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Formation and Incorporation of a Company

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After being incorporated under the Companies Act of 2013 or any prior Companies Act, a company is said to exist. Before engaging in business transactions, any company must become incorporated. At the time of incorporation, it must be decided in advance whether the business will be private or public, what its purpose will be, how much capital will be put into it, and many other factors. At first, numerous legal formalities and processes must be completed. Only after all legal formalities have been completed by the correct processes can a corporation be founded. Every business organisation must adhere to a system that is set up by the authorities to start doing business. Once a company is registered or formed, it is said to have a birth certificate called the Certificate of Incorporation.

Keywords: *power, duties, responsibilities, liabilities, promoters, registration, company.*

INTRODUCTION

A company's creation and incorporation resemble a person's birth in that both go through several stages of body component formation while still in the womb. A lot of preparation work is done before a company is founded. Putting a concept into a business involves several stages, the most important of which are the pre-incorporation and formation stages, which are covered in depth below. This article offers insights into situations involving pre-incorporation contracts

and describes a promoter's roles, responsibilities, and liabilities. This page focuses on the comprehensive company registration process.

PROMOTION

As the name implies, this incorporation phase focuses on the Company's marketing that has not yet taken place. It is when the Promoter approaches possible investors to solicit funding for a concept, either one of his creations or the creation of another. To be able to incorporate the business, the Promoter attempts to increase investor faith in the Idea and builds upon the investment. According to Section 2(69)¹ of the 2013 Companies Act, "promoter"² is a term. A promoter is, technically speaking, a person who is thus identified in the Company's prospectus. The Company shall also identify its Promoter in the annual return submitted according to Section 96³. A promoter is to a business what parents are to a child. Along with persuading investors to support the business concept, the Promoter assembles the physical capital of labour, raw materials, managerial talent, machinery, etc.

The Promoter must SWOT analyze the Idea in light of its prospects and viability in light of societal dynamics, notwithstanding their passion for the Company's ideas. The SWOT analysis works on four parameters: Strengths, Weaknesses, Opportunities, and threats. It is used to evaluate the overall competitive position of the company in the market and to develop strategic planning. It is sometimes called situational assessment or situational analysis. SWOT Analysis is a tool that can help to analyse the company's best now and devise a successful future strategy. SWOT can also uncover areas of the business that are holding it back or that competitors could exploit if not protected timely.

There are three different ways to look at the concept of a promoter:

- A promoter is a person who is listed in the Company's prospectus, is mentioned as a promoter in the Company's annual reports, and

¹ Companies Act 2013, s 2(69)

² Avatar Singh, *Company Law by Avtar Singh* (17th edn, Eastern Book Company 2018)

³ Companies Act 2013, s 96

- A promoter is a person with the ability to nominate the person selected by the majority of the board of directors, a person in charge of formulating corporate policy, and/or
- A promoter is someone whom the advisory board of directors is used to acting for.

FUNCTIONS OF A PROMOTER

(i) Identifying a Market Demand for a Business

Before pushing a business concept, the Promoter first seeks a potential business opportunity. Any new product, service, or even the creation or manufacture of an existing product using new techniques could be a prospective opportunity.

(ii) The practicality of the Idea

The Promoter must scrutinize the new potential Company's concept from a technical and financial viability standpoint. Therefore, the business idea's promoters must conduct thorough research into every area of the business idea utilizing various methods, including market economic studies, comments from technical specialists on related products, chartered accountants, economists, etc. The concept that the Promoter plans to utilize to defraud the Market. The three tests listed below can be used to gauge the Idea's viability.⁴

- Technical conceivability: Although a business's ideas may be sound, there are instances when they are technically challenging to realize because of obstacles like the cost of acquiring raw materials or the difficulty of producing a product on a tight budget.
- Budgetary viability: Due to limited resources and perhaps tight deadlines, it is occasionally impossible to raise a sizable sum of money needed for the business. Financial institutions can also be cautious about providing sizable loans to start-up businesses.
- Financial viability: Although an idea of a business may be technically and financially feasible, it may not be commercially viable. It might not be profitable or bring in enough money. In this situation, the business's promoters choose not to do so.

