

CAF 03 Presentation

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Abdus Salam Jan – FCA, FPFA

Faculty Member PAC – Khyber Campus - Peshawar

Certificate in Accounting & Finance

CAF - 03

Business Law

Certificate in Accounting & Finance

CAF - 03

Company Law

Objective of Syllabus

To give students an understanding of the

- Legal system [1 chapters]

and laws relating to

- Contract Act, [7 chapters]
- Partnership Act, [1 chapters]
- Negotiable Instruments Act, [1 chapters]
- Companies Act and Securities Act. [6 chapters]

ICAP's Grids & Weightage for CAF - 03

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| | Mercantile Law | |
| 2 | Contract Act | 20-30 |
| 3 | Partnership Act | 10-15 |
| 4 | Negotiable Instruments Act | 5-10 |
| | Company Law | |
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Chapter 11

Introduction to company and incorporation process

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- Effect of registration

Introduction to company and incorporation process

1 THE FEATURES OF A COMPANY

1.1 Company as artificial legal person

A sole trader is an individual who owns and runs his or her own business. The law does not recognize the business: the law recognizes only the individual who runs it. The individual is liable for the debts of the business and is also personally liable for any breaches of the law by the business.

A partnership is a group of individuals who own and run their own business. Each partner usually contributes capital to the business. A partnership business is not recognised as a 'person' by the law. individual partners are personally liable, jointly with the other partners, for the debts of the business.

Introduction to company and incorporation process - Continued

Unlike sole traders and Partnerships, a company is a legal person, separate from its owners. This is called doctrine of corporate personality i.e. the law recognises a company as a person, with legal rights and obligations similar to those of ordinary individuals.

A company is an 'artificial person', whereas individual people are 'natural persons'. Essentially, however, the law treats persons in the same way, whether they are artificial or natural.

Please See The Example 01: Separate legal personality

Characteristics of a Company

The following are characteristics of company as an artificial person:

Contractual rights and obligation

As a legal person, a company may enter into contracts with other persons – individuals or other companies.

Debts and liability

If a company incurs a debt, the company itself is liable and its owners (the shareholders) are not.

Ownership of assets / property

A company owns its own assets. Although the members (ordinary shareholders) own the company, they do not own the assets of the company. The shareholders are simply owners of the shares in the company. The company itself is the legal owner of its assets.

Right to receive from debtors

The debtor of the company owes the money to the company, and not to its owners.

Management by directors

Companies are managed by their directors, who should be members of the company as well (with a few exceptions). In small companies, the shareholders and directors may be the same individuals, but in large companies, the directors might hold a small proportion of the shares or even no shares at all.

Liability to pay tax

A company is personally liable to pay tax on its income (profits).

Legal obligations

If a company breaks the law, it is usually the company itself that is liable, although there are circumstances in which its owners or its 'officers' (mainly directors) may be personally liable.

1.2 Consequences of separate personality

The separate legal personality of companies has several consequences:

- limited liability of the owners of business
- separation of ownership from control i.e. members and directors
- transfer of ownership and perpetual succession/perpetual existence.

1.3 Transfer of ownership and perpetual succession

Share capital and members

The capital of a company is represented by shares, and the shareholders (members) are its owners. The term “member” and “shareholder” are used interchangeably, however, there are few differences that have been discussed later in this chapter.

Who can own shares?

Any legal person can own shares in a company. This includes other companies. It is very common in practice for some companies to own some or all of the shares of other companies.

Transfer of ownership

The shares can be transferred easily (by sale, gift, and inheritance) without seeking any approval from other owners (as opposed to partnership).

Share transfer

When shares are transferred, the rights associated with the shares, such as the right to receive a portion of any dividend paid by the company or the right to attend and vote at general meetings of the company, are transferred to the new owner.

Perpetual succession (perpetual existence)

The change in ownership or even the death or bankruptcy of owners does not affect the existence of company (as opposed to partnership).

1.4 The concept of limited liability

Liability of company

Limited liability applies to the shareholders of a company. It does not apply to the company itself. A company is fully liable for all its debts and other liabilities; just as any other person is fully liable for the debts that he or she incurs.

Liability of directors

The directors and other officers of a company act on behalf of the company (as an agent), and provided that they act within their powers and in accordance with the law, they will not be personally liable for debts of the company.

Liability of members

The concept of limited liability applies to the owners (members) of a company. The liability of the owners of a company for the debts of the company is limited to the amount of their investment in the company and they don't have to pay any other amount in case of insolvency of the company.

