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PAPER-4 – CORPORATE AND ALLIED LAWS

Question No. 1 is compulsory.

Answer any five from the rest

Question 1

- (a) Suspecting of bungling the financial resources of the company, the shareholders of Dubious Industries Ltd. led by Mr. X, at the Annual General Meeting of the company held on 30-09-2013 resolved to appoint M/S Sharma & Sharma, the Statutory Auditors of the company to carry out special audit in accordance with the provisions of the Companies Act, 1956. The management of the company refused to cooperate with the statutory auditors in carrying out the special audit. Examine whether the management is justified in their refusal. Advise Mr. X with reference to the relevant provisions of the Companies Act, 1956. (5 Marks)
- (b) CBA Ltd. wants to declare dividend in the year 2013-14 though it will not earn any profit this year due to heavy losses. The company has been declaring dividend for the last 5 years. To maintain its reputation the company wants to declare dividend this year too out of accumulated past profits. Explain how the company can achieve the objective to declare dividend. (5 Marks)
- (c) Mr. AMR was appointed as a sole selling agent of M/S ZYX Ltd. with effect from 1st January, 2009 for a period of five years. Mr. AMR earned his remuneration during the year 2009 to 2011 as mentioned below:

₹

Year 2009 – 5,00,000

Year 2010 – 6,00,000

Year 2011 – 7,00,000

From 1st January, 2012, the sole selling agency agreement was terminated by ZYX Ltd. Calculate the amount of compensation payable by the company to Mr. AMR under the provisions of Companies Act, 1956. (4 Marks)

- (d) A group of complainants have alleged that Mr. Z, a Member of the Securities and Exchange Board of India (SEBI) has pecuniary interest in some of the cases that came up before the Board and that he misused his position and therefore, he should be removed from his office. The complainants seek your advice. Advise. (6 Marks)

Answer

- (a) **Special Audit:** According to section 233A of the Companies Act, 1956, where the Central Government is of the opinion-

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- (i) that the affairs of any company are not being managed in accordance with sound business principles or prudent commercial practices; or
- (ii) that any company is being managed in a manner likely to cause serious injury or damage to the interests of the trade, industry or business to which it pertains; or
- (iii) that the financial position of any company is such as to endanger its solvency;

the Central Government may at any time by order direct that a special audit of the company's accounts for such period or periods as may be specified in the order, shall be conducted.

In the present case, the shareholders of Dubious Industries Ltd. led by Mr. X, at the Annual General Meeting of the company held on 30-09-2013 resolved to appoint M/S Sharma & Sharma, as the Statutory Auditors of the company to carry out special audit suspecting of bungling the financial resources of the company. The management of the company refused to cooperate with the statutory auditors in carrying out the special audit.

Here, the management of the company is justified in their refusal as section 233A of the Companies Act, 1956 authorizes only the Central Government to order for the conduct of a special audit of any company. Thus, the shareholders of Dubious Industries Ltd. led by Mr. X are not authorized to appoint the statutory auditors of the company to carry out special audit.

The shareholders of Dubious Industries Ltd. can make a complaint to the Central Government requesting for conducting the special audit. If the Central Government is satisfied that there exist sufficient reasons, it may order a special audit to be carried out.

Hence, the management of the company is justified in their refusal and the shareholders are not authorized to appoint statutory auditors of the company to carry out special audit of Dubious Industries Ltd.

- (b) **Declaration of Dividends out of past profits (Section 205 of the Companies Act, 1956):** Dividends may be declared out of the profits of the company for any previous financial year or years arrived at after providing for depreciation in accordance with Section 205 of the Companies Act, 1956. However, the Central Government may in the public interest relax the payment of the profits without providing for depreciation. The Companies (Declaration of Dividend out of Reserves) Rules, 1975 provided that-
- (1) The rate of dividend declared does not exceed the average of the rates at which dividend was declared by it in the 5 years immediately preceding that year or 10% of its paid-up capital, whichever is less.
 - (ii) The total amount to be drawn from the accumulated profits earned in previous years and transferred to the reserves does not exceed an amount equal to 1/10th of the sum of its paid-up capital and free reserves and the amount so drawn must first be

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utilized to set off losses incurred in the financial year before any dividend in respect of preference or equity shares is declared.

- (iii) The balance of reserves after such drawal does not fall below 15% of its paid-up capital.

Hence, the CBA Ltd. may undertake the above steps to declare dividend in the year 2013-14 out of accumulated past profits.

(c) Compensation to Sole Selling Agent (Section 294A of the Companies Act, 1956).

According to Section 294A(2) of the Companies Act, 1956, any compensation payable by a company to its sole selling agent for premature loss of office shall not exceed the remuneration which he would have earned if he would have been in office for the unexpired residue of his term, or for three years, whichever is shorter, calculated on the basis of the average remuneration actually earned by him during a period of three years immediately preceding the date on which his office ceased or was terminated, or where he held his office for a period lesser than three years, then average remuneration actually earned by him during such lesser period.