⁴ *Taxmann's Company Law* (4th edn, Taxmann)

(iii) Name of the Company

After coordinating the Idea's debut, the Promoter wants to give the Company a name. Wherever the Promoter plans to establish the Company's registered head office, the Promoter applies to the registrar of companies in that jurisdiction. The three names "X or Y, or Z" in the application to the registrar are listed in order of priority, and the Promoter complies with Section 8 of the Companies (Incorporation) Rules, 2014.

(iv) Finalizing MOA Signatories

The promoters choose the members who will all sign the memorandum of association for the new Company. The first Directors of the Company are typically the signatories of the MOA. To become a firm director, the memorandum's signatories must give their written approval.

(v) Hiring Professionals

Certain specialists, such as mercantile bankers, auditors, lawyers, etc., must be appointed by promoters. These experts assist the Promoter in putting together the appropriate paperwork that has to be submitted to the concerned Registrar of Companies for the Company to be registered.

(vi) Creating the Required Documents

The promoters are in charge of gathering the paperwork that must be provided to the Registrar of Companies to register the Company. These papers include the return of allotment, the articles of association, the memorandum of association, the directors' approval, and the statutory declaration.

DUTIES OF PROMOTORS

Since the Company has not yet been formed during the pre-incorporation stage, the relationship between the Promoter and the Company cannot be characterized as a principal-agent relationship. It has been determined through several legal interpretations that the relationship

between the Promoter and the corporation is fiduciary⁵. These judicial interpretations have taken place in both ordinary law courts and Indian courts.

Duties of the Promoter shall be discussed herewith:

Duties to reveal hidden profits: The promoters have a fiduciary duty to the Company that will be incorporated, as was previously stated. Promoters are responsible for informing the Company of any hidden profits they may have made. The Promoter is entitled to reimbursement from the firm for any costs incurred during the incorporation process.

Obligation to inform the Company about transactions: The Promoter may intend any firm property for sale, leasing, or rental. However, suppose such a transaction is carried out without the business's knowledge. In that case, the Company may revoke the sale, lease, or rental agreement, and it may even seek reimbursement for any profits the Promoter gained from the transaction as a result of approving the Promoter's contract.⁶

Obligation of loyalty to prospective shareholders: The Promoter is under a fiduciary obligation to the firm, the memorandum of association's signatories, and the recipients of the Company's future share allocations. Relationships of trust between the Promoter and potential shareholders demonstrate that the Promoter will uphold all the standards the Company has set for him.

Obligation to reveal revenues from promotions: Given that the Promoter has a fiduciary relationship with the firm and may occasionally be subject to private agreements that benefit him personally, he must declare the gains he makes during the promotion of the business as indicated to the Company.

Obligation to pay the business any funds received as trustee: A fiduciary connection exists between the Promoter and the Company, and it is his responsibility to return to the firm any benefits he has received while serving as the trustee for the business.

⁵ *Ibid*

⁶ Sindhuja S, 'Promoter of a Company: Functions, Duties and Liabilities' (*Business Management Ideas*) <<https://www.businessmanagementideas.com/company-management/promoter-of-a-company-functions-duties-and-liabilities/8952>> accessed 25 November 2022

LIABILITIES OF THE PROMOTER

According to the different sections of the Companies Act 2013 which have been elaborated below, a Promoter is liable for his misconduct or actions because he stands in a fiduciary relationship with the company. The Promoter is liable for the following:

1. The duty to defend the transactions of the business

The Company and the Promoter have a fiduciary relationship, so the Company has the authority to look into the transactions the Promoter has undertaken without the Company's permission. When dealing with such a transaction, the firm has two options: it can either reject the Promoter's agreement with the third party or sue him to get his money back and any profits he made doing business against the Company's wishes.