Liability of members in case of partly paid shares

There is an exception to this rule of no further liability, but only when the shares issued by a company have not yet been fully paid up.

Please See The Example 02: Liability of members in case of partly paid shares

How creditors are warned?

The word 'limited' in the name of the company draws the fact of limited liability to the attention of anyone dealing with it.

- This is why private limited companies in Pakistan are required to include the word “(Private) Limited” in their name.
- It is also why public companies in Pakistan are required to include the words “Limited” in their name.

1.5 Law and governance of a company

Relevant law

Companies are created by a process established by company law (i.e. Companies Act, 2017).

Memorandum of association

A company must also have a written constitution. The constitutional document that focuses on external stakeholders is called memorandum of association.

Articles of association

The bye-laws which focuses on internal procedures of a company are called articles of association.

2 DEFINITION AND TYPES OF COMPANY

2.1 Definitions

“Company”

means a company formed and registered under the Companies Act, 2017 or the company law.

“Company law”

means the repealed Companies Act, 1913, Companies Ordinance, 1984, Companies Ordinance, 2016 and also includes Companies Act, 2017 unless the context provides otherwise.

Definition: Body corporate [Section 2(9)]

"Body corporate" or "corporation" includes

- a company incorporated under Companies Act, 2017 or company law;
- a company incorporated outside Pakistan, or
- a body corporate declared as body corporate in the relevant statute

but does not include

- A co-operative society registered under any law relating to the registration of co-operative societies; or
- Any other entity, not being a company as defined in Companies Act, 2017 or any other law for the time being, which the concerned Minister of the Federal Government may, by notification, specify in this behalf.

The literal meaning of 'body corporate' is artificial legal person and therefore, every company (as defined above) is also a body corporate.

However, the definition of body corporate is broader and in addition to companies registered in Pakistan it also includes companies registered in foreign countries and statutory body corporates, for example, State Bank of Pakistan constituted under State Bank of Pakistan Act, 1956.

However, for the purpose of Companies Act, 2017, a cooperative society shall not be considered a body corporate. Federal Government may also exclude a foreign company or statutory body from the definition of body corporate for the purposes of the Act.

Please See The Example 03: Company and body corporate

Please See The Example 04: Not a company but a body corporate

Please See The Example 05: Cooperative society as a body corporate

Please See The Example 06: Excluded from scope of body corporate by notification

Please See The Example 07: Body Corporate

2.2 Types of company – according to members' liability

Company limited by shares

Definition: Company limited by shares [Section 2(20)]

“company limited by shares” means a company; having the liability of its members limited by the memorandum to the extent of amount, if any, remaining unpaid on the shares respectively held by them.

Most businesses that incorporate as companies are companies limited by shares. The great advantage of this form of company is that the company is able, if the shareholders approve, to raise additional capital by issuing new shares.

Company limited by guarantee

Definition: Company limited by guarantee [Section 2(19)]

“company limited by guarantee” means a company having the liability of its members limited by the memorandum to such amount as the members may respectively thereby undertake to contribute to the assets of the company in the event of its being wound up.

A company limited by guarantee may or may not have share capital. The liability of members of company limited by guarantee not having share capital is restricted to the amount of guarantee as mentioned in memorandum.

The liability of members of company limited by guarantee having share capital is restricted to the amount of guarantee as mentioned in memorandum, in addition to unpaid amount on shares, if any.

Unlimited company

Definition: Unlimited company [Section 2(71)]

“unlimited company” means a company not having any limit on the liability of its members .

This has all the advantages of a normal company except that the liability of its members is not limited. In practice unlimited companies are fairly rare but are sometimes used by a ‘partnership style’ business.

2.3 Types of company – private vs public

Private company (single member company)

Definition: Single member company [Section 2(65)]

“single member company” means a company which has only one member. It is a company which consists of a single member who is also the director of the company. These companies are governed by special rules. In these companies, “(SMC PVT) Limited” is added to the name of the company.

Private company (other than single member company)

Definition: Private company [Section 2(49)]

“private company” means a company which, by its articles:

- (a) restricts the right to transfer its shares;
- (b) limits the number of its members to fifty not including persons who are in the employment of the company; and
- (c) prohibits any invitation to the public to subscribe for the shares or debentures of the company:

Provided that, where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this definition, be treated as a single member.

Private companies are usually small and medium sized family owned businesses.

