COMPANY LAW IN INDIA

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"People must come to accept private enterprise not as a necessary evil, but as an affirmative good."

—Eugene Black

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By

JUSTICE D. N. SINHA

Company Law in India has had a chequered history. It was in 1850 that, following the English Companies Act of 1844, an Act for "registration of joint-stock companies" was, for the first time, enacted. Every unincorporated company of partners associated under a deed contaning a provision that the shares in the stock or business of the said company were transferable without the consent of all the partners, and also every company established for some literal, scientific or charitable purpose, which did not carry on any business for the pecuniary benefit of any of the proprietors or shareholders, was entitled to registration under this Act. The Supreme Courts of Calcutta, Madras and Bombay were authorised to order such registration. Thus from the very inception, the Courts came to have an important interest in company legislation. One of the things to be noticed in the 1850 Act is that it did not introduce the privilege of limited liability which is one of the most salient features of joint-stock companies to-day. There were, however, several important provisions, e.g., provisions relating to holding one or more general meetings every year, holding of extraordinary general meetings upon special requisition, prohibition as to purchase by the company of its own shares, half-yearly audit and report of auditors on balance-sheet and profit and loss account. Permission to sue and be sued was given to the company in its registered name, thus recognising the distinct entity.

This was followed by the Act of 1857 for the incorporation and regulation of joint-stock companies and other associations either with or without limited liability of its members. Under this Act, the privilege of limited liability was not extended to any company formed for the purposes of banking or insurance. This disability was removed by Act VII of 1860 passed on the lines of the English Act of 1857. This was followed by a comprehensive Act of 1866 which was a consolidating and amending Act. It was recast in 1882 and there were a

number of amendments until in 1913 was passed the Companies Act VII of 1913 which was based on the English Companies (Consolidating) Act of 1908, amended by Act XXII of 1936.

The present Act I of 1956 is based largely on the recommendation of the Company Law Committee. Even this Act has been amended from time to time of which Act 65 of 1960 comprising of as many as 218 sections is the most important. Very substantial changes in the law have been introduced. The latest amendment which has given rise to great controversy is section 388B of the Companies Act, 1956. The Indian Companies Act is based on the English law. Before dealing with the complexities of this branch of the law, it is necessary that we should have a proper appreciation of the history of incorporated companies. Unless we know of the exact need in human affairs which they were intended to serve, it would not be possible to understand the merit or demerit of company legislation.

Incorporated companies in England were preceded by unincorporated companies. These companies made their appearance first in the 17th century. It was a time when men of business were beginning to recognise the advantages derivable from co-operation in commercial enterprises, the advantages which it offered, that is to say, on the one hand for raising funds for the purpose of large and more or less speculative undertakings by means of contributions from a number of small capitalists ready and willing to co-operate, and on the other hand, intent on minimising the risk by spreading the liability. The difficulty was how to secure these advantages. The outcome of these commercial needs was the unincorporated company, lineal ancestor of the ordinary company incorporated under the Companies Act. At first the law frowned on these Associations. Unscrupulous persons floated a series of fraudulent and objectionable concerns so that in 1719 Parliament in England had to pass "the Bubble Act" connected with the famous "South Sea Bubble" scandal. The control of commercial undertakings by legislation was not, however, always looked upon with favour. In the 17th Century, Sir Josiah Child, one of the leading lights of the First East India Company, expressed his belief "that the laws of England are a heap of nonsense, compiled by a few ignorant country gentlemen who hardly know how to

make laws for the good government of their families much less for the regulating of companies and foreign commerce". (Michael Edward's, 'A History of India' P. 197).

The formation of Companies by private or special Act of Parliament grew out of the success of the Bridge Water Canal Acts. Companies were also incorporated by Royal Charter. In England, the Act of 1844 was the first general legislative Act in regard to Companies. The necessity for legislation on this behalf has been described by Lord Cranworth in Oakes v. Turques (1867) L. R. 2 H. L. 358. "When it became the habit and interest," said that learned Judge, "of persons engaged in commerce to unite in great numbers for carrying on any particular trade, it soon became evident that the ordinary provisions of the laws in this country were ill-adopted to the business of such bodies."

The object of company legislation with its numerous amendments and consolidating statutes has been to make effective the object with which companies are incorporated, namely, to enable a large number of persons to band together in carrying on trade, business or industry, most effectively. To-day joint-stock company has become a rule rather than the exception and dominates the whole field of commerce and industry. It is, therefore, not only an grounds of prudence that the State has intervened to control their activities, but it is based on grounds of political, social and economic necessity. Indeed, it may be said that upon the healthy and wholesome development of these incorporated bodies depend the well-being of the nation. This may best be illustrated in the words of Justice Douglas of the American Supreme Court. "To-day it is generally recognised," says the learned Judge, "that all corporations possess an element of public interest. A corporation director must think not only of the stock-holders but also of the labourer, the supplier, the producer and the ultimate consumers. Our economy is but a chain which can be no stronger than any of its links; we all stand together or fall together in our highly industrialised society of to-day."