Based on the above provision of the Companies Act, 1956, Mr. AMR is entitled to compensation for the unexpired residue of his term, i.e., for two years since it is shorter than three years. Such compensation shall be calculated on the basis of average remuneration received by him during the years 2009 to 2011. On the basis of figures given in the question, the amount of compensation shall be as follows:

Year	Amount of Remuneration (₹)
2009	5,00,000/-
2010	6,00,000/-
2011	7,00,000/-
Total Remuneration	18,00,000/-
Average Remuneration per annum	6,00,000/-
Compensation payable to Mr. AMR for two years	12,00,000/-

(d) Removal of Member of the SEBI (Section 6 of the Securities and Exchange Board of India Act, 1992)

According to section 6 of the Securities and Exchange Board of India Act, 1992, the Central Government shall have the power to remove a member appointed to the Board, if he:

- (i) is, or at any time has been adjudicated as insolvent;
- (ii) is of unsound mind and stands so declared by a competent court;

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- (iii) has been convicted of an offence which, in the opinion of the Central Government, involves a moral turpitude.
- (iv) has, in the opinion of the Central Government so abused his position as to render his continuance in office detrimental to the public interest.

Before removing a member, he will be given a reasonable opportunity of being heard in the matter.

In the present case, a group of complainants have alleged that Mr. Z, a member of the SEBI has pecuniary interest in some of the cases that came up before the Board and he misused his position and therefore, he should be removed from his office.

Here, above complainants may approach the Central Government for removal of Mr. Z, a member of the SEBI and if the Central Government is of the opinion that Mr. Z has so abused his position as to render his continuation in office detrimental to the public interest, the Central Government may remove Mr. Z from his office after giving him a reasonable opportunity of being heard in the matter.

Question 2

- (a) *Sweet Tea Limited wants to sell its tea by entering into contract with the following parties*
- (1) *Tea Bros. a partnership firm in which a director of Sweet Tea Limited is a partner.*
 - (2) *R & T Private Limited in which one of the director of Sweet Tea Limited is a member.*
 - (3) *Strong Tea Limited in which one of the directors of Sweet Tea Limited is a director holding 3% of the paid up capital of Strong Tea Limited.*

Advise the steps that should be taken by Sweet Tea Limited taking into account the relevant provisions of the Companies Act, 1956 for entering into contracts in which the directors are interested. (8 Marks)

- (b) (i) *Mr. OK is a director of VRS Ltd. He intends to construct a residential building for his own use. The cost of construction is estimated at ₹ 1.35 Crores, which Mr. OK proposes to finance partly from his own sources to the tune of ₹ 60 lacs and the balance ₹ 75 lacs from housing loan to be obtained from a housing finance company. For the purpose of obtaining the loan, he has approached the housing finance company which has in principle agreed to grant the loan, but has put a condition. The condition put by the housing finance company is that the Company VRS Ltd. of which Mr. OK is a director should provide the guarantee for repayment of the loan and interest as per the terms of the proposed agreement for granting the loan to Mr. OK. You are required to advise Mr. OK on the matter with reference to the provisions of the Companies Act, 1956.*

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- (ii) Draft a Board Resolution of VRS Ltd. for providing guarantee for ₹ 75 lacs in respect of a loan to be obtained by Mr. OK, a director thereof from a Housing Finance Company for construction of a residential house for his own use. (8 Marks)

Answer

- (a) Board's sanction to be required for certain contracts in which particular directors are interested (Section 297 of the Companies Act, 1956):

According to Section 297(1) of the Companies Act, 1956, a director of the company or his relative, a firm in which such a director or relative is a partner, any other partner in such a firm or a private company of which the director is a member or director, must not enter into contracts with company for the sale, purchase, or supply of goods, materials or services or for underwriting the subscription of any shares in, or debentures except with the consent of the Board of Directors.

According to the proviso to sub-section (1) in the case of a company having a paid-up capital of ₹ 1 crore or more, no such contract shall be entered into except with previous approval of the Central Government.

Section 297(3) of the Act provides that a director or persons connected with him may enter into a contract in the circumstances of urgent necessity without obtaining consent of the Board, even if the value of such a contract exceeds ₹ 5,000 in the aggregate, but in such a case the consent of the Board must be obtained at meeting within three months of the date of entering into the contract.

The consent of the Board is deemed to have been given only if it is accorded by a resolution of the Board and not otherwise, either before or within three months of the date of entering into the contract [sub-section (4)].

In the present case, Sweet Tea Limited wants to sell its tea by entering into contract with the following parties:

- (1) Tea Bros, a partnership firm in which a director of Sweet Tea Limited is a partner:

In this case, a resolution in the meeting of the Board of Directors is required to be passed before entering into a contract with Tea Bros. If due to urgency, it is not possible to pass a Board resolution before entering into the contract, the requisite consent of the Board shall be obtained within three months of the date on which the contract was entered into. The director of Sweet Tea Limited who is also a partner in Tea Bros. must disclose his interest as per section 299.