Please See The Example 08: Number of members in a private company

Public company

Definition: Public company [Section 2(52)]

“public company” means a company which is not a private company. A public company may (or may not) apply for listing on stock exchange.

Public listed company

Such form of public company whose securities are listed on an exchange and they are traded as per regulations of that stock exchange.

Definition: Listed company [Section 2(38)]

“listed company” means a public company, body corporate or any other entity whose securities are listed on securities exchange.

Public unlisted company

Public unlisted companies have not made an offer of their shares to general public hence their shares are not traded on a stock exchange.

A public unlisted company however is entitled to make an offer to the general public as and when it thinks fit unlike private companies which are forbidden to invite subscriptions from general public .

2.4 Holding company and subsidiary company

Definition: Holding company [Section 2(37)]

“holding company”, means a company which is another company’s holding company if, but only if, that other company is its subsidiary.

Definition: Subsidiary company [Section 2(68)]

“subsidiary company” or “subsidiary”, in relation to any other company (that is to say the holding company), means a company in which the holding company:

- (a) controls the composition of the board; or
- (b) exercises or controls more than one-half of its voting securities either by itself or together with one or more of its subsidiary companies.

For the purpose of above meaning of subsidiary company:

- (i) a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (a) or sub-clause (b) is of another subsidiary company of the holding company.
- (ii) the composition of a company's board shall be deemed to be controlled by another company if that other company by exercise of power exercisable by it at its discretion can appoint or remove all or a majority of the directors.

Please See The Example 09 to 11: Holding and subsidiary company relationship

3 AUTHORITIES, OFFICIALS, MEMBERS AND RESOLUTIONS

3.1 The Commission (SECP)

Definition: The Commission [Section 2(16)]

The Commission means the Securities and Exchange Commission of Pakistan constituted under Section 3 of Securities and Exchange Commission of Pakistan Act, 1997.

Organization

Securities and Exchange Commission of Pakistan (SECP) established under the Securities and Exchange Commission of Pakistan Act 1997 was operationalized on 1st January 1999. SECP replaced Corporate Law Authority, the former corporate regulatory body. It has been vested with adequate operational, administrative and financial autonomy.

Offices

The SECP's head office is at the Federal Capital, Islamabad and it has eight regional offices (Company Registration Offices), one at Federal Capital, four at provincial capitals and three in other major cities i.e. Multan, Faisalabad and Sukkur.

Powers and Functions [Section 7]

The Commission shall exercise such powers and perform such functions as are conferred on it by or under Companies Act, 2017.

The powers and functions of the Commission under Companies Act, 2017 are in addition to the powers and functions of the Commission under the Securities and Exchange Commission of Pakistan Act, 1997.

SECP has been vested with lot of powers under the Companies Act 2017 and other relevant laws. SECP has got powers to regulate the affairs of all the companies including Insurance Companies, Banking Companies, and other companies.

Law has vested various powers to SECP and also federal government is empowered to vest its powers to the SECP to the extent it thinks fit.

3.2 Registrar

Definition: Registrar [Section 2(57)]

“Registrar” means a registrar, an additional registrar, an additional joint registrar, a joint registrar, a deputy registrar, an assistant registrar or such other officer as may be designated by the Commission, performing duties and functions Companies Act, 2017.

Power and Duties

The powers and duties of registrar start from registration of companies to receiving various documents which the companies are required to submit to the authorities under Companies Act, 2017.

He keeps the record of mortgages and charges and also keeps track of company routine documents besides his powers to call the officers of the company including directors for information and explanations and he is also empowered to inspect the books and records of the company. He may seize the books and records if he believes that seizure is necessary to reach out certain facts by SECP.

3.3 Officials in a company

Definition: Officer [Section 2(45)]

“officer” includes any director, chief executive, chief financial officer, company secretary or other authorised officer of a company.

Definition: Board [Section 2(8)]

“board”, in relation to a company, means board of directors of the company . The meetings of directors are called board meetings in which they make decisions on behalf of company.

3.4 Members of a company [Section 118]

Definition: Members [Section 118]

“The subscribers to the memorandum of association are deemed to have agreed to become members of the company and become members on its registration and every other person:

- (a) to whom is allotted, or who becomes the holder of any class or kind of shares; or
- (b) in relation to a company not having a share capital, any person who has agreed to become a member of the company;

and whose names are entered; in the register of members, are members of the company.