2. Responsibility for the prospectus's false statements

The information which needs to be included in the prospectus is outlined under Section 26 of the Companies Act of 2013. If the clause is breached, the Promoter could be held accountable. The Promoter may be held accountable under Section 63 of the Companies Act of 1956⁷ for making false statements in a prospectus. Making false representations in the prospectus is punishable by up to two years in prison and a fine as high as 5000 rupees under Section 63. According to Sections 34 and 35 of the Companies Act of 2013, the Promoter may be held accountable for any false claims made in the prospectus that led a person to subscribe for shares and debentures in the mistaken belief that the statements in the prospectus were true. However, only the initial share allottees – not the future ones – are subject to the Promoter's liability cap.

3. Personal liability towards the contracts

The Promoter may be held personally accountable for all contracts made during the pre-incorporation stage of the Company until they are fulfilled by their terms or until the Company assumes the Promoter's duty once it is incorporated.

⁷ Companies Act 1956, s 63

4. Liability of the Promoter throughout the Company's liquidation process

As per Section 340⁸, the official liquidator may apply to the court throughout the winding-up process to hold the Promoter accountable for misbehaviour or a breach of trust toward the Company. Additionally, if the liquidator asserts that there was fraud in the promotion or establishment of the firm, the Promoter may be subject to examination under Section 300⁹.

STATUS OF THE CONTRACT IN THE PRE-INCORPORATION PERIOD AND THE PRE-INCORPORATION PROMOTER LIABILITY PRINCIPLE

Pre-incorporation contracts are agreements made by the Promoter before the Company's incorporation and are crucial to the business's long-term survival. However, these pre-incorporation contracts differ from regular contracts in nature. These agreements are bipartite, and their effects are also bipartite. The Promoter engages with service providers or interested parties, and these agreements positively impact the potential firm while it is still in the pre-incorporated stage. The instruments of the contract are often used in quid pro quo transactions involving two parties. Still, in this case, they are remarkably used for the benefit of a third party since the contract does not include the corporation as a party.

According to the para mentioned above, the Company is essentially the recipient of the pre-incorporation contracts. The reason a firm is not accountable for the pre-incorporation contracts may cause some confusion; nevertheless, the simple answer is that one cannot hold someone liable if they do not exist and are not a party to the pre-incorporation contract in question. Until the enactment of the Specific Relief Act, the Company's non-liability concerning the pre-incorporation transactions was the same as the common law court in India. Pre-incorporation contracts and agreements that deviate from the common law's course are valid under Sections 15(h)¹⁰ and 19(e) of the Specific Relief Act.¹¹

⁸ Companies Act 2013, s 340

⁹ *Ibid*

¹⁰ Specific Relief Act 1963, s 15(h)

¹¹ Specific Relief Act 1963, s 19(e)

According to Section 15(h)¹², which specifies who may seek particular performance, the Company must have issued a message of acceptance to the other side party of the contract when a promoter signs a contract before incorporation on the Company's behalf and the Company guarantees such contract. According to Section 19(e)¹³, a party may pursue particular performance relief if the Promoter of the Company engaged in a contract before incorporation and the contract was justified at that time. The business must have acknowledged its contract acceptance and informed the other party.

Contrary to the usual course of action against the Promoter in this circumstance, the Company can be held accountable if it has accepted the contract and has notified such acceptance of the other party of the contract. This is made possible by the aforementioned provisions of the Specific Relief Act 1963. To comprehend the liability of pre-incorporation contracts, the judiciary has heard several instances; we will explore these examples below.

The *Weavers Mills v Balkis Ammal and Others*¹⁴ case, in which the Promoter had consented to buy several properties on the business's behalf, but, following incorporation, the firm acquired possession of the lands and built structures thereon. Even though there had been no conveyance of the properties between the Promoter and the firm, it was decided that. According to the ruling, the Company's ownership of the assets was legitimate and could not be overturned. The Madras High Court had broadened the definition of the principle mentioned above. To comprehend the liability of pre-incorporation contracts, the judiciary has heard several instances; we will explore these examples below.

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¹² Specific Relief Act 1963, s 15(h)

¹³ Specific Relief Act 1963, s 19(e)

¹⁴ *The Weavers Mills Ltd. v Balkis Ammal & Ors* (1969) Mad 462

¹⁵ *Ibid*

Madras High Court had broadened the definition of the principle mentioned above. According to the learned judge, there could not have been a principal-agent relationship because the principal and agent could not have existed without incorporation. It was also added that the Company could not assume responsibility for a pre-incorporation contract through adoption because it was not a party to the agreement and was not even present at the time of the contract.