- (2) R & T Private Limited in which one of the directors of Sweet Tea Limited is a member:

In this case also, a resolution in the meeting of the Board of Directors is required to be passed before entering into a contract with R & T Private Limited. If due to urgency, it is not possible to pass a Board resolution before entering into the

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contract, the requisite consent of the Board shall be obtained within three months of the date on which the contract was entered into. The director of Sweet Tea Limited who is also a member in R & T Private Limited must disclose his interest as per section 299.

- (3) **Strong Tea Limited in which one of the directors of Sweet Tea Limited is a director holding 3% of the paid up capital of Strong Tea Limited:**

Section 297 does not cover cases of Public Limited Companies; hence the approval of Board of Directors will not be necessary. According to section 299(6), where a director or more than one directors whether alone or together holds more than 2% of the paid up capital in the other company then disclosure is required. Therefore, the interested directors must make disclosure of interest as required under section 299 as the director of Sweet Tea Limited is holding 3% of the paid up capital of Strong Tea Limited.

- (b) (i) According to the provisions of section 295 of the Companies Act, 1956, no company shall make any loan or give any guarantee or any security in connection with a loan made by any other person to any director of the lending company unless the previous approval of the Central Government is obtained in this respect.

In view of the above provisions of the law, Mr. OK is required to approach VRS Ltd. intimating the company the full details of the loan transaction and the condition imposed by the housing finance company. The company VRS Ltd. is required to pass a Board Resolution as required by section 292 of the Companies Act, 1956 and also a special resolution in terms of section 372A if the facts of the case so require. Thereafter, the company is required to make an application to the Central Government for obtaining the approval under Section 295 of the Companies Act, 1956. On receipt of the approval of the Central Government, VRS Ltd. can provide the guarantee to housing finance company in respect of the loan proposed to be granted to Mr. OK.

- (ii) **Resolution passed in the meeting of the Board of Directors of VRS Ltd. held on_____**

"RESOLVED that, subject to the approval of the Central Government, sanction be and is hereby accorded to the proposal of furnishing the guarantee in respect of a loan of ₹ 75 lacs to be obtained by Mr. OK, a director of the company, from M/s_____, a housing finance company as per terms and conditions contained in the draft loan agreement to be entered into between the said housing finance company and Mr. OK, a copy of which is placed before this meeting and initiated by the Chairman for the purpose of identification.

RESOLVED FURTHER that Mr._____, Secretary of the company be and is hereby authorized to digitally sign the e-form 24AB, submit the application to the Ministry of Corporate Affairs and comply with all other formalities in this regard."

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Question 3

(a) ABC Private Limited was incorporated on 15-09-2013 in the State of Maharashtra by a group of Professional Engineers without any knowledge about the maintenance of the books of account. The company has appointed you as the Chief Accounts Officer at New Delhi where the books of account will be maintained. Keeping the provisions of Section 209 of the Companies Act, 1956, advise the management on

- (i) the nature of books to be maintained
- (ii) the period for which the accounts have to be preserved and
- (iii) the steps to be taken if the books of accounts are to be kept in New Delhi. (8 Marks)

(b) The Balance Sheet of Royal Ltd. as at 31-03-2013 disclosed the following details:

- (i) Authorised share capital ₹ 400 crores
- (ii) Paid up share capital ₹ 150 crores
- (iii) Reserves and surplus ₹ 750 crores

The company has issued in the year 2008, Fully Convertible Debentures of ₹ 100 crores which are due for conversion in the year 2013. The company proposes, after the conversion of Debentures to issue Bonus shares in the ratio of 1: 1. Explain briefly the requirements of the Companies Act, 1956 and the Securities and Exchange Board of India (SEBI) guidelines to be followed by the company in this regard. (8 Marks)

Answer

- (a) (i) According to Section 209(1) of the Companies Act, 1956, every company is required to maintain at its registered office proper books of account with respect to-
- (1) all sums of money received and expended by the company and the matters in respect of which receipt and expenditure take place;
 - (2) all sales and purchases of goods by the company;
 - (3) all assets and liabilities of the company; and
 - (4) in the case of a company pertaining to any class of companies engaged in production, processing, manufacturing or mining activities, such particulars relating to utilization of material or labour or other items of costs as may be prescribed, if such class of companies is required by the Central Government to include such particulars in the books of account.

According to section 209(3) of the Companies Act, 1956, proper books of accounts shall not be deemed to be kept with respect to the matters specified in Section 209(1) & 209(2) of the Companies Act, 1956-

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- (1) if there are not kept such books as are necessary to give a true and fair view of the state of affairs of the company or branch office, as the case may be, and to explain its transactions; and
 - (2) if such books are not kept on accrual basis and according to the double entry system of accounting.
- (ii) According to section 209(4A), the books of account of every company relating to a period of not less than 8 years immediately preceding the current year together with the vouchers relevant to any entry in such books of account should be preserved in good order.

