after it has received the Certificate of Incorporation from the Registrar of companies.

However, Public Companies and Private Companies having share capital and which are incorporated after 2nd November, 2018 have to obtain a Certificate of Commencement of business from the Registrar of Companies before it can commence its business activities or exercise borrowing powers.

• Steps to obtain Certificate of Commencement of business:

1) Filing of declaration by Director:

A Director of the company has to file with the ROC, a declaration in the prescribed form along with fees. The declaration states that every subscriber of the Memorandum has paid the value of the shares agreed to be taken by them. The contents of the declaration shall be verified by a Company Secretary in practice or a Chartered Accountant or a Cost Accountant in practice.

The declaration should be filed within 180 days from date of incorporation of a company.

2) File Verification of Registered Office:

Company has to also file a verification of its registered office with the ROC.

3) Obtain license or approval from Sectoral Regulator:

Certain companies which propose to conduct banking business, insurance business or proposed to be listed on stock exchanges, require registration from Sectoral Regulators like Reserve Bank of India, Securities and Exchange Board of India, etc. Such companies must submit to ROC the approval obtained from the Sectoral Regulator.

Sectoral Regulators: are regulators appointed by Government to regulate a particular sector. e.g. SEBI is the regulator of securities market.

4) Commencement of business:

After filing declaration in prescribed form, the ROC then shall issue Certificate of Commencement of business.

Public and Private companies having share capital can now start its business or start collecting or borrowing money to undertake its business activities.

A Public company issues Prospectus to the public. A Prospectus is an invitation to the public to buy the shares of the company.



Activity: Find out the promoter or promoters shareholding of Maruti Suzuki India Ltd. and Reliance Industries Ltd.

SUMMARY

A company is an artificial legal person created by law. It comes into existence only after it is incorporated as per the provisions of the Companies Act, 2013.

The stages in formation of a company are -

- a) **Promotion :** Where promoters, the ones who want to form a company, take necessary steps to incorporate a company.
- b) **Incorporation :** In this stage all the necessary documents are filed with the ROC in SPICe form. ROC issues Certificate of Incorporation and CIN to the Company. The company has now come into legal existence.
- c) **Commencement of Business :** Public and Private companies not having a share capital can start its business immediately after getting Certificate of Incorporation. Whereas public and private companies having share capital must file declaration in prescribed form to obtain Certificate of Commencement of business from ROC.

Public company can issue Prospectus to sell its shares only after getting this certificate.



EXERCISE

Q.1 A. Select the correct answer from the options given below and rewrite the statements.

- 1) A company is.....
 - a) a human being
 - b) an artificial person created by law
 - c) an natural individual
- 2) are the persons who undertake the process of formation of a company.
 - a) Promoters
 - b) Directors
 - c) Registrar of companies

- 3) A..... company needs minimum two or more members.
a) Public b) Private c) One person Company
- 4) In a public company there must be minimum or more members.
a) one b) two c) seven
- 5)refers to contracts entered into by the promoters on behalf of a proposed company.
a) Pre-incorporation / Preliminary contracts b) Fiduciary contracts
c) Memorandum of Association
- 6) A Director must have a to be appointed as a Director of a company.
a) PAN b) DIN c) CIN
- 7) has 21 digit alpha numeric code which is a unique number assigned to every company at the time of Incorporation.
a) DIN b) PIN c) CIN
- 8) is a document which invites the public to buy the shares of a company.
a) Articles of Association b) Prospectus c) Certificate of Incorporation.

B. Match the pairs.

Group 'A'		Group 'B'	
a)	Minimum 7 members	1)	Persons who conceive idea of setting up a company
b)	DIN	2)	Public company
c)	Preliminary contracts	3)	Promoters
d)	Fiduciary duties towards company	4)	Eight Digit alphanumeric number
e)	CIN	5)	Private company
		6)	Unique number assigned to each Director
		7)	ROC
		8)	21 digit alphanumeric code number
		9)	One Person Company
		10)	Contracts entered by Promoters with third parties

C. Write a word or a term or a phrase which can substitute each of the following statements.

- 1) Term which means registering a company as per provisions of Companies Act, 2013.
- 2) Persons who undertake the necessary steps to set up a company.
- 3) Term which refers to contracts entered into by Promoters with third parties on behalf of the proposed company.
- 4) The Birth Certificate of a company.