The terms ‘shareholder’ and ‘member’ is used interchangeably but from the above definition it is clear that ‘member’ is a broader term.

Please See The Example 12,12(a) to 13

3.5 Types of resolutions by members

The decisions of company are made in meetings through resolutions. A meeting of members is called general meeting.

Definition: Ordinary resolution [Section 2(46)]

“ordinary resolution” means a resolution passed by a simple majority of such members of the company entitled to vote as are present in person or by proxy or exercise the option to vote through postal ballot, as provided in the articles or as may be specified, at a general meeting.

Definition: Special resolution [Section 2(66)]

“special resolution” means a resolution which has been passed by a majority of not less than three fourths of such members of the company entitled to vote as are present in person or by proxy or vote through postal ballot at a general meeting of which not less than twenty -one days' notice specifying the intention to propose the resolution as a special resolution has been duly given: Provided that if all the members entitled to attend and vote at any such meeting so agree, a resolution may be proposed and passed as a special resolution at a meeting of which less than twenty-one days' notice has been given.

Please See The Example 14: Special resolution

4 ASSOCIATION NOT FOR PROFIT

4.1 Licencing of associations with not for profit objects [Section 42]

Concept

People working for useful objects of the society sometimes need protection of limited liability for such work. Companies Act allows the registration of companies as associations not for profit if they satisfy certain conditions to SECP.

Criteria for licence

Where it is proved to the satisfaction of the Commission that an association is to be formed as a limited company and meets the following criteria, the Commission may, by licence for a period to be specified, permit the association to be registered as a public limited company, without addition of the word “Limited” or the expression “(Guarantee) Limited”, to its name.:

- (i) for promoting commerce, art, science, religion, health, education, research, sports, protection of environment, social welfare, charity or any other useful object;
- (ii) such company:
 - intends to apply the company's profits and other income in promoting its objects; and
 - prohibits the payment of dividends to the company's members; and
- (iii) such company's objects and activities are not and shall not, at any time, be against the laws, public order, security, sovereignty and national interests of Pakistan,

Please See The Example 15: Association not for profit

Conditions and regulations

The licence may be granted on such conditions and subject to such regulations as the Commission thinks fit and those conditions shall be inserted in and deemed part of the memorandum and articles, or in one of those documents.

Form of memorandum and articles

Memorandum and articles of association of a company, licenced as above, shall be in accordance with the form set out in Table F in the First Schedule and approved by the Commission.

Privileges and obligations

The association on registration as above shall enjoy all the privileges and be subject to all the obligations of a limited company.

4.2 Revocation of licence [Section 42]

Reasons for revocation

The Commission may at any time by order in writing, revoke (cancel) a licence granted with such directions as it may deem fit, on being satisfied that:

- (a) the company or its management has failed to comply with any of the terms or conditions subject to which a licence is granted; or
- (b) any of the requirements specified or any relevant regulations are not met or complied with; or
- (c) affairs of the company are conducted in a manner prejudicial to public interest; or
- (d) the company has made a default in filing with the registrar its financial statements or annual returns for immediately preceding two consecutive financial years; or
- (e) the company has acted against the interest, sovereignty and integrity of Pakistan, the security of the State and friendly relations with foreign States; or
- (f) the number of members is reduced, below three; or

- (g) the company is:
- (i) conceived or brought forth for, or is or has been carrying on, unlawful or fraudulent activities; or
 - (ii) run and managed by persons who fail to maintain proper and true accounts or they commit fraud, misfeasance or malfeasance in relation to the company; or
 - (iii) run and managed by persons who are involved in terrorist financing or money laundering; or
 - (iv) managed by persons who refuse to act according to the requirements of the memorandum or articles or the provisions of Companies Act, 2017 or failed to carry out the directions or decisions of the Commission or the registrar given in exercise of the powers conferred by Companies Act, 2017; or
 - (v) not carrying on its business or is not in operation for one year; or
- (h) it is just and equitable that the licence should be revoked .

Opportunity of being heard

However, before a licence is so revoked, the Commission shall give to the company a notice, in writing of its intention to do so, and shall afford the company an opportunity to be heard.

4.3 Effect of revocation of licence [Section 43]

Requirements on revocation

On revocation of licence of a (not-for-profit) company by the Commission:

- (a) the company shall stop all its activities except the recovery of money owed to it, if any;
- (b) the company shall not solicit or receive donations from any source; and
- (c) all the assets of the company after satisfaction of all debts and liabilities shall be transferred to another (not-for-profit) company, preferably having similar or identical objects to those of the company, within 90 days from the revocation of the licence or such extended period as may be allowed by the Commission.