However, in case of a company incorporated less than 8 years before the current year, the books of account for the entire period preceding the current year together with the vouchers relevant to any entry in such books of account should be so preserved.

- (iii) According to section 209(1) of the Companies Act, 1956, the books of account are required to be kept at the registered office of the company.

However, proviso to Section 209 of the Companies Act, 1956 allows the company to keep all or any of the books of account at any other place in India as the Board of Directors may decide. In such a case, the company should file with the Registrar of Companies, a notice in writing giving the full address of that other place within 7 days of the Boards' decision.

Thus, as per the above provisions, the company ABC Private Limited desiring to keep the books of accounts at any other place in India (i.e. Delhi) other than the registered office should file with the Registrar of Companies, a notice in writing giving the full address of that place within 7 days of the Boards' decision.

(b) Bonus Issue (Chapter IX of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009)

Chapter IX of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 contains the regulations (Regulations 92 to 95) for issue of bonus shares. Royal Ltd. can issue bonus shares in the ratio of 1:1 as follows:

1. The Articles of Royal Ltd. must authorize it to issue the bonus shares and capitalization of reserve. If there is no provision in the Articles authorizing the company, firstly, the Articles shall be amended by passing a special resolution.
2. Steps for determining whether any increase in authorised share capital is required:
 - (a) Paid up share capital as on 31st March, 2013: ₹ 150 crores.
 - (b) Paid up capital (after conversion of ₹ 100 crores fully convertible debentures, assuming that these debentures shall be converted into share capital of ₹ 100 crores) ₹ 250 crores (150+100).

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- (c) Proposed bonus issue - 1 share for every 1 share held.
- (d) Post bonus issue capital: ₹ 500 crores (250+250).
- Since the Authorised share capital of the company is only ₹ 400 crores, it has to take steps to increase the amount to ₹ 500 crores or beyond by complying with the provisions laid down in sections 94 and 97 of the Companies Act, 1956.
3. Sources of bonus shares:
- Reserves and surplus (free reserves built out of the genuine profits can be used for issue of bonus issue): ₹ 750 Crores
- Since the source of issue of bonus shares (₹ 750 crores) is sufficient to issue bonus shares (₹ 250 crores), the proposed issue can be made.
4. Other legal requirements for issue of Bonus shares are as under.
- (a) A resolution shall be passed by the Board in a duly convened Board meeting.
- (b) The bonus issue shall be made within 15 days of passing the Board resolution.
5. The bonus issue can be made if there is no default in payment of interest or principal in respect of fixed deposits and interest on existing debentures or principal on redemption thereof; and payment of statutory dues of the employees such as contribution to provident fund, gratuity, bonus, etc.

Question 4

- (a) *Mr. RK, a director of Excellent Limited has applied for a loan of ₹ 70 lacs for the purpose of financing the education of his son. The company has applied to the Central Government for approval to grant the loan. While the matter is under consideration of the Central Government, the company has lent a sum of ₹ 50 lacs to Mr. RK. Finally, the Central Government has rejected the company's request for the grant of loan and Mr. RK has refunded the amount of ₹ 50 lakhs to the company. The above said facts have been pointed out by the auditors of the company in their audit report and based on that report the Registrar of Companies has issued a show cause notice to the company and its directors. Examine whether the company has contravened any of the provisions of the Companies Act, 1956 and the remedial action to be taken by the company in this regard.*
- (8 Marks)
- (b) *A group of minority shareholders of SP Financiers Limited has made a complaint to the Central Government that the persons in charge of the management of the company have been guilty of fraud and negligence causing huge losses to the company and to the detriment of minority shareholders. Examine the powers of the Central Government to redress the grievances of the minority shareholders of the company under the provisions of the Companies Act, 1956.*
- (8 Marks)

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Answer

(a) Loan to Directors (Section 295 of the Companies Act, 1956)

According to section 295 of the Companies Act, 1956, no public company shall make any loan to any of its directors either directly or indirectly without obtaining the previous approval of the Central Government. As the Act envisages prior approval, the Central Government will not entertain any application from the company seeking approval for a loan already given to its director.

In the instant case, Mr. RK, a director of Excellent Limited has applied for a loan of ₹ 70 lacs for the purpose of financing the education of his son. The company has applied to the Central Government for approval to grant the loan. While the matter is under consideration of the Central Government, the company has lent a sum of ₹ 50 lacs to Mr. RK. Finally, the Central Government rejected the company's request for the grant of loan and Mr. RK has refunded the amount of ₹ 50 lacs to the company. The above said facts have been pointed out by the auditors of the company in their audit report and based on that report the Registrar of Companies has issued a show cause notice to the company and its directors.