In The *Newborn v Sensolid Ltd.*¹⁶ case, an unformed corporation entered into a contract where the other party refused to fulfil its obligations. This is how the appeal court understood the results of *Kelner v Baxter*¹⁷. The judge had noted that there could not be a pre-incorporation contract action because the Company could not have existed or entered into a contract before incorporation. The idea was that if an agent or Promoter signed a contract, the Promoter would be held personally accountable but that the contract would be unenforceable if that individual acted as a representative of an unformed company, confusion was thus caused.

The pre-incorporation contracts and the Promoter's liability principle can be concluded in that common law establishes that the Promoter will be held personally responsible for the Company's pre-incorporation contracts. This was also the case in England and India before the passage of the Specific Relief Act of 1963. Essentially, it implies that the Promoter's obligation cannot be avoided. However, there are recognized methods under Indian law to transfer responsibility from the Promoter to the Company in the event of a pre-incorporation contract. The first and most important method is contract novation, which common law courts recognize concerning the transfer of responsibility from the Promoter to the Company. However, India has a special law known as the Specific Relief Act 1963, which contains provisions that apply if the Promoter entered into the contract during the pre-incorporation stage. However, in the absence of a Pre-incorporation agreement, the Promoter is held accountable.

¹⁶ *Newborne v Sensolid (Great Britain) Ltd* [1954] 1 QB 45

¹⁷ *Kelner v Baxter* [1866] LR 2 CP 174

REGISTRATION/INCORPORATION OF THE COMPANY

The corporate body is given legal status by registering the Company according to company law. Section 7¹⁸ provides detailed instructions on the registration process. The conditions for the Company's incorporation are spelled out in this clause. The following are the specifics of the documents:

- Memorandum of association, which is the Company's constitution and is officially stamped; for a private business, the minimum number of signatories is two; for a public company, the minimum number of signatories is seven;
- The Articles of Association, which were filed with the MOA;
- A list of the directors, which includes information on their names, jobs, and addresses;
- Written approval from the board of directors, which must be presented to the company registry;
- A verification document must be digitally signed by an attorney, company secretary, or recognized chartered accountant.

INTEGRATED PROCESS OF COMPANY REGISTRATION

The Ministry of Corporate Affairs website offers possibilities for online company registration, unifying the different legal stages of formation into one webpage. Additionally, to incorporate or register a business, you must first apply for the distinctive name that will be reserved for your prospective firm in exchange for a cost of Rs. 1000. The next step requires in the process is to complete the "simplified proforma for incorporation" form online. The proforma offers a practical way to incorporate a business online, which begins by filling out the necessary information for the Company's Promoter.¹⁹

Second, you can fill out the e-MOA (electronic Memorandum of Association) and the e-AOA (electronic Articles of Association) on the electronic proforma in form numbers INC-33 and INC-

¹⁸ Companies Act 2013, s 7

¹⁹ 'Formation of Company - Promotion and Incorporation' (Taxmann, 25 August 2022)

<<https://www.taxmann.com/post/blog/formation-of-company-promotion-and-incorporation/>> accessed 25 November 2022

34, respectively. As we all know, the MOA serves as the Company's constitution and typically outlines the organization's goal and the directors that participated in its establishment. An e-AOA puts forth rules and regulations for corporate affairs after the memorandum of association, which further simplifies the formation procedure. The E-AOA also specifies managers, officials, and the board of directors' responsibilities, rights, and authority.

The Company may create the Articles of Association following its own needs, or the firm may choose them from the different possibilities listed in the Companies Act schedule. AOA must be completed, signed by all directors, and witnessed by two people. The philosophy of indoor management refers to the articles of association of a company since they address a variety of topics, including The philosophy of indoor management refers to the articles of association of a company since they address a variety of topics, including:

- The privileges of each class of shareholders,
- The process for allocating shares, Throughout the share certificate issuance process,
- Share transfers,
- Guidelines for holding meetings,
- The process for appointing or dismissing the Company's directors, etc.