It is perhaps with this object, that the latest amendment in the Indian Companies Act has been introduced for the purpose of maintaining corporate morality. The legislation for the con-

rol of companies has two facets. One is legislation by the legislature and the other is the administration of it by the Court and now by the Tribunal. This is supplemented by the day-to-day administration by the Registrar of Companies and other officials. Something needs to be stated with regard to some of them. Coming to legislation, we have seen how the Indian Companies Act came into existence and how it has been constantly amended and altered until now it is beset with bewildering complications. It has always been a matter of wonder to me that whether it be in the region of commercial law or taxation, it is thought that the best way of legislating is to make the law so complex that it becomes more and more incomprehensible to the ordinary men whose needs it is intended to serve. Many years ago, Alexander Hamilton wrote in the "Federalist" as follows :—

> "It will be of little avail to the people that the laws are made by men of their own choice, if the laws be so voluminous that they cannot be read, or so incoherent that they can not be understood. If they be repealed or revised before they are promulgated or undergo such incessant change, that no-man knows what the law is to-day can guess what it will be tomorrow".

I think, this profound remark of the American Jurist is fully applicable to company legislation in India to-day.

I agree that Jaw in a changing society cannot be static. Does that mean that the process of legislation should consist of a continued problem of hasty additions or unwise omissions from the body of law, already groaning under the burden of prolixity? A complaint was made to me the other day by an eminent solicitor who is considered to be an expert in Company Law. He said that some years ago he thought that he knew Company Law. To-day he is constrained to admit that he does not. Nobody does. The bewildering rate at which changes are introduced, experiments made and hasty amendments introduced — the pattern has been rendered so complicated that it is utterly impossible for any one man to keep abreast of it. The first thing forgotten in legislation for the commercial community is that the object of such legislation should be to advance the cause of commerce and not to retard

it. This object has not been achieved. It is no uncharitable remark to say that the Indian Companies Act as it stands today fails to serve its purpose because of its bulk and complexity. This view, I think, is now widely held. In my opinion, the real reason is that there has not been deep thinking on the subject as to what was really intended to be achieved by legislation in this particular field. The institution of joint-stock companies was evolved for the advancement of economic prosperity. It was a stroke of genius to have introduced the principle of limited liability. Without this, funds for giant undertakings would not be forthcoming. It is true that this is putting the matter somewhat simply. The principle of limited liability is the basis on which a large super-structure has been built. There are a number of contingencies which has to be cared for by legislation because the individual shareholder has to be protected from the management. There must be some degree of control over the activities of an incorporated company, to ensure that the interests of the shareholders are not jeopardised by the greed or dishonest action of the management. It was necessary also to provide against monopolies or the tyranny of the majority. It has to be ensured that there is no dishonest concealment of the real affairs of such concerns from the ultimate owners, the shareholders. But these various facets of the company law have now had a reasonable period of experiment, not only in India but all over the world. The company law in India is based on the English Law and we may usefully consult the law as it has evolved in America.

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Ideal legislation would be that which pinpoints the disease and prescribes a simple cure. Control, to be effective, should be such as requires the least effort to administer and the easiest to comply with. Complicated controls, put in the hands of different authorities, defeat the very purpose for which they are created. One of the means of control envisaged by the law is judicial control. So far this control has been most effectively administered. Now, however, it is thought that the law should overstep its normal boundaries and invade the territory of business morality. It is, however, not correct to say that the court was hitherto not concerned with morals. Jurisprudence indicates that law is primarily based on morals. There would be no necessity for legislation if in human society there is no necessity for keeping up standards. No law is acquired in the

jungle. Indeed, the law prevailing at any given moment reflects the standard of morality reached by the people for whom it is intended. The Company Law was always intended to ensure justice and equity between all the components of incorporated bodies. If it did not do that, it was not a law at all. Why it was ineffective in stamping out business immorality is another matter altogether. The defect is not to be sought onl in the law but in the people themselves, for whom it is intended: To start with, business morality can never be successfully enforced unless there be a climate for it. If people are not minded to keep up to standards of morality in their social behaviour, the most austere legislation would fail to remedy the defect.

The next observation that I should make upon the complexity of legislation is that it fails to realise that the object of commercial legislation is not to suppress commerce or retard economic growth but rather to foster it. In our country, there is but a growing economy. We have hitherto been under foreign domination and it is only during the last decade that we have commenced serious industrialisation of the country. In a growing economy, there must be simple laws. Complicated laws which are difficult to understand and hard to administer kill initiative, make capital shy and, therefore, defeat the very purposes for which they were intended. It is true that where a disease is detected the surgeon's scalpel may be necessary but there is the old saying about killing the goose which lays the golden eggs.