Thus, the company has, therefore, contravened the provisions of section 295(1) and for this offence every person who is knowingly a party to this contravention including the person to whom the loan is made shall be punishable either with fine which may extend to ₹ 50,000 or with simple imprisonment for a term which may extend to six months [Section 295(4)]. Where any such loan has been repaid in full, no punishment by way of imprisonment shall be imposed and where the loan has been repaid in part, the maximum punishment, which may be imposed by way of imprisonment, shall be proportionately reduced. [Proviso to section 295(4)]. So, by refunding the loan in full, it is possible to avoid punishment in the form of imprisonment, but it is not possible to avoid prosecution and punishment in the form of fine.

In the present case, Mr. RK has refunded the amount of ₹ 50 lacs to the company, thus, no punishment by way of imprisonment shall be imposed.

Remedial action to be taken by the Company: Mr. RK has refunded the amount of ₹ 50 lacs to the company, thus, no punishment by way of imprisonment shall be imposed. The company and the directors are liable only with fine which may extend to ₹ 50,000.

Section 621A (1) of the Act, provides that notwithstanding anything contained in the Code of Criminal Procedure, 1973, any offence punishable under this Act (whether committed by a company or any officer thereof), not being an offence punishable with imprisonment only, or with imprisonment and also with fine may, either before or after the institution of any prosecution be compounded by

(i) the Company Law Board; or

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- (ii) the Regional Director, where the fine imposed for such offence does not exceed 50,000/-, on payment or credit, by the company or the officer, as the case may be to the Central Government of such sum as the Board or the Regional Director as the case may be, may specify.

According to section 621A (7), any offence which is punishable with imprisonment or with fine, or with both, shall be compoundable with the permission of the Court, in accordance with the procedure laid down in that Act for compounding of offences.

Thus, in the instant case, the company and the directors are liable only with fine which may extend to ₹ 50,000. The company and the directors may take the permission of the court for compounding of their offence. The said offence may be compounded by the Regional Director as the fine imposed does not exceed ₹ 50,000.

(b) Powers of the Central Government under Section 388B, 388C, 388D and 388E of the Companies Act, 1956

On receipt of the complaints from the minority shareholders of SP Financiers Limited, the Central Government may refer the matter to the Company Law Board (C.L.B.) by stating a case as provided in section 388-B of the Companies Act, 1956.

(1) Reference of case to the C.L.B: The Central Government may exercise this power where in its opinion there are circumstances suggesting:

- (i) that any person concerned in the conduct and management of the affairs of a company is or has been in connection therewith guilty of fraud, misfeasance, persistent negligence or default in carrying out his obligations and functions under the law, or breach of trust; or
- (ii) that the business of a company is not or has not been conducted and managed by such person in accordance with sound business principles or prudent commercial practices; or
- (iii) that a company is or has been conducted and managed by such person in a manner which is likely to cause, or has caused, serious injury or damage to the interest of the trade, industry or business to which such company pertains; or
- (iv) that the business of a company is or has been conducted and managed by such person with intent to defraud its creditors, members or any other person or otherwise for a fraudulent or unlawful purpose or in a manner prejudicial to public interest [Section 388- B (1)].

Every case under sub-section (1) shall be stated in the form of an application which shall be presented to the C.L.B. or such officer thereof as it may appoint in this behalf [Section 338-B(2)].

The person against whom a case is referred to the C.L.B. under this section shall be joined as a respondent to the application [Section 388-B(3)]. The application made to the C.L.B. must contain a concise statement of the circumstances and material as

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the Central Government may consider necessary for the purpose of the enquiry, and be signed and verified in the manner laid down in the Civil Procedure Code, 1908 for the signature and verification of a plaint in a suit by the Central Government [Section 388-B(4)].

- (2) **Interim order by C.L.B.:** The C.L.B. may, on the application of the Central Government, or on its own motion, by an interim order direct that the respondent shall not discharge any of the duties of his office until further orders of the C.L.B.; and appoint a suitable person in place of the respondent [Section 388-C(1)].
- (3) **Decision of the C.L.B.:** At the conclusion of the hearing of the case, the C.L.B. must record its findings (Section 388-D).
- (4) **Power of Central Government to remove managerial personnel on the basis of C.L.B. decision:** If the finding of the C.L.B. is against the respondent, the Central Government, by order, shall remove him from office [Section 388-E(1)]. The person against whom order of removal from office is made must not hold the office of a director or any other office connected with the conduct and management of affairs of the company for a period of 5 years from the date of the order of removal. The Central Government may, with the previous concurrence of the C.L.B., remit or relax this period of 5 years [Section 388-E(3)]. On the removal of a person from office in the above manner, no compensation in any circumstance whatever is payable to him for the loss or termination of office [Section 388E-(4)]. The company may, with the previous approval of the Government, appoint another person to the office in place of the person removed [Section 388E-(5)].