Along with the directors' digital signatures, all the documents deemed relevant under Section 7 of the Companies Act²⁰ must be submitted. By incorporating this request form with the PAN and TAN card of the proposed organization that is being incorporated, the Ministry of Corporate Affairs has made an effort to make the process of receiving a DIN number for the directors of a newly incorporated company simpler. The central government of India made efforts to expand the practicality and scope of incorporation by establishing a single-window clearance process for company incorporation.

²⁰ Companies Act 2013, s 7

CERTIFICATE OF INCORPORATION

The registrar does the registration of the association's memorandum, articles of incorporation, and other papers. The registrar will consider granting the certificate of incorporation after they are pleased with the application and supporting documentation. The definitive document attesting to a company's existence is its certificate of incorporation.

Effect of the Certificate of Incorporation

- According to Section 35 of the Companies Act of 1956²¹, the incorporation certificate is the ultimate proof of the Company's existence or presence in law.
- Once issued, the certificate of incorporation constitutes convincing proof of the business's legal existence as of the date specified in the certificate, even if the documents filed for the Company's creation include formal flaws.²²
- If the certificate of incorporation was received on the 24th but the certificate reflects the date 22nd, the Company shall be deemed to have existed as of the 22nd as indicated by the incorporation certificate, and this will also serve to certify the authenticity of the transactions made by such Company on 22nd and 23rd in the eyes of the.

CERTIFICATE OF COMMENCEMENT OF BUSINESS

- A private firm may launch operations once it receives its establishment certificate. Once a public firm gets its certificate of incorporation, it creates a prospectus to encourage the public to subscribe for its share capital. The minimum subscription amount is set in the prospectus. The minimum number of shares specified in the prospectus must, after that, be sold.
- The certificate and a letter from the bank confirming full payment are delivered to the registrar after the necessary number of shares have been sold.

²¹ Companies Act 1956, s 35

²² Pankaj Tyagi, 'Certificate Of Incorporation: Meaning, Significance, And Legalities' (*Corpbiz*, 25 April 2022) <<https://corpbiz.io/learning/certificate-of-incorporation-meaning-significance-and-legalities/>> accessed 25 November 2022

- The registrar then examines the documents. The registrar issues a certificate known as a "certificate of the beginning of business" if all legal requirements are met. This is indisputable proof of the start of the public Company's operations.

CONCLUSION

According to the aforementioned article, the Company's incorporation time may be interpreted as the fusion of the Pre-incorporation period and the incorporation era. The time before incorporation might be viewed as the Company's concept phase. When raising capital for the business, the Promoter whose name appears in the firm's prospectus is crucial. The Promoter also performs a SWOT analysis of the business to determine its market potential and if investors would be able to consider it a viable investment. The Promoter's obligations and liabilities have been thoroughly explained, demonstrating the fiduciary nature of their relationship with the firm. The pre-incorporation contract principle has been thoroughly discussed, and it has been determined that the Promoter will be held personally accountable for all pre-incorporation contracts unless there is a novation of the contract or, in the case of India, when the provisions of the Specific Relief Act apply, wherein the Company ratifies the contract and notifies the other party of its liability. Since it affects possible investor intentions toward businesses in the Market, the government's role in simplifying the incorporation procedure is quite important.

The Ministry of Corporate Affairs offers options to incorporate the Company with a unique name by providing the online option of submitting the memorandum of association along with the articles of association online with the declaration digitally signed stating that the respective Company has met all legal requirements for incorporation of a company. This has increased the ease of incorporation. This legislation reflects the State's obligation to support businesses to boost the economy. The certificate of incorporation is essential for demonstrating that the industry has been adequately created and cannot be revoked unless the registrar of companies decides to wind up the firm after discovering fraud in the formation process. The incorporation certificate speaks for itself, and the date of incorporation is unaffected by the date of receipt, so even if the certificate is received on February 20 but clearly states that the date of incorporation is February 14, all actions taken after that date are presumed to have been taken by the law.