D. State whether the following statements are True or False.

- 1) A company is an artificial person.
- 2) To form a Public company, there must be minimum 2 persons/promoters.
- 3) Promoters are persons who take the necessary steps to set up a company.
- 4) Promoters can make secret profits while setting up a company.
- 5) In India companies have to be incorporated as per the provisions of Companies Act, 2013.
- 6) DSC is needed by Directors when they have to sign documents for e-filing.
- 7) A company can be registered even without submitting Memorandum of Association and Articles of Association.
- 8) Every Director has to quote his DIN while giving his consent to be a Director of a company.
- 9) ROC issues CIN only to certain companies.
- 10) All companies need Certificate of Incorporation.
- 11) All companies need Certificate of Commencement of business.

E) Find the odd one.

- 1) CIN, DIN, PAN
- 2) Promotion, prospectus, Incorporation of a company

F) Complete the sentences.

- 1) Promoters are the persons who undertake the process of
- 2) The document issued by the Registrar of companies when a company is incorporated is called as
- 3) On incorporation of a company the ROC allots a unique identity number called as
- 4) On behalf of a proposed company, preliminary contracts with third parties are entered by

G) Select the correct option form the bracket.

Group 'A'	Group 'B'
1) Promoter	-----
2) -----	Certificate of Incorporation
3) CIN	-----
4) RUN is used for	-----

(Corporate Identity Number, Reserving name of a company, Formation of a company, Birth certificate of a company)

H) Answer in one sentence.

- 1) Who is a Promoter?
- 2) What is CIN?

- 3) Which company needs Certificate of commencement of Business?
- 4) What are Preliminary Contracts?

I) Correct the underlined word and rewrite the following sentences.

- 1) ROC prepares draft Memorandum and Articles of Association.
- 2) Certificate of Commencement of Business is like a birth certificate of a company.

J) Arrange in proper order.

- 1)
 - a) Appoint First Directors
 - b) Prepare Draft Memorandum of Association and Articles of Association.
 - c) Come up with business idea
- 2)
 - a) Incorporation of a company
 - b) Commencement of a company
 - c) Promotion

Q.2 Explain the following terms/concepts.

- 1) Promoters
- 2) Promotion
- 3) Certificate of Incorporation
- 4) SPICe
- 5) CIN

Q.3 Study the following case/situation and express your opinion.

- 1) Mr. Ram, Mr. Sam and Mr. Tom who are partners have come together to convert their business into a company. They have finalized all the details about the business they want to do, capital needed, etc. However, they do not know how to proceed with the legal formalities. Hence they appoint Mr. Shah who is a Practicing Company Secretary to help them prepare documents needed for incorporating the proposed company.
 - a) Can Mr. Ram, Mr. Sam and Mr. Tom convert their partnership firm into a company?
 - b) Name 2 most important documents needed to incorporate a company.
 - c) Will Mr. Shah be considered as a Promoter of the Company? Why?
- 2) Mr. T along with his 5 friends have submitted all the necessary documents for incorporation of TRIM private limited company.
 - a) How many minimum promoters are needed to incorporate a private company?
 - b) When can TRIM Private limited company be said to have come into existence.
 - c) Name the two most important documents that must be submitted at the time of Incorporation of a company.
- 3) Sagar company limited got its Certificate of Incorporation on 1st Sept. 2018. The application for Incorporation was submitted on 16th Aug. 2018. There were 10 promoters who took the steps to incorporate the company.
 - a) State the date on which Sagar company limited came into existence legally?
 - b) On which date will the company get its Corporate Identity Number?
 - c) How many minimum promoters are needed for incorporating a public company?

Q. 4 Answer in brief.

- 1) State the contents of Certificate of Incorporation
- 2) State the importance of Certificate of Incorporation.
- 3) Write a note on - Role of Promoter
- 4) Draw the flow chart of steps in promotion of a company.

Q.5 Justify the following statements.

- 1) Certificate of Incorporation is like a Birth Certificate of a company.
- 2) Every Company on incorporation gets a CIN.
- 3) Promoters play an important role in formation of a company.

Q.6 Answer the following questions:

- 1) Explain briefly the steps involved in incorporation of a company.
- 2) Promoters play an important role in formation of a company. - Explain.