Question 5

- (a) *Superb Limited went for a public issue of Equity shares (₹ 10 crores) of ₹ 10 each. The shares were subscribed to an extent of 95% of the total issue. The shares of the company were accepted for listing by Bombay Stock Exchange but subsequently the permission was cancelled on certain grounds. On an appeal to the Central Government by the company, the decision of the Stock Exchange was held to be valid. As a result, the application money had become refundable to the allottees. The company, had no prospects of doing any business and there was a complete deadlock among the Directors. Looking at the circumstances, certain creditors filed a petition in the court for winding up of the company on the ground that the company had become commercially insolvent. The shareholders of the company object to the petition of the creditors. Decide giving reasons:*
- (i) *Whether the objections of the shareholders will sustain and the court can dismiss the petition of creditors for winding up of the company?*
 - (ii) *State the provisions of the Companies Act, 1956 in this regard. (8 Marks)*
- (b) *Due to financial irregularities, the affairs of MNP Bank Limited have gone from bad to worse and this fact has come to the notice of the Reserve Bank of India as well as*

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Central Government. Examining the provisions of the Banking Regulation Act, 1949, answer the following:

- (i) Powers of RBI to inspect the Bank.
- (ii) Powers of Central Government to give directions in this matter. (8 Marks)

Answer

(a) (i) Commercial Insolvency of Superb Ltd.: In this case three facts are given i.e.:

1. Superb Limited went for a public issue and subsequently it was required to refund the amount received on application.
2. As a result, the company has no prospects of doing any business.
3. There was a complete dead lock among the directors.

These three circumstances may be construed as indicators of commercial insolvency of the company.

Section 433 (e) read together with Section 434 of the Companies Act, 1956, provides that a Court may order for winding up of a company if it is unable to pay its debts or deemed to be unable to pay its debts and it is proved to the satisfaction of the Court after taking into account all the liabilities including the contingent and prospective liabilities of the company. Moreover, Section 439 gives powers to the creditors for filing an application for its petition for winding up. There are no chances for the sustainment of shareholder's objection [*Deccan Farms & Distilleries Ltd. vs. Velabai Laxmidas Bhajji (1979)*]. The Court has got wide discretionary powers regarding winding up. It may or may not dismiss the petition of creditors for winding up. Even if a winding up petition is a proper remedy against a company which is unable to pay its debts, the Court may in its discretion refuse to put an end to the life of the company [*Jugalkishore Banarsidas vs. South India Saw Mills P. Ltd. (1975)*].

(ii) The Provisions of the Companies Act, 1956, which will apply in this case, are:

- (a) A company may be wound up by the Court, if the company is unable to pay its debts. [Section 433(e)]
- (b) A company shall be deemed to be unable to pay its debts, if it is proved to the satisfaction of the Court that the company is unable to pay its debts, and in determining whether a company is unable to pay its debts, the Court shall take into account the contingent and prospective liabilities of the company. [Section 434(1)(c)].
- (c) An application to the Court for the winding up of a company shall be by petition presented, subject to the provisions of this section, by any creditor or creditors, including any Contingent or prospective creditor or creditors. [Section 439(1)(b)]

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- (b) (i) **Power of the RBI to inspect banks:** As per section 35 of the Banking Regulation Act, 1949, the RBI at any time may, and on being directed so to do by the Central Government shall cause an inspection to be made by one or more of its officers of any banking company and its books and accounts. The RBI shall supply to the banking company a copy of its report on such inspection. All banks are bound to comply with such directions. Every director or other officer of the bank shall produce all such books, documents as required by the inspector. The inspector may examine on oath any director or other officers of the banking company in relation to its business. The RBI shall, if it has been directed by the Central Government to cause an inspection to be made, and may, in any other case, report to the Central Government on any inspection made under this section.
- (ii) **Power of the Central Government to give directions in this matter:** Apart from the powers of the Reserve Bank, the Central Government has also the power to direct the RBI to cause an inspection to be made under section 35 of the Banking Regulation Act, 1949. The RBI submits report to Central Government and the latter, on scrutiny, if is of the opinion that the affairs of the bank are being conducted detrimental to the interest of its depositors, it may, after giving an opportunity of being heard, to the bank, may order in writing prohibiting the bank from receiving fresh deposits, direct the RBI to apply section 38 of the said Act for winding up of the bank.

Question 6

- (a) (i) *In the case of a producer company, the auditor is required to report on additional matters apart from the provisions contained in Section 227 of the Companies Act, 1956. State the additional matters on which the auditor has to report in the case of a producer company. (4 Marks)*
- (ii) *State the documents that are required to be delivered by a foreign company at the time of establishment of a place of business in India. State to whom the said documents are to be delivered. (4 Marks)*
- (b) *Mutual Distrust Private Limited has two shareholders namely A and B holding 51% and 49% respectively. Both are working as directors. Due to differences between them, A decides to hold a board meeting on 30th April, 2014 but the same could not be held due to non-co-operation from B and lack of quorum. Advice A about the steps that can be taken under the Companies Act, 1956 to resolve the matter. (8 Marks)*

Answer

- (a) (i) **Duties of auditor of a producer company:** According to section 581ZG of the Companies Act, 1956, without prejudice to the provisions contained in section 227, the auditor shall report on the following additional matters relating to the producer company, namely:-
- (a) The amount of debts due along with particulars of bad debts if any;