However, a reasonable amount to meet the expenses of voluntary winding up or making an application to the registrar for striking the name of the company off the register may be retained by the company.

Report to Registrar

After compliance of the requirements mentioned above, the board of the company shall file within 15 days from the date of such compliance, a report to the registrar containing relevant information and documents.

Proceedings for winding up

Within 30 days of acceptance of the report by the registrar, submitted by the company, the board shall initiate necessary proceedings for winding up of the company voluntarily or where it has no assets and liabilities make an application to the registrar for striking the name of the company off the register.

Appointment of Administrator

In case of default, the Commission may appoint an administrator to manage affairs of the company and initiate necessary proceedings for winding up of the company.

Restriction on members and officers

Where any assets of the company are transferred, in consequence of revocation of licence, to another (not-for-profit) company, the members and officers of the first mentioned company or any of their family members shall not be eligible to hold any office in the later company for a period of 5 years from the date of transfer of such assets.

Please See The Example 16: Effect of revocation of licence

Please See The Example 17: Transfer of assets in case of revocation of NFP licence

5 INCORPORATION (REGISTRATION) OF A COMPANY

5.1 Process of incorporation

The process of incorporation usually involves the following steps:

- Getting availability of suitable name from the registrar of companies
- Preparing memorandum of association, articles of association of proposed company along with supportive documents.

- File the above documents along with application form for incorporation to registrar.
- Registrar shall issue the certificate of incorporation of company upon being satisfied that all the requirements have been complied with.

5.2 Registration of memorandum and articles [Section 16]

Filing with Registrar

There shall be filed with the registrar an application on the specified form containing the following information and documents for incorporation of a company, namely:

- (a) a declaration of compliance with all of the requirements of Companies Act, 2017 in respect of registration;
- (b) memorandum of association of the proposed company signed by all subscribers, duly witnessed and dated;
- (c) articles of association (optional for company limited by shares) signed by the subscribers duly witnessed and dated; and
- (d) an address for correspondence till its registered office is established and notified.

Revised documents / Removal of defects

Where the registrar is of the opinion that any document or information contains any matter contrary to law or does not otherwise comply with the requirements or is not complete owing to any defect, error or omission or is not properly authenticated, the registrar may either require the company to file a revised document or remove the defects or deficiencies within the specified period.

Refusal by register

Where the applicant fails to remove the deficiencies conveyed within the specified period, the registrar may refuse registration of the company.

Appeal to Commission

The subscribers of the memorandum or any one of them authorised by them in writing may, within 30 days of the order of refusal, prefer an appeal to the Commission. An order of the Commission shall be final and shall not be called in question before any court or other authority.

Criteria for registration

If the registrar is satisfied that all the requirements of Companies Act, 2017 and the rules or regulations made thereunder have been complied with, he shall register the memorandum and other documents delivered to him.

Please See The Example 18: Refusal of registration

Certificate of incorporation

On registration, the registrar shall issue a certificate of incorporation that shall state:

- (a) the name and registration number of the company;
- (b) the date of its incorporation;
- (c) whether it is a private or a public company;
- (d) whether it is a limited or unlimited company; and
- (e) if it is limited, whether it is limited by shares or limited by guarantee.

Certificate to be Conclusive evidence

The certificate shall be signed by the registrar or authenticated by the registrar's official seal.

The certificate shall be conclusive evidence that the requirements of Companies Act, 2017 as to registration have been complied with and that the company is duly registered under the Act.

5.3 Effect of registration [Section 18]

The registration of the company has the following effects, as from the date of incorporation:

- (a) the subscribers to the memorandum, together with such other persons as may from time to time become members of the company, are a body corporate by the name stated in the certificate of incorporation;
- (b) the body corporate is capable of exercising all the functions of an incorporated company, having perpetual succession and a common seal;
- (c) the status and registered office of the company are as stated in, or in connection with, the application for registration;
- (d) in case of a company having share capital, the subscribers to the memorandum become holders of the initial shares; and
- (e) the persons named in the articles of association as proposed directors, are deemed to have been appointed to that office.

Please See The Example 19: Effects of registration

Topic Covered

- Company as artificial legal person
- Consequences of separate personality
- Transfer of ownership and perpetual succession
- The concept of limited liability
- Law and governance of a company
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