There is another important comment to be made on this aspect of prolix legislation. It is about the interdependence and interplay of various statutes which affect a common object. For example, it is greatly desired that industry should rapidly multiply in this country. For that purpose, elaborate provisions are made in company legislation to protect everybody concerned. But this protection is of no avail because of the taxation laws which introduce crippling taxation. With all our socialist ideals, business men are still carrying on because of the profit motive. On the one hand, we say that the nation should industrialise rapidly and at the same time by complicated company laws and crippling taxation, make this impossible of achievement. In my view, therefore, the ideal state of affairs is where all laws are co-ordinated to ensure tbat the common

object, namely, rapid industrialisation within the shortest period of time, is achieved and not retarded.

To run the State, the Government must have money, and for that purpose raise revenue. The need came into painful prominence during the last Chinese War. Although massive help was received from the West, the cost of a modern War is so staggering that steep taxation was inevitable. But, taxing legislation rather than the incidence of taxation has become an intolerable burden on the taxpayer. It is well known that in India the entire incidence of income tax is borne by less than 1% of the total population. The country is still so poor that 99% of the people do not come within the net of taxation. Amongst tax payers, only a small portion disclose incomes in the highest categories. The method of fixing the rates at which the income tax is to be paid is to fix slabs. As the slab goes up, the rate goes up by leaps and bounds. It does not do so gradually. Therefore, it has become the best of "big business" to devise ways and means of keeping the income in the lower slabs. This is not done by legitimate means. To ***avoid*** taxation is not illegal, it is illegal to ***evade*** it. By employing all sorts of dishonest means, income is concealed so that the return may show ncome within the lower limits. In such cases it is no use saying that men should be honest. Human nature being what it is, human ingenuity will always be expended if it brings massive pecuniary gain. Men will be dishonest if the stakes are sufficiently high. While tax-dodging remains so remunerative, it cannot be stopped by tinkering with the Law. It remains a battle of wit between the large-scale tax dodger and the revenue officers, and it would not be far from the truth to say that it is the Revenue that is losing all the way. This means that in the long run, excessive technicality favours tax evasion. The larger fry escape from the net and the burden on the ordinary, honest tax-payer is increased.

Incomes being what they are in India, it may well be said that the incidence of tax on middle class income is crushing. Yet in India, it is the middle class which has been the solid backbone of all progress, political or otherwise. When the ordinary tax-payer is compelled to part with a substantial portion of his hard-earned income, to support the Government, and get

it going, is he not entitled to say that he should have a clear idea of his liabilities? The Income Tax Act to-day, supplemented by the annual Finance Acts, taken together with the Wealth Tax Act, the Gift Tax Act, the Estate Duty Act and so on, form a bewildering array of tax legislation which pursues a man from birth to death and even beyond and is yet utterly incomprehensible to him. The law is so prolix, so full of technicalities, so immensely complicated and so rapidly changing that even practising lawyers do not profess to know it fully, and even the Income Tax Departments are in the dark. Let us take the latest complications, viz., the Compulsory Deposit and the Annuity Deposit Schemes. Nobody knows what are their real incidence. Even the Income Tax Department is waiting to have 'Clarihcations' from above to understand its duties. On what basic principles should a man be deprived of his property by means of laws which are not comprehensible to anybody—laws which he cannot understand, which do not tell him simply and without ambiguity, what he has to pay and in what manner he should do so. In my opinion, all taxation laws should be simple, straightforward, easily comprehensible and should have as little technicality as possible. There should be no frills. A man should be able to know in advance what his liabilities are and would be in the immediate future, so that he can prepare his own budget of living in order to conform with it.

I regret to say that in this respect our legislators have signally failed us altogether. Not only are taxation laws prolix, complicated, full of unnecessary technicalities and incomprehensible to the ordinary tax-payer, but they are getting worse* every day. There should be a halt somewhere. No society can go on with an indefinite rise in prices and an intolerable tax burden.

There is, in our country, a crying need for research in law. By this I do not mean mere academic research, but a search for new laws and the reform of existing ones. Legal research finds priority amongst all advanced nations. It is in India alone that legal research is sadly neglected. The Indian Law Institute is doing its best to fill the gap, and in the West Bengal State Unit we are doing some very good work.

Law has two facets. We have dealt with the legislative one. The other is judicial. Judges can only interpret and administer the law as it stands or as they find it. They cannot legislate. Time and again, there have been weighty pronouncements from the bench deprecating hasty and ill-digested legislation. But always it falls on deaf ears. The drafting of statutes is an expert job, to be done by men patiently trained in the art of drafting legislation. In India, there is no place where such training can be given. The result is a prolific production of ill-drawn, ill-considered and inept legislation. It means long-drawn, expensive litigation cluttering up the normal working of the courts and contributing to the delay in normal litigation. The sufferer is the ordinary citizen for whose benefit or protection the Law was primarily intended.

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Based on a speech delivered by the Hon'ble Mr. Justice D. N. Sinha, Executive Chairman, West Bengal State Unit of the Indian Law Institute, inaugurating the Fourth Annual General Meeting of the Association of Company Secretaries & Executives, Calcutta, on 30th June, 1964, and reproduced with kind permission of the Association.

"Free Enterprise was born with man and shall survive as long as man survives."

— A. D. Shroff

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