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- (b) The verification of cash balance and securities;
 - (c) the details of assets and liabilities;
 - (d) all transactions which appear to be contrary to the provisions of this part;
 - (e) the loans given by the producer company to the directors;
 - (f) the donations or subscriptions given by the producer company;
 - (g) any other matter as may be considered necessary by the auditor.
- (ii) **Documents to be furnished by foreign companies carrying on business in India:** As per Section 592 of the Companies Act, 1956 a foreign company has to furnish the following documents to the Registrar of Companies within 30 days of the establishment of the place of business in India for registration:
- (1) A certified copy of Charter, Statute or Memorandum and Articles of the company or other instruments constituting or defining the Constitution of the company. If it is not in English Language, its certified translation should be submitted.
 - (2) The full address of the registered or principal office of the company.
 - (3) List of Directors and Secretary giving details like present and former name and surname, his usual residential address, nationality, business occupation etc.
 - (4) The names and address of one or more persons resident in India authorized to accept on behalf of the company, service of process and any notices or other documents required to be served on the company.
 - (5) The full address of the office of the company in India which is to be deemed its principal place of business in India.

The aforesaid documents shall be required to be filed at two places, first with the Registrar of the state where principal place of business is situated and second with the Registrar of New Delhi (Section 597 of the Companies Act, 1956).

- (b) There are two shareholders in Mutual Distrust Private Limited, A (holding 51% shares) and B (holding 49% shares). They are also the only directors of the company. There are differences between the two. A held a Board meeting but B did not attend the Board meeting. Thus, the meeting could not be held due to non co-operation from B and lack of quorum.

If a meeting of the Board could not be held for want of quorum, then, unless the Articles provide otherwise, the meeting automatically stands adjourned by virtue of Section 288(1) of the Companies Act, 1956, till the same day in the next week, at the same time and place. And if that "same day" is a public holiday, then the meeting stands adjourned till the next succeeding day, which is not a public holiday, at the same time and place.

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However, due to differences between the two there is no guarantee as to whether B will attend the next meetings also or not.

According to section 186 of the Companies Act, 1956, if for any reason it is impracticable to hold a meeting of the company, other than an Annual General Meeting, in any manner in which the meetings of the company may be called, or to hold or conduct the meeting of the company in the manner prescribed by the Companies Act, 1956, or the Articles, the Company Law Board may, either on its own motion or on the application of any director of the company, or of any member of the company who would be entitled to vote at the meeting-

- (a) order a meeting of the company to be called, held or conducted in such a manner as the Company Law Board thinks fit, and
- (b) give such directions as the Company Law Board thinks fit for the conduct of the meeting. [*Opera Photographic Ltd., Re, 1989 BCLC 763, HR Paul & Sons Ltd, (1973)*]

The Company Law Board can also give a direction that one member of the company present in person or by proxy shall be deemed to constitute a meeting.

Thus, A can approach the Company Law Board to conduct an Extra- Ordinary General meeting. He being a member of the company can then transact the necessary business or take necessary actions at the extra- ordinary general meeting [*Sticky Fingers Restaurant Ltd, Re, 1992 BCLC 84*]

Question 7

Attempt any four

- (a) Mr. V, a person of Indian origin and resident of USA desires to acquire two immovable properties in India comprising
 - (i) a residential flat in Mumbai and
 - (ii) a farm house on the outskirts of Mumbai.

Explain the steps he has to take in this matter having regard to the provisions of FEMA, 1999. (4 Marks)

- (b) MNO Tyres Limited is in the business of manufacture of automotive tyres for the past one year. To increase its market share, the company has decided to reduce the prices of tyres. The cost structure of the passenger car tyre is as under:
 - (i) Cost of production ₹ 5,000 per tyre
 - (ii) Selling price ₹ 6,000 per tyre

The company started selling tyres @ ₹ 5,200 per tyre and the other tyre manufacturers made a complaint to the Competition Commission of India stating that MNO Tyres Limited is guilty of predatory pricing having the effect of reducing the competition or

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eliminating the competition. Advise MNO Tyres Limited as to the meaning of predatory pricing and whether the company can be said to have indulged in the said practice having regard to the provisions of the Competition Act, 2002. (4 Marks)

- (c) *The Board of directors of SUV Limited, a banking company incorporated in India, for the accounting period ended 31-03-2013 transferred 15% of its net profit to its Reserve Fund. Certain shareholders of the company object to the above act of the Board on the ground that it is violative of the provisions of the Banking Regulation Act, 1949. Decide whether the contention of the shareholders is tenable under the Banking Regulation Act, 1949.*

(4 Marks)

- (d) *Explain the meaning of the terms "non-performing asset" and "asset reconstruction" used in the SARFAESI Act, 2002. (4 Marks)*

- (e) *Explain the meaning of the term "Money Laundering". Z, a known smuggler was caught in transfer of funds illegally exporting narcotic drugs from India to some countries in Africa. State the maximum punishment that can be awarded to him under Prevention of Money Laundering Act, 2002. (4 Marks)*

Answer

- (a) **Permissible Transactions:** Acquisition and transfer of immovable property in India by a person resident outside India is a permissible transaction under the Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000.

Acquisition and transfer of property in India by a person of Indian origin

A person of Indian origin resident outside India may acquire immovable property in India other than an agricultural property, plantation, or a farm house.

However, in case of acquisition of immovable property, payment of purchase price, if any, shall be made out of:

- (i) funds received in India through normal banking channels by way of inward remittance from any place outside India, or
- (ii) funds held in any non-resident account maintained in accordance with the provisions of the Foreign Exchange Management Act, 1999, and the regulations made by the Reserve Bank of India.

Further, no payment of purchase price for acquisition of immovable property shall be made either by traveller's cheque or by currency notes of any foreign country or any mode other than those specifically permitted by this clause.

Thus, by following the above steps as mentioned in the provisions of the Foreign Exchange Management Act, 1999, and the Regulations made thereunder, Mr. V, a person of Indian origin and resident of USA (i.e. resident outside India):

- (iii) can acquire a residential flat in Mumbai and

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- (iv) can not acquire a farmhouse on the outskirts of Mumbai.
- (b) Section 4(2)(a) of the Competition Act, 2002 prohibits abuse of dominant position by any enterprise or group. There shall be abuse of dominant position if an enterprise or a group directly or indirectly, imposes unfair or discriminatory-
- (i) condition in purchase or sale of goods or services; or
 - (ii) price in purchase or sale (including predatory price) of goods or service.

"Predatory price" means the sale of goods or provision of services, at a price which is below the cost, as may be determined by regulations, of production of the goods or provision of services, with a view to reduce competition or eliminate the competitors.

In the present case, MNO Tyres Limited is in the business of manufacture of automotive tyres for the past one year. To increase its market share, the company has decided to reduce the prices of tyres. The cost of production is ₹ 5,000 and selling price is ₹ 6000. The company started selling tyres @ ₹ 5,200 per tyre. The other tyre manufacturers made a complaint to the Competition Commission of India stating that MNO Tyres Limited is guilty of predatory pricing having the effect of reducing the competition or eliminating the competition.

According to the provisions given under section 4(2)(a) of the Competition Act, 2002, MNO Tyres Limited cannot be said to have indulged in predatory pricing as the revised selling price (₹ 5,200 per tyre) is more than its cost of production (₹ 5,000 per tyre).

- (c) According to section 17 of the Banking Regulation Act, 1949, every banking company incorporated in India must create a reserve fund and transfer a sum equal to not less than 20% of its net profits. However, the Central Government is empowered to exempt from this requirement on the recommendation of the Reserve Bank of India (RBI). Such exemption will be allowed only:
- 1 when the amount in the reserve fund and the share premium account are equal to the paid-up share capital of the banking company.
 2. when the Central Government feels that its paid-up share capital and reserves are adequate to safeguard the interest of the depositors.

If the banking company appropriates any sum from the Reserve Fund or the Share Premium account, it must be reported to RBI within 21 days explaining the circumstances leading to such appropriation.

In the present case, The Board of directors of SUV Limited, a banking company incorporated in India, for the accounting period ended 31st March, 2013 transferred 15% of its net profit to its Reserve Fund.

Thus, according to the provisions of the Act, contention of shareholders of SUV Limited shall be tenable since the percentage of transfer of profits to Reserve Fund is lower than statutory limits, as provided in the Act.

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- (d) **Non-performing asset**" means an asset or account of a borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset, in accordance with the directions or under guidelines relating to asset classifications issued by the Reserve Bank [Section 2(o) of the SARFAESI Act, 2002]

"Asset reconstruction" means acquisition by any securitisation company or reconstruction company of any right or interest of any bank or financial institution in any financial assistance for the purpose of realization of such financial assistance. [Section 2(b) of SARFAESI Act, 2002]

- (e) **Money Laundering:** Whosoever directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or is actually involved in any process or activity connected with the proceeds of crime and projecting it as untainted property shall be guilty of offence of money laundering. [Section 3 of the Prevention of Money Laundering Act, 2002]

Paragraph 2 of Part A of the Schedule to the Prevention of Money Laundering Act, 2002, covers Offences under the Narcotic Drugs And Psychotropic Substances Act, 1985. Illegal import into India, export from India or transshipment of narcotic drugs and psychotropic substances (section 23) is covered under paragraph 2 of Part A.

Punishment: Section 4 of the said Act provides for the punishment for Money-Laundering. Whoever commits the offence of money-laundering shall be punishable with rigorous imprisonment for a term which shall not be less than 3 years but which may extend to 7 years and shall also be liable to fine which may extend to five lakh rupees. But where the proceeds of crime involved in money-laundering relate to any offence specified under paragraph 2 of Part A of the Schedule, the maximum punishment may extend to 10 years instead of 7 years.

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